ANNEXURES

Two annexures are available on the National Treasury website (www.treasury.gov.za):

- Annexure W1: Explanatory memorandum to the division of revenue
- Annexure W2: Structure of the government accounts

A

Report of the Minister of Finance to Parliament

Introduction

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

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

Budgetary review and recommendation reports

Section 5 of the act sets out a procedure to be followed by the National Assembly, through its committees, for assessing the performance of each national department before the national budget is introduced. This procedure provides for committees to prepare budgetary review and recommendation reports that assess the department's service-delivery performance given available resources, as well as the effectiveness and efficiency of the department's use and allocation of those resources. The reports may also include recommendations on the use of resources in future.

The relevant portfolio committees tabled their reports in October and November 2017. Given the large number of reports, a separate document will be tabled in Parliament with detailed responses to the portfolio committees' recommendations. In many instances, the different committees made similar recommendations. Below is a summary of the common issues raised.

General issues

- A new funding model for the National Health Laboratory Service should be developed and the disputes regarding historical debts owed by provincial departments of health to the service should be resolved.
- A long-term funding arrangement should assist departments with losses caused by foreign currency exposure.
- Underfunding the post-school education system restricts achievement of the National Development Plan's goals.
- The Decent Work Commission should be adequately resourced to ensure the timely implementation of the national minimum wage.
- The Directorate for Priority Crime Investigation should be established as a separate budget vote independent from the South African Police Service.
- The nuclear procurement plan should not be pursued at the expense of the financial sustainability of Eskom and the country.
- A strategy is needed to reduce state-owned companies' reliance on government guarantees.
- Farmer support programmes, especially those linked to the revitalisation of agriculture, agro-processing and small business development, should be reviewed to avoid programme duplication across government.
- Monitoring and evaluation of the *municipal infrastructure grant* should be improved to ensure that the allocation related to the municipal facilities project is used effectively.
- The funding model for the Commission for Gender Equality should be aligned with the rest of the Chapter Nine institutions.
- The roles and responsibilities of different spheres of government for the provision of water services should be clarified.
- Issues raised in previous budgetary review and recommendation reports should be addressed.

A range of parliamentary committees recommended that additional budget allocations be made available to establish new entities, implement new policies and enhance existing programmes. However, the scope to provide additional funding is limited given the constrained fiscal outlook. Departments, public entities and constitutional institutions have to reprioritise funds within their existing baselines to fund new priorities. Should the fiscal outlook improve, recommendations for additional funding may be considered in future budgets.

The rest of this report details the Minister of Finance's response to matters contained in the other committee reports. Where different reports make the same recommendations, responses have not been repeated.

Recommendations of the Standing Committee on Appropriations on the 2017 Medium Term Budget Policy Statement

Managing accruals in public institutions

The Minister of Finance should ensure that the National Treasury develops and implements mechanisms to prevent the build-up of unpaid accounts that contribute to a hidden deficit. These mechanisms would include strategies to clear accruals across government, prevent new accruals, make provision in public institutions' budgets to address accruals, and use information and communications technology and other systems to control expenditure.

Issues in the management of accruals are a result of inadequate controls established by accounting officers, rather than a failure of information and communications technology. The National Treasury has issued regulations that require the accounting officers of departments to pay invoices within 30 days of receipt under the Public Finance Management Act (1999). Bi-monthly reports of non-compliance are provided to the Forum of South African Directors-General. The National Treasury, the Department of Planning, Monitoring and Evaluation, the Department of Small Business Development and the Department of Trade and Industry have engaged with suppliers to note their concerns. In several instances, the National Treasury and the Department of Planning, Monitoring and Evaluation have mediated disputes between departments and suppliers. Departments are required to submit their annual reports to the Standing Committee on Public Accounts, which oversees timely payments and good financial practices. In several instances, departments overspend and then use accruals to ensure that unauthorised expenditure is not recorded. This constitutes a serious breach of the Public Finance Management Act and the committee should take appropriate steps with accounting officers in such cases.

