ENGAGING WITH GOVERNMENT BUDGETS
AN ACTIVIST’S GUIDE TO SOUTH AFRICAN GOVERNMENT BUDGETS AT LOCAL, PROVINCIAL AND NATIONAL LEVEL
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CHAPTER 1

OVERVIEW OF INTERGOVERNMENTAL BUDGETING

The annual process of planning, preparing and debating government budgets is an exercise which requires the participation of a large number of individuals and a significant amount of time and resources. This is with good reason – the outcome of the process affects the lives of everyone in the country. Municipal services, access to healthcare, the quality of basic education, community safety – these are only a few examples of the many different things that need to be considered during the budget process. It is for this reason that communities, and particularly activists, need to engage with the government budget. By doing so they can develop an understanding of where and on what money is being spent, and evaluate if government’s priorities adequately address people’s needs. By engaging with government budgets, communities are in a better position to approach government and to voice their concerns and needs. Every resident, whether rich or poor, must be given an opportunity to have a say in the budget process.

This guide gives an overview of government budgeting at all three levels of government – national, provincial and local – although the primary focus is on local government. This guide will introduce the reader to essential budget terms and concepts, and provide an overview of how the budget process unfolds every year, including a look at budget trends in recent years. Finally, this guide will also introduce the reader to the different pieces of legislation that enforce how government budgets are prepared and implemented in South Africa, and what community members can do to have their voices heard and keep government accountable.

1.1. DEFINING BASIC TERMS

Before we go ahead, it is useful to first consider certain key terms related to budgeting and economics.

INFLATION is an economic term referring to an increase in the general price of goods and services over time. An example would be the increase in price of most grocery products from one year to the next – whereas a tin of Coca Cola might have cost R5 in 2000, it now costs R10.
**GROSS DOMESTIC PRODUCT (GDP)** is a macroeconomic measure of the total value of goods and services produced within the country over a specific period. **Real GDP Growth** is the percentage change in the GDP from year to year, after the effect of inflation is taken into account. It is often used as a measure of how well the country's economy is performing.

**Figure 1: Inflation and GDP growth**


**PER CAPITA** is another way of saying ‘per person’ and comes from the Latin for ‘per head’.

**GDP PER CAPITA** is calculated by dividing the GDP by the country’s population. It is a macroeconomic measure considered to be an indicator of a country’s standard of living.

**VALUE ADDED TAX (VAT)** is an indirect tax paid by consumers on most products and services. In South Africa, VAT is calculated at 14% of the value of the product or service. VAT is an important source of income for government and accounts for about 26% of total tax revenue in South Africa.

**REVENUE** can be understood in simple terms as all the money ‘coming in’. When we talk about revenue in government budgets, we are talking about the income from taxes (for example: VAT and personal income tax) and from non-tax sources (such as mineral royalties and the sale of capital assets).

**EXPENDITURE**, on the other hand, can be understood simply as spending or expenses. When we talk about government expenditure, we are talking about on what and how much government is spending.
**DEFICIT AND SURPLUS** are terms to describe the difference between the revenue (the money coming in) and the expenditure (the money going out). To calculate the deficit or surplus, we subtract the expenditure from the revenue. If government is spending more than it is getting in, we say that government is operating with a deficit. Whereas if government is getting more money in than it is spending, we refer to a surplus. Typically governments operate with a deficit as they are trying to encourage economic growth – remember the saying, ‘you can’t make money unless you spend money’?

**Figure 2:** South Africa’s Total Revenue and Expenditure

![Graph showing South Africa's Total Revenue and Expenditure from 2008/09 to 2014/15.](image)


The size of the deficit is an important issue in public finance. On the one hand, if the deficit is larger, more can be spent on programmes to deliver services to people. On the other, having a larger deficit means that government will have to borrow more money and have a larger debt to pay off in the future. Because having large debts is risky, this can have the effect of scaring off foreign investors and, as a result, can hurt the economy. Making sure the deficit is not too large or too small is a careful balancing act.

For these reasons, Treasury officials and economists look carefully at the deficit as a percentage of the country’s GDP. The deficit is compared to GDP because its size relative to the economy is what is important: South Africa’s deficit may seem large in comparison to its GDP, but South Africa’s deficit would be tiny compared to China’s GDP.
1.2. BASIC POWERS AND FUNCTIONS

Now that some essential economic and financial terms have been introduced, let us consider the different basic powers and functions of government. We often hear about the three levels or ‘spheres’ of government, referring to national, provincial and local government. The principle of cooperative governance calls on the three spheres to work together and support each other to provide citizens with services. In addition to setting out the principle of cooperative governance, the Constitution also specifically assigns the responsibility for certain functions to different spheres of government.

What are these functions? Municipalities are mainly responsible for the delivery of basic services: electricity, water, sanitation, and refuse removal. For example, municipalities take care of area cleaning, street lighting, and municipal roads. They are also responsible for municipal planning, including zoning regulations. Some areas are concurrent functions, which means that the responsibility to deliver those services is shared between the provincial and national government. Education, health, housing, public transport and welfare services are important concurrent functions. Finally, some functions are exclusively provincial functions, such as ambulance services, libraries and museums, liquor licenses, provincial planning, and provincial roads.
1.3. THE VERTICAL DIVISION OF REVENUE

The budget process recognises that the three spheres each have their own sets of functions to perform. The money which national government raises through taxes needs to be divided between the three spheres of government to enable each sphere to perform its functions and fulfil its responsibilities. The division of revenue between the three spheres of government – national, provincial and local – is often referred to as the ‘vertical split’.

However, it is important to note that not all the nationally-raised revenue is allocated to the three spheres. Before the vertical split occurs, a portion of the revenue is first ‘top-sliced’ and set aside for certain specific functions: an emergency reserve, repayment of national debt, and a reserve for meeting particular policy priorities. Only once this ‘top slice’ has been allocated, does the remaining revenue get divided between the different government departments and other spending agencies.

What does the vertical split look like? In 2012/13 the total nationally-raised revenue was divided as follows: national government received 47.2%, provinces received 44%, and local government received the remaining 8.8%. You might be wondering why local government gets the smallest share. There are two main reasons. First, remember that the funds are split between the three spheres of government in such a way as to make sure that each sphere has enough funds to deliver the services for which it is responsible. Therefore national policies will affect the vertical division of revenue: for example, if health is given top priority, then it follows that the health departments – and accordingly, provincial government – will receive a greater portion of the nationally-raised revenue.

The second reason why local government receives the smallest share of the nationally-raised funds is that local government has the authority to raise its own revenue through key taxes, such as property rates and service charges for electricity. Provinces, however, are almost entirely reliant on funds from national government and collect very little money from taxes they collect themselves. Together, provinces received 97% of their revenue from national government, while Local governments together received 75% of their budgets from national and provincial government. In fact, municipal own sources of revenue can be substantial – in the final Cape Town 2012/13 budget, more than three quarters of the City’s Operating Revenue is expected to come from property rates and services charges. However, whereas Metros are able to raise a large amount of money themselves because of economic growth in their urban areas,
some smaller and rural municipalities still rely almost completely on funds transferred from national government in order to operate.

To understand how funds are divided between the different spheres a little better, we will now look at the two ways national government makes funds available to provinces and local government in practice – through the equitably share grant and conditional grants.

1.4. THE EQUITABLE SHARE GRANT AND HORIZONTAL DIVISION OF REVENUE

Of the total amount of funds which national government sends to provinces, 20% is conditional grants and 80% is equitable share grants.

Of the total amount of funds flowing from national government to municipalities, 49% is conditional grants and 39% is equitable share grants. The remaining 12% is a fuel-sharing levy, whereby national government redistributes the funds raised from the petrol tax to large municipalities.

Source: National Treasury, 2012 National Budget Review

According to the Constitution, provinces and municipalities are entitled to receive an equitable share grant. This is a lump sum of the nationally-raised revenue which they can spend as they choose (although the transfers are typically accompanied by recommendations).

The equitable share grant from national government is the main source of revenue for provinces. The amount each province receives is determined by a technical formula which takes into account a number of different factors, such as the size of the school-age population, case loads in hospitals, and number of poor people. The formula National Treasury uses is largely population-driven and is intended to give more funds to the provinces with bigger populations and more people who are poor and require services. Figure 4 illustrates the equitable share to be received by each province in 2012/13.
Each municipality in South Africa also receives an equitable share grant. Municipalities are intended to use their equitable share grant to provide free basic services to poor households and to cover basic municipal administration costs. Municipalities often use part of the equitable share to finance their indigent policies and most of the rural municipalities use the equitable share to sustain their operations because this is their most important source of income. Similar to provinces, the size of the equitable share grant to each municipality is determined by a formula with multiple factors.
1.5. CONDITIONAL GRANTS

Besides the equitable share grant, the second way that national government sends money to provinces and local government is by conditional grants. Conditional grants are funds which are given by a particular national department to provinces or municipalities for specific purposes. The funds are administered by the national department which decides what the funds can be used for, sets conditions on how the funds are spent, and also decides how much each province or municipality will receive. Often provincial departments are required to submit a proposal or business plan to their counterpart national department before the conditional grant funds are released to them. With conditional grants, national government retains more control over how the funds are spent. The national department can withhold funds or shift them between provinces or municipalities if there is underspending. In this way, conditional grants are an important tool which national government uses to protect national policy priorities and to ensure certain standards of service delivery across the country.
In this section we will have a closer look at municipal budgeting. A municipal budget is a crucially important document – it says where the municipality receives its funds and how it will use those funds. Essentially, a municipal budget dictates how public money and resources are distributed across the municipality. By engaging with the budget we can learn what the municipality’s priorities are.

