

Department of Public Administration and Management

Public Financial Management II

only study guide for PUB2607

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PREFACE

1 INTRODUCTION AND GENERAL ORIENTATION

It gives us great pleasure to welcome you to the module PUB2607 offered by the Department of Public Administration and Management. We, your lecturers, are at your disposal and will gladly assist you in your studies. Be assured of our enthusiasm and willingness to support you with advice during your study programme.

The study material has been designed to serve as an introductory text to public financial management. We trust that you will be able to apply the relevant ideas to good effect after you have completed the module.

The module Public Financial Management is aimed at providing knowledge of and insight into public sector expenditure management and control, including policy requirements and data-collection techniques.

We trust that you will benefit from everything that this module has to offer.

In order to ensure that this module is nationally and internationally accredited, it has been registered as follows in the National Qualifications Framework (NQF):

Syllabus or subjects covered or essential prior knowledge:

- Orientation and theoretical overview
- Public financial management functions and practices
- NQF level: 6
- Credits allocated to paper: 120
- SAQA (South African Qualifications Authority) field: Public administration and management

The NQF and SAQA are government structures responsible for ensuring that all South African qualifications are nationally and internationally accredited.

At present, all South African qualifications are graded on ten levels (NQF levels 1 to 10). Note that each level indicates clearly what knowledge, skills and values you need to master in order to be declared competent on that level. The number of credits allocated to the module also indicates the number of hours which it should ideally take to master the learning outcomes of the various learning units. In practice, this means that you have to spend at least 120 hours on this module in order to master the learning material. You can divide up the 120 hours as follows:

Working through the study guide, consulting the recommended book, reading other sources such as academic textbooks and journal articles, obtaining information on the internet, watching relevant DVDs and videos, attending seminars and conferences, and

talking to experts in the field equal 40 hours. Completing activities in the study guide and assignments equals 40 hours, and preparing for the examination equals 40 hours.

The general aim of the module is to impart comprehensive, systematic, organised and clear knowledge of the field of public finance to students. This will enable you to prepare yourself for financial management tasks in the public sector and elsewhere by means of self-study, case studies, learning activities, assignments and other research methods.

A range of tasks in study guides, tutorial letters, various forms of multimedia, assignments and examinations will show that students have achieved the following learning outcomes and assessment criteria:

Learning outcome 1

Students understand the most important policy and legislative requirements for public financial management.

Assessment criteria

We will know that students have mastered the most important concepts and ideas relating to policy and legislative requirements when they understand and can explain the following:

- legislation and other documents which influence public sector financial management
- the role and function of National Treasury in expenditure control
- the relationship between legislative accountability and policy directives in financial management

Learning outcome 2

Students understand expenditure management and control in the public sector environment.

Assessment criteria

We will know that students have mastered the most important concepts and ideas relating to the public sector when they understand and can explain the following:

- the various elements that cause budget variance and the application of procedures to alleviate budget variance
- correct internal control procedures and measures

Learning outcome 3

Students understand data collection techniques in public financial management.

Assessment criteria

We will know that students have mastered the most important concepts and ideas relating to data collection techniques when they understand and can explain the following:

- the identification and use of data for budgetary purposes and information dissemination

As lecturers, we are well aware that we need to deliver a high-quality service to you, the student. This has led us to conclude that we need to develop a learning environment that promotes learning. For this purpose, we undertake the following:

- to provide you with current, augmented, relevant learning material which is regularly compared with similar local and international financial management courses
- to liaise with employers and the profession in order to develop learning material that equips our students to meet the needs of the public sector
- to give you the support you need in your studies, as and when you want it
- to give clear guidelines on formative assessment so that students will know exactly what is expected of them
- to provide feedback on assignments in good time (i.e. to return assignments, with feedback, to students within three weeks of the closing date for submission)

The lecturers in the Department of Public Administration and Management expect the following of students:

- to take personal responsibility for the learning process, as we expect students to have an acceptable level of skill to cope with public finance problems in the public sector
- to be sensitive to and have empathy with the cultural and academic views of other students, and to work together effectively where necessary
- to read with insight about public finance theories and philosophies, and to interpret and report on them insightfully in the broader context of public administration
- to collect public finance information from a wide range of sources, and to analyse it innovatively, organise it creatively and evaluate it critically
- to investigate public finance problems with understanding, to analyse them thoughtfully and to solve them judiciously
- to manage the learning process in the field of public finance responsibly by evaluating your own progress and acquiring the skills you need to complete assignments, write examinations and do research
- to use scientific methods and technological aids effectively in order to master the learning activities, while at the same time taking responsibility for the environment and the welfare of other people

We have arranged the learning material in a specific way to ensure that all students achieve the learning outcomes. The study guide is divided into learning units that each consists of learning outcomes, an introduction, self-assessment and feedback on self-assessment.

Answer the self-evaluation questions at the end of each theme to make sure that you have mastered the contents of that particular section. Make sure that you know what you will be tested on in this module. Your progress will be tested by means of

(i) formative assessment
(ii) summative assessment

Formative assessment is done as you complete the activities in the study guide and the assignments in the tutorial letter. The examination at the end of the academic semester is a summative assessment. You should assess your own progress constantly and revise the aspects of each learning outcome that you have not mastered.

In Tutorial Letter 101 we list the resources you need to achieve the learning outcomes for this module. Note that you need these resources to complete the activities in every learning unit.

It is in your own interest to consult the recommended textbook:

Pauw, JC, Van der Linde, GJA, Fourie, D.& Visser, CB. 2015. *Managing public money.* 3rd edition. Cape Town: Pearson.

This study guide forms the nucleus of this module.

Public financial management is an interesting and dynamic field that offers attractive career opportunities in the public sector. We hope that you will find the contents of this module interesting and instructive, and that you will enjoy your studies.

Connecting online to the module PUB2607

Computers and the internet are becoming essential in the workplace, in life and in education. The myUnisa online tools play a huge role in your study experience at Unisa as you do not attend face-to-face lectures. The internet is simply the fastest, most effective and efficient way to obtain the information you need and to communicate with your lecturers and fellow students. It allows you to submit assignments or get results at the click of a button. Your online studies at Unisa will prepare you for the demands of the digital age.

myLife e-mail

Registered Unisa students all get a free myLife e-mail account. Important PUB2607 announcements and notices are sent only to your myLife e-mail address. Please check your e-mails regularly to ensure that you receive important communiqués from your lecturers.

How to register on myUnisa

Unisa's online student portal (myUnisa) is your most important study tool for this module – it is your PUB2607 lifeline. You can start at the main Unisa website, http://www.unisa.ac.za, and then click on **myUnisa**, which will take you to the myUnisa website. When you are on the myUnisa website, click on the **Claim Unisa Login** on the left-hand side of the screen. You will then be prompted to give your student number to claim your initial myUnisa and myLife login details. Should you experience any difficulties registering your myUnisa account, consult the *Study @ Unisa* brochure for detailed information.

myUnisa tools for PUB2607

The purpose of myUnisa is to support your learning; please visit the PUB2607 webpages on myUnisa frequently. If you make a habit of regularly checking your module webpage, you can take full advantage of the myUnisa tools explained in Tutorial Letter 101.

Do not hesitate to contact your lecturers if you experience any difficulties with any aspects of the module. You can contact us either via e-mail, telephone or the **Course Contact** option on myUnisa. Our contact details are available on the home page of the module site. Remember, help is just a click away.

We wish you a fascinating and satisfying journey through the learning material and trust that you will complete the module successfully.

2 USE OF ICONS

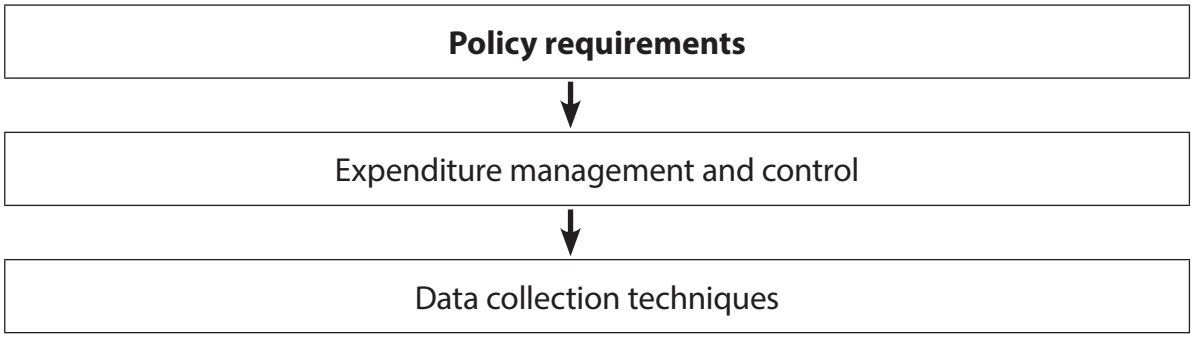
The icons that will be used in this study guide are as follows:

	**Learning outcomes.** The learning outcomes indicate what aspects of the particular topic or learning unit you have to understand. You should be able to demonstrate your understanding.
	**Study.** This icon indicates the relevant sections of the prescribed book or the study guide that you need to study and internalise.
	**Activity.** This icon refers to activities that you must do to develop a deeper understanding of the learning material.
	**Assessment.** When you see this icon, you will be required to test your knowledge, understanding and application of the material you have just studied.
	**Feedback.** This icon indicates that you will receive feedback on your answers to the self-assessment activities.
	**Example.** Examples are given for further clarification and are indicated by this icon.
	**NB/Take note.** This icon indicates information of particular importance.

ROUTE MAP

Use the route map below to determine where we are and how this learning unit fits into the module.

MODULE: PUBLIC FINANCIAL MANAGEMENT II



LEARNING UNIT 1

Policy requirements



LEARNING OUTCOMES

Once you have completed this learning unit, you should be able to

- identify the legislation and the documents issued in terms of this legislation which influence public sector financial management
- discuss the importance of legislation and policy for financial management
- explain the role and function of National Treasury in expenditure control
- determine the relation between legislative accountability and policy directives for financial management

INTRODUCTION

All functions undertaken by any government official must be legal and preferably authorised by legislation, thus legislation precedes all actions performed by executive authorities. Without legislation, executive functions would be deemed legally unauthorised.

In terms of the utilisation of public resources, especially finances, legislative authority must be gained before a single transaction can be made, whether revenue collection or spending activities. In many instances public officials are too involved in their particular sphere of activities to be concerned about legislative aspects – they leave that to others, such as the legal experts, accounting officers or relevant departments. However, understanding the role, purpose and function of legislation also helps public officials to have a clear understanding of their own particular functions in their respective departments. Therefore the overall aim of this learning unit is to provide some insight into elements of policy and related legislation in the public financial management environment.

1.1 BACKGROUND

If you were to ask a question about the aims, intention and objectives of legislation in general to a class of 30 students, you would probably get 30 different answers. When you ask the same question about a specific Act or Bill, you could get just as many answers, but this should not be the case if your subject area is underpinned by particular Bills or Acts.

Many students regard legislation as legal gobbledygook, and not many really try to study legislation thoroughly. As a result they become confused, particularly about the many elements of financial management. If we choose to make an effort to study legislation,

how should we approach it? Should we choose pieces of legislation at random and start reading through them, perhaps making notes as we progress? What would we achieve? It is important to understand why legislation should be studied, because that would enable us to determine and understand its implications, intent and objectives, and how its objectives can be realised.

The challenge is to explain the relevance of legislation in a way that promotes understanding and provides a clear perspective on the link between policy and public financial management. This will enable you to understand the principles and practices of effective, efficient and economic financial management and the use of internal controls in the process.

1.2 POLICY AND LEGISLATION CONCEPTUALISED

Policy and legislation are not the same thing. Policy can assume a variety of dimensions and applications, whereas legislation usually relates to Acts or Bills passed by the highest legislative authority. Legislation is also a legal instrument, and its contravention is unlawful or illegal. The same principle does not necessarily apply to policy. The reason for this will became clear as you study the rest of the learning unit.

Policymaking constitutes the various political processes followed to determine and enact policy through legislation. The purpose of policy is to

- determine national priorities (and ultimately spending in accordance with these priorities)
- provide guidance to executive authorities
- pass legislation to legalise policy
- authorise the spending of public funds by legislation only

1.3 CONSTITUTION

The Constitution of the Republic of South Africa, 1996, must be regarded as the dominant legislation with regard to public finances in South Africa. All other legislation pertaining to public sector finances must be consistent with the Constitution.

