

Induction Manual: Accounting Officers

Republic of South Africa
National Treasury

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Introduction

A department must have an accounting officer, and the accounting officer must be the head of the department, according to the Public Finance Management Act (PFMA) section 36.

While the power and duties of the accounting officer can be delegated to a chief financial officer, the accounting officer remains responsible for the actions carried out as part of this delegation. Therefore, heads of departments must be familiar with the duties and responsibilities and the framework in which the accounting officer operates.

This manual has been developed specifically for accounting officers of departments and public entities and enterprises to meet this need. It tries to highlight some of the key responsibilities and challenges of the accounting officer, and seeks to provide you with a background understanding of the most important aspects of the legal and fiscal systems in South Africa.

The National Treasury appreciates that time is valuable and limited. At the same time we maintain that a good understanding of the public financial management system will serve to save many hours of head ache and hard work in the future. Therefore we recommend you to invest the time to read through this manual and digest its content. We have tried to ensure that the text indicates further background reading where possible. While the subject matter admittedly is complex, we have strived to be as brief as possible, while maintaining the key points in each chapter.

In chapter 1, we have indicated some of the most important issues and challenges that you need to be mindful of. These include to develop budget submissions of high standard, meeting reporting requirements for financial and non-financial information, but also to ensure good lines of communication with the provincial treasury.

Chapter 2 to 4 serve as background information on the allocation of functions and funds and the public management system, while the chapters 5 to 16 provide more detailed information relating to the tasks of the accounting officer.

Chapter 2 presents 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 key national financial institutions and the process required in the passing of the Budget bills are presented.

Chapter 3 describes the intergovernmental fiscal system, its key players and forums, the nature of intergovernmental transfers, and some of the crucial legal requirements in the Division of Revenue Act.

Chapter 4 outlines the budget process and the sharing of the national revenue in detail. This includes the processes that take place to update the policy priorities and review the available resources captured in the Medium Term Expenditure Framework (MTEF), the coordination processes, and the role of the involved committees and Cabinet.

On the subject of revenue, Chapter 5 concerns borrowing by provinces, while chapter 6 presents opportunities and issues in provincial taxes.

Chapter 7 concerns oversight functions. The chapter introduces the oversight role of legislatures and public accounts committees, and the need to develop annual reports with audit reports and performance information on service delivery to ensure value for money. Further to the theme of oversight, chapter 8 introduces the requirements for annual reports.

Chapters 9 to 12 introduce aspects such as internal control systems, revenue and expenditure, and management of cash, banking and transfers, and the Integrated Financial Management System. Issues in supply chain management, including requirements to tendering processes, are presented in chapter 13.

Chapter 14 regards monitoring of programmes and introduces some key concepts in monitoring of service delivery, in line with the need to produce performance information. Chapter 15 on infrastructure management encapsulates lessons learned, including on asset management and integrated planning for infrastructure projects.

Chapter 16 introduces Public Private Partnerships (PPP) as an avenue for service delivery. Chapter 17 concerns capital budgeting for large projects.

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

In the annexures, you will also find some of the most important legal documents, such as the Public Finance Management Act (PFMA), the Treasury Regulations in terms of the PFMA, and the Framework for Managing Programme Performance Information, and Guide for Implementation of Provincial Quarterly Performance Reports, in addition to materials providing more background information on PPPs and budgeting for capital projects.

It is our hope that you will find the manual of relevance, and we look forward to working with you in the future.

Signed

1

Role and responsibilities of accounting officers

- The Constitution, the Public Finance Management Act, and other key legal documents outline the most important responsibilities for accounting officers, including the accounting officer of the provincial treasury. These responsibilities are introduced on the following pages.
- The underlying tenet is that successful financial management in departments is about more than budgeting and compliance with rules. As contained in the Public Finance Management Act, it is very much about ensuring value for money, overseeing the monitoring of programme, playing a constructive role in financial matters, and assuring the quality of budget submissions, thereby enhancing the chances that the Province will obtain funding for its programmes in the budget process.

■ More than financial compliance and budgeting

The Constitution and crucial legal documents such as the Public Finance Management Act (PFMA) establish the division of labour in the interphase between the technical departments and the provincial treasury. As a principle, the actual implementation of programmes is left to the administration, the technical departments, while the MEC for Finance leads policy development for financial management, which is implemented by the provincial treasury under the supervision of its accounting officer, according to the PFMA Section 17(2).

Financial management concerns more than budgeting and compliance issues: the issues of the value for money and oversight of performance are equally important. Furthermore, the allocation of budget resources is a politically driven process, in which the macro economic priorities are a cornerstone, and the track record of the departments and the quality of their project and programme submissions, not least as concerns performance information systems, shape their chances of success.

The budget process is driven by political priorities and the quality of projects

This means that the provincial treasuries and accounting officers can play a key role in making sure that the provincial priorities are funded in the national budget, by developing budget submissions that meet the required standards. With this in mind, and to ensure good use of resources resulting in efficient service delivery and value for money for the province, accounting officers can take on a number of issues:

Key issues for accounting officers

- **Establishing good working relationships** with the provincial treasury will facilitate guidance in financial matters and create options to discuss questions at an informal level, thereby reducing formal work processes and resolving issues at an early stage.
- **Communicating well** with the political level, by creating a narrative about the programs and project, that can serve to put data and information into context and create a better understanding of the situation in which implementation is taking place.
- **Managing the technical department** in an effective manner by as appropriate delegating responsibility, and focusing on the bigger picture and the challenges to the organisation.
- **Oversight and management information:** The technical department has to ensure that information of both financial and non-financial nature is available for oversight purposes. Performance information for goals and outcomes of public investments makes it possible to assess whether a programme is delivering as expected. Technical departments have an important function to include this information in their programmes. Please see the chapter 7 on Oversight and chapter 14 on Monitoring.

Role of provincial treasuries in capital projects, loans and PPPs

- **Capital expenditure and project submissions** require sufficient documentation to be successful in the budget process. Often the quality of submissions and the background information as needs assessment and feasibility studies have been found wanting, and in this area the technical departments can strengthen their proposals (please see chapter 17 on Budgeting for Infrastructure and Capital Expenditure).
- **Borrowing can be a way to finance the infrastructure development**, which is crucial for many aspects of service delivery. Provincial treasuries have options to take out loans for certain purposes, and technical departments can initiate discussions with the provincial treasury to assess if borrowing is a relevant option to increase service delivery (please see chapter 15 on Borrowing by provinces).
- **Public private partnerships** are an underutilized option to finance service delivery. Technical departments can consider the options of utilizing PPPs for service delivery, while provincial treasuries can support by playing the role as facilitator, assess the relevance of PPPs for departments, and

as required support technical discussions and processes leading to PPPs (please see chapter 16 on PPPs).

- **Maintenance of infrastructure** is an area where audit reports show that technical departments in some cases fail to live up to their responsibility outlined in the PFMA. The technical departments can focus adequate attention to maintenance issues, while provincial treasuries can facilitate policies to ensure that maintenance of assets is included in budgeting. In a similar vein, integrated strategic planning by departments will serve to avoid “white elephants” (please see chapter 15 on Infrastructure management).

The main responsibilities of accounting officers, including accounting officers of the provincial treasuries, as defined in the Constitution and the PFMA are outlined in the parts below.

■ The Constitution

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

Responsibilities according to the Constitution

Departments and entities have an obligation to provide information to the provincial treasuries that will allow these to follow the form and timing prescribed by national legislation. They must show the sources of revenue and the way the proposed expenditure will comply with national legislation, according to section 215(2).

Further, the accounting officer’s input to the provincial budgets must 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 is the main legal framework for the accounting officers of technical departments and other public provincial entities. The PFMA assigns a number of responsibilities on the accounting officer, of which the main points are introduced in the following. The accounting officer may choose to delegate these responsibilities to a chief financial officer (CFO). This however does not divest the responsibility of the exercise of delegated power from the accounting officer.

Responsibilities according to the PFMA

General responsibilities

The general responsibilities of the accounting officer are outlined in the PFMA section 38. These responsibilities include:

- to ensure that the department has effective, efficient and transparent systems of financial and risk management and internal control
- a system of internal audit under the direction of an audit committee
- appropriate procurement and provisioning systems, that are fair, equitable and transparent, competitive and cost-effective
- a system to evaluate all major capital projects prior to final decision on the project.

The accounting officer:

- is responsible for effective, efficient and transparent use of the resources of the department or entity, and must prevent unauthorised, irregular, fruitless or wasteful expenditure
- is responsible for the management including safeguarding and maintenance of assets, and management of liabilities, and must inform the relevant treasury of details of such cases
- must take disciplinary steps against any official who makes or permits such unauthorised, irregular, fruitless or wasteful expenditure, or who contravenes the PFMA or undermines the financial system
- when transferring funds, the accounting officer must ensure that the transfer is in compliance with the Division of the Revenue Act
- when transferring funds into an institution outside of Government, the accounting officer must obtain written confirmation that the receiving institution has effective, efficient and transparent financial management systems
- when policy proposals are being considered that may affect the accounting officers responsibilities, s/he must take into account relevant financial information, including issues as value for money, and bring these to the attention of the responsible executive authority
- if considering to establish a new entity, the accounting officer must consult and seek the approval of the National Treasury.

More specific responsibilities are outlined in relation to budget control and reporting:

Budget control

The accounting officer must ensure that expenditure for a department is within the vote of the department and the main divisions within the vote. S/he must take effective steps to prevent unauthorised

expenditure and take effective steps to prevent any overspending. The accounting officer must report to the executive authority and the treasury in case of undercollection of due revenue, shortfalls in the budgeted revenue, or overspending of the department's vote or within the main divisions of the vote, as outlined in section 30 of the PFMA.

Reporting

In terms of reporting responsibilities, the accounting officers have to ensure financial records of the department are kept as prescribed by norms and standards.

The accounting officer must prepare financial statements for the financial year in accordance with generally recognized accounting practice (text box), and submit the financial statements no later than two months after the end of the financial year to the Auditor-General for auditing, and to the provincial treasury for preparation of consolidated financial statements.