By law, municipal budgets must adhere to two basic principles: transparency and accountability. In terms of transparency, municipalities are required to make accurate financial information available to communities so that they can participate in the budget decision-making process. In terms of accountability, all financial decisions made with public money must be made responsibly and follow all the correct procedures set out in the Municipal Finance Management Act (MFMA).

Every municipal budget is made up of two sides: an operating and a capital side. Each of the two sides has its own sources of revenue (where the money is coming from) and its own types of expenditure (what money is being spent on). Operating budgets are used for the day-to-day spending of municipalities, including general expenses, salaries and wages, and repairs and maintenance. The capital budget is spent on municipal assets and infrastructure, including land, buildings, roads and so forth.

The operating budget of a municipality is typically much larger than its capital budget. This is clearly visible in the City of Cape Town 2012/13 Annual Budget where, of the total budget of R30.3 billion, the operating budget is just over 80% (R24.4 billion) while the capital budget makes up approximately 20% (R5.9 billion).

"Operating budgets are used for the day-to-day spending of municipalities, including general expenses, salaries and wages, and repairs and maintenance. The capital budget is spent on municipal assets and infrastructure, including land, buildings, roads and so forth."
In order to perform all their Constitutional duties, municipalities need access to financial resources. As mentioned earlier, there are two main sources of municipal revenue – money received from national and provincial government (in the form of grants and transfers), and money raised by the municipality itself (through service charges, rates and so forth).

To illustrate local government budgets, we will draw on the City of Cape Town 2012/13 Final Annual Budget as an example.

### 2.1. MUNICIPAL OPERATING REVENUE

If we look at all the municipalities in South Africa, the main sources of income for the operating budgets for local government are service charges, transfers from national and provincial government and property rates. For example, in 2010/11 (the most recent year for which we have data compiled for all 283 municipalities), 50% of municipal operating revenue came from service charges, 22% from transfers, and 17% from property rates.

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**PRINCIPLES OF MUNICIPAL TAXATION**

Ideally municipal taxes should uphold these principles:

**Benefit Principle**: The one who pays the tax should be the one who gets the benefits of the service. The tax payer should get value for their money.

**Ability-to-Pay Principle**: Those with less income should pay less. This applies to both horizontal and vertical equity:

- **Horizontal equity**: Households with the same income should pay at the same rate.
- **Vertical equity**: Those who earn more should have to pay a larger share of their income (progressive taxation).
Figure 6 shows how, over the last few years, local governments have started to rely more on grants to fund their operating budgets. In 2003/04, on average municipalities only got 12% of their operating budgets from grants but by 2010/11, that share had increased to 22%. This is largely because many municipalities are depending more on their equitable share grant to fund their operating budgets. Some municipalities, and particularly those located in rural areas, rely heavily on income from the equitable share grant and other transfers to sustain their operations because their economy is not strong enough to generate significant revenue from property rates and service charges. However, in Metros such as Cape Town, income from service charges and property rates tend to be the largest contributors of operating revenue, far outweighing the contribution of transfers from national or provincial government.

Some municipalities, and particularly those located in rural areas, rely heavily on income from the equitable share grant and other transfers to sustain their operations because their economy is not strong enough to generate significant revenue from property rates and service charges.

If we look at Cape Town as an example, Figure 7: City of Cape Town 2012/13 Operating Revenue by Source shows the sources of operating revenue for Cape Town for the 2012/13 budget year. The total operating revenue for the City for the 2012/13 budget year is R 23.9 billion. (The 2012/13 financial year starts 1 July 2012 and ends 30 June 2013. We will talk more about the municipal budget calendar in Section 5 below). 

Figure 6: Sources of Municipal Operating Revenue – All Municipalities in South Africa (2006/07 – 2012/13)

Source: National Treasury. 2011 Local government Budgets and Expenditure Review.
Service charges make up more than half of the revenue, contributing R13.3 billion (55.8% of the total operating revenue), which represents a 9.9% increase from the full year forecast for 2011/12. The second largest source of operating revenue for the City is property rates, contributing R5.1 billion (21.4% of the total operating revenue) to the 2012/13 budget, increasing by 9.1% from the 2011/12 full year forecast.

The third largest source of operating revenue for Cape Town is transfers which contribute just under a tenth of the operating budget - R2.3 billion (9.7% of the total operating revenue). This refers mainly to the income from the equitable share grant which Cape Town receives from national government—see Section 1.4 above for more information on the local government equitable share grant.

2.1.1. Service Charges

Service charges, and in particular electricity charges, are a large and important source of revenue for municipalities. On average, about 65% of service charge revenue comes just from electricity. Electricity revenue has been increasing because of higher electricity prices and pressure to implement tariffs which reflect the actual cost of buying the electricity from Eskom. Although municipalities collect significant amounts from electricity charges, approximately 65-85% of the revenue
they collect from electricity tariffs is used by the municipality to pay Eskom for bulk electricity (which the municipality then distributes to residents), meaning that it is not money which the municipality can use for providing services or paying staff.

Figure 8 looks at the different kinds of charges that make up the City of Cape Town’s largest source of operating revenue, service charges. The most significant source for 2012/13 is electricity charges, contributing 67% (approximately R9 billion) of the total service charge revenue. Second is water revenue, contributing 16% (R2.1 billion).

Figure 8: City of Cape Town 2012/13 Revenue from Service Charges

Most consumers pay for the services which they receive from the municipality – electricity, water, refuse removal and sanitation – but municipalities also provide a certain amount of these services free to poor households. Each municipality has the authority to set their own tariffs each year although there are some guidelines from national government which municipalities must adhere to. Section 74 of the Municipal Systems Act requires municipalities to have a tariff policy which should reflect reasonable costs of delivery of services, enable financial sustainability (allow cross subsidisation), encourage environmental objectives (demand management), and take into account households’ ability to pay. (The MSA does not actually require municipalities to provide free basic services.) Local governments in South Africa typically use any extra income they
receive from trading services to cross-subsidise other services. For example, the surplus amount they receive in electricity charges may be used to pay for free sanitation services in informal settlements.

2.1.2. Property Rates

As we mentioned above, in 2010/11 across South Africa, on average municipalities received approximately 17% of their operating budgets from property rates. Property rates are intended to fund services which provide general benefits to residents and therefore cannot be funded by service charges which are collected from the specific households or individuals who use the service. Typically municipalities use property rates to pay for economic services, such as municipal roads, storm water systems, street lighting, and street cleaning.

Every municipality sets their own property rates each year, as per the Municipal Property Rates Act (2004). According to the MPRA, each municipality must update their rates policy each year and also maintain an updated property valuation roll. The municipal rates policy divides property into different categories (e.g. commercial, residential) and then taxes all property in the same category at the same rate. Residential properties which are below a certain value, are exempted from paying property rates – that amount differs between municipalities but cannot be lower than R15 000. Municipalities can also decide to offer rebates to poor households or they can create incentives for land owners to use land in a certain way by offering lower tax rates on different types of land. For example, many municipalities levy higher rates on vacant land to encourage land owners to either develop and build on their land, or to sell it.

2.2 Municipal Capital Revenue

Unlike operating budgets which are mainly financed by service charges and property rates, the capital budgets of municipalities are largely financed by transfers or grants from Provincial and National government. Figure 9 shows sources of capital revenue for all municipalities in South Africa from 2006/07 to 2012/13. In 2010/11, 58% of municipal capital budgets was financed by grants and subsidies. For example, infrastructure transfers are used by municipalities to build roads, houses, sporting facilities and infrastructure for water and sanitation.

In addition to transfers, municipalities also pay for their capital budgets by borrowing money. Generally contributions to municipal capital budgets from internally-generated funds and borrowing is dropping, which means that municipalities are
relying more and more on funds from national government to pay for their infrastructure.

**Figure 9:** Sources of Municipal Capital Revenue – All Municipalities in South Africa (2006/07 – 2012/13)

![Bar chart showing sources of municipal capital revenue (2006/07 to 2012/13)](chart1.png)

*Source: National Treasury. 2011 Local Government Budget and Expenditure Review.*

**Figure 10:** Municipal own contributions to capital expenditure (2006/07 to 2012/13)

![Line graph showing municipal own contributions to capital expenditure (2006/07 to 2012/13)](chart2.png)

Cape Town is a good example of this growing reliance on funds from national government to pay for infrastructure. More than half of the City’s capital budget (55%; R3.3 billion) is funded by transfers from national and provincial government. The next largest source of capital funding is borrowing, contributing 30% of the total capital budget (R1.8 billion). Next, 14% of capital funding comes from ‘internally generated funds’ (14%; R 826 million), which is made up of previous years’ accumulated surpluses, contributions made to a Capital Replacement Reserve in the previous year’s budget, and funds from development charges referred to in the budget as Bulk Infrastructure Contribution Levies. Finally, only 1% (R54 million) comes from public contributions and donations.