Chapter 13 of the Constitution deals with finance and is divided into four parts:

- General financial matters
- Financial and Fiscal Commission
- Central bank
- Provincial and local financial matters

Each of these parts is subdivided into various sections, which we briefly discuss below.

1.3.1 General financial matters

The part entitled "General financial matters" is divided into the following sections:

- National Revenue Fund
- Equitable shares and allocations of revenue
- National, provincial and municipal budgets
- Treasury control
- Procurement
- Government guarantees
- Remuneration of persons holding public office

1.3.1.1 National Revenue Fund

All money received by national government is paid into the National Revenue Fund. Money may be withdrawn only in terms of an appropriation by an Act of Parliament, or as a direct charge against the National Revenue Fund when it is provided for in the Constitution or in an Act of Parliament. A province's share of revenue raised nationally is also a direct charge against the National Revenue Fund.

This means that no money may be used before an Act of Parliament authorises it. In other words, money spent over and above the authorised amount is regarded as unauthorised expenditure. In practice, authorisation to withdraw money from the National Revenue Fund means authorisation by the annual Appropriation Act.

1.3.1.2 Equitable shares and allocations of revenue

This section addresses the division and allocation of money to the national, provincial and local spheres of government, how and according to which considerations equitable shares are determined, and the allocation of equitable shares among the governments in the provincial and municipal spheres. A formula to determine the allocation of revenue is determined by the Financial and Fiscal Commission.

The following elements must be taken into account in terms of the sharing and allocation of revenue:

- national interest
- any provision that must be made in respect of the national debt and other national obligations
- the needs and interests of the national government, determined by objective criteria
- the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them
- the fiscal capacity and efficiency of the provinces and municipalities
- developmental and other needs of provinces, local government and municipalities
- economic disparities within and among the provinces
- obligations of the provinces and municipalities in terms of national legislation
- the desirability of stable and predictable allocations of revenue
- the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria



ACTIVITY

Why is legislation required to authorise the use of public funds, do you think?

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1.3.1.3 National, provincial and municipal budgets

Section 215 of the Constitution stipulates that national, provincial and municipal budgets should promote transparency, accountability and the effective financial management of the economy, debt and the public sector. National legislation must therefore prescribe the form of budgets and when budgets must be tabled. It also determines that budgets must show the sources of revenue and how they comply with national legislation.

Budgets must contain estimates of revenue and expenditure, and they must differentiate between capital and current expenditure. They must include proposals for financing any anticipated deficit and indicate possible increases in public liability that will increase public debt in the next year.

1.3.1.4 Treasury control

National legislation must establish a national treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government. This must be done by introducing the following:

- generally accepted accounting practice
- uniform expenditure classifications
- uniform treasury norms and standards

The rest of this section deals with the transfer of funds, the conditions for stopping such transfers and the various aspects of this function.



ACTIVITY

Give two reasons why National Treasury is important.

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1.3.1.5 Procurement

The Constitution states that any institution which contracts for goods or services must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective. This does not prevent these institutions from implementing a procurement policy that provides for categories of preference in the allocation of contracts and the protection or advancement of people, or categories of people, disadvantaged by unfair discrimination.

1.3.1.6 Government guarantees

The Constitution stipulates that the national government, a provincial government or a municipality may guarantee a loan only if the guarantee complies with conditions set out in national legislation.

1.3.1.7 Remuneration of persons holding public office

In terms of the Constitution, an Act of Parliament must establish a framework for determining the following:

- the salaries, allowances and benefits payable to members of the National Assembly, permanent delegates to the National Council of Provinces, members of the cabinet, deputy ministers, traditional leaders and members of any councils of traditional leaders
- the upper limit of salaries, allowances or benefits payable members of provincial legislatures, members of executive councils and members of municipal councils of the different categories

The rest of this section deals with how the above is determined, and the relevant procedures and frameworks.

1.3.2 Financial and Fiscal Commission

In terms of the Constitution, the Financial and Fiscal Commission makes recommendations envisaged in chapter 13 of the Constitution, or in national legislation, to Parliament, provincial legislatures and any other authorities determined by national legislation. The Commission is independent, subject only to the Constitution and the law. It must be impartial and it must function in terms of an Act of Parliament.

1.3.3 Central bank

The Constitution provides that the South African Reserve Bank is the central bank of the Republic and is regulated in terms of an Act of Parliament. The Reserve Bank basically

protects the value of the currency in the interest of balanced and sustainable economic growth in the Republic.

1.3.4 Provincial and local financial matters

1.3.4.1 Provincial revenue funds

Each province has a revenue fund into which all money received by the provincial government must be paid, except money excluded by an Act of Parliament.

1.3.4.2 National sources of provincial and local government funding

Local governments and each province are entitled to an equitable share of revenue raised nationally to enable them to provide basic services and perform the functions allocated to them. They may receive other allocations from national government revenue conditionally or unconditionally.

In terms of the Constitution, additional revenue raised by provinces or municipalities may not be deducted from their share of revenue raised nationally, or from other allocations made to them out of national government revenue.

1.3.4.3 Provincial taxes

Provincial legislatures may impose various taxes, levies and duties other than income tax, value-added tax, general sales tax, rates on property or customs duty to raise revenue in a province, as stated in this section. However, certain conditions apply. These powers to raise revenue may not be contrary to national economic policies, economic activities across provincial boundaries or the national mobility of goods, services, capital or labour; and should be regulated by an Act of Parliament.



ACTIVITY

What is the primary condition attached to the powers of provinces with regard to the raising of provincial revenue?

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1.3.4.4 Municipal fiscal powers and functions

A municipality, subject to specific considerations, imposes rates on property and surcharges on fees for services provided by or on behalf of the municipality. The right of a municipality to receive revenue is subject to constraints similar to those of provincial fiscal powers and functions.

1.3.4.5 Provincial and municipal loans

Provinces and municipalities may raise loans for capital or current expenditure in accordance with reasonable conditions determined by national legislation. However, loans for current expenditure may be raised only when necessary for bridging purposes during a fiscal year and must be repaid within 12 months.

1.4 LEGISLATION AND OTHER MEASURES

The intention of the Constitution is not to arrange all aspects relevant to public sector financial management itself – it intends to provide a broad framework for applying public sector financial management, and to identify the spheres of government and the issues relevant to revenue and expenditure. Most important of all, the Constitution is the supreme law of South Africa and as such no other South African Act may conflict with it.

The Constitution does not provide detailed information or guidance on how public finances should be managed, as public finances involve a vast range of activities that is too comprehensive to be included in the Constitution. Another reason why the Constitution does not contain detailed information or guidance is that it aims at providing a framework for other legislation; this framework can be used to make legislative arrangements for the objectives stated in the Constitution. A final consideration in this regard is that changes in the environment invariably mean changes to legislation from time to time, even annually. The Constitution, or sections or subsections of it, can only be amended by a two-thirds majority in Parliament. This involves extensive preparation and is time-consuming. It is more efficient to change other legislation to make provision for new conditions at operational level.

Public financial management involves a variety of elements that need to be structured, organised, managed and controlled. By now you will know that it involves the budgeting process, the process of implementing the budget and, finally, control and accountability.

Sound financial management, which basically relates to efficiency, effectiveness and economy, does not happen by itself. Neither is it a result of a haphazard, fragmented approach. Sound financial management is achieved through the implementation of carefully predetermined systems and procedures to direct and manage budgeting, to manage expenditure and to control processes. Legislation and other measures are needed for sound financial management.

Legislation on public sector financial management may seem to be confusing; it may seem to impose too many rules, regulations and systems. It also seems to be too control-oriented, systems-driven and compliance-directed. However, a study of the various Acts

and other documents relating to public sector financial management will soon make it clear that although they are complex, they fill a particular void, supplement one another in a particular sequence and do not, as the impression may be, contradict one another.

From the above it is evident that the various Acts and documents contribute towards sound public financial management in a variety of ways. In this unit learning we look at the following Acts and documents:

- Appropriation Act
- Public Finance Management Act 1 of 1999
- Treasury Regulations for departments, constitutional institutions and trading entities
- Public Audit Act 25 of 2004
- Normative measures for public financial management
- Medium-term Expenditure Framework (MTEF)
- Division of Revenue Act 3 of 2016 (DoRA)

1.5 APPROPRIATION ACT

The Appropriation Act provides for the allocation of revenue to state departments and entities, and is approved by Parliament for the period of one financial year, starting on 1 April and ending on 31 March of the next year. The annual budget sets out the estimated funds that will be required by departments, constitutional institutions and trading entities, and lists their programmed objectives and revenue required to achieve their stated objectives.

A new Appropriation Act is passed each successive year, since the Act can only exist for one financial year. This implies that budgeted money can only be spent in the specific year for which the Appropriation Act provides. Other Acts that provide for the appropriation of money are also passed annually.

1.6 PUBLIC FINANCE MANAGEMENT ACT 1 OF 1999

The Public Finance Management Act 1 of 1999 (PFMA) aims to provide a broad framework for arranging the financial affairs of all spending entities in order to promote efficiency, effectiveness and economy.

The following elements are contained in the Act:

Chapter

1. *Interpretation, objective, application and amendment of the Act (sections 1–4)*: Chapter 1 contains definitions, the objectives of the PFMA, the departments to which it applies and a procedure for amending the Act. The PFMA applies to national and provincial departments, and to the entities under their control. The definitions of ownership control, national government business enterprise and public entity determine which entities are under the control of a national or provincial executive authority.

2. *National Treasury and National Revenue Fund (sections 5–16)*: This chapter provides for the establishment of the National Treasury and deals with its composition, functions, powers and responsibilities. It gives effect to section 213 of the Constitution, which provides for the management of the NRF, any exclusions to depositing money received and the authorisation required before any money can be withdrawn from the NRF.
3. *Provincial treasuries and provincial revenue funds (sections 17–25)*: Chapter 3 establishes provincial treasuries and deals with their composition, powers and functions. It also deals with the management of provincial revenue funds.
4. *National and provincial budgets (sections 26–35)*: Chapter 4 gives effect to section 215 of the Constitution, which provides for the timing and contents of national and provincial budgets, and sets out the reporting requirements for transparency in the implementation of a budget. It introduces the concept of measurable objectives and deals with the authorisation of unauthorised expenditure.
5. *Departments and constitutional institutions (sections 36–45)*: This chapter ensures that constitutional institutions and national and provincial departments appoint accounting officers, and spells out their responsibilities. It also addresses the movement of funds between programmes and the responsibilities of other officials.
6. *Public entities (sections 46–62)*: All public entities are to be listed in terms of the PFMA. Chapter 6 outlines the fiduciary and other responsibilities of controlling bodies. It also assigns certain responsibilities to the accounting officer of the department, as designated by the executive authority responsible for the public entity.
7. *Executive authorities (sections 63–65)*: Executive authorities are defined as Ministers or MECs responsible for a department. This chapter deals with the responsibilities of the executive authorities of departments.
8. *Loans, guarantees and other commitments (sections 66–75)*: This chapter outlines general principles for borrowing and the issuing of guarantees. It gives effect to section 218 of the Constitution on the issuing of guarantees.
9. *General Treasury matters (sections 76–80)*: Chapter 9 provides for the regulations and instructions that Treasury is authorised to issue and the composition of audit committees.
10. *Financial misconduct (sections 81–86)*: This chapter defines financial misconduct and lays down the procedures for disciplining public officials who are guilty of financial misconduct. It also includes provisions for criminal prosecution in cases of gross financial misconduct.
11. *Accounting Standards Board (sections 87–91)*: An Accounting Standards Board has been established to set accounting standards for the public sector. Chapter 11 deals with the composition, powers and functions of this Board.
12. *Miscellaneous (sections 92–95)*: This chapter provides for sundry matters, including exemptions and transitional provisions.



ACTIVITY

What is the primary objective of the Public Finance Management Act 1 of 1999?

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1.6.1 Interpretation, object, application and amendment of the PFMA

Definitions of the terminology used in the PFMA are provided to facilitate the interpretation of the Act. Section 2 states that the object of the PFMA is to secure transparency, accountability and sound management of the revenue, expenditure, assets and liabilities of the institutions to which the PFMA applies.