No later than five months after the end of the financial year, the accounting officer must submit an annual report, which includes the financial statement and the auditor-general's report on the financial statement, and the accounting officer's report on the activities of the department to the treasury, as outlined in the PFMA Section 40 (1).

Annual report

The accounting officer must provide the provincial treasury with a breakdown per month of anticipated revenue and expenditure of the department for the financial year, and each month submit records as prescribed of actual revenue and expenditure of the preceding month and expected amounts for the coming month.

Monthly reporting

Furthermore, within 15 days of the end of the month, s/he must report to the provincial treasury and executive, the financial information for that month, and a projection of the expected revenue and expenditure for the remaining parts of the year. S/he should as required explain any significant differences and steps taken to address these differences, as outlined in section 40 (4) of the PFMA.

When assets and liabilities are transferred the accounting officer must establish an inventory of the assets and liabilities, and provide the receiving accounting officer with records, including personnel records of staff to be transferred. This copy must be signed by both the transferring and receiving accounting officer and filed with the provincial treasury and the Auditor-General, according to the PFMA Section 42.

Transfer of assets

These responsibilities are introduced in greater detail in the chapters 9 - 11. Please see also the full text of the PFMA, in particular the section 38 – 42, and the "Treasury Regulations issued in terms of the PFMA".

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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, “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.”

One state – with three spheres of government

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 co-operative government and intergovernmental relations.

■ The spheres of government and the allocation of functions

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

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, 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.

Allocation of functions

Schedule 4 and 5 of the Constitution specifies 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 shared between several spheres of Government

The big 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.

National exclusive functions are e.g. defence, the criminal system, higher education..

The exclusive functions are the sole responsibility of the relevant government only. In the case of national government, large exclusive functions include national defence, the criminal-justice system (safety and security, courts), higher education, water and energy (electricity) resources and administrative functions such as home affairs and 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.

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 are paid into a National Revenue Fund, according to 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 bills:

- the Division of Revenue Act
- the Appropriation Act and
- 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 the Constitution (section 214). The Division of Revenue Act then divides the remaining revenue between the three spheres of government ('vertical division'), giving each their 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 need for stable and predictable revenue, as outlined in the Constitution section 215. Further allocations to provinces and municipalities are also made from the national equitable share, as conditional or unconditional grants.

Vertical and horizontal division of the revenue

Once each government has received its equitable share allocation, that government 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 Public Finance management Act (PFMA) and Municipal Finance Management Act (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 on 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 in 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 section 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 remuneration of persons holding public office.

■ The National Treasury, Reserve Bank and FCC

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 SA 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 (FCC) serves as an independent body accountable directly to Parliament and provincial legislatures. The FCC is required to make annual recommendations on the Division of Revenue Act and other

FCC makes recommendations on the Division of Revenue Act

legislation required in Section 220 of the Constitution. It is therefore a key institution in relation to the development of the national budget.

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 (exclusive provincial and local government competence) functions, and that different approval processes apply for Schedule 4 (concurrent national and provincial competence), particularly where they affect provincial finances.

The legislative powers of the National Assembly and the National Council of Provinces

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 for 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.

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.

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

In 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 Division of Revenue Bill has 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.

Preparation of bills

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 MEC of 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 whilst legislation to amend money bills is outstanding, Parliament can still amend the budget through their 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, whilst 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 they have been assigned to it by national or provincial legislation.

3

The intergovernmental fiscal system

- All parts of government need funds to carry out their functions. However, some parts of Government 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 decentralized features. Some functions are performed exclusively by one sphere of Government but most functions are shared, or concurrent, as the official expression is.

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 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.

Limited opportunities to raise revenue for provinces...

...and good opportunities to raise revenue for some municipalities

The provinces can only raise about four 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 provision of water, electricity, solid waste removal, which to a large degree are self-funded. There are, however, large differences between the municipalities' revenue generating capacities. The large urban municipalities are able to generate strong revenues, while many rural and smaller municipalities have weaker fiscal powers.

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.

The equitable share is the rightful entitlement

Revenue is mainly collected at the national level and then transferred to provincial and municipal level 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 financial year 2007/2008 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 further down in this text.

■ 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

¹ These principles were first presented in the 2005 *Intergovernmental Review*

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 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 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, which 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 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.

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

Key coordinating forums in the Budget process

■ Co-operative governance and role-players

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

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

- Extended Cabinet comprises of the national executive and the nine premiers. The Extended Cabinet is the highest co-operative mechanism advising the national Cabinet when finalising the fiscal framework and division of revenue on which MTEF budgets are based.
- The President's Co-ordination Council, which comprises of the national executive, nine 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 in terms of 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 in 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 Budget Council and representatives of organised local government. It plays a similar role to the Budget Council, but in respect of local government financial matters.
- MinMECs, which are sectoral policy forums of the Ministers and their provincial counterparts.
- Joint MinMECs between selected sectors and the Budget Council.

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

■ The division of revenue act

Each of the three spheres of government is entitled to a share of the 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 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.

*Requirements to the
Division of Revenue Act*

The key components of the Revenue act are the schedules that set out the allocations and the provisions regulating the conditional grants. The Act is complimented 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 down.

Intergovernmental transfers

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

*The equitable share is
unconditional*

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
for a number 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 interjurisdictional spillovers resulting from services provided by subnational governments (grants for central hospitals are an example)
- to create 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:

Key requirements in transfer of funds

- 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

Description of grants is found in the DOR Gazette

The Division of Revenue Act is complimented 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 of main interest to understand 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 memo is based in Section 10(5) of the Intergovernmental Fiscal Relation Act which requires that the Division of Revenue Bill, when introduced to Parliament, must 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 memo 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 explanatory memo explains the background for the division of revenue

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 Nation 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 months 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 in detail, with its forums, committees, institutions, and legislative hearings.

■ 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 envelop
- 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 is a politically driven process

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

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

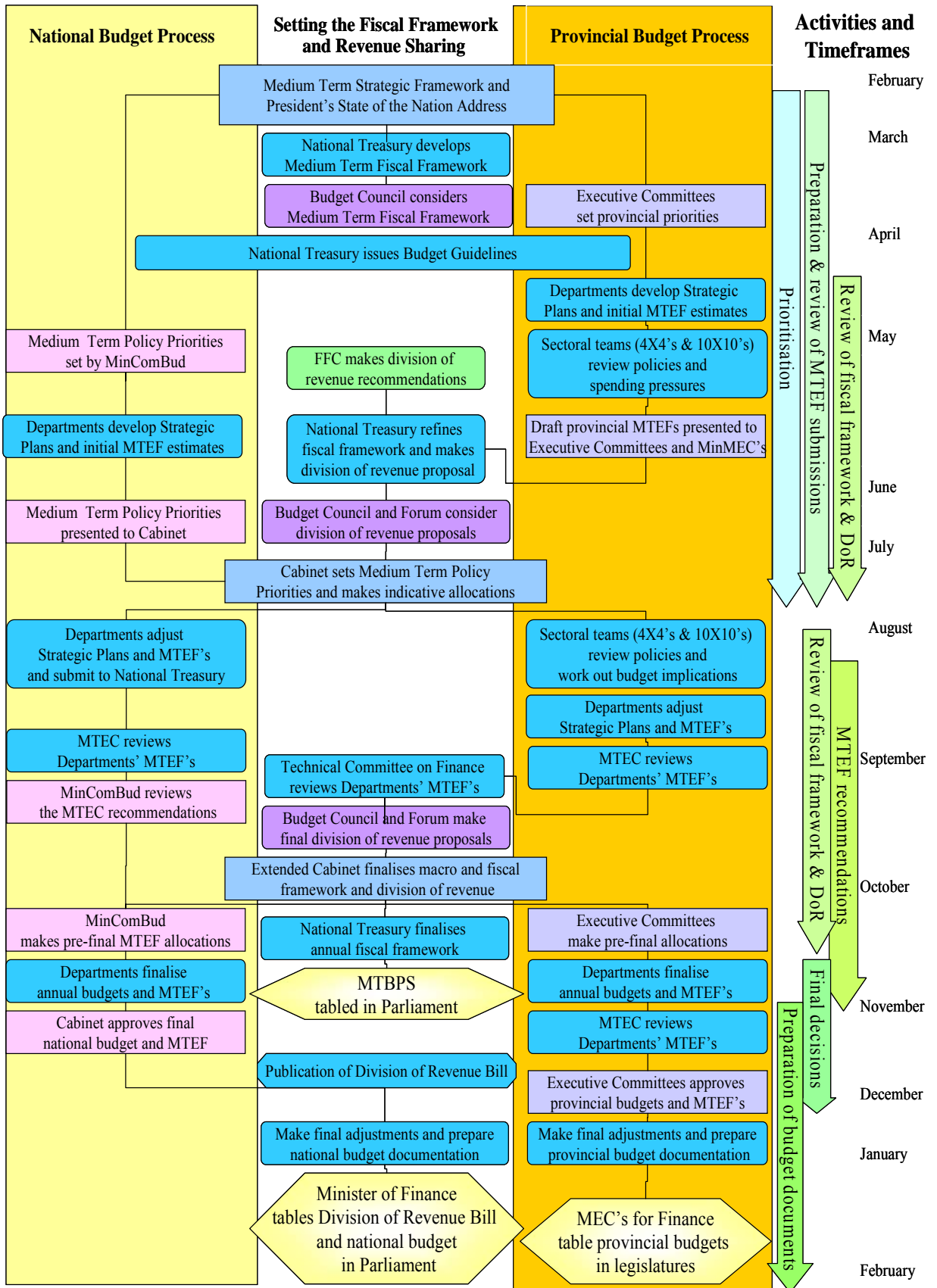
Financial crisis expected to impact on public spending

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 of 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.

The Medium Term Strategic Framework is the basis for policy priorities

■ Policy prioritisation

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 State President's 'State of the Nation Address' in February each year. In this speech the State President spells out Government's priorities in the short and medium term. The short-term priorities should refer to objectives that Government has already funded 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 strategic plans

Working within the framework of the MTSF, the Minister's Committee on the Budget (MinComBud) will develop 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) will set provincial priorities to guide provincial departments' strategic planning.

