

# Public Expenditure and Financial Accountability Assessment

PEFA Report  
Republic of South Africa  
KwaZulu-Natal Province

*Final Report*

31 January 2014



**PROVINCE OF KWAZULU-NATAL  
ISIFUNDAZWE SAKWAZULU-NATALI**

**Currency Unit – Rand (ZAR)**  
**US\$1 = 10.8578 ZAR @ 31 October 2014**  
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**Fiscal Year: FY 2010/11, FY 2011/12, FY 2012/13**

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The information contained in this report does not necessarily reflect the position or opinion of the National Treasury and the Provincial Treasury. Responsibility for the views expressed and for any errors of fact or judgment remains with the consultants who are accountable for providing an accurate assessment of events, opinions and comments. The PEFA assessment exercise and the consultants aim to be as factual as possible.

When reading in text (important for PI-6, PI-10, PI-11, PI-12, PI-26, PI-27, PI-28):

<b>Previous Year</b>	<b>Prior Year</b>	<b>Current Year</b>	<b>Next Year</b>
Year N-2	Year N-1	Year N	N+1

## List of abbreviations and acronyms

AccGen	Accountant-General
AG	Auditor-General
AGA	Autonomous government agencies
AO	Accounting officer
ASB	Accounting Standards Board
APP	Annual performance plan
BAS	Basic accounting system
BBBEEA	Broad-based Black Economic Empowerment Act
BC	Budget council
BIU	Business intelligence unit
BO	Budget office
BS	Budget support
CC	Commitment control
CFI	Consolidated financial information
CFO	Chief financial officer
COFOG	Classification of the functions of government
CPI	Consumer price index
DDG	Deputy director-general
DE	Department of Education
DG	Director-general
DHS	Department of Human Settlements
DORA	Division of Revenue Act
DORB	Division of Revenue Bill
DPW	Department of Public Works
DOT	Department of Transport
EPRE	Estimates of provincial revenue and expenditure
FFC	Financial and Fiscal Commission
FMIP	Financial management improvement programme
FY	Fiscal year
GDP	Gross domestic product
GFS	Government financial statistics
GIAMA	Government Immovable Asset Management Act
GNI	Gross national income
GRAP	Generally Recognised Accounting Practice
HDI	Human development index
HLG	Higher level of government
HOD	Head of department, also referred to as accounting officer
HR	Human resources
IA	Internal audit
ICT	Information and communications technology
ID	Identification document
IDASA	Institute for Democracy in South Africa
IDC	International development cooperation
IDP	Integrated development plan
IFMS	Integrated financial management systems
IGR	Intergovernmental relations
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
ISA	International Standards on Auditing
JBC	Joint budget committee
KZN	KwaZulu-Natal
LG	Local government
MINCOMBUD	Ministers' committee on the budget
MEC	Member of the executive council
MF	Minister of Finance
MFMA	Municipal Finance Management Act
MTBPS	Medium-term budget policy statement

MTEC	Medium-term expenditure committee
MTEF	Medium-term expenditure framework
NA	National Assembly
NCOP	National Council of Provinces
NDM	National department minister
NGP	New Growth Path
NRF	National Revenue Fund
NT	National Treasury
ODA	Official development assistance
OMA	Offices, ministries, agencies
OSD	Occupational specific dispensation
OTP	Office of the Premier
PAA	Public Audit Act
PAIA	Promotion of Access to Information Act
PARC	Provincial audit and risk committee
PCF	Portfolio committee on finance
PE	Public entity
PEFA	Public expenditure and financial accountability
PETS	Public expenditure tracking survey
PF	Public finance
PFM	Public finance management
PFM-PMF	Public finance management performance management framework
PFMA	Public Finance Management Act
PGDS	Provincial growth and development strategy
PSEDS	Provincial spatial economic development strategy
PI	Performance indicator
PIAS	Provincial internal audit services
PPP	Public private partnership
PPPFA	Preferential Procurement Policy Framework Act
PPR	Preferential procurement regulations
PRF	Provincial revenue fund
PT	Provincial treasury
PU	Procurement unit
RDP	Reconstruction and Development Programme
RFQ	Request for quotation
RRTF	Rural road transport forum
S&T	Subsistence and travel
SA	South Africa
SACCI	South African Chamber of Commerce and Industry
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARB	South African Reserve Bank
SARS	South Africa Revenue Service
SA-SAMS	South African School Administration and Management System
SBS	Sector budget support
SCM	Supply chain management
SCOPA	Standing committee on public accounts
SEIFSA	Steel and Engineering Industries Federation of Southern Africa
SITA	State Information and Technology Agency
SMME	Small, medium and micro enterprise
SNG	Sub-national government
SOE	State-owned enterprise
SOP	Standard operating procedure
TOR	Terms of reference
TSA	Treasury single account
VAT	Value Added Tax
ZAR	South African Rand

## Table of contents

<b>Summary assessment</b> .....	<b>1</b>
1. Integrated assessment of PFM performance.....	2
2. Assessment of the impact of PFM weaknesses.....	7
3. PEFA performance indicators.....	10
<b>1. Introduction</b> .....	<b>11</b>
1.1 Objectives .....	11
1.2 Process.....	11
1.3 Methodology .....	11
1.4 Scope.....	12
<b>2. Background to the province</b> .....	<b>14</b>
2.1 KwaZulu-Natal Province: Socio-economic background .....	14
2.2 Allocation of resources and budgetary outcomes .....	17
2.3 Legal and institutional framework for PFM.....	23
<b>3. PFM systems, processes and institutions</b> .....	<b>24</b>
3.1 PFM out-turns: Credibility of the budget .....	24
HLG-1 Predictability of transfers from a higher level of government .....	24
PI-1: Aggregate expenditure out-turn compared to original budget.....	29
PI-2: Aggregate expenditure out-turn compared to original approved budget.....	31
PI-3: Aggregate revenue out-turn compared to original approved budget .....	33
PI-4: Stock and monitoring of expenditure payment arrears .....	37
3.2 Comprehensiveness and transparency .....	42
PI-5: Classification of the budget .....	42
PI-6: Comprehensiveness of information included in budget .....	44
PI-7: Extent of unreported government operations .....	46
PI-8: Transparency of intergovernmental fiscal relations .....	48
PI-9: Oversight of aggregate fiscal risk from other public sector entities .....	53
PI-10: Public access to key fiscal information .....	56
3.3 Policy based budgeting .....	58
PI-11: Orderliness and participation in the annual budget process.....	58
PI-12: Multi-year perspective in fiscal planning, expenditure policy and budgeting .....	62
3.4 Predictability and control in budget execution .....	65
PI-13: Transparency of taxpayer obligations and liabilities .....	65
PI-14: Effectiveness of measures for taxpayer registration and tax assessment .....	68
PI-15: Effectiveness in collection of tax payments .....	70
PI-16: Predictability in the availability of funds for the commitment of expenditures .....	72
PI-17: Recording and management of cash balances, debt and guarantees .....	74
PI-18: Effectiveness of payroll controls .....	76

PI-19: Competition, value for money and controls in procurement .....	80
PI-20: Effectiveness of internal controls for non-salary expenditure .....	89
PI-21: Effectiveness of internal audit.....	93
3.5 Accounting, recording and reporting.....	96
PI-22: Timeliness and regularity of accounts reconciliation .....	96
PI-23: Availability of information on resources received by service delivery units .....	97
PI-24: Quality and timeliness of in year budget reports .....	98
PI-25: Quality and timeliness of annual financial statements .....	100
3.6 External scrutiny and audit .....	102
PI-26: The scope, nature and follow up of external audit .....	102
PI-27: Legislative scrutiny of the annual budget law .....	105
PI-28: Legislative scrutiny of external audit reports .....	107
3.7 Donor practices .....	109
Annexure 1: List of officials consulted .....	110
Annexure 2: Documents consulted .....	112

## List of tables

Table 1:	Summary of PEFA Assessment Scores, 2014
Table 2:	KZN provincial government fiscal operations in composition and as per cent of provincial GDP
Table 3:	Provincial fiscal operations (using actual figures, of GDP)
Table 4:	Budgeted and actual KZN provincial government fiscal operations
Table 5:	Department actual expenditure as a percentage of total expenditures
Table 6:	Actual receipts composition as a percentage of total receipts
Table 7:	Weightings of provincial own revenue by categories
Table 8:	Weightings of provincial total revenue by source
Table 9:	Analysis of original revenues estimates against revenues by sources
Table 10:	Comparison of budgeted and actual transfers of earmarked grants including equitable shares
Table 11:	Comparison of actual transfers to budgeted transfers (amounts and period)
Table 12:	Summary of results relating to variances in aggregate revenue and composition revenue
Table 13:	Comparison of budget estimates against actual expenditure
Table 14:	Summary of results relating to variances in aggregate expenditure and composition
Table 15:	Contingency reserve estimate as a percentage of aggregate expenditure estimate
Table 16:	Summary of provincial own revenue by provincial departments
Table 17:	Summary of provincial total revenue by source
Table 18:	Comparison of total budgeted provincial own revenues and outturns
Table 19:	Comparison of total budgeted provincial own revenues against actual by department
Table 20:	Accruals measures for 2010/11, 2011/12 and 2012/13 for all departments
Table 21:	Measurement of accruals for three departments (Education, Health and Transport)
Table 22:	Availability of budget information
Table 23:	Comparison of foreign aid receipts with total receipts
Table 24:	Total transfers and own revenue for 61 municipalities, as share of municipalities total revenues
Table 25:	Total transfers and own revenue for 58 municipalities, as share of municipalities total revenues
Table 26:	Rule-based transfers for 61 municipalities, as share of total transfers
Table 27:	Rule-based transfers for 58 municipalities, as share of total transfers
Table 28:	Provincial transfers to public entities in terms of schedule 3 of the PFMA
Table 29:	Budget process timeline and roles of each entity
Table 30:	Approval of budget by legislature and passing of Appropriation Act
Table 31:	Provincial revenue
Table 32:	Composition of provincial revenue
Table 33:	Collection arrears stock for DOT and OTP
Table 34:	Conditions of procurement thresholds
Table 35:	Legal and regulatory framework for procurement
Table 36:	Department of Public Works: Statistics on procurement for the period 2012/13
Table 37:	Department of Public Works: Statistics on procurement for the period 2011/12
Table 38:	Irregular expenditure awaiting condonation
Table 39:	Fruitless and wasteful expenditure awaiting condonation
Table 40:	Public access to procurement information
Table 41:	Level of compliance and material findings.
Table 42:	Percentage of improved financial statements

## List of graphs

- Graph 1: Weight and distribution of employees' compensation by departments compared to total expenditures
- Graph 2: PEFA scores distribution by dimension
- Graph 3: Weight of departments included in the assessment as per cent of total expenditures
- Graph 4: Sources of revenues for KZN years 2010/11 to 2012/13
- Graph 5: Expenditures composition by economic classification for KZN years 2010/11 to 2012/13
- Graph 6: Summary of personnel numbers per department
- Graph 7: Illustration of departmental actual expenditure for the period assessed
- Graph 8: Sources of revenues for KZN
- Graph 9: Sources of own revenues in KZN
- Graph 10: Evolution of aggregate departmental accruals versus total departmental expenditures and goods and services accruals versus aggregate departmental goods and services expenditures
- Graph 11: Age profile of accruals stocks for Departments of Health, Education and Transport for 2012/13
- Graph 12: Visualising Department of Education's accruals as per cent of total actual expenditures, goods and services and goods and services and capital actual expenditures
- Graph 13: Comparison of weight of total transfers to total revenues in KZN municipalities with and without the largest three
- Graph 14: Provincial budget -and budget of its public entities - coming from transfers of the Provincial Treasury. Average (2010/13)
- Graph 15: Occurrence of SCM risks
- Graph 16: Percentage of irregular expenditures on goods and services
- Graph 17: Trends in key controls
- Graph 18: Overall control ratings for FY2012/13
- Graph 19: Material misstatement before and after correction for 2012/13



## Summary assessment

This public expenditure and financial accountability (PEFA) assessment was initiated and sponsored by the National Treasury (NT) of South Africa. It has been undertaken with the formal agreement and active support of the provincial government of KwaZulu-Natal (KZN). The assessment adopts the methodology of the public financial management performance measurement framework (PFM PMF) issued by the PEFA multi-donor programme in June 2005 and revised in 2011, and adapted to sub-national governments (SNGs). The approach is based upon evidenced, demonstrated public financial management (PFM) systems, procedures and practices in KZN at the time of the assessment, as determined through direct interviews with government officials and the perusal of official documents and reports. Evidence from independent sources outside the government, such as the media and people not involved in the state, was collected whenever possible.

The purpose of the PFM performance report is to assess the current status of the provincial government's PFM system. The terms of reference (TOR) identify the main objectives of the four sub-national PEFA assessments as:

- Establishing a baseline for future monitoring of progress in financial management performance and for informing the financial management capacity and maturity model (FMCMM) and donors; and
- The four assessments are to be conducted in 2013. This working draft report is submitted to the Provincial Treasury (PT) to support the ongoing analysis and data collection. A draft report will be submitted on 29 November 2013 to initiate the review process. A workshop with NT is planned for January 2014 to take stock of comments and finalise the report.

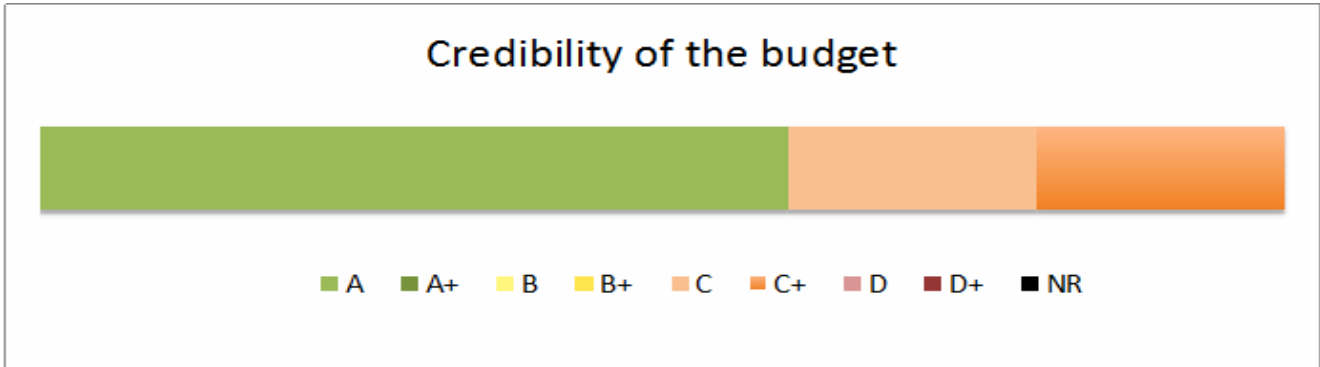
In 2008, a PEFA assessment of the central level was conducted and serves as a reference for the national PFM systems and the description and performance of practices.

This assessment is not designed to comment on any aspects of specific fiscal or expenditure policy and has been careful not to do so. It has not taken into account considerations of capacity, except to the degree implicit in the capacity to carry out the assessed PFM procedures. It is important also to underscore that the objective of the assessment has not been to evaluate and score the performance of institutions or any PFM offices or officials, but rather to assess the capacity of the PFM systems to support sound fiscal policy and financial management.

In essence, this assessment provides a measure of whether the main conditions necessary for delivering sound PFM practice have been met, rather than providing an insight into all of the sufficient conditions necessary to conclude that sound PFM is being carried out. For example, while it assesses whether the PFM systems provide a sound framework for assessing fiscal risk arising from public enterprise activity, it makes no comment as to what authorities do or should do in response to the information provided by the fiscal risk assessment. Such comment would be beyond the scope of a PEFA assessment.

## 1. Integrated assessment of PFM performance

### Credibility of the budget (HLG-1, PIs 1-4)



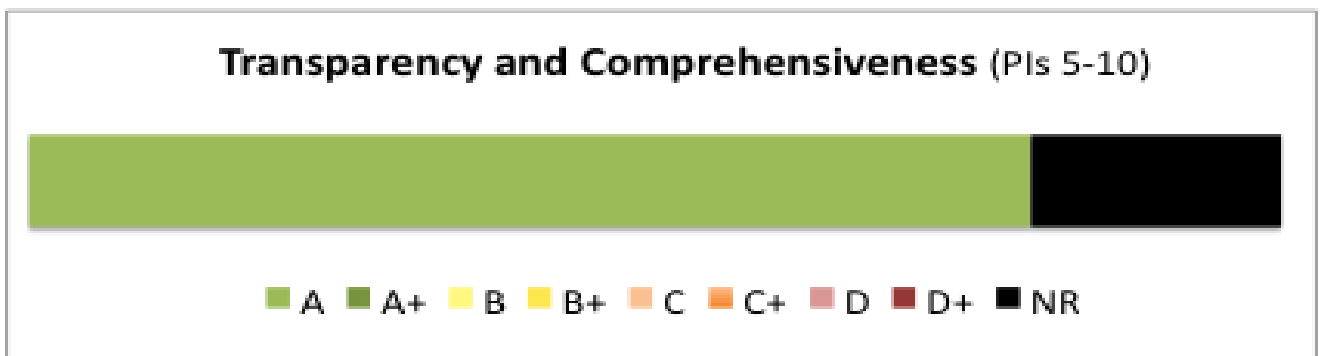
The credibility of the budget as assessed through PI-1 to 4 and HLG-1 appears high, suggesting there is strong coupling between the budget formulation, as guided by the National Treasury MTEF guidelines and relayed by the Provincial Treasury guidelines, and the budget preparation. However when looking at accruals, rising above 7 per cent for goods and services in some departments, *de facto* shifting expenditure to subsequent years, credibility may not be fully achieved.

Although PI-4 scores C, suggesting a discrepancy between the revenue forecast and actuals, the small share of own revenue does not impact significantly on the budget credibility. This is largely driven by the transfers from the National Treasury and national departments on the revenue side.

The robustness of the MTEF, though tested under the current fiscal constraints, has contributed to budget credibility. In spite of the absence of costing of 5-year strategies, the 3-year rolling MTEF and its strong coupling to the budget execution through the cash pro forma contributes to budget credibility on the expenditure side.

Credibility of the budget is impacted by the effectiveness of internal controls in budget execution, which appear to be weak for commitment control, explaining the rise in accrual, payroll and procurement. Indeed the credibility of the budget was directly questioned by the finance portfolio committee as supplementary budgets are required year on year, revealing patterns of overspending for items that can be forecast.

### Transparency and comprehensiveness (PIs 5-10)



The budget is transparent and comprehensive. South Africa rates high on the open budget index and national standards are applied to provincial level: the budget classification is the same as well as the requirements for disclosure. The documentation presented to the legislature, as applicable to the provincial level, is detailed and complete while the documentation disclosed to the public meets the highest PEFA standard.

In terms of unreported government operations, KZN reports extensively on operations in its annual financial statements, though there are potential cases, not measurable, which may not have been reported. The province also does well in terms of fiscal oversight of its public enterprises.

The relationship between the provincial and local government level can only be assessed taking into account the three spheres of government as local government is funded through transfers originating at national level with some going through at provincial level. Although all transfers are not rule based, with the application of criteria derived from national and provincial policies, the 90 per cent benchmark is met. This is achieved in a context of complex relationships and sectors such as human settlements that involves long-term planning and multiyear programmes.

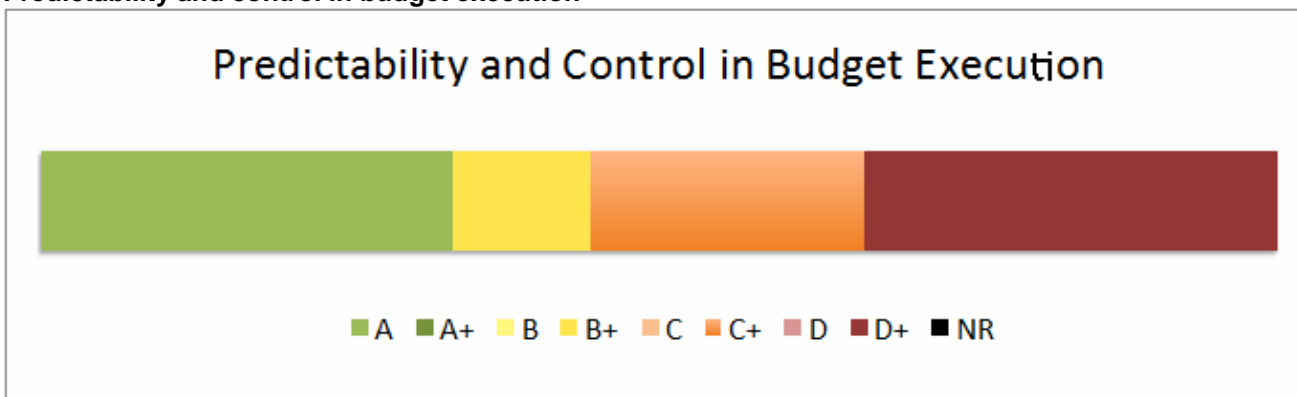
**Policy based budgeting (PIs 11-12)**

The MTEF guidelines that serve as the budget calendar, are clear and comprehensive and include explicit ceilings. The calendar is adhered to and allows meaningful interaction with the Cabinet and with the portfolio committees of the legislature. It would allow passing the budget prior to the beginning of the fiscal year, although for reasons connected to the legislature’s established practice, it is usually passed within two months after the start of the new fiscal year. This does not jeopardise the budget execution. The MTEF process allows the application of baseline for existing programmes, projecting future expenditure growth funded through the equitable share and the conditional grants. In addition, the bids mechanism for new activities allows departments seeking additional funding for new initiatives or to reinforce policy orientations. This worked well prior the current fiscal tightening.

The MTEF has demonstrated its robustness, anchoring budget preparation into three-year rolling expenditure plans and transmitting policies from national and provincial level through the conditional grants and bids mechanisms. It is notable that the infrastructure conditional grants for the three sectors of health, education and transport created to alleviate infrastructure shortage are conditional on capital expenditure and not maintenance. This has contributed to a significant increase in recurrent expenditure needs that are currently covered. There are no criteria in selecting projects or approving them, thereby ensuring that the forward recurrent costs, including maintenance, can be met. The 5-year plans, which are not costed, do not allow a clear mechanism for prioritisation of projects.

Finally, although there is no debt accrued at a provincial government level, except in the form of accruals, no fiscal sustainability analyses are done for key sectors and their policies. The “10\*10” meetings allow some issues to be raised and debated, but it is not clear that this allows a thorough appraisal of the future costs of current and new policy initiatives. Some departments simply explained that resources do not allow budgeting for all policy obligations. This, coupled to weak internal controls, may explain the rise in accruals.

**Predictability and control in budget execution**



**Revenue administration systems (PIs 13-15):**

The legislation and procedures is clear and comprehensive, with no discretionary power in applying the taxes. Discretion may exist in the application of user fees due to lack of a control system, but this is circumscribed in the health sector. Information on obligations is clear and accessible.

The forecast of specific revenues such as vehicle registration is difficult as shown in PI-3 but the collection is efficient, using databases that are current and shared with SARS where possible, and coupled to audit and anti-fraud measures. Transfers, reconciliations of taxes due and collected, and collections with transfers, are

performed monthly.

Difficulties with user fees in health are due to manual controls and no access to a database for verifying user information. In addition, as medical personnel can practice in both the public and private sectors concomitantly, there is a possibility that fees for services partly delivered in the public sector are paid to the private sector. The DOH is developing mechanisms to monitor this in 2013.

#### **Cash and debt management (PI-16 and PI-17):**

In line with policy, no debt is accrued. Debt contracting mechanisms are well specified and under the control of the provincial MEC for Finance with the national Minister for Finance approval.

Cash management is performed through a Provincial Treasury single account. BAS, the accounting system, allows a streamlined payment mechanism, in addition to PERSAL for personnel compensation. Departments cannot open a commercial account without Provincial Treasury approval. This enables efficient cash management, with Provincial Treasury maintaining a surplus since 2010 through consolidating cash balance and interest generated from the positive cash position with SARB daily.

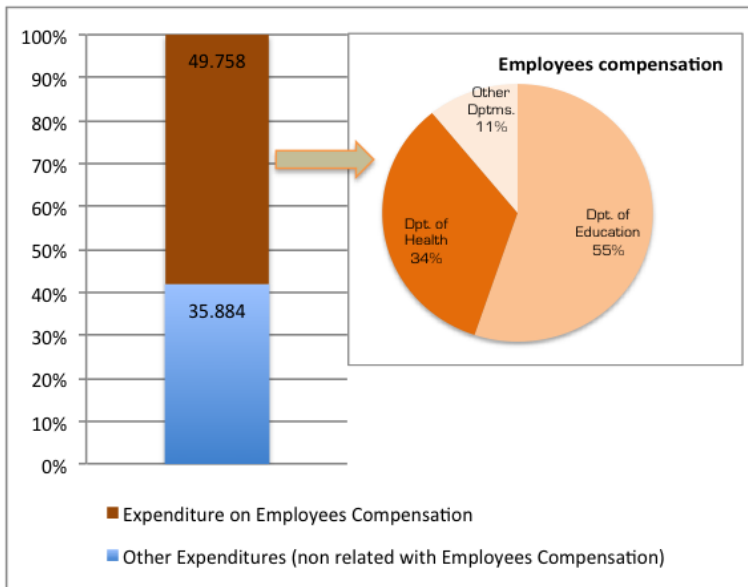
Proforma cash flows are prepared for the year and the two outer years of the MTEF and are adjusted monthly using BAS data and forecasts including recorded commitment allowing for predictability and commitment control, in principle. Adjustments between programmes for less than 8 per cent of the programme allocation do not require ex-ante approval and are decided by the accounting officer. Above 8 per cent it requires ex-ante approval of the legislature.

#### **Payroll, commitment and procurement controls and other internal control systems (PI-18 to 21)**

Overall, controls are the weak link in the public finance management system in KZN. This is in spite of a functioning internal audit and robust payroll management system.

PERSAL, the national establishment, personnel and payroll management system, is rolled out to all provinces. Although robust and allowing integration of establishment and personnel data and controls on payroll, the data quality is either poor or insufficient for an efficient use of the system, and the use of the system is inadequate for allowing the forecasting of the wage bill and for effectively controlling the payroll. These weaknesses are explained by the de-concentrated function for the establishment and management of personnel records, and compounded by a failure to control absenteeism. Controls that would reduce absenteeism are rejected by some personnel in the health and education sectors. Considering the weight of payroll (58 per cent) and these two sectors in terms of personnel compensation (87 per cent), this is a critical issue.

#### **Graph 1: Weight and distribution of employees' compensation by departments compared to total expenditures**



Commitment control is failing due to the inadequate use of BAS, the accounting system, and the requisition of procurement without reference to procurement plans. This is exacerbated by the constraining fiscal space, causing some departments to commit beyond available funds, thereby reporting accruals.

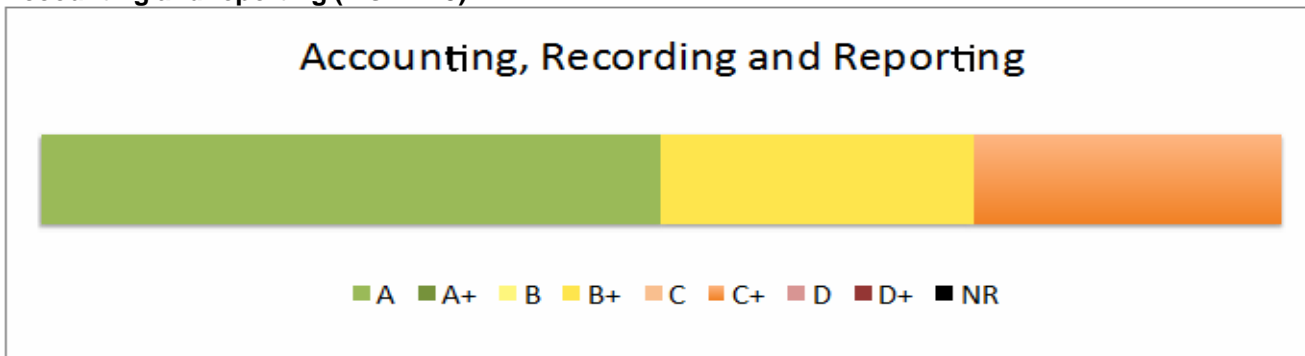
The SCM process is not based on adequate procurement planning that links budget preparation, cash flow projection and procurement plans. Further, systematic recording and reporting of all procurement processes is lacking, so data for analysis is not available. This implies that procurement is monitored through BAS, from a transaction-done basis, reducing scope for the SCM unit and PF units of the Provincial Treasury to intervene.

The SCM processes are regulated by national laws and policy frameworks that do not clarify open tender as the preferred method and authorise non-competitive procurement in situations where a tender is not considered practical. With no data available for monitoring, this makes SCM processes open to errors and misapplication. The size of irregular expenditure stock reported at year-end and waiting to be condoned attests to the problem. SCM is also weakened since functionality is no longer a compulsory requirement for all tenders, reducing the evaluation of bidders, beyond administrative compliance, to compliance with preference criteria only.

Departments also reported that they depend largely on external services for designing and implementing tenders and infrastructure projects, including works supervision, and cannot supervise all ongoing contracts. The departments and SCM unit reported insufficient capacity to implement the preferential procurement framework when designing procurement packages and weak market capacity to respond. Both issues suggest that value for money cannot be achieved in SCM processes.

Internal controls are well developed and known to most, though staff turnover poses challenges to an effective knowledge base. Internal controls are not applied systematically and improved based on internal audit and Auditor-General's findings, raising significant concerns from PIAS and the finance portfolio committee on the ability to improve spending and make efficiency gains. Compliance with existing laws and regulations and internal controls is failing in 50 per cent of cases and leads to material findings in 60 per cent of cases. Internal audit is operational but reports indicate insufficient follow up on findings and a lack of corrective measures

**Accounting and reporting (PIs 22-25):**

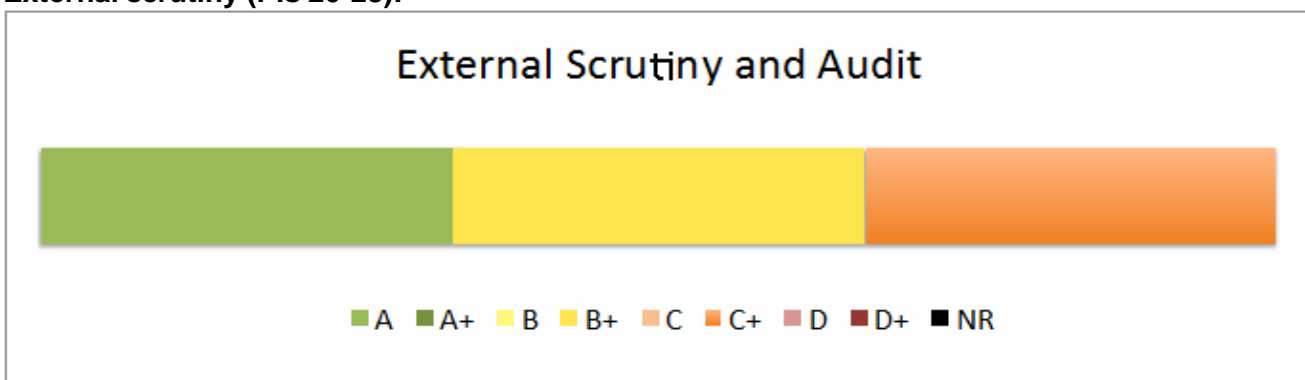


Accounting and reporting standards are those developed nationally (modified cash basis) and make clear requirements for exhaustive and detailed financial statements. These are adhered to in KZN. Reconciliations and clearing of suspense accounts run on clear and applied rules and are performed monthly and within two weeks from month end. The chart of accounts is an extension of the budget classification and thus allows detailed reporting, and the generation of data on resources at the spending unit level (service delivery units).

Overall data quality is affected by weak internal controls. The Accountant-General, the Auditor-General and the public finance unit expressed concerns on data quality and accuracy contained in the reports. This is due to misallocation when using the drop-down menu of BAS and when reporting irregular expenditures (regular expenditures reported as irregular and vice versa), leading to significant amounts to be analysed for condonation.

Format and timing of in-year budget reports and submission of annual financial statements for audit are consistent with the budget classification and systematically adhered to. Although the provincial revenue fund financial statements were submitted later than provided for in the PFMA, the Accountant-General and the Auditor-General have improved the timing of the submission of the department's financial statement for audit and of the audited financial statements, allowing for submission of provincial revenue fund financial statement within seven months of year-end.

**External scrutiny (PIs 26-28):**



The legislature's scrutiny of the budget is extensive and performed over the full cycle of the budget, based on clear plans. It covers the fiscal policies of the province, the provincial revenues and expenditures (including all transfers from the National Treasury and departments) as well as the provincial priorities and MTEF, including the pre-determined objectives of each department. The legislature has at least two months to review the budget proposals, including the work of the finance portfolio committees, and usually takes four to six weeks from April to review and debate the budget proposal which is tabled in March.

The Auditor-General's standards are the same at provincial and national level, including its independence and the planning and conduct of its audits. It conducts a full range of audits covering revenues, expenditures, assets and liabilities with a focus on systemic issues and performance plans, including value for money, as shown in its reports. The reports published provided a graphic basis for assessing progress in addressing public finance management weaknesses.

Scrutiny of the budget execution, through the finance portfolio committee, and annual audit reports through SCOPA is thorough and the hearings are public. The committee plans its work in detail, carrying out substantial work and providing clear guidance through resolutions. However, the follow up on findings and resolutions by the executive is weak and though there are corrective measures, to which the Auditor-General's report and legislature's resolutions attest, similar systemic issues are raised year on year. This resonates with the weak compliance with internal controls. Sanctions are rarely applied and usually directed to more junior staff, while the PFMA clearly specifies the responsibilities of the senior management and accounting officer. The legislature reported a significant challenge in applying its constitutional prerogatives for legislative control with regards to investigation reports.

## **2. Assessment of the impact of PFM weaknesses**

### **Aggregate fiscal discipline**

Aggregate fiscal discipline was largely achieved by the system in place for transfers to the province, controls of the budget formulation and preparation through strict guidance and MTEF process and systems for executing the budget such as BAS and PERSAL. However, under the current constraints, the increase of accruals to 15 per cent for goods and services reveals an increasingly tight fiscal space that poses difficulties for aggregate fiscal discipline. Four factors affecting the fiscal space were noted:

- Negotiations between the DPSA and the unions that lead to agreement were not factored in the annual budget until the agreement passed in 2013 for three fiscal years from 2013/14. The National Treasury did not fully cover the additional funding gap.
- The baseline budget, covering all ongoing programmes, increases less than that of the personnel compensation, requiring funding of the difference by cutting other expenditures. The cost-cutting policy operational since 2009/10 may have eased the pressure.
- The accrual of arrears leaves the department with a funding gap for the next year that cannot be compensated for in the next budget cycle due to the ongoing fiscal tightening, implying a further tightening of the next year's budget or a displacement of accruals.
- The infrastructure conditional grants to health and education are monitored on spending level and pressure for increased infrastructures, in turn leading to an increasing pressure on the fiscus to fund the maintenance costs. Maintenance is currently underfunded for all departments.

In addition to these pressures, the province lost some of its equitable share allocation through the 2011 census. Departments have also mentioned a decoupling between the policy objectives (and obligations in terms of the concurrent functions of the Constitution) and the resources available.

Aggregate fiscal discipline is also conditioned by the effective controls in budget execution. Controls in payroll, procurement and commitment control have revealed significant weaknesses:

- Commitment control is not operational for all expenditures and spending units, leading to overspending, with commitments made before the departments and Provincial Treasury can prevent them in spite of the focus on spending efficiency. This arises largely from partial use of the BAS functionalities and the absence of a software solution for procurement that encompasses commitment controls based on the procurement plans.
- Procurement is not adequately planned and does not serve as the basis for systematic requisition;
- Procurement does not ensure value for money as the preferential treatment laws in place require increased capacity (which is absent) to specify procurement packages and market capacity (which is weak) in the province to take advantage of the preferential treatment while ensuring delivery at competitive prices. Procurement therefore impacts negatively on the fiscus.

Aggregate fiscal discipline is impacted by the quality of financial data. This is probably as marginal in KZN as in South Africa, as the system in place, BAS, is effective and the financial statements are exhaustive, though concerns expressed about data quality should be considered. The misclassification of expenditure into irregular expenditure leads to a high percentage of expenditure to needs to be condoned.

Finally, aggregate fiscal discipline is also affected by non-compliance with rules and agreed practices. Both the weak impact of the internal audit function on compliance, and the recommendations issued by the finance portfolio committee and SCOPA to take remedial actions on recurrent weaknesses found by the internal audit

and Auditor-General limit the possibility of achieving aggregate fiscal discipline.