It is also worth noting that, of the transfers being received in Cape Town’s 2012/13 Capital Budget, 89% (R2.9 billion) is coming from national government and only 11% (R 355 million) is coming from provincial government (see Figure 12: Cape Town 2012/13 Budget: Contributing shares of national and provincial transfers to the capital budget). Figure 13 depicts the capital transfers being received in the City of Cape Town 2012/13 budget. We notice that the largest transfer is the Public Transport Infrastructure & Systems Grant from National Treasury to the value of R2 billion.

**Figure 11: City of Cape Town 2012/13 Capital Funding by Source**
**Figure 12:** Cape Town 2012/13 Budget: Contributing shares of national and provincial transfers to the capital budget

- Transfers - National: 89%
- Transfers - Provincial: 11%

**Figure 13:** Cape Town 2012/13 Budget: Sample of capital grants received from national and provincial government and other grant providers

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<td>National Treasury: Other</td>
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<td>Health: Global Fund</td>
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<td>Other Other Grant Providers</td>
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2.3. MUNICIPAL OPERATING EXPENDITURE

Now that we have considered where municipal funding comes from, let us now have a look at municipal expenditure. Figure 14 shows the operating expenditure by all municipalities in the country from 2006/07 to 2012/13. We notice that two of the largest areas of municipal operating expenditure have been employee related costs and bulk purchases. Spending on employee related costs constitutes between 26% and 29% of municipalities’ operating expenditure during this period, and has been increasing by nearly 12% every year.

‘Bulk purchases’, on the other hand, refers to the funds which municipalities spend to purchase bulk electricity from Eskom and bulk water from the Department of Water Affairs. Expenditure on bulk purchases is rising fast due to the increase in the price of electricity from Eskom. In 2010/11 municipalities spent 33% of their operating expenditure on bulk purchases, compared to only 22% in 2006/07.

**Figure 14:** Trends in municipal operating expenditure (2006/07 – 2012/13)

When municipalities present their operating budgets, they use two different formats. Operating expenditure can be broken down by type of cost (such as employee-related costs, or contracted services) or the total operating budget can be broken down by vote, which is similar to sectors or departments (for example, water, housing or transport).

Using Cape Town as an example, we look first at the operating budget by type. Of the total operating expenditure in the 2012/13 Cape Town budget, the largest portion (32%; R7.8 billion) is going towards employee-related costs, which includes the payment of salaries to City officials and municipal staff. The next largest slice is bulk purchases, which involves the City purchasing electricity and water for distribution to residents, and makes up 26% (R6.4 billion) of the total operating budget. Spending on ‘contracted services’ (in other words, the outsourcing of municipal services) makes up 11% (R2.6 billion).

**Figure 15:** City of Cape Town 2012/13 Operating Expenditure by Type
Looking at operating expenditure by vote (in other words, by ‘sector’), we notice that the Utility Services directorate is spending more than half (51%; R12.4 billion) the operating budget. Transport, Roads and Stormwater is spending 8% (R1.8 billion) of the total operating budget, while the Corporate Services and Finance directorates are each spending about 7% (R 1.7 billion each).

Figure 16: City of Cape Town 2012/13 Operating Expenditure by Vote

2.4 MUNICIPAL CAPITAL EXPENDITURE

As we described above, capital expenditure refers to spending on municipal assets or the infrastructure which the municipality owns including land, buildings, vehicles and so on. As you can see from Figure 17, across South Africa, spending by municipalities on infrastructure jumped significantly in recent years due to preparations for the 2010 FIFA World Cup, especially transport infrastructure. However capital spending started to flatten out again from 2010/11.
In the Cape Town 2012/13 budget, the vote with the largest capital expenditure is the *Transport, Roads and Stormwater* directorate, spending 39% (R2.3 billion) of the total capital budget.

"Across South Africa, spending by municipalities on infrastructure jumped significantly in recent years due to preparations for the 2010 FIFA World Cup, especially transport infrastructure. However capital spending started to flatten out again from 2010/11."
The chart below shows the new capital projects in the Cape Town 2012/13 final budget. Some of the notable ones are by the Utility Services directorate and involve electricity infrastructure - the Steenberg Upgrade to the value of R43 million and the Hout Bay Low Voltage Depot to the value of R40 million.
Municipalities often have difficulty spending their entire capital budget in any given financial year. This is an ongoing problem which government is trying to rectify. Spending rates on the operating side of the budget are fairly good in most cases (above 95%), but municipalities struggle to spend their capital budgets because of generally poor infrastructure planning in municipalities, which leads to non-credible 3 year projections and slow spending.

In national and provincial government, all departmental budget allocations that remain unspent at the end of the financial year are automatically returned to the relevant revenue fund (Provincial or National Treasury). Departments which have unspent monies can apply to Provincial or National Treasury for a rollover, which means that the funds are re-allocated in the next year's budget. Rollovers may or may not be approved, depending on whether the department can show it has credible plans to spend the funds in the near future.

This same system applies for funds which come from conditional grants. If a municipality has not spent its grants by the end of the municipal financial year, the municipal manager must apply to National Treasury for the funds to be rolled over. If the municipal manager can prove that the unspent funds are committed to identifiable projects then National Treasury will approve a rollover; if not, then the funds must be returned to the National Revenue Fund.

2.5. MUNICIPAL OUTSOURCING

Outsourcing is when government appoints an outside company to provide certain services on its behalf. Money spent on municipal outsourcing can be substantial – for 2012/2013, the City of Cape Town has allocated about 11% (R2.6 billion) of its operating budget towards the outsourcing of services, referred to in the budget as “contracted services”.

The Local Government Municipal Systems Act (MSA), Act 32 of 2000, is a piece of legislation that regulates how municipalities operate, including regulations for municipal outsourcing. Amongst other things, the MSA ensures that municipalities fulfil their Constitutional obligation to provide affordable access to essential services to all, and to work towards the social and economic upliftment of local communities. It also provides the framework for planning, performance management, and for the provision of services by the municipality.

In terms of outsourcing, the MSA and the City of Cape Town budget refer to appointed companies as ‘external mechanisms’. The contract between the municipality and the ‘external mechanism’ is referred to as the Service Delivery Agreement (or SDA). The SDA states exactly what the company has to deliver—we discuss the SDA and why its important below.

The provision and maintenance of sanitation services in the City of Cape Town is one example of a basic municipal service that might be outsourced. Currently, some of the other services that Cape Town outsources to outside companies include community-based refuse collection, area cleaning, maintenance of city parks, and supply and delivery of temporary housing units.

For instance, the City appointed a company to service container toilets in informal settlements for 2 years and 10 months at a cost of R38.4 million. Another company has been appointed to supply and maintain portable non-flushing chemical toilets in informal settlements and at ‘public transport interchange sites’ in a tender valued at over R164 million. The contract is also for 2 years and 10 months.

As already mentioned, large amounts of public money are spent on outsourcing important basic services. It is therefore important that we consider why government uses outside companies to deliver services and how these companies are appointed and then monitored.

There are many reasons government may choose to go the outsourcing route. Sometimes a company has more specialist
skills and particular experience and, as a result, may be able to provide the service more efficiently and quickly than government, or may be able to provide a better quality service than government could by itself. Government is unable to be an expert in the delivery of all types of services and so relies on the private sector.

In some cases, government decides to outsource a service they usually provide themselves because they lack the capacity at that particular time. In these cases it may be easiest and quickest to use an outside company. In other instances, government decides that it is not cost-effective to build the capacity in-house to deliver the service and so they decide it is more efficient to use an outside company in the long-term.

With these potential benefits, there are also some disadvantages to outsourcing. Because outsourcing adds an additional organisation to the delivery process, one can argue that outsourcing distances the municipality from the residents who are receiving the service and as a result can reduce government’s accountability. Also, because the City is not providing the service themselves and are dealing with an outside company, service provision may be harder to monitor.

What does the law say about basic municipal services?

First and foremost, how does the MSA define a basic municipal service? According to Section 1 of the MSA, a basic municipal service is “a municipal service that is necessary to ensure an acceptable and reasonable quality of life and, if not provided, would endanger public health or safety or the environment”.

In South Africa, local government is responsible for delivering basic services to communities. This includes provision of water, sanitation, refuse removal and area cleaning services, electricity, and roads. Local government is given a developmental duty by Section 153 of the Constitution, which means that they must conduct their planning, budgeting and administration in a way which gives priority to meeting the basic needs of the community and its social and economic development.

According to Section 73 of the MSA, a municipality must act in line with the Constitution, give priority to the basic needs of the local community, promote the development of the local community, and ensure that all members of the local community have access to at least the minimum level of basic municipal services. The municipal services must be also equitable (fair and unbiased) and accessible, provided in a way so that the quality improves over time, and must be regularly reviewed.
Deciding whether to outsource a municipal service: What must a municipality do?