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 after the number of national and provincial department participants. These technical meetings are often mirrored by HeadCom and MinMEC's 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 FFC is required to submit its recommendations on the division of revenue amongst 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 recommendation 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.

Toward the end of July the 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.

A 'first draft' of the budget in July

The 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 the 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, i.e. it sets an initial 'resource envelope' for the budget process.

Review of the fiscal framework seeks to determine the budget envelope that will be available

Based on this resource envelope, the 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 the National Treasury by the end of June. Provincial departments follow a similar procedure, except they also have to take cognisance of the recommendations arising out of the first round of 10X10 and 4X4 processes referred to above.

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

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 amongst the three spheres.

Second round of technical consultations to look 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 the National Treasury and organized local government also takes place for local government grants.

Budget Council and Budget Forum prepare for the decision making process

The information from these consultations feed 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 the Deputy Director-General of the 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.

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

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

Criteria for successful MTEF proposals

- the proposed revisions to a department's medium-term plans and how the 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.

MTEC makes recommendation to MinBudCom 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 3-year allocations for national votes taking 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 macro-economic 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.

MTBPS summarizes budget decisions

The National Treasury is responsible for drafting MTBPS during October. A revised macro-economic 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 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

Following the tabling of the MTPBS, the 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 division of revenue 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 of 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 and the 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.

The National Treasury is responsible for the production of the Budget Review, and co-ordinates 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 the 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.

ENE contains policy developments, expenditure trends and service delivery indicators

The 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 into Estimates of Provincial Expenditure.

Format for budget documentation by 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 prior to 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 tabled two weeks after national budget

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

■ 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 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 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 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
- implications of tax policy
- the impact of fiscal policy on the budget framework, including changes to expenditure and the deficit
- the management of Government's assets and liabilities; and
- Government's medium-term expenditure framework and the division of resources between the three spheres.

Hearings in Parliament

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 the macroeconomic and tax policy.

Public hearings and debate in the two committees mainly focus on the allocation of resources in the year two and three of the MTEF. In this way, the legislature and the public is 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 this 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.

Amendment of the division of revenue bill

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:

Tabling of provincial budgets

- Overview of Provincial Expenditure (previously called Budget Statement I) is the equivalent of the national Budget Review
- Estimates of Provincial Expenditure (previously Budget Statement II) 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 given the funding made available to them through the provincial budgets.

Provincial departments table annual performance plans

Provincial legislatures only have Portfolio Committees on Finance which follows a similar procedure to the JBC to approve the provincial budgets. Namely, a first and second reading and then a debate in the House followed by a vote.

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5

Borrowing by provinces

- A province has the ability to take out loans, which can create options for a technical department to speed up delivery of its public service obligations, e.g. by improving existing buildings or building new schools.
- The accounting officer must liaise with the provincial treasury in case a department wishes to pursue the opportunity to borrow funds through the provincial treasury. The key point of repayment should of course be carefully considered, when a department wishes to take out a loan.
- This chapter introduces the conditions, purposes and processes involved when a province intends to take out a loan.

■ Loans for bridging purposes and capital projects

Provinces are granted the ability to take out loans, according to the Constitution section 230, 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, Act No 48 on Borrowing Powers of Provincial Governments of 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 authorized to do so by the Minister for Finance
- the interest of the loan shall be within certain limits and accepted by the Minister of 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 Minister 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, since 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
- economic development in other ways.

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 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 scrutinized by the CBC.

Small projects or programmes: Estimated to cost less than R50 Million per year and not more than R150 million for a three year period. 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 annum for more than three year – the process is as follows:

Steps in the loan 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% margin of error on the cost estimates. Furthermore, the prefeasibility study should note if the project will require national co-funding

TCF makes first review and recommends projects for further scrutiny

Capital Budgets Committee carries out detailed review

Budget Council makes final recommendation

- 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 to Cabinet for approval.

Mega projects typically require long-term funding beyond the three-year timeframe of the MTEF. Therefore funding for full project cost 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 fully within the relevant 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:

Elements in the project appraisal

- **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.

More information about the Provinces' ability to take out loans can be found in Act no. 48 on Borrowing Powers of Provincial Governments of 1996. See also chapter 17 on Budgeting for infrastructure and capital projects and chapter 16 PPPs.

Further information

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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 provincial treasury is a key role player in the oversight process, and the accounting officers of departments are responsible for providing access to oversight information.
- 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 demand for access to performance information from departments.
- 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 adopted by Parliament, 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 are provided with similar oversight powers to the National Assembly in regard the oversight of provincial executive organs of state.

Provincial legislatures have an oversight function over the provincial executive

Historically, oversight functions have focused on financial aspects of programmes, with the aim to ensure that rules and regulations were observed. However, the need to ensure value for money means that the oversight functions of legislatures increasingly focus on service

delivery outputs and outcomes, i.e. if departments are delivering the services that they are required to, and if 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, in combination with 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 to carry 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 oversight

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. This must be seen in the context 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 Public Finance Management Act (PFMA).

As responsible for the financial matters in the province, the provincial treasuries have an oversight responsibility. Furthermore, the provincial treasury must enforce the PFMA, and prescribed national and provincial norms and standards, according to the PFMA section 18(2)(c and d). This includes also the need for non-financial information from departments.

On the following pages, various key tools and documents for oversight are presented. Please see also the chapter on monitoring in this manual.

In-year monitoring

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. The 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-year monitoring safeguards against overspending

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 and monitoring are presently a challenge for departments

For concurrent functions that are shared with provinces, the National Treasury 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.

The role of provincial treasuries

The provincial treasuries compile, quality assure and forward the Provincial Quarterly Performance Report to the National Treasury, which will use the data to draft a sector-wide quarterly performance report and a Government-wide quarterly performance report, which enables legislatures to monitor progress.

Process in the quarterly provincial performance reporting

Provincial treasuries thereby fulfil a key monitoring role in the performance reporting system, by tracking the implementation of strategic plans and objectives of departments. Quarterly performance information allows tracking of progress of what has been planned against what is actually delivered in the form of service delivery outputs.

The concrete process works as follows: When the provincial treasury has received from provincial departments the quarterly financial performance plans, the provincial treasuries:

Role of the provincial treasury

- verify that the formats of the QFR model have been used

- verify data against the annual performance plan targets and their quarterly target (Guide for implementation of Provincial Quarterly Performance Plans p.19-20)
- if data and formats are incorrect, the provincial treasury will return the departments' reports and request a revision
- when the data set is correct, the provincial treasury will sign off on the data and submit to National Treasury.

Once the data have been received by the National Treasury, they are evaluated to determine the quality. The data provide inputs for the quarterly sector- and government-wide reports.

Standardised reporting formats

Nine sectors have standardised reporting formats

Standardised reporting formats have been developed for nine sectors: Education, Health, Social Development, Housing, Agriculture, Public Works, Local Government and Transport, Arts and Culture, and Environmental Affairs. The reporting formats are based on standard objectives in the strategic plans for these sectors. A database facilitates the capturing of output related data, and a template developed for the narrative section provides for the budget, strategic objectives, measurable objectives and performance measures, etc.

For the sectors where no standardised reporting formats have been developed, the narrative needs to provide a brief explanation of key achievements, challenges, and management actions to respond to issues.

Performance measures and performance indicators

A recurrent issue often found in technical departments' strategic plans, objectives and related monitoring systems, is the distinction between performance measures and performance indicators:

Performance measures define the relationship between inputs and outputs, that is how successfully outputs are produced. E.g. if task is building schools, the inputs would be the sum of money allocated to building the schools, and the performance measure would be the price for building a school with a certain number of class rooms.

Performance indicators monitor the relationship between outputs and outcomes, that is how successful the outputs are to produce the outcomes. In the example above, the outcome would be e.g. the increase in the number of children going to school, or the number of children passing a certain grade in school.

The distinction above also reflects the responsibility of the political and administrative systems: While the political leaders are responsible for the outcome of the programmes, i.e. how well the programmes lead to improvements in levels of education in the above example, the administrative system is responsible for the effective management of the resources allocated to produce the outcomes.

Performance audits

The Auditor-General has started on performance audits in a phased approach. Performance information should be submitted for audit with

the annual financial statement within two months after the end of the financial year. Note that the Auditor-General will express an opinion on the 2009/2010 performance information.

■ Annual Reports

All national and provincial departments and public entities are required to prepare annual reports that will be tabled in the relevant legislature, according to section 40 and 55 of the PFMA.

Annual reports are another key tool for departments to provide oversight information, and the provincial treasury must monitor whether departments and provincial entities develop and deliver their annual reports in time, according to the MFMA section 18(2)(b).

Annual reports are the main 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 such departments report against those targets in their annual reports.

Annual Performance Plans should have performance targets

Reforms since 2000, based in the PFMA and Public Service Act, 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 2) 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 the 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 statement

Annual reports as noted earlier must include also 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.

Any overspending of a vote or the main division within a vote must be defined as "unauthorised expenditure" and must be investigated, to see

if charges of financial misconduct should be raised according to section 81 of the PFMA.

The notes of the financial statement are often the most important part, as they provide the context and detailed information to the numbers in the financial statement.

The main aim of the financial statement is to report on the department's use of funds that was made available by the legislature through the budget. Furthermore the aim is to report on management of income, expenditure, transfers, cash and assets and the financial management system.

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 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 the “emphasis of matter”.

Information on programme 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 weak, but departments are required to pay attention to this aspect of oversight.

*Key information on
programme performance*

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

- have they achieved the expected outcomes, i.e. progress in reaching stated goals and objectives;
- have they delivered the planned outputs, i.e. performance against performance measures and targets in the strategic plan and Estimates for Provincial Expenditure (Budget 2 Statement) 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, e.g. 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.

Key service delivery departments should also report per municipality and for major cost centres, as hospitals, prisons and similar.

While the need for performance information is integral to determine value for money, the economic crisis in 2009 and expected decrease in tax revenue underlines the need for such performance indication to determine value for money.

