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The Budget Review Recommendation Report for 2012/13

1. Introduction

The promulgation of the Money Bills Amendment Procedure and Related Matters Act in 2009 (No. 9 of 2009) gave Parliament the opportunity to partake in the budget allocation process of departments. The Act does not contest treasury's powers in drafting the national budget but simply invites legislators to partake in the process by assessing executive's priorities and budgetary requirements and make recommendations were necessary. The process involves looking at the department's expenditure and performance targets, and how these two important factors impact on the department's delivery mandate.

The process also looks at the department's strategic plan and how the programmes are structured to carry out the department's strategic objectives. Furthermore, the process includes identifying challenges (and achievements) to which the department might be grappling with to efficiently meet its budgetary requirements. This is done taking into consideration the fact that the Department has oversight responsibilities over eight State-owned companies, namely Alexkor, Broadband Infraco, Denel, Eskom, South African Airways (SAA), South African Express (SAX), Safcol and Transnet.

2. Analysis of expenditure trends
2.1 Public Enterprises

The Department of Public Enterprises maintained a relatively high expenditure rate of 99.0 per cent in the first three years (i.e. 2007/08, 2008/09 and 2009/10). However in 2010/11 and 2011/12, the Department's expenditure slowed down to 96.7 per cent and 98.0 per cent, respectively. The Department's highest under-expenditure in terms of Rand value was recorded in 2010/11 by an amount of R18.3 million, and this was preceded by an unspent balance of R8.2 million in 2009/10.

2.1.1 Irregular, fruitless, wasteful and unauthorised expenditure

The Department of Public Enterprises incurred most of its irregular, fruitless, wasteful and unauthorised expenditure in the 2006/07 financial year, as indicated in Table 2.1.1(a) below. Unauthorised expenditure for the period amounts to R26.1 million.

Table 2.1.1(a) Irregular, fruitless, wasteful and unauthorised expenditure[1]

Year Incurred	Irregular Expenditure	Fruitless and wasteful expenditure	Unauthorised Expenditure
2006/07	R228 000	R80 000	R26 165 000
2007/08	R0	R0	R0

[1] Five Year Expenditure Review (2011)

2008/09	**R0**	**R 0**	**R0**
2009/10	**R0**	**R0**	**R0**
2010/11	**R0**	**R 4000**	**R0**

Source: Auditor-General (2006/07-2010/11)

3. Public Enterprises, First Quarter Expenditure 2012/13

Programme	Appropriation	Available Budget	Actual Expenditure	% of Budget Expended
	R'000	R'000	R'000	R'000
Public Enterprises	R 1 249 072	R 1 212 785	R 36 287	2.91%
Administration	R 104 394	R 81 751	R 22 643	21.69%
Legal & Governance	R 26 937	R 23 013	R 3 924	14.57%
Portfolio Management & Strategic Partnership	R 1 117 741	R 1 108 021	R 9 720	0.87%
Total	**R 1 249 072**	**R 1 212 785**	**R 36 287**	**2.91%**

The department's budget increased from R353.3 million in 2010/11 to R1 249.1 billion in 2012/13 as a result of transfers to Denel and Alexkor. Of the total amount, R700 million is earmarked for the recapitalisation of Denel's Aerostructures division whilst R350 million is earmarked for Alexkor's outstanding settlement under the Richtersveld Community Deed of Settlement (DoS). After the transfer payments the department is only left with less than R200 million to fulfil its oversight responsibilities over State-owned companies.

First quarter expenditure of the Department shows that the Department has spent R36. 2-million and about 2.91% in terms of percentage. The bulk of the expenditure came from the administration programme, specifically on compensation of employees. Out of the R104.3 million allocated for the administration programme, the Department spent R22.6 million, and about 21.69% in terms of percentage. This is followed by the Legal & Governance programme which only spent R3. 9 million, and 14.57% in terms of percentage. The last programme, Portfolio Management & Strategic Partnership only spent R9.7 million and about 0.87% in terms of percentage. During the end of the first quarter transfers earmarked for both Denel and Alexkor were not made. At the end of the first quarter the department was left with R1.2 billion, and having spent only 2.91% of its total budget.

2.1.1 Second quarter expenditure

Compensation of Employees: An amount of R46.6 million was spent under this item. This is 41.81% of the total budget. There is an under-spending on this item which is due to vacant posts mainly at MMS and SMS levels. It is anticipated that spending under this item will accelerate as vacant positions are expected to be filled in the coming months.

Goods and Services: The expenditure under this item is R35.8 million. If commitments (orders placed) are taken into consideration, 55.28% of the total budget has been spent. It must be noted that the commitments is for recurring expenditure for the financial year. Roll-overs amounting to R3.2 million have been approved by National Treasury in the adjusted budget for the following projects: Project support for the implementation of the locomotive fleet procurement programme – R2.7 million SAFCOL Strategy in terms of its future role within the forestry industry – R430 920.