Municipalities cannot decide to use an outside company to provide certain municipal services without consulting the community and going through a process set out in the MSA. Section 73 of the MSA requires that, when a municipality is deciding whether to use an external company to deliver a service, it must first give notice to the local community that it is considering doing so. The municipality must then consider a number of criteria before making the decision, including:

- **the direct and indirect costs and benefits** of outsourcing the service versus providing it in-house;
- **the capacity and potential future capacity** of the municipality and of prospective service providers;
- **the views of the local community**;
- **the likely impact on development and employment patterns in the municipality**; and finally,
- **the views of the labour unions**.

It is important to note that, if a municipality does not have the capacity to provide the service internally, this is **not** a sufficient reason on its own for appointing an external provider. The other criteria must also be taken into account.

How must municipalities select an external service provider?

If the municipality has gone through the due process and decided that it is best to use an external company to provide the service, Section 83 of the MSA then specifies the process the municipality must use to decide on which company to appoint. According to this section of the Act, the selection process must be:

- **competitive, fair, transparent, equitable** and cost-effective;
- allow all prospective service providers to have **equal and simultaneous access to information** relevant to the bidding process;
- **minimise the possibility of fraud and corruption**;
- make the municipality accountable to the local community about progress with selecting a service provider and **the reason for any decision**; and
- **take into account the need to promote the empowerment of small and emerging enterprises**.
If the project to provide a basic municipal service is large and the government is considering appointing an outside company to carry it out, the municipality must by law follow certain procedures to ‘put out a tender’. Usually this involves the following:

1. First, the municipality must **openly advertise** that they are looking for a company to do the work and invite interested companies to submit proposals to the municipality by a particular deadline. The municipality will publish a document called the **tender specifications** which sets out the details of exactly the type of work they require, including timeframes, quality, quantities and so on.

2. Next, once the deadline has passed and all applications have been received, the municipality must then check the **eligibility** of the applications they received.

3. Those applications that are determined to be eligible are **evaluated by a Bid Evaluation Committee** and points are awarded in terms of a number of different criteria, including the price that the company will charge to do the work, their experience and qualifications, their proposed approach and work plan, and their BBBEE status.

4. When all the eligible applications have been evaluated, the **company ranked highest in terms of points is selected**. Government may decide to appoint a different company than the one which scored the most points, but it must give good reasons for this. When this happens, Section 114 of the MFMA requires the Accounting Officer of the municipality to notify, in writing, the Auditor-General, the Provincial Treasury and the National Treasury of the reasons.

5. After a prospective service provider has been selected, Section 84 of the MSA then requires municipalities to negotiate the **final terms and conditions** of the **Service Delivery Agreement (SDA)** with the selected service provider.

6. If the negotiations are **successful**, the municipality and the service provider must enter into the **SDA**. If, however, **they cannot reach agreement within a reasonable time**, the municipality may negotiate with the **next-ranked** prospective service provider.
The SDA includes all the details about the service to be provided, including exactly what needs to be done, who is meant to do it, when they must do it, when the agreement commences and expires, and how costs will be determined.

What happens after an external service provider is appointed?

Here we come to a crucial point touched on earlier: even when an external company is appointed to provide a service to communities on behalf of the municipality, the municipality still remains responsible for ensuring that those services are delivered properly. As required by Section 81 of the MSA, when a municipality enters into an SDA with an external provider, it must:

- regulate the provision of the service;
- monitor and assess whether the service provider is keeping to the agreement, including how well it is performing the service; and
- use its authority to make sure that services are delivered without interruption and in the best interest of the local community.

It is important to remember that, even if a service is outsourced, the municipality remains primarily responsible for ensuring delivery. Municipalities can still be held accountable for service delivery shortcomings and cannot blame these shortcomings on the external service provider.

How can the local community learn about SDAs?

In general, South African law emphasizes that municipalities must allow local communities to participate in the affairs of the municipality and to submit petitions and complaints which are considered and responded to by municipal officials. Municipalities must consult with communities and report back to them about service delivery.

In terms of outsourcing, we remember that the MSA refers to the agreement between municipalities and external service providers as the Service Delivery Agreement or SDA. In practice however, municipalities often do not develop a single document they refer to as the SDA, which can make gaining access to the SDAs problematic. Instead municipalities sign a contract with the outside company and attach the tender specifications which
set out the details of what work will be provided. It is important to realise that this contract, along with the attached tender specifications, then serve as the SDA.

\[ \text{SDA} = \text{contract} + \text{tender specifications} \]

The MSA includes a number of requirements around the SDAs:

- **Before** a municipality enters into an agreement with an outside company, Section 80 of the MSA requires municipalities to establish a mechanism and programme for **community consultation** and **information dissemination** regarding the Service Delivery Agreement. This includes a requirement for the contents of the agreement to be communicated through the media.

- **After** a municipality has entered into an SDA, Section 84 of the MSA requires municipalities to **make copies of the agreement available at its offices for public inspection during office hours**. Notice must also be given in the media, notifying communities of the details of the service, the name of the selected service provider, and when and where copies of the SDA are available for public inspection. As a member of the community you have the right to ask for the contract and tender specifications, because the law says that the SDA must be available to you. Section 75 of the MFMA, goes one step further to even require municipalities to make all SDAs available on their websites – although currently most municipalities in South Africa do not comply with this requirement.

- Finally, in terms of changes to existing SDAs, when a municipality and a service provider want to modify the SDA after the tender process has been completed, Section 81 of the MSA requires the municipality to give the **local community reasonable notice that it wants to change the agreement** and the reasons for the proposed changes, and **sufficient opportunity** to make representation to the municipality. This also applies when the municipality wants to **renew** an SDA.

**What role can the local community play?**

Section 77 of the MSA requires municipalities to review and decide on the appropriate mechanisms to provide a municipal service anytime the local community requests it. This means that **if the local community is unhappy or concerned about the way that a service is being provided, they can raise this with the municipality.** They can do so either by submitting
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a petition or a complaint, or by mentioning it at a public meeting or consultative session with the municipal Council. The municipality is then required by law to review how the municipal service is delivered, including whether the service should be provided in-house by the municipality or through an outside company.

IN SUMMARY...

Community members have an important role to play in monitoring whether services are delivered properly. It’s important to remember that even if the municipality is using an outside company to deliver basic services, the municipality — not the company — is still responsible for whether those services are delivered on time, at the right quality, and to the right people.

The law requires municipalities to go through an open process when they appoint an outside company, and to make information about what services the company must provide, available to the public. This enables the community to be a part of the decision and to get involved in monitoring whether the company is delivering the services for which it is paid and which the municipality is obligated to deliver.
In the previous section we addressed how municipal budgets are structured, including a brief look at both operating and capital revenue and expenditure. We also considered the issue of municipal outsourcing and the role communities can play to ensure that government remains responsible for delivery, even when services are outsourced. Now that we have a sense of what makes up a municipal budget, in this section we will have a look at the actual process municipalities go through every year to prepare their budgets.

### 3.1. KEY LEGISLATION

Before we continue, it is worth noting that there are two main pieces of legislation that regulate the functioning and financial conduct of municipalities: the Municipal Finance Management Act and the Municipal Systems Act, both of which were already mentioned in the previous section.

#### 3.1.1. The Municipal Finance Management Act (MFMA)

The main piece of legislation governing the financial management and budgets of local government is the Municipal Finance Management Act (2003). The MFMA covers: municipal sources of revenue, budgets, debt, financial reporting requirements, financial misconduct, and the responsibilities of Councillors and Mayors. The MFMA also sets out the requirements for the budget process for local government, including deadlines and specific roles and responsibilities for the Mayor, Municipal Manager, Council and other spheres of government.

#### 3.1.2. The Municipal Systems Act (MSA)

The Municipal Systems Act (2000) is a piece of legislation which aims to ensure and empower municipalities to fulfil their duties as stated in the Constitution. Amongst other things, it establishes the framework to ensure that municipalities run effectively and use resources responsibly, while ensuring that all residents have access to basic services.
The MSA also promotes community participation in local governance. Chapter 4 of the Act requires municipalities to encourage such participation and to build the capacity of the local community to do so, as well as the capacity of Councillors and staff to foster such participation. Section 17 of the Act includes a number of provisions around the mechanisms the community must be able to use in order to participate, including the requirement for municipalities to: receive and consider complaints and petitions from the local community; hold public meetings and hearing with the local community, and consultative sessions with recognized community organisations; and report back to the local community.

### 3.2. KEY PLAYERS

The two pieces of legislation which we just discussed – the MFMA and the MSA – give specific responsibilities to the Mayor and the Council in the budget process. Below is a brief description of the role of both in the municipal budget process.

#### 3.2.1. The Mayor

Section 52 of the MFMA gives a municipality’s Mayor certain responsibilities. The Mayor must:

- provide political guidance over the municipality’s financial affairs (and may manage and oversee the responsibilities of the Accounting Officer and the CFO, without interfering),
- coordinate the municipal budget process (including reviewing the IDP), and
- take steps to ensure that the municipality is performing its constitutional and legal obligations.