More information about performance information for service delivery can be found in chapter 14 on monitoring. In the annexures, the documents Framework for Managing Programme Performance Information and Guideline for Implementation of Provincial Quarterly Performance Reports also provide more detailed information.

Timing and tabling of annual reports

The annual report by the technical department must be tabled by the responsible MEC in the legislature no later than six months after the end of the financial year, according to section 65 of the MFMA. In general most departments have been able to meet this deadline, while the public entities have shown a more limited ability to meet this deadline.

■ 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.

Among the issues that the Public Accounts Committees are likely to consider are:

- any issue raised by the Auditor-General
- issues of financial honesty (e.g. fraud), highlighted in the audit report or that come to the committee's attention in any other way
- compliance with the PFMA and associated treasury regulations
- the interrogation and evaluation of instances of over-expenditure, and other instances of unauthorised expenditures
- interrogation of instances relating to irregular and fruitless and wasteful expenditure
- function of risk management systems, including fraud prevention, financial management systems, and personnel management systems (e.g. leave management and disciplinary processes)
- supply chain management and procurement, particularly large tenders, large capital projects and Public Private Partnership deals

- disposal of significant state assets, and any major financial or related losses suffered by government
- corporate governance of departments, public entities and constitutional institutions
- consolidated financial statements of government, and the National Treasury's adherence to its deficit targets.

■ Portfolio committees

Provincial portfolio committees focus on whether provincial departments have delivered on the targets set out in their annual performance plans, which was the basis for appropriating funding to the programmes by the legislatures. Portfolio committees are likely to consider the following issues:

- the technical quality of the annual reports produced by the department and public entities
- whether entities report on all performance targets in their strategic plans and budget
- the quality of the performance information as highlighted by any audit of performance information by the Auditor-General may perform, or in the light of any other information that comes to the committee's attention
- the economy, efficiency and effectiveness of service delivery as measured by the performance indicators presented in the annual report
- the equity of service delivery
- the implementation of the entity's service delivery improvement programme
- evaluating management's explanations as if the service delivery performance did not attain the targets;
- investigating the circumstances that led to under- or over-expenditure and the impact this had on service delivery, and the measures taken by management to comply with the Budget
- comments to the MEC's evaluation of the accounting officer's performance and appropriateness of proposed performance bonus or sanctions.

National portfolio committees for concurrent functions such as education, health, housing, agriculture etc need to have consolidated national perspective on the sector. The national portfolio committee should therefore consider the nine provincial portfolio departments report to assess the full impact of the national policy. The national portfolio committee can meet this need by establishing a workshop with the nine provincial portfolio committees.

How provincial treasuries facilitate oversight

The provincial treasuries can carry out an evaluation of the degree to which the departments' annual reports comply with regulations and guidelines. Provincial treasuries can also prepare a consolidated report for the provincial EXCO on audit outcomes for all provincial departments and entities. This will serve to give an overview and help to provide information about where financial management may need to be strengthened.

The following documents provide more guidance on the oversight process and its requirements for information: Framework for Managing Programme Performance Information, Guideline for Legislative Oversight through Annual Reports, and Guideline for Implementation of Provincial Quarterly Performance Reports.

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. The audit committee is described further in the chapter 9 on corporate management and internal controls. 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 has established a Special Investigations Unit to look into issues of serious financial mismanagement.

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9

Corporate management and internal controls

Accounting officers have to establish internal control systems in their departments. Provincial treasuries must monitor and assess the implementation of national and provincial norms and standards for financial management in the provincial departments and entities. The internal control systems of departments and provincial entities include internal audits and fraud preventions plans. In the following chapter, key aspects of corporate management and internal controls in provincial departments and entities are introduced.

■ Responsibility for financial management

The philosophy of the PFMA is to allow managers to manage, while loosening the strict procedures and regulation that were entailed in the precious Exchequer Act. At the same time, accounting officers are held responsible for the effective, efficient and transparent systems of financial management, risk management and internal control, as outlined in the PFMA section 38(a)(i).

The PFMA assigns the responsibility for reporting on financial management matters and overseeing of all financial management activities to the accounting officer. As noted in the introduction this responsibility, however, may be delegated to a Chief Financial Officer (CFO). The accounting officer, however, remains responsible for the actions carried out as part of this delegation of power an authority.

Internal control systems are established to assist accounting officers in meeting the organisation's objectives with effectiveness and efficiency, in compliance with laws and regulations, and ensure reliable financial reporting.

Different stakeholders have the responsibility for internal control systems, as follows:

- department's management has the ultimate responsibility for the operation of systems of internal control
- department's internal audit committees take action in case management overrides internal controls
- the Auditor-General plays an important role in ensuring that weaknesses are identified in internal control systems
- members of legislative committees exercise oversight and guidance as representatives of the public.

The department's internal audit committee is an important link in the above system of control, which in many cases has not been utilized to its full potential for strengthened management and accountability.

Internal control systems

Internal control systems should ensure that:

- targets are met with efficient use of resources
- financial information is reliable and useful
- assets are accounted for and protected from losses
- laws, policies, regulations and procedures are followed.

Requirements to control systems

Internal control systems should be of high quality but also of reasonable cost, and managers must continually ensure that controls over operations and resources are adequate and effective. However, design and extent of control measures must also match the risk and exposure, in other words its benefits should outweigh costs.

Key elements of internal control

The five key elements of internal control are:

- the control environment
- risk assessment
- control activities
- information and communication
- monitoring arrangements.

The first two points in particular may require elaboration:

The control environment

The control environment includes the governance structures and functions of the department, the approach to risk management, its style of operation, the approach to delegating authority and responsibility, as well the nature and extent of the risks involved, the systems for controlling expenditure, personnel policies and procedures, use of computer-based systems, protection of cash and securities, and management information systems. These are elements that may help to control the inherent risks in a financial environment.

The weaknesses in the control environment in the public sector are considerable. They may appear for instance where staff do not understand the logic behind separation of functions.

Risk assessment

A risk assessment should be carried out by all accounting officers. They must decide what an acceptable level of risk is (given the cost and other social factors) by objectively assessing the factors (risks) that may prevent a particular activity from meeting its objective. For example, the risk of delay in constructing a new clinic may be offset or managed by ensuring that the stock level of building material is adequately monitored; or, the risk of an asset such as a photocopier breaking down will be reduced by ensuring that it is not misused and regularly maintained.

Risk assessments are obligatory

Risk management

Elements of risk management include:

- assessing the nature and extent of the risks associated with the department's operations
- deciding on an acceptable level of loss or degree of failure
- deciding how to manage or minimise the risk
- monitoring, reporting and, from time to time, reassessing the level and implications of the risk exposure

Internal audits

Internal audits are established as key requirement of the PFMA, section 38 (1)(ii). While internal audits traditionally are seen as an operation by the finance department, it is today rather an independent appraisal function in an organisation to examine and evaluate its activities. Internal audits are a tool for management to carry out its responsibilities, by providing analysis, appraisals and advice about activities under review.

Internal audit must be conducted in accordance with standards set by the Institute of Internal Auditors. The internal audit unit must prepare, in consultation, with and for approval by, the audit committee:

- a modus operandi, with management inputs, to guide the audit relationship
- a rolling three-year internal audit plan based on assessment of key areas of risk
- a plan for the first year of the rolling plan, which indicates the proposed scope of each audit
- a quarterly report to the audit committee detailing performance against the plan.

Fraud prevention plans

Fraud prevention plans aim to manage the risk of fraud through cost-effective use of the control environment, information systems, control procedures and an ethical culture within the department. Each accounting officer must ensure that the fraud prevention plan is before the start of the financial year.

Audit committees

In section 77, the PFMA specifies that each department must establish an audit committee, unless the relevant treasury has agreed that two or more departments may share a committee. In the provinces, this may be a relevant option, but it is the responsibility of the department to consult with the provincial treasury.

Composition of the audit committee

The audit committee must consist of at least three persons – three to five is the norm in the private sector. One of the members must be from outside the public service, and the chairperson may not be employed by the department.

Objective of the audit committee

The objective of the audit committee is to assist management in carrying out its accountability responsibilities to safeguard assets, operate adequate systems and controls, and prepare annual financial statements. The audit committee can do this by:

- improving communication and increasing contact, understanding and confidence between management and internal and external auditors, which may result in a more cost-effective external audit, to benefit both the organisation and the auditors
- scrutinising the performance of internal and external auditors, thus increasing accountability
- facilitating the imposition of discipline and control, thus reducing the opportunity for fraud
- strengthening the objectivity and credibility of financial reporting.

Qualifications in the audit committee

The audit committee is expected to play a proactive role, and its members should have a sound understanding of the complexities involved, and a good understanding of the department's activities. At least one member should have the necessary financial and auditing expertise to advise the committee in the execution of its duties and responsibilities. Members should rotate on a regular basis, to ensure a mix of experience and new members. Common sense and objectivity are essential criteria. Ideally, the committee should have a mix of skills and experience.

The audit committee should perform the following duties:

- make recommendations on the appointment or retention of auditors

- review and discuss the scope of the audit
- satisfy itself that the audit plan sufficiently addresses the critical risk areas in the organisation
- review the effectiveness of the organisation's systems of internal control
- monitor management's response to reported weaknesses in controls (particularly those raised as audit queries), deficiencies in systems and recommendations for improvement
- consider differences of opinion between management and auditors
- evaluate the performance of auditors and of management
- consider the quality of financial information produced
- review the financial statements prior to approval by the accounting officer, including the accounting policies adopted, before submission to the Auditor-General
- communicate to stakeholders regarding its activities.

Qualifications in the audit committee

The audit committee should meet before the annual external audit to consider its scope and approximate timing, as well as the audit fee. It should also meet on completion of the audit to review the audit and all significant matters arising from it, in addition to the performance of the auditors.

The audit committee and the accounting officer must facilitate the risk assessment to determine the material risks to which the department may be exposed and to evaluate the strategy for managing those risks. The strategy must be used to direct audit effort and priority, and to determine the skills required for managing these risks.

The audit committee must report and make recommendations to the accounting officer, but the accounting officer retains responsibility for implementing such recommendations. The committee may communicate any concerns it deems necessary to the executive authority, the relevant treasury and the Auditor-General.