### **Efficient service delivery**

Efficient service delivery is derived from the quality of the planning and how it translates into the annual budget and is executed. It is further impacted by the performance of the payroll, procurement and internal controls functions. Efficient service delivery is affected by the challenges faced in maintaining fiscal discipline. With rising accruals and tightening fiscal space, efficiency gains need to be achieved, especially in procurement and payroll. However, these gains require better linkages between the three-year rolling MTEF, 5-year departmental plans, procurement plans and cash flow projections. They further require securing adequate funding for controlling absenteeism. Efficient service delivery is well supported by the cash management in place, although it would improve if commitment control were to be more effective. Cash management is well supported by the low variance between budgeted revenues and actuals transfers from the National Treasury and departments. Own revenue collection is good. The Province Treasury has achieved a surplus since 2010 and generates interest earnings using a treasury single account and controlling payments through BAS and PERSAL. The budget transparency should contribute to efficient service delivery, although this is hampered by the fact that procurement plans are not published. However, all activities funded by infrastructural grants are published, thereby providing a sound basis for market information.

Although five-year plans exist, these are not costed and the criteria for prioritisation into the three-year rolling MTEF are unclear. This is impacting efficiency as projects are entered into while forward recurrent costs cannot be secured, impeding efficient service delivery. This is exacerbated by current fiscal constraints. Insufficient provisioning of maintenance costs leads to degradation of infrastructure.

Procurement plans are not always fully implemented and, when performed, do not serve as a basis for commitment control. This is a missed opportunity to reconcile the MTEF process further with the budget execution and controls. It weakens the quality of the cash flow projections and their monthly update. In the absence of systematic recording and reporting of all procurement processes and their outcomes, the data for monitoring and analysis is not available. Using BAS, a transaction based system, is tantamount to working retroactively. Given the issues pertaining to procurement and compliance, efficiency cannot be achieved on that basis.

Value for money in procurement is further hindered by the application of the current laws and frameworks that do not necessarily secure best bids, as evaluation, beyond administrative compliance, is limited to compliance with preference criteria only. Although national departments offer framework contracts, those are not always used by KZN departments. The capacity to package procurement in an efficient way to address the needs of KZN, while complying with the preference schemes, is not available. Competition is not secured by law and, in the absence of data, it is not possible to verify and improve how SCM processes ensure adequate levels of competition. The difficulties of hiring and retaining staff and the volume of management lead to departments being largely dependent on external personnel to design and supervise work and design and evaluate procurement proceedings. This is further reducing the capacity of the department to control the efficiency of SCM processes and to reconcile procurement and contract management to achieve value for money. Local government is also affected as in the case of housing programmes funded through the Department of Human Settlements. SCM processes are also affected by weak internal controls, such as inventory, and the cost impact may be high in the case of the Department of Health.

Personnel and payroll management also negatively impact on efficient service delivery. The quality of the data does not allow for making the projections that would reinforce the quality of the budget preparation and MTEF, ensuring a better allocation of funds and easing the budget execution. The lack of control over absenteeism places major pressure on the wage bill of the two largest departments and restricts their ability to deliver services efficiently. Inadequate staffing noted in departments visited and by the Auditor-General also means that strategic posts remain vacant and reduces the capacity of departments to take corrective measures to improve internal controls that would contribute to cost cutting and gains in efficiency.

### **Strategic allocation of resources**

Budget formulation, preparation, execution and reporting are based on economic, administrative, programme and sub-programme classification that, using a bridging table, produces consistent documentation according to GFS and COFOG standards. The chart of accounts is derived from the budget classification and details it by



categories of transactions. This allows the execution of and reporting on linking plans.

South Africa strives for transparent and exhaustive budget documentation, supporting engagement with civil society. In KZN, financial literacy initiatives support this goal. The levels of openness of the budget, media reporting and engagement of the civil society are important to ensure that the budget allocates strategic resources in response to the province’s priorities. However, the non-costing of strategies and non-prioritising of activities leads to a decoupling between the five-year strategies developed by departments and the three-year rolling MTEF. This impacts negatively on the strategic allocation of resources.

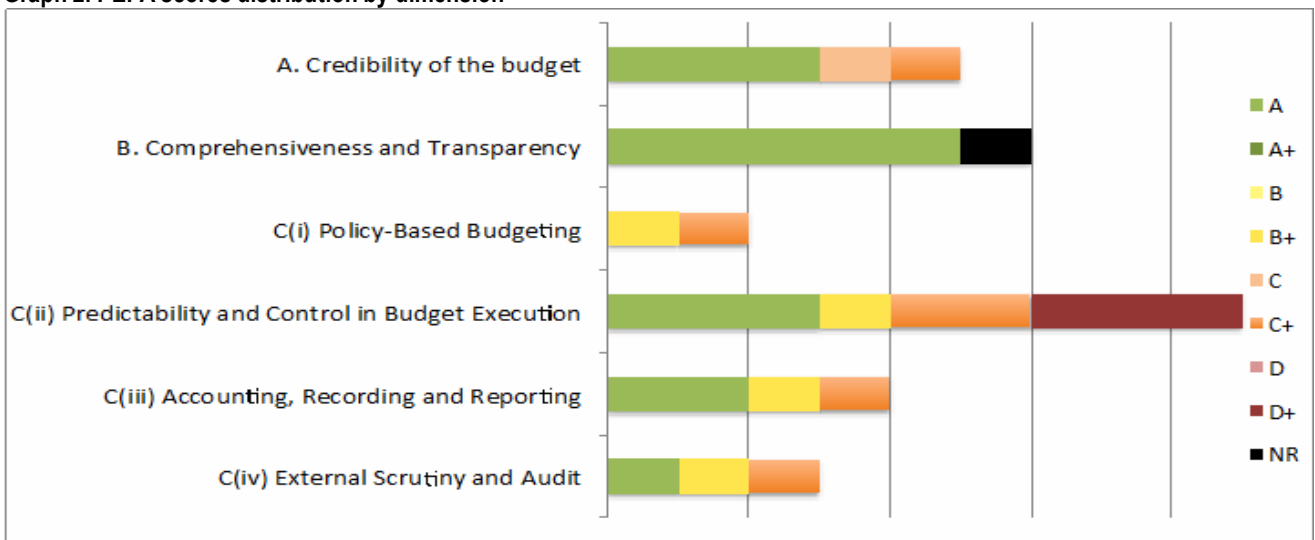
Further, fiscal sustainability analyses are not performed for key sectors and their policies. This is a requirement for ensuring strategic allocation of resources. Such analyses would allow focus to shift away, for example, from infrastructure building to recurrent costs and maintenance, securing the full life cycle of the infrastructure.

Up to this year, strategic allocation of resources has also been undermined by the unpredictability of the evolution of the wage bills due to negotiations between unions and national government. Reprioritising expenditure during the year does not facilitate secure long-term strategic allocation through the MTEF mechanism, nor does it allow efficiency in the budget execution. Departments have raised concerns about the cut to the equitable share that, although it is rolled out over three fiscal years, will imply making new savings in an already tight budget.

As neither procurement nor payroll functions are efficient, strategic allocation of resources is not achievable as resources are allocated to inefficient spending. The annual supplemental budget process, and the difficulty of controlling under- and over-spending, also negatively impacts the allocation of resources. This is a concern raised by the finance portfolio committee.

Below is a graphic representation of the scores distribution by dimension where each vertical bar represents one indicator. It shows that the main challenges are with predictability and control in budget execution and with policy-based budgeting.

**Graph 2. PEFA scores distribution by dimension**



### 3. PEFA performance indicators

Table 1: Summary of PEFA Assessment Scores, 2014

PFM performance indicator		Scoring method	Dimension ratings				Overall rating
			D (i)	D (ii)	D (iii)	D (iv)	
<b>A. PFM-out-turns: Credibility of the budget</b>							
HLG-1	Predictability of transfers from a higher level of government	M1	A	A	A		A
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	A				A
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	A	A			A
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	C				C
PI-4	Stock and monitoring of expenditure payment arrears	M1	C	B			C+
<b>B. Key cross-cutting: Comprehensiveness and transparency</b>							
PI-5	Classification of the budget	M1	A				A
PI-6	Comprehensiveness of information included in budget documentation	M1	A				A
PI-7	Extent of unreported government operations	M1	NR	A			NR
PI-8	Transparency of intergovernmental fiscal relations	M2	A	A	A		A
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	A	A			A
PI-10	Public access to key fiscal information	M1	A				A
<b>C. Budget cycle</b>							
<b>C(i) Policy-based budgeting</b>							
PI-11	Orderliness and participation in the annual budget process	M2	A	A	C		B+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	A	N/A	D	C	C+
<b>C(ii) Predictability and control in budget execution</b>							
PI-13	Transparency of taxpayer obligations and liabilities	M2	A	B	N/A		B+
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	A	A	B		A
PI-15	Effectiveness in collection of tax payments	M1	A	C	A		C+
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	A	A	A		A
PI-17	Recording and management of cash balances, debt and guarantees	M2	N/A	A	A		A
PI-18	Effectiveness of payroll controls	M1	A	D	D	B	D+
PI-19	Competition, value for money and controls in procurement	M2	B	D	C	A	C+
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	D	C	D		D+
PI-21	Effectiveness of internal audit	M1	A	A	D		D+
<b>C(iii) Accounting, Recording and Reporting</b>							
PI-22	Timeliness and regularity of accounts reconciliation	M2	A	A			A
PI-23	Availability of information on resources received by service delivery units	M1	A				A
PI-24	Quality and timeliness of in-year budget reports	M1	A	A	C		C+
PI-25	Quality and timeliness of annual financial statements	M1	A	B	A		B+
<b>C(iv) External scrutiny and audit</b>							
PI-26	Scope, nature and follow-up of external audit	M1	A	B	B		B+
PI-27	Legislative scrutiny of the annual budget law	M1	A	A	A	A	A
PI-28	Legislative scrutiny of external audit reports	M1	A	A	C		C+
<b>D. Donor practices</b>							
D-1	Predictability of direct budget support	M1					N/A
D-2	Financial info provided by donors for budgeting/reporting on project/programme aid	M1					N/A
D-3	Proportion of aid that is managed by use of national procedures	M1					N/A

## **1. Introduction**

### **1.1 Objectives**

The purpose of the PFM performance report is to assess the current status of the provincial government's PFM system. The terms of reference (TOR) identify the main objectives of the four sub-national PEFA assessments as:

- Establishing a baseline for future monitoring of progress in financial management performance and for informing the financial management capacity and maturity model (FMCMM) and donors.
- The four assessments are to be conducted in 2013. This working draft report is submitted to the Provincial Treasury (PT) to support the ongoing analysis and data collection. A draft report will be submitted on 29 November 2013 to initiate the review process. A workshop with NT is planned for January 2014 to take stock of comments and finalise the report.

In 2008, a PEFA assessment of the central level was conducted and serves as a reference for the national PFM systems and the description and performance of practices.

### **1.2 Process**

This public expenditure and financial accountability (PEFA) assessment was initiated and sponsored by the National Treasury (NT) of South Africa. This assessment has been undertaken with the formal agreement and active support of the provincial government of KwaZulu-Natal (KZN).

The assessment adopts the methodology of the public financial management performance measurement framework (PFM PMF) issued by the PEFA multi-donor programme in June 2005 and revised in 2011, and adapted to sub-national governments (SNGs). The approach is based upon evidenced, demonstrated public financial management (PFM) systems, procedures and practices in KwaZulu-Natal at the time of the assessment, as determined through interviews with government officials and the perusal of official documents and reports. Evidence from independent sources outside the government, such as the media and people not involved in the state, was collected whenever possible.

The process included formal preparatory workshops for national and provincial levels. A team comprising two provincial team leaders ran a 3-day workshop for the National Treasury and junior experts in Pretoria from 30 September to 2 October 2013. A workshop was held in each province, aimed at informing provincial treasuries and departments on the ongoing exercise and providing an understanding of the PEFA framework and its requirements. In KZN, this was held from 7 October to 8 October with 40 delegates from the KZN Treasury and departments participating. It was successful in ensuring broad understanding and engagement of provincial departments. The KZN Treasury public finance has ensured that the assessment team met with the Auditor-General's office in KZN and Parliament. The team was invited to the opening hearing of the SCOPA season 2012/13 and had a meeting with the chair of the finance committee of the KZN legislature (who is also a member of the SCOPA).

### **1.3 Methodology**

In applying the methodology, the team has explained the basis for each indicator, the narrative and the rating during interviews. The objective was to ensure that each stakeholder understood the framework's objective globally and specifically when dealing with the PFM system. The interviews with each stakeholder and regular conversations with the public finance unit of the KZN Treasury have helped test and verify the understanding. A debriefing meeting was held with the public finance unit on Friday 25 October to present the salient issues for each indicator and possible scores. A working draft report was shared on 8 November. However, this corresponded to the mid-term budget review, and did not allow the KZN Treasury to review the report in depth.

The draft report submitted herewith should be reviewed by all stakeholders to confirm the exactness of the data and facts reported. The team has been careful to use data and evidence publicly available and/or shared by the stakeholders. Evidence and interviewees are listed in the annexures. The draft report is also submitted to the National Treasury for review and comments. All comments will be collated and given to the team by 20 December 2013 for review, response and integration into the report. All comments will be listed in an annexure to the report and responded to, with changes to the report indicated. The National Treasury will submit the report to the PEFA secretariat for to review the application of the methodology.

## 1.4 Scope

The scope of assessment of this PEFA PFM PMF report is the province of KwaZulu-Natal for 2010/11, 2011/12, 2012/13. The scope is determined by the indicator set of the PEFA framework as revised in 2011, including new dimensions and the SNG guidelines for the HLG-1 indicator on high government level transfers to the province. Indicators D-1 to D-3 on donor practice was considered for this assessment. Given that no donor support is given directly to the province, these were not rated.

All revenues sources were included in the scope of this assessment. This implies that although own receipts are relatively small, given the fiscal buffer that they provide to the provincial budget, they were included in PI-3 and PI-13 to PI-15. The equitable share and conditional grants transferred from the national level are covered in the HLG-1 indicator.

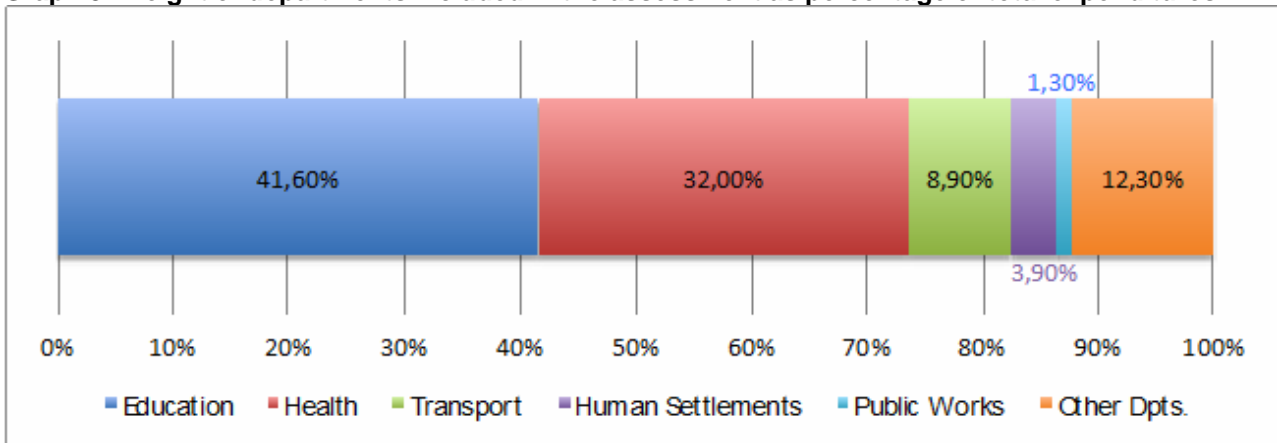
**Table 2: KZN provincial government fiscal operations in composition and in percentage of provincial GDP**

	2010/11	2011/12	2012/13
<b>Composition of revenues by sources</b>			
Equitable share from national %	80.0	79.7	79.7
Conditional grants from national %	17.2	16.8	17.2
KZN provincial receipts %	2.8	3.4	3.1
<i>Total revenue, % of GDP</i>	23.6	25.3	26.6
<b>Composition of expenditures</b>			
Compensation of employees %	58.1	58.5	58.1
Goods and services interest and rent on land %	19.1	20.2	19.9
Transfers and subsidies to various entities %	0.0	0.0	0.0
Payments for capital assets %	13.6	12.1	12.0
Payments for financial assets %	8.4	9.1	10.0
Statutory payments %	0.7	0.0	0.0
<i>Total expenditure, % of GDP</i>	22.2	25.0	26.5
<b>Balance and financing</b>			
Net borrowing requirement	0	0	0
Surplus balance, % of GDP	1.4	0.4	0.2

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

The provincial department to be included in the assessment were selected by the National Treasury as the Departments of Health, Education, Public Works and Human Settlement. Transport was added given its weight both in expenditures and revenues.

**Graph 3: Weight of departments included in the assessment as percentage of total expenditures**



The intergovernmental transfers from the provincial level to the local government level (municipalities) and the fiscal oversight of public enterprises are covered as well.

As the structure of the state in South Africa is federal, with provincial legislatures, external scrutiny and oversight were fully covered.

Where specific benchmarks (see PI-6 and PI-10) or dimensions (see PI-17) are not applicable, this is indicated. Rating was done using the methodology M1 or M2 as specified in the PEFA framework revised in 2011 and the guidelines for its application to the SNG level.

## 2. Background to the province

### 2.1 KwaZulu-Natal Province: Socio-economic background

KwaZulu-Natal (KZN) is the second most heavily populated province in South Africa, with just over 10 million people (2011 census), and it is ranked second in terms of its gross domestic product (GDP). It is also the second poorest province of the country. It spans a wide geographical area from the coast to the plateaus of the midlands, significantly impacting the cost of service delivery and development and maintenance of adequate infrastructures. Although the province is predominantly rural and agricultural, the two most important economic centres are Durban and Richards Bay. Mining, steel manufacturing and the textile industry are important employers.

The financial and economic crises that affected the global economy have impacted emerging economies including South Africa. The sluggish economic recovery, if any, impacts South Africa and KZN in two ways:

- Possible interest rate hikes by the US Federal Reserve may redirect much need capital from emerging economies to the bond market; and
- The reduced domestic and foreign demand for the province's products such as manufacturing, services, tourism, agriculture and timber.

The IMF<sup>1</sup> noted a need for rebalancing the composition of spending away from the wage bill toward capital spending for South Africa. Total compensation represents 58.1 per cent of the provincial budget. Because of the negotiation mechanism in place between government and unions, the wage bill is determined nationally. As noted by departments, the levels of productivity and adequacy of skills required for the province to invest in its economy and shift away from poverty through the provincial inputs in education, health, transport and human settlements are not always met.

**Table 3: Provincial fiscal operations (using actual figures, per cent of GDP)**

R' 000	2010/11	2011/12	2012/13
<b>Gross domestic product (GDP)</b>	<b>305 110</b>	<b>315 282</b>	<b>323 777</b>
Total revenue, % of GDP	23.6%	25.3%	26.6%
Total expenditure, % of GDP	22.2%	25.0%	26.5%
Surplus balance, % of GDP	1.4%	0.4%	0.2%
Financing (net), % of GDP	0%	0%	0%
<b>Expenditure composition</b>			
Compensation of employees %	58.1%	58.5%	58.1%
Goods and services %	19.1%	20.2%	19.9%
Interest and rent on land %	0.0%	0.0%	0.0%
Transfers and subsidies to various entities %	13.6%	12.1%	12.0%
Payments for capital assets %	8.4%	9.1%	10.0%
Payments for financial assets %	0.7%	0.0%	0.0%
Statutory payments %	0.1%	0.1%	0.1%

Source: Estimates of provincial expenditure 2010/2011, 2011/2012, 2012/2013 and annual financial statements 2012/2013.

The objective at national and provincial levels is on rebuilding fiscal buffers in the medium term. However,

<sup>1</sup> IMF Country Report No. 1 2/247, Article IV Consultation

the current macro-economic situation leads to further tightening of the fiscal space which does not facilitate the rebuilding of fiscal buffers but rather promotes the search for ways to gain efficiency and reprioritise expenditure. We note that KZN is not borrowing and has moved from a net deficit, shown as an overdraft at the Reserve Bank up to 2009, to a net cash surplus from 2010. Driven by the PT and the MEC for Finance's cost cutting and austerity measures, this shift demonstrated that efficiency gains can be made in overall public spending without cutting services, in order to improve the impact on economic recovery.

This shift is in spite of the baseline, used for medium-term expenditure planning<sup>2</sup>, expanding at a slower rate than the wage bill since 2009/10. In 2013, unions and government (through the Department of Public Service Administration) agreed for the first time to salary increases for three years based on a CPI+1 per cent increase applying to the fiscal years 2013/14, 2014/15 and 2015/16. This will provide much needed predictability for the government (see PI-16) and businesses and should allow for effective fiscal tightening policies and the rebuilding of fiscal buffers. Prior to 2012/13, the negotiated wage increase was usually known only after the preparation of the budget and medium-term expenditure framework (MTEF), creating a gap which resulted in the reprioritisation of other expenditures or accruals (see PI-4).

The national and provincial government policies of preferential procurement, broad-based black economic empowerment (B-BBEE) and the Preferential Procurement Policy Framework Act (PPPFA) have not yielded the expected socio-economic impact. Rather than fostering small business growth and employment and increasing private sector activities, they appear to generate administrative burden (see PI-19) and may induce biases in the procurement processes, leading to inefficiencies. They do not guarantee value for money. Local content is seldom achieved and thus the province does not fully benefit from the economic impact of provincial public sector activities.

The province still lags behind in the provision of basic services such as access to safe water and electricity, and the removal of refuse. These services are necessary for growth through an active resident population and investment in small, medium and micro enterprises (SMMEs).

The following social and demographic dynamics play an important role in the economic changes of the province and impact negatively on the province's ability to deliver services<sup>3</sup>:

**Growing domestic migration of the active population** - the current population growth in the province is 0.8 per cent, significantly lower than the national average of 1.5 per cent. The low growth is largely a result of the migration of KZN's active population to other provinces, and to a lesser extent HIV/Aids related deaths.

**Increase in the unemployed, unskilled population and poverty level** - due to education levels, skills and poverty, the province does not contribute to GDP in line with its population weight and economic potential. KZN still has a low average household income, compared to other poorer, economically smaller provinces, ranking fourth and below the national average in 2011. KZN has the highest poverty rate (48.4 per cent) in the country, well above the national average of 37.7 per cent. The province's unemployment rate stands at 21.9 per cent, compared to a national average of 24.7 per cent<sup>4</sup> while its job scarcity index (0.43) is also higher than the national average. The dependency ratio is high and the GINI coefficient is 0.64.

**Growing pressure on public services** - the cost cutting measures undertaken since 2010 have allowed the provincial government to maintain a high focus on education and health including a growing HIV package. Over one third of the population is comprised of children, largely registered in quintiles 1 to 3 schools (free tuition without any fees). This equates to a growing demand on education services to ensure minimum standards while the province still struggles to achieve adequate and low leaner educator and learner support ratios. The province ranks first in social grant beneficiaries, putting further pressure on the province's budget<sup>5</sup>.

**The equitable share formulae adopted for the Division of Revenue Act is predominantly population sensitive** -the province's population migration has reduced its share of the national population from 21 per cent

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<sup>2</sup> Equitable share and conditional grants, see budgetary outcomes HGL1 to P1-3

<sup>3</sup> All statistics drawn from the Socio-Economic Review and Outlook 2012/13, Provincial Treasury, KwaZulu-Natal.

<sup>4</sup> Note that these are unemployment rate measuring those actively seeking jobs only.

<sup>5</sup> The South African Social Security Agency (SASSA) provides social grants assistance to beneficiaries so these costs are not impacting the province's budget, but the demand for other services associated with a dependent population is. This explains partly the emigration from the active population seeking better services for their taxes.

to 19.8 per cent (census 2011), which has translated into a reduction of approximately R6billion in its equitable share from 2013/14.

The province is actively engaged in ensuring its population can face the challenges of development by promoting vigorous financial literacy campaigns and providing antiretroviral treatment for HIV positive persons to maximise employment creation and the share of active population. This is critical as the current population growth rate and the age pyramid show that in 30 years, the province will be facing the economic challenges of an ageing population and an increased demand on public services. The provincial government's objectives in the medium term are to continue the implementation of cost cutting initiatives, promoting competitiveness, strengthening economic development and improving infrastructure in all sectors while maintaining its commitment to social expenditure.



## 2.2 Allocation of resources and budgetary outcomes

### Fiscal performance

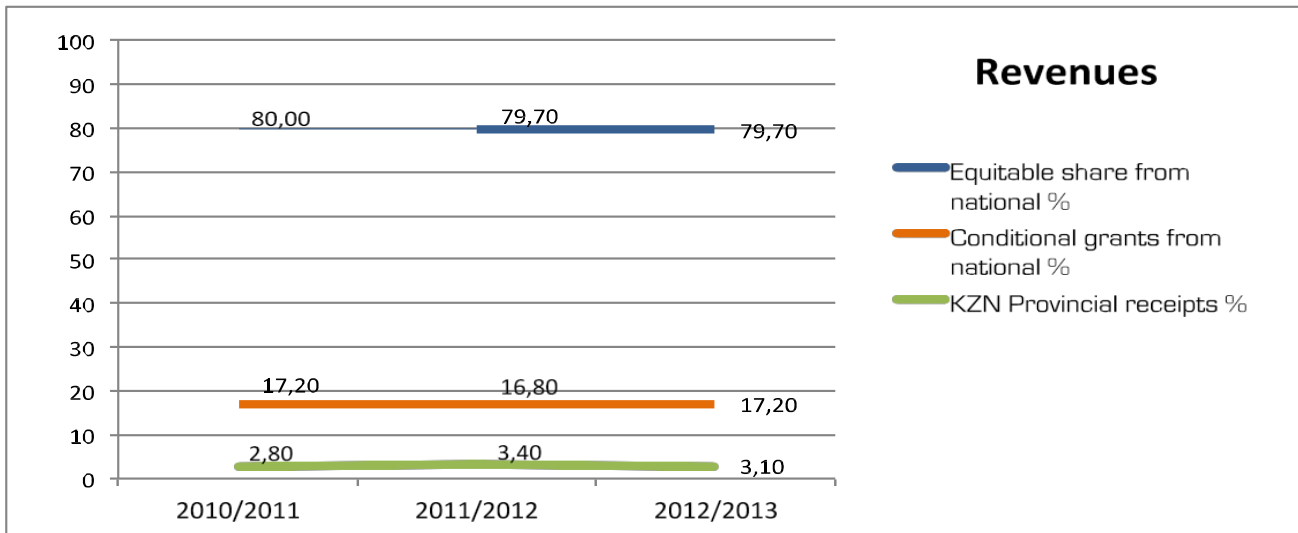
Table 4 provides a summary of the KZN provincial government's fiscal operations. Provincial equitable share allocation and expenditure increased in 2010/11, 2011/12 and 2012/13 at a moderate rate. Compensation equated to 58 per cent of the total expenditure in the last two fiscal years despite projections of 56 per cent. As shown in graph 1, the bulk of this expenditure emanates from education and health provincial departments (i.e. approximately 190 000 out of a total of 216 000 employees).

**Table 4: Budgeted and actual KZN provincial government fiscal operations**

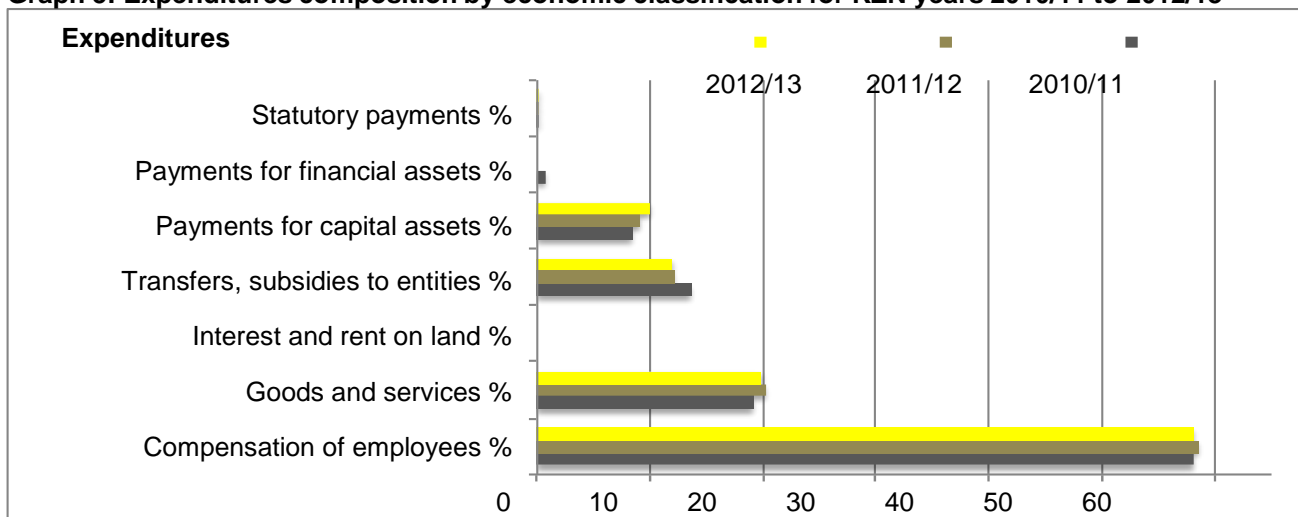
R million	2010/11		2011/12		2012/13	
	Forecast	Actual	Forecast	Actual	Forecast	Actual
Total revenue	70 289	72 026	78 185	79 734	84 570	86 102
Equitable share from national %	78.8	80.0	78.9	79.7	78.7	79.7
Conditional grants from national %	16.3	17.2	16.7	6.8	16.8	17.2
KZN provincial receipts %	2.5	2.8	2.4	3.4	2.7	3.1
Total expenditure	69 077	67 675	77 300	78 644	83 572	85 642
Compensation of employees %	57.4	58.1	56.0	58.5	56.1	58.1
Goods and services %	21.5	19.1	21.1	20.2	20.9	19.9
Interest and rent on land %	0.3	0.0	0.1	0.0	0.1	0.0
Transfers and subsidies to various entities %	12.4	13.6	11.8	12.1	11.8	12.0
Payments for capital assets %	9.8	8.4	9.2	9.1	8.6	10.0
Payments for financial assets %	0.5	0.7	0.0	0.0	0.0	0.0
Statutory payments %	0.1	0.1	0.1	0.1	0.1	0.1
Surplus balance	1 212	4 351	885	1 090	998	478
Net borrowing requirement	0	0	0	0	0	0
Gross Domestic Product (GDP)	305 110	305 110	315 282	315 282	323 777	323 777
Total revenue, % of GDP	23.04	23.6	24.80	25.4	26.12	6.6
Total expenditure, % of GDP	22.64	22.2	24.52	25.0	25.81	26.5
Surplus balance, % of GDP	0.40	1.4	0.28	0.4	0.31	0.2
Financing (net), % of GDP	0	0	0	0	0	0

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

**Graph 4: Sources of revenues for KZN years 2010/11 to 2012/13**



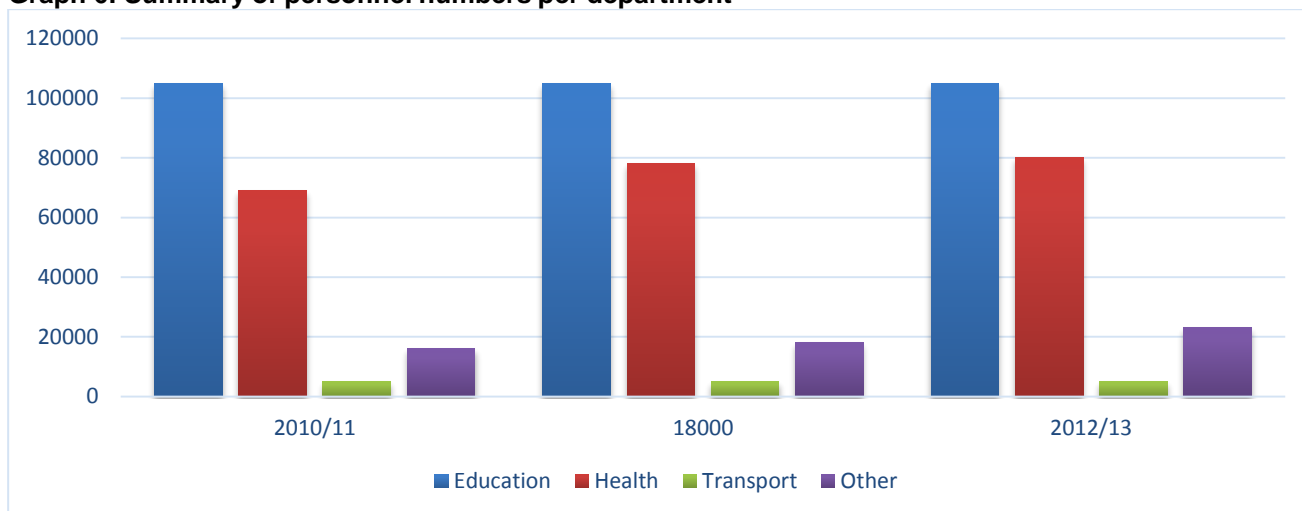
**Graph 5: Expenditures composition by economic classification for KZN years 2010/11 to 2012/13**



The slight increase in the wage bill and mismatch between estimate and actual is also attributable to higher than anticipated wage increase agreements negotiated by unions, and the various occupational specific dispensations (OSDs) negotiated, the impact of which is hard to forecast (see PI-18). Nonetheless, the PT's policy not to agree to new functional department structures and increase in the baseline for compensation has contained the wage bill growth.

However, departments have significant vacancies in strategic positions, potentially reducing their ability to take corrective measures to improve internal controls, procurement and contract management. This reduces value for money, a key concern at a time of fiscal tightening. A more accurate compensation figure would be obtained if the fees of consultants, who worked regularly and fulfilled departmental tasks, was recorded in goods and services.

**Graph 6: Summary of personnel numbers per department**



Source: Estimates of Provincial Expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.

The share of transfers and subsidies from KZN provincial government (including large capital projects) to departmental agencies, public and private enterprises/institutions decreased from 13.6 per cent in 2010/11 to 12 per cent of the total expenditure in 2012/13, mainly due to the completion of the Dube Trade Port project and the reallocation of excess funding to the Department of Education (DoE) for the upgrading of school quintile statuses.

The reduction from 2010/11 in payment for financial assets reflects the shift from a deficit to a balance budget led by the PT's (administration of the Department of Health for 18 months) and MEC for Finance's cost-cutting measures. The stable level of payments for capital assets reflects the impact of infrastructure conditional grants. The decrease in goods and services payments is driven by the tightening fiscal space; as compensations and capital expenditures are controlled externally. This represents the adjustment item. This is further contributing to the pattern of accruals observed in PI-4.

### Allocation of resources

Based on the twelve national outcomes, the New Growth Path (NGP), the provincial growth and development strategy (PGDS), and the provincial spatial economic development strategy (PSEDS), the provincial strategic priorities are translated in a rolling 3-year medium-term expenditure framework (MTEF).

Given the fiscal tightening, the increase of the wage bill compared to the baseline and impact of accruals, the provincial budget adopts an austere outlook with a focus on reprioritisation of expenditure. Since 2010 the PT makes provision for a small budget contingency to provide a cushion for unforeseen and unavoidable expenditures.

Over the last few years, the share of social services in the overall expenditure has increased only marginally, reflecting fiscal tightening in spite of growing demand for services and new programmes. Provincial departments consider that the means available are insufficient to budget for all policy priorities established at national and provincial levels. This is reinforced by the KZN province's stance regarding the importance of providing additional services for HIV positive citizens with a view to improving the socio-economic impact. When compared to the share formulae of the Division of Revenue Act (DORA), the share allocated to education is significantly less.