The application refers to the institutions to which the PFMA applies, which are the following:

- departments
- public entities
- constitutional institutions
- Parliament (subject to particular provisions, which exempt Parliament from certain powers of National Treasury)

The link between the PFMA and the Treasury Regulations has become more apparent, since the Treasury Regulations are issued to the same institutions listed in the PFMA.

1.6.2 National Treasury and National Revenue Fund

This chapter refers to the establishment of National Treasury, identifying it as the national department responsible for financial and fiscal matters. The following areas are relevant to National Treasury:

- banking, cash management and investment framework
- annual consolidated financial statements
- financial statistics and aggregations
- delegations by National Treasury

National Treasury has the following responsibilities regarding the National Revenue Fund:

- deposits and withdrawals by the South African Revenue Services in revenue funds
- deposits into National Revenue Fund
- withdrawal of exclusions
- withdrawals and investments from National Revenue Fund
- use of funds in emergency situations

The above sections are divided into numerous subsections, each dealing with a particular element of that section. The scope of this learning unit does not allow us to discuss of these subsections individually.



ACTIVITY

Explain in your own words the importance of National Treasury with regard to control over expenditures.

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1.6.3 National budgets

The sections dealing with national budgets cover the following topics:

- Annual appropriations. Parliament must appropriate money for each financial year for the requirements of the state.
- National annual budgets.
- Multi-year budget projections.
- Expenditure before the annual budget is passed.
- National adjustments budgets.
- Publishing of reports on the state of the budget.
- Withholding appropriated funds.
- Unauthorised expenditure.

1.6.4 Departments and constitutional institutions

This chapter deals primarily with the accounting officers in terms of their appointment, duties, functions, powers and responsibilities. It also provides for reporting responsibilities and virement. This chapter is crucial to financial management in the public sector as the accounting officer is responsible for the proper application of the Public Finance Management Act and Treasury Regulations in his or her departments.

1.6.5 Public entities

This chapter deals with the following:

- application
- unlisted public entities
- classification of public entities
- accounting authorities
- fiduciary duties of accounting authorities
- general responsibilities of accounting authorities

- annual budget and corporate plan by Schedule 2 public entities and government business enterprises
- annual budgets by non-business Schedule 3 public entities
- information to be submitted by accounting authorities
- annual report and financial statements
- assignment of powers and duties by accounting officers
- responsibilities of other officials
- appointments of auditors
- discharge of auditors
- duties and powers of auditors
- reports of the auditor
- duties and powers of the Auditor-General.

These entities are listed in Schedules 2 and 3 to the Act and include the following:

- Air Traffic and Navigation Services Company
- Airports Company
- Central Energy Fund
- ESKOM
- Transnet Limited
- Accounting Standards Board
- Board on Tariffs and Trade
- Council for Nuclear Safety

The public entities are listed in Schedules 2 and 3, which are subject to the provisions of the Public Finance Management Act.



ACTIVITY

Why do you think public entities are subject to the provisions of the Public Finance Management Act and the treasury regulations in a similar and/or different way to departments?

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1.6.6 Executive authorities

This chapter deals with the following:

- financial responsibilities of executive authorities

- executive directives having financial implications
- tabling in legislatures

This section is basically aimed at clarifying the reporting and documentation responsibilities of executive authorities with regard to their functional activities.

1.6.7 Loans, guarantees and other commitments

The Act provides for the following aspects of loans, guarantees and other commitments:

- restrictions on borrowing, guarantees and other commitments
- no provincial foreign commitments
- consequences of unauthorised transactions
- regulations on borrowing by public entities
- guarantees, indemnities and securities by cabinet members
- purposes for which the Minister of Finance may borrow money
- signing of loan agreements
- interest and repayments of loans to be direct charges
- repayment, conversion and consolidation of loans
- obligation from lien over securities

1.6.8 General treasury matters

The following sections in the Act are applicable to general treasury matters:

- Treasury Regulations and instructions
- audit committees
- publishing of draft Treasury Regulations for public comment
- departures from Treasury Regulations, instructions or conditions
- determination of interest rates for debt owing to the state

1.6.9 Financial misconduct

Financial misconduct is dealt with in the following sections:

- financial misconduct by officials in departments and constitutional institutions
- financial misconduct by treasury officials
- financial misconduct by accounting authorities and officials of public entities
- applicable legal regime for disciplinary proceedings
- regulations on financial misconduct procedures
- offences and penalties

1.6.10 Accounting Standards Board

The following sections relate to the Board's functions regarding accounting procedures, systems and standards:

- establishment
- composition

- functions of Board
- powers of Board
- regulations on accounting standards of Board

1.6.11 Miscellaneous

This chapter includes the following:

- exemptions
- transitional provisions
- repeal of legislation
- short title and commencement (of the Act)

To enable accounting officers to implement the provisions of the Public Finance Management Act as intended, National Treasury issued the *Guide for accounting officers: Public Finance Management Act* in March 2000. The preface to this guide states that it has been compiled to help accounting officers to familiarise themselves with the changes brought about by the introduction of the Public Finance Management Act 1 of 1999. It will also assist accounting officers, ministers and MECs who are accountable to Parliament or the provincial legislature (executive authorities) in determining their reporting responsibilities under the Act, as well as indicate changes to these responsibilities.

It is very important to note that this guide cannot be deemed to be a substitute for the Public Finance Management Act and it cannot be used for legal interpretations of the Act (treasury.gov.za).

1.7 TREASURY REGULATIONS

Treasury regulations were issued in terms of the Public Finance Management Act 1 of 1999 and are officially known as the "Treasury regulations for departments, constitutional institutions and trading entities" (South Africa, 2005). The Treasury Regulations serve to supplement the Public Finance Management Act in that they provide more detailed information on how financial management should be implemented in the public service.

These regulations cover the whole field of practical management without being unduly detailed. They range from internal control to planning and budgeting, asset and liability management, banking and cash management, and accounting and reporting. Although the executive, in the form of National Treasury, promulgated these regulations, the regulations must be consistent with the PFMA.

The following main aspects are dealt with in the treasury regulations:

1. *Definitions and application (chapter 1)*: These regulations relate to departments, constitutional institutions, public entities and the South African Revenue Services in so far as it collects and administers state revenue.
2. *Management arrangements (chapters 2–4)*: This part addresses corporate management issues, including the appointment of a CFO and arrangements for internal audits and the audit committee. Chapter 4 deals with financial misconduct.

3. *Planning and budgeting (chapters 5 & 6)*: These chapters set out the requirements and time frame for quantifying strategic plans over the MTEF period, as well as the arrangements for virement, rollovers and adjustments budgets.
4. *Revenue and expenditure management (chapters 7–9)*: The accounting officer's responsibilities in respect of revenue management, and authorising and controlling expenditure (including transfer payments) are set out. Chapter 9 deals with unauthorised, irregular, fruitless and wasteful expenditure.
5. *Assets and liability management (chapters 10–14)*: Frameworks are provided for managing revenue due to the state, arranging for payments from debtors, dealing with assets and liabilities, and managing losses and claims. Chapter 13 sets out arrangements for loans, guarantees and other commitments, and chapter 14 deals with money and property held in trust.
6. *Frameworks (chapters 15 & 16)*: Detailed frameworks are provided to cover banking, cash management and investment, and public–private partnerships.
7. *Accounting and reporting requirements (chapters 17 & 18)*: The requirements for maintaining accounting records, and the formats for annual financial statements and various other reports are contained in this part of the regulations.
8. *Miscellaneous (chapters 19–23)*: This part deals with sundry matters, including the operation of trading entities; commissions and committees of inquiry; payments, gifts, donations and sponsorships; refunds and remissions as an act of grace; and the repeal of legislation.

The Treasury Regulations serve as a guideline for accounting officers, chief financial officers and officials with delegated responsibilities.



ACTIVITY

Explain in your own words the connection between the Public Finance Management Act and the treasury regulations.

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1.8 PUBLIC AUDIT ACT 25 OF 2004

In terms of the Constitution, the Auditor-General is considered to be one of the state institutions supporting constitutional democracy in South Africa. The Auditor-General's office is the supreme audit institution in South Africa.

The Auditor-General is authorised by Parliament to audit the financial and other records of government departments, constitutional institutions and trading entities, and to report its findings to Parliament.

Although the auditing function of the Auditor-General occurs after the end of the financial year, it remains a valuable tool in ensuring sound financial management in the public sector. It is valuable because accounting officers are aware that the Auditor-General will audit their departments and report its findings to Parliament. As a result, accounting officers strive to make sure that they maintain effective, efficient and economical financial management; that they adhere to the Public Finance Management Act, treasury regulations, their own strategic plans and the prescriptions of the Accounting Standards Board; and, above all, that their internal control procedures are applied diligently.

1.9 MEDIUM-TERM EXPENDITURE FRAMEWORK (MTEF)

The MTEF was introduced in 1998. It is regarded as the cornerstone of the South African government's budget reform. The MTEF is a cycle of three-year spending plans of national and provincial governments. It is published together with the main budget by the Minister of Finance as part of the budget every year. Money is allocated via an Appropriation Act for a year in the context of rolling estimates for three years. "Rolling" means that the duration of the period is fixed (e.g. three years), while the amounts are revised annually. Year three becomes the revised year two in the next year and the revised year one in the year following that.

The MTEF is the outcome of the spending plans and is compiled once the technical work, consultation and dialogue are completed in each national and provincial government between the governments and the legislatures, and between the government and civil society in various forums are completed.

1.10 DIVISION OF REVENUE ACT (DoRA)

The Division of Revenue Act 3 of 2016 (DoRA) provides for the equitable division of revenue raised nationally among the national, provincial and local spheres of government.

The objects of the Act are to

- promote better coordination between policy, planning, budget preparation and execution processes between and within the different spheres of government
- promote predictability and certainty in respect of all allocations to provinces and municipalities in order that such governments may plan their budgets over a multiyear period
- promote transparency and equity in the resource allocation process
- promote accountability by ensuring that all allocations are reflected on the budgets of receiving provinces and municipalities

1.11 CONCLUSION

Managing public finances as intended in legislation is a daunting task. Accounting officers have to function within the parameters of legislation and relevant provisions, since the ultimate aim is to ensure accountability. Apart from that, government must continue to ensure that it provides the services needed by citizens who pay taxes to receive these services.

Legislation should be viewed not only as a control mechanism for monitoring and regulating accounting officers and other officials, such as chief financial officers, but also as an instrument that assists them in managing their departments in a way which is conducive to effectiveness, efficiency and economy.

1.12 SELF-ASSESSMENT



(1) Why is legislation important in public sector financial management? (1)
(2) Provide two objectives of policies on public sector financial management. (2)
(3) Identify the seven general financial matters that are regulated by the Constitution. (7)
(4) Which three methods can National Treasury use to control public finance? (3)
(5) Briefly explain government guarantees. (2)
(6) Can provinces raise customs duty as a source of revenue? (1)
(7) What are the four most important documents except the Constitution that relate to public sector financial management? (4)
(8) Which institutions are subject to the provisions of the Public Finance Management Act 1 of 1999 and the treasury regulations? (4)
(9) Identify four areas relevant to the functions of the National Treasury. (4)

1.13 FEEDBACK ON SELF-ASSESSMENT



(1) Legislation gives authorisation to the executive to make payments and receive revenue. It also forbids and therefore prevents certain actions.
(2) It provides direction in terms of spending objectives. It clarifies the legislative delegation of responsibility to the executive.
(3)
- *National Revenue Fund*
- *Equitable shares and allocations of revenue*
- *National, provincial and municipal budgets*
- *Treasury control*
- *Procurement*
- *Government guarantees*
- *Remuneration of persons holding public office.*

(4) Generally accepted accounting practice
Uniform expenditure classification
Uniform treasury norms and standards
(5) The national government, a provincial government or a municipality may guarantee a loan only if the guarantee complies with conditions set out in national legislation.
(6) No, customs duty is national income.
(7) Public Finance Management Act 1 of 1999
Appropriation Act

Treasury regulations
Public Audit Act 25 of 2004

(8) *Departments*
Public entities
Constitutional institutions
Parliament (partially)

(9) *Banking, cash management and investment framework*
Annual consolidated financial statements
Financial statistics and aggregations
Delegations by National Treasury

1.14 REFERENCES AND ADDITIONAL READING

http://www.treasury.gov.za/legislation/pfma/guidelines/Accounting%20Officers%20Guide%20to%20the%20PFMA.pdf (accessed on 12 February 2018)

South Africa. 1996. *Constitution of the Republic of South Africa, 1996*. Pretoria: Government Printer.