Reporting by the audit committee

The PFMA, and "Guide for Accounting Officers (to the) Public Finance Management Act" provides more information about internal control systems.

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Revenue and expenditure

- The financial responsibility vested with accounting officers for departments and entities includes ensuring that revenues and liabilities are handled as outlined in the PFMA and the PFMA Regulations. These regulations issued in 2001 provide more detailed guidance on the management of revenue and expenditure. The main points are outlined in this chapter.

■ Revenue

Some institutions are able to collect revenue through charges, levies, fees. Such funds must be paid into the provincial or national revenue fund.

Accounting officers must continuously examine their departments' operations to identify potential or actual sources of revenue. As a minimum, they must conduct a review during the budget preparation process and include this in the initial submission to the relevant treasury. Accounting officers should identify limits to the revenue base of their departments, such as policies affecting particular sections of the community, the need for government services to reflect value for money, community expectations and the rate of inflation.

Potential to generate revenue must be assessed

In case of an institution that charges fees, at least annually the tariff structure must be reviewed and approved by the relevant treasury. The tariff policy must be disclosed in the annual report. This should include details of any free services rendered but not taken into account in the budget, which could have yielded significant revenue.

Tariffs must be reviewed annually

Revenue management processes must ensure adequate separation of duties and provide for effective supervision and monitoring of revenue

collected. For example, activities related to the collection, recording and banking of revenue may not be undertaken by the same person.

■ Debts

Debt management

The amount owed by debtors is among the significant current assets of a department. The accounting officer must take effective steps to ensure that the department collects all debts. Relevant steps include:

- monthly age analysis report and procedures for follow up in terms of reminder
- procedures for monthly reconciliation of the debtor's ledger with each debtor's account
- charging of interest on all debts
- procedures for writing off debts.

Among the requirements to management of debts are to:

- maintain accounts in the name of each debtor to determine and analyse the total debt
- maintain separate ledger accounts for the recovery of debts by installment
- maintain separate records for the portion of debts or advances that has matured or become due
- provide a summary of all individual debts, to ensure the integrity and reliability of individual accounts
- separate duties between functions related to maintaining accounting records and receipt of money
- ensure that employees do not have continuous control of any one function for an extended period, by using annual leave and job rotation.

After having taken all reasonable steps to recover a debt, an accounting officer may write it off. This applies also if it has been determined that waiving the claim is to the state's advantage. When a debt is waived, the annual financial statements must disclose it, indicating the policy followed.

Losses

When writing off losses, the principles to be followed are outlined in chapter 12 of the PFMA Regulations. The main points are summarized below:

- the state bears its own damages and accident risks, and is responsible for all claims and losses of state property where these arise from activities by an official who is liable by law
- departments may choose to insure certain moveable assets, such as vehicles, up to an annual premium limit of R250 000

- a department may accept liability for any loss or damage suffered by another person, where this arose from an act or omission by an official
- if an official has sustained a loss or damage in the execution of official duties and has not been compensated, the accounting officer may make good the loss or damage
- losses or damages suffered by a department because of an act committed or omitted by an official must be recovered from the official if he or she is liable in law
- the accounting officer may write off losses or damages arising from criminal acts or omissions and other unavoidable causes if, after a thorough investigation, it is found that the loss or damage is irrecoverable. The Act requires all such write-offs to be disclosed in the annual report, and the policy adopted to be set out in a note to the annual financial statements.

■ Expenditure

Some of main principles concerning expenditure are:

- accounting officers must exercise control over all government expenditure, whether incurred directly by a department or through a transfer payment
- expenditure must be incurred in accordance with the Budget unless it is a direct charge or a transfer specified in the Division of Revenue Act
- procurement practices must be competitive, fair and equitable, and payments to suppliers are to be made within 30 days of receipt of invoice, unless otherwise specified in a contract. (see also chapter 13 on supply chain management)
- personnel cost of all appointees, and promotion and salary increases, must be met within the budget allocation of the department
- accounting officers must take all reasonable care to prevent or detect unauthorised, irregular, or fruitless and wasteful expenditure.

Accounting officers control the expenditure

Procurement practices

Virement

An accounting officer may utilise a saving of up to eight per cent of the amount under a main division for defraying excess expenditure under another main division within the same vote, unless the relevant treasury directs otherwise. This operation must be reported to the executive authority and the relevant treasury within seven days.

The relevant treasury must give prior approval before any personnel expenditure or transfers are increased, or before any earmarked allocations are used for other purposes.

Roll overs must be approved by provincial treasuries

Roll overs

The PFMA Regulations allow for unspent appropriated funds to be rolled over to a subsequent year in certain circumstances, subject to approval by the relevant treasury. A maximum of five per cent of a department's current expenditure may be carried into the next financial year. Capital funds may be rolled over to finalise projects still in progress or for other capital purposes. Transfer payments may not be rolled over for purposes other than originally voted. Requests for roll overs must be submitted before the last day of April.

However, roll overs must generally be seen as a case of underperformance by the technical department.

■ Unauthorised, irregular and fruitless expenditure

The PFMA defines unauthorised expenditure as either expenditure that is not in accordance with the purpose of a vote or a main division, or as overspending within a vote or a main division.

Irregular expenditure refers to expenditure that is incurred in contravention of or without basis in legislation such as the PFMA or the PPPFA.

Fruitless or wasteful expenditure refers to expenditure made in vain, which could have been avoided with reasonable care.

Cases of unauthorised, irregular, or fruitless and wasteful expenditure must be disclosed in the monthly reporting, and as appropriate disciplinary steps taken. Money lost due to unauthorised, irregular expenditure, or fruitless and wasteful expenditure must be reported in the notes to the annual financial statement.

Financial misconduct

If an official is alleged to have committed financial misconduct, the accounting officer must investigate and ensure that any disciplinary proceedings are carried out in accordance with the relevant prescripts.

An official commits financial misconduct if wilfully or negligently failing to exercise a power or perform duties assigned to him or her by the accounting officer, or by failing to comply with his or her general responsibilities, or specific responsibilities related to:

- budgetary control
- reporting
- submission of information
- transfer of assets and liabilities
- unauthorised bank accounts
- failure to pay all revenue into the relevant revenue fund

- prevention of unauthorised, irregular or fruitless and wasteful expenditure

In case an accounting officer is alleged to have committed financial misconduct, the executive authority must initiate disciplinary measure. An accounting officer, who fails to comply with the general responsibilities of the position or with budgetary control or reporting responsibilities, is liable to a fine or imprisonment for up to five years, according to the PFMA section 86.

Financial misconduct by an accounting officer

Disciplinary hearings

The accounting officer must submit to the relevant treasury and the Auditor-general a list of:

- the name and rank of officials who are facing disciplinary hearing or criminal charges
- the outcome of any disciplinary charges and or criminal charges
- any sanction taken against the relevant officials.

The department must furthermore inform the Executive, the relevant treasury, the department of Public Service and Administration and the Public service Commission of the outcome of any criminal proceedings for financial misconduct.

For more information, please see the PFMA chapter 10, and the “Treasury Regulation issued in terms of the Public Finance Management Act.”

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11

Transfers, cash and banking

- Transfers comprise more than half of the expenditure on the national Budget. While accounting officers have full responsibility for their own expenditure, the responsibilities between receiving and transferring institutions have tended to create confusion. The main aspects of transfer payments and conditional grants are outlined in this chapter, in addition to the basic requirements to cash management and banking.

■ Accountability and transfers

A transferring accounting officer must ensure that all funds are deposited in the provincial revenue fund or, in the case of a municipality, into an authorised bank account. The receiving accounting officer must account for the money received, and the manner in which it is spent. The PFMA section 22 and DoRA both clarify these accountability responsibilities.

Auditing of transferred funds

The transferring accounting officer must consider the arrangements for auditing in the recipient entity, as these arrangements may determine the degree of caution and oversight necessary before any funds can be released. The audit arrangements will differ according to the type of body receiving the transfer, as follows:

When the transfer is to an NGO, caution is required, since NGOs have individual requirement for auditing and are not audited by the Auditor-General. In contrast, a province or municipality is covered by audits of the Auditor-General and therefore no specific considerations

are required. If the transfer is to a public entity, the transferring accounting officer should be mindful of the auditing arrangements, which probably fall within the domain of the Auditor-General, but the responsibility of the accounting authority may differ.

General principles

No transfer, grant or agency payment can be made outside the terms of the DoRA. Any such payment will constitute unauthorized expenditure, unless it has been gazetted before funds are transferred.

In case of a grant to another sphere of government, the accounting officers transferring grants must ensure that the transfer complies with the DoRA. This obligation in terms of the Constitution covers conditional grants and any other grants transferred to a province or municipality.

In case of a grant to a public entity within the sphere or a private institution, the accounting officer must make sure that the transfer is provided for in terms of the DoRA.

When assessing the degree of accountability, accounting officers should consider the following:

Organisations audited by the Auditor-General

Key question: Is the organisation audited by the Auditor-General?

When a receiving entity falls under the audit scope of the Auditor-General (e.g. a provincial department, municipality or public entity), then the transferring accounting officer is not expected to maintain micro-control once transfers are effected; the receiving authority is accountable for the actual spending. This does not, however, absolve the transferring accounting officer from putting in place a basic monitoring mechanism for some of these transfers, e.g. conditional grants.

Organisations not audited by the Auditor-General

When a receiving entity (excluding households) falls outside the audit scope of the Auditor-General, such as e.g. a welfare society or NGO, the accounting officer has greater responsibility to ensure that proper auditing and internal arrangements are in place in that entity. The accounting officer never ceases to be responsible after the transfer of funds, and should therefore take action to ensure regular monitoring mechanisms are in place for proper accountability and recourse.

Agency payments

Agency payments, however, are not transfers, and full accountability for spending these funds always resides with the transferring accounting-officer.

Agency funds should not be on the budget of the entity performing the agency service, but should rather be treated in the same way as an outsourced service. The agency payment agreement must comply with the DoRA, and all such agreements must be reported to the relevant treasury. The transferring accounting officer is responsible for

ensuring that funds are only deposited in bank accounts that have been authorised by the relevant treasury.