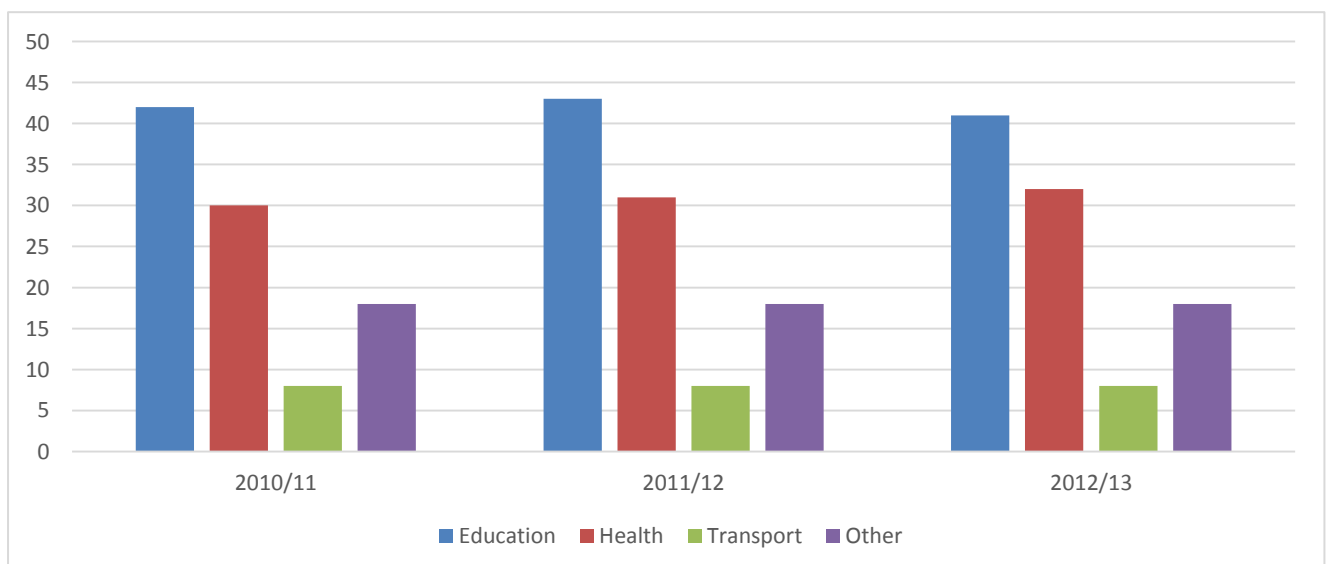
**Table 5: Department actual expenditure as a percentage of total expenditures**

Department	2010/11	2011/12	2012/13
Office of the Premier	0.6%	0.6%	0.8%
Provincial Legislature	0.5%	0.5%	0.5%
Agriculture, Environmental Affairs	3.0%	3.1%	3.3%
Economic Development and Tourism	2.4%	2.0%	2.0%
Education	42.5%	43.0%	41.6%
Provincial Treasury	0.6%	0.5%	0.6%
Health	30.6%	31.5%	32.0%
Human Settlements	4.6%	3.9%	3.9%
Community Safety and Liaison	0.2%	0.2%	0.2%
The Royal Household	0.1%	0.1%	0.1%
Co-operative Governance and Traditional Affairs	1.5%	1.4%	1.5%
Transport	8.8%	8.4%	8.9%
Social Development	2.1%	2.5%	2.3%
Public Works	1.6%	1.5%	1.3%
Arts and Culture	0.5%	0.5%	0.6%
Sport and Recreation	0.4%	0.4%	0.4%
Total	100%	100%	100%

Source: Estimates of Provincial Expenditure 2010/2011, 2011/2012, 2012/2013 and Annual Financial Statements 2012/2013.

As depicted in Graph 7, the largest functional categories of government spending are education, health and transport, attaining approximately 73 per cent of total expenditure for health and education alone.

**Graph 7: Illustration of departmental actual expenditure for the period assessed**



## Provincial receipts

Table 6 shows the summary of actual receipts as a percentage of total receipts by source for the province, and estimates for fiscal years 2013/14 and 2014/15. The equitable share of the province has increased naturally from 2010/11 through inflation, economic growth and collection of revenues by the South African Revenue Service (SARS), however less than the wage bill increase. It is still planned to increase nominally in 2013/14 and 2014/15 in spite of the impact of the national census which will lead to a staggered 6 billion Rand reduction of the equitable share of KZN.

The 2011 census revealed a decrease in population, leading to lower national transfers by way of the equitable share from fiscal year 2013/14. As this will impact on the ability of the province to deliver services, the NT is providing additional funding over three fiscal years, up to 2015/16. This means that the province must use the next three years to adjust its expenditures to the new share size. This adds further to the fiscal tightening experience since fiscal year 2010/11.

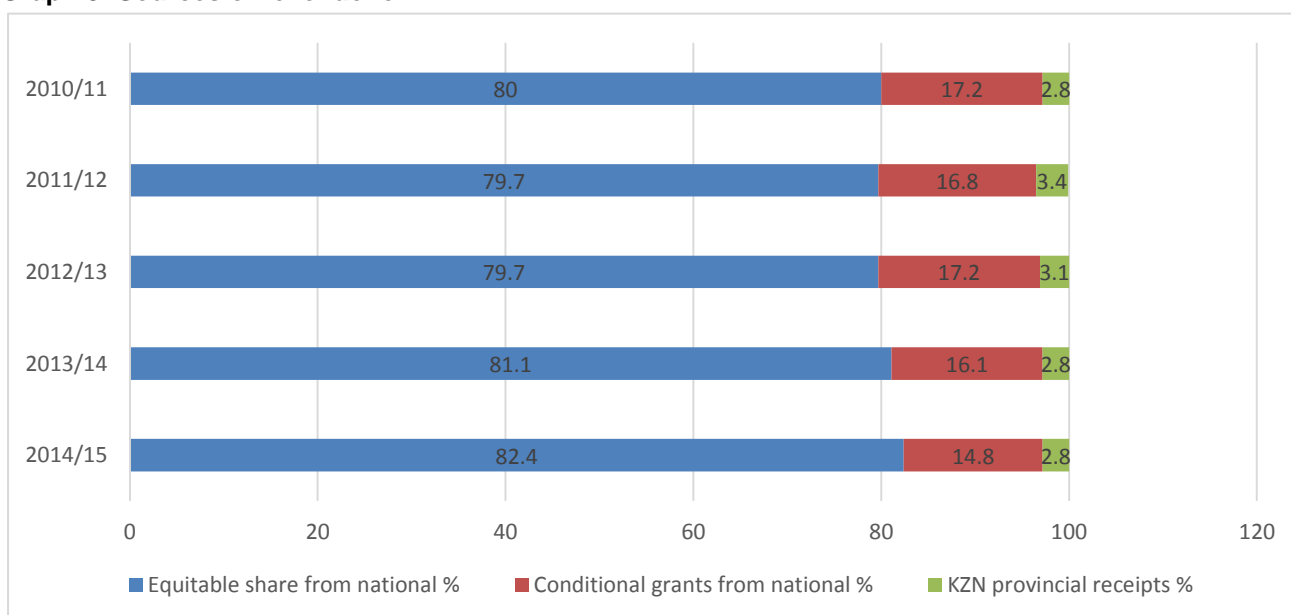
The equitable share can be “ring fenced” to supporting specific sector policies so in effect it reduces the equitable share and introduces a conditional element. However the equitable share is released in full, independently from the decision of the province to implement the condition, as both the Public Finance Management Act (PFMA) and DORA prohibit any retention of transfers from one level of government to the next, except in the case of conditional grants. The policy impact of the ring-fencing is not clear.

**Table 6: Actual receipts composition as a percentage of total receipts**

Revenue	2010/11	2011/12	2012/13	2013/14	2014/15
Equitable share from national	80.0%	79.7%	79.7%	81.1%	82.4%
Conditional grants from national	17.2%	16.8%	17.2%	16.1%	14.8%
KZN provincial receipts	2.8%	3.4%	3.1%	2.8%	2.8%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Estimates of expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

**Graph 8: Sources of revenue for KZN**



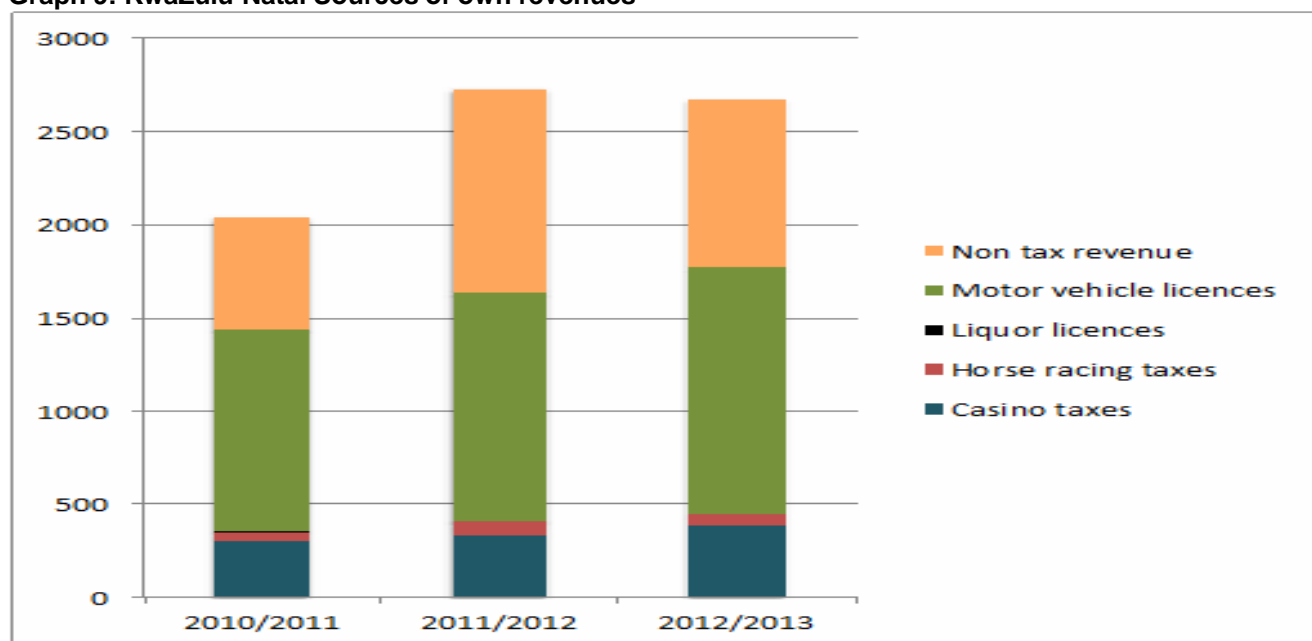
In 2012/13, provincial own revenue was 3 per cent of total receipts, which comprised tax revenue (approximately 66.3 per cent) relating to motor vehicle, licences, casino and horse racing taxes and liquor licences. Non-tax revenue was largely from user fees in health.

**Table 7: Weightings of provincial own revenue by categories**

Description (R'000)	2010/2011		2011/2012		2012/2013	
	Actual	Weighting %	Actual	Weighting %	Actual	Weighting %
Casino taxes	301	14.7%	338	12.4%	383	14.3%
Horse racing taxes	46	2.3%	68	2.5%	65	2.4%
Liquor licences	5	0.2%	1	0.0%	5	0.2%
Motor vehicle licences	1 084	53.1%	1 231	45.1%	1319	49.4%
Non tax revenue	605	29.6%	1 089	39.9%	899	33.7%
<b>Total</b>	<b>2 041</b>	<b>100%</b>	<b>2 727</b>	<b>100%</b>	<b>2 671</b>	<b>100%</b>

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.

**Graph 9: KwaZulu-Natal Sources of own revenues**



Growing the own revenue base largely depends on growth and consumption. Improved management and transparency of user fees may also yield additional revenues. As shown in PI-3, forecasts are usually below actual collections, thereby providing a small buffer.

## **2.3 Legal and institutional framework for PFM**

The institutional arrangements are similar in all provinces as described in the country profile. The PT's and MEC for Finance's roles and responsibilities mirror those of the NT and are defined in the PFMA.

All departments, except for three, are structured in accordance with the national departments' structure and implement the budget following the provisions laid down in the PFMA as national departments. The head of department (HOD), the accounting officer (AO) in the PFMA, is responsible for the financial management and adherence to laws and regulations.

The Auditor-General (AG) has an office in each province, and is led by a business executive selected by the AG. The office enjoys the same level of independence as the AG and operates on the same basis.

More specifically, the province chose to develop a provincial internal audit service (PIAS) that supports the work of internal control units in departments and reports to the internal audit committee.

In terms of revenue management, the province raises about 3 per cent of its revenues from own sources while it receives the largest share through transfers from the NT. The arrangements for revenue collection by the Department of Transport (DOT) are specific to vehicle licences, while revenue collection by the Department of Health (DOH) is based on user fees. The Office of the Premier (OTP) oversees the gaming board and manages taxes on casinos, bookmakers and other games, and liquor.

### **Legal framework**

The legal framework applicable is the same as that for the national level as described in the country profile.

Each province can add to this framework, to reinforce it but cannot change it substantively or reduce controls. For example, a KZN policy framework for procurement exists. Some departments apply a lower threshold for tender of R200 000 instead of R500 000.

In the report, these differences are highlighted where necessary.

### 3. PFM systems, processes and institutions

#### Introduction

The following sub-sections provide the detailed assessment of the PFM indicators contained in the public finance management performance measurement framework (PFM PMF). The scoring methodology only takes into account the existing situation and does not cover ongoing and planned activities that may result in higher scores under future assessments, but these are summarised at the end of the discussion on each section where applicable.

Each indicator contains one or more dimensions in order to assess the key elements of the PFM process. Two methods of scoring are used. Method 1 (M1) is used for all single dimensional indicators and for multi-dimensional indicators where good performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). A plus sign is reflected where any of the other dimensions are scoring higher.

Method 2 (M2) is based on averaging the scores of individual dimensions of an indicator. It is prescribed for multi-dimensional indicators, where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator. A conversion table for 2, 3 and 4 dimensional indicators is used to calculate the overall score. The PEFA handbook ("PFM performance measurement framework, [www.pefa.org](http://www.pefa.org)) provides detailed information on the scoring methodology. Effective January 2011, a revised methodology is being used for PI-2, -3 and -19.

The PEFA assessment reviews PFM performance under the existing situation. The relevant time period depends on the type of indicator. For some indicators, the relevant time period is the last completed fiscal year, for example, PI-1 to -4, -25, -26, and -28. For many indicators (e.g. PI— 13 and -14 concerning revenue administration and the first three dimensions of PI-18, concerning payroll control), the relevant time period is the situation up to the time of the assessment. More information is available in the PEFA Secretariat's publication 'Guidance on evidence and sources of information to support the scoring of indicators and supplementary guidelines for application of the PEFA framework to sub-national government, dealing notably with the higher level of government indicator (HGL-1) and challenges in applying the indicator set to SNG.

#### 3.1 PFM out-turns: Credibility of the budget

##### HLG-1 Predictability of transfers from a higher level of government

**Dimensions to be assessed (scoring method M1):**

- (i) Annual deviation of actual total HLG transfers from the original total estimated amount provided by HLG to the SN entity for inclusion in the latter's budget***
- ii) Annual variance between actual and estimated transfers of earmarked grants***
- iii) In-year timeliness of transfers from HLG (compliance with timetables for in-year distribution of disbursements agreed within one month of the start of the SN fiscal year)***

Transfers from higher level of government (HLG) (i.e. NT and national departments) constitute the largest share of revenue for the KZN provincial government as a whole. It comprises of equitable shares and conditional grants, which made up 97 per cent of provincial revenue in 2010/11, 2011/12 and 2012/13 (See table 8 below). Provincial own revenue makes up the balance of the total provincial funding: taxes imposed on motor vehicle licences, casino, horse racing, liquor licences and health user fees (see PI-3). For the purposes of this indicator, provincial own revenues have been excluded.



**Table 8: Weightings of provincial total revenue by source**

Description (R million)	2010/11		2011/12		2012/13	
	Actual	Weighting %	Actual	Weighting %	Actual	Weighting %
Aggregate equitable share from national	57 632	80.0%	63 584	79.7%	68 639	79.7%
Aggregate conditional grants from national	12 353	17.2%	13 423	16.8%	14 810	17.2%
Aggregate provincial own revenues	2 041	2.8%	2 727	3.4%	2 671	3.1%
<b>Total</b>	<b>72 026</b>	<b>100.0%</b>	<b>79 734</b>	<b>100.0%</b>	<b>86 120</b>	<b>100.0%</b>

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

The equitable share relates to revenue emanating from taxes imposed on international trade, Value Added Tax (VAT), customs duties, income tax, PAYE, domestic goods and consumption amongst others collected nationally by the SARS. The DORA provides the origins of revenues by sphere of government and its distribution. This distribution is determined by a formula, which is revised annually by National Treasury and advised by the Financial and Fiscal Commission (FFC)<sup>6</sup>, to calculate equitable share across the provinces. This formula consists of the following six components that capture the relative demand for services between provinces and takes into account specific provincial circumstances:

- Education component based on the size of the school-age population and the number of learners enrolled in public ordinary schools;
- Health component based on a combination of a risk-adjusted capitation index for the population, which takes into account the health risks associated with the demographic profile of the population and the relative share of case-loads in hospitals;
- Basic component derived from each province's share of the national population;
- Institutional component divided equally between the provinces;
- Poverty component reinforcing the redistributive bias of the formula; and
- Economic output component based on GDP-R data.

Conditional grants are used for specific purposes, *inter alia*, infrastructure provision, institutional capacity building, and the implementation of various national priorities (e.g. HIV and Aids and school nutrition programmes). Their primary objective is to promote national priorities and to compensate provinces for the provision of specialised services across provincial boundaries.

There are four types of conditional grants that are distributed to provinces as approved in terms of the DORA:

- Schedule 4A specifies general grants that supplement various programmes already funded by provinces which are aimed predominantly at provincial health, education and infrastructure sectors with varied transfer and spending accountability arrangements as more than one national or provincial department may be responsible for different outputs;
- Schedule 5A specifies specific purpose conditional grants, with specific responsibilities for both the transferring and receiving departments of provincial accounting officers (AOs);
- Schedule 6A specifies in-kind allocations through which a national department implements projects in provinces; and
- Schedule 7A specifies swift allocation and transfer of funds to a province to help it deal with a disaster.

<sup>6</sup> The DORA is the subject of policy research and analysis by the FFC, an independent constitutional advisory institution that advises the Parliament and the National Treasury. It establishes the annual transfers to all provinces including the equitable share and the conditional grant share which are determined by a well-defined formula. In terms of section 214(1) of the Constitution, DORA must be enacted and voted annually to determine the vertical and horizontal allocation of resources prior to the commencement of each financial year. The FFC has the responsibility of advising and making recommendations to Parliament, provincial legislatures, organised local government and other organs of state on financial and fiscal matters. See <http://www.ffc.co.za/index.php/about-ffc/what-is-the-ffc>

Section 22(3)(a) of the DORA stipulates that the NT must, within 14 days after the DORA takes effect, approve the payment schedule for the transfer of an allocation listed in schedule 4A or 5A to a province. In addition, in terms of section 22(3) (d), NT must determine the requirements regarding payment schedules for the transfer of allocations listed in schedule 6A.

Section 7(d) of the DORA stipulates that schedule 7A grants may be released to provinces to fund disaster response within a period from three days up to three months following a declared disaster in terms of the conditions of the Disaster Management Act, 2002 (Act No. 57 of 2002).

All unspent conditional grants at the close of the fiscal year are returned to the NT and are lost by the related departments. During execution, national departments monitor the spending of the grants and other provincial departments can ask for the unspent funds to be reallocated to them. Equitable share cannot be reduced once approved.

A comparison of budgeted versus actual revenues from NT and departments are presented in table 8 below. It demonstrates that deviations did not decrease and that transfers have not increased by more than 2.2 per cent over the estimated amount. These deviations were primarily a result of additional equitable share funding due to technical adjustments in the data that informs the equitable share formula and carry through costs of the 2011 employees' wage agreement (supplementary funding granted by NT to cover part of the gap created).

**Table 9: Analysis of original revenues estimates against revenues by sources**

(R million)	2010/11	2011/12	2012/13
Equitable share from national (forecast)	56 743	62 928	67 803
Equitable share from national (actual)	57 632	63 584	68 639
<b>Equitable share percentage disbursed</b>	<b>101.6%</b>	<b>101.0%</b>	<b>101.2%</b>
Equitable share receipts deviation	889	656	836
<b>Equitable share receipts deviation %</b>	<b>1.6%</b>	<b>1.0%</b>	<b>1.2%</b>
Conditional grants from national (forecast)	11 742	13 314	14 428
Conditional grants from national (actual)	12 353	13 423	14 810
Conditional grants percentage disbursed	105.2%	100.8%	102.7%
Conditional grants deviation	611	109	383
Conditional grants deviation %	<b>5.20%</b>	<b>0.82%</b>	<b>2.65%</b>
Total receipts from national (forecast)	68 485	76 242	82 231
Total receipts from national (actual)	69 985	77 007	83 449
<b>Total receipts percentage disbursed</b>	<b>102.2%</b>	<b>101.0%</b>	<b>101.5%</b>
Total receipts deviation	1 500	765	1 218
<b>Total receipts deviation %</b>	<b>2.2%</b>	<b>1.0%</b>	<b>1.5%</b>

Source: *Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.*

Comparisons of budgeted and actual transfers of earmarked grants are presented in Table 9. Relative to other provincial departments, DOH is the largest recipient of grant allocations, followed by DOE, Department of Human Settlements (DHS) and DOT.

Through its distribution of conditional grants to provincial departments, government supports higher levels of infrastructure provision and capital expenditure particularly in DOH, DOE, DHS and DOT. Given the reduced fiscal space, this adds to a growing pressure with respect to comprehensive funding of maintenance expenditure for the existing infrastructure as well as newly built infrastructure across the province. This is reflected in the significant accruing of payment arrears in goods and services across the departments (see PI-4).

**Table 10: Comparison of budgeted and actual transfers of earmarked grants including equitable shares**

R' 000	2010/11			2011/12			2012/13		
	Forecast	Actual	Var %	Forecast	Actual	Var %	Forecast	Actual	Var %
Total equitable shares (Non earmarked)	56 742 834	57 632 201	1.6	62 927 556	63 584 195	1	67 802 913	68 638 663	1.2
Office of the Premier	0	0	0	0	0	0	0	0	0
Provincial Legislature	0	0	0	0	0	0	0	0	0
Agriculture Environmental Affairs	174 525	174 525	0	233 935	242 251	4	276 738	272 676	2
Economic Development and Tourism	0	0	0	0	536	100	1 000	1 000	0
Education	2 592 124	2 598 423	0.3	3 078 939	3 180 057	3	3 344 801	3 529 349	6
Provincial Treasury	0	1 634	100	0	0	0	0	0	0
Health	3 894 131	3 924 609	0.8	4 434 66	4 435 205	0.1	4 820 849	5 023 849	
Human Settlements	2 847 909	2 768 502	-3	2 769 871	2 801 547	1	2 915 297	2 915 297	0
Community Safety and Liaison	0	0	0	0	0	0	1 673	1 673	0
The Royal Household	0	0	0	0	0	0	0	0	0
Co-operative Governance and Traditional Affairs	0	0	0	0	0	0	0	0	0
Transport	1 842 447	2 040 505	11	2 139 957	2 157 272	1	2 373 740	2 373 740	0
Social Development	2 688	2 700	0.5	4 494	3 821	-15	0	0	0
Public Works	259 891	713 331	175	518 585	465 546	-10	552 608	552 608	0
Arts and Culture	38 282	38 282	0%	45 401	48 971	8%	48 619	48 619	0%
Sport and Recreation	90 256	90 756	0.6%	87 694	87 694	0%	92 122	91 548	-0.6%
<b>Total</b>	<b>68 485 087</b>	<b>69 985 468</b>	<b>2.2%</b>	<b>76 241 101</b>	<b>77 007 095</b>	<b>1%</b>	<b>82 230 360</b>	<b>83 449 022</b>	<b>1.5%</b>

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

**Table 11: Comparison of actual transfers to budgeted transfers**

Description R million	2010/11				2011/12				2012/13			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>Forecast</b>												
Equitable shares	14 186	14 186	14 186	14 186	15 732	15 732	15 732	15 732	16 951	16 951	16 951	16 951
Conditional grants	2 873	2 965	3 018	2 885	3 074	3 488	3 708	3 043	3 546	3 947	4 266	2 668
<b>Total</b>	<b>17 059</b>	<b>17 151</b>	<b>17 204</b>	<b>17 071</b>	<b>18 806</b>	<b>19 220</b>	<b>19 440</b>	<b>18 775</b>	<b>20 497</b>	<b>20 898</b>	<b>21 217</b>	<b>19 619</b>
<b>Disbursement</b>												
Equitable shares	14 186	14 186	14 779	14 482	15 732	15 732	15 732	16 388	16 951	16 951	16 951	17 786
Conditional grants	2 873	2 898	3 671	2 991	3 056	3 468	3 794	3 089	3 540	3 953	3 956	3 200
<b>Total</b>	<b>17 059</b>	<b>17 084</b>	<b>18 450</b>	<b>17 473</b>	<b>18 788</b>	<b>19 200</b>	<b>19 526</b>	<b>19 477</b>	<b>20 491</b>	<b>20 904</b>	<b>20 907</b>	<b>20 986</b>
% Disbursed	100.0	99.6	107.2	102.4	99.9	99.9	100.4	103.7	100.0	100.0	98.5	107.0
% Weighted delay	0	0.40	0	0	0.20	0.10	0	0	0	0	1.50	0

**Table 12: Summary of results relating to variances in aggregate revenue and composition revenue**

	2010/11	2011/12	2012/13
Variance in aggregate revenue	2.2%	1.0%	1.5%
Variance in revenue composition	1.7%	0.3%	0.6%

Table 12 provides the results of the analysis of variances in aggregate revenue and composition revenue. It indicates that the variances in aggregate revenue and composition of actual revenue to original estimates were 2.2 per cent or less for all three years analysed.

With regards to the in-year timeliness of transfers, a disbursement timetable based on the DORA forms part of the agreement between national and KZN provincial government and this is agreed by all stakeholders at or before the beginning of the fiscal year. Actual disbursements delays have not exceeded 1.5 per cent in 2010/11, 2011/12 and 2012/13) fiscal years.

Indicator	Score	Explanation
<b>HLG-1 Predictability of transfers from a higher level of government</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Annual deviation of actual total HLG transfers from the original total estimated amount provided by HLG to the SN entity for inclusion in the latter's budget	A	Over the last three years of assessment, HLG transfers have not been less the estimate, nor exceeded the estimate by more than 2.2 per cent.
(ii) Annual variance between actual and estimated transfers of earmarked grants	A	Variance in provision of earmarked grants (composition of revenue) did not exceed 2.2 per cent in any of the last three years (2010/11, 2011/12 and 2012/13).
(iii) In-year timeliness of transfers from HLG (compliance with timetables for in-year distribution of disbursements agreed within of month of the start of the province FY)	A	A disbursement timetable forms part of the agreement between national and provincial government and this is agreed by all stakeholders at or before the beginning of the fiscal year. Actual disbursements delays have not exceeded 1.5 per cent in the last three years of assessment (2010/11, 2011/12 and 2012/13).

**PI-1: Aggregate expenditure out-turn compared to original budget**

**Dimensions to be assessed (scoring method M1):**

**(i) The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure)**

This PEFA assessment covers the fiscal years 2010/11, 2011/2012 and 2012/13 with 2012/13 being the most recent fiscal year for which final appropriations accounts were available at the time of the assessment. The approved original and actual expenditure presented in table 12 were obtained from the appropriated estimates of provincial revenue and expenditure for 2010/11, 2011/12 and 2012/13 and audited annual financial statements.

KZN uses a modified cash basis of accounting for its provincial government accounts with the fiscal year from April 1 to March 31. Under this basis, the effect of transactions and other events are recognised in the financial records when the resulting cash is received or paid. This places importance on the adequate reporting of outstanding commitments for goods, works and services (i.e. open purchase orders) not delivered by the end of the fiscal year and rolled over to the next budget year. Outstanding payments for more than 30 days are reported as accruals (expenditure arrears). In addition, invoices received in March (i.e. last month of the fiscal year) and not paid during that fiscal year have to be recorded as accruals as per provincial treasury policy. Any uncommitted funds at the close of the fiscal year are returned to the Provincial Treasury. Those policies affect how reported out-turns match estimates. Accrued payment arrears are not reported as spending in the current financial year, thereby possibly reducing the amount of unauthorised expenditures but are reported in the following year's expenditure, thereby reducing the accuracy of the annual financial statement reporting with respect to the execution of new departmental votes. There are elements of this PEFA assessment that suggest the accuracy of data necessary to correctly interpret these results may not be fully achieved as demonstrated by the increasing quantum of arrears (see PI-4), weaknesses in expenditure control (see PI-20) and the absence of procurement planning across a number of provincial departments (PI-19). In the three fiscal years reviewed, there were no substantive major external factors that significantly impacted on budget expenditure.

**Table 13: Comparison of budget estimates against actual expenditure**

R million	2010/11	2011/12	2012/13
Primary original estimate	69 077	77 300	83 572
Primary out-turn	67 675	78 644	85 642
Aggregate expenditure deviation	-1 402	1 344	2 070
<b>Aggregate expenditure deviation</b>	<b>-2.03%</b>	<b>1.74%</b>	<b>2.48%</b>

Source: *Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.*

For all three fiscal years that were reviewed, the aggregate actual expenditures matched the budget estimates to within 3 per cent variance. Further, all three budget years' revenues exceeded budget estimates (see PI-3) which were primarily due to additional equitable share funding (due to technical adjustments in the data that informs the equitable share formula) and carry through costs of the 2011 national employees wage agreement as well as collection of higher than projected provincial receipts. While from 2010/11 the Provincial Treasury implemented cost cutting measures reflected in a negative deviation, the positive deviation in 2011/12 and 2012/13 is funded through the increase in revenues and a contingency provision. KZN Treasury operates a cash surplus.

Indicator	Score	Evaluation
<b>PI-1 Aggregate expenditure out-turn compared to original approved budget</b>	<b>A</b>	<b>Scoring method M1</b>
Aggregate expenditure outturn compared to original approved budget	A	Actual primary expenditure deviated from expenditure estimates below 3 per cent for three of the years considered. Deviations were 2.03 per cent, 1.74 per cent and 2.48 per cent respectively.

**PI-2: Aggregate expenditure out-turn compared to original approved budget**

<p><b>Dimensions to be assessed (scoring method M1):</b>  <b>(i) Extent to which the variance in the composition of primary expenditure exceeded the aggregate variance (as defined in PI-1) in the past three years excluding contingency items</b>  <b>(ii) The average amount of expenditure charged to the contingency vote over the last three years</b></p>
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Table 14 presents the results of the analysis of variances in aggregate expenditure and composition expenditure. These indicate that the variances in aggregate expenditure and composition of actual expenditure to original estimates were 3.3 per cent or less for the 2010/11, 2011/12 and 2012/13 fiscal years reviewed.

**Table 14: Summary of results relating to variances in aggregate expenditure and composition**

	2010/11	2011/12	2012/13
Variance in aggregate expenditure	-2.0%	1.7%	2.5%
Variance in expenditure composition	3.3%	1.6%	1.2%

Source: Estimates from estimates of provincial expenditure 2010/11, 2011/12, 2012/2013 and 2012/13 annual financial statements.

The low variances in expenditure composition at the aggregate level shown in table 13 may indicate disciplined alignment to the formula in the budget preparation process. As explained in PI-16, budget releases are based on forecast aligned with the departmental votes and that control is maintained through the combined oversight and supervision of the finance portfolio committee and the public finance unit of the Provincial Treasury (see PI-11 and PI-27), although the commitment control procedures are not fully effective. While the PFMA accommodates an adjustment budget process during September/October, this does not result in significant adjustments to the original budget estimates.

For unforeseen and unavoidable expenditures, a “contingency provision” is kept by Provincial Treasury and is used during the year to provide additional funding. It is thus not specifically included in the estimates of provincial revenue and expenditure documentation. However, it is reflected as a surplus between overall provincial revenue and total expenditure. These amounts are only directly reflected in adjustment budgets and departmental votes following necessary approval from legislature. The non-budgeted “contingency provision” protects the province against small fiscal shocks (such as unfunded mandates) that may occur in-year and acts as a safety net, especially in view of the spending pressures at certain departments. It also protects the province in so far as it should not go into overdraft should any department overspend its adjusted budget allocation.

An analysis of this table shows that the percentage of contingency reserve estimate was on average 1.4 per cent of the aggregate expenditure estimate for the last three financial years assessed.

**Table 15: Contingency reserve estimate as a percentage of aggregate expenditure estimate**

R million	2010/11	2011/12	2012/13	Average
Contingency provision estimate	1 211	948	1 129	1 096
Aggregate expenditure estimate	69 077	77 300	83 572	76 650
Percentage of contingency reserve to aggregate expenditure estimate	1.8%	1.2%	1.4%	1.4%

Source: Estimates from estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.

Indicator	Score	Evaluation
<b>PI-2 Aggregate expenditure out-turn compared to approved budget original</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Extent of the variance in expenditure composition during the last three years, excluding contingency items	A	Variances in expenditure composition were below 5 per cent for the last three years. Variances were 3.3 per cent, 1.6 per cent and 1.2 per cent respectively.
(ii) The average amount of expenditure charged to the contingency vote over the last three years	A	Percentage of contingency provision estimate was on average less than 3 per cent of the aggregate expenditure estimate for the last three financial years assessed.



**PI-3: Aggregate revenue out-turn compared to original approved budget**

**Dimension to be assessed (scoring method M1)**

**(i) Real domestic income collection in comparison with estimates in the original approved budget**

For this indicator, own revenues only are included, as HLG-1 covers transfers in the form of equitable share and conditional grants. The principal sources of KZN provincial revenue were from the provincial Department of Transport (i.e. vehicle registration and licence fees, sale of personalised and specific number plates), Office of the Premier (i.e. casino, horse racing and slot machines taxes), Department of Health (i.e. health patient fees) and Provincial Treasury (i.e. interest earned on positive bank balances at the prevailing rates). These constituted 89 per cent, 85 per cent and 93 per cent respectively of the total KZN provincial own revenue for the three financial years assessed.

Other own revenue consists of sale of goods and services other than capital assets, rent on land, fines, penalties and forfeits and sale of capital assets, sales of bidding documents. Table 15 shows the weight of provincial revenue by provincial departments.

**Table 16: Summary of provincial own revenue by provincial departments**

Provincial department R'000	2010/11		2011/12		2012/13	
	Actual	Weighting	Actual	Weighting	Actual	Weighting
Office of the Premier	352 612	17.3%	406 662	14.9%	448 553	16.8%
Provincial Legislature	4 076	0.2%	1 554	0.1%	2 331	0.1%
Agriculture, Environmental Affairs	18 534	0.9%	22 687	0.8%	22 103	0.8%
Economic Development and Tourism	105 494	5.2%	1 293	0.0%	10 457	0.4%
Education	63 864	3.1%	89 105	3.3%	85 812	3.2%
Provincial Treasury	30 826	1.5%	289 253	10.6%	270 446	10.1%
Health	191 221	9.4%	207 998	7.6%	267 071	10.0%
Human Settlements	8 117	0.4%	269 168	9.9%	15 096	0.6%
Community Safety and Liaison	105	0.0%	70	0.0%	75	0.0%
The Royal Household	513	0.0%	154	0.0%	99	0.0%
Co-operative Governance and Traditional Affairs	5 622	0.3%	3 959	0.1%	7 578	0.3%
Transport	1 245 979	61.0%	1 409 482	51.7%	1 502 265	56.2%
Social Development	7 017	0.3%	16 417	0.6%	13 270	0.5%
Public Works	6 608	0.3%	6 116	0.2%	23 642	0.9%
Arts and Culture	609	0.0%	2 647	0.1%	1 755	0.1%
Sport and Recreation	167	0.0%	394	0.0%	512	0.0%
<b>Total</b>	<b>2 041 364</b>	<b>100%</b>	<b>2 726 959</b>	<b>100%</b>	<b>2 671 065</b>	<b>100%</b>

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.

In the past three years, provincial own revenue constituted 2.8 per cent to 3.4 per cent of the total provincial revenue including equitable share and conditional grants.

**Table 17: Summary of provincial total revenue by source**

Description (R million)	2010/11		2011/12		2012/13	
	Actual	Weighting	Actual	Weighting	Actual	Weighting
Aggregate equitable share from national	57 632	80.0%	63 584	79.7%	68 639	79.7%
Aggregate conditional grants from national	12 353	17.2%	13 423	16.8%	14 810	17.2%
Aggregate provincial own revenues	2 041	2.8%	2 727	3.4%	2 671	3.1%
<b>Total</b>	<b>72 026</b>	<b>100.0%</b>	<b>79 734</b>	<b>100.0%</b>	<b>86 120</b>	<b>100.0%</b>

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and 2012/13 annual financial statements.

A comparison of budgeted versus actual provincial own revenues reveals positive deviations in 2010/11, 2011/12 and 2012/13 (see Table 18). Provincial Treasury explains that this is due to both the difficulty of developing forecasting models for such revenues and to a conservative approach in forecasting.

**Table 18: Comparison of total budgeted provincial own revenues and out-turns**

R'000	2010/11	2011/12	2012/13
Revenue estimates - provincial own receipts	1 803 568	1 942 965	2 338 953
Revenue out-turns - provincial receipts	2 041 364	2 726 959	2 671 065
Deviation amount	237 796	783 994	332 112
<b>Deviation %</b>	<b>13.18%</b>	<b>40.35%</b>	<b>14.20%</b>

Source: Estimates from estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

Department of Transport is the main contributor to total provincial own revenue, accounting for an average of 56 per cent over the past three financial years. Its deviation from revenue forecast primarily relates to the improved efficiencies at the various registering authorities, annual increase in motor vehicle licence fees and higher than anticipated net growth of motor vehicles registration and license renewals. The forecasts are based on historical trends.