Within 30 days of the end of each quarter in the municipality’s financial year, the Mayor must also submit a report to Council on the budget’s implementation and on the state of the municipality’s finances. The oversight, monitoring and reporting role of the Mayor helps to ensure transparency and accountability within the municipality.

#### 3.2.2. The Municipal Council

Section 4(2) of the Municipal Systems Act ascribes the municipal Council a duty to use the municipality’s resources in the best interests of the community, encourage the involvement of the local community and ensure that services are provided in a way that is financially and environmentally sustainable. The MSA further requires the Council to engage with the local community.
about the quality, level, range and impact of municipal services and the different options for service delivery, be this service provision by the municipality itself (‘in-house’) or through appointing an external service provider. The Council must also promote development in the municipality, and promote a safe and healthy environment.

Ultimately, the role of the Council is to enforce laws and make strategic policy decisions. A large part of this is approving the municipality’s annual budget and ensuring that its priorities are aligned with those identified in the IDP.

### 3.3. STEPS OF THE MUNICIPAL BUDGET PROCESS

Unlike the national and provincial financial year which starts on 1 April, the local government financial year starts on 1 July and ends at the end of June the following year. The reason that a municipality’s financial years start three months later is to allow them time to find out how much they will be receiving through national transfers and to structure their budgets accordingly.

In terms of budgeting, the MFMA gives the minimum requirements for what municipalities must do when drawing up their budgets, and also gives specific deadlines for key milestones in the process:

- **By 31 August of each year,** the Mayor must present Council with a time schedule for the preparation of the budget (Section 21).
- **Between August and November of each year,** the Municipality works to review the Integrated Development Plan (IDP) and municipal policies, and to prepare the budget.
- **By 31 March,** three months before the start of the financial year on 1 July, the draft annual budget must be tabled, or presented, to the Council (Sections 16 & 17). The draft annual budget includes: anticipated revenue and projected expenditure for the next financial year, plus the two following years. According to the MFMA, the draft annual budget must be credible and include forecasts of future revenue which are realistic.
- **Immediately after the draft budget is tabled,** it must be made public along with all the accompanying documentation, and the municipality must invite the local community to express their views on the budget (Sections 22 & 23). The municipality is required to consider the views
of the local community on the draft budget (Section 23). Municipalities usually run public engagement processes and give individuals and organizations the opportunity to submit written input on the draft budget. Council must consider these submissions and revise the budget if necessary.

- By 1 June (one month before the start of the financial year), the Council must take a vote on whether it approves the draft budget (Sections 24&25). If the annual budget is not approved by the Council, the Municipal Manager must rework the budget and table a revised version to Council within one week.

- The municipal budget must be approved by 30 June (before the start of the municipal financial year on 1 July).

- The budget must be published on the municipal website within 5 days of approval.

- Council must also approve the Service Delivery Budget Implementation Plan (SDBIP) within 28 days of the approval of the budget. (Section 53).

- Performance agreements for top managers at the municipality are concluded within one month of the start of the financial year (by 1 August) (Section 57).

- The performance agreements must be made public within 14 days after approval of the SDBIP. (Section 53).

Metros and local and district municipalities each come up with their own individual budget calendars each year, and may slightly change the dates from year to year. However, at a minimum, the law requires them to meet the deadlines and standards contained in the MFMA.

The budget process also needs to include proper planning and consultation with various stakeholders and Ward Committees. Including Ward Committees in the consultation process ensures that community members can give an input into the budget and help decide on the projects to be funded by the budget.

### 3.4. Key Documents for Understanding Local Government Budgets

What follows is a look at some of the key documents that form part of the local government budget process, including: the Integrated Development Plan; certain budget-related policies; the Service Delivery Budget Implementation Plan (SDBIP); the Intergovernmental Fiscal Review (IGFR); and the Division of Revenue Act (DORA).
3.4.1. The Integrated Development Plan (IDP)

Among the three spheres of government, local government is responsible for municipal planning, including planning related to the spatial, economic and social development of the municipality. The Integrated Development Plan (IDP) is the main planning tool for municipalities and contains their 5-year development plan. According to the MSA, after local government elections, the newly-elected Council in each municipality must develop and adopt a new 5-year IDP for their municipality. The IDP sets the priorities of the municipality in terms of service delivery, budgets and capital investment.

While entirely new IDPs are only drawn up every five years, the law requires every municipality to review and update its IDP every year, as part of the annual budget process. The annual budget is based on the IDP, so that the policy priorities which are identified in the IDP should be the same priorities which receive funding in the Budget. In this way, the budget ensures that the service delivery objectives contained in the IDP receive the financial resources which are needed in order for the services to be delivered properly.

3.4.2. Budget-Related Policies

At the same time that the IDP is updated and the annual budget is drawn up, each municipality is also required to review and update various budget-related policies which form annexures to the annual budget and set out policies which underpin the budget. Some of these budget-related policies are particularly important to residents because they specify the tax and tariff rates as well as defining who is responsible for rebates and assistance from the municipality. In the same way that the draft annual budget is subject to public input and discussion, the municipality must publish and take public input on the budget-related policies before they are finalised and approved alongside the budget. Some of the key budget-related policies include:

- Property tax rates – contains the actual cent-in-rand rates applicable to various categories of properties
- Rates Policy – sets out the components of the rates policy, including property categories, exemptions and rebates which are available
- Tariff policies – this includes services charges for water and sanitation, electricity, and refuse removal
• Tariff book - lists the amounts the municipality charges for all goods and services it provides, such as the hire of community halls, entrance fees for parks etc.

• Credit control and debt collection policy

3.4.3. The Service Delivery Budget Implementation Plan (SDBIP)

The Service Delivery Budget Implementation Plan (SDBIP) is a detailed plan that accompanies the municipal budget and has guidelines and measurable targets for achieving the service delivery goals identified in the IDP.

According to the law, every municipality must develop and approve an SDBIP every year. Section 53 of the MFMA provides the following timeframes:

• The Executive Mayor must approve the SDBIP within 28 days after the approval of the budget.

• Within 14 days of the approval of the SDBIP, the revenue and expenditure projections for each month and the service delivery targets and performance indicators as set out in the SDBIP must be made public.

The MFMA requires the SDBIP to have 5 parts:

• Monthly projections of revenue to be collected for each source

• Monthly projections of expenditure (operating and capital) and revenue for each vote

• Quarterly projections of service delivery targets and performance indicators for each vote

• Non-financial measures and targets for reduction in backlogs of basic services

• Ward information for expenditure and service delivery

The SDBIP must also include service delivery targets and performance indicators for each quarter of the municipality's financial year, as well as information about collected revenue by source, and operating expenditure and capital expenditure by vote. In this way, the purpose of the SDBIP is to operationalise the budget and enable the performance of the municipality to be evaluated.
"The SDBIP must also include service delivery targets and performance indicators for each quarter of the municipality’s financial year, as well as information about collected revenue by source, and operating expenditure and capital expenditure by vote. In this way, the purpose of the SDBIP is to operationalise the budget and enable the performance of the municipality to be evaluated."
The relationship between the IDP, the budget and the SDBIP is worth noting. As illustrated in Figure 20 below, the IDP comes first and establishes the municipality’s development priorities. Next, a budget is prepared that pursues these priorities. Finally, the SDBID is developed and provides a practical, detailed plan (including outputs and targets) for delivery.

**Figure 20:** Linkage between the Municipal IDP, Budget and SDBIP

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### 3.4.4. Intergovernmental Fiscal Review (IGFR)

The Intergovernmental Fiscal Review (IGFR) is a document first issued by National Treasury in 1999. It offers detailed comparative budget information for the country’s provinces and municipalities, and includes financial information as well as information on service delivery progress. By enabling comparison between provinces and municipalities, the IGFR enables debate and assessment of budgets and plans among the different parliamentary committees, municipal Councils and Provincial legislatures. It also encourages provinces and municipalities to implement best-practices.

The National Treasury produces provincial and local government IGFRs, usually in alternate years. The most recent
LG IGFR was published in September 2011 and is called the *Local Government Budget and Expenditure Review: 2006/07 - 2012/13*. The most recent Provincial IGFR, called the *Provincial Budget and Expenditure Review: 2005/06 to 2011/12*, was released in September 2009.

The IGFRs are particularly useful because they are the only document which compiles and analyses the budget figures for all 283 municipalities in one place (in the case of the Local Government Budget and Expenditure Review, or LGBER) or all nine provincial budgets (in the case of the Provincial Budget and Expenditure Review, or PBER). The IGFRs are typically organised into chapters which each cover various sectors. For example, the PBER contains chapters summarising, comparing and analysing provincial spending on: education; health; social development; human settlements; agriculture; and roads and transport. The LGBER, on the other hand, includes chapters on: water and sanitation; electricity; roads; solid waste; financial management; and the delivery of municipal services in rural areas and cities. Civil society organisations which are concerned with a particular sector can use these publications to obtain a sectoral analysis at provincial or municipal level, with a country-wide comparative perspective.

