

BUDGETARY REVIEW AND RECOMMENDATION (BRRR) OF THE STANDING COMMITTEE ON FINANCE, DATED 18 OCTOBER 2017

The Standing Committee on Finance (SCOF/ the Committee), having considered the National Treasury's (NT) and South African Reserve Bank (SARB) 2016/17 annual reports as presented to the Committee on the 1 August and 4 October 2017, reports as follows:

1. INTRODUCTION

- 1.1 On 4 October, the Deputy Minister of Finance, Mr Sifiso Buthelezi provided a brief political overview of NT's annual report for 2016/17. The Director General, Mr. Dondo Mogajane, and senior officials from the Department also participated. Officials of the Office of the Auditor-General of South Africa presented a report on the audit of NT and entities that fall under it.
- 1.2 The Committee did not receive a briefing on Programme 9: Revenue Administration from the Commissioner of the South African Revenue Service (SARS), because SARS had not tabled its annual report to Parliament. The Committee will consider SARS' annual report in late November.
- 1.3 The South African Reserve Bank (SARB) tabled its annual report in August 2017. The Governor of the Reserve Bank, Mr Lesetja Kganyago, briefed the Committee on SARB's performance and key aspects of its mandate. The SARB's primary mandate and independence are entrenched in sections 224 and 225 of the Constitution.
- 1.4 The overall legislative mandate of NT is based on section 216 (1) of the Constitution which requires it to ensure transparency, accountability and sound financial controls in the management of the country's finances and the Public Finance Management Act (1999).

2. POLITICAL OVERVIEW BY THE DEPUTY MINISTER OF FINANCE

- 2.1 The Deputy Minister of Finance stated that South Africa's economy is experiencing lower than expected growth levels which created huge challenges in reducing poverty, creating employment and addressing inequality. He said that government is working with stakeholders on various developmental partnerships around specific economic issues and growth areas in order to drive a common and focused agenda for growth and development.
- 2.2. He said that the test of NT's work was the extent to which it positively impacted on growth and transformation. In that regard, the Government and National Treasury are working hard to ensure policy certainty, he said. He added that South Africa was working together with its regional counterparts to advance free trade areas, improve regional transport infrastructure and to reduce border delays.
- 2.3. He also said that NT is working on modernising the public procurement regime to ensure that it delivers on its economic transformation mandate. Public procurement should enhance the efficiency of the public sector and deliver value for money. It should also maximize the developmental impact of public spend by targeting black, women-owned and youth-owned businesses, and provide access for township entrepreneurs and others.
- 2.4 To advance transformation, NT was working with stakeholders to ensure the finalisation of the Financial Sector Codes in line with the Broad-Based Black Economic Empowerment Act of 2013. This is being done in order to advance the inclusion of blacks, women and youth in the economy through ownership and management, among other considerations. He emphasised that using procurement to transform the economy was urgent as there was a paucity in the use of black professionals in the economy, including in the public service. He said that government should lead by example on this, especially as it expected the private sector to transform.

3. STRATEGIC GOALS FOR 2016/17: NATIONAL TREASURY

- 3.1 The NT is responsible for managing the country's finances and draws its mandate from Chapter 2 of the Public Finance Management Act, as well as Chapter 13 of the Constitution.
- 3.2 The performance of the Department as indicated in its 2016/17 annual report is measured against the Performance Indicators which were contained in the Annual Performance Plan of the Department for the 2016/17 financial year. The Annual Performance Plan (APP) 2017–2020 builds on the Department's previous strategic plans by outlining its key goals and tasks.