Transfer Payments: The transfer payments influence the overall expenditure of the Department, being R118.4 million of the total budget. To date an amount of R74 257 has been disbursed automatically via PERSAL from this item under households for a leave gratuity. The transfer payment to Denel which has been approved in the adjustments budget amounting to R118.3 million will be disbursed later in the year. R100 000 under the economic classification for Transfer to Households is a provision for gifts, donations and sponsorships.

Payments for Financial Assets: R1.050 billion which comprises 82.27% of the adjusted appropriation is allocated to Denel (R700 million) and Alexkor (R350 million) respectively under this item. No disbursements have been effected under this item which has a substantial effect on the Department's overall expenditure.

Capital Expenditure: The expenditure under this item amounts to R1.2 million (55%) of the total budget for capital expenditure. If commitments are taken into consideration, 70% of the budget has been spent. In total the Department has spent 6.07% of its budget

3.1 Programme Structure

The department has undertaken an organisational review process that has resulted in the development of a new organisational model and functional structure in line with the department's strategic objectives, namely to "drive investment, productivity and transformation in its portfolio of SOCs, their customers and suppliers so as to unlock growth, drive industrialization, create jobs and develop skills."[2] These objectives are guided by the overarching policy and strategic direction and priorities of Government, as articulated in the New Growth Path, Industrial Policy Action Plan (IPAP) and the National Development Plan.[3]

To fulfil these objectives the Department has trimmed its six programmes into only three, and this also to make it easier for treasury to cluster departmental budgets without creating the impression that, for example the DPE's Transport Enterprises' programme (which has now been transformed into a sub-programme) belongs to the Department of Transport. The three programmes are the following;[4]

[2] Public Enterprises (2012), Strategic Plan
[3] Ibid.
[4] National Treasury (2012), Estimates of National Expenditure

3.1.1 Administration

The programme's mandate is to provide strategic management, direction and administrative support to the department which enables the department to meet its strategic objectives. The programme is expected to spend in total about R104.4 million from the 2012/13 department's budget. The programme's priority areas include the following:

- Continuous performance improvement to ensure delivery of the department's strategic goals.
- Effective talent management and attraction and retention of key skills.
- Consistent and clear messaging on Government's intent for State-owned companies.

The department had raised concerns with respect to the challenges facing their staff complement, arguing that overseeing eight State-owned companies operating in different sectors of the economy requires more employees than they can provide. The Director-General, Tshidiso Matona even pointed out that only a budget increase would enable them to appoint the required employees. The current budget however does not cater for a staff increase and this remains a challenge for the department.

Over the medium term, expenditure is expected to increase to R116. 4 million at an average annual rate of 4.7 per cent, mainly to provide for inflation related adjustments and the centralisation of services.

3.1.2 Legal and Governance

The programme is responsible for providing legal services and corporate governance systems, and to facilitate the implementation of all legal aspects of transactions that are strategically important to the department, and the State-owned companies, and ensure alignment with government's strategic intent. The programme's expenditure for the 2012/13 financial year is expected to reach R26.9 million, and key focus area include the following:[5]

- To provide legal services to the department and support oversight of State-owned companies as well as developing effective corporate governance and shareholder management services on an ongoing basis.
- Repeal of the Aventura Resort Act: This will be initiated once the process to wind up and deregister Aventura is completed.

The programme has about three units, namely Management, Legal Services and Governance. The Management Unit provides strategic leadership and management of the programme personnel. Legal Services provides internal legal services and support to State-owned companies, including transaction and contract management support to the department as well as commercially related work activities in respect of the State-owned companies.[6]

[5] National Treasury (2012)
[6] National Treasury (2012)

Expenditure is expected to increase from R23.7 million in 2011/12, at an average rate of 11.1 per cent, and is expected to increase to R32.9 million over the medium term, at an average annual rate of 11.6 per cent. The increase in both periods is driven by centralisation of legal services from the sector units and the shifting of the risk, compliance and secretariat functions from the Administration programme to this programme, as part of the realignment of the department for efficiency and costs saving purposes.

3.1.3 Portfolio Management and Strategic Partnerships

The programme is responsible for aligning the corporate strategies of State-owned companies with government's strategic intent whilst also monitoring and benchmarking their financial and operational performance and capital investment plans. This include aligning shareholder oversight with overarching government economic, social and environmental policies, and build focused strategic partnerships between State-owned companies, strategic customers, suppliers and financial institutions.

This programme is as a result of the programme restructuring that has taken place in the department. It has about four sub-programmes:[7]

- Energy & Broadband Enterprises,
- Manufacturing Enterprises,
- Transport Enterprises,
- Economic Impact and Policy Alignment; and
- Strategic Partnerships

Over the medium term, expenditure is expected to decrease to R73.8 million, at an average annual rate of 31.4 per cent, due to a further reduction in transfer payments to State-owned companies, particularly the Pebble Bed Modular Reactor (PBMR) project and Denel. Expenditure in the economic Impact and Policy Alignment sub-programme is expected to increase from R13.1 million in 2011/12 to R169 million in 2014/15, at an average annual rate of 8.7 per cent, due to the unit being expanded to accommodate the newly created sub-programme.