Public participation in the budget process

The National Treasury, in partnership with the Department of Planning, Monitoring and Evaluation, should embark on budget outreach programmes that educate all stakeholders and the general public on the work of the Presidential Fiscal Committee to stabilise national debt, and on proposals to narrow the deficit, stimulate economic growth and build investor confidence. These departments should also educate stakeholders on the steps being taken to fund unfunded and underfunded policy interventions. These include additional funding for the post-school education and training system, national health insurance, qualified teachers for Grade R, the implementation of the Defence Review, land restitution and large infrastructure projects. These outreach programmes will ensure that the public is informed about government's policy choices, which will help build trust and transparency.

Trade-offs are discussed in extensive detail in the budget documents, such as the Budget Review, the People's Guide to the Budget and the Estimates of National Expenditure. The People's Guide is published in several official languages. These documents contain extensive information on the availability and use of resources available to government. They are also transparent about the feasibility of different programmes. The National Treasury will discuss with the Department of Planning, Monitoring and Evaluation how to improve the public's understanding of the budget and the decisions informing it. The National Treasury has planned several budget outreach events at higher education institutions to improve public participation in the budget process. The events will take place following the 2018 Budget in February. Students, civil society and the public are invited to attend these presentations, which discuss the economic forecast, government's fiscal policy objectives and measures to improve living standards. These outreaches will run from 26 February to 9 March at the University of Mpumalanga, the Central University of Technology, the University of KwaZulu-Natal, Nelson Mandela University, the University of Limpopo, the Vaal University of Technology and Sol Plaatje University.

Higher education infrastructure

The National Treasury should consider developing cost-control instruction notes for infrastructure projects at higher education institutions, similar to the cost-control instruction notes governing school construction.

Infrastructure grants to higher education institutions are subject to rigorous performance and financial monitoring and oversight by the Department of Higher Education and Training to ensure that these grants are used efficiently and for the intended purpose. Monitoring takes place throughout the year and independent external auditors provide annual audited progress reports on institutional expenditure. The National Treasury will work with the Department of Higher Education and Training to strengthen the existing expenditure management processes by exploring the development of cost-control instruction notes for infrastructure projects.

Managing fiscal risks

The National Treasury should expand the scope of the fiscal risk statement to include long-term fiscal projections that span the timeframes outlined in the National Development Plan. The fiscal risk statement should include government's risk appetite, determine the benefits perceived from specific risk-related activities and assess the potential costs should that risk materialise, including the costs of different policy responses. This will help align resource planning with long-term fiscal sustainability.

The National Treasury uses a long-term model to assess fiscal risks and spending pressures. South Africa is currently the only country outside of the Organisation for Economic Cooperation and Development to implement a long-term fiscal model. The model makes forecasts beyond the timeframe of the National Development Plan. The most recent model projections are included in the 2017 *Medium Term Budget Policy Statement*'s fiscal risk statement. The National Treasury's goal in developing a fiscal risk framework is to encourage a discussion about the choices facing the country and public finance limitations in the long term. It continues to engage with local and international experts to improve the framework.

Accelerating economic growth through microeconomic reforms

The National Treasury and all relevant stakeholders should develop and implement a detailed programme of microeconomic reforms and other measures to boost business confidence and accelerate inclusive growth. This programme should be incorporated into dialogues with legislatures, departments and other role players and then urgently implemented.

In response to weak economic growth, government has prioritised certain policies that will increase confidence, such as ensuring that fiscal policy is sustainable, stabilising state-owned companies and creating policy certainty by finalising key legislative and policy processes.

Government's microeconomic reforms are contained in the National Development Plan and expressed for implementation through the Nine-Point Plan. Implementation of these reforms is managed and monitored through the economic sectors, employment and infrastructure development cluster, which reports directly to Cabinet.

Ensuring high-quality audits

The National Treasury and all relevant stakeholders should develop and roll out a detailed programme ensuring that internal audit units and audit committees, as part of the governance system within departments and state-owned entities, are held to account for executing their functions competently. Internal audit units and audit committees must be prepared to recognise and report:

- *Corruption*
- *Abuse of authority*
- *Failure to provide equity*
- *Failure to provide quality and relevant information*
- *Failure to follow due process in the implementation of governmental policy or regulatory activities.*

The Minister of Finance will develop an audit practice note for all accounting authorities to enhance execution of their fiduciary duties.

The National Treasury should ensure departments and state-owned companies comply with the reporting requirements of the Public Finance Management Act and the Municipal Finance Management Act (2003). This should include the application of consequence management for the late submission of annual financial statements.