Reporting

Accounting officers of departments making or receiving grants to or from other spheres of government through the DoRA must comply with the reporting requirements of that Act, which includes a requirement to monitor the actual expenditure of funds. These reports should be submitted together with the monthly reports required by the PFMA, as part of a single reporting process.

Transfers in whatever form by provincial accounting officers to municipalities must be reported monthly in terms of the DoRA. The reports will include grants such as health and ambulance subsidies, or for municipal infrastructure, housing, roads etc. Provincial treasuries are expected to ensure that normal cash management arrangements apply.

Transfers to municipalities

Division of revenue funds

Accounting officers transferring grants must eliminate any ambiguity as to which department or municipality will be audited for spending such transfers. The basic considerations in this regard are that:

- the allocation must be on the budget of the entity responsible for spending, and the entity will be audited. Unless otherwise approved by the relevant treasury, the spending department should be the beneficiary province or municipality
- original documents must be kept with the responsible spending entity, for audit purposes
- procurement must be carried out according to the responsible spending entity's procedures
- the spending entity will be expected to take over ownership and future maintenance responsibilities.

Where any of these considerations apply, the grant should be treated as a transfer, and the transferring accounting officer is accountable only for the transfer itself; the receiving accounting officer will be responsible for the actual spending.

Fiscal dumping

Accounting officers must not transfer funds to conceal underspending in their departments, a practice known as "fiscal dumping" and which may constitute financial misconduct. Intentions to transfer funds should be outlined during the budget preparation process, before the financial year begins.

Other transfer payments

Transfer payments are typically made to assist other government or non-government entities in delivering outputs. Efficiency, effectiveness, economy and transparency in the use of the money by

Receiving institutions must have sound financial systems

the end users are as important as they are for Government's own programme delivery.

Therefore, accounting officers must ensure that entities receiving government money have appropriate financial management and control systems. Before funds are transferred to an entity (not to a household or individual) outside Government, the accounting officer must obtain the most recent audited statement and annual report, together with a written assurance that the entity has or will implement effective, efficient and transparent financial management and control systems.

Principles for good cash management

■ Cash management

Responsibilities of departments

The accounting officer is responsible for establishing systems, procedures, processes and training and awareness raising programmes to ensure efficient and effective banking and cash management.

These arrangements include:

- ensuring that money collected by a department is paid into the department's Paymaster-General account and accounted for in its ledger
- avoiding prepayments for goods or services (i.e. payments in advance of the receipt of the goods or services), unless required by contractual arrangements with the supplier
- taking any other action to avoid locking up money unnecessarily.
- accepting discounts to effect early payment only when the payment has been included in the monthly cash flow estimates provided to the relevant treasury.

Good cash management includes:

- collecting all revenues promptly
- placing money in bank accounts as soon as possible
- pursuing debtors with due rigour
- selling surplus or underperforming assets
- maintaining stocks at levels no higher than required for efficient programme delivery
- making transfer payments or other payments on schedule rather than ahead of the date due
- forecasting the timing and amounts of material cash flows.

The accounting Officer or CFO must ensure that the department's systems, records and statements of procedures meet the purposes of sound cash management. He or she must monitor cash management

performance and report to the accounting officer, in writing, at least monthly.

Banking practices

Good banking practices are in line with the above outlined principles for cash management.

Departments may not open a bank account without the written approval of the relevant treasury. Previous approvals continue to apply unless revoked, as long as they are listed. Departments that are authorised to open a bank account may only do so at a bank registered in South Africa and approved in writing by the national Treasury, after prescribed tendering procedures have been followed.

Banks must be approved by the provincial treasury

Money deposited into the Paymaster-General account must immediately be available to the relevant treasury for spending or investment according to its central cash management responsibilities.

Money held in trust (that is, money or property held by a department on behalf of other persons or entities) should not be mixed with the trustee's own money. Hence, the accounting officer must maintain a separate bank account for each portion of trust money, maintain individual accounting records for each account, and prepare separate financial statements.

Money held in trust

The PFMA and the PFMA Regulations provide further guidance on transfers, cash and banking management.

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12

The Integrated Financial Management System

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

■ Integrated Financial Management System

What is the IFMS?

Presently a number of IT 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 goes 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 VULINDLELA, 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.

Implementation in a phased approach

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.

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Supply chain management

Supply chain management (SCM) includes demand, acquisition or procurement, logistics, and disposal management. The procurement by departments and public entities is one of the most important areas of public expenditure in South Africa, and requires specific attention by accounting officers/authorities and provincial treasuries. This chapter gives an overview of key aspects of supply chain management.

■ 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, 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

Accounting officers/authorities are responsible for supply chain management...

The Public Finance Management Act (PFMA) compels the accounting officer 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/accounting authority.

... but may delegate decision-making to subordinates

While the accounting officer/authority may delegate decisions to subordinates, only the decision-making can be transferred, not the responsibility for the decisions. The delegation of authority should be handled in such a way that no individual official is in a position to take a decision in isolation regarding key SCM issues as e.g. award of a contract. Further to the above principles, 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.

Risk management in SCM

Risk management in SCM entails that accounting officers/authorities should determine what an acceptable level of risk is, by assessing the risks that may prevent a particular activity from meeting its objective. This will include ensuring that risks such as price or currency fluctuations are allocated to the appropriate party in a clear contract document or that guarantees or insurance arrangements are in place.

In addition, the award and management of contracts is an area where fraud and corruption has been found in the past. The department's Fraud Prevention Plan should reflect this, through cost-effective use of control measures and procedures and promotion of an ethical culture.

■ 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 bids.
- **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 bid, according to the delegation of authority by the accounting officer.

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

The accounting officers of the provincial treasuries also have oversight responsibility for the supply chain management by municipalities. National Treasury has delegated this Constitutional responsibility to the provincial treasuries, for 266 of the 283 municipalities in South Africa. Some key aspects of the General Procurement Guidelines (GPG) provide guidance in this aspect.

Can a councillor serve on a tender committee?

This question is relevant for provincial treasuries, since they have oversight responsibility for municipal procurement.

“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.*

General Procurement Guidelines

The GPG elaborates the principles for procurement outlined in section 217 of the constitution. The GPG prescribes that successful government procurement is based on five pillars of procurement. These five pillars are: 1) value for money, 2) open and effective competition, 3) ethics and fair dealing, 4) accountability and reporting, and 5) equity.

The five pillars of procurement

In regard to value for money, it should be noted that price alone is not a reliable indicator, and the lowest price does not always equate 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.

Value for money

The procuring entity 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 timely manner. Government staff who is involved in procurement, especially those dealing with suppliers, must observe criteria for ethics and fair dealing. These include among others that they do not compromise the standing of the state by accepting gifts or hospitality, and recognize 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

Accountability inside the organisation

procurement are accountable to heads of department, and individual procurement officers are accountable to heads of procurement.

Equity in procurement

Equity in the context of the GPG refers to observing government policies to advance persons 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).

■ Four aspects of SCM

The document Supply Chain Management, A Guide for Accounting Officers/Authorities, (in the following referred to as the Supply Chain Management Guide) provides further guidance on how to approach the specific elements in supply chain management, which are:

- demand management
- acquisition management
- logistics management
- disposal management.

■ Demand management

Demand management is the first phase of SCM. The objective of demand management is to ensure that the resources required to fulfil the needs identified in the strategic plan of the institution are delivered at the correct time, price and place and that the quantity and quality will satisfy those needs.

Establish a total needs assessment

Departments should undertake a total needs assessment as part of the strategic planning process of the institution. This includes a detailed analysis of the goods, works and services required, such as how much can be accomplished, how quickly and with what materials, equipment, etc. Managing demand is a cross-functional exercise that ensures that value for money is achieved.

■ Acquisition management

Traditionally, the focus in supply chain management has been on procurement processes. Acquisition management, however, includes also:

- decisions on how to approach the market
- to determine the total cost of ownership of an asset
- to ensure that bid documentation is complete, including evaluation criteria
- to evaluate bids in accordance with published criteria
- to ensure that proper contract documents are signed.

If a need has to be satisfied by an outside supplier, whether for goods, works or services, the availability of sources in the market should be investigated. The purpose is to establish a balanced approach when considering, among others, keeping pace with modern technology and development, enabling newcomers/HDIs to supply the goods/services, making use of labour intensive methods and promoting broadbased black economic empowerment (BBBEE).

To stimulate the promotion of BBBEE and the development of HDIs and SMMEs, department institutions should advertise in the local media for businesses to register as potential suppliers for goods and services to be obtained by quotations. Provincial departments and entities should also advertise in the government tender bulletin.

Thresholds for provincial procurement

Value up to R2000	Internal procedures for petty cash apply.
Value up to R10 000	Obtain at least three verbal or written quotes. Place order against written confirmation.
Value up to R500 000	Obtain as many written quotations as possible.
Value above R500 000	Use competitive bidding process.

All threshold figures include VAT.

National Treasury Practice Note No 8 2007/2008.

Thresholds for municipal procurement

Value up to R2000	Internal procedures for petty cash apply.
Value up to R10 000	Obtain at least three verbal or written quotes. Place order against written confirmation.
Value up to R200 000	Formal written price quotations.
Value above R200 000	Use competitive bidding process.
Long term contracts	Use competitive bidding process.

All threshold figures include VAT.

Municipal Supply Chain Management Regulations, Government Gazette Vol. 479, 2005.

Bidding procedures

There are five key stages in a bidding procedure:

- compiling the bid document
- inviting the bids
- receiving the bids
- evaluating the bids
- clearing successful bids and awarding the contract.

Experience shows that inadequate attention is given to compilation of bid documents. These documents describe the nature of the services to be provided, and failing at this stage will have dire consequences, when the services are to be delivered.

Bids should be advertised for at least 21 days. They should as a minimum be advertised in the Government Tender Bulletin, if issued by provincial departments and entities. After bids have been received,

and until the evaluation has been carried out, information regarding the evaluation of the bid should not be disclosed to the bidders or other persons who are not part of the official process. Late bids should not be accepted.