Office of the Premier is the second main contributor, yielding an average of 16 per cent over the past three financial years. The increased revenue collection is attributed to an effort to increase compliance, through increased focus on enforcement and surveillance of the operations of casinos and bookmakers as well as various initiatives such as the expansion of slot machine which stimulated demand across the province. In spite of the high level of poverty, revenues are increasing more rapidly than planned. This may also suggest that compliance increase leads to increase declared revenues by economic operators.

Deviations in revenue of Department of Health in 2010/11 and 2011/12 relate to manual billing systems, inadequate systems and processes to collect revenue from patients (see PI-13 to 15) and organisations as well as a lack of a consistent strategy to enhance collections from medical aid schemes, Road Accident Fund and other statutory accounts. In the 2012/13, the department demonstrated a positive variance which was primarily due to revenue over recoveries from the Road Accident Fund and the Compensation of Injuries and Disease Act (COIDA) entities.

Department of Human Settlements' once-off peak in 2011/12 relates to funds received together with interest income from liquidated developers received for housing projects (i.e. Ingwavuma Rural Projects, Wiggins and

Bonela Housing projects) which did not take place as planned in previous financial years. As these amounts related to previous financial years, they had to be paid to Provincial Treasury.

The upward trend in Provincial Treasury from 2010/11 to 2011/12 and 2012/13 is largely due to the interest income earned from their increased level of positive bank balance during the last two fiscal years.

**Table 19: Comparison of total budgeted provincial own revenues against actual by department**

Provincial Department R'000	2010/11			2011/12			2012/13		
	Forecast	Actual	Var %	Forecast	Actual	Var %	Forecast	Actual	Var %
Office of the Premier	341 566	352 612	3	366 761	406 662	11	404 110	448 553	11
Provincial Legislature	567	4 076	619	601	1 554	159	629	2 331	271
Agriculture, Environmental Affairs	16 450	18 534	13	17 273	22 687	31	18 136	22 103	22
Economic Development and Tourism	42 081	105 494	151	46 281	1 293	-97	48 595	10 457	-78
Education	48 457	63 864	32	54 835	89 105	62	57 819	85 812	48
Provincial Treasury	6 968	30 826	342	8 848	289 253	3169	185 505	270 446	46
Health	214 904	191 221	11	227 798	207 998	-9	213 992	267 071	25
Human Settlements	1 033	8 117	686	1 136	269 168	23 594	1 250	15 096	1108
Community Safety and Liaison	53	105	98	53	70	31	52	75	44
The Royal Household	89	513	476	93	154	66	98	99	1
Co-operative Governance and Traditional Affairs	1 970	5 622	185	2 083	3 959	90	2 703	7 578	180
Transport	1 120 697	1 245 979	11	1 207 948	1 409 482	17	1 395 850	1 502 265	8
Social Development	4 549	7 017	54	4 720	16 417	248	4 227	13 270	214
Public Works	3 792	6 608	74	4 120	6 116	48	5 498	23 642	330
Arts and Culture	342	609	78	360	2 647	635	394	1 755	345
Sport and Recreation	50	167	234	55	394	616	95	512	439
<b>Total</b>	<b>1 803 568</b>	<b>2 041 364</b>	<b>13</b>	<b>1 942 965</b>	<b>2 726 959</b>	<b>40</b>	<b>2 338 953</b>	<b>2 671 065</b>	<b>14</b>

Source: Estimates of provincial expenditure 2010/11, 2011/12, 2012/13 and annual financial statements 2012/13.

Indicator	Score	Explanation
<b>PI-3 Deviations in aggregate revenue out-turn compared with the original approved budget</b>	<b>C</b>	<b>Scoring method M1</b>
(i) Real collection of domestic income in comparison with estimates in the original approved budget	C	Provincial own revenue collection was between 92 per cent and 116 per cent of budgeted revenue in two of the last three budget years. The ratios of aggregate revenue out turn to original approved budget were 113 per cent, 140 per cent and 114 per cent respectively.



**PI-4: Stock and monitoring of expenditure payment arrears**

<b>Dimensions to be assessed (scoring method M1):</b> <i>(i) Stock of expenditure payment arrears</i> <i>(ii) Availability of data to monitor the stock of expenditure payment arrears</i>
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**(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.**

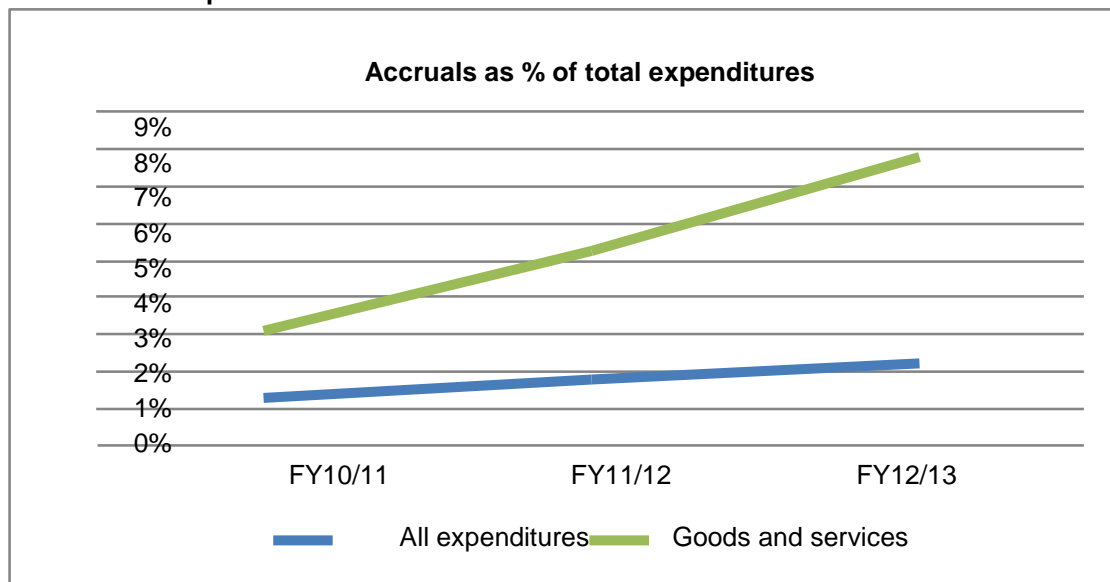
Section 8.2.3 of the Treasury Regulations specifies that “all payments due to creditors must be settled within 30 days from receipt of an invoice” hence an unpaid bill outstanding for more than 30 days after verification of the invoice is deemed to be a payment in arrears (called “accrual” in South Africa).

**Table 20: Accruals for 2010/11, 2011/12 and 2012/13 for all departments**

R'000	2010/11	2011/12	2012/13
Total departmental expenditures	68 124 821	78 803 023	86 135 386
O/w goods and services expenditures	13 177 685	15 850 900	17 043 796
Total accruals	873 584	1 397 502	1 926 938
<b>As % of total dept. expenditures</b>	<b>1.28%</b>	<b>1.77%</b>	<b>2.24%</b>
O/w goods and services	408 241	834 636	1 323 345
<b>As % of department goods and services exp.</b>	<b>3.10%</b>	<b>5.27%</b>	<b>7.76%</b>

Source: Provincial Treasury, departmental AFS

**Graph 10: Evolution of aggregate departmental accruals versus total departmental expenditures and goods and services accruals versus aggregate departmental goods and services expenditures**



Source: Provincial Treasury, departmental AFS

In 2008 the PEFA reported that the membership of the Steel and Engineering Industries Federation of South Africa (SEIFSA) recorded a significant number of cases of late payments on supplies and services made to the central government towards the end of the FY and that this was more significant in provinces. The data suggest that this is an ongoing weakness.

In addition, it is possible that accrual figures do not record the differing financing of employees’ compensation. DPISA’s negotiations with unions results in agreement that leaves unfunded gaps in annual budgets. In the case of education, the department is still in arrears for the payment of wage and OSDs due since 2008/09.

When measured as a ratio of expenditure arrears to total expenditure, the aggregate department accruals for the three years 2010/11 to 2012/13 appear contained, standing at 1.28 per cent of total departmental expenditures but increasing year on year to reach 2.24 per cent in 2012/13. When considering accruals in composition, the situation worsens, revealing stock of goods and services accruals at 3.1 per cent in 2010/11 versus total goods and services departmental expenditures increasing to 7.76 per cent in 2012/13. This analysis is justified as the per cent capital expenditures of the largest spenders - health, education and transport - are driven by conditional grants, creating pressure to spend. Thus goods and services is the most economic item in the departments in the face of the tightening fiscal space.

When considered at departmental level and for non-compensation budget, the ratio become substantial as well as the year on year changes as shown in table 20. This is most significant for the two highest spending departments, DOH and DOE.

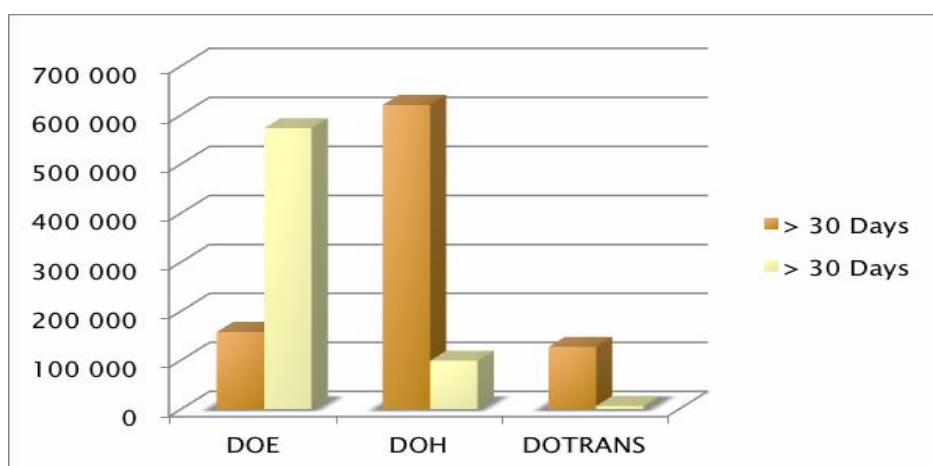
**Table 21: Measurement of accruals for three departments (education, health and transport)**

	2009/10	2010/11	2011/12	2012/13
<b>Department of Education</b>				
<i>Accruals as % of total exp.</i>	1.0%	0.4%	1.1%	2.1%
<i>Accrual as % GS</i>		3.3%	6.4%	15.6%
<i>Accrual as % GS&amp;C</i>		2.8%	7.2%	13.4%
<b>Department of Health</b>				
<i>Accruals as % of total exp.</i>	1.63%	1.01%	1.48%	2.62%
<i>Accrual as % GS</i>		3.24%	4.8%	8.92%
<i>Accrual as % GS&amp;C</i>		2.89%	4.1%	7.18%
<b>Department of Transport</b>				
<i>Accruals as % of total exp.</i>	2.11%	4.95%	3.10%	1.74%
<i>Accrual as % GS</i>		1.65%	1.4%	0.15%
<i>Accrual as % GS&amp;C</i>		7.01%	4.3%	2.36%

Source: Provincial Treasury, departmental AFS

When looking at accruals by age category, limited to 30 days or less, or more than 30 days in the AFS, the departments are generally reporting the majority of their accruals as less than 30 days, suggesting that they are delaying payments in the next fiscal year to avoid unauthorised expenditures. This, however, reduces the next year's budget. In the case of the Department of Education, the reverse is found.

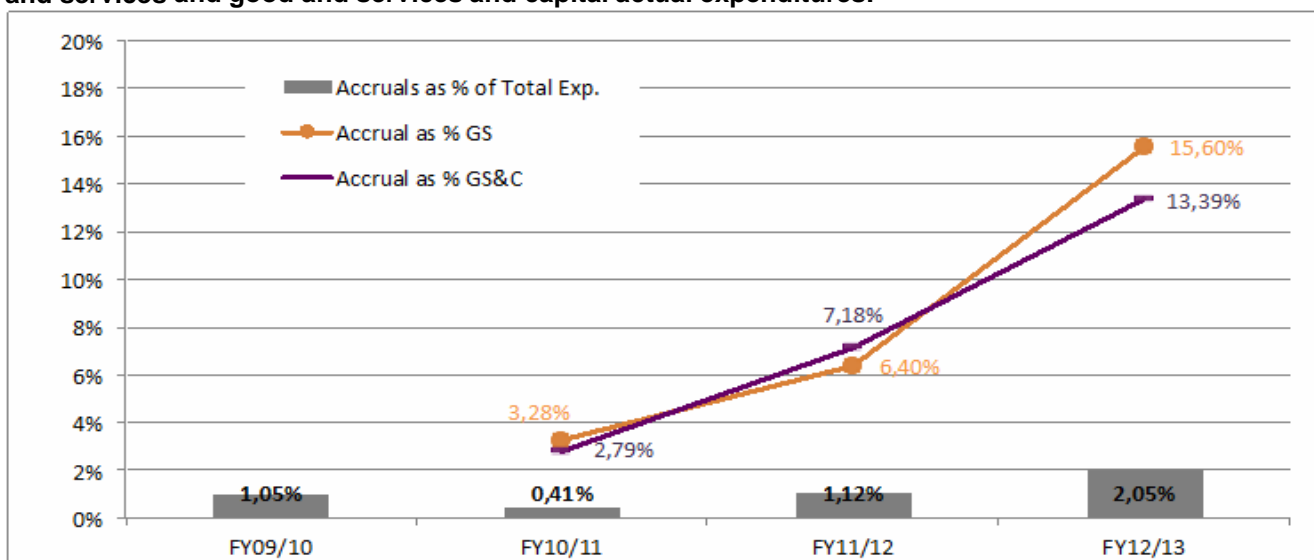
**Graph 11: Age profile of accruals stocks for Departments of Health, Education and Transport for 2012/13**



Source: Provincial Treasury, Departmental AFS

The increase in accruals is most critical in the departments of health and education as depicted in the graphs below. Again, for both departments, the accruals stocks are most important for G&S item. Both departments have legal obligations to spend their infrastructure conditional grants, and though they accrue payment arrears in capital expenditures, this is limited as it could reduce their grants. Since 2012/13, the department of health has been able to convert 25 per cent of its grant for maintenance, reducing pressure on its budget.

**Graph 12: Visualising department of education’s accrual as per cent of total actual expenditures, good and services and good and services and capital actual expenditures:**



Source: Departmental AFS

**(ii) Availability of data for monitoring the stock payment arrears**

Although there is the possibility to control commitment in BAS, it is not consistently and fully applied to all transactions. Further the dates of invoicing are not easily controlled, allowing users to adjust it to ensure recorded invoices in BAS are paid within the prescribed time period. The Accountant-General believes that this practice limits the credibility of the figures reported as forecast (including commitment) and accruals. As such the stock of accrual reported below cannot be fully ascertained.

The rush of commitments made at the end of the year, reported in 2008, has been brought under control in the province according to the Accountant-General. However the practice is to book invoices in March to allow a 30-day period bringing their payment into the next fiscal year. The current policy is that any invoice originated in March and paid in April should be recorded as an accrual.

The annual financial statements of each department reports accruals and commitments, including accruals of more than 30 days and commitments of more than a year. However, the Accountant-General does not consider the data accurate, although the impact of errors cannot be estimated.

The annual financial statements disclose payables which are presented in financial notes about accruals: age profile and recurrent/non-recurrent. However, there are doubts as to the comprehensiveness of the information for employee compensations as reported by DOE.

The AG’s report on financial health of departments and public entities includes a review of the creditors and debtors, with an age profile.

**Underlying factors**

The concurrent functions of government imply that service delivery is largely a function of provincial governments and municipalities and this is where the weakness of arrear is most notable. There are a number of dynamics impacting on the accrual of payment arrears:

## **Controls**

- The commitment control is not operational for all expenditures and spending units, leading to overspending, with commitments made before the departments and Provincial Treasury can stop them (PI-20).
- The procurement is not adequately planned and does not serve systematically as the basis for requisition (PI-19) while the procurement does not ensure value for money due to a coupling of preferential treatment, lack of capacity to specify procurement packages and insufficient capacity of SMMEs in the province to take advantage of the preferential treatment.
- The supply chain management is not fully operational with significant weaknesses in the control of stocks and inventories in the Department of Health.

## **Budget and predictability of funds**

- The budget has been constrained since 2008/09 by regular negotiations between the DPSA and the unions that had resulted in agreements that are not factored into the annual budget, leaving unfunded gaps. These gaps have to be paid from cutting other expenditure which is not always possible (PI-16).
- The baseline budget increases less than the personnel compensation, forcing the province to fund the difference by cutting other expenditure. A cost-cutting policy has been operational since 2009/10 (PI-12)
- The accrual of arrears leaves the department with a funding gap for the next year that cannot be compensated for in the next budget cycle due to ongoing fiscal tightening.
- The DORA allocation to the province has been cut since the 2011 census, leading to further tightening in expenditure.
- The infrastructure conditional grants to health and education are monitored on spending level and the push for increased infrastructures in turn leads to increasing pressure on the fiscus to fund maintenance costs. Maintenance is currently underfunded in all departments.
- There is thus increasing pressure to achieve value for money in procurement and to reduce wasteful expenditure in personnel compensation.

In 2009, the Provincial Treasury applied the first charge principle in accordance with the PFM Act. This basically allows a department to retain a portion of allocated funds. The PT had to resort to this mechanism for DOH in order to pay the DOH overdraft. When PT applied this principle, it took over key functions of DOH in accordance with section 20 of the PFM Act to cut costs over an 18-month period so that new arrears did not build up. Currently arrears are again building up.

## **On-going and planned reform activities**

To deal with the limitation of BAS, the Provincial Treasury is investigating how to roll out LOGIS, the national procurement management software. LOGIS commitment controls impede payment without commitment. Some departments proposed, however, to introduce the INTENDER software.

For 2013/14, Provincial Treasury allowed DOH to use 25 per cent of the infrastructure conditional grant towards maintenance (whereas the PFMA does allow virement funds from capital to recurrent expenditure).

All departments are currently reprioritising expenditures, applying the cost cutting measures imposed by PT and increasing their funding of maintenance for infrastructures.



Indicator	Score	Explanation
<b>PI-4 Stock and monitoring of expenditure payment arrears</b>	<b>C+</b>	<b>Scoring method M1</b>
(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and a recent change in the stock	C	The ratio of expenditure arrears to total expenditure for all three years considered started at lower than 2 per cent and increased to 2,25 per cent warranting a C. The analysis shows that when considered in proportion to non-compensation expenditures (i.e. Expenditure that is more discretionary in the short term), the ratio is significantly higher, standing at 7,76 per cent in aggregate and picking at more than 15 per cent for some departments.
(ii) Availability of data for monitoring the stock payment arrears	B	Complete consolidated expenditure arrears data is provided as part of the annual financial statement for each department. However the data may not be reliable given the limitations in the use of BAS for commitment control and the absence of systematic procurement plan and contract management system.

## 3.2 Comprehensiveness and transparency

### PI-5: Classification of the budget

**Dimension to be assessed (scoring method M1):**

***(i) The classification system used to formulate, execute and report on the province budget***

The execution and its financial reporting of the provincial budget respond to prescribed classification and chart of accounts by the National Treasury. The estimates of provincial expenditure (EPE) and the rolling MTEF budgetary framework on which they are based is structured on the basis of administrative (departments), economic, programme and sub-programme classifications.

The structure of the programmes and sub-programmes are defined by the National Treasury and all sectors at provincial level are informed of any amendments. The format for the preparation of the next year's MTEF framework and budget is provided in Treasury guidelines. Most departments belong to a structured sector with national statutory programmes, For example, public works and transports are two sectors. Although they can institutionally merge in a province (Cabinet arrangement), it has no impact on the budget structure which is decided nationally. Not all departments belong to a sector (Office of the Premier, Provincial Legislature and Royal Household) and thus are not structured nationally but provincially. The programme and sub-programme classifications employed for the budget are used to produce documentation consistent with COFOG at both the functional and sub-functional levels by the National Treasury.

Cash forecasting for commitment control is done using the same classification, with a level of detail to the spending entity, by GFS classification. The budget classification and the chart of accounts is the same except that budget is presented at a more aggregated level. It is reported that some departments use the detailed classification for preparation of the budget, but it is not evident for all according to the Accountant-General and those departments who were met. Using the baseline leads to an exercise of allocation across the-classification while new bids require a budget prepared at detailed level of the classification. There are eight levels of GFS classification, applied at programme level for each administrative entity.

The revenue budget, Division of Revenue Act (DORA), is classified into recurrent and capital revenues, with each segregated by tax type and further by administrative heading. Revenues are classified as tax and non-tax revenue and by own sources and external grants.

The institutional arrangements of government reflect the programme/sub-programme structure and so permit clear lines of accountability for delivering on the budgetary programmes and the pre-determined objectives. Although the 2008 PEFA reported that the disadvantages appeared to be a pressure to institute new administrative structures with the introduction of new programmes, the MTEF practice shows that new initiatives funded using the bid system for over and above the baseline that all have embedded into the existing programmes.

#### **On-going and planned reform activities**

N/A

Indicator	Score	Explanation
<b>PI-5 Classification of the budget</b>	<b>A</b>	<b>Scoring method M1</b>
(i) The classification system used to formulate, execute and report on the provincial government budget	A	The budget formulation and execution are based on economic, administrative, programme and sub-programme classification that can produce consistent documentation according to GFS and COFOG standard using a bridging table. The chart of accounts is derived from the budget classification and details it by categories of transactions. Provincially defines programmes is limited to three departments.

**PI-6: Comprehensiveness of information included in budget**

**Dimension to be assessed (scoring method M1):**

**(i) Share of the above listed information contained in the budgetary documentation most recently issued by the central government**

The budget documentation presented to KZN Provincial Legislature includes comprehensive information on the budgetary context, intent and recent financial achievements. The budget is set against a medium-term expenditure framework of the government's strategic objectives. The approved votes, which usually do not differ from the proposed allocations, are gazetted and promulgated as appropriation acts of the Provincial Legislature. These form the basis for the preparation of the cash flow projections. The MTEF format includes forward estimates (budget year plus two forward years), revised estimates for the year prior to the budget year, and actual audited outcomes from three years previous to the budget year.

Budget documentation is comprehensive and consists of the following main components:

- The budget speech by the KZN MEC of Finance which outlines financing, new initiatives, activities, priorities as well as revenue allocation shifts and expenditure forecasts;
- The estimates of provincial revenue and expenditure documentation which contains the socio-economic outlook, economic growth, structure and performance, labour market and development indicators analysis, provincial population information, the votes and programme appropriations with three-year forward estimates as well as the adjusted appropriation of the year previous to the budget along with the audited outcomes for the previous three years. It separately highlights any public private partnerships that are being undertaken by any of the departments and the budgets of the public entities;

**Annual financial statements and department reports**

- Departmental annual reports that incorporate the audit report and the audited financial statements including statement of financial assets and liabilities and a cash flow statement by 31 August each year; and
- The medium-term budget policy statement which is submitted to parliament at the beginning of the budget cycle.

**Table 22: Availability of budget information**

Elements of budget documentation	Availability	Notes
Macro-economic assumptions, incl. at least estimates of aggregate growth, inflation and exchange rate	Yes	KZN provincial budgetary documentation for 2010/11, 2011/12 and 2012/13 includes information relating to KZN's socioeconomic outlook, economic growth, structure and performance, labour market and development indicators analysis, population, education, health and housing.
Fiscal deficit, defined according to GFS or other internationally recognised standard	Not applicable at provincial level	KZN provincial budgetary documentation for 2010/11, 2011/12 and 2012/13 revealed budget surpluses. Fiscal deficit defined according to GFS is presented in the macroeconomic framework at a National Treasury level. The KZN provincial internal policy is to not borrow or approve loans guarantees.
Deficit financing, describing anticipated composition	Not applicable at provincial level	KZN provincial budgetary documentation for 2010/11, 2011/12 and 2012/13 revealed budget surpluses hence no deficit financing required by the province.
Debt stock, incl. details at least for the beginning of the current year	Not applicable at provincial level	KZN provincial budgetary documentation for 2010/11, 2011/12 and 2012/13 revealed zero debt stock for all provincial departments.
Financial assets, incl. details at least	Yes	Information on financial assets is included in the

for the beginning of the current year		2010/11, 2011/12 and 2012/13 KZN provincial budgetary documentation e.g. budget surplus funds which generates interest for the province during the year.
Prior year's budget out-turn, presented in the same format as the budget proposal	Yes	Information related to prior year's KZN provincial budget outturn is included in the estimates of provincial expenditure and revenue documentation for 2010/11, 2011/12 and 2012/13 financial years and is presented in the same format as the budget proposal.
Current year's budget (revised budget or estimated out-turn), presented in the same format as the budget proposal	Yes	Information related to current year's KZN provincial budget estimate, adjusted budget and forecast out-turn is included in the estimates of provincial expenditure and revenue documentation for 2010/11, 2011/12 and 2012/13 and is presented in the same format as the budget proposal.
Summarised budget data for both revenue and expenditure according to the main heads of the classification used, including data for current and previous year.	Yes	The estimates of provincial revenues and expenditure documentation for 2010/11, 2011/12 and 2012/13 includes summarised budget data according to the main heads of classification by departments (votes), economic classification (GFS) and programmes for both revenue and expenditure.
Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programmes	Yes	The MEC for Finance budget speech and estimates of provincial expenditure and revenue documentation outlines all initiatives, activities, priorities as well as revenue allocation shifts and expenditure forecasts. New initiatives at departmental level are presented separately by programmes with carry through estimates.

Indicator	Score	Evaluation
<b>PI-6 Comprehensiveness of information included in budget documentation</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Proportion of information mentioned above and contained in the most recent budgetary documentation published by the central government	A	Comprehensive budget documentation fulfils all applicable elements at a provincial level. (Note: Only six elements, all of which were achieved, were applicable at a provincial level).

## PI-7: Extent of unreported government operations

### Dimensions to be assessed (scoring method M1):

- (i) Level of extra-budgetary expenditure (not including projects financed by donors) that is not declared – in other words that does not appear in fiscal reports
- (ii) Information on income and expenditure in relation to projects financed by donors included in the fiscal reports

### (i) Level of extra-budgetary expenditure (other than donor-funded projects), which is unreported, i.e. not included in fiscal reports

In PI-7(i), it is necessary to seek potentially unreported government operations in expenditures, revenues and financing. In South Africa, the reporting is directed by the PFMA and regulations and any changes are determined at national level. The level of reporting, as can be verified in the annual financial statements, is extensive and detailed, with disclosures covering all items of expenditures, revenues, financing, assets, accrual, commitments and liabilities, irregular, unauthorised, wasteful and fruitless expenditure.

It is possible that the exhaustiveness of the statements is not assured due to failing internal controls, but it is not possible to determine to what extent this would lead to unreported operations.

There are a number of specific cases that have been investigated in terms of internally generated funds. As IGF is part of the provincial own revenues, these are fully reported and disclosed, though they are significant issues in the case of health.

Department of Education: In South Africa, schools are public and organised in quintiles. Schools in quintiles 1 to 3 cannot charge any fees while those in quintiles 4 to 5 can. These fees are paid to the schools directly and are reported as part of their financial statements, under the direction of their boards. By law, these fees are not public monies (schools' revenues are excluded by PFMA Schedule 4: exclusion from revenue fund). Note that the assets created belong to the government. Schools are allowed in principle to raise debt, subject to authorisation from the HOD of DOE but this is not currently allowed. However if a school were to decide to override that authority, DOE would be legally bound to accept its position.

Property Rates: There is a potential non-payment of rates for properties on tribal land in municipalities (Traditional Levies Act): this would be negligible in any case but the commitment to pay rates should be reported. We note that all transfers to the King are done through Royal Household Department and to the *Inkosi* (chief) by bank transfers, giving greater transparency to communities.

Movable assets registers: There is potentially an issue with the current value disclosed for each asset.

Department of Public Works: As the department acts as a service provider to other department, accrued invoices from contractors are not shown in its AFS but should be reflected in its client department's AFS as a commitment. The exhaustiveness of this disclosure is not ascertained.

Department of Health: For lack of controls and largely relying on manual cash payments for user fees in institutions, it is not possible to determine the share of unreported lost user fees (collected not reported, corruption). This is compounded by the practice of some public sector doctors who are also practicing in their private capacities, being paid privately by clients but using public facilities and equipment.

### (ii) Income/expenditure information on donor-funded projects which is included in fiscal reports

No donor-funded projects are signed at provincial level. In the past, there has been support for this from the South African Development Bank, but this was terminated in 2010. The donor funds are transfers from the national departments, fully reflected as receipts and expenditures in the annual financial statements. One instance of direct donor activity at provincial level has been found, amounting to less than R2 000 000, i.e. less than 1 per cent of revenue.

**Table 23: Comparison of foreign aid receipts with total receipts**

R' 000	2010/11	2011/12	2012/13
Total provincial revenues	75 892 026	80 007 626	87 089 112
Foreign aid through RDP account	101	0	0
Foreign aid from other sources	46 297	5 931	1 850
Total foreign aid	46 398	5 931	1 850
<b>% Foreign aid / provincial revenues</b>	<b>0.061%</b>	<b>0.007%</b>	<b>0.002%</b>

Sources: provincial treasury, consolidated annual financial statements

### On-going and planned activities

N/A

Indicator	Score	Evaluation
<b>PI-7 Extent of unreported government operations</b>	<b>NR</b>	<b>Scoring method M1</b>
(i) Level of extra-budgetary expenditure (as distinct from that for projects financed by donors) which is not declared, in other words does not appear in fiscal reports	NR	The data available in the AFS and the investigations in specific departmental issues does not indicate that unreported government operations represent a large share of total expenditures. However it is possible that some IGF go unreported, as in DOH, or accrual as in the case of works managed by the DOPW, though this is likely to be small. In absence of data it is not possible to rate this dimension.
(ii) Information on income and expenditure relating to projects financed by donors that is included in fiscal reports	A	All donor funds transferred to the province are reflected in the estimates of provincial revenue and the overall amount is less than 1 per cent of revenue.

**PI-8: Transparency of intergovernmental fiscal relations**

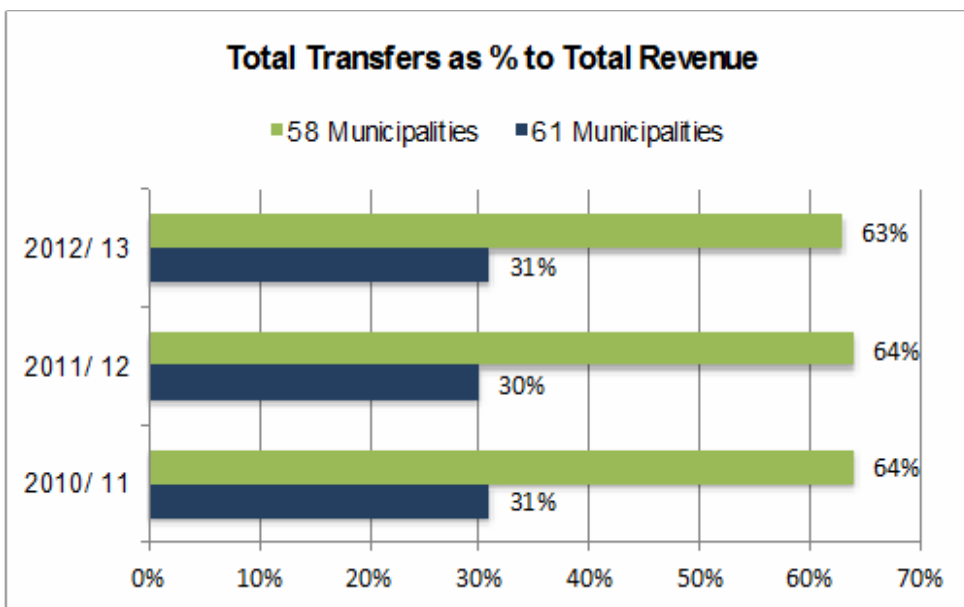
**Dimensions to be assessed (scoring method M2):**  
*(i) Transparent systems based on regulations governing horizontal allocations to municipalities of unconditional and conditional transfers from provincial government (budgeted and real allocations).*  
*(ii) Timely provision of reliable information to municipalities on the allocations to be made to them by Provincial Government for the following year.*  
*(iii) Degree to which consolidated general government fiscal data (at least on income and expenditure) is collected and made available, broken down by sector categories*

In South Africa, there are three spheres of government: national and provincial departments and local government (municipalities). Legislation applicable to municipalities includes the Municipal Finance Management Act (MFMA) and DORA. The fiscal year for municipalities is 1 July to 30 June 30.

Funds are transferred from national departments to municipalities in the form of equitable share and conditional grants. Provincial departments transfer conditional grants to municipalities to implement selected service delivery responsibilities. Conditional grants are geared toward infrastructure and capacity building. There are 61 municipalities in KZN of which three (Ethekwini, Msunduzi and Mhlathuze) are directly accountable to the National Treasury due to their critical importance from a GDP perspective. The supervision of the remaining 58 municipalities has been delegated to KZN Provincial Treasury’s municipal finance unit.

Overall, transfers from national and provincial spheres of government are relatively small as the largest share of municipalities’ revenue is generated from their revenue-raising powers through property rates and service charges (electricity, water, refuse, sanitation). However, as depicted in table 22 and the graph below, the proportion of transfers is significant for the smaller municipalities (excluding the largest three).

**Graph 13: Comparison of weight of total transfers to total revenues in KZN municipalities with and without the largest three**





**Table 244: Total transfers and own revenue for 61 municipalities, as share of municipalities total revenues**

Municipalities (total of 61) R'000	2010/11	2011/12	2012/13
National transfers (equitable share and conditional grants)	10 086 039	11 133 196	12 814 385
Provincial transfers	1 441 062	1 153 984	1 452 157
Total operating own revenue	25 527 676	29 254 646	32 213 290
Total	37 054 777	41 541 826	46 479 832
Total transfers % to total revenue	31%	30%	31%

Source: DORA 2010, KZN EPRE 2013/2014, National Treasury, budget and reporting schedules A1 to A10 (KZN)

**Table 25: Total transfers and own revenue for 58 municipalities, as share of municipalities total revenues**

Municipalities (total of 58) R'000	2010/11	2011/12	2012/13
National transfers (equitable share and conditional grants)	6 999 104	8 098 757	9 451 943
Provincial transfers	1 441 062	1 153 984	1 452 157
Total operating own revenue	4 796 954	5 316 840	6 413 748
Total	13 237 120	14 569 581	17 317 848
Total rules based transfers	6 999 104	8 098 757	9 451 943
Total transfers % to total revenue	64%	64%	63%

Source: DORA 2010, KZN EPRE 2013/14, National Treasury budget and reporting schedules A1 to a10 (KZN)

The equitable share allocated to municipalities is based on census data and is allocated annually in DORA in terms of section 214(1) of the Constitution. To ensure predictability, indicative allocations are published for the second and third years of the MTEF.

The equitable share formula uses demographics and other data to determine each municipality's share and is made up of five components:  $LES = BS + (I + CS) \times RA \pm C$

The five components are:

- The basic services component (free basic services for poor household) (BS);
- The institutional component (I) to afford basic administrative and governance capacity and perform core municipal functions;
- A community services component (CS) providing services not included under basic services;
- The revenue adjustment factor (RA) ensures that funds are only provided to municipalities with limited potential to raise own revenues; and
- A correction (C) and stabilisation factor that provides predictability and stability, and ensures that the formula's guarantees can be met.

National government allocates funds to municipalities through conditional grants, which are categorised under infrastructure and capacity building. The emphasis on infrastructure investment is supported by significant increases in the infrastructure conditional grants.

Provincial transfers from departments to municipalities occur on the basis of the national and provincial priorities and programmes, using specific criteria on a project basis. There is no specific rule allocating resources amongst the municipalities and as such all municipalities do not receive funding from the province in a given year. The departments and municipalities generally enter into service level agreements and transfers are conditional upon satisfactory progress and service delivery.

**Table 26: Rule-based transfers for 61 municipalities, as share of total transfers**

Municipalities (total of 61) R'000	2010/11	2011/12	2012/13
Total rules-based transfers	10 601 387	11 625 963	13 368 665
% rule-based transfer to total transfers	87%	91%	90%

Source: DORA 2010, KZN EPRE 2013/2014, National Treasury budget and reporting schedules A1 to A10 (KZN)

**Table 276: Rule-based transfers for 58 municipalities, as share of total transfers**

Municipalities (total of 58) R'000	2010/11	2011/12	2012/13
Total rules-based transfers	7 514 452	8 591 524	10 006 223
% rule-based transfer to total transfers	83%	88%	87%

Source: DORA 2010, KZN EPRE 2013/14, National Treasury Budget and Reporting Schedules A1 to A10 (KZN)

The bulk of the provincial transfers are administered by Department of Cooperative Governance and Traditional Affairs (COGTA), Human Settlements, Health and Public Works.