4. OVERVIEW OF NATIONAL TREASURY'S PERFORMANCE

- 4.1. NT spent R28.1 billion (99 %) of its final appropriation of R28.4 billion for the 2016/17 financial year.
- 4.2 Programme 1: Administration spent 93.9% of its R464.4 million, and Programme 2: Economic Policy, Tax, Financial Regulation and Research spent 96.6% of its R156.6 million budget. The unspent funds for both programmes are the result of EXCO's decision to freeze vacant positions in order to remain within the current expenditure ceiling.
- 4.3 Programme 3: Public Finance and Budget Management spent 95.7% of its R294.5 million budget. Other savings were generated on various items in goods and services as a result of effective implementation of the cost containment measures and payment of capital assets due to delays in replacing obsolete capital assets that are still in good working condition.
- 4.4 Programme 4: Asset and Liability Management spent 97.4% of its R113.1 million budget, Programme 5: Financial Accounting and Supply Chain Management System spent 96.7% of its R1.252 billion budget and Programme 6: International Financial Relations spent 99.9% of its R4.962 billion for the 2016/17 financial year.
- 4.5 Programme 7: Civil and Military Pensions, Contribution to Funds and Other Benefits spent 98.6% of its R4.463 billion budget. The unspent funds of R62.5 million were due to:
 - 4.5.1 Special Pensions – a decline in membership as a result of deaths or members opting for Non-Statutory Forces (NSF);
 - 4.5.2 Injury on Duty - challenges experienced in obtaining the outstanding awards that are in the employer's possession;
 - 4.5.3 SA Citizen Force - the rejected number of disability grant applications on military pensions; and
 - 4.5.4 Other Benefits ex-servicemen - a high rejection rate on medical accounts as the treatment was not approved for disability.

5 STRATEGIC FOCUS AREAS 2016/17: SOUTH AFRICAN RESERVE BANK

- 5.1 The core mandate of the South African Reserve Bank (SARB) is to achieve and maintain price stability and protect and enhance financial stability. The 2020 strategy seeks to ensure that the SARB continues to be positioned as a high-performing institution and a centre of excellence in central banking. The 2016/17 financial year marks the first year of the SARB's strategy process implementation.
- 5.2 The strategic objectives are prioritised into key areas of work, which seek to drive significant change in performance and accelerate the achievement of SARB's Strategic Focus Areas which are to: maintain headline inflation within the target range; protect and enhance financial stability to achieve a safer financial system; promote and enhance the safety, soundness and integrity of the regulated entities, enhance South Africa's resilience to external shocks and ensure cost effective availability and integrity of notes and coins. The role of the Bank will expand with the implementation of the Financial Sector Regulation Act of 2017, through the establishment of the Prudential Authority.

6 OVERVIEW OF THE SOUTH AFRICAN RESERVE BANK PERFORMANCE

- 6.1 For the period under review, the economy experienced a low interest rate environment, which influenced the SARB's financial results. Revenue in the form interest income is derived mainly from foreign investments and accommodation to the banks which increased to R13.8 billion (2016: R12.2 billion). Operating costs increased by R200 million in the year under review, mainly attributable to higher staff costs and operational expenditure, offset by a reduction in the cost of new currency.
- 6.2 The Group's total assets decreased by R68.6 billion to R753.8 billion (2016: R822.4 billion), largely as a result of a decline in gold and foreign-exchange reserves of R70.6 billion to R617.6 billion (2016: R688.4 billion). Total liabilities of the Group decreased by R69.7 billion to R744.4 billion (2016: R814.1 billion) largely as a result of the Gold and Foreign-Exchange Contingency Reserve Account (GFECRA) (used for the currency re-evaluation of foreign asset and liabilities which is for the South African government's account) decreasing by R73.5 billion to R231.1 billion (2016: R305 billion).
- 6.3 The decrease in both total assets and total liabilities was mainly as a result of a stronger rand and a lower gold price. The contingency reserve increased by R0.8 billion to R7.3 billion (2016: R6.5 billion) due to the profit after taxation achieved for the year.