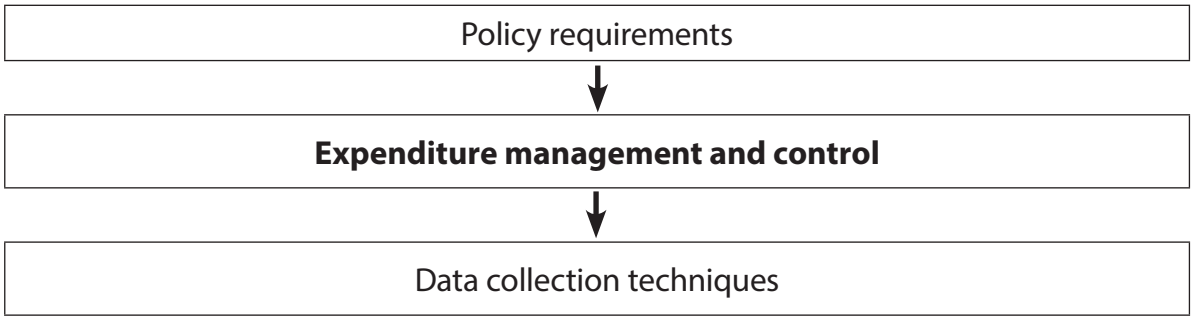
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ROUTE MAP

Use the route map below to determine where we are and how this unit fits into the module.

MODULE: PUBLIC FINANCIAL MANAGEMENT II



LEARNING UNIT 2

Expenditure management and control



LEARNING OUTCOMES

Once you have completed this learning unit, you should be able to

- identify the various elements that cause budget variance
- apply the correct procedures to alleviate budget variance
- follow the correct procedures to ensure that internal control measures are applied

INTRODUCTION

Expenditure management may well be regarded as one of the most crucial stages in the budgeting system since this process determines whether or not policy objectives have been achieved, and whether government functions and services have been provided according to the principles of efficiency, effectiveness and optimal utilisation of scarce resources.

This learning unit deals with various elements as they apply to expenditure management in the South African public sector.

2.1 CONCEPTUALISATION

What is financial management?

Financial management is not an end in itself. It is, however, crucial to the successful running of any organisation, as it relates to how the resources available to the organisation are used.

In the private sector, financial management centres on the examination of alternative sources of finance, the effective utilisation of such finance, and cohesion between financial and utilisation decisions. In the public sector, financial management focuses on the prioritisation and use of scarce resources, on ensuring effective "stewardship" over public money and assets, and on achieving value for money in meeting the objectives of government, that is, on rendering the best possible services. This must be done in a transparent and accountable manner, and in terms of relevant legislation.

Public financial management

In essence the aim of government financial management is to ensure that we safeguard and use available funds and scarce resources in the best interest of the public (Pauw, Van der Linde, Fourie & Visser, 2015:134).

Financial management ranges from daily cash management through to the formulation of long-term financial objectives, policies and strategies in support of the strategic and operational plans of the department. It includes planning and control of capital expenditure, working capital management, interaction with the relevant Treasury, and funding and performance decisions. It supervises the supporting financial and management accounting functions, which are predominantly concerned with the collection, processing and provision of financial information, and the planning, operation and control of supporting financial systems.

Public sector organisations can learn from the private sector, where the success and survival of an organisation depend on its financial results. This is not to suggest that the public sector should pursue profits, but rather to acknowledge that public spending is an investment made by taxpayers, which should therefore be managed optimally.

General principles for financial management in the public sector

- Financial management must be performed by personnel with the necessary technical training and proficiency.
- In all decisions affecting departmental outputs, the financial impact must be considered objectively with the aim of providing the public with economical, efficient, effective and appropriate services or products.
- Due professional care must be exercised when taking all financial decisions affecting departmental outputs.

Performance requirements for financial management in the public sector

- Expenditure must be planned carefully and funds must be allocated optimally to realise the required outputs.
- Optimal investment in total assets required to support specified departmental outputs must be quantified and economically funded.
- The use of financial resources to achieve specified outputs must be monitored and controlled against the strategic and operational plans of the department by means of quantitative and qualitative data.
- Internal control must be designed, implemented and maintained.
- Financial resources must be used to achieve outcomes that have meaningful impacts on the citizens of the country.

Public financial management in South Africa

Contrary to what many believe, the legislature has an executive function in public financial management. In this regard, the South African Parliament has the following main functions:

- raising taxes
- allocating expenditure
- regulating public finances
- overseeing public finances

Parliament carries out the first three functions by means of legislation. Legislation for public finance is based on chapter 13 of the Constitution of the Republic of South Africa,1996. From the Constitution flows Acts and then regulations. They are followed by institutional

policies and procedures, which are formulated at a lower level, for example by government departments. These policies and procedures may never conflict with Acts and regulations.

The National Revenue Fund (which is not a body or a person, but an accounting entity) plays a crucial role in Parliament's management of public finances. (All money received by the national government must be paid into the National Revenue Fund, except money reasonably excluded by an Act of Parliament.) At provincial level, the relevant provision is section 226 of the Constitution ("Provincial revenue funds"). Funds are put aside for departments for particular purposes, and in so doing certain expenditure is authorised in the expenditure budget.

The expenditure budget, which is called the Estimates of National Expenditure (ENE), is a result of the need for resources that will be used in producing certain outcomes to satisfy prioritised needs. "Expenditure budget" therefore means a plan authorising the expenditure of money to achieve public goals for a specific fiscal year.

Money needed to pay for the activities of a national department is withdrawn from the National Revenue Fund only

a. in terms of an appropriation by the annual National Budget. Since the budget is an Act, the majority in a house must approve it by means of voting. (Three Acts make up the budget, namely the Appropriation Act, the Tax Administration Act 28 of 2011 and DoRA.)
b. as a direct charge against the National Revenue Fund, when it is provided for in the Constitution or in an Act of Parliament.

A province's equitable share of revenue raised nationally is also a direct charge against the National Revenue Fund.

It is clear that the legislature is firmly in charge of public income and the expenditure of public money. For the purpose of this module, we focus on expenditure management in the South African public sector at both central and provincial government levels.

EXPENDITURE MANAGEMENT

- **Background to expenditure management**

The budget cycle consists of four phases, namely preparation, approval, execution and control. Expenditures can only be incurred once the budget has been approved by Parliament, with the official date and duration of one financial year from 1 April to 31 March of the next year (e.g. from 1 April 2018 to 31 March 2019). Legislative authorisation is therefore granted to all spending agencies to receive and make payments of various types (such as transfers, grants and salaries) during one financial year.

Expenditure management thus relates to the various procedures and systems used to manage the financial transactions (revenue and disbursement) of spending agencies. The term "spending agencies" is used to indicate that a variety of institutions other than state departments receive money from the budget.



Prior to the legislative approval of the budget, particular processes have to be followed, such as planning and prioritisation, estimating and budget preparation. Up to that stage, the budget remains essentially a plan which comprises specific objectives linked to monetary outlays. After obtaining legislative approval, the budget adopts a new dimension – that of a working document. As a working document, it identifies the objectives to be achieved in that particular financial year, it states the monetary needs required to achieve the objectives and it automatically reflects the timespan of one year, since expenditures are only allowed to be incurred up to 31 March of the next year.

The responsibility to ensure that a department achieves its budgeted objectives lies with the accounting officer, in most cases the director-general of the department. The accounting officer must take steps to implement the budget. The realities facing the accounting officer daily may be far removed from the time when the current objectives were planned. Contingencies need to be managed on a day-to-day basis, especially with regard to financial management. Later in this learning unit we will deal with the elements and issues that need to be managed by departments in order to achieve their objectives. We base our approach on programme and expenditure management principles and procedures. The accounting officer of an institution is responsible for the outputs achieved by that institution, while the executive authority is responsible for the outcomes achieved by that department.



To ensure that budgeted objectives are achieved, accounting officers need to manage their departments and/or constitutional institutions. To do that, they must take into account all legislation, instructions and procedures relevant to their functions. They must organise their departments; appoint, train and utilise staff; ensure that proper control systems are in place; and ensure that there are mechanisms for communication between organisational units in the department. Of crucial importance is the need to maintain effective and efficient financial management. All of this must be achieved in an environment characterised by its dynamic nature, constraints imposed by resignations (turnover rate), escalating prices, natural disasters, breach of contract by suppliers, labour actions (strikes) and so forth. At present, accounting officers enter into performance agreements with their respective ministers. This adds additional strain which needs to be considered. Accounting officers are also aware that additional income will not be readily available during the financial year – they have to make do with the revenues allocated to them, unless circumstances completely beyond their control force them to incur over-expenditures. Such circumstances may include natural disasters, when the government might be forced to spend money which was not authorised by a budget in order to prevent serious harm to the country and its citizens (Pauw et al, 2015:143–147).

Accounting officers must manage their departmental programmes and expenditures both efficiently and effectively, considering economy measures, as well as possible and real cost savings.



ACTIVITY

Identify the three norms according to which objectives must be achieved.

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Expenditure must be incurred only in accordance with the purpose approved by the legislature in an appropriate vote, unless it is a direct change or a transfer specified in the Division of Revenue Act (DoRA). However, even when expenditures are authorised by the National Budget for a valid purpose and within spending limits, they must always comply with the *ex ante* (before the event) controls of Treasury Regulations and prescribed legislation.

Expenditure management must be directed at achieving the three Es: economy, effectiveness and efficiency. Reasonable care must be exercised to prevent and detect unauthorised, irregular, and fruitless and wasteful expenditure.

Expenditure management must also address the equitable distribution of financial and other resources. Equitable means that needs are addressed according to the principles of fairness – it does not necessarily imply an equal distribution of funds. This fourth E is aimed at redressing imbalances that are remnants of the apartheid era in South Africa.

Expenditure management and control are based on three distinct elements:

- the legislative framework
- the procedural framework
- the internal control framework

2.1.1 Legislative framework

- Constitution of the Republic of South Africa, 1996
- Public Finance Management Act 1 of 1999 and the *Guide for accounting officers*
- National Budget
- Treasury Regulations
- Division of Revenue Act
- Preferential procurement legislation

The Public Finance Management Act 1 of 1999 (PFMA) was introduced to promote effective public financial management in South Africa. The objectives of the PFMA is to secure transparency, accountability and sound management of the revenue, expenditure, assets and liabilities of the institutions to which this Act applies.

The PFMA lays down the basic rules of public financial management and puts into effect section 216 of the Constitution, which provides for treasury control. The detailed regulation of the use of allocated funds is found in the Treasury Regulations (TR), which came into effect on 5 June 2000. These Regulations cover the whole field of practical management without being unduly detailed. They provide for a range of activities, from internal control to planning and budgeting, asset and liability management, banking and cash management, and accounting and reporting. Although the executive, in the form of National Treasury, promulgated these regulations, the regulations must be consistent with the PFMA. The PFMA thus enables authorities to make sure that the public financial interest is protected.

The above framework provides the legal and authoritative foundation for expenditure (and revenue) management. It serves to clarify roles, boundaries, delegations and the procedures prescribed for conducting expenditure management.

2.1.2 Procedural framework



The procedural framework comprises all the prescribed procedures and systems for managing expenditure. The legal framework is the enabling framework for providing authorisation to receive revenue and incur payments. Particular methods and procedures are devised to facilitate the variety of aims to ensure that revenue and expenditure management is conducted according to particular principles and practices, such as stewardship, regulation, compliance, authorisation and achievement of spending objectives, and according to the tenets of economy, efficiency and effectiveness. The specific mechanisms which enable accounting officers and staff of public entities to manage revenue and expenditures are the following:

- Public Finance Management Act
- Treasury Regulations
- Manual on the financial planning and budgeting system of the state
- Financial management system

The reasons why legislation is integrated with procedural arrangements are that no single element of public financial management is conducted in isolation; and that each possible action is linked to a variety of other actions, directly or indirectly and in sequence (although actions are not necessarily linked in sequence), depending on the type of service and the particular transaction resulting from the service.

Section 38(1)(b) of the PFMA gives an example of the integration of legislation with procedural arrangements. It prescribes that each accounting officer (head of a department/ chief executive officer of a constitutional institution) is responsible for the effective, efficient, economical and transparent use of the resources of the department or institution. The accounting officer must take effective and appropriate disciplinary steps against any official in the service of the department who makes or permits any unauthorised expenditure, irregular expenditure or fruitless and wasteful expenditure.