Department of Human Settlement: The department has a five-year strategic plan incorporating various projects which are aligned to the provincial growth and development plan. Due to the nature of housing developments, these are long-term projects and funds are not transferred in advance to the municipalities (implementing agents). In respect of conditional grants, DHS prepares and submits monthly business plans incorporating cash flows per project to NDHS and, on the basis of these plans the National Treasury will provide approval for Provincial Treasury to release funds to DHS. DHS allocates funds for rectification of houses, hostels/community residential unit programmes, accreditation of municipalities and transfers to households.

Municipalities are required to submit housing development proposals to DHS which should be aligned to their integrated development plans. The housing proposals will be assessed by DHS to determine the feasibility of the process and to determine if the proposal is aligned to the DHS's and provincial development plans. If approved, the municipalities will proceed with the development and will only be paid by DHS once the relevant documentation and approval has been completed by DHS at each stage of the development process.

Department of Cooperative Governance and Traditional Affairs: In respect of COGTA, the bulk of the transfer payments, such as the corridor development, massification and the small town rehabilitation programmes, are usually budgeted for under goods and services during the budget process. They are reclassified as transfers and subsidies to provinces and municipalities in the adjustments estimate if the municipalities have the required capacity to implement the projects. Municipalities are required to submit proposals to COGTA for assessment on which the funding will be granted.

Department of Health: The transfers from DOH are made to a single grant, namely municipal clinics within the sub-programme for community health clinics. Although these funds have been earmarked for transfer to municipalities, the transfer is dependent on the provision of satisfactory services in line with service level agreements signed by municipalities. The purpose of the transfer is to subsidise primary health care for services provided by local authorities/municipal clinics. DOH had taken a decision to provide additional funding to meet the health funding requirements of the clinics.

Department of Public Works: The allocations from DOPW relate to rates payments in respect of the devolution of property rate funds grant. As part of the devolution process, the national Department of Public Works (DOPW) assisted provinces in setting up systems for paying property rates, and budgets have been adjusted to provide for property rates bills. The funds from this grant are absorbed into the equitable share allocation from 2013/14.

## **(ii) Timeliness of reliable information on fiscal transfer allocations to LGAs**

The municipal equitable share of revenue, which resides under the auspices of DORA, is known in February each year when DORA is tabled, and adjusted in November during the MTEF mid-term review. For the conditional grants, managed by national and provincial departments, the MTEF framework provides firm guidelines for the provinces' budget process and their budget is tabled in March of the current year. The

municipalities' fiscal year is from 1 July to 30 June providing an opportunity to base their budget preparation on the MTEF allocation. Budgets are then finalised on the tabled estimates at both national and provincial levels.

In terms of MFMA circular number 59 relating to the 2012/13 MTEF for municipalities, the National Treasury gazettes and sends allocation letters informing each municipality of its equitable share, national conditional grant and provincial transfers (as reflected in the relevant provincial budget/gazette) in keeping with section 29 of the PFMA, usually when the MEC of Finance tables the budget in March each year.

### **(iii) Extent of consolidation of fiscal data for general government according to sectoral categories**

The municipal annual financial statements are submitted to the AG by 31 August according to section 126 of the MFMA which requires financial statements to be submitted to the AG within two months of the financial year end. Once the annual financial statements have been submitted to AG, they are also submitted to Provincial Treasury and the National Treasury. The entities prepare financial statements on an accrual basis in accordance with the Accounting Standards Board and using the classification format. The AG submits audit reports on those statements to the accounting officer of each municipality within three months of receipt of the statements, i.e. by 30 November each year.

There is no specific legislation governing the requirement to submit the financials to the National or Provincial Treasuries. However in terms of Section 74 of the MFMA, the accounting officer of a municipality must submit information, explanations and motivations as may be prescribed or as may be required to the National Treasury, Provincial Treasury, COGTA or the AG. This section was invoked in requesting municipalities to submit their financial statements to Provincial Treasury and the National Treasury.

The municipalities report their pre-audited outcomes electronically in the national classification format to the National Treasury using the operating statement, the capital acquisition and the cash flow as prescribed by it. The municipalities are also required to send a scanned copy of the pre-audited annual financial statements to the National Treasury. Once the AG has completed the audit, the information is resubmitted electronically in the same format for updating.

The National Treasury prepares and publishes the information on the website and consolidates the figures into a budget summary document which includes the audited financial outcomes. The publication dates on the website for the consolidated annual information (referred to as the summary dimensions - multiple budgets and reporting regulations format) is reflected as November 2011 and November 2012 respectively, i.e. eight months after the close of the national and provincial fiscal year and five months after the close of the municipalities' fiscal year. The 2012/13 audited information is currently in the process of being consolidated and should be available in December 2013.

### **On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-8 Transparency of intergovernmental fiscal relations</b>	<b>A</b>	<b>Scoring method M2</b>
i) Transparent systems based on regulations regarding horizontal allocation between local governments of unconditional and conditional transfers from provincial government (budgeted and real allocations)	A	The transfers from national government are formula based and rule-driven while transfers from provincial government apply criteria by departments that meet provincial and national policy objectives. Overall, the NT transfers are equal or higher than 90 per cent of total transfers for all 61 municipalities in the last two years. It is slightly below 90 per cent when excluding the largest three municipalities falling directly under the supervision of the National Treasury.
ii) Punctual provision of reliable information to local governments about the allocations to be made to them by provincial government in the coming year	A	All municipalities are provided reliable guidelines and information prior to the start of their detailed budget procedures. The municipalities' fiscal year starts three months later than the national and provincial ones, allowing sufficient time to integrate estimates of equitable share and conditional grants.
iii) Degree to which consolidated fiscal data is gathered and made known (at least in terms of income and expenditure) relating to general government, broken down by sector categories	A	100 per cent of municipalities fiscal information is consolidated at NT level using the NT established classification within eight months of the close of the fiscal year (national and provincial) and five months of the close of the municipal fiscal year.

**PI-9: Oversight of aggregate fiscal risk from other public sector entities**

**Dimensions to be assessed (scoring method M1):**  
 (i) Degree of province monitoring of the main autonomous public organisations and state companies.  
 (ii) Degree to which the province monitors the fiscal position of local government

**(i) Extent of central government monitoring of autonomous government agencies and public enterprises**

The Provincial Treasury has an oversight role in relation to public entities in KZN and prepares the consolidated annual financial statements for 14 entities (in terms of Schedule 3 (c) and 3 (d) of the PFMA, listing the public entities and business enterprises which have been formally legislated under PFMA). The consolidation at a provincial level does not include entities which have not been formally converted from a section 21 company to listed public entity.

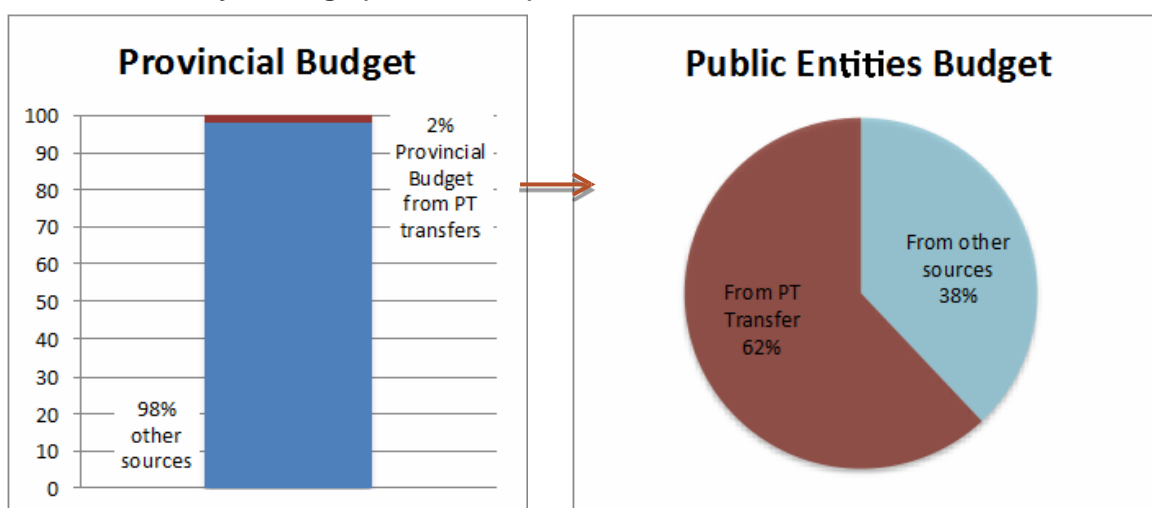
The listed public entities in KZN fall within the ambit of and are accountable to specific parent government departments i.e. Department of Economic Development, Office of the Premier, Department of Agriculture and Environmental Affairs, Royal Household and Department of Cooperative Governance and Traditional Affairs (COGTA) in KZN. The entities are regulated by chapter 6 of the PFMA in respect of budget preparation and approval, budget execution including cash management, internal controls and procurement, annual financial statements and audits. Public entities can either be fully funded by transfers from their parent department or be semi-autonomous by generating their own revenue.

**Table 28: Provincial transfers to public entities in terms of Schedule 3 of the PFMA**

	2010/11	2011/12	2012/13
Total transfers from PT	1 764.00	1 706.00	1 751.00
% total provincial budget	3%	2%	2%
% total PE budgets	62%	63%	60%

Source: EPRE 2013/14

**Graph 14: Provincial budget - and budget of its public entities - coming from transfers of the Provincial Treasury. Average (2010-201313)**



The public entities' board or controlling body is recognised as the accountable authority for the purposes of the PFMA and is responsible to the MEC of the relevant parent department. The entities' governance structures are dictated by their corporate identity as some entities are trusts and others are companies. The entity will have a board of directors or trustees and specific committees including risk, internal control and human resources. The MEC and public entities board generally meet on a monthly basis.

The entities are required to have an internal audit or shared internal audit function for entities under one MEC. The entities can, in terms of the tendering process, contract out the internal audit function to an external institution with specialist expertise provided that the external auditors do not perform the internal audit. The entities are audited annually by the AG or an external auditor appointed in consultation with the AG.

Each entity submits a corporate plan covering three years (aligned with MTEF) that must include strategic objectives and initiatives and key performance indicators. An annual strategic plan must be developed and approved by the MEC. Each entity submits a budget of estimated revenue and expenditure for the new financial year at least six months before the start of the financial year for approval. The entities' budgets are published under the vote of their parent department in the EPRE. An annual service level agreement is signed between the public entity and the MEC for the department indicating the deliverables linked to the budget that has been allocated by the department.

The entities under the Department for Economic Development submit a monthly cash flow forecast (IYM) and financial report. Other entities generally submit quarterly financial and non-financial reports including an income and expenditure statement to their parent department and the Provincial Treasury. These documents are analysed by Provincial Treasury and a quarterly report is prepared by Provincial Treasury for each entity. A joint meeting is held by Provincial Treasury with the entity and department to discuss the entity's performance. The National Treasury is invited to participate in these meetings.

Corrective actions may be agreed on and followed up. However Provincial Treasury does not have specific authority to enforce compliance and can only offer support to resolve issues raised.

Provincial Treasury updates the reports with the discussion points from the quarterly reports and follows up again in the next quarter, thereby facilitating risk management. Provincial Treasury holds formal bi-laterals with the public entities twice annually. Provincial Treasury reports are sent to the Provincial Legislature.

Each entity must prepare its financial statements in accordance with GRAP and submit within two months of the financial year end to the AG with an annual report. The audited financial statements and annual report are tabled at the Provincial Legislature. The audited financial statement and the annual report must be submitted within five months of the financial year end to Provincial Treasury for consolidation. This consolidation does not, however, include a fiscal risk analysis.

Public private partnerships (PPPs) are designed by departments at national and provincial levels but are approved at National Treasury level. Although there is no formal mandate, the Provincial Treasury's PPP unit ensure a follow-up of existing PPPs and provide advice to the respective departments. The PPP framework and treasury regulation 16 indicates how departments should work with the PPP unit at Provincial Treasury up to signature of the contract. There are no regulations stipulating the procedures to be followed in managing the contracts.

## **(ii) Extent of central government monitoring of SN governments' fiscal position**

In terms of Section 3 of the Borrowing Powers Act (Act No. 48 of 1996), no person other than the responsible member may borrow monies on behalf of a provincial government. Anybody established by a provincial government may only accept financial assistance from anybody other than the national government with written approval.

Local government (municipalities) cannot generate fiscal liabilities for provincial or national government. A municipality may incur both short- and long-term debt on its own behalf without approval from Provincial Treasury as it is independent. A municipality is required to inform Provincial Treasury of its intention to borrow prior to incurring debt. Provincial Treasury will analyse the municipality's submission and make recommendations. However, the municipality is not obliged to adhere to the recommendations. Neither Provincial Treasury nor the National Treasury is liable to honour the debt of a municipality should the municipality default. From a constitutional perspective, however, the National Treasury may intervene to ensure continuation of service delivery at a municipality.

## **On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-9 Oversight of aggregate fiscal risk from other public sector entities</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Degree to which the provincial government monitors the autonomous public organisms (AGAs) and public companies (EPs)	A	The entities' budgets are reflected in the EPRE and they report to their parent departments monthly and PT quarterly. The annual financial statements are audited annually by the AG. A consolidated annual report is prepared by PT though it does not address fiscal risks.
(ii) Degree to which the provincial government monitors the fiscal position of sub-provincial governments	A	Municipalities cannot generate fiscal liabilities for provincial and national government.

## PI-10: Public access to key fiscal information

### **Dimensions to be assessed (scoring method M1):**

***(i) Number of the elements regarding public access to information, mentioned in table 3.5 that are used (an element can only be considered for the purposes of this evaluation if it fulfils all the requirements)***

Public access to key fiscal information is protected by the Constitution<sup>7</sup> which stipulates that information should be timely, accessible and accurate to foster transparency of public administration. The Promotion of Access to Information Act (Act No. 2 of 2000) lays down the procedures for accessing information from government. Fiscal transparency is underpinned by accessible and useable information by the public and civil society. The Provincial Treasury runs financial literacy education campaigns to enable effective participation.

The information available to the public covers the full budget cycle i.e. budget formulation, budget process and budget execution. Public access to key fiscal information in KwaZulu-Natal is transparent, generally comprehensive, user friendly and timely. The main source of information is the internet, though relevant information is also made available through other means such as public libraries and provincial printed media. The importance of dissemination of fiscal information is recognised by both the provincial government and as the public.

Budget documents are made available to the public at the time they are tabled by KZN MEC for Finance in the Provincial Legislature. Legislature sessions on budget discussions are open to the public and are broadly discussed in the printed media. Following the KZN Province budget speech in the Legislature, a succinct and easy to read version of the budget called "Budget at a Glance" is published in print and is distributed to the general public.

Provincial Treasury has embarked on a number of budget road shows and financial literacy programmes across KZN. The objective is to educate the public on budgetary processes as well as financial activities and issues.

On a monthly basis, consolidated KZN provincial in-year monitoring reports incorporating revenue and expenditure budget/actual analysis are forwarded to the National Treasury which aggregates them on a quarterly basis and makes them available to the public via its website within one month after the end of each quarter. In addition, the Auditor-General's Manual on the Promotion of Access to Information Act (PAIA) provides guidelines on the free provision to the public of a number of reports including annual reports of provincial departments.

The Public Finance Management Act (section 55 (d)) stipulates that the relevant accounting officer must submit an annual report detailing the department's business activities, financial results, financial position and performance against predetermined objectives within five months of the end of the financial year. In addition, annual reports also include information on the department's strategic overview, objectives, structure, governance, human resources management, financial information, annual financial statements and external audit report of the Auditor-General. These annual reports are made available to the public via the provincial department's websites.

With regards to public information on procurement, a 'tender bulletin' is published weekly in which KZN provincial departments advertise bids and awards for procurement greater than R500 000 (approximately \$50 000). The bulletin is accessible via the National Treasury website. In addition, there is a tender information centre located in the National Treasury as well as a helpdesk for telephonic inquiries.

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<sup>7</sup> The Constitution of the Republic of South Africa (Act No. 108 of 1996), chapter 2, section 32  
Page 56



Elements of information for public access	Availability	Notes
Annual budget documentation when submitted to the legislature	Yes	Made available to the public through the provincial websites and public libraries following submission to the KZN province legislature. The annual budget documentation includes all provincial applicable elements mentioned in PI-6. (Note: Only six elements are applicable at a provincial level).
In-year budget execution reports within one month of their completion	Yes	Public has ready access to regular and reliable information on KZN provincial in-year monitoring reports which includes budget implementation via The National Treasury website. These are made available to the public within one month after close of quarter.
Year-end financial statements within six months of completed audit	Yes	Audited year-end financial statements are included in departmental annual reports which are tabled in KZN legislature and are made available to the public via their respective website as well as print within five months after the end of the year.
External audit reports within six months of completed audit	Yes	External audit reports from Auditor-General are included in departmental annual reports which are tabled in KZN Legislature and are made available to the public via their respective website as well as print within five months after the end of the year.
Contract awards (app. US\$100 000 equivalent) published at least quarterly	Yes	For procurement greater than R500 000 (approximately \$50 000) awards are published weekly by the respective provincial departments in the tender bulletin which is available to the public via The National Treasury website.
Resources available to primary service unit at least annually	No	Information relating to resources available to primary service unit level (ie elementary schools or primary health clinics) is available from BAS but is not published annually.

Indicator	Score	Evaluation
<b>PI-10 Public access to key fiscal information</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Number of elements listed above regarding public access to information that are fulfilled	A	Five of the six listed elements of information are made available to the public access via websites and print media.

### 3.3 Policy based budgeting

#### PI-11: Orderliness and participation in the annual budget process

**Dimensions to be assessed (scoring method M2):**

- (i) Existence and observance of a fixed budget calendar*
- (ii) Guidance on the preparation of budget submissions*
- (iii) Timely approval of the budget by the legislature*

- (i) Existence of and adherence to a fixed budget calendar**
- (ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions**

South Africa has adopted a medium-term expenditure framework (MTEF) as part of its annual budgeting process. The objectives of the MTEF is to develop an effective resource framework, providing guidance and assurances on resource allocations for two outer years to the current year and to improve the reallocation of resources to strategic priorities. This is facilitated by the programmatic classification of the budget.

The budget process is guided by a clear and comprehensive document titled medium-term expenditure framework treasury guidelines, issued in June of each year to prepare the next year's budget. A workshop led by the Provincial Treasury clarifies the application of the guidelines and formats for all departments and public entities.

The guideline reflects budget ceilings communicated to Provincial Treasury by the National Treasury in two forms:

- Movements in the equitable share baselines for the new MTEF as a result of underlying macro- economic factors and demographic changes. Following the 2011 national census, KwaZulu-Natal will have to factor in a significant reduction to its baseline from 2013/14. In addition to the equitable share from the Division of Revenue Act, the Provincial Treasury includes provincial own revenues.
- Separate instructions on the proposed changes to conditional grants, managed by national departments.

Departments have the opportunity throughout the budget cycle to adjust their budgets, with a first submission in August, a second in November and a final submission in January. This allows the factoring of national changes to conditional grants and the incorporation of new programmes following the bid for resources over and above the baseline.

Between the first submission in August and the final submission, departments are required to ensure that their budget submissions and annual performance plans (APPs), as well as the input from the public entities, are discussed with the relevant portfolio committees of the legislature before they are submitted to the Provincial Treasury, thus ensuring the involvement of political leadership in the budget preparation process. Although there is no formal endorsement of the portfolio committees, this process complements the oversight of the ministers' committee on the budget (MinComBud) and Cabinet. The MinComBud is a committee comprising of the Minister of Finance and three selected MECs appointed by the Premier. It is a smaller technical sub-committee of the Cabinet, which deliberates on budget priorities and is most closely involved in the development and oversight of the upcoming budget.

The departments submit their funding requests (bids) and baseline reprioritisations to Provincial Treasury during the medium-term expenditure committee (MTEC) process in August. The accounting officer (AO), chief financial officer (CFO), senior officials and public entities are invited to the first MTEC hearings in September. MTEC is a technical committee that evaluates departmental budget submissions, and makes recommendations to the MinComBud. During this process Provincial Treasury requires proof of political support for funding requests and reprioritised budgets. The MinComBud recommendations are presented to Cabinet for final approval on which Provincial Treasury will issue preliminary allocation letters to departments. The MEC for Finance tables the provincial budget before the Provincial Legislature in March.

Table 27 reflects the detail budgetary cycle applied in KZN. This indicates that departments have at least six weeks before the first budget submissions and another 12 weeks before the second submission. In total, departments are allowed at least 24 weeks before their final budget submission.

Department of Education (DOE): the KZN DOE feels that that has insufficient time to compile meaningful detailed estimates and requires more time for interaction with stakeholders.

**Table 29: Budget process timeline and roles of each entity**

Month	Budget and MTEF	Dept	PT	NT	Legislature
June	PT holds a workshop for departments to present the MTEF treasury guidelines document. This includes ceilings emanating from NT and PT	X	X	X	-
June	Departments commence preparation of next year's budget	X	-	-	-
June	Functional budget group discussions (previously called 10 x 10) <sup>8</sup> on priorities affecting next year's budget and the MTEF	X	X	X	-
August	Departments submit their first draft APPs and budget (and MTEF) submissions to PT. On submission, departments engage with their respective portfolio committees on their proposed budget before second submission	X	-	-	-
August	PT submits the draft budgets for preparing the medium-term budget policy statement (MTBPS) and first draft APPs to NT	-	X	X	-
September	MTEC hearings take place to evaluate the departmental budget proposals	-	X	-	-
November	A second round of MTEC hearings takes place to give certain departments an opportunity to provide further input in respect of their proposed allocation including bids for additional funding	X	-	-	-
November	The MinComBud convenes to consider recommendations by MTEC and recommend the budget (and MTEF) allocations to the provincial Cabinet	-	X	-	-
November	PT receives an allocation letter from NT for next year's budget (and MTEF)	-	X	X	-
November	On provincial Cabinet's approval of the MinComBud recommendations, the departments receive their budget allocation letters from the PT for the next year's budget (and MTEF)	X	X	-	-
November	Departments' second budget submission and final draft APPs to PT	X	X	-	-
March	The MEC for Finance tables the provincial budget (budget speech) before the provincial legislature	-	X	-	X
March	Departmental budget hearings with finance portfolio committee	X	-	-	-

<sup>8</sup> 10\*10 refers to the nine provinces and national department meeting with nine provincial treasuries and The National Treasury

April	Start of fiscal year: spending is authorised by PFMA	-	-	-	-
April/May	Approval of budget by the Legislature	-	-	X	X
May/July	Passing of Appropriation Act	-	-	X	X

Source: KZN PT MTEF treasury guidelines 20 June 2011

### (iii) Timely budget approval by the legislature or similarly mandated body

Once the estimates of provincial revenue and expenditure (EPRE) are tabled in March of the current year, the Legislature reviews and debate it. The MEC for Finance tables the provincial budget before the provincial Legislature in March. Thereafter the finance portfolio committee hears all departments and public entities before presenting its report to the House. Each departmental budget is approved separately, usually from April to May, i.e. in the new fiscal year. The Appropriation Act, prepared by PT, is normally enacted in July, i.e. three or four months after the start of the fiscal year.

Section 29 of the PFMA allows expenditure of budget funds prior to the approval of an annual budget.

The table below reflects the dates that the Legislature approved the budget for the last three financial years, bearing in mind that the fiscal year starts on 1 April.

**Table 30: Approval of budget by legislature and passing of Appropriation Act**

Financial year	Budget approval	Time lapsed	Appropriation Act signed	Time lapsed
2010/11	April	0-30 days	1 June 2011 and 23 February 2012	60+ days
2011/12	April	0-30 days	Unknown	Unknown
2012/13	June	60-90 days	17 July 2013	107 days

Source: KZN Legislature and PT Public Finance office<sup>9</sup>

### On-going and planned activities

N/A

<sup>9</sup> The assessment team was unable to confirm the dates reported. Based on interviews and data available, we have reconstituted this table. For scoring, the approval by the legislature is retained. This may lead to changes once dates are confirmed.

Indicator	Score	Evaluation
<b>PI-11 Orderliness and participation in the annual budget process</b>	<b>B+</b>	<b>Scoring method M2</b>
(i) Existence and observance of a fixed budgetary calendar	A	A clear and comprehensive budget calendar is prepared and generally adhered to. It allows departments approximately two months to prepare their detailed estimates from the date of receipt of the MTEF treasury guidelines. Departments have another 12 weeks before their second submission to Provincial Treasury and this includes engagement with their relevant portfolio committees.
(ii) Directives on the preparation of budgetary documents	A	A clear and comprehensive budget circular is presented to the departments at the commencement of the budget process, and reflects budget ceilings communicated by NT. Departments must ensure that their APPs and budget (and MTEF) submissions have been discussed with the relevant portfolio committees before submission to Provincial Treasury. The MinComBud considers recommendations by MTEC and recommends the budget (and MTEF) allocations to provincial Cabinet for approval.
(iii) Timely approval of the budget by the legislature	C	During the three years under review, as is customary, the budget has been approved by the Legislature within two months after the start of the fiscal year for the last three years.

## PI-12: Multi-year perspective in fiscal planning, expenditure policy and budgeting

### **Dimensions to be assessed (Scoring method M2):**

*(i) Preparation of multi-year fiscal forecasts and functional allocation*

*(ii) Scope and frequency of debt sustainability analysis*

*(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure*

*(iv) Linkages between investment budgets and forward expenditure estimates*

### **(i) Preparation of multi-year fiscal forecasts and functional allocations**

South Africa has adopted a MTEF on a three-year rolling basis. This format is applied at provincial level too. The provincial MTEF details expenditure and revenues for all three years using the annual budget classification (vote, programme and sub-programmes, and economic classification). This is based on three-year macro fiscal forecasts, that are established at national level. The multi-year estimates are performed within specific budget ceilings, reflecting increased baseline and conditional grants for three years on a rolling basis. Whilst preparing the MTEF budget, provincial departments are required to focus on the national outcomes, the NGP, the PGDS, as well as the PSEDS, ensuring close alignment between priorities and spending programmes.

The budget ceilings reflect the proposed movements in the equitable share baselines for the new MTEF as a result of underlying factors such as inflationary wage adjustments. The circular provides separate instructions on the proposed changes to conditional grants as these are finalised only later in the budget cycle.

The Constitution entitles each sphere of government to an unconditional equitable share allocation of revenue raised nationally. The division of revenue takes into consideration the capacity of each government to pay for functions through its own receipts and revenues. Transfers to provinces, representing a significant share and policy transmission mechanism, also take the form of conditional grants from the national departments. Own revenue refers to any additional revenue raised by the province and is not included in the calculation of the province's equitable share.

The DORA provides for the equitable division of revenue raised nationally amongst the different spheres of government based on a formula which relies on provincial population estimates. The results of the 2011 census reflect that KZN has a reduced proportion of South Africa's population when compared to 2001. This reduced the province's equitable share allocation proportionally and has placed greater emphasis on the need for grants and funding from private sector and international organisations.

Although the reduced equitable share allocation has put pressure on future budget estimates, the impact has been phased in over the three-year MTEF, resulting in a good alignment between the current budget and first outer year of the MTEF.

### **(ii) Scope and frequency of debt sustainability analysis**

The current policy of the province is not to borrow and concede guarantees (see PI-17). As such there is no debt stock and sustainability analysis is not justified.

On a more general note with regards to policy sustainability, although there is a functional group discussion forum, known as 10 x 10s, whereby the nine provincial departments meet with the national department to debate priorities and funding as part of the MTEF process, there does not appear to be a clear process mechanism which deals with how the change in national policies may impact on the future sustainability of programmes at provincial level. This is particularly important for the health sector and public sector labour negotiations. For example, the infrastructure conditional grants to health, education and transport have led to an important increase in maintenance costs that is now impacting the fiscus, at a time when the fiscal space is tightening.

### **(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure**

Each department has a five-year strategy that broadly reflects its objectives, but is not costed over this period. It is argued that the MTEF provides the costing of the strategies, using a more effective three-year rolling horizon. The five-year plans are aligned with the five-year political election cycle and guide the national strategic direction, as well as the inclusion of projects in existing programmes and new bids into the three-year MTEF.

DOT: Although the five-year strategy is not costed, the costing of recurrent and investment expenditure is performed on a project basis. The components within the KZN DOT prepare operational plans based on the future projects they expect to perform. The operational plans are assessed and prioritised by the rural road transport forum (RRTF), thereby promoting community participation through consultation with the relevant community structures. A budget committee reviews all operational plans and assesses the need for a project, taking into account its alignment with the departmental strategy and overall budget availability.

DOE: The KZN DOE's five-year strategy is not costed. Provincial plans are geared by the national policies and programmes. The South African school administration and management system (SASAMS), that aims to achieve common reporting formats, control of learners, teachers and attendance, is currently a key programme.

DOH: The five-year strategic plan includes national priorities. However, it is not costed. The costing exercise is performed as part of the three-year MTEF. Policies and decisions by national DOH and the DPSA which are not included in the provincial DOH funding have put pressure on the budget and the baseline cannot meet the requirements.

DHS: The five-year strategic plan is not costed. The APP and annual business plans will determine how to deliver on priorities reflected in the strategic plan. As with other departments, the costing exercise is done as part of the three-year MTEF. The DHS' grant for housing delivery is allocated and transferred to implementing agents, including municipalities, on delivery. Municipalities have individual integrated development plans (IDP) which drive their projects. The IDPs must align with the provincial growth and development strategy (PGDS).

#### **(iv) Linkages between investment budgets and forward expenditure estimates**

Certain departmental forecasts take into account the relationship between investments and the recurrent forward expenditure estimates when preparing their MTEF budget estimates. However, there is no formal mechanism linking capital and recurrent expenditure. Historical infrastructure development and insufficient funding of running costs and maintenance has resulted in a backlog which the current level of maintenance funding is unable to address. The conditional grants on infrastructure have further increased investment in health education and transport. However there is no formal mechanism to prevent investment in new projects where the recurrent maintenance cannot be guaranteed. Section 13 of the DORA stipulates that the receiving officer of the respective education infrastructure grant, health facility revitalisation grant or provincial roads maintenance grant must maintain a database of every contract that is fully or partially funded by the grant. Unfortunately the departmental asset management systems are ineffective in forecasting the value of the required maintenance budget.

DOT: A budget committee and the RRTF review all operational plans and assesses the need for reprioritisation. However, there are no tests to assess the future maintenance costs and their impact on the budget. The ratio between investment expenditure and forward recurrent expenditure has gradually moved to 40 per cent investment and 60 per cent maintenance over the last three years. Previously the split reflected a higher investment to maintenance ratio, resulting in maintenance shortfalls. A roads asset management system is still to be implemented which will improve the accuracy in determining future requirements.

DPW: The KZN DPW includes an operational section that advises other departments on maintenance plans for budgeting their respective provincial infrastructure plans. In terms of the Government Immovable Asset Management Act (GAIAMA), the DPW is the custodian of all immovable assets. Provincial departments are responsible for submitting an asset management plan to DPW which filters into the infrastructure plan and includes new capital expenditure. The KZN DPW determines drivers of maintenance costs and must approve departmental infrastructure plans. Provincial Treasury's infrastructure unit has the power to cancel departmental proposals for maintenance - an area of concern for the KZN DPW.

DOH: In order to fund maintenance costs of infrastructure, the provincial DOH has requested national DOH to allow 25 per cent of the infrastructure grant allocation to be used for maintenance from 2013/14. The DOH asset management plan indicates that there is a funding gap between investment and recurrent expenditure.

DHS: Prior to the commencement of any infrastructure project, the planning phase must reflect whether there is sufficient "bulk infrastructure". This is a major challenge for policy coordination. At provincial level, this is addressed partly through the work of the provincial planning commission and a number of clusters addressing sector coordination. DHS is piloting a new scheme where policy coordination has been reinforced in order to

produce positive outcomes. The responsibility for ensuring that maintenance costs are budgeted for and are sustainable is thus the responsibility of each department. This complexity is compounded by the period of implementations during which each department's priorities and fiscal space will change.

Indicator	Score	Evaluation
<b>PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting</b>	<b>C+</b>	<b>Scoring method M2</b>
(i) Multi-annual fiscal forecasts and functional allocations	<b>A</b>	The MTEF process compliance requires institutions to work within functional medium-term expenditure committee (MTEC) structures in preparation for final programme allocations and estimates of expenditure. The multi-year estimates are aligned to the budget ceilings and the process is designed to encapsulate 'top-down' macro-economic and fiscal policy processes, together with the 'bottom-up' estimated cost of existing and medium-term departmental plans and expenditure programmes.
(ii) Scope and frequency of debt sustainability analyses	<b>N/A</b>	Although the regulatory framework allows for it, the policy is not to accrue debt and guarantees.
(iii) Existence of sector strategies with cost determination	<b>D</b>	Although five-year strategic plans are prepared by departments, these are not costed. Costing of the strategies takes place as part of the MTEF, using a more effective three-year rolling horizon.
(iv) Links between investment budgets and future expenditure estimates	<b>C</b>	Certain departmental forecasts take into account the relationship between investments and the recurrent forward expenditure estimates when preparing their MTEF budget estimates. However there is no formal mechanism linking capital and recurrent expenditure. Historical infrastructure development and insufficient maintenance funding has resulted in a backlog which is exacerbated by the lack of any formal mechanism preventing new projects where the maintenance and running costs cannot be guaranteed from commencing. The forecasting of required maintenance budget is ineffective.



### 3.4 Predictability and control in budget execution

This set of indicators reviews the predictability of funds for budget execution and the internal controls and measures in place to ensure that the budget is executed in an accountable manner. The set is divided into three sub-components: Revenue administration, budget execution and cash/debt management, and internal control systems.

#### PI-13: Transparency of taxpayer obligations and liabilities

**Dimensions to be assessed (scoring method M2):**

**(i) Clarity and comprehensiveness of tax liabilities**

**(ii) Access by taxpayers to information on their tax responsibilities and administrative procedures**

(iv) **-Existence and functioning of a tax appeals mechanism**

The principal sources of KZN provincial revenue are from equitable share while provincial own revenues form approximately 3 per cent of the total receipts in the province.

**Table 31: Provincial revenue**

Description	2010/11		2011/12		2012/13	
	Actual	Weighting	Actual	Weighting	Actual	Weighting
Aggregate equitable share from national	57 632	80.0%	63 584	79.7%	68 639	79.7%
Aggregate conditional grants from national	12 353	17.2%	13 423	16.8%	14 810	17.2%
Aggregate provincial own revenues	2 041	2.8%	2 727	3.4%	2 671	3.1%
<b>Total</b>	<b>72 026</b>	<b>100.0%</b>	<b>79 734</b>	<b>100.0%</b>	<b>86 120</b>	<b>100.0%</b>

Source: EPRE 2013/14, annual financial statements 2012/13

The bulk of provincial own revenue is collected from tax receipts which comprise motor vehicle licences (DOT), and casino and horse racing taxes and liquor licences (OTP). The next largest revenue collection category is the sale of goods and services particularly health patient fees (DOH). DOT revenue represented approximately 56 per cent of the province's own revenue in 2012/13.

**Table 32: Composition of provincial revenue**

Composition of own revenue	2010/11		2012/13		2011/12	
	Actual	Weighting	Actual	Weighting	Actual	Weighting
OTP	253 612	17%	406 662	15%	448 553	17%
DOH	191 221	9%	207 998	8%	267 071	10%
DOT	1 245 979	61%	1 409 482	52%	1 502 265	56%
Other department	251 552	12%	702 817	26%	453 176	17%
<b>Total</b>	<b>2 041 364</b>	<b>100%</b>	<b>2 726 959</b>	<b>100%</b>	<b>2 671 065</b>	<b>100%</b>

Source: EPRE 2013/14, annual financial statements 2012/13

#### (i) Clarity and comprehensiveness of tax liabilities

DOH: DOH generates revenue mainly from patient fees which includes medical aid claims for services rendered, road accident fund for treatment of patients injured from public roads and other health services rendered by hospitals to patients and other departments. The patient fees are based on the uniform patient fee schedule (UPFS) which is prescribed by and updated annually by the national Department of Health.

These rates are fixed and predetermined and specifically indicate rates applicable for medical procedures and services. Free services rendered by the department are in line with the UPFS and include primary health care services at all clinics and community health centres.

DOT: The motor licensing revenue generated from tax liabilities imposed by the DOT are predominantly attributable to licence fees, driver licence card renewal fees, traffic fines, sale of vehicles and abnormal loads. The National Road Traffic Act (Act No. 93 of 1996) (NRTA) prescribes the registration and licensing of motor vehicles, manufacturers, builders and importers, as well as the licensing of drivers of motor vehicles. The NRTA Regulation 24 (2) (b) stipulates that each province determines its own registration and licence fees, which are increased from time to time by proclamation in the respective provincial gazettes. The annual licence fees are assessed on the basis of the vehicle's tare with separate scales for vehicle types. The KwaZulu-Natal Road Traffic Act and amended regulations prescribe the fees applicable for registration and licensing of motor vehicles in the province.

The Road Traffic Management Corporation (RTMC) Act 1999 stipulates how levies are collected on behalf of the national DOT. The registration and license fees are fixed and clearly defined as per the legislation and there is no discretion allowed in the application of fees.