7 AUDITOR GENERAL'S REPORT

- 7.1 The office of the AGSA said that of the 14 entities it audits that report to the Minister of Finance, none received a qualified audit opinion. Five received unqualified audit opinions without findings. Seven received unqualified audit opinions with findings. The audits of SARS and SAA were outstanding.
- 7.2 The five entities with unqualified opinions without findings are: the Financial Services Board (FSB), the Independent Regulatory Board of Auditors (IRBA), the Pension Fund Adjudicator (PFA), the Public Investment Corporation (PIC) and the Office of the Ombudperson for Financial Services Providers. The entities with unqualified opinions with findings are: NT, the Financial Intelligence Centre (FIC), the Government Pensions Administration Agency (GPAA), the Cooperative Bank Development Agency (CBDA), the Financial and Fiscal Commission, the Land Bank, and the Government Technical Advisory Centre (GTAC).
- 7.3 The SAA audit had not been finalised because the AGSA has not yet received financial statements. Without these, the AG cannot conduct an audit. The SARS's audit was not finalised due to audit disputes between the AGSA and SARS.
- 7.4 The AGSA said that the most common findings on supply chain management (SCM) were on failure to: apply the preference point system, invite three written quotations, comply with competitive bidding processes and, ensure that Suppliers' tax affairs were in order.
- 7.5 The AGSA said that an expenditure of R69.6 million was incurred by NT as a result of fruitless and wasteful expenditure. R67 million was paid to Oracle for technical services not rendered in respect of the Integrated Financial Management System (IFMS) project. R2.5 million was spent on rent for the unoccupied premises of the New Development Bank in Sandton.
- 7.6 An expenditure of R140 million was incurred as a result of irregular expenditure. R27 million of this was incurred by NT mainly in relation to the extension without inviting competitive bids of an existing contract for LOGIS in respect of the development and enhancement of the Central Supplier Database.
- 7.7 The AGSA expressed concerns about consequence management, the slow response in improving key internal controls and addressing risk. It said that senior and executive authorities were not responding with the required sense of urgency to the AG's calls for improving internal controls and risk management.

8 OBSERVATIONS AND RECOMMENDATIONS

- 8.1 The Committee notes that the Deputy Minister and the DG stressed that NT is working on the challenges identified by the AG. The Committee recommends that NT report on the implementation of its audit action plans as part of its quarterly reports to the Committee.
- 8.2 The Committee notes NT's improved financial expenditure from 97.8% (2015/16) to 99% (2016/17). There has however been a slight regression in achieving performance targets from 76.5% (2015/16) to 75% (2017/18). The Committee believes that this performance is good, but there is obviously room for improvement, especially in ensuring that financial expenditure is more aligned to the achievement of targets. However, it is not clear to the Committee that the NT's APP reflects all the Performance Indicators stipulated in the Medium Term Strategic Framework outcomes that it has to pursue. This needs to be clarified at NT's next Quarterly Briefing to the Committee. The Committee also needs to get a better sense of the quality of the spend, which means NT has to provide us with impact assessments against the Performance Indicators. NT should use the assessment tool provided by the Department of Planning, Monitoring and Evaluation and report to the Committee accordingly.
- 8.3 The Committee is concerned about non-compliance with SCM policies and processes as outlined in the AG's report. We are concerned about the cases of extension of tenders without inviting competitive bids (evergreen contracts), the failure to invite three quotations and failure to apply the preference point system. (We also condemn the granting of tenders to entities whose tax affairs are not in order and the miscalculation of B-BBEE points where an irregular expenditure of R12.1 million was incurred). The Committee believes that it is unacceptable for NT and the entities that fall under it, particularly as they are in the finance portfolio, not to comply with laws and regulations on SCM. There must be speedy investigations on these matters, corrective action and consequences.
- 8.4 The Committee notes AGSA's concerns about consequences management, the slow pace in improving internal controls and addressing risk by senior and executive authorities. We recommend that the Minister and the DG intervene more actively to ensure that there is an awareness of the urgency of the AGSA messages of improving internal controls and risk management.
- 8.5 The Committee is concerned about fruitless, wasteful and irregular expenditure. Fruitless and wasteful expenditure increased from R2 million (2015/16) to R69.6 million in (2016/17) and irregular expenditure from R66 million to R140 million, over the same period. The increase in fruitless and wasteful expenditure mainly due to the IFMS project is of particular concern as it relates to payments (R67 million) to Oracle for services that have not yet been rendered. The Committee was informed by the DG that investigations on this and other issues are ongoing. The Committee recommends that these investigations be expedited and we be briefed, during NT's quarterly reports to the Committee on the outcomes.
- 8.6 The Committee notes the failure by GPAA to achieve some of its targets and the regression of the FFC from an unqualified opinion without findings to an unqualified opinion with findings. The Committee will call the GPAA and the FFC to account for these shortcomings.
- 8.7 The Committee welcomes the opening of the New Development Banks' (NDB) Africa Regional Centre and believes that it should provide loans for infrastructure on much better terms than other multi-lateral institutions. The Committee however notes that the money used by NT to pay for the rent of the NDB premises was found to have been fruitless and wasteful expenditure by the AGSA. The Committee requires NT to brief it on this at its next Quarterly Report.
- 8.8 The Committee welcomes the auditing of SAA by the AGSA, which is what we had previously recommended. We believe that as far as possible SOEs should be audited by the AGSA. We are concerned that SAA has not submitted its financial statements for auditing to the AGSA. We believe that the 'going concern' assumption should not delay the submission of financial statements and the conducting of audits. The Committee believes that the SAA AGM should be held on 3 November as proposed by NT.