Unauthorised expenditure means

- overspending of a vote or main division within a vote

- expenditure not in accordance with the purpose of a vote or, in the case of a main division, not in accordance with the purpose of the main division

Fruitless and wasteful expenditure means expenditure which was made in vain and would have been avoided had reasonable care been exercised.

Irregular expenditure means expenditure, other than unauthorised expenditure, incurred in contravention of or that is not in accordance with a requirement of any applicable legislation, including

- the PFMA
- the State Tender Board Act 86 of 1968 or any regulations made in terms of that Act
- any provincial legislation providing for procurement procedures in that provincial government

When an accounting officer determines the appropriateness of disciplinary steps against an official in terms of section 38(1)(g) of the PFMA, the accounting officer must take the following into account:

- the circumstances of the transgression
- the extent of the expenditure involved
- the nature and seriousness of the transgression



ACTIVITY

Why do you think the legislative framework is the most important aspect of expenditure management? Give a brief explanation.

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2.1.3 Control framework

An elaborate control framework has to be maintained to provide an acceptable level of accountability. The legislative framework forms the basis of the control framework both by implication and by decree. However, neither decree nor procedures provide an acceptable basis for accountability, since mere approval and execution do not constitute a cycle in terms of financial management practices. By decree, expenditures (and revenue) are authorised; by procedures and prescribed standards and systems, expenditures are incurred. Without a control framework the underlying accountability premises of legislation cannot be linked to the expenditure process. In this, the control framework serves a dual purpose in that it provides a partial basis for expenditure management and also evaluates performance, the utilisation of resources and adherence to all relevant legislation and procedures.



ACTIVITY

Explain in your own words the link between the legislative framework and the control framework.

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2.2 IMPLEMENTING PROGRAMMES

The link between programme and expenditure management is not coincidental. Programmes are executed by programme managers at operational level and this means that expenditure management is required because money has to be spent to achieve programme objectives. Expenditure management relates to the flow of money. It is the responsibility of programme managers who control the execution of programmes, which involves elements such as organising, personnel management and monitoring. A programme manager would also be concerned with his or her programme functions, and to a lesser extent with expenditure management as far as the programme is concerned.

Expenditure management relates to both programme management and achieving the overall departmental objectives. It includes accounting, expenditure control, cash flow management, reporting, asset management and procurement, all of which form part of public sector financial management processes.



ACTIVITY

How does a programme manager know whether there is money left at a specific point in time?

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2.3 RELEASING FUNDS

Although departmental budgets are approved by the legislative authority for the ensuing financial year, this does not mean that the full amount budgeted for is transferred to the department and at its disposal.



There are two specific reasons for this. In the first instance, National Treasury does not have the money to give to all departments all at once according to their respective budgets. (National Treasury means the South African Treasury established by section 5 of the PFMA.) **A treasury is an institution responsible for the management and some of the regulation of finances of a government as a whole**. The money is provided on a monthly basis through "monthly drawings" by the departments. A monthly requisition is made to Treasury; and funds are transferred from the National Revenue Fund (which is not a bank account) to the department's Paymaster General (PMG) Account. Revenue through taxation and other means is paid to the Revenue Service on a continuous basis, daily and monthly, implying that the government does not receive income on a once-off basis. It is because of this practice that departments can only receive their working capital on a monthly basis.

The second reason relates to control. Monthly transfers to the accounts of the respective departments and other constitutional institutions enable Treasury to regulate the flow of money between the Treasury and the departments in order to ensure that all financial commitments and obligations are suitably met. In addition, owing to the compulsory three months' advance estimate of departmental financial needs, Treasury can predetermine what the total shorter-term financial obligations of the state will be to make sure that money will be available when required. This process is repeated monthly until the end of the financial year. Ultimately, it means that departments receive one-twelfth of their total budget every month. Why, then, do departments have to prepare monthly estimates of their required needs for up to three months in advance? Apart from fixed payments, such as salary requirements and pre-committed payments for particular products and/or services, a variety of circumstantial changes (e.g. price increases, natural disasters and exchange rates) distort the original financial requirements of departments. This can obviously result in a variance in the approved budget. To ensure that this problem is dealt with properly and expediently, and with due consideration of aspects such as economy, Treasury must monitor the cash flow situation of every department individually. It can do so only if funds are released according to the procedure described above.



ACTIVITY

Why is it impossible for departments to receive their full budget for one financial year immediately after legislative approval?

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2.4 FUND MANAGEMENT

Fund management basically aims to estimate cash flow requirements and to monitor expenditure against the budget. According to Hildreth (in Savoie, 1996:363–367), fund management relates to the following:

- day-to-day accounting and reporting on the value of individual transactions
- reporting on the use of funds
- using general accounting systems, monitoring appropriations and expenditures, applying internal controls, and preparing and auditing financial statements
- ensuring liquidity, linking it to the ability to pay current bills
- tracking, projecting and monitoring cash flow

Incidentally, Coe (1989:116) equates fund management with treasury management. This is true, in a sense, but from a South African perspective fund management relates only partially to the functions of Treasury. In terms of the financial management system in South Africa, the following components form part of fund management:

- estimating cash flow requirements and revenue
- funding
- monitoring expenditure against the budget
- managing investment



ACTIVITY

Why can fund management not be regarded as the same as Treasury management in the South African context?

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2.4.1 Long-term financing

Fund management is not necessarily limited to immediate financial management obligations – it also includes longer-term financing requirements. Knowing what future expectations in terms of financing requirements will be could influence current decision-making.

One of the prerequisites for the management of funds is that the funding requirements of departments must be continuously evaluated and reconciled with the availability of funds

in both the short term and the long term, keeping in mind that the long-term strategy implementation must be affordable. Long-term needs, which should be based on the long-term strategic plan of a department, must also be integrated into an acceptable financial multi-year plan, hence the concept of long-term financing. The medium-term expenditure plans (MTEPs) and medium-term revenue plan (MTRP) of government serve as examples of these planning mechanisms.

The Medium-term Expenditure Framework (MTEF) provides government with a tool to manage the tension between competing policy priorities and budget realities. It helps to reprioritise expenditure and make informed policy choices that are affordable in the medium term (www.treasury.gov.za).

2.4.2 Cash flow forecast

Coinciding with the multiyear financial plan, a multiyear cash flow forecast (known as a funding statement) must be prepared. This is necessary because it takes time to restructure a tax base and to structure loan arrangements, and these must be considered prior to committing to future expenses.

Long-term strategic planning and its consequent financial implications, as contained in the multiyear cash flow forecast and implemented through the annual budget, need not be cast in stone. In fact, future estimates are not likely to all stay at the predetermined or envisaged price levels. Annual rolling updates would therefore solve this problem and simultaneously provide an overall view of future expenditure trends.



ACTIVITY

- What is the link between long-term financing and expenditure management?

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- Is expenditure management conducted over the short, medium or long term?

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2.5 CASH FLOW MANAGEMENT

In simple terms cash flow means the difference between revenues and expenditures.

From a private sector perspective, cash flow relates to the inflows and outflows of cash during a particular period and includes the following considerations (Broadbent & Cullen, 1997:36):

- operating activities
- returns on investments and servicing of finance
- taxation
- investing activities
- financing activities

Cash flow in the public sector is not entirely dissimilar to cash flow in the private sector, although invariably principles, practices, organisations and authorising entities differ. The Treasury Regulations formulated in terms of sections 7 and 21 of the PFMA contain exact stipulations for sound cash management in the public sector, namely:



- collecting revenue when due, and banking
- making payments and transfers to other entities, with due regard for efficient, effective and economical programme delivery and the government's normal terms for account payments
- avoiding repayments for goods or services, unless required by contractual arrangements with the supplier
- accepting discounts to effect early payment only when the payment has been included in the monthly cash flow estimates provided to the relevant treasury
- pursuing debtors with appropriate sensitivity and rigour to ensure that amounts receivable by the government are collected and banked promptly
- accurately forecasting the institution's cash flow requirements so that National Treasury can optimise its central cash management responsibilities on behalf of the government
- timing the inflow and outflow of cash
- recognising the time value of money, that is, managing cash economically, efficiently and effectively
- taking any other action to avoid locking up money unnecessarily and inefficiently, such as managing inventories to the minimum levels necessary for efficient and effective programme delivery, and selling surplus or underutilised assets.

Cash flow management relates to all revenue, spending and recording activities of departments. Expenditures are classified into various categories to facilitate the tracking of transactions, and to monitor the inflow and outflow of money.

The accounting officer must submit a breakdown of anticipated revenue and expenditure annually to the relevant treasury. The breakdown must be submitted in the format determined by National Treasury. It should reach the relevant treasury no later than the last working day of February preceding the financial year to which it relates.

Provincial treasuries must submit projections of their expenditures, revenue and borrowing to National Treasury by the 15th working day in March, in a format determined by National Treasury.

Once such amounts have been modified as necessary after consultation with the relevant treasury and approved, the accounting officer may not withdraw from the revenue fund

more than the amount approved for a month without prior approval from the relevant treasury.

Should the accounting officer need to adjust the approved projections, the proposed adjustments must be motivated to the relevant treasury for evaluation against the availability of funds.



Note: The expenses of entities are rarely even throughout the whole year. A department that pays out large quarterly subsidies, for example, has a specific cash flow pattern.



ACTIVITY

Describe and explain cash flow management in no more than one page.

2.6 CONTROL OF BUDGET VARIANCE

2.6.1 Overview

Budget variance occurs primarily because of the time lag between planning, where envisaged costs are determined and included in the budget, and the actual date when transactions are concluded. The second reason for budget variance is that various future changes cannot be predicted, let alone planned or estimated. It is therefore a principle of probability that no budget will be executed within its approved limits and that certain contingency measures need to be taken to alleviate the problems relating to this phenomenon.

In this regard, contingency measures do not constitute crisis management; they rather form part of a structured and financially responsible way of dealing with the dilemmas of budget variances. To some extent, budget variances may well be predicted in advance, some with a degree of accuracy, others based on conjecture, and even fewer based on mathematical prediction. This will help accounting officers at least to know what they can expect.



For example, salaries are mostly fixed and increases predetermined, so that the occurrence of unexpected variances is limited, even given the fact that vacancies may not have been budgeted for where moratoriums exist. Even if the moratoriums should be lifted, the job classifications and the related salary scales are known, presenting a clear figure if money is requested The main problem relating to budget variance seems to be in the areas of services, stores, transport and maintenance. The degree of predictability is limited; even predictability based on historical information or extrapolations is limited.

Managing variances is not approached in an incidental manner, but is dealt with according to Treasury Regulations and legislation relating directly to these Regulations. Basically, variance management assumes the following pattern:

- The variance or its occurrence is identified.
- The variance is classified in terms of type, nature, programme and amount.
- The solution is determined and applied, for example virement and rollover (see 2.6.3 and 2.6.4).

2.6.2 Identifying variances

Variances occur when expenditure exceeds the approved budget. This means that authorisation for the amount beyond the budgeted amount does not exist. Defrayment of these extras is therefore regarded as unauthorised expenditure in the strict sense of the law. In the literal sense, unauthorised expenditure is against the law. The PFMA makes legal sanction possible for unauthorised expenditure of a serious nature. Unauthorised expenditure, together with fruitless and wasteful expenditure, should be avoided at all costs by the accounting officer. They are negative forces working against the three Es (economy, effectiveness and efficiency).

- In the case of unauthorised expenditure, either the legislature must pass legislation to authorise it after the fact, or
- disciplinary steps must be taken against the responsible person.

Variances (invariably over-expenditure) should preferably be identified before the monthly fund estimate and fund request are passed to Treasury, thus ensuring that the department will have sufficient amounts available. In terms of the Treasury Regulations, accounting officers have to prepare monthly reports for submission to the relevant treasury and executive authority within 15 days of the end of each month. The "early warning report" contains information on the following:

- the actual revenue and expenditure for that month, in the format determined by National Treasury
- projections of anticipated expenditure and revenue for the remainder of the current financial year
- any material variances, and a summary of actions to ensure that the projected expenditure and revenue remain within the budget.