The audit practice note discussed above will include a provision for consequences for late submissions of corporate plans and annual and quarterly reports. The executive authority will be required to provide reasons for late submission to Parliament and detail the disciplinary measures taken.

Data improvement

The National Treasury, in partnership with the Department of Planning, Monitoring and Evaluation, should embark on educational outreach programmes to all departments and state entities on the importance of reliable, regular data collection and management, which is essential to good governance and infrastructure sustainability. The programme should entrench a data-driven culture to enable evidence-based, accountable decision-making from infrastructure providers and operators. The programme should also create a sense of civic responsibility and awareness about infrastructure.

The National Treasury collects data on a quarterly basis to monitor the performance of state-owned and public entities. Departments provide the National Treasury with information every month through the in-year monitoring process. These entities need to improve their compliance and the timeliness of their submissions so that government can make informed decisions. The executive authority of the state-owned companies must submit quarterly reports to Parliament. These reports should detail progress on capital expansion programmes, including expenditure, reasons for delays, mitigation measures to prevent falling behind on performance targets, and corrective and disciplinary actions.

Turnaround of South African Airways

The National Treasury should help South African Airways implement its long-term turnaround strategy. This entails funding support without compromising the fiscal objectives of the state.

Government recapitalised South African Airways with R10 billion in 2017/18 to repay debt and provide working capital. The airline remains technically insolvent and it relies on government guarantees to achieve going-concern status. Government has issued guarantees totalling R19.1 billion to the airline, of which R11.8 billion has been used. South African Airways therefore has R7.3 billion in remaining guarantees, which it can use to source funding for its long-term turnaround plan.

Managing contingent liabilities

The ministers of Finance, Public Enterprises, Transport and Water and Sanitation and all relevant stakeholders should develop and implement a comprehensive framework for managing contingent liabilities. Risks to the state should be minimised through a central registry that includes risk assessments, monitoring guidelines and regulations governing these. In addition, a contingency reserve should be created for guarantees and an annual report on the financial health of state-owned companies should be published. Parliament should be briefed on the use of guarantees as well as the lessons learnt for future policy choices.

The National Treasury has a central guarantee register where all national government guarantees are recorded. The register is updated quarterly with the latest issuances and usage of guarantees, and is published in the *Budget Review* as required by the Constitution. In 1998, Cabinet approved the formation of the Fiscal Liabilities Committee to manage government's contingent liabilities. The committee reviews all requests for guarantees before they are issued and makes recommendations to the Minister of Finance, who issues guarantees. Once guarantees are issued, the committee reviews credit risk reports on the guarantee portfolio and reports on compliance with guarantee conditions. The National Treasury conducts annual credit risk assessments on all state-owned companies that have been granted guarantees. Each entity with a guarantee is charged a fee, which is deposited into the National Revenue Fund. These fees act as a disincentive for guarantee applications and defray the costs of a call on a guarantee.

Recommendations of the Standing Committee on Appropriations on the 2017 Adjustments Appropriation Bill

Funding for state-owned companies

The Minister of Finance should strengthen the conditions attached to the recapitalisation of South African Airways and the South African Post Office to minimise the risk to the state. Additional conditions could include no-bailout clauses, stricter monitoring of the companies' contingent liabilities, publishing conditions that would negate provision of government guarantees and holding boards and executives personally liable for failure.

Recapitalisations of South African Airways and the South African Post Office include conditions, some of which are disclosed in the 2018 *Budget Review*. Government has committed to reducing the issuance of government guarantees and determining consequences of non-compliance with guarantee conditions. The National Treasury is developing a framework that will outline the process to reduce the current level of guarantees. If approved, this framework should improve government's contingent liability exposure from guarantees.

Recommendations of the Select Committee on Appropriations on the proposed division of revenue and the conditional grant allocations to provincial and local spheres of government

Accelerating reviews of the provincial equitable share and the local government equitable share

The National Treasury should accelerate the provincial equitable share and the local government equitable share review processes to compensate for conditional grant and transfer losses incurred by provinces and municipalities so that they can continue to provide much-needed services.

The conditional grants are not created to compensate for shortfalls in the provincial equitable share. In line with the Constitution, the equitable share should be applied as a direct charge against the National Revenue Fund so that provinces can deliver on their mandated responsibilities. Conditional grants are created to allow local and provincial government to accelerate policy outcomes within a particular sector that align with national developmental priorities.