OTP: In respect of OTP, tax receipts comprise revenue from casino, bingo, gaming and horse racing taxes. Casino revenue is collected in accordance with the KwaZulu-Natal Gaming and Betting Act (Act No. 8 of 2010).

Horse racing taxes are collected in respect of horse racing and gaming, in terms of the KwaZulu-Natal Gaming and Betting Tax Act (Act No. 9 of 2010). The Act specifies the rates applicable and payable by parties licensed in terms of the Act.

## **(ii) Taxpayer access to information on tax liabilities and administrative procedures**

DOH: The DOH fee structure is gazetted and available to all funders. In addition, the information is generally published on the hospital notice boards for easy access but this may not be applicable in all instances.

DOT: In respect of DOT, each province determines its own registration and licence fees by proclamation in the respective provincial gazettes. The registration and licence fees are clearly defined in the relevant legislation which is publicly available on the provincial DOT website. Although there is no legislated requirement to communicate motor vehicle licence renewal notices, the RTMC communicates renewal notices to vehicle owners in the province by posting notices to vehicle owners.

OTP: The fee structure in respect of casino and horse racing tariffs has been legislated and is published on the Provincial Legislature website in the Betting and Gaming Tax Act.

## **(iii) Existence and functioning of a tax appeals mechanism**

There is no appeals mechanism for DOH and OTP as the rates are legislated and not negotiable.

DOT: The payment of vehicle licences and registration fees is not negotiable. There is a waiver process which is managed administratively and this applies should there be a legitimate reason for an appeal. This, however, is rare.

## **On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-13 Transparency of taxpayers' obligations and liabilities</b>	<b>B+</b>	<b>Scoring method M2</b>
(i) Clarity and comprehensiveness of tax liabilities	A	There is generally clear and comprehensive legislation and procedures in respect of most major taxes about which government entities have limited discretionary power.
(ii) Access by taxpayers to information about responsibilities and administrative procedures in relation to taxes	B	There is public access to comprehensive, user friendly and up-to-date information on the related fees and tariffs. However there is no evidence of active education campaigns targeting taxpayers.
(iii) Existence and functioning of a tax appeals mechanism	N/A	There is no existing tax appeals system due to the process followed prior to the tariffs being gazetted.

## PI-14: Effectiveness of measures for taxpayer registration and tax assessment

### Dimensions to be assessed (scoring method M2):

#### (i) Controls in the taxpayer registration system

#### (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

#### (iii) Planning and control of tax auditing programmes

### (i) Controls in the taxpayer registration system

DOH: In line with the uniform patient fee schedule (UPFS), patients are either given free service or charged a specific fee. The fee is charged on the basis of a patient's level of income. This, however, is based on verbal information, so there is no guarantee that the information provided by the patient is correct. DOH does not have a mechanism to validate a patient's claim and could therefore be under-collecting revenue. The system is manually maintained and the controls in terms of compliance and monitoring are weak.

DOT: All new vehicles in the province are registered and recorded on the national traffic information system (eNaTIS) at the point of manufacturer or entry. eNaTIS is an online system that supports the relevant legislation in terms of motor vehicle registration and licensing. The purpose of eNaTIS includes the registration of all motor vehicles and the identification and monitoring of the source of motor vehicles through the registration of motor vehicle manufacturers, importers and builders. The system identifies the title holder and owner of every registered motor vehicle and facilitates the collection and recovery of annual and outstanding motor vehicle licence fees. The South African Revenue Service (SARS) has access to eNaTIS but the DOT is responsible for collecting taxes in respect of vehicle registration and licensing.

OTP: The KwaZulu-Natal Gaming and Betting Tax Act 2010 stipulates that gambling can only be conducted in accordance with the Act. Prospective licencees must apply and pay the required fee as set out in the Act. Applications are open to public inspection. The Board must hold a hearing for each application and the hearing must be accessible to the public. The monthly amounts payable by the gambling operators are specified in the KZN Gaming and Betting Tax Act, 2010 (Act No. 9 of 2010).

### (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

DOH: There are no penalties in respect of the under-collection of fees.

DOT: Failure to license or register a vehicle will result in penalties being charged. The penalties are incurred automatically from the date of non-compliance and remain on the system until settled. According to regulations, the penalties are calculated as one tenth of the appropriate fee for every month or part month that the licence remains unpaid.

OTP: The provisions of section 78, 135 and 145 of the Act are applicable if the licensee fails to pay or underpays the tax prescribed in terms of the Betting Act and this is regarded as an offence. The licence can be suspended according to section 78 and 135 of the Act which stipulates that the licence is immediately suspended until all taxes due along with penalty interest are paid. Penalty interest is calculated at 30 per cent per annum in terms of the Act. In terms of section 145 any person convicted of performing any licensable act in terms of gambling without a valid licence is liable for conviction and any competent forfeiture. In addition to any other penalty a person convicted must pay into the provincial revenue fund such amount as Provincial Treasury determines, provided that such amount does not exceed R500 000.

Anyone convicted of an offence involving the non-payment or underpayment of any tax or deduction in terms of the Act must, on demand by the Board, pay to the Board an amount equal to the unpaid tax or deduction payable, together with the penalty interest. This amount must be paid to the provincial revenue fund and its beneficiaries. Any penalty imposed by a court under this section accrues to the provincial revenue fund.

### (iii) Planning and monitoring of tax audit and fraud investigation programmes

DOH: DOH conducts assessments. However, the system is manual and there is no audit trail to validate the revenue that is recorded at the health institutions.

DOT: There are 83 registering authority (RA) agents contracted to the DOT to facilitate registration and licensing function throughout the province. Audits may be performed by the motor transport services directorate, the DOT administrative compliance component or the RA management. The audits focus on procedural, financial or eNaTIS system functionality, depending on the preliminary finding. Audits or inspections, also known as special tasks, are performed in instances where fraud has been detected at any of the RA sites.

OTP: Provincial Inspectors are appointed by the gaming and betting board for the purpose of generally ensuring that the gambling industry is regulated and undertaking audits or investigations into gambling operations. OTP undertakes an annual audit plan. Monthly audits are done for monitoring the correct revenue collection and banking costs.

### On-going and planned activities

N/A

Indicator	Score	Evaluation
<b>PI-14 Effectiveness of measures for taxpayer registration and tax assessment</b>	<b>A</b>	<b>Scoring method M2</b>
(i) Application of controls in the taxpayer registration system	A	For DOT and OTP, the database system and linkages exist. However, DOH does not have a system in this regard. OTP and DOT comprise 95 per cent of total own revenue for the province. Based on weighting of revenue, the indicator was scored as A.
(ii) Effectiveness of sanctions for failure to register and declare taxes	A	There are effective penalties for DOT and OTP but no penalties are applicable to DOH.
(iii) Planning and control of tax audit programmes	B	There are effective audit plans and inspections for DOT and OTP. The risk assessments for DOH are manual and therefore weak. This impacts on the overall score.

**PI-15: Effectiveness in collection of tax payments**

**Dimensions to be assessed (scoring method M1):**  
 (i) *The collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of fiscal year, which was collected during that fiscal year (average of the last two fiscal years)*  
 (ii) *Effectiveness of the transfer of tax payments to the Treasury by the revenue administration*  
 (iii) *Frequency with which the Treasury completely reconciles accounts reflecting tax valuations, payments, records of late returns and income*

**i) Collection ratio for gross tax arrears**

DOH: No data was submitted for DOH.

DOT: DOT arrears relate to motor vehicle licensing and registration fees. The arrears total for the past two financial years is 1 per cent of its total revenue.

OTP: OTP has indicated that it does not have any arrears as failure to pay taxes by licensees results in their licenses being suspended.

**Table 33: Collection arrears stock for DOT and OTP**

<b>DOT Composition of own revenue</b>	<b>2011/12</b>	<b>2012/13</b>
Arrears balance	19 244 732	13 786 754
Total revenue	1 409 482 000	1 502 265 000
% of total	1%	1%
<b>OTP Composition of own revenue</b>	<b>2011/12</b>	<b>2012/13</b>
Arrears balance	0.00	0.00
Total revenue	406 662.00	448 553.00
% of total	0%	0%

Source: DOT and OTP annual financial statements for 2011/12 and 2012/2013

**(ii) Effectiveness of transfer of tax collections**

DOH: The revenue from the various health institutions are collected and deposited into the DOH account. As the DOH account is effectively a Provincial Treasury account, the revenue is being paid directly into an account under Provincial Treasury's control. The funds are transferred into Provincial Treasury's revenue fund monthly.

DOT: A single bank account for DOT was opened for capturing all motor revenues. Since 2012 revenue reconciliations and payments take place monthly.

OTP: All departmental revenue from gaming and betting is recognised when received and deposited into OTP's bank account, and subsequently paid monthly into the provincial revenue fund. The licensees submit monthly returns and the monthly download of their systems to the OTP compliance division within 10 days of month end along with the payment as per section 129 and section 131 of the Act. The compliance division audits the information and prepares a schedule of the amounts due by each licensee. The board then has until the fifteenth working day to pay over the amount to the intended beneficiaries as specified in the Tax Act.

**(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts**

DOH: Due to the weak controls around the charging of tariffs, manual system and lack of audit trail, the completeness of revenue is a concern since not all revenue may be recorded and collected, or the revenue being

charged may be less than that stipulated in the tariffs. The revenue being reflected as health service fees could therefore be understated. Reconciliations of service fees are done monthly and the monies from DOH are transferred into Provincial Treasury's revenue fund monthly.

DOT: A single bank account exists for capturing all motor revenues. Since 2012 revenue reconciliations and payments occur monthly.

OTP: A single bank account exists for betting and gaming revenue. Revenue reconciliations and payments to Provincial Treasury's revenue fund are done monthly. The funds are transferred to the Provincial Revenue Fund by the 15th working day of the month following the tax period. The taxes are due within 10 days after the end of the month. In terms of section 135 of the Act, the licence is immediately suspended until such time as all taxes due, along with penalty interest, are paid.

**On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-15 Effectiveness of tax collection</b>	<b>C+</b>	<b>Scoring method M1</b>
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of fiscal year, which was collected during that fiscal year (average of the last two fiscal years)	A	DOT arrears for the past two financial years are 1 per cent. OTP does not have any arrears. There was no data for DOH arrears for the patient fees. However in terms of the weighting the DOT and OTP form the larger component of the revenue and had the greatest impact on the scoring.
(ii) Effectiveness in the transfer of recovered taxes to the Treasury by the revenue administration	C	The funds are transferred monthly into PT's revenue fund.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and transfers to Treasury	A	Reconciliations of health service fees are done monthly and the monies from the department's accounts are transferred into PT's revenue fund monthly. Reconciliations for DOT and OTP are done monthly.

## PI-16: Predictability in the availability of funds for the commitment of expenditures

### Dimensions to be assessed (Scoring method M1):

*(i) Degree to which cash-flow forecasts and monitoring are carried out*

*(ii) Reliability and time horizon of the information on maximum limits and payment commitments provided to the MDA during the year*

*(iii) Frequency and transparency of adjustments to budgetary allocations at a level higher than MDA administrations*

#### **(i) Extent to which cash flows are forecast and monitored**

In terms of Section 40 (4) of the PFMA, before the beginning of a financial year departments must provide Provincial Treasury with a monthly breakdown of the anticipated revenue and expenditure cash flow for the financial year. The PFMA does not specify a date, however the annual cash flow process is completed in March of each year after the estimated budget for the new year is tabled in the Legislature (in practice, it does not usually change).

Once submitted and approved, the forecast is “locked” for the year but is revised monthly using the in-year monitoring reports (IYM), based on the actual expenditure recorded in BAS. This monitoring mechanism does not lead to changes by Provincial Treasury but the public finance unit and the portfolio committees use it for alerting departments on under- or over-spending. The cash flow forecast is structured on the basis of administrative, economic, programme and sub-programme classifications and allows in principle for commitment control.

Departments submit their monthly in-year monitoring reports to Provincial Treasury (by the 15<sup>th</sup> day of the next month), containing actual revenues and expenditures in a format consistent with the classification. The report includes a projection of expected expenditure and revenue collection for the remainder of the current financial year and, when necessary, an explanation of any material variances and a summary of the steps that are taken to ensure that the projected expenditure and revenue remain within budget. The forecast includes current commitment, although this is not accurate due to commitment control weaknesses (see PI-20 and PI-4).

The consolidated provincial IYM report is forwarded to the National Treasury by the 22<sup>nd</sup> day of each month. This report is consolidated and summarised for publication by the National Treasury (Section 32 of the PFMA)<sup>10</sup>.

#### **(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment**

The departments receive funding from both provincial and national levels: this is reflected in the EPREs as equitable share and conditional grants. The cash flow forecast is based on the EPREs for the new fiscal year and the two outer years, and there are usually few deviations (see PI-1 and PI-2). The PFMA does not allow the transfers from one sphere of government to another to be reduced (less than the budgeted amounts) in terms of Section 43 (4) (b).

The DORA is approved in February of the previous year, determining the transfers that have already been communicated in the previous year’s MTEF and confirmed in the mid-term review in November. Conditional grants may be reduced in terms of section 17 of DORA Act 2 of 2013 if the department is not using the funds. Such decreases are not made hastily and the monitoring of the Public Finance Unit of PT and the National Treasury or national department usually engages in early dialogue and resolution. This is done by the national transferring officer giving seven days’ notice to the relevant department prior to the transfer and allowing the department to make written representations as to why the grants should not be withheld.

As the EPREs are not appropriated before the start of the fiscal year, departments and provincial treasury execute the budget as permitted by PFMA section 29, using the EPREs tabled in March and cash flow forecast.

<sup>10</sup> Within 30 days after the end of each month, the National Treasury must publish in the national government gazette a statement of actual revenue and expenditure with regard to the national revenue fund.



**(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs**

In South Africa, in terms of the PFMA, adjustments between programmes for less than 8 per cent of the programme allocation do not require ex-ante approval. Above 8 per cent it requires ex-ante supplemental budgetary approval. Although BAS has built in expenditure controls its application (record keeping and use of functionalities) does not allow commitment control. The public finance unit of Provincial Treasury and the portfolio committees analyse overspending, which is used for management purposes. Provincial Treasury does not impose a revised allocation to departments during the year.

Indicator	Score	Evaluation
<b>PI-16 Predictability of availability of funds for commitment of expenditure</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Degree to which cash flow forecasting and monitoring is carried out	A	A cash flow forecast is prepared for the fiscal year and the two outer years by each department, submitted to Treasury and updated monthly on the basis of actual transactions, known commitments and planned expenditure level.
(ii) Reliability and time horizon of the periodic information during the year providing the MDAs with information about maximum limits and payment commitments	A	Departments have a stable yearly forecast to plan and commit expenditures in accordance with the budgeted appropriations.
(iii) Frequency and transparency of the adjustments made to the budgetary allocations available at a level higher than MDA administrations	A	Adjustments between programmes for less than 8 per cent of the programme allocation do not require ex-ante approval and are decided by the accounting officer. Above 8 per cent they require ex-ante supplemental budgetary approval by the legislature.

## PI-17: Recording and management of cash balances, debt and guarantees

### ***Dimensions to be assessed (scoring method M2):***

#### ***(i) Quality of debt data recording and reporting***

#### ***(ii) Degree of consolidation of the government's cash balance***

#### ***(iii) Systems for contracting loans and issuance of guarantees***

### **(i) Quality of debt recording and management**

In terms of section 66 of the PFMA, the national Minister of Finance is the sole authority for the contracting of loans that bind the national revenue fund. Any loans or guarantees committing the provincial revenue fund must be approved by the MEC for Finance in the province with the concurrence of the national minister in terms of section 70 of the PFMA.

In KZN the de facto policy applied by the Provincial Treasury is to run a cash surplus and not to incur any forms of debt or issue guarantees. Consequently no records are maintained at provincial level. Debt and guarantees are managed only at national level (see PEFA 2008).

### **(ii) Extent of consolidation of the government's cash balances**

An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated, and the overall balance utilised to earn interest. The provincial revenue fund is held with the South African Reserve Bank. National government transfers funds to the province through this account and interest is earned. The balance in the SARB account is optimised by the Provincial Treasury.

For management purposes, the Provincial Treasury has established a single treasury account with ABSA. Monies are transferred from the SARB by Provincial Treasury to its ABSA account as the departments require the funding. Although each department has a separate bank account for accounting purposes held at ABSA, they are effectively held under PT<sup>11</sup>. Payments are run centrally by the Provincial Treasury three times a month, allowing better cash management and planning. No arrears are accrued due to the Provincial Treasury as all transactions booked are honoured. The overall balance is monitored by Provincial Treasury banking unit on a daily basis to ensure that the overall balance is positive. Provincial Treasury's monitoring of the overall position with ABSA allows a more effective cash management, transferring funds from the provincial revenue fund held by SARB.

Provincial Treasury has access to the bank statements of the departments. It uses the data on BAS and PERSAL and the fixed dates for payments of employee compensations and suppliers to determine the timing of transfers. Compensation payments are paid twice monthly, on the 15<sup>th</sup> day and end of each month respectively. Supplier and other transactions are paid three times per month generally during the first, third and last week of the month. Subsistence and travel is paid weekly.

In addition, the agreements between departments and their institutions and service delivery units are organised to optimise cash management where possible, e.g. schools receive their subsidies twice a year with 40 per cent being paid in May and 60 per cent in September. Certain service delivery units e.g. hospitals, have imprest bank accounts in respect of purchasing items. In terms of Provincial Treasury instruction note 18, all requests to open petty cash accounts must be submitted to Provincial Treasury which will advise the department accordingly once the account has been opened. Funds are transferred from the department's main account held at ABSA into the petty cash accounts.

### **(iii) Systems for contracting loans and issuance of guarantees**

Any loans or guarantees must be approved in respect of the provincial revenue fund by the MEC for finance in the province with the concurrence of the national minister in terms of section 70 of the PFMA and section 3 of the Borrowing Powers Act. If a person, otherwise than in accordance with section 66, lends money to an institution to which PFMA is applicable, the state and that institution are not bound by the lending contract.

<sup>11</sup> The ABSA arrangement is the result of a tender. It allows operating a STA consolidating the balance daily and maintaining cash at SARB. Through such stringent cash management, PT has been in a cash positive situation since 2009/2010.

In KZN there are no loans contracted, guarantees given or debt due. As noted in PI-9, although neither the provincial nor the national government are liable for debts accrued by municipalities, should the municipality default, National Treasury may intervene from a constitutional perspective to ensure continuation of service delivery.

### On-going and planned activities

N/A

Indicator	Score	Evaluation
<b>PI-17 Recording and management of cash balances, debt and guarantees</b>	<b>A</b>	<b>Scoring method M1</b>
i) Quality of the records and reports presented on debt data	NA	In KZN there are no loans or debt funding incurred by Provincial Treasury or the departments. Therefore, no data is recorded in this regard.
ii) Degree of consolidation of government cash balances	A	The cash balance, through the banking arrangement made by Provincial Treasury allowing the operation of an STA, is consolidating daily, and allows generating interest from the positive cash position with SARB. All departments use the same banking arrangement and cannot open accounts in other banking and financial institutions without Provincial Treasury's authority.
iii) Systems for contracting loans and issuance guarantees	A	Any loans or guarantees for government departments must be approved in respect of the provincial revenue fund by the MEC for finance in the province with the concurrence of the national minister.

## PI-18: Effectiveness of payroll controls

### **Dimensions to be assessed (scoring method M1):**

- (i) Degree of integration and reconciliation between personnel records and payroll data***
- (ii) Timeliness in the introduction of changes to the personnel records and payroll***
- (iii) Internal control over changes to personnel records and payrolls data***
- (iv) Existence of payroll audits to identify control weaknesses and/ or ghost workers***

The national Department of Public Service and Administration is the regulator for human resources, including human resources management policy, regulations, occupational specific compensations (OSDs), for national and provincial governments, and establishment and revision of organisational structures and posts. It also negotiates with unions on behalf of the government. In the recent years, a number of negotiations have impacted on the employee compensation budget through changes to the OSDs, policy to upgrade all level one employees to level two, etc.

As the department is not in charge of the financing of those policies and the assessment of their impact and fiscal sustainability, this has posed difficulties. The National Treasury has been funding part of the increases (gap) for some years, but it has not been in a position to fully fund these increments, leaving the provincial treasuries and departments to seek alternatives.

The Public Service Administration Act requires that new posts are approved by the MEC of the department and OTP and that budget implications receive a certificate from the Provincial Treasury. KZN Provincial Treasury has refused any increase to the baseline. If departments wish to reorganise their personnel structure, they have to fund the difference from a revision of their allocation or do so as a zero-increment to the baseline.

The establishment of new posts is the basis for budget formulation and preparation process pertaining to wages and salaries. Projections are facilitated by PERSAL, software used nationally, as the salary structure depends largely on the posts. With the revision of the OSDs, the history of staff and their location (rural/urban) have become key drivers of salary structures: the quality of the information held for each employee impacts on the ability to forecast. However, PERSAL is using the organisational establishment while the National Treasury funds through a financial establishment structure. The two structures are neither compatible nor bridged. In terms of policy, all non-funded vacancies and funded vacancies are removed from PERSAL, in order to lower the vacancy. This however reduces the emphasis placed by the AG in its annual report on the necessity to fill strategic and technical vacancies in order to reinforce internal controls and take corrective measures.

### **(i) Degree of integration and reconciliation between personnel records and payroll**

PERSAL is a system that integrates the establishment of the HR and payroll functions of each department, down to the level of the decentralised spending unit. It is fully decentralised, implying that HR units and paymasters are decentralised functions at the spending unit level. There is central oversight in each department and its establishment is approved by DPSA (though DPSA does not approve the funding, since this is a treasury function).

The payroll is done programmatically, unless there is a paymaster's stop order. This means that the system relies heavily on HR units to effect changes on time.

There are two salary runs per month (on the 15<sup>th</sup> day and at end of the month) and a supplementary run every week for S&Ts or late appointment. The payroll runs are directly extracted from PERSAL: establishment information is linked to the post, and HR information is linked to the employee and his or her work during the month. Paymasters have to ensure that each employee is recorded on the runs and sign for his or her payslip, providing a reconciliation mechanism between the nominal and establishment rolls.

### **(ii) Timeliness of changes to personnel records and the payroll**

The timeliness of changes is well supported in principle by PERSAL. This is fully decentralised, with little downtime and two salary runs plus a weekly complementary run to treat compensations as travel expenses.

However, the accuracy of the data input and the time for effecting changes is questioned by the departments'

CFOs, the PERSAL team at the OTP, Provincial Treasury and the AG. This is a situation for concern, since HR units are not effecting the necessary changes to allow an accurate forecast of the budget and to ensure that employees are paid only for time spent on duty.

The Public Service Administration Act and the public sector regulations authorise any employee of the government to work privately and compete in government bids, following approval of the HOD of department. This has created growing concerns about conflict of interest and absenteeism that the departments and provincial treasury have not been able to control.

Department of Education: The payroll controls have not improved according to the CFOs. For example, absenteeism is not adequately reported, educator/learner ratios are inflated to create new educators' posts, terminations are not reflected fast enough so salaries continue to be paid, in some cases for six months after termination of employment. As of 31 March 2013, unrecovered monies were R241 million (Note 3.11 in the annual report).

At school level, the controls on payroll are not effective as principals do not report to the district in which PERSAL is managed. By law, any absence should be justified, with specified limits and if a teacher does not report to school for 14 days without justification, the employee should be deleted from the payroll. Overtime is not controlled with staff getting over 1,5 times their salary in overtime work, contrary to the law.

The department is introducing a new school management system, South African school administration and management system (SASAMS) to ensure common financial reporting format, control of learners, teachers and attendance.

There is an ongoing head count to reconcile between payroll and persons.

Department of Health: 60 per cent of the department is composed of medical professionals. The average vacancy rate is 8,5 per cent, although this ratio is higher for medical professionals in rural areas. The HR function is decentralised to the medical institution level including PERSAL.

Doctor' absenteeism is a growing concern. Many run private practices and do not report for duty (some use public facilities and equipment for which they charge privately). Managers report that confronting doctors results in their resignation and, given the need for qualified medical staff, managers accept this situation and do not report absenteeism. Doctors refuse to sign attendance registers and so no basis for the payroll is established.

The department carries out headcounts and visits but it cannot give an assessment of the magnitude of the problem. The controls are manual and dependent on reporting by managers. Such problems are more prominent in large cities where private practices are common place and seek doctors to work for them. A special investigation unit of the department investigates but it lacks the necessary capacity and ability to impose sanctions. It uses data from medical aid and health insurance mechanisms on procedures performed in private hospitals to reconcile working hours of doctors.

To control this situation, the HOD has issued a directive that no outside work can be done but this has not been enforceable.

The department also reports cases of resignation and other terminations where the employees are still paid for a long period of time after their service has come to an end.

Department of Transport: The department has a smaller workforce of approximately 4 000 employees. However, its vacancy rate is 22 per cent. Since 2009 a moratorium was imposed on new hiring. In FY2012/13 the department published 850 technical posts and struggled to secure 650 people to fill those vacancies. As the department relies on external consultants, it has diminished capacity to control design, tender specifications and work execution. In addition, the department runs a number of programmes that require the creation of extraordinary posts on PERSAL (e.g. Zimbabwale contractors programme has 42 000 appointed labourers, board members, Vukusakhe programme on a claims basis for SMMEs). Those programmes are subject to controls by field staff, though the department has recognised it as a high-risk area and will audit the generation of claims. Data quality is considered an issue with delays in capture and errors not corrected.

### **(iii) Internal controls of changes to personnel records and the payroll**

Each department has a PERSAL controller who creates user IDs with assigned functions. The OTP PERSAL office audits all the PERSAL controllers and their work annually, in terms of the audit trail function. The AG has also introduced a focus on IT systems and controls while the PT PIAS does so every two to three years.

The HR units are responsible for creating posts and components as per the policies. A central control unit in the department has access to those records for verification but cannot effect changes to them. It can only query the HR function and request changes to be done. There are three levels of controls: make a change, approve it and authorise it. This is sometimes not possible to apply in smaller entities.

The central control unit ensures the distribution of payroll runs and payslips produced by the state it agency (SITA). The paymasters sign every payslip and employee signs the payroll run to vouch that all employees paid are working in his or her institution. Most paymasters do not have access to PERSAL.

Since 2010, the provincial policy on the use of PERSAL is that every user should be trained. A 13-course training programme has been developed and is tied to the functions assigned to users. A former user can just take the test to validate its experience. The OTP PERSAL office is in the process of training all users in basic courses.

The system has internal controls and exception report functions that are done centrally at the OTP. It validates employee identities with the Department of Home Affairs database. Exception reports are done on banking details (duplicate accounts, though there are no laws to stop same bank accounts being used more than once, staff over 65 years, changes in banking details and payment made in the same space of time, etc.)

Termination codes are differentiated to make sure that a person cannot be dismissed and reappointed in PERSAL without the HOD and MEC being aware and having to override the control. A new control named "departmental or criminal case pending" has also been created. Other data improvements through increased automatic controls and gates, though available, are not yet operational, leaving important "free" fields leading to inconsistencies in the data.

However, as clearly explained by OTP, PERSAL office and the departments, in spite of PERSAL's powerful functions, the system relies on practice: data accuracy and timeliness cannot easily be controlled. In its presentation to SCOPA for 2012/13, the Provincial Treasury reported inadequate HR policies and payroll management and controls. The Accountant-General reported that the focus on controlling overtime work had impacted positively on the compensation budget confirming reports of failure to control overtime within the specified boundary of 50 per cent of the annual salary in previous years.

Control is weakened by the use of two different systems: organisational, reflected in PERSAL and financial, generated by National Treasury. The two structures are not integrated. As by policy non-funded vacancies are taken away from PERSAL, hence the two structures cannot be compared either in aggregate. In practice this creates great difficulties when management seeks to fill vacancies, as their funding is unclear. This weakens the control of HR in institutions across the province.

The HR persons interview explained that although their functions are clearly defined, there are by-passed by decision makers in managing S&Ts, hiring new personnel, and receiving instructions. This is a breach of the segregation of duties, leading to an environment of weak controls. Some claimed that the situation, coupled with a high vacancy rate, is creating mounting pressure on staff leading to resignations and poor health.

#### **(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers**

PERSAL is tested annually by the Provincial Treasury, its PIAS, and the AG. All departments had to perform a headcount by end of March 2013. However, the headcounts methodology is inadequate for the level of decentralisation and they are recognised as ineffective.

Previously, Treasury did a headcount of all schools and stopped paying salaries to bank accounts to force each teacher to present him or herself. This has helped to remove a number of "ghost" workers.

Departments have reported the existence of "ghosts" created through collusion with the Department of Home Affairs in creating fake ID numbers, banks to create the necessary bank accounts and schools or medical institutions staff. At DOE, ghost pupils are created to establish fake pupils/educators ratios in order to appoint

fictitious teachers: this involves moving pupils from school to school for inspections.

The DOE's school inspection aims to move to unannounced inspections to avoid collusion amongst school principals and teachers but they have limited capacity. At the DOH, a headcount has been ongoing since 2010, and has covered approximately 90 per cent of the work force. The DOPW, a service provider to other departments, staff has performed several headcounts, particularly to curb absenteeism arising from staff working as private consultants in other institutions.

**On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-18 Effectiveness of payroll controls</b>	<b>D+</b>	<b>Scoring method M1</b>
(i) Degree of integration and reconciliation between personnel registers and payroll data	A	PERSAL integrates the organisation, its HR function and its payroll, allowing reconciliations to be done.
(ii) Timeliness of changes to personnel records and the payroll	D	Although PERSAL allows real time changes to be made and reflected in the payroll within a month, departments and Treasury concur that there are significant delays of up to six months and widespread non-reporting of absenteeism.
(iii) Internal control of changes to the staff register and payroll	D	The authority to makes changes is clearly defined and changes result in an audit trail. The data integrity present on the system is considered poor due to delays, errors and instructions received by HR.
(iv) Payroll auditing to identify weaknesses and/ or ghost workers	B	Audits are carried annually on PERSAL and headcounts have been performed in the last three years for the largest departments, though they are considered ineffective

## PI-19: Competition, value for money and controls in procurement

### **Dimensions to be assessed (scoring method M2):**

- (i) Transparency, comprehensiveness and competition in the legal and regulatory framework***
- (ii) Use of competitive procurement methods***
- (iii) Public access to complete, reliable and timely procurement information***
- (iv) Existence of an adequate administrative procurement complaints system***

Major challenges identified by the AG during its audit of the KZN provincial government for 2012/13 include slow response by management, vacancies in key positions and a lack of appropriate competencies among key officials. The standing committee on public accounts (SCOPA) reported that this, along with issues concerning SCM, was a constant problem which impacted on compliance and performance. Among the departments interviewed, the lack of capacity was cited as a major concern and factor impacting on service delivery, contract management, inventory management and the general efficient functioning and compliance with SCM. The Chamber of Commerce and Section 27, a public interest law centre, cite procurement and SCM processes as areas of concern. Specific concerns include poor management and lack of capacity in the evaluation and awarding of bids, poor contract management, and lack of accountability and transparency.

Section 217 of the Constitution stipulates that any public sector entity contracting for goods or services must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

The State Tender Board Act 86 of 1968 prescribes the establishment of a state tender board consisting of members appointed by the Minister of Finance. The board has the power to procure supplies and services for the state, to arrange the hiring or letting of anything on behalf of the state, and to dispose of movable state property. An amendment to the regulations allows the AOs of the state to procure their supplies and services through the state tender board or by using the provisions contained in the SCM framework in terms of the PFMA.

Section 76 of the PFMA stipulates that the NT may make regulations for all levels of government to determine a framework for an appropriate procurement system that is fair, equitable, competitive and cost-effective. Expenditures made in deviation to the PFMA are considered to be irregular and must be reported.

In terms of the PFMA the Minister of Finance approved regulations in respect of the SCM framework which places a duty on the AO or accounting authority of an institution to develop and implement an effective and efficient SCM system. In the case of procurement through a bidding process, the SCM framework requires that the system must provide for the adjudication of bids through a bid committee and the approval of bid committee recommendations.

The B-BBEE Act aims to promote economic empowerment of all Africans, Coloureds and Indians through integrated socio-economic strategies that include preferential procurement. All bidders have to be compliant.

The PPPFA provides for an organ of state to implement a procurement policy based on a preferential points system whereby preference is given to historically disadvantaged individuals and/or the implementation of the reconstruction and development programme (RDP).

Section 2 of the PPPFA allows 80 or 90 points to be allocated based on price, and the remaining 10 or 20 points to be allocated for preferential treatment. Section 8 of the preferential procurement regulations (PPR) stipulates that the 80 or 90 points include both price and functionality<sup>12</sup>. As a result of this discrepancy, and subsequent to an application lodged in the KZN High Court in Pietermaritzburg, it was found that functionality should be dealt with separately from price and other specific goals.

This means that functionality is no longer part of the standard evaluation mechanism and weighting of bids. A NT instruction note dated September 2010 establishes that the evaluation of bids on the basis of functionality was dependent on the nature of the goods or services. When applied, functionality must be treated as a minimum threshold and thereafter the qualifying bids must be evaluated in terms of the 80/20 or 90/10 preference points system. In practice, this means that functionality is no longer applied for all quotations and tenders, potentially reducing value for money in the procurement process.

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<sup>12</sup> In South Africa, public procurement functionality refers to the specifications for evaluating the quality of bids: quality, reliability, viability and durability of the goods or services.



At provincial level, the PT SCM office develops procurement policy and regulations and exercises oversight. According to the SCM framework, the SCM office includes a compliance monitoring operational component which undertakes performance reviews on departmental contracts, investigates departmental complaints on inadequate performance by contractors and reviews compliance with practice notes, policies and legislation by departments. The SCM framework requires the AO or accounting authority to take steps to prevent abuse of the SCM system and to investigate any allegations of corruption, improper conduct or non-compliance with the system. The SCM office performs annual compliance audits for each department and municipality in the province. Areas of concern are raised with IA to investigate further. The practice note no. SCM-02 of 2008 stipulates that competitive bids in the form of an open tender must be invited for all procurement requirements in excess of R500 000.

**Table 34: Conditions of procurement thresholds**

Value of procurement	SCM requirement
Up to R2 000	Procure through shopping
R2 000 to R10 000	Obtain three verbal/written quotations
R10 000 to R500 000	Obtain three written quotations
Over R500 000	Invite bids

Source: Practice note number: SCM-02 of 2008

The legal and regulatory framework does not clearly establish open competition as the default procurement method. Section 16A6.1 of the treasury regulations stipulates that the procurement of goods and services, whether by way of quotations or through a bidding process, must be within the threshold values as determined by the NT. Section 16A6.4 however stipulates that where it is impractical to invite competitive bids, the AO may procure the goods or services by other means, provided that the reasons for deviation are recorded and approved by the AO.

Departments have separate SCM units which manage procurement through separate policies, procedures and practice notes. The DPW has developed its own standard operating procedures (SOPs) which are more prescriptive in terms of processes and cover contract management and variations. The DOT SCM thresholds and the DOE finance circular no. 15 of 2012 requires an open tender for all procurement requirements over R500 000. The DOH prescribes open tenders for all procurement in excess of R200 000.

Section 16A6.3 of the treasury regulations requires the AO to ensure that bids are advertised in at least the government tender bulletin. In addition the regulation stipulates that the awards must also be publicised in the government tender bulletin and other media by means of which the bids were advertised. Section 13 of the DORA stipulates that a receiving officer in respect of infrastructure conditional allocations to provinces must publish a list of infrastructure projects for education, health and roads that will require funding from conditional allocations in the gazette, and provide NT with the published list. In addition the receiving officer must maintain a database of every contract that is funded by the respective grants.

Section 16A9.3 of the treasury regulations stipulates that the NT and each PT must establish a mechanism to receive and consider complaints regarding alleged non-compliance with the prescribed minimum norms and standards. In KZN, a provincial bid appeals tribunal is functioning.

**(i) Transparency, comprehensiveness and competition in the legal and regulatory framework.**

The table below indicates the extent that the legal and regulatory framework meets minimum requirements as established in the PEFA framework.<sup>13</sup>

**Table 354: Legal and regulatory framework for procurement**

Minimum requirements	Yes/ No	Explanation
(i) Be organised hierarchically and precedence is clearly established	Yes	The Constitution stipulates that any public sector entity contracting for goods or services must do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. The legal and regulatory framework includes national legislation, such as the PFMA, Treasury Regulations, PPPFA, and B- BBEEA, provincial SCM practice notes and departmental SCM SOPs.
(ii) Be freely and easily accessible to the public through appropriate means	Yes	The legal and regulatory framework is available to all South Africans on the websites of the National Treasury and the provincial treasuries where applicable.
(iii) Apply to all procurement undertaken using government funds	Yes	The legal and regulatory framework in connection with procurement applies to all public sector entities.
(iv) Make open competitive procurement the default method of procurement and define clearly the situations in which other methods can be used and how this is to be justified	No	The legal and regulatory framework does not clearly establish open competition as the default procurement method. Thresholds are, however, established. The PFMA and section 16A6.4 of the treasury regulations define the situations where other methods can be chosen by the AO and require justification to be recorded.
(v) Provide for public access to all of the following procurement information: government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints	No	Treasury regulations require that bids and awards be advertised in the government tender bulletin. There is no law that prescribes the publishing of procurement plans. The DORA requires education, health and roads infrastructure projects, funded from conditional grants, to be gazetted, thus serving as a proxy for the publishing of procurement plans for these three grants. The publication of resolution of procurement complaints and statistics is not legislated.
(vi) Provide for an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature	Yes	Treasury regulations require NT and each provincial treasury to establish a mechanism to receive and consider complaints regarding alleged non-compliance with the prescribed minimum norms and standards. The KZN SCM policy framework and practice note no. SCM-07 of 2006 stipulates that the MEC for Finance must establish an independent and impartial bid appeals tribunal. The framework requires the bidder to appeal within five days of notification of the award.