- 8.9 The Committee notes the decision of NT and the Minister of Finance to bail out SAA through the utilisation of emergency reserves as per section 16 of the PFMA. The Committee requested Parliament’s Legal Services Unit to provide an opinion on the legality of the use of section 16 for this. The legal opinion noted that “Section 16 is intended to be used in circumstances where good financial planning and management could not avert the need for exceptional or unusual expenditure. The use of this provision by the Minister of Finance for the reasons set out in the Report to Parliament and the Auditor-General does not appear to be exceptional or unusual as the expenditure was foreseeable and has been made in the past. Clearly there was a need to authorise the expenditure as a default on the debt obligations of SAA would have serious prejudice to public interest. However, this should have been done by way of a special appropriation Bill. Whether the use of section 16 was irregular or unlawful in this instance must be considered by the Auditor-General.” The majority in the Committee believe that the allocation to SAA could have been foreseen and should have been done through an Appropriation Bill, but accept that it was necessary to rescue SAA, otherwise there would have been a call on the total R16,4 billion guarantee exposure. However, we strongly believe that National Treasury must explain what exactly are the terms on which this money has been granted. The Committee reiterates its views that the turnaround strategy should be significantly improved and effectively implemented, the SAA AGM should be held on 3 November as proposed by Treasury, the current Board Chair’s term should end with the AGM, people with appropriate aviation experience and expertise should be appointed to the Board, the management should be strengthened, and allegations of corruption speedily tackled. The Committee will engage with the Appropriations Committee on taking some of these issues forward.
- 8.10 The Committee agrees with the Deputy Minister that the Financial Sector Codes have to be finalised soon to drive inclusive growth and transformation in the financial services sector. The Committee, together with the Portfolio Committee on Trade and Industry, has completed an interim report on the Financial Sector Transformation Hearings it had earlier this year and had sent it to the participants in the hearings for their comments before finalising it soon. The Committee recommends that its observations and recommendations in that report be considered before the Financial Sector Charter is finalised and that relevant issues in the Report be also considered at the Financial Sector Charter Summit. The Committee believes that the NT should not have a tick-box approach to the Summit and prepare properly before it is held. The Committee recommends that the Summit be held in the first quarter of 2018.
- 8.11 Our 2017 NT Budget Vote report noted that “...government has to “walk the talk” by procuring from black-owned businesses and small and medium enterprises, also because it requires private sector to do this anyway. This must be done in line with the government’s revised preferential procurement policies, incorporating supply chain management reforms that are meant to unlock the effective participation of black businesses, professionals and the marginalised in the economy...” The Committee is however concerned that under Programme 5, NT did not meet its target of publishing the Draft Procurement Bill for public comment. We recommend that this process be expedited.
- 8.12 The Committee recommends that consideration be given to ensuring that the establishment of the Financial Markets Conduct Authority and the Prudential Authority, when implementing the Financial Sector Regulation Act, are aligned with the start of financial year in order to ensure a smooth transition with the auditing cycles of the AGSA.
- 8.13 The Committee believes that auditors should detect wrongdoing, particularly corrupt activities, early-on in their audits. It is unfortunate that the public gets to hear of major cases of corruption after auditees were constantly receiving clean audits. This raises serious questions about the adequacy of the role of auditors in detecting particularly corruption, including illicit financial flows. The Committee is monitoring developments within the auditing profession and was recently briefed by IRBA on its KPMG investigation. Consideration should be given to enhancing the audit processes and methods to detect and expose instances of corruption and maladministration. We recommend that the state and the AG not use the services of firms and individuals that are involved in professional misconduct, including KPMG, if it is found guilty by IRBA. We also believe that those found guilty should not be given fines and have their licences withdrawn, but they should also be referred to the police for action.