The ongoing review of the provincial equitable share formula is a response to concerns among provinces that allocations do not change quickly enough to reflect evolving dynamics affecting needs in their areas. Extensive consultation is increasing understanding of formulaic adjustments and ensuring that the allocations preserve stability and equity. The formula is reviewed periodically to ensure that it remains equitable. As part of the review, all available data sources for each component of the formula, including the health component, will be assessed. Any review outcomes would have to comply with prevailing legislation, and would then be implemented in future medium-term expenditure frameworks.

The current formula for local government's equitable share was introduced in 2013/14, after a review of the previous formula by the National Treasury, the Department of Cooperative Governance and the South African Local Government Association, in partnership with the Financial and Fiscal Commission and Statistics South Africa. The formula's principles and objectives were detailed in the Explanatory Memorandum to the 2013 Division of Revenue. The Budget Forum had endorsed a five-year phase-in to minimise the effect of allocation changes on municipalities, with 2017/18 as the final year of the phase-in. However, key data used in the formula is updated annually. The new formula links allocations to the service-delivery responsibilities of municipalities, but it remains the municipalities' responsibility to prioritise these funds, deliver services and maintain infrastructure.

Supporting municipalities to collect debt and deliver basic services

The National Treasury, the South African Local Government Association and other relevant stakeholders should help municipalities to implement their debt-collection policies effectively so they can deliver basic services. The National Treasury and the South African Local Government Association must provide a progress report to the committee in the first quarter of 2018.

The National Treasury agrees with the concern that municipalities do not collect all the revenues due to them, because of a culture of non-payment and ineffective punitive measures. The National Treasury, the South African Local Government Association and the Department of Cooperative Governance are available to provide further briefings on dates nominated by the committee.

The first step to improving the quality of billing and invoicing is to improve internal systems affecting revenue generation and collection. The National Treasury and the Department of Cooperative Governance support municipalities with these improvements so that they can fulfil their minimum responsibilities as articulated in section 95 of the Local Government: Municipal Systems Act (2000). The National Treasury has administered revenue management programmes and workshops with provincial treasury officials to build capacity in municipal billing and revenue collection.

To improve the quality of local government budget data, the municipal standard chart of accounts is being introduced. These accounts will create a general ledger to ensure more consistent classification of income and expenditure items, making this data comparable and verifiable across all municipalities. As a result, the National Treasury, provincial treasuries and other stakeholders will greatly improve their ability to monitor and analyse municipal budget and expenditure data, including the extent to which tariffs reflect costs.

Improving audit outcomes in municipalities

The National Treasury, provincial treasuries, the South African Local Government Association and the Department of Cooperative Governance should increase support to municipalities to improve their audit outcomes in 2018, and report the plans to achieve this within three months of the adoption of this report.

The National Treasury agrees with the recommendation. As part of the audit process, the Auditor-General has assessed poor internal control measures as the root cause of audit findings.

Government is rolling out a customised provincial support and capacity-building programme that addresses the specific needs of each province. Provincial treasuries have finalised organisational structures appropriate to their responsibilities concerning local government (either a standalone Municipal Finance Management Act Unit or an integrated structure where the unit forms part of units in provincial treasuries responsible for sustainable resources management) and are currently addressing specific local government performance failures in their respective provinces.

The National Treasury's Municipal Finance Improvement Programme advisors will also support the chief financial officer and the municipal manager in overseeing and reporting progress to the municipal council, which is ultimately responsible for the audit outcome.

Structural increases in municipal expenditure

The National Treasury should also indicate if there are any prospects for structural increases in expenditure to be matched by structural increases in revenue, especially in local government, given the current debt levels and poor revenue collection by municipalities.

Although there is scope for local government to maximise its existing revenue streams and improve its revenue collection rate, the full extent of service delivery needs cannot always be met through the existing local government fiscal framework. The National Treasury is exploring a broader package of financing sources for municipalities to help them meet their developmental mandate. The package includes reviewing the municipal borrowing policy framework, setting rules for levying development charges and exploring the introduction of appropriate local taxes.