Variances from the budget are calculated to determine the cash position of a department, in order to prepare requisitions to Treasury that provide for such variances. These variances should always be explained. The following areas need to be reflected in monthly financial control reports:

- estimate totals compared to current budget
- expenditure plus commitments compared to estimates
- sharp increases and decreases in unplanned spending
- any other surpluses and deficits



Note: There are important differences between the various state departments' reports on expenditure. Their reports differ in purpose or intent and frequency, and the reporting entities differ.

Cash flow estimates are compiled to prepare a requisition to the relevant treasury to obtain money to defray expenses in the ensuing month. They necessarily include variances as a result of price increases. As stated above, requisitions are submitted at least four full working days before the end of the month preceding the month during which the funds are required.

In terms of the financial management system (FMS), most of which are nowadays computerised, managers are delegates of the accounting officer. In performing their functions, programme managers should, in particular, do the following:

- Estimate total spending compared to the current budget.
- Calculate expenditure plus known commitments and compare them with estimates.
- Make sure that variances not reflected in the estimates are at least known.
- Make sure that any unplanned spending or increases and decreases in planned spending are noticed immediately.
- Make sure of any other surpluses or shortages.

The following aspects are relevant to the financial management system:

- internal controls
- internal audit
- risk assessment
- fraud plan
- accounting standards
- performance budgeting
- reporting requirements
- accountability arrangements
- procurements policies and practices (Pauw et al, 2015:310).

The information obtained through this process enables accounting officers to determine whether or not over-expenditures are pending and should be provided for. Programme managers play an important role in the identification of specific programmes (and the specific functions in those programmes) where variances occur.



ACTIVITY

What must be done before measures can be taken to deal with the possibility of over-expenditure?

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2.6.3 Virement



There must be scope for managers who have to manage allocations to profit from savings using **virement**. Virement encourages managers to accomplish savings and may offer a way out when expenditure patterns exceed planned levels in departments. **Virement is the use of a saving for a different purpose than the one stipulated in the original budget**. Virement therefore means that the accounting officer may approve that a saving under a specific programme be used to defray shortages under another programme within the vote.

Unless the relevant treasury directs otherwise, an accounting officer may use a saving of up to 8% of the amount appropriated under a main division (a programme) for defraying excess expenditure under another main division within the same vote. This must be reported to the executive authority and the relevant treasury within seven days. Prior approval by the relevant treasury is required

- before any personnel expenditure and transfer payments are increased
- before any earmarked allocations are used for other purposes

Section 43(1) of the PFMA stipulates the following:

- Compensation of employees and transfers and subsidies to other institutions, excluding transfers and subsidies to other levels of government for purposes of paying levies and

taxes imposed by legislation, may not be increased without approval of the relevant treasury.
- New transfers and subsidies to other institutions may not be introduced without the approval of the relevant treasury.
- Virement of funds from compensation of employees to transfers and subsidies for payment of severance/exit packages are excluded from the aforementioned provisions.

Virement is therefore subject to the following limitations:

- Savings on capital expenditure and transfer payments may not be used for purposes other than those intended.
- Special allocations for disasters, drought relief and capital projects financed from the selling of assets may not be used for purposes other than those intended.



Note: Excesses on main divisions arising from expenditure against the special programme: thefts and losses are not subject to the provisional virement rules. In other words, accounting officers may not apply virement in the case of theft in the department.

2.6.4 Rollovers

Funds appropriated but not spent in a particular financial year may be rolled over to a subsequent year, subject to the approval of the relevant treasury. Such approval is guided by the following limitations:

- *Payments for capital assets*: Unspent funds on payments for capital assets may only be rolled over to finalise projects or asset acquisitions still in progress.
- *Transfers and subsidies*: Savings on transfers and subsidies may not be rolled over for purposes other than originally voted for.
- *Current payments*: Savings on compensation of employees may not be rolled over.

A maximum of 5% of a department's payments for goods and services may be rolled over.

Requests for rollovers must be submitted to the relevant treasury on or before the last working day of April, in a format determined by National Treasury, and must include:

- the purpose for which the funds were appropriated
- the reasons why the funds have not been spent
- proposed changes to the use of the funds, if any
- a disbursement schedule indicating the month(s) in which the expenditure is expected to be incurred

Funds for a specific purpose may not be rolled over for more than one financial year, unless approved in advance by the relevant treasury.

The main argument in favour of rollovers is that savings are encouraged. However, when institutions know that they have money for one year only, they might go on spending sprees near the end of the year in order to use up allocations. Also, underspending for a year might be as bad as overspending from the point of view of the clients of public services.



ACTIVITY

Do you think accounting officers should pursue rollovers rather than virement, or should they use virement instead of rollovers? Substantiate your answer.

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2.7 CONTROL MEASURES AND PROCEDURES

Because of the emphasis on accountability, control measures permeate public financial management. Of course, the same applies for all other functions and activities in the public sector, given the premise that all activities have some direct or indirect financial implication. The ultimate aim of control is accountability to the taxpayer, on whose behalf government is providing services and functions.

It could be said that control measures dictate all financial and other activities for the sake of control, and in the process lose track of what is really required for good, proper and efficient financial management in the public sector. This approach, however, presents a rather negative view of control *per se*, thereby diminishing the value of control measures as powerful tools that support good management practices rather than undermine them.

From a more positive viewpoint, control measures serve as monitoring, evaluation, comparative, measuring, recording and analysing mechanisms, and not really as instruments with a penalising intent. Viewed from this perspective, control measures adopt a new angle and new dimensions for the public official. In this regard, officials view control measures as negative only when threatened by their implied penalising characteristics.

The range of control measures applicable to all functions and activities in the public sector is far too comprehensive to be dealt with sufficiently in this learning unit. Each single piece of legislation in itself serves as a control measure, whether by intent or directly. Included here are documents issued in terms of an Act with the purpose to provide control measures.

Finance control measures, that is all the relevant documents linked to direct financial control and the monitoring of expenses, can be classified into two broad spheres: enabling control measures and monitoring measures.

2.7.1 Enabling control measures

Enabling control measures are those measures that provide the basis for financial management.

- The budget provides guidance on spending programmes, the amounts authorised under each spending programme and the objectives of spending programmes.
- Financial legislation, such as the Public Finance Management Act 1 of 1999 and the Treasury Regulations, provides stipulates the executive authority should conduct its business.
- Treasury instructions provide guidelines on various types of functional activities in the operational field.
- The financial planning and budgeting system of the state provides guidelines on planning, estimating and budgeting procedures.
- The FMS determines how transactions should be recorded and how financial statements (including cash flow statements and various others) should be compiled.



Note: The above-mentioned measures do not necessarily relate exclusively to an enabling function – they can double as monitoring, evaluation and comparative instruments (control instruments). The reason for that will become clear in the following section.

2.7.2 Monitoring, evaluation, recording and comparative control

Control means that the correct procedures and principles must be applied according to established frameworks to achieve a predetermined objective.

This means that two distinct elements form the basis of what should be controlled: firstly, whether procedures and principles have been adhered to; and, secondly, whether objectives have been achieved given their particular conditions. In simple terms, this means that no unauthorised expenditure or irregular expenditure has been made, no fruitless expenditure has resulted from the various activities, all money has been utilised optimally to the best advantage of state and society, all assets are accounted for, no fraud or theft took place, all revenue due to the state has been received (including debts), no outstanding creditors remain unpaid, and so forth.

To achieve all of the above, control measures form part of the comprehensive framework of public financial management. Two dominant types of control procedures are possible, namely internal and external control measures.

2.7.3 Internal control measures

Internal control measures are those measures that apply continuously during the operational phase of a financial year and are directed at the management echelon of the entity. The purpose of the internal control function is to test the effectiveness of the implemented controls in an environment continuously and to make recommendations to management to effect necessary changes.

Internal control measures include the following:

- internal auditing (monitoring procedures and transactions)
- reporting (i.e. performance)
- reports (reflecting the state of finances, revenues and expenditures, cash flow and various transaction types)
- inspection (stores, facilities, properties and capital projects)
- authorisation (i.e. for payments)
- signature (for delegations and payments).

Financial management information must be supplied to management regularly to facilitate objective corrective decisions where activities are not in line with the budget of the department. Financial management information must also be useful, reliable and timeous in support of the evaluation of performance. Financial reports must conform to the standards of reporting stipulated by applicable legislation.

2.7.4 External control measures

The predominant external control measure is exercised through the Auditor-General and subsequent reporting to the legislature. In the legislature, standing committees deal with public accounts and consider the recommendations in the Auditor-General's reports. Standing committees refer to Parliamentary oversight committees, for example the Standing Committee on Public Accounts (SCOPA).

2.8 CONCLUSION

Despite the existence of legislation, procedural manuals and instructional guides, good financial management can prevail only as a result of the integrity, training, diligence and professionalism of public officials. Many elements, especially those relating to training and experience, take time and are not achieved overnight. The correct use and application of all the various procedures and mechanisms are paramount to effective, efficient and economical public financial management. However, this can be achieved only by proper education and training in the field of financial management and, very importantly, by developing a code of professionalism among those responsible for dealing with public finances as entrenched in section 195 of the Constitution of the Republic of South Africa, 1996.

2.9 SELF-ASSESSMENT



(1) Which three frameworks represent the environment in which expenditure management and control function? (3)

(2) Identify four mechanisms, systems or procedural manuals which, in conjunction with one another, provide a framework for public officials dealing with financial management in the public sector. (4)

(3) Why does budget variance occur? (3)

(4) What are the elements of expenditure management in its relation to programme management? (6)

(5) *What is meant by the release of funds?* *(5)*
(6) *What elements constitute fund management?* *8)*
(7) *What do the abbreviations MTEP, MTEF and MTRP stand for?* *(3)*
(8) *What does cash flow management entail in practice?* *(4)*
(9) *In terms of spending patterns, what should programme managers report on regularly in standard format?* *(6)*
(10) *Briefly explain virement and rollovers as mechanisms used to deal with deficits or shortages and surpluses.* *(10)*
(11) *What constitutes enabling control measures?* *(5)*
(12) *List six internal control measures.* *(6)*

2.10 FEEDBACK ON SELF-ASSESSMENT



(1)
- *Legislative framework*
- *Procedural framework*
- *Internal control framework*

(2)
- *Public Finance Management Act*
- *Treasury Regulations*
- *Treasury Instructions*
- *Manual of the financial planning and budgeting system of the state*
- *The financial management system*

(3) *Budget variance occurs because of the time lag between the date that the budget estimates are determined and the date that the actual spending takes place. In that timespan prices increase, unforeseen changes in spending objectives take place or disasters occur, all of which might influence the authorised spending amounts.*

(4)
- *Accounting*
- *Expenditure control*
- *Cash flow management*
- *Reporting*
- *Asset management*
- *Procurement*

(5) *Departments do not receive their full budgeted allocations in one single transfer from Treasury. As revenue and expenditure represent a simultaneous action, Treasury will not have sufficient funds to transfer all funds due to departments on a once-off basis. Therefore departments receive their allocations in 12 allotments. These allotments (i.e. the authorised amounts) must be requested monthly through treasury requisitions. The time value of money (opportunity cost) is a very important issue here.*

(6)
- *The day-to-day accounting and reporting the value of individual transactions*
- *Reporting on the use of funds*
- *Using general accounting systems*
- *Appropriations and expenditure monitoring procedures*
- *Internal controls*
- *Preparing and auditing financial statements*
- *Ensuring liquidity, linking it to the ability to pay current bills*
- *Tracking, projecting and monitoring cash flow*

(7)
- *MTEP: Medium-term expenditure plan*
- *MTEF: Medium-term expenditure framework*
- *MTRP: Medium-term revenue plan*

(8)
- *Planning functions*
- *Revenue functions*
- *Spending functions*
- *Recording functions*

(9)
- *How much money has already been spent*
- *The amount of funds remaining in terms of the budget*
- *What amount is committed*
- *What the monthly cash flow requirements will be*
- *In which months a higher cash flow will be required*
- *Monthly expenditures measured against budget*

(10) *Virement is the authorisation that an accounting officer has to defray shortages under one programme with the surpluses or savings effected under another programme, but within the same vote. However, it is limited to a certain percentage and also to particular functions. For example, savings on capital or staff may not be transferred to another account without prior permission from the relevant treasury.*

Rollovers occur when a department is permitted to transfer the savings or surpluses of the department from one financial year to the ensuing financial year. There are particular preconditions that govern this practice. For example, savings are given to the Treasury for re-allocation to the department's credit, rollover on any particular function or programme is limited to a single occurrence and rollovers may not result in recurring spending.