<sup>13</sup> This indicator is also contained in OECD DAC's national procurement assessment framework.

**(ii) Use of competitive procurement methods**

Except for the DPW, it was not possible to obtain statistical data on procurement at all provincial departmental levels. Consequently the data on spend by method and reflecting the proportion of tenders above the open tender threshold that were carried out using a method other than open tender is generally unavailable. The lack of data is a recurrent weakness in public procurement in South Africa already noted in the 2008 PEFA report. In KZN, it was explained that it is largely attributed to the absence of a system for recording procurement and managing contracts, leaving departments with manual records and spreadsheets, thus resulting in ineffective monitoring by the departments and PT (SCM and public finance). LOGIS is the national procurement control system, but has not been rolled out across the provinces and is not used at provincial departmental level.

Department of Public Works (DPW): The DPW provided information for 2011/12 and 2012/13 which reflects deviations from the SCM process. Reasons for dispensing with the prescribed competitive bidding process were recorded and the deviations were approved by the CFO.

**Table 36: Department of Public Works: Statistics on procurement for the period 2012/13**

Description	Volume	Value (R)
Total procurement for DPW	332	1 044 797 201
Total procurement through quotations for DPW	154	46 598 130
Total procurement through tender for DPW	178	998 199 071
Total justified deviations from SCM processes for DPW	20	56 318 208
Percentage of deviations	6%	5%

Source: KZN Department of Public Works

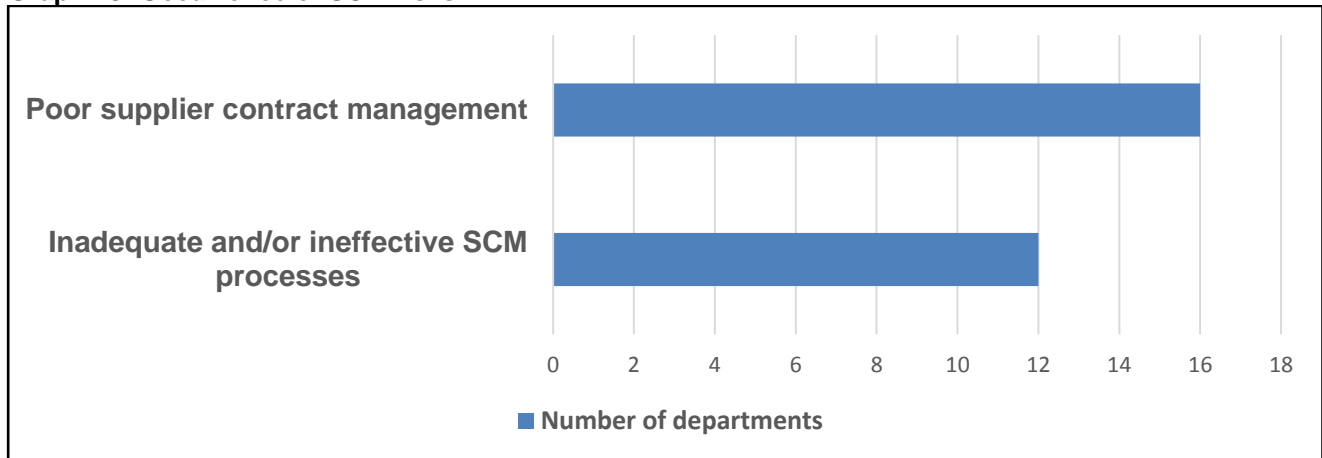
**Table 37: Department of Public Works: Statistics on procurement for the period 2011/12**

Description	Volume	Value (R)
Total procurement for DPW	252	1 301 819
Total procurement through quotations for DPW	29	9 166
Total procurement through tender for DPW	223	1 292 653
Total justified deviations from SCM processes for DPW	20	110 296
Percentage of deviations	8%	8%

Source: KZN Department of Public Works

The findings reported in the 2012/13 annual report of the provincial audit and risk committee (PARC) prepared by the KZN provincial internal audit services (PIAS) highlights inadequate and/or ineffective SCM processes, and poor contract management across the majority of the departments. The PIAS opinion is based on the findings and high risks identified during the review of the control environment in respect of the implementation of the SCM framework by all departments.

**Graph 15: Occurrence of SCM risks**



Source: PIAS annual report 2012/2013

The PFMA defines irregular expenditure as expenditure, other than unauthorised expenditure, incurred in the contravention of or that is not in accordance with a requirement of an applicable legislation, including the PFMA, the State Tender Board Act or any provincial legislation providing for procurement procedures in that provincial government. Fruitless and wasteful expenditure means expenditure that was made in vain and would have been avoided had reasonable care been exercised.

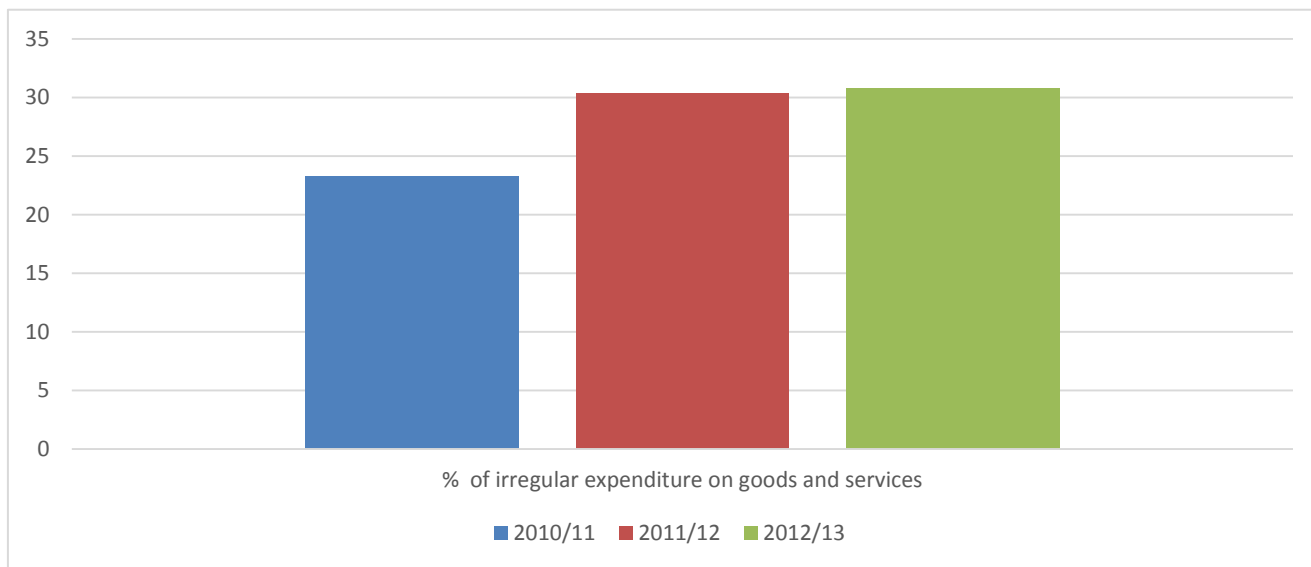
The consolidated financial statements for KZN Provincial Treasury include disclosure notes which reflect the amounts attributable to irregular, and fruitless and wasteful expenditure awaiting condonation.

**Table 38: Irregular expenditure awaiting condonation**

R'000	2010/11	2011/12	2012/13
Goods and services	13 177 685	15 850 900	17 043 796
Irregular expenditure - prior year	333 774	1 040 510	1 343 443
Irregular expenditure - current year	803 027	1 600 009	2 287 682
Irregular expenditure awaiting condonation - balance	3 051 876	4 819 789	5 242 104
Percentage of goods and services expenditures	23.16 %	30.41%	30.76%

Source: Consolidated annual financial statements for KwaZulu-Natal for the years ended 31 March 2012 and 31 March 2013

**Graph 16 Percentage of irregular expenditures on goods and services**



**Table 39: Fruitless and wasteful expenditure awaiting condonation**

R'000	2010/11	2011/12	2012/13
Goods and services	13 177 685	15 850 900	17 043 796
Fruitless and wasteful expenditure - prior year	(1)	23 229	851
Fruitless and wasteful expenditure - current year	11 957	69 054	14 782
Fruitless and wasteful expenditure awaiting condonation - balance	4 725	11 270	13 915
Percentage of goods and services	0.04%	0.07%	0.08%

Source: Consolidated Annual Financial Statements for KwaZulu-Natal Province for the years ended 31 March 2012 and 31 March 2013

**(iii) Public access to complete, reliable and timely procurement information**

It was not possible to obtain statistical data reflecting the proportion of procurement information made available for public access, but it is assumed that for the bidding opportunities and award publications, there is more than 90 per cent compliance, based on reports analysed.

Public access to procurement plans: Procurement plans do not have to be published by law. Section 13 of the DORA stipulates that a receiving officer in respect of infrastructure conditional allocations to provinces must publish in the gazette a list of infrastructure projects for education, health and roads that will require funding from conditional allocations, and provide National Treasury with the published list. This acts as a proxy for these three grants. In addition, the receiving officer must maintain a database of every contract which is funded by the respective grants. Departmental procurement plans are, however, not publicised.

Public access to bidding opportunities: Section 16A6.3 of the treasury regulations requires the accounting officer to ensure that bids are advertised in at least the government tender bulletin. Requests for quotation (RfQs) are usually advertised on internal notice boards at departmental level, while tenders are advertised in public print media, the government tender bulletin and departmental websites.

Public access to contract awards: Treasury regulations stipulate that the awards must also be publicised in the government tender bulletin and other media by means of which the bids were advertised. Departments publish awards in the same media used to publish the respective bid; however awards in connection with the RfQs are generally not advertised.

Public access to data on resolution of procurement complaints: Data on the resolution of procurement complaints does exist for a limited timeframe within PT's SCM unit. However, this data is not made available to the public.

The outcome of any resolved procurement complaint is reported to the prospective appellant and the department only.

**Table 409: Public access to procurement information**

Type of information	Public access to information
Procurement plans	No
Bidding opportunities	Yes
Bid awards	Yes
Resolution of procurement complaints	No

**(iv) Existence of an independent administrative procurement complaints system**

An independent bid appeals tribunal exists under the PT SCM unit and reports to the MEC for Finance. The MEC for Finance must appoint the members after consultation with Cabinet and the portfolio committee. The members of the tribunal are professionals with appropriate skills and expertise in the legal and SCM fields. The tribunal must consist of four members appointed from civil society, two members with appropriate legal qualifications and experience, and two members with appropriate SCM experience. The chairperson is appointed from one of the legally qualified members. The tribunal is currently chaired by a retired judge. The members of the tribunal are independent and have no involvement in the procurement process. There is no formal process requiring members to declare their interests. There have been instances in the past where members have recused themselves from hearings due to a declared potential conflict on specific cases.

Any aggrieved bidder may lodge a complaint directly with the tribunal. The process does not require lodging a complaint with the department, though in some cases aggrieved bidders do write to the department which transfers the case to the tribunal. The appeals tribunal reviews the appeal to decide if it is valid or not. The appeals tribunal has the power to set an award aside and make an order regarding the procedures to be followed to determine the matter. While rulings are binding for the department, the appellant may initiate legal recourse. The tribunal does not charge fees for appeals but it does reserve the right to make an appropriate order as to costs if it is found that the appeal was frivolous, vexatious or without merit.

The complaints/appeals mechanism is assessed according to the following criteria.

Complaints are reviewed by a body which:	Evaluation
(i) is comprised of experienced professionals, familiar with the legal framework for procurement, and includes members drawn from the private sector and civil society as well as government;	Yes - the members of the tribunal are appointed by the MEC for Finance and are professionals with appropriate skills and expertise. The tribunal consists of four members appointed from civil society, two members with appropriate legal qualifications and two members with appropriate SCM experience.
(ii) is not involved in any capacity in procurement transactions or in the process leading to contract award decisions;	Yes – the members of the tribunal are independent and have no involvement in the procurement process. There is no formal declaration of interest process in place to ensure independence and impartiality.
(iii) does not charge fees that prohibit access by concerned parties;	Yes – the tribunal does not charge fees for appeals but it does reserve the right to make an appropriate order as to costs if it is found that the appeal was frivolous, vexatious or without merit.
(iv) follows processes for submission and resolution of complaints that are clearly defined and publicly available;	Yes – the process for submission and resolution of complaints is clearly defined in the KZN SCM policy framework and practice note no. SCM-07 of 2006, which appears on the KZN PT website.
(v) exercises the authority to suspend the procurement process;	Yes – the appeals tribunal has the power to set an award aside and make an order regarding the procedures to be followed to determine the matter.
(vi) issues decisions within the timeframe specified in the rules/regulations;	Yes – the chairperson of the appeals tribunal must determine whether the appeal is frivolous, vexatious or without any merit within three working days after receipt of written representations by an appellant. The appeals tribunal must resolve all appeals within 14 working days of determining that the appeal is not frivolous, vexatious or without any merit as defined within the KZN SCM policy framework and practice note no. SCM-07 of 2006.
(vii) Issues decisions that are binding on all parties (without precluding subsequent access to an external higher authority).	Yes - the department is bound by the decision of the appeals tribunal however the appellant may consider further legal action.
Number of criteria met out of the 7 specified	7

**On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-19 Competition, value for money and controls in procurement</b>	<b>C+</b>	<b>Scoring method M2</b>
i) Transparency, comprehensiveness and competition in the legal and regulatory framework	B	<p>The legal and regulatory framework meets four out of six benchmarks. The legal and regulatory framework does not:</p> <ul style="list-style-type: none"> <li>• Clearly establish open competition as the default procurement method; and</li> <li>• Provide for public access to procurement plans and data on the resolution of procurement complaints.</li> </ul>
ii) Use of competitive procurement methods	D	<p>It was not possible to obtain statistical data for all sampled provincial departments reflecting the proportion of tenders above the open tender threshold which were justifiably carried out using a method other than open tender. The statistical data obtained from the DPW indicates that reasons for dispensing with the prescribed competitive bidding process is recorded and deviations are approved by the CFO. The KZN provincial internal audit services (PIAS) identified the existence of poor contract management and inadequate and/or ineffective SCM processes across the majority of the departments. The consolidated financial statements for KZN PT reflect substantial amounts attributable to irregular expenditure awaiting condonation.</p>
(iii) Public access to complete, reliable and timely procurement information	C	<p>Departmental procurement plans are not published even when prepared. RfQs are advertised on internal notice boards and tenders are advertised in public print media, government gazettes and departmental websites. Contract awards are advertised in the same print media that were used to advertise the bid. Data on the resolution of procurement complaints exists for a limited timeframe in PT's SCM unit, but is not made available to the public. The outcome of any resolved procurement complaint is reported to the prospective appellant only.</p>
(iv) Existence of an adequate administrative procurement complaints system	A	Seven of the benchmarks are met.



## PI-20: Effectiveness of internal controls for non-salary expenditure

### **Dimensions to be assessed (scoring method M1):**

*i) Effectiveness of expenditure commitment controls*

*ii) Scope, relevance and understanding of other internal control regulations and procedures*

*iii) Degree of compliance with regulations on the processing and registration of transactions*

#### **(i) Effectiveness of expenditure commitment controls**

The budget execution is based on an annual cash flow projection, updated monthly for the current year. These projections are reviewed by the public finance division (Provincial Treasury) and deviations have to be explained by the department, including to the portfolio committee of the department. The Treasury engages the department formally twice a year and ensures a continuous monitoring.

Commitment control is the responsibility of the AOs in their respective departments. The basic accounting system (BAS) (transverse system based on proprietary software and operated across the country at the national and provincial levels of government) includes a commitment control function that can capture commitments at different stages (requisition of funds for SCM process, legal order, invoicing/acceptance of delivery). However it requires different entries in different registers, and does not facilitate easy recording and retrieval of the information. The Accountant-General and the CFOs interviewed recognised that in practice it is not used, especially across the decentralised spending units in the province. Departments rely on manual systems, using excel spreadsheets, but do not effectively control commitment.

LOGIS, transverse proprietary procurement software, is not rolled out in the province. It has the capacity to ensure commitment control effectively for all procurement and thus solve the weaknesses encountered with BAS. The procurement process is thus not controlled by another system that could ensure procurement. Some departments are seeking to introduce INTENDER, a new software that would serve this purpose.

In effect, commitments are not necessarily controlled and the reporting of commitments in the in-year monthly reports (forecast) and AFS is not considered accurate.

Departments, such as health and education, representing 73,6 per cent of total provincial expenditures in FY2012/13, have reported going into accruals because commitment control is ineffective. In addition, they also report that the current fiscal tightening is preventing them from budgeting for all their obligations by the Constitution and national and provincial policies. Neither can they use the budget as a reliable guide, since changes during the year due to previous year accruals, future cash requirements for existing commitments are not forecast adequately and changes to the budget allocation due to changes in employees' compensations. This limits the effectiveness of the cash flow forecast for commitment purposes.

Commitments controls are routinely violated. Departments report that they use the transactions report to verify what procurement has been done and query spending units. The Provincial Treasury public finance unit analysts also use these data to supervise spending. Portfolio committees work on the same basis to control spending.

#### **(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures**

Sections 38 to 41 of the PFMA define clearly the responsibilities of accounting officers in terms of internal controls and verifications. Chapters 8 and 15 of the treasury regulations complete the PFMA. Internal control units (internal compliance units in some cases) exist in each department. Their effectiveness is questioned due to the ongoing deficient controls and repeat audit findings.

Although training takes places, the level of turnover and the level of deconcentration across the province, means that in practice, controls application is largely relying on willingness and competence. This is so in the absence of systems that impose specific information requirements and course of action, with central reporting. The strategic vacancies at management level and lack of competencies reported by PIAS, AG and departments are limitations to an effective control environment that foster the effective application of internal controls.

The Accountant-General reports that the control functions in the departments are lacking and though there are IA and SCM functions at the Provincial Treasury, controls are not sufficiently reinforced to detect irregularities.

For example, the DOPW has gone into a capacity development programme that supports internal controls specifically in its domain. Its internal control unit has eight staff and staff managers and rely on the PT's IA and SCM functions. Its unit only focuses on compliance and risk management process. Its top risks are skills, capacity, ownership of immovable assets, SCM fraud, infrastructure/construction industry knowhow for high level corruption. The DOE and DOH both report that their internal controls are not sufficiently robust to detect and prevent irregularities and that they are not improving fast enough.

**(iii) Degree of compliance with rules for processing and recording transactions**

For FY 2012/13, the AG reports that of the three largest spenders, representing 75 per cent of the provincial budget, two had a qualified audit opinion and one was unqualified with findings. Of the other departments, 77 per cent had either a qualified audit opinion or unqualified with findings. In total, the AG found per cent material findings in 61 per cent of auditees, though the situation has appeared to improve since FY2010/11.

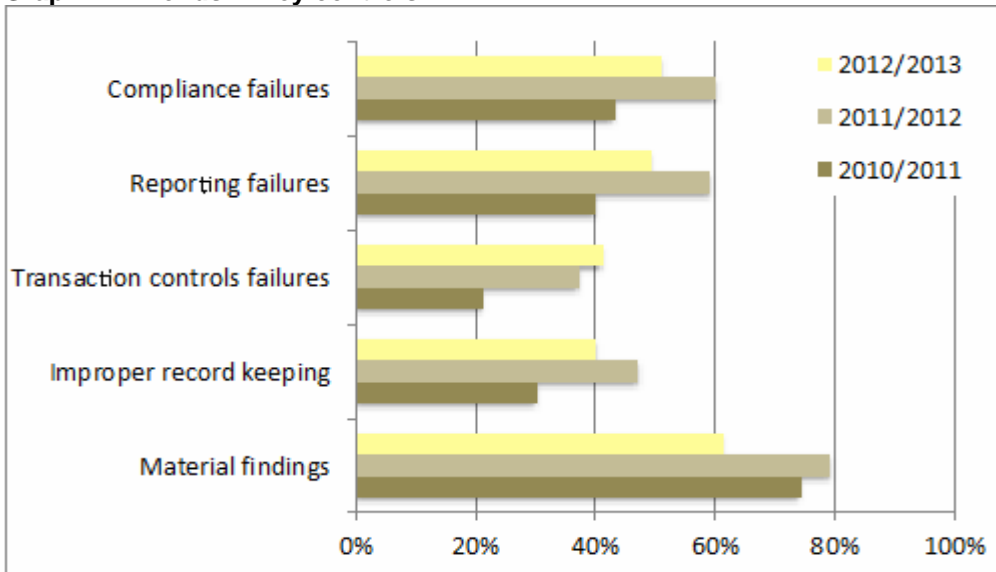
**Table 41: Level of compliance and material findings**

Topic	FY2010/11	FY2011/12	FY2012/13
Material findings	74%	79%	61%
Improper record keeping	30%	47%	40%
Failing controls on daily and monthly processes (reconciling of transactions)	21%	37%	41%
Failure to prepare regular, accurate and complete financial and performance reports (supported by reliable evidence)	40%	59%	49%
Failures of ensuring compliance with applicable laws and regulations	43%	60%	51%

Sources: AG's reports to SCOPA FY2012/13 and AG's annual report 2010/11

The AG reports to SCOPA FY2012/13 notes a regression in governance compliance (risk management, internal audit and audit committee). The reports express the view that the top management should improve management of their areas and better coordinate and improve on risk management to avoid non-compliance and irregularities. In addition, the executive authorities do not provide sufficient assurance in 42 per cent of cases. The AG has implemented a dashboard reporting system including quarterly meetings with top management and the executive authority.

**Graph 17: Trends in key controls**

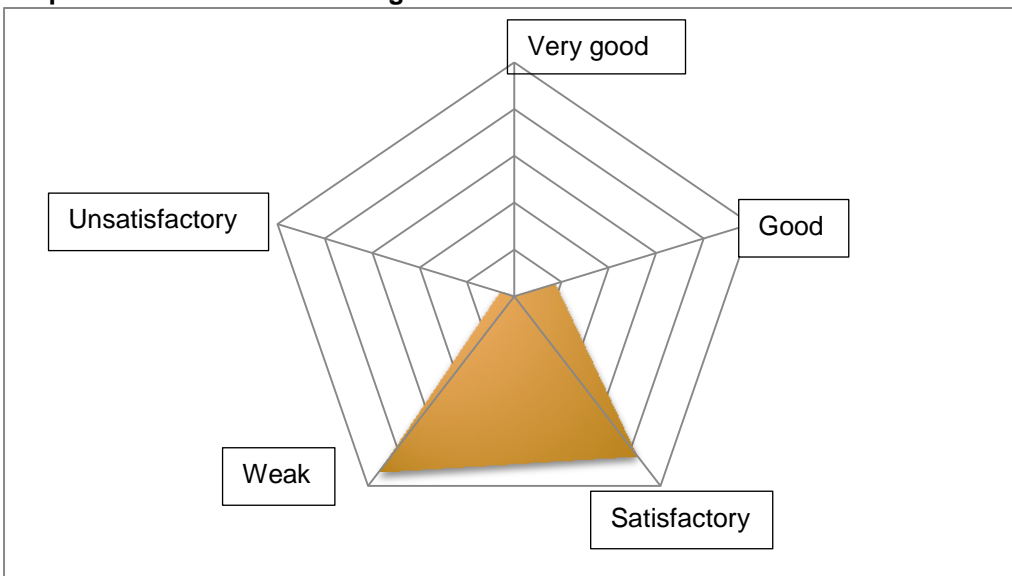


Sources: AG's reports to SCOPA FY12/13 and AG's annual report 2010/2011

The AG reports its interaction with MECs did not yield significant impact in 41 per cent of cases (7 per cent had minimal impact and 34 per cent had some impact on key controls).

The PIAS report for 2012/13 gives also a negative picture of the state of internal controls compliance in its reporting on the overall findings of 222 audits: half are weak and unsatisfactory, and 40 per cent are satisfactory, defined as existing but with room for improvement. Only in 8.6 per cent of reports were internal controls found to be "good". None were found to be "very good".

**Graph 18: Overall control ratings for FY2012/13**



Sources: Provincial internal audit service, annual report 2012/13

The PIAS report considers that in half of the cases, major control deficiencies were found, indicating significant non-compliance.

The SCOPA and finance portfolio committee confirm those findings, reporting that they see the same trends every year, and suggesting that the current governance framework is ineffective in ensuring the implementation of corrective measures and disciplinary actions.

## Ongoing activities

LOGIS, another transverse proprietary procurement software, is not rolled out in the province. It has the capacity to ensure effective commitment control for all procurement, thereby addressing the weaknesses encountered with BAS. The Provincial Treasury is investigating how to roll out LOGIS.

Departments are introducing a new procurement management software, INTENDER such as DOH and DOPW.

Indicator	Score	Evaluation
<b>PI-20 Effectiveness of internal controls on non-salary expenditure</b>	<b>D+</b>	<b>Scoring method M1</b>
(i) Effectiveness of controls on expenditure commitments	D	Although BAS has the capacity to manage commitment control from the requisition stage, but it is not optimally used. In practice, commitment controls are routinely violated.
(ii) Scope, relevance and understanding of other internal control regulations and procedures	C	Internal controls exist and are generally known and understood by the management, though they may not be known and understood by everyone concerned with their application.
(iii) Degree of compliance with the regulations for processing and registering transactions	D	Compliance with existing laws and regulations and internal controls is failing in 50 per cent of cases and leads to material findings in 60 per cent of cases.

## PI-21: Effectiveness of internal audit

**Dimensions to be assessed (scoring method M1):**  
**(i) Scope and quality of internal audit function**  
**(ii) Frequency and distribution of reports**  
**(iii) Management response to internal audit findings**

KwaZulu-Natal has a centralised internal audit service in the Provincial Treasury, as defined in the KwaZulu-Natal Internal Audit Act (Act No. 2 of 2001). The Public Audit Act (Act No. 25 of 2004) allows for the centralisation of the internal audit function by provincial treasury. The departments have internal control units and risk units that support the internal control functions and internal audits.

The centralised internal audit branch has two main functions: assurance risk and forensic. It supports all departments and ten public entities (some of them have established their own internal audit unit, in accordance with the PFMA reporting to the internal audit branch of Provincial Treasury). The risk and forensic division also covers municipalities, supporting their IA functions and reporting to municipal finance unit in the Provincial Treasury.

There is a provincial audit and risk committee (PARC) made up of subcommittees and organised in clusters (social, economic development, government and administrative). Each sub-committee is made up of up three members (Section 77 of PMFA), and the chair, who sits on all three clusters, is appointed from outside the public sector. Appointments are made by the MEC for finance following advertising and checks on potential conflicts of interest.

Each committee convenes at least quarterly to review internal audits reports and findings risk assessments and determine measures to be taken. The HODs, CFOs and GMs are coopted to the meetings that deal with their departments.

The PFMA, sections 38 to 40, assigns responsibility to the AO to ensure effective internal controls and risk management, the efficient use of resources, determine what steps should be taken to prevent unauthorised, irregular, wasteful and fruitless expenditure and decide on effective disciplinary measures.

### **(i) Coverage and quality of the internal audit function**

Audits are planned on the basis of risk assessment and cover all departments and public entities. The risks reports are prepared by the departments with support from the PIAS and the AG. Reports also integrate previous audit findings.

The PIAS develops a risk and control matrix that maps all the risks and when those will be audited. A three-year rolling audit plan is prepared in which each department is audited every year, but not for all risks. SCM, HRM, assets management performance (pre-determined objectives) and transfer payments are audited every year (transversal audits required in PFMA and DORA).

The PIAS work is not fully supported by the department's internal control units due to lack of capacity. The PIAS is initiating an assessment of those units with a view to improving their impact on internal controls.

The PIAS has a staff of 122 who are largely qualified auditors, accountant and economists, as well as IT specialists. It does not have procurement expertise but can call on the help of other services from the Provincial Treasury. Although training for professional development is available, there is no specific training plan. The service falls under the Provincial Treasury's workplace skill plan. The Treasury does not have a training policy in place.

The PIAS limitation is linked to budget and capacity issues that do not allow delivery on all targets. It outsources some of its tasks on forensic audits, compliance and financial audits. To do so, it uses a pool of service providers who have developed public sector knowledge and are supervised by the PIAS. Audit guidelines developed are applied to all audits and the software "teammate" is used for quality assurance done on all audit work.

### **(ii) Frequency and distribution of reports**

Internal audit reports are distributed to the HOD, CFO, and their line functions. A copy is sent to the AG. Quarterly summaries are provided to the internal audit committees. A close-out report for each financial year is sent to the MEC for Finance via the IAC and is tabled at Cabinet, reporting both activities and key findings.

The forensic reports are sent to the AO, IAC and AG, though the PIAS is concerned that they may not reach unit level, impacting thereby on the imposition of disciplinary measures. The portfolio committee for finance regrets that KwaZulu-Natal is the only legislature of South Africa where such reports are not given to this committee, contrary to sections 56 and 115 of the Constitution.

The chair of the IAC reports annually to SCOPA.

### **(iii) Extent of management response to internal audit findings**

The PIAS follows up on repeat audit findings but there is no systematic mechanism for doing so for each finding. At each PARC meeting the department presents an audit improvement strategy, a separate document from the AG's dashboard report. The AG is present during the PARC meeting and may present the dashboard (this is used for quarterly meeting between the AG and the MEC). The PARC can escalate issues to the department MEC or through the MEC for Finance.

In 2012/13, the PIAS reported its concern at the degenerating trend in audit findings and noted that the Departments of Health and Education, *inter alia*, had significant weaknesses. The report added that departments had not adequately implemented or agreed on timely corrective action since the follow up audits revealed that the control weaknesses and non-compliance issues identified by the PIAS were still prevalent at the time of the follow up audits.<sup>14</sup> These findings suggest that departments operate in a weak control environment where compliance cannot be ascertained nor value for money achieved.

By law, sanctions may be applied, but in practice there are no sanctions applied for not taking corrective measures and performing on commitments given in PARC meetings. The PIAS finds that many of the AG's findings are repeat findings, and concur with their findings. Neither are the disciplinary measures emanating from forensic investigations consistent. It is considered that the current provisions of the PFMA and the public sector regulations are not allowing effective mechanisms for sanctions and disciplinary actions, leaving a significant level of discretion to individual HODs and MECs. In regard to the forensic audits performed, the PIAS alerted Cabinet to restrictions in accessing information imposed by departments and inconsistent application and implementation of disciplinary measures, with "some serious transgressions being punished with final written warnings."<sup>15</sup>

### **On-going and planned activities**

The PIAS is initiating assessments of departmental internal control and risk units to improve their capacity and impact on internal controls.

As forensic audits lead to findings and recommendations with little disciplinary follow-up, the Office of The Premier has initiated a central disciplinary court to clear the backlog of cases and implement a consistent system. However due to the current legislation, the departmental HOD decides which cases should be heard by this central mechanism.

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<sup>14</sup> Provincial internal audit services, draft close-out report for 2012/13.

<sup>15</sup> Provincial internal audit services, draft close-out report for 2012/13.

Indicator	Score	Evaluation
<b>PI-21 Effectiveness of internal audit</b>	<b>D+</b>	<b>Scoring method M1</b>
(i) Scope and quality of internal audit function	A	The internal audit function is operational for all departments and public entities, under the management of a centralised internal audit branch at the Provincial Treasury. It performs a range of audits, including performance, procurement, compliance and forensic, on a risk basis to test the effectiveness of internal controls and recommend remedial actions.
(ii) Frequency and distribution of reports	A	The internal audit reports adhere to a fixed schedule and are distributed to the AOs, the IAC (Treasury) and the AG.
(iii) Management response to internal audit findings	D	Although to some degree management takes some corrective measures, both AG and PIAS report slow responses, insufficient to impact on compliance ratings and positively affect the control environment. This leads to repeat findings over the years. Forensic audits seldom lead to disciplinary actions.

### 3.5 Accounting, recording and reporting

#### PI-22: Timeliness and regularity of accounts reconciliation

<b>Dimensions to be assessed (scoring method M2):</b> <i>(i) Regularity of bank account reconciliations</i> <i>(ii) Regularity of reconciliation and clearance of suspense accounts and advances</i>
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#### (i) Regularity of bank reconciliations

The KZN Provincial Treasury single account held with Absa bank is reconciled to the cash book on a monthly basis and takes place within 10 days of the close of the month. Provincial Treasury cash management function maintains a real time status of departmental sub-accounts within the Provincial Treasury single account to enable it to perform monthly bank reconciliations for all provincial departments.

KZN Provincial Treasury currently uses the BAS accounting system, which provides an automated basis for assisting in the completion of the bank reconciliation process. In terms of PFMA section 32 (2), KZN Provincial Treasury submits a quarterly statement of revenue and expenditure reconciled to the bank account to the National Treasury for publication in the national government gazette within 30 days of the end of the quarter.

#### (ii) Regularity of reconciliation and clearance of suspense accounts and advances

Section 40(1)(a) of the PFMA and Section 17.1 of the treasury regulations requires that all suspense accounts be cleared and correctly assigned to a cost centre on a monthly basis. All suspense accounts and advances are cleared and reconciled monthly and reviewed by all provincial departments as part of their IYM process. As part of the financial monitoring process, all departments are required to submit to Provincial Treasury a listing of their suspense accounts balances from the trial balance together with ageing analysis as well as explanations of non-clearance and corrective actions to clear or reduce these accounts. This is reviewed for accuracy, completeness and reasonableness.

The main source of advances booked to suspense accounts is un-acquitted advances made to government officials for foreign travel. Specific advance accounts are reconciled and cleared each month. In a number of departments, unacquitted advances pertaining to governmental officials are recovered directly from salary payments and may become fruitless and wasteful expenditure based on the circumstances. As part of the year-end closing procedures, reconciliations of all suspense and advance accounts together with explanations are prepared and reviewed in detail by management to facilitate the auditing and issuing of the departmental annual financial statements.

Indicator	Score	Evaluation
<b>PI-22 Timeliness and regularity of accounts reconciliation</b>	<b>A</b>	<b>Scoring method M2</b>
Regularity of bank reconciliations	<b>A</b>	Monthly bank reconciliations for all provincial departments are prepared within two weeks of the end of each month.
Regularity of reconciliation and clearance of suspense accounts and advances	<b>A</b>	Monthly suspense and advances reconciliations for all provincial departments are prepared within two weeks of the end of each month.



**PI-23: Availability of information on resources received by service delivery units**

**Dimensions to be assessed (scoring method M1):**  
***(i) Compilation and processing of information to show the resources effectively received (in money or in kind) by the majority of front-line service delivery units (with particular focus on primary schools and primary health care clinics) in relation to the resources made available by the relevant sector or sectors, regardless of the level of government responsible for the functioning and funding of these units***

The financial reporting indicates all resources, except fees (see PI-7) received by primary schools and primary health care facilities. This is possible as reporting on the resources (in cash or in kind) disbursed to the service delivery units is facilitated through BAS. The administrative structure of the budget as reflected in BAS includes cost centres specified to the level of primary schools and health centres.

These schools and hospitals receive funds from provincial transfers and their own revenue receipts. The school fees are not considered public monies by law in terms of Schedule 4 of the PFMA which, under the SA Schools Act, excludes school fees from the revenue fund. These amounts are therefore not included as part of the Department’s own revenue receipts in budgets, annual financial statements or reports. We note that assets funded by school fees are reflected in the financial statements.

The provincial health care centres, hospitals and clinics receive funds from provincial transfers and their own revenue receipts. They collect revenue in the form of patient fees according to the uniform patient fees schedule (UPFS). These monies are included as part of the department’s own revenue receipts in budgets, annual financial statements or reports and consolidated as part of the revenue reflected under the sales of goods and services.

Indicator	Score	Evaluation
<b>PI-23 Availability of information on resources received by service delivery units</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Compilation and processing of information to show the resources effectively received (in payment or in kind) by the majority of front-line service delivery units	A	Data on resources received by schools and health clinics, in cash and in kind is produced routinely. It is compiled in the AFS.