Recommendations of the Standing Committee on Appropriations on the 2017 Division of Revenue Amendment Bill

In-year revision of conditional grant frameworks

The Minister of Finance should ensure that the National Treasury effects the proposed corrections to the conditional grant frameworks that were submitted together with the bill, in accordance with section 16(4) of the Division of Revenue Act (2017):

- *Comprehensive HIV, AIDS and TB grant*
- *Health professions development and training grant*
- *National health insurance indirect grant (health professionals contracting component)*
- *National health insurance indirect grant (ideal clinics component)*
- *National tertiary services grant*
- *Substance abuse treatment grant.*

The corrections were implemented as recommended by Parliament.

Developing and monitoring targets for municipal compliance

The Minister of Finance and the Minister of Cooperative Governance and Traditional Affairs should ensure that their departments and relevant stakeholders develop explicit targets, with timelines, and submit quarterly reports to:

- *Align funding for and functions of district and local municipalities.*
- *Design mechanisms that minimise overlap between the Municipal Systems Act and the Municipal Finance Management Act so that functional responsibilities for local government performance monitoring and oversight are clear across national and provincial treasuries and provincial departments of cooperative governance.*
- *Eliminate non-compliance with legislation, identify transgressors and apply consequences.*
- *Report on matters pertaining to improvements in municipal audit outcomes and related financial management.*

The National Treasury agrees that there is an urgent need to address the misalignment between powers and functions for an effective fiscal system. The Department of Cooperative Governance is reviewing the functional arrangements of district municipalities.

The alignment of legislation to minimise overlaps between the Municipal Finance Management Act and the Municipal Systems Act is under way, informed by the roles and responsibilities of the respective departments. The Minister of Finance and the Minister of Cooperative Governance and Traditional Affairs have mandated the new directors-general of their departments to finalise this process.

The Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings address financial misconduct and mismanagement, including processes for reporting, investigating and disciplining misconduct. The current legal framework includes mechanisms to hold councillors and municipal officials accountable for maladministration and non-compliance. The law is seldom enforced, however, and compliance remains a problem.

Ring-fencing funding for and accelerating sanitation programmes

The Minister of Water and Sanitation and the Minister of Finance should ensure that the Department of Water and Sanitation and the National Treasury ring-fence funding for sanitation programmes, accelerate sanitation programmes and enhance capacity to deliver the bucket eradication programme.

The National Treasury believes that water and sanitation are inextricably linked and thus the funding should not be split. Separating these functions would complicate integrated planning and implementation. The bucket eradication programme is expected to be concluded by end-March 2019. A total of R1 billion has been reprioritised within the *water services infrastructure grant* and the *regional bulk infrastructure grant* in this regard. The *municipal infrastructure grant* also includes conditions to prioritise funds for the reticulation aspects of the programme.

Reversing the culture of non-payment across government

The Minister of Finance and the Minister of Cooperative Governance and Traditional Affairs should ensure that their departments and relevant stakeholders consult broadly and develop initiatives to reverse the culture of non-payment across the three spheres of government.

The National Treasury agrees that this is a major concern. The Presidential Coordinating Committee is discussing the culture of non-payment across the three spheres of government, and possible measures to reverse the trend.

Recommendations of the Select Committee on Appropriations on the 2017 Division of Revenue Amendment Bill

Timely approval of rollover funds

The National Treasury should effectively manage rollovers and approve them in time for the receiving provinces or municipalities to spend without compromising service delivery.

The recommendation is supported. Section 21 of the 2017 Division of Revenue Act stipulates that only committed or identifiable projects would be considered for rollover funding purposes. The National Treasury instituted measures to ensure that rollover funds would be used correctly, including evidence that the project is under way and submission of a progress report on each project. Without this proof, the funding application is rejected. The provincial process begins with provincial treasuries requesting rollovers from the National Treasury on 30 April each year. After assessing the requests, the National Treasury finalises rollover amounts in consultation with provincial treasuries, based on valid commitments. Approved rollovers are then communicated to provinces within the first three months of every financial year, so provinces have the rest of the year to spend and deliver services for which rollovers have been approved.

For municipalities, the application process is outlined in the Municipal Finance Management Act budget circulars. For the 2016/17 municipal financial year, the rollover funding process was concluded in the middle of October 2017, which is three months after the start of the new municipal financial year. Municipalities are expected to manage projects effectively and to reprioritise funds during the rollover funding approval period. Once the approval is granted, municipalities have almost nine months to spend their approved rollover funds.