(11)
- *The budget*
- *Financial legislation*
- *Treasury Instructions*
- *Financial planning and budgeting system*
- *Financial management system (FMS)*

(12)
- *Internal auditing*
- *Reporting*
- *Financial reports*
- *Inspection*
- *Authorisation*
- *Signature*

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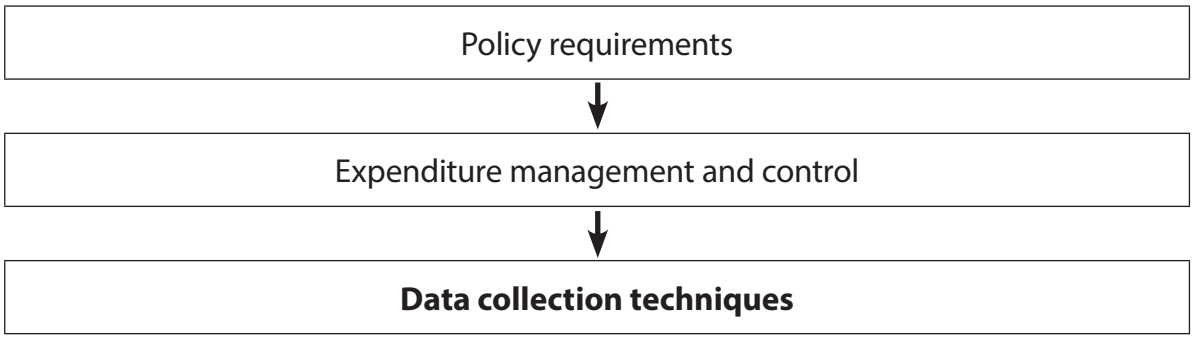
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ROUTE MAP

Use the route map below to determine where we are and how this unit fits into the module.

MODULE: PUBLIC FINANCIAL MANAGEMENT II



LEARNING UNIT 3

Data collection techniques



LEARNING OUTCOMES

Once you have completed this learning unit, you should be able to

- identify relevant data for budgetary purposes
- disseminate information
- classify data
- use data for budgetary purposes

INTRODUCTION

The underlying efforts in preparing a budget for the next financial year are seldom highlighted, except in official procedural manuals. However, preparing a budget comprises one of the most critical issues of modern budgeting and financial management. It is during the preparation of the budget that crucial decisions need to be made – decisions that will need money and that will need to be managed until the desired outcomes are achieved.

In the process of making decisions about budgeting objectives, data needs to be obtained to make the correct decisions. The challenge is not to identify objectives on which to spend money – it is choosing between spending alternatives since there are more needs than resources. Data collection is therefore a central element of this process, since it provides information for decision-making. In this learning unit we deal with the processes, procedures and instruments that facilitate data collection in the public sector and that serve as important elements of public financial management.

Data is raw, unorganised facts that need to be processed. When data is processed, organised, structured or presented in a given context to make it useful, it is called information.

3.1 THE NEED FOR DATA

No decision can be made if the information that is required and/or necessary to make the decision is unavailable. Individuals, households, couples, companies, government and virtually every person are involved in the quest for information that would enable them to make a decision. Decisions such as what to buy, where to invest, where to spend a holiday, what type of car to buy, what to study after school and what to eat at a restaurant all involve a choice between alternatives. That means that when you make any decision, you

reject one or more alternative options. Your decision to choose a particular option instead of it alternatives is usually not based on psychological factors or personal preferences, but on the information at your disposal. When deciding to buy an appliance, for example a refrigerator, few people would purchase the first one they see in a store. Prospective buyers will probably study various brands, prices, stores that offer discounts, sizes of various refrigerators and guarantees. Then, based on this information, they compare the various brands. Their final decision is probably be based on the affordability of the refrigerator. Their aim is to purchase the best possible refrigerator they can afford based on the information available to them.

Information and its availability determine the relative success of decisions. The more information you have about a specific theme, the sounder your decision-making basis will be. The degree and level of your decision-making basis also determine the variance between informed decision-making and a calculated risk mode of decision-making. In a way, informed decision-making and calculated risk represent two approaches: firstly, calculated risk does not necessarily represent a lack of information at the time when the decisions are made and, secondly, the number of variables and their nature act as a catalyst between the two modes.

Variables can be either dependent or independent, which pertains to things that you can control and things you cannot control. The behaviour, origin, truthfulness or result of dependent variables can be predicted accurately. Independent variables are less secure and predictable than dependent variables. The more dependent variables you have, the more informed the decision will be. By contrast, if a decision is based mainly on independent variables, the ultimate decision is more of a calculated risk.

Let's use an example to explain this. A person is driving a car on a long trip. The driver comes to a point along the way where he has two alternative routes to the same destination. Route A is a toll road with double lanes and it is 20 kilometres shorter than route B, but the driver has to pay R25 to use it. Route B is a single-lane road, but the driver does not have to pay any toll fees.



The driver now has to consider the situation. His considerations may include any of the following, and can be influenced by various other factors:

- If the driver takes the toll road and pays the R25, he is reasonably sure that he will reach his destination sooner.
- If the driver takes the alternative route, he does not need to pay the toll fee, but it will him take longer to reach his destination.

The driver has two options. The first option represents an informed decision with known outcomes. The outcomes of the second option are also known in advance, but the extent of the doubt is greater than in the first option. If the driver therefore takes the first option, he will reach his destination on time, but he will have to pay R25 (based on the fixed and dependent variables). If the driver takes the second option, he takes a calculated risk but saves R25. In this case some variables (e.g. heavy traffic) are unknown (quantity), but at least acknowledged (probability of occurrence).

Of course, decisions like the one in the above example can be influenced by other elements. If the driver is late for a meeting, he will not choose route B (the alternative route). An accident could happen on either route. If the driver's car is low on petrol, he will choose the safest option, since he probably does not know how many petrol stations there are on the alternative route.

To conclude, every decision has at least one alternative, and the alternatives have arguments both for and against them. These arguments are influenced by the type of information that is available, and its reliability in terms of truth and relevance (old or new information, hearsay or based on scientific tests).

From the above it should be evident that information forms part of our daily lives. It should also be obvious that, owing to the effect of the combination of and interaction between information and decision-making, modern society is a product of the extent to which information has been applied to decisions.

This, more than anything else, should emphasise the importance of information, or data, in our lives and in society. We cannot make decisions without access to information. Decisions form part of human behaviour. Some decisions, such as what to eat today, what to wear or what toothpaste to buy, are taken on the spur of the moment, while others such as what to study, what vehicle to buy or where to spend a holiday, may take longer. The difference should be obvious – choosing toothpaste is far less important than choosing a field of study and therefore requires less attention.



ACTIVITY

Think of specific reasons why departments need data and explain your answer.

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3.2 DATA CONCEPTUALISED

Why do we use the term "data" instead of "information"? After all, they seem to have more or less the same meaning. The differentiating factor is found in the application. Information, if generalised, relates to all existing knowledge. Knowledge refers to everything that is known currently, and includes everything that happened in the past up to today, everything that has been recorded in any conceivable way and all the information that is readily available to everyone.

Knowledge also includes information about the future, although there is less certainty about such information than there is about existing information. Future information includes the knowledge that the four seasons will recur year after year, it will rain sometime in the future, natural disasters will probably occur, children will be born, interest rates will continue to increase and decrease in a continuous cycle, the government will provide medical care and other services, and so forth. The reliability of future information is highly relative as it can only be proved after time has passed – this is called the problem of induction.

A specific advantage of processing information as data is that it enables the observer or person applying the data to compare it with previous sets of data. This is possible because it contains specific information structured in a specific order for a specific purpose. The budget is an excellent example of such an application.



ACTIVITY

What is your own understanding of the meaning of data and information, and the difference between the two?

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3.3 DATA COLLECTION AND PUBLIC FINANCIAL MANAGEMENT

No budget can be prepared without access to the necessary data. No decision can be made without the necessary information on which to base the decision. To prepare a proper budget and make a proper decision, **relevant** information is required. Consider for a moment what the budget is all about – it basically needs to allocate public money to spending objectives. However, a process of selection and decision-making needs to precede the identification of spending objectives, especially since there are more needs and wants than resources. The budget, in its current format, is a mechanism to facilitate the process of determining objectives, selection and decision-making. This process is very similar to the one you use in everyday life when you buy a car or go on holiday. The only difference is that you probably do not call it a budget or a budget process. Most people plan what they intend to do and then calculate the cost. In reality this is nothing more than a budget. The availability and relevance of data are crucial for the purposes of public financial management and public sector budgeting. We discuss this in the next section.

3.3.1 Need for and relevance of data

There are various approaches to decision-making during the budget process, and particular ideological, political, social and economic conditions influence such decision-making. Let's briefly consider the various elements of this assumption.

The ideological content of the budget is representative of the type of government and society in the country. In a socialist country, the budget will assume a socialist character, which will be reflected in the services rendered and functions fulfilled by the government. The political element refers to the influence of the majority political party in government, which is the ruling party in a democracy. The budget will also reflect the political priorities of that party. Social imperatives reflected in the budget should correspond with the current social elements of a society. Social elements are aspects such as poverty, HIV/AIDS, unemployment and crime. Economic considerations will also be reflected in the budget and include the scarcity of means, the availability of money and other resources, the prevailing saving and investment propensity of society, taxes, economic growth rates and exchange rates.

3.3.2 Budget approach

Each of the above elements has an effect on the budget and on the approach to preparing the budget. The different approaches to budgeting include an item approach, a zero-based approach, a function approach and a programme approach. The differences between these approaches are found in the use and application of budgetary data. The approach that is followed does not necessarily change the budget objectives, and therefore the data itself will change only marginally. The purpose of this approach is to align the relevance of data and its collection with public sector financial management. Therefore, the budget is one of the points of departure for data collection.



ACTIVITY

Can data be substituted for anything else when a budget is prepared? What are the possible alternatives?

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3.4 COLLECTING DATA FOR THE BUDGET

We have already mentioned that the budget incorporates a variety of elements, such as political, economic and social considerations. In addition, it also serves as an instrument

of government's fiscal policies. Fiscal policies refer to government spending policies that influence macro-economic conditions, for example by improving unemployment rates and controlling inflation. All the elements of a budget serve as parameters for the type, quantity and quality of information or data required.

How do departments or constitutional institutions know what type of information they require and how they should use that information? The Department of Health, for example, should focus on health-related matters in preparing a budget and not on military matters. Some elements, such as personnel and finance, are generic to all departments but a department's functional classification determines on which what data framework it focuses.

The following sections (3.4.1 to 3.4.5) is an extract from the manual on the financial planning and budgeting system of the state prepared by National Treasury and reflects the official approach to budget data.

The needs for detailed budget information, whether for internal departmental purposes or for submission to the National Treasury, Cabinet or Parliament at various levels of decision-making, are not identical. Details should therefore be collected and submitted selectively and in accordance with each decision-maker's specific needs.

3.4.1 Purpose of the expenditure

The decisive consideration when allocating means (money and resources) is the purpose for which funds are being requested by departments (spending agencies), that is the specific need to be met, the problem to be dealt with or the benefit to be achieved from spending the funds. This is reflected in terms of envisaged outputs or results. The most important question, especially from a policy point of view and for priority determination, is what part of the limited means should be allocated to the achievement of the alternative and competitive policy objectives.

Those who decide on the allocation of means at departmental and cabinet levels should therefore be informed of the purpose for which funds are requested. Each spending agency will have to compile a complete estimate of expenditure objectives to be pursued. This means that the cost of all departmental activities is determined and made available to decision-makers within the framework of a suitable objective or programme structure, that is, a structure reflecting the programmes, sub-programmes, elements and activities for achieving each objective. The intention is, as much as possible, to connect and integrate each departmental policy objective directly with a specific executive programme with a specific budget. The integration of an objective with a programme and an estimate should also be maintained on a multi-term basis.

3.4.2 Centre of financial responsibility

It remains essential to identify who requests funds for a specific objective. In other words, which spending agency and, where necessary for the internal needs, which lower organisational units (e.g. regional offices, divisions or institutions of spending agencies)

request funds. An estimate of planned expenditure must be compiled for each centre of financial responsibility.