## PI-24: Quality and timeliness of in year budget reports

### Dimensions to be assessed (scoring method M1):

- (i) Scope of the reports in terms of coverage and compatibility with budget estimates*
- (ii) Timeliness of report presentation*
- (iii) Quality of information*

#### **(i) Scope of reports in terms of coverage and compatibility with budget estimates**

The standard format of the IYM reports has been designed by the National Treasury for use by all provinces and uses information from BAS. The report known as the Treasury consolidation IYM model S 40 (4) is consolidated per province in respect of the projected and actual expenditure and provincial own receipts. BAS uses a seven-level classification and allows reporting in the same classification as the budget. The chart of accounts is an extension of the budget classification.

The model contains the expenditure reports for each of the 16 departments in the province in terms of their programmes. The IYM model covers expenditures as transactions undertaken and forecasts include planned expenditures and known commitments<sup>16</sup>. The report includes the prior year actual expenditure, the actual expenditure for the current month and the updated projections for the remaining months and includes transactions, planned expenditures and known commitments. The information is reported per economic classification (current payments, current transfers and subsidies, capital transfers and subsidies, payment for capital assets and payment for financial assets). Infrastructure spend in respect of new and existing infrastructure assets is also reflected in the IYM in addition to the provincial transfers to municipalities.

Each department's IYM report incorporates its own revenue in terms of tax receipts (casino and horse racing taxes and liquor and motor vehicle licences), the sale of goods and services, transfers received, penalties and fines, interest, dividends, rental, sale of capital assets and financial assets and liabilities.

#### **(ii) Timeliness of the issue of the reports**

Departments are required to submit their monthly IYM reports to Provincial Treasury by the 15<sup>th</sup> day of the next month. Most departments meet the deadline, but there have been occasional delayed submissions. The late submission does not impact the consolidation and submission to National Treasury by the 22<sup>nd</sup> of each month.

IYM reports are submitted to Provincial Treasury's budget unit for analysis and submission. Provincial Treasury's budget analysts request explanations as necessary where there is evidence of under/over spending. Should Provincial Treasury not be satisfied with the explanations received the matter can also be raised at the relevant portfolio committees. Provincial Treasury consolidates the financial information all departments into a consolidated KZN provincial IYM report and forwards it to National Treasury by the 22<sup>nd</sup> of each month for consolidation at national level.

#### **(iii) Quality of information**

According to the Accountant-General of KZN and other interviewees at Provincial Treasury and in departments, the financial statements include misallocation due to the incorrect use of the BAS classifier, misreporting commitments arising from the inconsistent practice of recording commitments, irregular expenditure that is incorrectly reported as regular and vice-versa. BAS's seven-level classification includes some internal controls on classification errors, but it is still prone to errors in selection of items in the drop-down menus. This has led to misclassification. The impact on the quality of accounts is not measurable but it was reported that when the Public Finance Unit of Provincial Treasury alerts departments on spending patterns (e.g. overspending), the "default answer" is often that they need to review the figures for misclassification (including recurrent as capital, capital as compensations, etc.) suggesting this may be a significant issue.

This is further emphasised by the AG's presentations for 2012/13 which reflects that 21 per cent of the auditees

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<sup>16</sup> See PI-20 – all commitments are not recorded, thus forecast in IYM may not be more than the planned expenditure and subsequent cash layouts presented in the cash forecast.

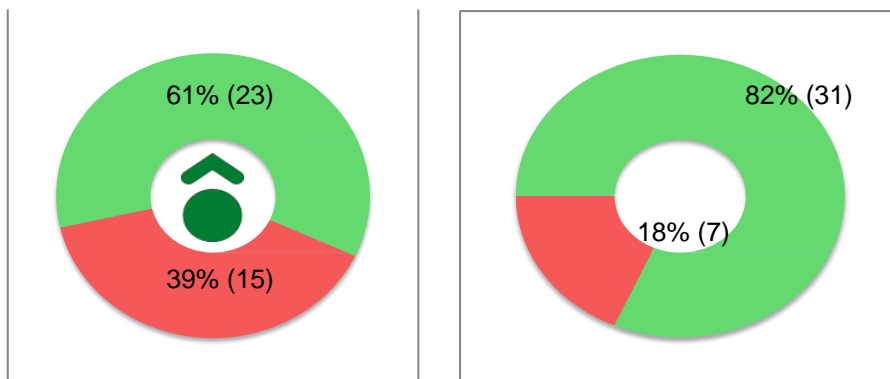
were able to avoid qualifications due to the correction of material misstatements during the audit process. The outcome rate was 61 per cent, compared to 82 per cent before the misstatements were corrected. This is an improvement from last year when only 62 per cent of the auditees were able to avoid qualifications after correcting all misstatements highlighted by the AG. In all three years under review, the AGs found that material misstatement was an issue, even after corrections had improved the outcome.

**Table 42: Percentage of improved financial statements**

	2010/11	2011/12	2012/13
% reported by AG after correction	57%	62%	82%

Source: AG provincial audit outcomes reports for 2012/2013 and 2011/2012

**Graph 19: Material misstatement before and after correction for 2012/13**



Source: AG's audit outcome of provincial government in KZN for 2012/2013

Indicator	Score	Evaluation
<b>PI-24 Quality and timeliness of in-year budget reports</b>	<b>C+</b>	<b>Scoring method M1</b>
(i) Scope of reports in terms of coverage and compatibility with budgetary forecasts	A	The IYM report format has been designed by the National Treasury for use by all provinces and aligns to the budget classification. It covers receipts, revenues and expenditures as in the budget in detail and at commitment and payment stages.
(ii) Timeliness in the presentation of reports	A	By the 15 <sup>th</sup> of each month the departments submit their IYM reports on actual revenue and expenditure for the previous month and their projections for future months to Provincial Treasury's budget unit.
(iii) Quality of the information	C	The Accountant-General, Auditor-General and Provincial Treasury's public finance unit report concerns about the quality and accuracy of data in the reports.

## PI-25: Quality and timeliness of annual financial statements

### **Dimensions to be assessed (scoring method M1):**

***(i) Comprehensiveness of financial statements***

***(ii) Timeliness in the presentation of financial statements***

***(iii) Accounting standards used***

Sections 87 and 89 of the PFMA authorise the constituting of the Accounting Standards Board (ASB) to set standards of Generally Recognised Accounting Practice (GRAP) for public entities. The PFMA and the Treasury Regulations along with an extensive set of published accounting policy guidelines, accounting practice notes and accounting standards define the legal and regulatory framework for public accounting in provincial departments. In setting these standards the ASB takes into account both local and international best practice.

All published financial statements include a detailed outline of the accounting policies and principles applied in the preparation of the statements. The financial statements also take into account the disclosure requirements of the PFMA and the treasury regulations which require an income statement, balance sheet, cash flow statement, accruals, commitments, details of irregular expenditure, details of wasteful and fruitless expenditure, transfers and subsidies, employee benefits, prepayments and a report on the financial position and performance of the provincial departments.

Section 19 of the PFMA states that in respect of provincial departments “the Provincial Treasury must prepare consolidated financial statements in accordance with Generally Recognised Accounting Practice for each financial year” and submit them to the Auditor-General within three months after the end of the financial year. However this has not been complied with for the period assessed due to the time taken to finalise, submit and audit the annual financial statements of 16 departments. Each KZN provincial department prepares stand-alone financial statements that are completed within two months of the close of the fiscal year and submitted to the Auditor-General for audit (Section 55 of PFMA). All KZN provincial departments met the legislated deadlines in respect of the timeliness of financial reporting for the three years under assessment. The audits of the provincial department’s annual financial statements are completed within two months and submitted to the Office of the Accountant-General for consolidation. The draft consolidated financial statements were thereafter submitted to the Auditor-General as:

- 2010/11 consolidated AFS submitted to AG on 21/10/2011: i.e. within seven months of the end of the fiscal year
- 2011/12 consolidated AFS submitted to AG on 8/10/2012: i.e. within seven months of the end of the fiscal year
- 2012/13 consolidated AFS submitted to AG on 5/09/2013: i.e. within six months of the end of the fiscal year

Indicator	Score	Evaluation
<b>PI-25 Quality and timeliness of financial statements</b>	<b>B+</b>	<b>Scoring method M1</b>
(i) Completeness of financial statements	A	Consolidated annual financial statements relating to KZN 16 provincial departments are prepared annually and include income and expenditure statement, balance sheet, cash flow statement, accruals, commitments, details of irregular, wasteful and fruitless expenditure, transfers and subsidies, employee benefits, and prepayments.
(ii) Timeliness in the presentation of financial statements	B	Annual financial statements relating to KZN 16 provincial departments were submitted to the Auditor-General within two months of the end of the fiscal year for each of the three years reviewed during this assessment and audited within two months of their submission. However submission of two of the three KZN consolidated annual financial statements to the Auditor-General for the period assessed were submitted within seven months of the end of the fiscal year.
(iii) Accounting standards used	A	The Accounting Standards Board of South Africa has been constituted to set and promulgate accounting standards. All provincial financial statements have been prepared on a modified cash basis of accounting which disclose the accounting policies that have been employed. (ie Generally Recognised Accounting Practice – GRAP).

### 3.6 External scrutiny and audit

This set of indicators looks at the quality and timeliness of external scrutiny of the government's budget estimates as well as the public accounts.

#### PI-26: The scope, nature and follow up of external audit

**Dimensions to be assessed (scoring method M1):**

- (i) Scope/nature of the audit carried out (including compliance with auditing standards)**
- (ii) Timeliness in submission of audit reports to the legislature**
- (iii) Evidence of follow up on audit recommendations**

#### **(i) Scope and nature of audit**

The 2008 PEFA assessment reported on the Auditor-General's powers and independence. The Auditor-General derives its independence, powers and mandate from the Constitution (section 188) and the Public Audit Act. The Auditor-General must audit and report on the accounts, financial statements of national and provincial departments, municipalities and any other public institutions as well as institutions receiving funds from the general revenue fund and must submit audit reports to the legislature. The Auditor-General is appointed by the President on the recommendation of the National Assembly and approval by the National Assembly with a supporting vote of at least 60 per cent of the members of the Assembly (sections 193 and 194 of the Constitution) for a fixed, non-renewable term of between five and ten years (section 189). He or she may be removed from office only with a supporting vote of at least two thirds of the members of the Assembly on the ground of misconduct, incapacity or incompetence (section 194). In a province, the nomination of the business executive and any other posts is an internal appointment in the AG office.

As provided for by the Constitution and the Public Audit Act, the Auditor-General is legally, financially and operationally independent from the public sector. The budget is in the form of fees charged to each auditee, with a maximum of 1 per cent of its total expenditure. The National Treasury covers audit fees over and above this percentage. The fee structure is an internal calculation that depends on risk.

Each auditee receives a strategic audit plan.<sup>17</sup> The AG office noted that it has receivables pending for more than 30 days.

The staff independence is guaranteed and the AG office operates a performance-based component of the remuneration structured around influencing/driving better outcomes of audit, the clarity of the message, the visibility of the AG's work and human resources development.

The AG can outsource its work. At provincial level, the AG contracts team members only. All departments and public entities are audited every year.

The AG office performs a full range of audits in accordance with the requirements of the PFMA and PAA under the regularity audit: financial, compliance, predetermined objectives, internal control systems and IT audit. The audit of the SCM process necessarily includes elements of value for money. The pre-determined objective audit performance plans realisations and their targets, focusing on service delivery. Full performance audits are carried out with a unit based in the AG office in Pretoria. The time spent on each type of audit depends upon the auditee's risk profile, established in the strategic audit plan. The AG reported to SCOPA in October that value for money audit represented about 10 per cent of the fees charged to its clients. The AG reports also cover the financial health of each auditee, including assets managements, receivables and payables (accruals). The annual audit report for the province presents easy to read reports, clarifying trends (opinion; areas of weaknesses).

#### **(ii) Timeliness of submission of audit reports to legislature**

Section 40 of the PFMA 40 and 28 of the treasury regulations specify that department have to submit their AFS within two months of the end of the fiscal year and the AG has to submit its audit reports within two months of their receipt. In addition, departments have to submit their audited AFS, annual report and the AG's management report within five months of the end of the fiscal year. The MEC is responsible for tabling all reports to the

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<sup>17</sup> These documents are internal and considered confidential between the AG office and the auditee.

legislature by the end of August, ie five months after the close of the fiscal year.

In the province, all departments and public entities submit their AFS on time, with the exception of the rehabilitation trust fund (a public entity under the purview of Department of Economic Development) while two pensions funds have been submitting late for actuarial reasons. The submission of the provincial revenue fund annual financial statements has usually been late leading to late audit, due to delays in first obtaining all other departments audited statements. This situation has improved since FY2010/11.

For each entity, the AG prepares a management report and an audit report. It prepares a consolidated report for the provinces, providing a graphic overview of the main findings and facilitating the work of SCOPA.

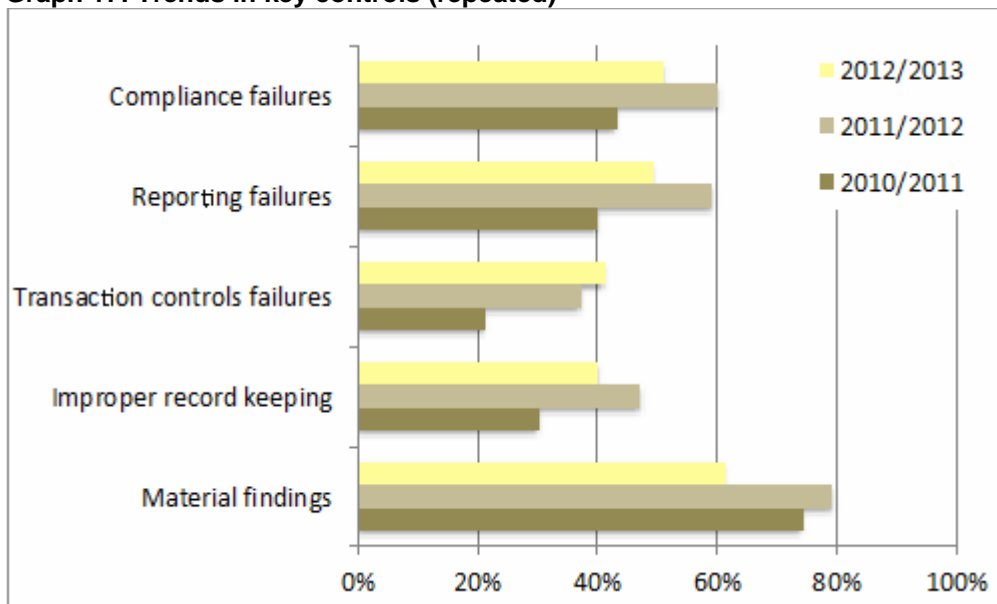
The AG reports to the Provincial Legislature for each department and public entities at provincial level by 31 July, whose reports are then tabled in August.

### (iii) Evidence of follow-up on audit recommendations

The AG has implemented a “clean audit initiative” with all departments since 2011/12. The auditee prepares a detailed action plans for discussion with the AG on how it intends to address the findings. Quarterly meetings are held with the management and MECs, using the dashboard report. This allows emphasis to be placed on issues of concerns while attempting to improve the leadership of senior management and the control environment.

However, the statistics provided in the AG’s annual reports for all three years reviewed, as reported in table 39 for PI-20, suggests that although formal responses are made to the audit findings, and to the resolutions of the portfolio committee for finance, the repeat findings suggest that the follow-up by management is ineffective. The AG’s report to SCOPA for FY2012/13 assessed the impact of its interaction with MECs through the quarterly dashboard meeting as leading to significant and sustained impact in only 48 per cent of cases, leaving 52 per cent with minimal or limited impact.

**Graph 17: Trends in key controls (repeated)**



### On-going and planned activities

N/A

Indicator	Score	Evaluation
<b>PI-26 Scope, nature and follow-up of external audit</b>	<b>B+</b>	<b>Scoring method M1</b>
(i) Scope/nature of the audit carried out (including adherence to audit standards)	A	All departments and public entities are audited annually. The AG uses a full range of audits covering revenues, expenditures, assets and liabilities. It focuses on systemic issues and performance plans, including VFM.
(ii) Timeliness in the presentation of auditing reports to the legislature	B	The Auditor-General is required to complete its audits of the department AFS and of their management within two months of receipt of the entities' AFS, i.e. four months from the end of the fiscal year. By law, audited AFS, department annual performance reports and AG's audit reports are submitted by the end of August to the Legislature, ie five months after the end of the fiscal year.
(iii) Evidence of follow up of audit recommendations	B	Although a formal response is made, and used for follow-up on a quarterly basis, there is no systematic taking of corrective measures by the executive, reflected in repeat findings by AG and PIAS.



## PI-27: Legislative scrutiny of the annual budget law

### **Dimensions to be assessed (scoring method M1):**

***(i) Scope of examination by the legislature***

***(ii) Degree to which legislative procedures are recognised and respected***

***(iii) Adequacy of the time for the legislature to provide a response to budget proposals***

***(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature***

### **(i) Scope of the Legislature's scrutiny**

Section 28 of the Public Finance Management Act stipulates that the provincial MEC for Finance must annually table a multi-year budget projection of a) the estimated revenue expected to be raised; and b) the estimated expenditure expected to be incurred, during each year of the multi-year period. The projection must be tabled in the provincial legislature.

The legislature scrutinizes the budget and its associated medium-term expenditure framework during the mid-term review in November of the current year. It reviews the macro-economic policies and priorities of the provincial government during the budget speech in March of the current year. The legislature scrutinises the pre-determined objectives and future year budget during the portfolio committee's interaction with their departments during budget preparation and after the tabling of the Estimates of Provincial Revenue and Expenditure (EPRE). It does not cover the analysis of the impact of new national policies. Note that the revenues are composed of transfers from the National Treasury (equitable share), departments (conditional grants) and own provincial revenues.

In addition, the portfolio committees oversee the budget's execution on a continual basis, including budget preparation, budget execution with monthly and quarterly reports, and close-out in May (after the submission of the department's AFS). This scrutiny is mandated by sections 56 and 115 of the Constitution, which empowers the legislature to summon any person to give evidence or produce documents. Nevertheless, the finance portfolio committee is encountering difficulties in obtaining information on forensic audits. The chair of the finance portfolio committee reported this has a great impact on financial misconduct, mismanagement of personnel compensations, SCM processes and contracts.

The finance portfolio committee's interaction with departments is largely performance oriented, in addition to addressing compliance and spending. The finance portfolio committee passes resolutions in March (review of the Appropriation Bill) and follows up closely on them at midterm reviews. During 2012, the finance portfolio committee passed 150 resolutions, compared to 155 resolutions in 2011 and 185 resolutions in 2010. It had requested the Provincial Treasury to intervene in the DOH in FY2009/10 in respect of section 18 of the PFMA, allowing the Treasury to take over the financial management of the department.

### **(ii) Extent to which the legislature's procedures are well-established and respected**

The KwaZulu-Natal Legislature has well-established practices enshrined in its standing rules. The constitutions, roles and operations of the committees are well defined and adhered to. Each committee's role is defined with respect to its portfolio and the types of oversight to be exerted. The finance portfolio committee and SCOPA prepare annual operational plans to guide their legislative control during the year. Public access and participation is well defined.

### **(iii) Adequacy of time for the legislature to provide a response to budget proposals**

There is ample time for the legislature to provide a response to the budget proposal, and this time is spread through the year. The portfolio committees engage with their respective departments from the first budget submission on 31 August of the current year to the final submission in January. The portfolio committees do not formally commit to the final budget submissions but informally give their consent. Once the Estimates of Provincial Revenue and Expenditure (EPRE) are tabled in the House in March of the current year, the finance portfolio committee reviews it, and holds hearings with each department. The House then debates and passes each vote, usually between end of April and May of the new fiscal year, i.e. after the start of the fiscal year. Thereafter the Appropriation Act is passed and enacted by the Premier. The budget calendar (see PI-11) is established by orders and practice.

**(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature**

Clear rules exist for in-year amendments to the budget without the ex-ante approval of the legislature defined in the PFMA section 43. Those rules allow an accounting officer to use savings from one division and apply it to another division, with exceptions. Those exceptions limit virements from savings on transfers to another institution, from amounts appropriated specifically for a purpose and from capital expenditure to defray current expenditure. Virements are capped at 8 per cent within a division. The AO should submit a report to the Provincial Treasury on those adjustments. Furthermore, the adjustment has to be approved by the legislature.

Section 31 of the PFMA provides for adjustments, usually tabled in October to the provincial legislature. This section refers to unforeseeable and unavoidable expenditure, adjustments in terms of transfers of assets and the shifting of funds associated with it, adjustments in terms of section 43 as mentioned and the rollover of unspent funds.

A National Treasury circular had been sent to all departments and provincial department to guide the process and reduce adjustments that did not arise from unforeseeable expenditures. The chair of the finance portfolio committee considers the annual adjustment process as abusing the principles of section 31 since departments inflate the allocation on some items and then underspend allowing virements and roll-over. This indicates a weakness in financial planning as reported in PI-12 and the limits of the strategic allocation resources to service delivery.

**On-going and planned activities**

N/A

Indicator	Score	Evaluation
<b>PI-27 Legislative scrutiny of the annual budget law</b>	<b>A</b>	<b>Scoring method M1</b>
i) Scope of examination by the legislature	A	The KZN Legislature’s review covers the fiscal policies of the province, the provincial revenues and expenditures (including all transfers from the National Treasury and departments) as well as the provincial priorities and medium-term expenditure framework, including the pre-determined objectives of each department.
ii) Degree to which legislative procedures are recognised and respected	A	The KZN Legislature’s procedures for budget review, oversight of its execution and debate are well established and respected. Roles of committees are clearly defined as well as rules and accepted practice for tabling and debating departmental budget and audit reports.
iii) Sufficiency of time for the Legislature to respond to the budgetary proposals	A	The Legislature has at least two months to review the budget proposals, including the work of the finance portfolio committees, and usually takes four to six weeks from April to review and debate the budget proposal, which has been tabled in March.
iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature	A	Clear rules exist for virements by the executive during the year, and require passing an adjustment budget, while virement in excess of those limits have to be approved by the Provincial Legislature.

## PI-28: Legislative scrutiny of external audit reports

### **Dimensions to be assessed (scoring method M1):**

***(i) Timeliness in examination of the audit reports by the legislature (reports received within the past three years).***

***(ii) Scope of the hearings carried out by the legislature into the main findings***

***(iii) Issuance of recommendations by the legislature and their implementation by the executive***

### **(i) Timeliness of examination of audit reports by the legislature**

SCOPA opens its hearings in October every year with the presentation of audits findings for all departments and public entities by the AG, a presentation of key issues by the chair of the internal audit committee and a presentation by the Accountant-General with regards to irregular expenditures. SCOPA usually finalises all hearings on departmental audit reports of the AG by the end of October or first week of November each year. It is very seldom that hearings are carried over to the next year but should this happens, it is usually limited to one or two reports, and these are done by the end of February. The report from the SCOPA hearings held in October/November is considered by the House before the end of the year: usually in the last week of November or first week of December before the recess, i.e. 3 to 4 months after the AG's report has been tabled. There is generally no undue delay in SCOPA reports being considered by the Legislature.

### **(ii) Extent of hearings on key findings undertaken by the legislature**

According to the sections 56 and 115 of the Constitution, SCOPA summons the MECs and HODs of the departments and public entities as it deems necessary. Usually the emphasis is placed on "overspenders and underspenders", and departments with qualified audit opinions. This emphasis is explained as a primary focus on service delivery, seeking to improve the quality of the budget preparation and its execution to ensure that services are delivered. This does not take away the focus on compliance and management, since the roles of the finance portfolio committee and SCOPA appear complementary and mutually reinforcing.

The hearings are detailed, based on an analysis of the AG's report and previous findings, portfolio committee's resolutions and SCOPA resolution. SCOPA's work is geared with an annual operational plan.

The hearings are public. There is wide media coverage, leading to detailed reports.

### **(iii) Issuance of recommended actions by the legislature and implementation by the executive**

Resolutions are passed by SCOPA and by portfolio committees. Internal audit and the Auditor-General follow up on them. While SCOPA emphasises that they find the same findings year on year and it is concerned that the situation is not improving, spite of the resolutions passed, the AG reports slow responses in 45 per cent of cases and attributes this outcome partly to key vacancies unfilled (32 per cent) affecting management capacity to fix issues and improve internal controls and in 21 per cent of cases to management lacking competencies that can only have a major impact on the compliance and performance. This raise questions as to why these underlying issues are not being addressed. During 2012 SCOPA passed 75 resolutions through the KZN Legislature compared with 71 resolutions in 2011 and 62 resolutions in 2010. The resolutions for 2013 will only be finalised after the hearings in November 2013.

The AG is of the view that financial management matters have improved over the past five years, for example, on timely submission of financial statements. The AG's initiative to help departments achieve clean audits with quarterly dashboard meetings with MECs is a response to reported weaknesses.

However, the taking of corrective measures is also hampered significantly by the absence of sanctions. Disciplinary decisions are seldom taken to sanction management, and when taken relate to staff at lower levels. In the view of interviewees, there is a limitation of the legal and regulatory framework: PFMA sections 38 to 40 on accounting officers' responsibilities, sections 81 to 86 on financial misconduct and treasury regulations 4.13. and 3.1.14 that limits the effective application of sanctions. The HOD is responsible for the decision on sanctions for his or her own staff while the Treasury can only inform or apply to the MEC of the department. This is compounded by public sector regulations that limit disciplinary actions and restrict their taking by the HOD of the

department. However, treasury regulation 4.1.3 ensures that the Provincial Treasury of financial misconduct and regulation 33.1.4 empowers the Provincial Treasury to investigate, having informed the MEC. Regulation 33.2.2 empowers the Provincial Treasury to direct a public entity to lay charges against any person should an accounting authority fail to take appropriate action. Overall, the situation makes the governance environment weak and does not allow improvements to be made in securing efficiency gains and value for money.

### Ongoing activities

Members of the KZN legislature are seeking a revision of the PFMA to address compliance and sanctions

Indicator	Score	Evaluation
PI-28 Legislative scrutiny of external audit reports	<b>C+</b>	Scoring method M1
(i) Timeliness in the examination of audit reports by the legislature (reports received within the past three years).	A	The report from the SCOPA hearings held in October/November is considered by the House before the end of the year: usually in the last week of November or first week of December before the recess, i.e. three to four months after the AG's report has been tabled.
(ii) Scope of the hearings held by the legislature into the main conclusions	A	In-depth, informed hearings are held for departments with qualified opinions and those showing problematic spending patterns. Hearings are public.
(iii) Measures recommended by the legislature and implementation of these by the executive	C	Resolutions are made by SCOPA, and during the year by the finance portfolio committee. There is evidence that some correctives measures are taken in response but these are consistently insufficient to ensure that resolutions are fully implemented and lead to significant progress in audit outcomes re. compliance and value for money.

### **3.7 Donor practices**

External donor activity is practically nonexistent in the Province, only domestic donors provide some monetary and in-kind support for certain activities and events (PI-7). The three indicators do not apply.

## Annexure 1: List of officials consulted

Name and surname	Department
Jeremy Upfold	KZN Provincial Treasury - Public Finance: Provincial Budget Management
Eddie Musasiwa	KZN Provincial Treasury - Public Finance: Senior Manager
Hlengiwe Mcuma	KZN Department of Education - Chief Financial Officer
Eddie Musasiwa	KZN Provincial Treasury - Public Finance: Senior Manager
Santanu Moodley	KZN Provincial Treasury - Financial Reporting: General Manager
Liesl Curtis	KZN Provincial Treasury - Public Finance: Senior Manager
Tanya Stielau	KZN Provincial Treasury - Public Finance: Senior Manager
Hermann Conradie	KZN Provincial Treasury - Financial Reporting: Acting Accountant General
Jacob Twala	KZN Provincial Treasury - Economic Analysis & Infrastructure: Economic Advisor
Jeremy Redfearn	KZN Department of Public Works - Chief Financial Officer
Pravesh Balloram	KZN Department of Public Works - SCM Manager
Kuben Kisten	KZN Department of Public Works - Deputy Manager: Compliance
Afazel Sakey	KZN Department of Public Works - Assistant Manager
Nkosinathi Buthelezi	KZN Department of Public Works - Deputy Manager
Benedict Hlophe	KZN Department of Public Works - State Accountant
Seema Sewrathan	KZN Office of the Premier - Senior Manager: Management Account
Makhosi Phungula	KZN Office of the Premier - Assistant Manager: Policy and Legislation Development
Shana Ranjith	KZN Office of the Premier - Admin Officer
Vishal Ramdas	KZN Gaming and Betting Board - Finance Manager
Innocent Mncube	KZN Gaming and Betting Board - Manager: Gaming Audit
Jeremy Upfold	KZN Provincial Treasury - Public Finance: Provincial Budget Management
Vanuja Maharaj	Auditor General South Africa - Business Executive
SJ Paine	Auditor General South Africa - Stakeholder Liaisons Manager
S Sivenarain	Auditor General South Africa - P/C
P Stamper	Auditor General South Africa - Deputy Business Executive
Indhren Perumaul	Auditor General South Africa - Deputy Business Executive
Wayne Evans	KZN Department of Transport - Chief Financial Officer
Sue Grobbelaar	KZN Department of Transport - Senior Manager: MTS
Gavyn Wirth	KZN Department of Transport - Senior Manager: SCM
Thabani Nkosi	KZN Department of Transport - Acting Senior Manager
Hester van Rooyen	KZN Department of Transport - Deputy Manager
Lowell Pelser	KZN Department of Transport - Acting Deputy Manager
Bathandwa Nogwanya	KZN Department of Transport - General Manager
Madhavy Bhaw	KZN Provincial Treasury Internal Audit - General Manager of Assurance Services and Acting Head of Internal Audit
Belinda Scott	Finance Portfolio Committee / SCOPA - Chairperson
Liesl Curtis	KZN Provincial Treasury - Public Finance: Senior Manager
Mashaka Ravhura	KZN Department of Health - Chief Financial Officer
Adri Mansvelden	KZN Department of Health - Business Manager
Sibusiso Mhlongo	KZN Department of Health - Acting Manager
Nosipho Mthembu	KZN Department of Health - Acting General Manager

Anesh Innerjeeth	KZN Department of Health - Deputy Manager
John Ramathar	KZN Department of Health - Deputy Manager
Andile Zondo	KZN Department of Health - Manager: SCM
Justice Mudau	KZN Department of Health - General Manager
RN Msebeni	KZN Department of Health - Assistant Manager
Lorraine Naidoo	KZN Provincial Treasury - SCM: Senior Manager
Christopher Raja	KZN Provincial Treasury - SCM: Senior Manager
Credo Mlaba	KZN Provincial Treasury - SCM: Senior Manager
Khondlo Mtshali	KZN Provincial Treasury - SCM: Senior Manager
Shirmala Pillay	KZN Department of Human Settlements - Chief Financial Officer
Raymond Mohan	KZN Department of Human Settlements
Bongekile Khoza	KZN Department of Human Settlements
Lydia Goba	KZN Department of Human Settlements
Nontobeko Mlaba	KZN Department of Human Settlements
Puseletso Nale	KZN Department of Human Settlements
Yadhir Singh	KZN Department of Human Settlements
Peter Woolf	KZN Department of Human Settlements
Tanya Stielau	KZN Provincial Treasury - Public Finance: Senior Manager
Louise Janse van Rensburg	KZN Office of the Premier - Human Resource Policy and Practices: Senior Manager
Lowell Pelser	KZN Department of Transport - Acting Deputy Manager
Daygan Eagar	Section27
Farhad Cassimjee	KZN Provincial Treasury - General Manager Municipal Finance
Thandiswa Khanqu	PPP: Manager
Mbongezi Dladla	PPP: Intern/Junior
Skumbuzo Hlope	PPP: Intern/Junior
Melanie Veness	CEO, Chamber of Commerce

## Annexure 2: Documents consulted

1. Constitution of the Republic of South Africa Act 108 of 1996
2. Public Finance Management Act No. 1 of 1999
3. Treasury Regulations issued in terms of the PFMA
4. Broad-Based Black Economic Empowerment Act, 2003
5. Preferential Procurement Policy Framework Act No. 5 of 2000
6. Preferential Procurement Regulations, 2001
7. State Tender Board Act No. 86 of 1968
8. Division of Revenue Act No. 2 of 2013
9. National Road Traffic Act 93 of 1996
10. Road Traffic Management Corporation Act No. 20 of 1999
11. National Treasury Instruction Note on the Amended Guidelines in Respect of Bids that include Functionality as a Criterion for Evaluation (September 2010)
12. KwaZulu-Natal Supply Chain Management Policy Framework
13. KwaZulu-Natal Provincial Treasury Practice Note Number: SCM-07 of 2006
14. KwaZulu-Natal Provincial Treasury Practice Note Number: SCM-02 of 2008
15. KwaZulu-Natal Department of Education Finance Circular No. 15 of 2012
16. KwaZulu-Natal Appropriation Act No. 02 of 2013
17. KwaZulu-Natal Provincial Treasury Medium Term Expenditure Framework Treasury Guidelines 20 June 2011
18. KwaZulu-Natal Provincial Treasury Socio-Economic Review and Outlook 2012/13
19. KwaZulu-Natal Auditor General Audit Outcomes of Provincial Government as at 31 August 2013  
Provincial Treasury: Provincial Internal Audit Services - Draft Close Out Report Provincial Audit and Risk Committee April 2012 to March 2013
21. Consolidated Annual Financial Statements for the KwaZulu- Natal Province for the year ended 31 March 2013
22. Consolidated Annual Financial Statements for the KwaZulu- Natal Province for the year ended 31 March 2012
23. Consolidated Annual Financial Statements for the KwaZulu- Natal Province for the year ended 31 March 2011
24. KwaZulu-Natal Department of Transport Annual Report 2012/13
25. Budget Speech 2010: KwaZulu- Natal Legislature
26. Submission and Tabling of Departmental APP and Strategic Plan 2011: KwaZulu-Natal Legislature
27. Submission of Departmental APPS and Budget Reports for 2012: KwaZulu-Natal Legislature
28. Auditor General: General Report on the Provincial Audit Outcomes of KwaZulu-Natal 2011/12
29. KwaZulu-Natal Provincial Treasury Estimates of Provincial Revenue and Expenditure 2013/14
30. Municipal Finance Management Act No.56 of 2003
31. Division of Revenue Act No. 2 of 2010
32. National Treasury Municipal Budget and Reporting Regulations format (Summary of financial dimensions) 2011 and 2012 - Schedule A1
33. National Treasury Municipal Budget and Reporting Regulations format (Summary of financial dimensions) 2011 and 2012 - Schedule A2 to 10
34. KwaZulu-Natal Department of Education Annual Report 2012/2013
35. KwaZulu-Natal Department of Health Annual Report 2012/2013
36. KwaZulu-Natal Department of Human Settlements Annual Report 2012/2013
37. KwaZulu-Natal Department of Public Works Annual Report 2012/2013
38. KwaZulu-Natal Department of Cooperative Governance and Traditional Affairs Annual Report 2012/2013
39. NT Document - Tabling and approval of municipal budgets for 2012 MTREF
40. NT Document - Tabling and approval of municipal budgets for 2011 MTREF



41. NT Document - Tabling and approval of municipal budgets for 2010 MTREF
42. Borrowing Powers Act no 48 of 1996
43. Uniform Patient Fee Schedule 2013
44. KwaZulu-Natal Gaming and Betting Act 8 of 2010.
45. KwaZulu-Natal Gaming and Betting Tax Act, 9 of 2010
46. KwaZulu-Natal Department of Transport Arrears Schedule 2012/2013
47. KZN Treasury Consolidation IYM Model 2012/201
48. KZN Treasury Note 18- Petty Cash
49. KwaZulu-Natal Provincial Treasury: Consolidated Financial Information for Public Entities for the year ended 31 March 2011
50. KwaZulu-Natal Provincial Treasury: Consolidated Financial Information for Public Entities for the year ended 31 March 2012
51. KwaZulu-Natal Provincial Treasury: Consolidated Financial Statements for Public Entities for the year ended 31 March 2013
52. KZN Treasury Schedule of submissions of municipalities AFS by 31 August for 2010
53. KZN Treasury Schedule of submissions of municipalities AFS by 31 August for 2011
54. KwaZulu-Natal Provincial Treasury Annual Report 2012/13
55. KwaZulu-Natal Estimates of Provincial Expenditure for the year ended 31 March 2010
56. KwaZulu-Natal Estimates of Provincial Expenditure for the year ended 31 March 2011
57. KwaZulu-Natal Estimates of Provincial Expenditure for the year ended 31 March 2012
58. KwaZulu-Natal Estimates of Provincial Expenditure for the year ended 31 March 2013
59. KwaZulu-Natal Provincial disbursement timetable for year ended 31 March 2011
60. KwaZulu-Natal Provincial disbursement timetable for year ended 31 March 2012
61. KwaZulu-Natal Provincial disbursement timetable for year ended 31 March 2013
62. KwaZulu-Natal Provincial MEC: Finance budget speech for 2012/13
63. KwaZulu-Natal Provincial medium term expenditure framework treasury guidelines
64. The Promotion of Access to Information Act (2000)
65. KwaZulu-Natal Provincial "Budget at a Glance" document for 2011/12
66. KwaZulu-Natal Provincial "Budget at a Glance" document for 2012/13