### 3.4.5. Division of Revenue Act (DORA)

The Constitution requires that every year a Division of Revenue Act is passed that determines how the nationally raised revenue will be divided between national government, the nine provinces and the 283 municipalities in South Africa. Particular steps to draft and pass the act must be followed every year, and this forms part of the annual division of revenue process. This process also takes account of the different functions performed by the different spheres of government and also invites public participation in order to promote transparency and accountability.

The DORA is useful because it contains schedules which show:

- The equitable share allocation to each province
- The equitable share allocation to each municipality
- The amounts for the conditional grants to provinces and municipalities
- Details on the objectives, conditions, and reporting requirements associated with each conditional grant

Civil society organisations which are concerned with a particular sector can use these publications to obtain a sectoral analysis at provincial or municipal level, with a country-wide comparative perspective.
CHAPTER 4:
OVERVIEW OF THE NATIONAL AND PROVINCIAL BUDGET PROCESS

In the previous section we looked how the municipal budget process unfolds. In this section we will again look at the budget process, but this time at national and provincial level.

4.1. KEY PLAYERS

Below are some of the key players in the National and Provincial budget process.

• **Minister’s Committee on the Budget (Mincombud)**
  The Mincombud (short for “Minister's Committee on the Budget”) is one of the most powerful bodies in the budget process. It is a sub-committee of the National Cabinet which includes the Minister of Finance as well as other key ministers. The Mincombud is specifically tasked with considering key policy and budgetary issues that will affect the budget process. It advises Cabinet on these issues and the budget, while also being responsible for determining the vertical division of the budget and approving the three-year spending envelope for various sectors. The Cabinet remains the ultimate decision-making authority and is responsible for final approval of the budget.

• **National Treasury and Provincial Treasuries**
  National Treasury (NT) is responsible for managing the South African government’s finances. Chapter 13 of the Constitution gives NT the task of ensuring transparency, accountability and sound financial controls in the management of public finances. Section 2 of the Public Finance Management Act (PFMA) further gives NT the responsibility to manage the budget preparation process (including advising Cabinet on the state of the economy and the amount of money available to be spent), to facilitate the Division of Revenue Act; and to monitor the implementation of provincial budgets. As part of the budget process, NT also develops and presents the National Medium Term Expenditure Framework (MTEF) to Parliament, while also finalising the Estimates of National Expenditure (ENE) for Budget Day.
In turn, the provincial treasuries in each province drive the provincial budget process, and produce the province’s Medium-Term Budget Policy statement and the provincial budget. The provincial treasuries are also responsible for monitoring the implementation of the budget (expenditure), asset management, and financial management. They play an oversight role over provincial departments and also provides oversight and support to municipalities on their budget processes.

- **Medium Term Expenditure Committee (MTEC)**
  The MTEC is made up of senior National Treasury officials and other Directors-General (or their representatives) from a number of departments. It is responsible for evaluating the budget submissions received from the different national departments to ensure that they are in line with Cabinet’s policy priorities and the availability of resources. (The MTEC process is covered in greater detail in Section 1.2.4 below). Typically NT convenes an MTEC hearing for each national department, at which point the national department or sector’s performance is discussed and the national department’s budget submission is scrutinised.

- **10x10’s**
  In Section 1.2 we introduced the idea of concurrent functions where the responsibility of delivering services is shared between the national and provincial government. (Human settlements, health and education are good examples of major concurrent functions.) When the function is shared between two spheres of government, coordination between national and provinces around budget planning becomes extremely important. The MTEC hearings which NT convenes for each national department work well for functions which are exclusive to national government (defense, for example), but in situations where the function is shared, NT also convenes special meetings called 10x10s. Typically there is a 10x10 meeting for each of the concurrent functions. The reason for the name ‘10x10’ is that the meeting is attended by the national minister for that sector and the nine provincial MEC’s for that sector, plus representatives from the NT and the nine provincial treasuries.

  Through the 10x10s the sector as a whole (both the national department and its provincial counterparts) discuss the budget plan for the sector as a whole and reach agreement on spending priorities. For example, at the Health 10x10 there might be discussion about additional funds which
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may be added to any of the major health conditional grants flowing to provinces from the national department. If a new programme or spending priority is introduced in the sector, the relevant 10x10 and Minmec would discuss whether funding for the new programme should flow through the ES grant to each province or via a conditional grant. (Minmecs are meetings convened—typically each quarter—by the National Minister with the nine provincial MECs for that sector. Minmec meetings are not specifically related to the budget process, but address all issues of the sector, including policy, performance, planning, and coordination.)

• **Formal Functional MTECs**

One of the recent improvements to the national budget process is the introduction of meetings called the ‘formal functional MTECs’. Beginning in 2011, the 2012 medium term expenditure planning process was organised into eight functional groupings or clusters, with both national and provincial departments and entities grouped together where they have concurrent responsibilities. The intention is to provide a means for wider planning and cooperation between all the national departments, provincial departments, and public entities which are involved in a particular functional area. Eight functional areas or groups were identified. They are: General Public Services; Science and Technology; Defence, Public Order and Safety; Economic Services and Environmental Protection; Economic Infrastructure; Local Government, Housing and Community Amenities; Education, Labour and Related Functions; and Health and Social Protection.

The formal functional MTECs are responsible for reviewing the budget submissions of all institutions within the functional group in order to make recommendations to the main MTEC on programme allocations, savings, reprioritisation, MTEF spending priorities, provision for personnel establishments, allocations for capital projects and earmarked transfer payments. The hearings of the formal functional MTECs are convened by the National Treasury, and will also provide an opportunity for input from the Departments of Performance Monitoring and Evaluation, Cooperative Governance, Public Service and Administration, and the National Planning Commission.
• **Budget Council**

The Budget Council is made up of the Minister of Finance and the members of the executive councils (MECs) responsible for finance in each province. The Budget Council advises on any financial and budgetary matters affecting provinces, legislation that financially impacts on provinces, and the financial management and monitoring of provinces. Part of its responsibilities is to make recommendations to Cabinet about the horizontal division of the budget at the provincial level.

**4.2. APPROACH AND STEPS OF THE PROCESS**

Section 3 above described the local government budget process which each municipality must follow. The national budget process, led by National Treasury, culminates in the tabling of the national budget in Parliament in February by the National Minister of Finance on Budget Day. At the same time that the national budget process unfolds throughout the financial year, each province is running its own budget process (driven by the respective provincial treasury) which culminates in the MEC for Finance in each province presenting the provincial budget to the provincial legislature within two weeks of the national Budget Day. Each of the nine provinces has slightly different budget calendars and different budget days, but they all generally follow the same steps.

National and provincial budget processes follow a number of steps taking up the full year leading up to the start of the next year’s budget. In this section we will have a look at how the national process unfolds.

The table below shows the key dates in the national budget process, while the sections below give more detail and explanation on the various steps. It is important to note that National Treasury makes changes and improvements to the budget process every year, so each year the specific dates change, but the overall process remains intact. The specific instructions and dates for the upcoming year’s budget process are typically shared with National departments and provinces in a National Treasury Circular or set of guidelines. Guidelines for the MTEF are usually issued by National Treasury in July, while guidelines for the Estimates of National Expenditure (ENE), or the national budget, are usually issued in November. These circulars and guidelines are available online at www.treasury.gov.za and are useful to have a look at if you wish to understand the specific details of the updated process for the next budget.
### ACTIVITIES

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<thead>
<tr>
<th>ACTIVITIES</th>
<th>APPROXIMATE MONTH</th>
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<tr>
<td>National Departments receive MTEF guidelines</td>
<td>July</td>
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<tr>
<td>National Departments submit their first budget submission to NT, which shows reprioritisation of expenditure within their baseline budgets</td>
<td>Early August</td>
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<tr>
<td>Formal functional MTEC committees meet and consider proposals for further savings, expenditure priorities, and possible additional allocations</td>
<td>August</td>
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<tr>
<td>MTEC discussions start (between NT and National Departments)</td>
<td>Mid August</td>
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<tr>
<td>10x10s start (between NT, PT, National Departments and Provincial Departments)</td>
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<tr>
<td>National Departments submit their revised budget submissions, in line with the recommendations of the formal functional MTEC committees</td>
<td>Late August</td>
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<tr>
<td>Cabinet Lekgotla discusses policy priorities for MTEF</td>
<td>September</td>
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<tr>
<td>National Departments submit chapters for Adjustments Estimate (for current budget year)</td>
<td>September</td>
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<td>MTECs and 10x10s end</td>
<td>End September</td>
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<tr>
<td>Adjustments Estimate and Medium Term Budget Policy Statement tabled in Parliament</td>
<td>Late October</td>
</tr>
<tr>
<td>NT issues guidelines to National Departments (for ENE)</td>
<td>Early November</td>
</tr>
<tr>
<td>NT sends allocation letters to National Departments</td>
<td>End November</td>
</tr>
<tr>
<td>National Departments submit first drafts of ENE chapter</td>
<td>Early December</td>
</tr>
<tr>
<td>National Departments submit second drafts of ENE chapter</td>
<td>January</td>
</tr>
<tr>
<td>Budget Day: Budget tabled in Parliament by Minister of Finance</td>
<td>February</td>
</tr>
</tbody>
</table>

### 4.2.1. How does the National Budget Process begin?

The national budget process starts with National Treasury’s Macro Unit calculating overall projections of the South African economy, looking at inflation, the impact of the global economy, and the performance in different sectors. They also forecast what the tax revenue is going to look like in the upcoming years. The Fiscal Analysis Unit of National Treasury then develops a broad fiscal framework, outlining total expenditure, total revenue, debt, interest, and the deficit. National Treasury must also consider whether changes must be made to tax
policy. What National Treasury is particularly concerned with are key economic ratios, including a comparison of the total tax revenue to the GDP (Tax:GDP), and comparing the deficit to the GDP (Deficit:GDP). National Treasury will then produce a broad fiscal framework called the Medium Term Budget Policy Statement (MTBPS).