Resolving debt owed to Eskom by municipalities and provinces

The committee recommends that the Department of Planning, Monitoring and Evaluation, the National Treasury, the South African Local Government Association, the Department of Cooperative Governance and Eskom should prioritise resolving the debt owed to Eskom by municipalities and provinces. The stakeholders mentioned above should develop an action plan with timeframes, and report to the committee on their progress within three months of this report.

This recommendation has been referred to the Minister of Cooperative Governance and Traditional Affairs, who is the chairperson of the Inter-Ministerial Task Team on constitutional matters relating to electricity reticulation, distribution and supply. The task team already has a work programme that addresses Eskom’s outstanding debt.

Addressing the culture of non-payment and improving revenue collection

The National Treasury and relevant stakeholders should aggressively implement initiatives to improve revenue collection and address the current culture of non-payment. The Minister of Finance and the Minister of Cooperative Governance and Traditional Affairs should provide strategic leadership and address governance issues in provinces and municipalities.

The National Treasury agrees that all organs of state and public entities should aggressively implement initiatives to improve revenue collection. The National Treasury supports provinces in monitoring their own-revenue strategies and improving their revenue collection, including ensuring an optimal mix of service providers collecting revenue on behalf of provinces. To strengthen local government revenue management, the National Treasury and the provincial treasuries will be rolling out a project to assist municipalities with appropriate tariff-setting and effective collection systems. Through this intervention, technical advisors for revenue management will be deployed to provincial treasuries within the framework of the Municipal Finance Improvement Programme III. The advisors will support the implementation of provincial and municipal revenue management initiatives.

Strengthening delivery of timely, high-quality services

The state needs to enhance the timely delivery of quality services. The National Treasury and the national and the provincial departments of Cooperative Governance should strengthen support provided to provinces and municipalities for expenditure of conditional grants and capital and report their progress to the committee.

The National Treasury supports this recommendation. Together with sector departments, it provides extensive capacity-building support to the provinces and municipalities. Several programmes and conditional grants aim to strengthen capacity in local government, including the Municipal Infrastructure Support Agent, the Municipal Finance Improvement Programme, the *financial management grant* and the *municipal systems improvement grant*. Several conditional infrastructure grants also include specific provision for a portion of their funds to be used to build capacity. There is a substantial allocation of resources for capacity-building in the budget. Over the next three years, government will consider increasing the efficiency of these multiple allocations by understanding and improving how they affect the actual capacity of provincial departments and municipalities.

Improving spending on the municipal infrastructure grant

The committee recommends that the National Treasury supports municipalities to improve spending on the municipal infrastructure grant. The National Treasury should also review the policy of withholding conditional grants and their reallocation to other municipalities. Reallocation to municipalities with perceived spending capacity does not necessarily address the core problem. Furthermore, redirecting funds away from underperforming and underspending municipalities could have unintended consequences.

The National Treasury supports this recommendation. The Department of Cooperative Governance is working to strengthen the coordination structures of the *municipal infrastructure grant* and ensure that all relevant departments actively participate in these structures. The Department of Cooperative Governance has also reprioritised additional resources to strengthen capacity and municipalities can increase their own capacity by allocating up to 5 per cent of the grant allocation to their project management unit.

The provisions for reallocating funds are not meant to be punitive. They are the final step after all efforts to assist an underperforming municipality have been exhausted. The reallocation of funds facilitates service provision by ensuring that municipalities with registered projects that are ready for implementation are prioritised. If a local municipality underperformed, then its funds can be transferred to the district municipality to complete the local municipality's project.

Addressing misalignment in the Municipal Systems Act and the Municipal Finance Management Act

The National Treasury and the Department of Cooperative Governance have made progress in addressing misalignment between the Municipal Systems Act and the Municipal Finance Management Act. The committee urges the two parties to resolve this matter speedily. The ministers should finalise outstanding issues and table the amendment bill(s) in Parliament.

The alignment of legislation to minimise overlaps between the Municipal Finance Management Act and the Municipal Systems Act is under way. The Minister of Finance and the Minister of Cooperative Governance and Traditional Affairs have mandated the new directors-general of their departments to finalise this process.