*Preferential Procurement
Policy Framework Act*

Accounting officers/authorities are not obliged to consider unsolicited bids.

Bid evaluation

As mentioned, bids can only be evaluated according to the criteria that are outlined in the bid document. The Preferential Procurement Policy Framework Act (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.

80/20 point system

The PPPFA includes an 80/20 point system for bids up to R500 000. The system implies that a maximum of 80 points for price may be awarded for the lowest acceptable offer, and bids higher in price would score lower points relatively to the difference to the 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 bid that scores the highest number of points within the combined 80 and 20 point categories. This system must be applied for all contracts above R30 000. A similar 90/10 point system applies for bids above R500 000.

Should the bid be awarded by either the bid adjudication committee or by the accounting officer/authority differently 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.

If no suitable offer is received, the accounting officer/authority should re-advertise the contract. Successful bidders should be notified by registered or certified mail.

The March Spike

What is occasionally seen towards the end of the financial year is that procurement suddenly burst 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 jeopardize the concept of value for money. Good management practices suggest that accounting officers prepare a plan of spending from all departments at the start of the financial year, which will allow monitoring of the progress in the departments’ procurement expenditure during the year.

Unsuccessful bidders should on request be informed of the reason why their bid was not successful. Information contained in bids must be treated as confidential and must not be disclosed, as it may reveal a bidder's trade secrets.

Selection of consultants

Consultant services are typically of advisory or intellectual nature, and specific procedures apply to these consultant contracts, as outlined in Chapter 5 of the Supply Chain Management Guide.

The term consultant includes not just individuals, but also consulting firms, engineering firms, management firms, procurement agents, auditors, investment and merchant banks, universities, research agencies, government agencies, and non-governmental organizations (NGOs), among others.

Consultants should only be engaged when the necessary skills or resources are unavailable in the department and the accounting officer/authority cannot be expected either to train or to recruit people in the time available.

The accounting officer/authority is responsible for selection consultants, and awarding and administering the contract. The rules and procedures for selecting the consultant depend on the circumstances. However, the following four considerations should guide the accounting officer/authority's policy in the process:

- the need for high-quality services
- the need for economy and efficiency
- the need to give qualified consultants an opportunity to compete in providing the services
- the importance of transparency in the selection process.

In most cases, the best way to consider these aspects is through competition among firms based on both the quality and the cost of the services to be provided, known as Quality- and Cost-Based Selection (QCBS). However, in some cases QCBS is not the most appropriate method of selection, for instance in complex or highly specialized assignments or those that require innovations. In these cases, selection based on the quality of the proposal alone, Quality-Based Selection (QBS), is more appropriate.

The most common forms of bidding procedures

Chapter 5 of Supply Chain Management Guide lists the various methods of selection of consultants and the circumstances in which they are appropriate. The particular method to be followed for the selection of consultants for any given project should be selected by the accounting officer/authority, in accordance with the criteria outlined in the Supply Chain Management Guide.

Conflict of interest

Consultants are required to provide professional, objective and impartial advice and at all times hold the client's interests paramount, and strictly avoid conflicts with other assignments or their own corporate interests. Consultants should not be hired for any assignment that would be in conflict with their prior or current, or that may place them in a position of not being able to carry out the assignment in the best interest of the State. Without limitation on the generality of this rule, consultants should not be hired under the following circumstances:

Use different consultants for consulting and provision of goods

A firm, which has been engaged to provide goods or works for a project should be disqualified from providing consulting services for the same project. Similarly, a firm hired to provide consulting services for the preparation or implementation of a project, should be disqualified from subsequently providing goods or works or services related to the initial assignment for the same project, contractor's obligations are under a turnkey or design-and-build contract;

Use different consultants for constructing and Environmental Impact Assessments

Consultants or any of their affiliates should not be hired for any assignment which may be in conflict with another assignment of the consultants. As an example, consultants hired to prepare an engineering design for an infrastructure project should not be engaged to prepare an independent environmental assessment for the same project.

Logistics management

This aspect addresses:

- setting inventory levels
- receiving and distribution of material
- management of stores, warehouse and transport
- review of vendor performance.

This aspect pertains, among others, to coding of items, setting of inventory levels, placing of orders, receiving and distribution, store and warehouse management, expediting orders, transport management and vendor performance.

On stock levels, the minimum and maximum stock levels should be determined, taking into account lead times and the concept of just-in-time delivery. A safety margin of ± 20 per cent should be added to the determined minimum stocking levels. At least once a year, a stock inventory must be carried out, and actual levels compared to official records.

All damages and losses of assets must be accounted for, in accordance with treasury regulations. Damages and losses must be investigated with a review to recovery.

Disposal management

At this stage consideration should be given to:

- obsolescence planning
- maintaining a data base of redundant material
- inspecting material for potential re-use
- determining a disposal strategy
- executing the physical disposal process.

Disposal of an asset may include selling the asset at a market-related price, transferral to another institution free of charge, selling per auction or price quotation, physical destruction of the asset. As concerns computer equipment, the department of education should be contacted for arranging free transfer to an educational institution.

It is recommended that the accounting officer/authority appoints a specific committee to deal with disposals.

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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Monitoring

- Financial management concerns not only the expenditure side of public funds, but also whether 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 accounting officers and provincial treasuries to know whether investments in programmes are delivering the expected results, and if the province is getting value for money. Monitoring also assists treasuries in benchmarking programmes and enables provincial government to meet their responsibility to provide oversight information for the provincial legislature.
- Key concepts and elements in monitoring are introduced in this chapter.

■ Management, monitoring and oversight

As managers, accounting officers need to know whether programmes of their institutions are delivering the expected results. This is a key imperative for any manager in any form of institution. Monitoring of the performance of programmes is a key management tool, which is indispensable for managers in both the public and private sector.

A further requirement for performance information stems from the responsibility of public institutions to publish administrative and performance information, to account to Parliament and provincial legislatures as outlined in the Constitution sections 92 and 114. Provincial MECs are accountable to their legislatures and have to

Performance information regards the non-financial information of a programme

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 towards actually meeting these objectives. This performance information enables accounting officers to track the progress of their institutions and the provincial treasuries to monitor and benchmark the performance of programmes.

Treasuries should evaluate the objectives and monitoring systems of budget submissions

However, the quality of this performance information has not always been optimal. Departments should therefore with critical eyes ascertain the quality of their monitoring frameworks. Furthermore provincial treasuries should in similar vein review the quality of the performance measure indicators that departments and institutions are establishing for their programmes and projects in budget submissions.

Treasuries have a number of responsibilities

Provincial treasuries are responsible for monitoring the implementation of the Framework for Managing Programme Performance Information (FMPPI) by all institutions within their respective spheres. Furthermore, provincial treasuries are also responsible for providing training on the use of performance information, and for providing input to the processes to select and define performance indicators. Also, the provincial treasuries are to monitor and report on the economy, efficiency, effectiveness and equity in the use of resources when delivering services, using information from other institutions.

Performance information and budget submissions

When budget submissions are considered in the budget process, performance information and the track record of an institution in service delivery are increasingly taken into account. This underlines why departments and institutions are wise to develop effective monitoring systems.

Impact of economic crisis further underscores need for performance information

The revenue shortfall in 2009 further accentuates the need for effective monitoring, because resources are limited. The need to improve monitoring systems must be seen against the background of budget increases over the last seven years; in some cases sector budget have grown exponentially, but outputs have not increased in tandem.

The Government-wide Monitoring and Evaluation System is the overarching system for public monitoring and evaluation in South Africa. The Framework for Managing Programme Performance Information is the part of the system that details how to monitor performance information.

■ Key concepts in monitoring systems

Monitoring is often misunderstood as a form of control. Rather, monitoring should be seen as an enabling tool for 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.

Monitoring is a management tool

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. Outcomes are "what we wish to achieve"
- **impacts:** the results of specific outcomes, such as reducing poverty and child mortality.

Performance information is usually structured along the above concepts, and a strong monitoring system will provide performance information for all five aspects of a programme outlined above. Where possible, departments should use direct indicators to measure inputs, activities, outputs, outcomes and impacts. Direct indicators include cost or price, distribution, quantity, quality, dates and time frames, adequacy and accessibility.

Direct indicators

Furthermore, indicators that capture aspects such as economy, efficiency, effectiveness and equity, are desirable.

- **economy indicators:** explore whether specific inputs are acquired at the lowest cost and at the right time; and whether the method of producing the requisite outputs is economical.
- **efficiency indicators:** explore how productively inputs are translated into outputs
- **effectiveness indicators:** explore the extent to which the outputs of an institution achieve the desired outcomes.
- **equity indicators:** explore whether services are being provided impartially, fairly and equitably. Equity indicators reflect the extent to which an institution has achieved and been able to maintain an equitable supply of comparable outputs across demographic groups, regions, urban and rural areas, and so on.

Often development of performance monitoring systems will take place in cooperation between national and provincial departments where some parts of the monitoring system is developed at national level while other aspects are developed at provincial level.

Involving the users of the monitoring system in its development is often a good way to make sure that the system reflects their needs.

How to develop performance indicators

The performance information process begins when policies are being developed. The challenge is to specify indicators that measure things that are useful for management and accountability. This means managers need to be selective when defining indicators.

Defining a good performance indicator requires careful analysis of what is to be measured. A thorough understanding of the nature of the input or output, the activities, the desired outcomes and impact, and relevant definitions and standards used in the field is required. For this reason it is important to involve subject experts and line managers in the process.

A good performance indicator should be:

- (a) **reliable:** the indicator should be accurate enough for its intended use and respond to changes in the level of performance
- (b) **well-defined:** the indicator needs to have a clear, unambiguous definition so that data will be collected consistently, and be easy to understand and use
- (c) **verifiable:** it must be possible to validate the processes and systems that produce the indicator
- (d) **cost-effective:** the usefulness of the indicator must justify the cost of collecting the data
- (e) **appropriate:** the indicator must avoid unintended consequences and encourage service delivery improvements, and not give managers incentives to carry out activities simply to meet a particular target
- (f) **relevant:** the indicator must relate logically and directly to an aspect of the institution's mandate, and the realisation of strategic goals and objectives.