4.2.2. How does Medium-Term Budgeting work?

In South Africa, government engages in medium-term budgeting. What this means is that government budget documents (at national and provincial levels) include figures for the coming financial year (the ‘budget year’) as well as indicative revenue and projected expenditure for two following financial years. The benefit of this system is two-fold: it allows for the budgeting of projects that span over longer than a single financial year, and it can also make budgeting in following years easier. This financial year’s forward estimates will be used as a starting point for drafting the next financial year’s budget and, as such, we do not have to start from scratch.

Every year, the last year’s medium-term projections for this year (the ‘baseline budget’) are increased to reflect inflation. Then, National Treasury will allocate funds that typically exceed these adjusted projections, meaning that there are ‘additional’ funds over and above the revenue we anticipated in last year’s budget. Departments then have to put in bids to get access to these ‘additional’ funds to fund new programmes. The CFO will consider all the bids made by various departments, and select a few which will receive this available funding.

This way of doing things has an interesting implication however. What this means in practice is that new programmes are primarily assessed against other new programmes hoping to get some of the ‘additional funds’, and not against programmes that are already in the budget. As a result, projects in the ‘baseline budget’ often receive less scrutiny – they do not have to compete to ‘remain’ in the budget – and the majority of the competitive budget process focuses on bids received for new programmes. Many of the recent reforms to the budget process are designed to introduce processes and bodies which better ensure that departments are pushed harder to scrutinise their baseline budgets and to look for savings or places where funds should be shifted to higher-priority programmes.
4.2.3. How does National government make expenditure choices?

National government starts by using key policy documents to guide its budget decisions and set priorities, including the State of the Nation Address, the Presidential Outcomes, the National Development Plan and Ministerial policies. Every national department goes through an MTEC process with National Treasury, where they present their proposed budgets and negotiate with Treasury for the allocation of the ‘additional’ funds available in the budget (see Section 1.1 above on the MTEC, 10x10s and formal functional MTECs.)

As we described above, MTEC refers to Medium Term Expenditure Committee made up of National Treasury officials and national department officials. There is an MTEC for each National department. Essentially, the MTEC process works as follows. First National Treasury conducts initial baseline assessments by removing once-off allocations (such as funds to build the stadiums for the World Cup) and then growing the remainder by inflation. National Treasury then provides projections which the national departments and provinces should use to budget for compensation of employees. National Treasury also asks national departments to reprioritise within their baseline budgets, shifting funds away from low to high priority programmes, away from slow-spending and non-performing programmes, and looking for other ways to make efficiency savings. Next national departments submit new programme proposals they wish to be funded by the ‘additional’ available funds.

In the case of concurrent functions (those shared by different spheres of government – for instance, Education) the process is a little more complex than the usual MTEC process. This is because the spending choices must be negotiated and coordinated with the national departments’ provincial counterpart department as well. First, funding proposals are developed through Minmecs as agreements between national and provincial Departments. These proposals are then presented at the 10x10s.

When evaluating new proposals and budget bids, National Treasury and provincial treasuries struggle with the reality that most budget bids from departments lack proper or complete information. Often there is not time for proper costing prior to submission; institutional delivery has not been worked out prior to allocation; not all departments use the latest demographic and socio-economic data when making their estimates; and some proposals may even not demonstrate a clear or coherent argument.
At this stage it also important to emphasise that government budgeting is a deeply iterative process and figures need to be adjusted throughout. Those submitting bids will produce budgets using only rough estimates of costs and submit these. Treasury will then allocate an envelope that typically provides substantially less than what was requested. The departments then have the task of reworking their budgets so that they fit within the envelope they would receive. This to-and-fro nature of the budget process has lead to it being called ‘chicken and egg budgeting’ by some.

4.2.4. Role of Parliament in the Budget Process

The Money Bills Amendment Procedure and Related Matters Act (No. 9 of 2009) is an important piece of legislation which gives details on Parliament’s role in the budget process. The Act gives Parliament the power to amend the budget and sets out conditions and limits on how Parliament can make amendments. It requires that, if Parliament is proposing an amendment, then the Minister of Finance and the relevant National Minister for the affected vote must be informed and given a chance to respond to the amendment before Parliament votes. Furthermore, the Act establishes a Parliamentary Budget Office to support the Parliament in the exercise of its powers.
According to the Act, both the National Assembly and the NCOP must have Finance Committee and Appropriations Committees.

- The National Assembly, through its committees, must annually assess the performance of each national department and submit Budgetary Review and Recommendation (BRR) Reports for each department, to be tabled in the National Assembly. The BRR Reports must be submitted ‘after the adoption of the Appropriation Bill and prior to the adoption of the reports on the MTBPS’.

- Both Finance and Appropriations Committees must submit reports on the MTBPS within 30 days of its tabling.

- The Finance Minister must table the National Annual Budget, Appropriations Bill and DOR Bill at same time, along with a report on how National Treasury responded to Parliament’s recommendations.

- Both Committees on Finance must hold public hearings and within 16 days submit a report on the fiscal framework and revenue proposals with statement of whether they accept or amend.

- After that, the DOR Bill and Appropriations Bill are considered by both Committees on Appropriation, which can amend them.
The emphasis of this guide is on local government budgets, but in order to fully understand municipal budgets, it is important to understand a little about the national and provincial budget process (which we described above). In this section we add more information specifically on provincial budgets: their main sources of revenue, provincial expenditure, and the major piece of legislation which governs provincial budgets, the Public Finance Management Act (PFMA).

5.1. SOURCES OF REVENUE FOR PROVINCIAL BUDGETS

There are three main sources of revenue for provincial budgets – the provincial equitable share grant, conditional grants to provinces, and provincial own revenue.

In Section 1.3 above, we explained that provincial government receives a slice of the total revenue which is raised by the national government. In 2012/13, the provincial share of nationally-raised revenue totalled 44%. Provinces are heavily reliant on these national transfers for their budgets. In fact, in 2011/12, provinces in aggregate received 97.1% of their budgets through transfers from National government.

The two types of national transfers to provinces are the provincial equitable share grant and conditional grants. In Section 1.5 above, we described how 80% of the funds which national government transfers to provinces each year is sent via the equitable share grant, while the remaining 20% of funds from national government to provinces are delivered via conditional grants. Section 1.4 above discussed how the size of the equitable share grant which each province receives depends upon a formula which tries to favour the poorer provinces with greatest service delivery needs. As the main source of provincial funding, the provincial equitable share is used to provide basic services and other functions that are in line with government’s strategic objectives.

In contrast to the equitable share grant, the conditional grants which flow from national departments to provincial departments are allocated for a specific purpose which is set out by national government.
There are three main types of conditional grants to provinces:

- Schedule 4 grants supplement various programmes partly funded by provinces, such as infrastructure and central hospitals.
- Schedule 5 grants are specific purpose allocations to provinces.
- A Schedule 8 grant, introduced for 2009/10, is an incentive grant intended to incentivise provinces and municipalities to meet or exceed prescribed targets.