- 8.14 The Committee expresses its serious concern that SARS has not tabled its Annual Report and expects it to settle its outstanding issues with the AG's Office soon and table its Report by mid-November so that it can be considered by the Committee before the current parliamentary term ends.
- 8.15 The Committee requested and has since received information on the number of staff employed in the Minister's Office. The Minister replied as follows: "The ministerial handbook provides a guideline for a **minimum** of 16 ministerial support staff for both the minister and deputy minister; excluding special advisors. Before the appointment of the current political heads the ministry was comprising of 14 core staff and 2 full-time special advisors and 1 short term advisor (less than 12 months contract), a total of 17. Currently, the composition is 17 staff and 2 fulltime special advisors and 1 short term part time advisor. Additional to the above, is 3 staff members seconded from the department and will return to their posts at the end of the Minister's term. This is well within the guidelines of the ministerial handbook." However, following an input from Parliament's Legal Services Unit and contributions from Committee members, the Committee's understanding at this stage is that Minister's response does not correspond with the guidelines in the Ministerial Handbook and mandated the Committee Chairperson to write to the Minister to seek clarity on several issues and secure a response from the Minister.

South African Reserve Bank

- 8.16 The Committee welcomes the performance of the SARB and will receive at least one briefing from the Bank a year, and more if time and space allows or need requires.
- 8.17 The Committee notes the calls made in the public for the state to be the sole shareholder of the SARB and its mandate to include employment creation. There is concern that the SARB has private shareholders. There is a perception that these private shareholders influence the constitutional mandate of SARB. The Committee notes that SARS explained that the private shareholders of SARB do not own the Bank and their rights are limited. They play no role whatsoever in the setting of monetary or financial stability policy, or in the day-to-day management of the Reserve Bank. Their shares are restricted to a maximum of 10,000 per subscriber out of 2 million issued shares and they receive a fixed return of 10 cents per share from profits, amounting to an overall dividend payment of R200,000 per year. 90% of the SARB's profits are transferred to government and the remaining 10% is allocated to SARB's reserves. The private shareholders do not have any claim on the foreign exchange reserves of SARB, and they are unable, by means of a resolution or otherwise, to amend or change SARB's affairs decisions by deviating from the provisions of the SARB Act. While the Committees accept SARB's explanations, we believe that if it is financially possible, the shares of SARB's private shareholders should be bought out.
- 8.18 The Committee notes that it is held that high inflation has negative redistributive effects, as the poor suffer disproportionately from it; high inflation reduces their purchasing power. It can create uncertainties about the future and adversely affect investments, reducing growth and jobs.
- 8.19 While the Committee recognise the value of these roles SARB plays, we support the need for a discussion on how SARB can further contribute to advancing socio-economic development.
- 8.20 The Committee believes that the Bank should play a more active role in the detection and combatting of Illicit Financial Flows, given its surveillance role over the country's exchange control regime. The Bank reported that it had handed over to law enforcement agencies 41 cases of exchange control contraventions for further investigations and prosecution over the past five to six years, but there had only been one prosecution – for seeking to bribe an official not for an exchange control offense. The Committee, as it agreed to do, raised this matter with the Hawks in a Joint Committee meeting on Illicit Financial Flows and the matter will be followed up by the Police Portfolio Committee.

Report to be considered.