Eliminating unfunded municipal budgets

The National Treasury and the Department of Cooperative Governance should exercise effective fiscal oversight over municipal budgets. The Minister of Finance and the Minister of Cooperative Governance should provide strategic political intervention and implement consequences for unfunded budgets. The two ministers should provide the committee with a progress report on the Back to Basics project. The Department of Cooperative Governance should provide an intervention plan with timeframes for improving performance and eliminating unfunded municipal budgets.

A funded budget is funded by cash surpluses from previous years and revenues realistically anticipated for the year. In terms of the Municipal Finance Management Act, a municipal budget must be funded before a municipal council can adopt that budget for implementation. It is a common municipal practice to overstate or inflate revenue projections when preparing an annual budget. Revenue estimates are seldom underpinned by realistic or realisable revenue assumptions, which results in cash flow difficulties. For example, the 2017/18 municipal operational deficit is R3.3 billion. If revenue underperforms projections, municipalities need to reduce expenditure.

The Constitution and the Municipal Finance Management Act mandate the provinces to intervene and place a municipality under administration if there is a financial crisis. In cases where expenditure exceeds revenue or there are problems making payments, the provinces may decide whether or not to intervene.

This recommendation has been referred to the Minister of Cooperative Governance and Traditional Affairs, who will elaborate further on the Back to Basics programme. The programme developed three categories of municipal performance for action to recognise good performance and ensure appropriate consequences and support for underperformance. The programme has resulted in municipality-specific action plans, including a financial component for which treasuries are responsible.

Supporting municipalities in spending and service delivery

The National Treasury, provincial treasuries and the Department of Cooperative Governance should provide comprehensive support to underperforming municipalities that lack the capacity to spend their allocated budgets. This support would ensure that services are delivered as intended.

The National Treasury shares the committee’s concern about additional support for underperforming municipalities. National government has a constitutional duty to support municipalities and build their capacity. Measures include capacity-building conditional grants and technical support through institutions such as the Municipal Infrastructure Support Agency. There are national programmes to build capacity in financial management and help stabilise institutional and governance systems.

There are a range of factors contributing to widespread financial instability in municipalities, including skills shortages, challenges in organisational structures and temporary incumbents in critical positions. The problem is compounded by ineffective councils and governance structures, and financial mismanagement. Many municipalities are politicised and poor relationships between the municipal leadership and the regional political leaders complicate governance.

Government intends to introduce a conditional grant in the outer years of the 2018 MTEF period to help municipalities facing financial crises. The grant will be made available to municipalities that have demonstrated a strong commitment to undertake reforms.

Filling municipal managerial vacancies

The longstanding issue of filling vacant municipal manager and chief financial officer positions in municipalities should be addressed. The Department of Cooperative Governance and the National Treasury should develop short- to medium-term action plans to address this matter and report their progress to the committee.

The National Treasury supports this recommendation. It is available to provide a briefing on dates nominated by the committee. Filling these vacancies should be fast-tracked with competent managers. Accountability is weaker in municipalities where the position of municipal manager is vacant or occupied by an acting incumbent, as an acting manager is less inclined to make decisions. The absence of a suitably competent chief financial officer presents a risk to sound financial management.

Responding to recommendations from the Financial and Fiscal Commission

The National Treasury should respond to and, where applicable, implement the Financial and Fiscal Commission’s recommendations.

The Constitution requires that the commission’s recommendations be considered before tabling the division of revenue. Government’s responses to the relevant recommendations are provided in part 3 of Annexure W1 of the Division of Revenue Bill (2018). The relevant national departments are considering the other recommendations and they will respond directly to the commission.

Recommendations of the Standing and Select Committees on Finance on the 2017 Revised Fiscal Framework

Improving supervision of revenue collection

The committee recommends that the South African Revenue Service and the National Treasury report in greater depth on revenue collection progress in their quarterly briefings.

The National Treasury publishes monthly tax revenue collections made by the South African Revenue Service, in line with section 32 of the Public Finance Management Act. Tax revenues are reported in detail according to tax type. The National Treasury and South African Revenue Service officials will endeavour to use this information and provide more in-depth revenue analysis on the in-year performance of tax revenue collections in their quarterly briefings to the committee.