Institutions should include performance indicators related to the provision of goods and services. These describe the interface between government and the public, and are useful for monitoring and improving performance as relevant to the citizens of the country.

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 time 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.

SMART indicators are key in good monitoring systems

Good monitoring systems utilize performance targets that are “**SMART**”:

- **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 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.

Performance information should be integrated into existing management systems and processes. It is the accounting officer who has the responsibility to make sure that the department or institution has appropriate capacity and systems to collect and manage performance information, and that the performance information is used.

■ Questions to ask about monitoring systems

Important questions to ask about 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?

Data should be readily available through existing data gathering systems, rather than have to be collected by way of specific studies. The number of indicators should be as limited as possible. However, the line manager may need access to more data than the accounting officer of an institution.

Often monitoring systems tend to be too complex. Fewer measures or indicators may be more suited to inform about the status of a programme. Monitoring systems should include only the most relevant aspects of the services delivered, such as critical inputs, activities and key outputs.

*realistic targets challenge
an organisation*

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

Responsibilities of the accounting officer

A department or institution should have documentation that addresses the following issues:

- how the performance information system is integrated into management systems
- definitions and standards of all information collected by the institution
- processes for identifying, collecting, verifying, and storing information
- how the information is used in management?
- how the information is published?
- an identified set of performance indicators for reporting for oversight purposes.

In departments and institution, it is the responsibility of the accounting officers to establish processes to:

- set performance standards and targets prior to the start of each service delivery period, as indicated in the text above.
- review performance and take management action to ensure service delivery stays on track should also be established.
- evaluate performance at the end of a service delivery period.
- ensure that responsibility for managing performance information is included in the individual performance agreements of line managers and other officials.

See also the chapter on Monitoring in this manual. For a more detailed account of monitoring in relation to programme delivery, please see the publications Framework for Managing Programme Performance Information, and Guide for the Implementation of Provincial Quarterly Performance Reports, in the annexures.

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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. The accounting officer is responsible for the maintenance of the assets of the department or entity, as outlined in the PFMA. 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 the technical departments and provincial treasuries, the following issues pertaining to infrastructure are of special concern:

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

■ Asset management

In terms of the Government Immovable Asset Management Act (GIAMA), provincial government departments 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 as can be seen from 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 the chapter on Oversight).

Maintenance costs should be included in budgets

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. E.g. roads that are near the end of the structural lifetime will require a higher percentage. When the maintenance of a provincial department building or another infrastructure asset is neglected, inevitably its 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. E.g. a total of 200 000 km of roads remain unclassified, and therefore it is unclear who should maintain them. The Roads Infrastructure Strategic Framework of South Africa (RISFSA) seeks to address this problem and resolve the issues of ownership and responsibility for maintenance for the roads sector.

Integrated planning

A first issue is that planning should be based in strategic priorities. Currently, one of the biggest challenges facing technical departments and provincial treasuries is that plans and budgets are not aligned which 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.

A second issue is that better coordination is required:

- there is need for strengthened high level co-ordination in the planning process. At the strategic level this should be

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

captured within the Provincial Growth & Development Strategy (PGDS)

- although PGDS provides strategic direction, planning and implementation needs to be co-ordinated by departments, through cooperative forums.

An example of this coordination is that 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 spending money on white elephants. In the interest of value for money and effective use of provincial funds, the provincial treasuries can with benefit seek to strengthen integrated planning between technical departments.

With good results, the provincial treasury promote such integration in cross-functional forums. In some provinces, quarterly infrastructure meetings are held, which can provide the provincial treasury an opportunity to monitor progress of projects and raise questions over funding of new projects, if required.

Use cross functional forums to strengthen integrated planning

■ Monitoring of infrastructure projects

Annual reports of departments should reflect the progress of projects, e.g. the status of finalization of infrastructure development. In some cases, however, technical departments have not checked the 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 monitoring of projects by technical departments should be a priority. Provincial treasuries can play a key role in promoting good practice in this area.

Tracking of progress in infrastructure development is an area where provincial treasuries should play a key role, as also described in the chapter on 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.

■ Changing priorities and over-expenditure

Avoiding over-expenditure is a critical area of concern for the departments – and 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 serves to avoid 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 lead to incomplete projects also distort monitoring and reporting patterns from quarter to quarter.

■ Delays in paying contractors

Related to the points above is that poor planning may lead to changing priorities. This may again lead to budget constraints, which again results in lacking or delayed payment to contractors. Unfortunately, a number of cases exist in which delays in the payment to contractors have resulted in 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 small, medium and micro enterprise (SMME) contractors with limited cash-flow who have abandoned project sites due to late payments by technical departments. This is particularly regrettable as legislation seeks to empower this segment of the economy.

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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 operator is motivated to provide a high level of service, as good returns on the initial investment will depend on the quality of services delivered.

■ PPPs in South Africa

Since 1999, PPPs in South Africa have been regulated under the Public Finance Management Act (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.

Definition of PPPs

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 a 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 has been proven in its application throughout South Africa and in most developed countries.

Examples of PPPs

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

Duration of PPPs

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 the provincial treasury – are of critical importance.

Support to transaction advisors from National Treasury

■ Accounting officers role in PPPs

Accounting officers should be mindful, when undertaking their implementation responsibilities, of the benefits of assessing and procuring services and infrastructure via a PPP. Advice and guidance on the PPP process can be sought in the first instance in the Provincial Treasury.

Signing of a PPP require that the MEC for Finance is involved as s/he will sign and bind to province to a future financial commitment, according to section 66(2)(b). Therefore it can be useful at the early stage of considering a PPP transaction to ensure the involvement of the MEC for Finance.

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.

■ 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:

Roles of the Provincial Treasury

- 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 foregoing list, which is not exhaustive, is not of “once off” matters. Provincial treasuries have important, ongoing roles in regard to these issues and must be capacitated and resourced appropriately.

In conclusion, in order to obtain the maximum benefits from our well-established PPP programme, it is essential there is a clear understanding of the roles and responsibilities of the technical department, the Provincial Treasury and all other provincial role players in terms of PFMA PPPs.

A more comprehensive introduction to PPPs is attached as an annexure, and 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 budget submissions for infrastructure and capital expenditure projects and programme proposals fail due to insufficient quality of the documentation. Accounting officers can improve the chances of their departments receiving funding for projects and programmes by making sure that their budget submissions meet their required standards.
- Provincial treasuries have an important role to play in strengthening the quality of the submissions by the departments and provincial entities, by promoting good practices. This strengthening will ensure efficiency in infrastructure planning and budgeting, and support better allocation of resources.

■ Requirements to 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

Project proposals require a feasibility analysis

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

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.

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

■ 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.

Take long term funding requirements into account

All projects extending beyond the Medium Term Expenditure Framework 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 provincial 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. Large and mega projects each require their own submissions. Appraisals will include:

- needs analysis
- cost-benefit analysis
- options analysis
- a scenario analysis.

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 to the entity's strategic objectives, highlighting how a proposed project or programme helps to achieve these goals. The analysis should describe clearly:

Why is a project needed?

- 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.

What are the cost and the benefits to society?

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.

Measuring costs

Departments should identify and calculate lifecycle costs associated with the planned investment, i.e. over the full period. These costs should include:

- capital or construction costs (e.g. land, buildings, equipment, labour costs, consultancy fees, contractors and any pre-production expenses)

- annual operating costs (e.g. purchases of additional equipment, personnel costs, loan repayments and associated interest)
- annual maintenance costs (see also chapter 15 on infrastructure management)
- a description of non-quantifiable costs and benefits.

Measuring benefits

All the direct social and economic benefits arising from the project should be measured, usually in the form of revenue earned, cost savings and direct employment created. All non-quantifiable benefits should be described in detail.

Externalities and “spillover effects”

Side effects to the project should be included

Externalities are costs and benefits to society that stem from a project, but which are not experienced directly by either the project owner or project beneficiaries. They can be environmental, economic and social effects, and can be either positive or negative. Negative externalities are to be included as economic costs, while positive externalities are to be included as economic benefits. Only externalities that result in a significant effect should be included.

An example of a negative externality is environmental pollution or degradation. An example of an economic positive externality when local businesses benefit from increased purchases of production materials and services due to the project.

Discounting

The economic desirability of a project is determined by the net present value (NPV) of the increased net economic benefits. Costs and benefits occurring at different times must be discounted. Departments and entities are required to provide any assumptions and calculations in the determination of the discount rate used in calculating the NPV.

A formula for discounting can be found in the document “Budgeting for Infrastructure and Capital Expenditure Guidelines” in the annexures.

Options analysis

Are there alternatives to the project?

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

When assessing alternatives, take the following issues 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.

The CEA determines the cost-effectiveness ratio by dividing cost with the effective benefits, as follows $CER = \text{Costs divided by effective benefits}$.

Determining cost-effectiveness

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

While programme A is the most cost-effective, it has the highest benefits and is also the most expensive.

The department must select its preferred option based on the cost benefit analysis and the CEA.

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 how will a 5 per cent devaluation in the exchange rate effect the cost of imported inputs? This is an essential part of the capital submissions, an example is shown below:

What happens if project assumptions change?

Risk variable	Cost variations		
	Pessimistic scenario (6%)	Baseline case (4.7%)	Optimistic scenario (4%)
Inflation	R102 000	R100 000	R98 000

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 must also 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 the 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.

For more details on the required information

Annexures

Glossary

Public Finance Management Act

Treasury Regulations in terms of the PFMA

Guide for Accounting Officers

Framework for Managing Programme Performance Information

Guideline for Implementation of Provincial Quarterly Performance Reports

Introducing Public Private Partnerships in South Africa

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 for Finance, the deputy Minister for 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.
Ex-ante	From Latin: Before the fact
EXCO	Executive Councils
Ex-post	From Latin: After the fact
Extended Cabinet	Extended Cabinet comprises of the national executive and the nine premiers. The highest co-operative 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 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.