3.4.3 Expenditure items

The body drawing up an estimate should budget for specific goods and services, such as expenditure items, or inputs, such as salaries, transport, equipment and stores, in respect of every objective pursued. An estimate of costs against the item structure is therefore essential.

3.4.4 Source of finance

The source to be used for financing, like a fund, vote or account, must also be identified. Separate estimates of expenditure must therefore be drawn up for each source of finance.

The above approach offers decision-makers at various levels the opportunity of reviewing the budget data of spending agencies in the public service as a whole on the following basis:

- estimates of expenditure according to objectives to be pursued, which means that each objective is aligned with an estimate
- estimates of expenditure according to centres of financial responsibility
- estimates of expenditure according to the items to be purchased
- estimates of expenditure according to the source from which the expenditure will be financed

The budget system therefore consists of four basic structures:

- objective structure
- responsibility structure
- item structure
- fund structure

Each of the above structures represents a wide variety of data collected and allocated to structures for budgeting purposes.

3.4.5 Demand classification

It is essential that decision-makers (politicians, Cabinet members, Parliament, chief executives) consider the cost of proposed new initiatives separately from the financial commitments involved in merely continuing existing programmes and activities. The following needs to be considered:

- For each objective (programme or sub-programme) an indication should be given of which centres of financial responsibility are involved, which expenditure items they are requesting, and against which vote, account or fund the expenditure will be charged.
- For each centre of financial responsibility an indication should be given of which objectives will be pursued, which expenditure items or outputs will be needed per programme and from which sources they will be financed.

- An indication should also be given for each expenditure item (e.g. salaries or stores) of which centre of financial responsibility requires the funds, which objectives are to be pursued and from which sources they will be financed.

Expenditure needs to be classified in terms of various objectives. This allows analysis, evaluation and comparisons, and is therefore useful for a variety of applications. Let's look at this in more detail.

3.5 INTRODUCTION TO THE ECONOMIC REPORTING FORMAT

The economic classification is a standard classification of all revenue and expenditure items, as contained in the Economic Reporting Format prescribed by National Treasury. This aligns with the Public Finance Management Act (PFMA), TRs and Standard Chart of Accounts (SCOA).

Background

Section 27(3) of the PFMA highlights the minimum requirements of an annual budget and allows the Minister of Finance to prescribe the format of the annual budget. The first part of this guideline outlines the process of developing the new economic reporting format.

In 1999, National Treasury embarked on a budget reform programme. The objective was to improve accountability and modernise the accounts of government by bringing reporting in line with international best practice. The ultimate aim of this reform process was to provide better quality information to legislatures to assist in the policy-making process and to reinforce Parliament's oversight role.

There was comprehensive stakeholder consultation at both the national and provincial levels during the development phase, which took about 18 months. This has ensured that financial practitioners are familiar with the proposed change.

An important component of the budget reform programme was initiated in 1998, when National Treasury started a process of reclassifying the existing expenditure items of government in line with the requirements of the Government Finance Statistics (GFS) classification developed by the International Monetary Fund (IMF). This was to ensure compliance with the requirements of the Special Data Dissemination Standard (SDDS), a minimum reporting standard set by the IMF to which South Africa is a signatory.

During this process many inconsistencies in the application of existing classification standards were identified. For example, disposable baby nappies were sometimes classified as capital expenditure and major school rebuilding projects as current expenditure. This was mainly due to classification rules being inconsistently applied and limited control over their application. Furthermore, departments were allowed to create their own accounting codes on the systems, leading to a vast number of codes and hundreds of duplications.

The process highlighted the fact that the existing classification regime was outdated and improperly used. Consequently, the Budget Council approved the development of a new

economic reporting format for implementation at the provincial level. It was decided that the existing classifications would be replaced with a more appropriate classification in line with international best practice.

This process was initiated at the provincial level in 1999 with the introduction of a GFS format as part of the Gauteng Provincial Budget. This reform involved the introduction of a new economic classification in line with the 1986 version of the GFS. The new format was included in budget documentation alongside the old "standard item" classification; a detailed functional classification of expenditure was also introduced. Over the next two years, the system was rolled out to all the other provinces. A similar reform was introduced at national level with the annual publication of the ENE.

While this project was initiated to develop a new budget format, it soon became clear that the new reporting format would only be effective with an appropriately amended chart of accounts. This was necessary as the chart of accounts contains the detailed spending items supporting the budget format, and any change to the budget format had to be supported by a corresponding change to the chart. The scope of the project was therefore expanded to include the development and implementation of a new SCOA.

Implementation process and time frame

The Minister of Finance approved the implementation of the new economic reporting format and SCOA on 1 April 2004. Departments were therefore required to submit their 2004 budget in line with the new format, in order to ensure that correctly classified budget data could be loaded onto the system for the 2004/05 financial year. Requirements for the budget documentation are outlined in detail in the *Treasury guidelines for preparing budget submissions* and *Provincial budget format guidelines* issued by National Treasury (www.treasury.gov.za).

The implementation was closely monitored and reviewed by National Treasury to ensure compliance with the PFMA and the Appropriation Act. The necessary procedures were put in place to assist departments in implementing the new economic reporting format and the SCOA.

The evolution of accounting and reporting requirements led to a review of the SCOA in 2008 and an improvement in government's ability to report on infrastructure spending. It provided for better control over departmental programme budgets, enabled the identification of more appropriate spending items in the chart, enhanced asset management through better recording of asset transactions and enabled government to monitor regional spending.

Structure of accounts

The reporting format organises all government transactions into three broad categories, namely receipts, payments and financing.

- Receipts

Government receipts are divided into: taxes, sales, transfers, fines, penalties and forfeits, interest, dividends, rental on land, and transactions in financial assets and liabilities.

- Payments

Payments are divided into four broad categories: current payments, transfers and subsidies, payments for capital assets and payment for financial assets.

- Financing

Financing includes all financial transactions other than transactions in financial assets and liabilities, and payment for financial assets, which are included in receipts and payments.

Functional classification

Each government payment should be classified according to its functional and economic characteristics.

The broad categories in the functional classification are listed below:

- general public services, which refer *inter alia* to the administration, operation or support of executive and legislative organs, financial and fiscal affairs, and external affairs
- defence, which includes administration, operation and support of military and civil defence, and the operation of military missions accredited to foreign governments
- public order and safety, which cover police services, fire protection services, justice and law courts, prisons, and related research and development (R&D)
- economic affairs, which include government spending associated with the regulation and more efficient operation of the business sector
- environmental protection, which relates to the conservation of biodiversity and landscape (the protection of habitats)
- housing and community amenities, which include the administration of housing and community development affairs and services, water supply, street lighting and related R&D
- health, which includes spending on services provided to individuals on a collective basis, including medical products, appliances and equipment, outpatient services, hospital services, public health services and related R&D
- recreation and culture, which include recreational and sporting, cultural, broadcasting and publishing services
- education, including spending on services provided to individual learners and students, as well as those provided on a collective basis (pre-primary, primary, secondary and tertiary education)
- social protection, which refers to services supplied directly to communities, households or individuals, including transfers for sickness and disability, old age, survivors, family and children, unemployment, support to households to meet the cost of housing and related R&D

The chart and the new format include elements of a number of other classification systems to ensure compliance with international classification standards. These include the following:

- *System of National Accounts (SNA):* This provides data to economists responsible for compiling the National Accounts of South Africa.
- *Central Product Classification (CPC):* This information is required by Statistics South Africa (StatsSA) to compile product statistics. It is provided for in the chart when possible.
- *International Standard Industrial Classification (ISIC):* This classification is used to categorise public entities according to the industry within which they operate.
- *North Atlantic Treaty Organisation (NATO) classification:* This classification was adopted before World War II as a defence supply chain classification system, and is used by most defence departments to classify logistical items. Interfaces to this classification system are provided for in the chart in line with existing interfaces used by the Department of Defence.
- *Classifications of Functions of Government (COFOG-UN Functional):* This provides for a uniform classification of internationally recognised functions of government.

Design principles

The new reporting tables have been designed in accordance with five main principles, namely:

- Labelling must be in line with the Constitution.
- Labelling should be clear, user friendly and easily accessible both for the user and the clerk completing forms.
- Labelling should be transparent and serve to enhance accountability.
- Items should be grouped together so that they easily lend themselves to calculating relevant economic variables, for example final consumption by government.
- Items should be displayed in such a way that GFS tables can easily be extracted for purposes of international comparisons.

Standard Chart of Accounts (SCOA)

Advantages of the SCOA

- It contributes towards greater transparency for both reporting and comparative analysis purposes.
- It offers a basis for various methods of information analysis, because it complies with various classification systems.
- It facilitates a standardised process for transacting in all national and provincial departments, thereby improving the mobility of finance personnel between various departments.
- It facilitates the automated production of financial statements and other reporting information.
- It allows for meaningful consolidation at various levels, as it properly identifies all transactions between various levels of government.
- It maintains a "single version of truth" for all reports in the various financial systems used by different national and provincial departments.
- It will have the same basis for data classification, ensuring consistency in the financial reports disseminated into the public domain.

3.6 INFORMATION FOR THE BUDGET

From the above it is evident that budgets represent an enormous database. Since they represent the total of executive functions and services in terms of financial and other resources, they therefore also reflect data needs. In this way, the budget provides the parameters for data collection in the public sector. Of course, the pre-data-collection process is too extensive to cover in detail in this learning unit. Pre-data-collection activities must be undertaken for each specific functional activity at the lowest possible level in executive agencies (departments and constitutional institutions) before such a function can be included in the budget.

Whenever the need for a particular service or function arises, and as part of the planning process, aspects such as viability, need, economy, organisation, resources, possible duplication, procedures, control measures and duration need to be determined. These elements can only be determined by collecting data. The following questions need to be answered:

- How or from what problem area did the need for the service originate?
- How many people require the service or function?
- What are the financial and resource consequences?
- Who will deliver the service?
- What is the unit price (if it can be determined)?
- For how long will the service be required?
- Is the same service provided at another level?
- What are the alternative service provision options?
- What will the results be if the service is not provided?
- Does the government have to provide the service?

Decisions can only be based on reality as disclosed by information obtained through data-gathering processes. Parliament will not consider requests for funding if it is not satisfied with the explanation provided in memorandums requesting this funding. Of course, Treasury will screen all requests beforehand and make sure that all information required accompanies requests for funding. Departments and constitutional institutions must therefore make sure that the information they use in the budgeting process is correct. Insufficient data on factors that could influence expenditure leads to poor planning and thus over-expenditure, which then has to be managed. If correct information is received in the first place, poor planning and over-expenditure can be avoided.

3.7 CONCLUSION

Data collection is a crucially important foundation of the budget process. It is virtually impossible to prepare a reliable and accurate budget without the required information obtained via data-collection processes to sustain decisions. The data is collected not only to prepare a budget, but also to ensure efficiency, effectiveness and economy. To collect data with the sole purpose of preparing a budget without due regard for the outcomes (whether objectives are achieved or not) is senseless and a waste of time.

Each of the stages in the budgeting process requires care and due diligence to ensure that government's objectives are achieved and value for money is attained. Good planning based on correct information (data) allows government to become more economical, render important services and carry out important functions.

3.8 SELF-ASSESSMENT



(1) List five things that need to be identified when data for the budget is collected. (5)
(2) Identify the categories of the economic classification of expenditure. (3)
(3) Briefly explain what is meant by ordinary capital transfers. (5)
(4) Write down the typical questions that should be asked when data is collected for budgeting purposes. (10)

3.9 FEEDBACK ON SELF-ASSESSMENT



(1)
- *The purpose of the expenditure*
- *Centre of financial responsibility*
- *Expenditure items*
- *Source of finance*
- *Demand classification*

(2)
- *Current expenditure*
- *Capital expenditure*
- *Transfers*

(3)
- *Payments by the state (for which it does not receive compensation and/or which do not create or extinguish a financial claim) incurred to enable the recipients of the payments (including other governments) to acquire capital assets and undertake capital forming projects*
- *Goods and services for capital expenditure*

(4)
- *How or from what problem area did the need for the service originate?*
- *How many people require the service or function?*
- *What are the financial and resource consequences?*
- *Who will deliver the service?*
- *What is the unit price (if it can be determined)?*
- *For how long will the service be required?*
- *Is the same service not provided at another level?*
- *What are the alternative service provision options?*
- *What will the results be if the service is not provided?*
- *Does the government have to provide the service?*

3.10 REFERENCES AND ADDITIONAL READING

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