Optimising government's borrowing strategy

The National Treasury should develop and implement a credible debt management strategy to monitor the "debt trap" and report to the committee quarterly. In addition to providing fiscal policy certainty, the Minister of Finance should indicate the timeframes and the levels at which debt is expected to stabilise. The minister has indicated that the debt-to-GDP ratio need not reach 60 per cent if government implements structural reforms. This must be done by government as a whole rather than by the National Treasury alone. However, the National Treasury should still report on its role in the reforms in its quarterly briefings, and the committee will hold it accountable where applicable.

Government borrows to finance spending designated by Parliament or the Constitution. The Constitution requires that a deficit funding plan be included in the national budget. A high-level plan is included in the *Budget Review* as the specifics are market sensitive. The National Treasury also publishes an online annual debt management report on its website. The funding strategy reflects a balance between funding costs and debt management risks. The main choices are the proportions of domestic and international funding, the tenor of the funding instruments and the drawdown of cash balances. With the assistance of the World Bank, government has developed strategic risk benchmarks for refinancing, interest, inflation and currency risks. The benchmarks are indicators of the preferred medium-term structure of government's debt portfolio in meeting liquidity needs subject to the cost and risk of various funding alternatives.

Preserving the expenditure ceiling

Considering the R3.9 billion breach of the expenditure ceiling, the National Treasury should review spending to identify savings, including a review of departmental programmes that have failed to achieve their intended objectives over a reasonable period of time, as well as a reduction in duplicated functions in line departments and implementing agencies. The National Treasury should also enhance oversight over these agencies. Progress should be reported to the committee on a quarterly basis.

Since 2013, the National Treasury has been producing performance and expenditure reviews through the Government Technical Advisory Centre. The reviews are published on the centre's website. They follow an internationally recognised methodology for quantifying, assessing and improving the cost effectiveness of public policy, including analysis of expenditure and programme performance data. Performance and expenditure reviews help identify more effective public expenditure options and assess the cost implications of legislation. Where policy is weakly formulated or institutions are not properly aligned for programme objectives, policymakers can use the review findings to reconfigure policies, institutions and activities. In this way, the reviews improve budget planning and reporting.

Satisfying the demands of credit-ratings agencies

The Minister of Finance should have a plan for managing the credit-ratings agencies and keep the public and the committee informed. Upfront and timely policy statements on policy issues would assist in restoring confidence in the South African economy and trust in government.

The National Treasury has developed communication and process plans for managing engagements with the ratings agencies. The same information on sovereign rating developments is provided to the public and the finance committees. This plan is executed at policy events such as the State of the Nation Address, the *Budget Review*, and the *Medium Term Budget Policy Statement*. The communications campaign uses television stations, print media, social media and online publications. The process plan includes conference calls with the ratings agencies on the days that the budgets are tabled in February and October to ensure that the agencies get timely information from policymakers. Officials from the National Treasury also hold face-to-face meetings with the ratings agencies, conduct international road shows and attend meetings of the International Monetary Forum and the Group of 20. The National Treasury has also partnered with the departments of Energy, Public Service and Administration, Public Enterprises, Economic Development, and Trade and Industry to address issues raised by the agencies.

Ending corrupt practices at the state-owned companies

The committee requires a progress briefing on the commitment of the Minister of Finance to improve government oversight of state-owned companies. Oversight challenges include appointing effective board members, ensuring that boards appoint competent managers, tackling wastage and corruption, and, crucially, acting against entities that are not performing. The committee urges that stringent conditions for bailouts be finalised as soon as possible.

All state-owned entities and development finance institutions will report on performance indicators on compliance with their memorandum of incorporation, the Public Finance Management Act, regulations from the National Treasury, the Companies Act (2008) and the King reports on good governance. Any transgression will require the company's board to provide Parliament with detailed reports of all incidents relating to corrupt practices and disciplinary actions taken against the perpetrators. The JSE is reviewing the requirements for bond listing by state-owned companies, in line with the requirements for listing of equities. Its focus will be on the competence and proper appointment of boards.

Increasing penalties for wasteful expenditure

The National Treasury should increase penalties for unauthorised, irregular and wasteful expenditure, which places unnecessarily pressure on the fiscus.

The National Treasury does not have authority to impose penalties for irregular expenditure. Remedial actions are the responsibility of accounting officers and authorities. The National Treasury will only condone irregular and wasteful expenditure after the accounting authorities demonstrate they have taken appropriate action.

This page was left blank intentionally.