There are approximately 28 different conditional grants to provinces, although each year some conditional grants are concluded or added. The main areas for conditional grants are health, education, human settlements and transport, which are service delivery sectors which are concurrent functions, i.e. shared between national and provincial government (see Section 1.2 above). The largest conditional grant is the Human Settlements Development Grant which provides for subsidised housing, the development of informal settlements, and rental housing, along with other human settlement programmes. The second largest conditional grant to provinces is the Comprehensive HIV/AIDS and TB Grant, which supports ART treatment as well as other interventions to combat HIV/AIDS and TB.
The third source of revenue is provincial own revenue, which is very small, making up only 3% of total provincial revenue (R9.6 billion in 2009/10). Provincial own revenue is made up of tax receipts (such as: casino taxes, horse racing taxes, liquor licenses and motor vehicle licenses), non-tax receipts, transfers received, sales of capital assets and other own revenue categories. Tax receipts are the largest source of own revenue and make up approximately 65% of provincial own revenue. The most significant tax collected by provinces is the motor vehicle licence fees which brought in R4.5 billion for provinces in 2009/10.
**Figure 22: Provincial Revenue Sources (2005/06 – 2011/12)**

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<tbody>
<tr>
<td>Transfers from National</td>
<td>153 668</td>
<td>178 161</td>
<td>205 014</td>
<td>245 220</td>
<td>280 319</td>
<td>309 704</td>
<td>335 925</td>
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<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Provincial equitable share</td>
<td>134 706</td>
<td>150 753</td>
<td>172 862</td>
<td>204 010</td>
<td>231 051</td>
<td>253 670</td>
<td>272 934</td>
</tr>
<tr>
<td>Conditional grants</td>
<td>18 962</td>
<td>27 408</td>
<td>32 153</td>
<td>41 210</td>
<td>49 268</td>
<td>56 034</td>
<td>62 991</td>
</tr>
<tr>
<td>Provincial own receipts</td>
<td>7 321</td>
<td>8 076</td>
<td>9 402</td>
<td>9 388</td>
<td>9 598</td>
<td>10 254</td>
<td>10 830</td>
</tr>
<tr>
<td>Total revenue</td>
<td>160 989</td>
<td>186 237</td>
<td>214 416</td>
<td>254 608</td>
<td>289 917</td>
<td>319 958</td>
<td>346 755</td>
</tr>
</tbody>
</table>

**Share of total revenue**

| Transfers from National | 95,5% | 95,7% | 95,6% | 96,3% | 96,7% | 96,8% | 96,9% |
| Of which:               |       |       |       |       |       |       |       |
| Provincial equitable share | 83,7% | 80,9% | 80,6% | 80,1% | 79,7% | 79,3% | 78,7% |
| Conditional grants      | 11,8% | 14,7% | 15,0% | 16,2% | 17,0% | 17,5% | 18,2% |
| Provincial own receipts | 4,5%  | 4,3%  | 4,4%  | 3,7%  | 3,3%  | 3,2%  | 3,1%  |

*Source: National Treasury Provincial Budget and Expenditure Review (2005/06 – 2009/10).*

Figure 22 reflects the situation across all provinces in South Africa and shows that on average, provinces received 80% of their budgets from the provincial equitable share, 17% from conditional grants and only 3% from provincial own revenue in 2009/10.

Figure 23 and Figure 24 below illustrate the situation in the Western Cape as an example. The figures show that in 2012/13, the Western Cape will receive 72% of its budget from the equitable share, 22% from conditional grants, and 5% from provincial own receipts. In addition, the Western Cape has also borrowed money in previous financial years to cover a very small portion of its budget. It's clear from Figure 24 that conditional grants and equitable share amounts are increasing, while the amount the Western Cape collects from own revenue has remained constant.
5.2. EXPENDITURE SIDE OF PROVINCIAL BUDGETS

The bulk of provincial budgets - approximately 75% - is spent on social services, namely health, education and social development. The largest slice of provincial budgets goes to education (typically 42%), while 29% is spent on health and 3%
Engaging with Government Budgets

on social development. The remaining 25% is used for non-social services, which would include road infrastructure, the expanded public works programme, and economic infrastructure projects such as the Gautrain Rapid Rail Link.

**Figure 25:** Consolidated provincial expenditure by sector (2005/06 – 2011/12)


### 5.3. THE PUBLIC FINANCE MANAGEMENT ACT (PFMA)

The purpose of the PFMA is to give effect to Section 216 of the Constitution which requires national legislation to establish a National Treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government. The PFMA introduces generally recognised accounting practices, uniform expenditure classifications, and uniform Treasury norms and standards.

The Act focuses on outputs and responsibility, rather than on rules as was the case with old legislation which it replaced.

In terms of the scope of the Act, the PFMA covers national and provincial government departments and entities under their ownership control. As we described in Section 3.1.3, local government finance is regulated by a similar but separate act called, the Municipal Finance Management Act (MFMA).
What the PFMA says on budget formats

- The PFMA requires provincial and national budgets to include **measurable objectives** for each main division within a vote, or in other words, for each programme.

- National and provincial government are required to table **multi-year budgets** (remember that in South Africa government does medium-term budgeting i.e. three-year rolling budgets).

- When voting on the budget, Parliament and the Provincial legislatures must consider **each main division within a vote**. In other words, they vote separately on each programme within a department rather than on the department budget as a whole. This approach ensures that the national and provincial budget documents contain more detailed information which enables greater transparency and accountability.

- After the budget has been approved, Accounting Officers of national and provincial departments are allowed to move or **shift funds** between different budget priorities, but certain conditions and limits are put on that power. Departments are allowed to shift up to 8% of the total allocation for one programme to a different programme (Section 43).

What the PFMA says on reporting requirements

- National Treasury must publish (in the Government Gazette) a statement of actual revenue and expenditure within 30 days of the end of each month. Each provincial treasury must submit a report of revenue and expenditure to National Treasury within 30 days of the end of each quarter. The report must include actual revenue (compared to planned revenue), actual expenditure per vote and actual borrowing. These reports, called the **Section 32 reports**, are all made available to the public on the National Treasury website.

What the PFMA says about the responsibilities of Accounting Officers

- Sections 38 and 39 lay out all the responsibilities of Accounting Officers. For national departments, the Director-General is the AO. The Head of Department is the AO for provincial departments. This includes setting up internal audit systems and an audit committee; reporting and taking action around unauthorised, irregular or fruitless and wasteful expenditure; and exercising budgetary control in order to avoid overspending.

**EACH PROVINCIAL TREASURY MUST SUBMIT A REPORT OF REVENUE AND EXPENDITURE TO NATIONAL TREASURY WITHIN 30 DAYS OF THE END OF EACH QUARTER... THESE REPORTS, CALLED THE SECTION 32 REPORTS, ARE ALL MADE AVAILABLE TO THE PUBLIC ON THE NATIONAL TREASURY WEBSITE.**
• Section 40 of the Act lists all Accounting Officer’s reporting responsibilities. This includes monthly reports of actual expenditure and revenue submitted to Treasury; annual reports and financial statements submitted within five months of the end of the financial year (i.e. by the end of August); and financial statements submitted to the Auditor General within two months of the end of the financial year, who then has two months to audit the report.

• Provisions in the Act also prevent Accounting Officers from using savings in particular situations to compensate for over-expenditure elsewhere. This includes using saving from earmarked funds, funds to be transferred to others institutions, and using funds allocated for capital expenditure in order to defray current expenditure.

• Accounting Officers remains responsible for the functions ascribed to them by the Act, even when they delegate these functions to other officials.

What the PFMA says on financial misconduct

• The Act considers financial misconduct to be when the Accounting Officers willfully or negligently fail to comply with the Act, or when the Accounting Officers allow fruitless and wasteful, irregular or unauthorized expenditure to occur. The Act provides precise definitions for these terms:
  
  – **Fruitless and wasteful expenditure** is “expenditure which was made in vain and would have been avoided had reasonable care been exercised”
  
  – **Irregular expenditure** is expenditure (other than unauthorised expenditure) which is not in compliance with legislation – including the PFMA, State Tender Board Act, and other provincial legislation
  
  – **Unauthorised expenditure** is overspending of a vote or main division within a vote, or “expenditure not in accordance with the purposes of a vote”

• Financial misconduct is recognised in Section 83 of the Act as grounds for dismissal, suspension or other sanctions. This applies for Accounting Officers, Treasury officials, departments, trading entities and constitutional institutions.

• Section 86 further states that the Accounting Officer is guilty of a criminal offence, punishable by fine or imprisonment for up to five years, if the Accounting Officer willfully, or in a grossly negligent way, fails to comply with the requirements of the Act.
CHAPTER 6

CONCLUSION

A good way to understand government budgets is to think of them as the products of a large web of interactions between different actors engaged in different processes and responsible for overlapping functions. The importance of these processes is not easily overstated – their impact can be felt at the macroeconomic level of the South African economy, and at community level where budget decisions affect access to service delivery.

In this guide we aimed to provide the reader with an understanding of how government budgets in South Africa are structured, the steps that government has to go through to develop them, and what communities can do to participate in the process. The ability to engage with government budgets is an invaluable tool that community members can use to ensure that their needs are addressed, that their voices are heard and that government is held accountable.
The annual process of planning, preparing and debating government budgets requires the participation of a large number of individuals and a significant amount of time and resources. This is with good reason – the outcome of the process affects the lives of everyone in the country. Municipal services, access to healthcare, the quality of basic education, community safety – these are only a few examples of the many different things that need to be considered during the budget process. It is for this reason that communities, and particularly activists, need to engage with the government budget. By doing so they can develop an understanding of where and on what money is being spent, and evaluate if government’s priorities adequately address people’s needs. By engaging with government budgets, communities are in a better position to approach government and to voice their concerns and needs. Every resident, whether rich or poor, must be given an opportunity to have a say in the budget process.

This guide gives an overview of government budgeting at all three levels of government – national, provincial and local. It introduces the reader to essential budget terms and concepts, and provides an overview of how the budget process unfolds every year, including a look at budget trends in recent years. Finally, it introduces the reader to the different pieces of legislation that enforce how government budgets are prepared and implemented in South Africa, and what community members can do to have their voices heard and keep government accountable.