4. Key policy developments and legislative changes

The Department did not table any legislation in Parliament during the 2011/2012 financial year. However, the following legislation and regulations, which may have an impact on the operations of the SOC, were proposed by other government departments:[8]

- The Integrated Coastal Management Bill by the Department of Environmental Affairs

[7] Ibid.
[8] Public Enterprise (2012)

- The Broad Based Black Economic Empowerment Amendment Bill, 2011 by the Department of Trade and Industry
- The Spatial Planning and Land Use Management Bill by the Department of Land and Rural Development
- The Industrial Development Zones Bill by the Department of Trade and Industry
- The Preferential Procurement Regulations, issued by the Minister of Finance
- Independent Systems and Market Operator Bill by the Department of Energy

The Department provided comment on these draft bills and legislations in the interest of its mandate and the SOC. In addition, the Presidential Review Committee (PRC), the Defence Review, the Presidential Infrastructure Coordination Committee (PICC) as well as the Department of Transport's Rail Policy are key developments likely to influence the policy and legislative environment in which the Department and State-owned companies operate.

5. Report on performance targets

The Department of Public Enterprises is not a service-oriented department like for example the Department of Social Development, Human Settlement or South African Police Services. For this reason the department's performance revolves around overseeing SOCs commercial objectives including monitoring compliance with legislative laws; the Public Finance Management Act, Treasury Regulations and the Companies Act. It is worth mentioning in this instance, that the department is only one of only three departments that have received clean audit opinions. Having said that, the department's performance evaluation includes the following key indicators among others:[9]

- The timely signing of Shareholder Compacts with SOCs
- The adoption of SOCs Corporate plans
- Consideration of SOCs quarterly reports
- Monitoring the infrastructure rollout plan implemented by both Eskom and Transnet
- The implementation of the Deed of Settlement by Alexkor with regard to the Richtersveld Community

As a performance measuring tool, each of the State-owned companies sign a Shareholder Compact with the minister in which they outline their targets and objectives. The Minister then signs a service delivery agreement with the President for the department's performance assessment for that financial year. Thus, the Department's objective is aimed at providing decisive strategic direction to all State-owned companies so that their businesses are aligned with the national growth strategies. The Department does this by ensuring that State-owned companies' planning and performance, investments activities are in line with government's Medium Term Strategic Framework and the Minister's service delivery agreement, which are:[10]

[9] Public Enterprises (2011)
[10] Public Enterprises (2011)

To improve the delivery and maintenance of infrastructure and monitoring the rollout of the Transnet's and Eskom build programme.

To achieve policy and regulatory clarity in sectors in which the State-owned companies operate

To improve the operational efficiencies of State-owned companies, particularly in relation to the reliable delivery of rail and ports services, and reliable generation, distribution and transmission of electricity.

To develop operational indicators for each of the required sub-outputs identified as part of the delivery agreement. Where necessary, these will be included in the Shareholder Compacts concluded between the Boards of the SOC and the Minister.

5.1 Improving competition and regulation

Work on the Rail Policy and Rail Act has progressed to the finalization of a draft green paper, now under industry stakeholder consultation.[11]

A Private Sector Participation framework has been developed to address private sector participation in rail

5.2 Generation, distribution and transmission of energy

Legislation for the creation of an Independent System and Market Operator (ISMO) has been introduced in Parliament by the Department of Energy and is expected to be promulgated this year.[12]

Eskom has ring-fenced the System and Market Operator unit. The implementation plan to establish the ISMO is being finalized.[13]

More 248 000 households have been electrified and 3 655 homes were connected to an off-grid solar systems.

5.3 Generation, distribution and transmission of energy

- The return to service program of several power units is 93.5% complete
- Medupi is 35% complete, with 56.9% of the budget having been spent
- Kusile is 17% complete, with 30% of the budget been spent
- Ingula is 41% complete, with 54% of the budget been spent

5.4 Logistics: road, rail and ports

[11] Public Enterprises (2012), Strategic Plan
[12] Ibid.
[13] Public Enterprises (2011), Strategic Plan

- Transnet's build projects are generally on track. Two container berths at the Ngqura port have been completed and an additional two will be completed by this year (2012).[14]
- The National Multi Products Pipeline trunk line for petroleum will be commissioned in 2012
- Three rail branch-line opportunities for private sector concessions in 2012/13 have been identified and there has been consultation with KZN, Northern Cape, and Free State Provinces.

5.5 Information and communication technology

- Following the establishment of Broadband Infraco, wholesale broadband prices have dropped by about 73%.[15]
- As part of its mandate to increase access to broadband services, Broadband Infraco has access to 18 Points of Presence (POPs), of which 5 are open access sites in the main centres
- Sentech and Broadband Infraco have also commenced with the Broadband Plan for the Kwazulu-Natal Province Pilot project, and site surveys on three districts are complete.[16]

5.6 Defence

- A framework for the resolution of Denel Aerostructures was developed, and a roll-over of guarantees amounting to R1. 85 billion was secured as interim support to Denel.[17]

5.7 Mining

- The Richtersveld Community and Alexkor have entered into a Pooling and Sharing Joint venture with the Richtersveld Mining Company on a 51%/49% profit share.

6. Programme performance

6.1 Successes

Achievements with regard to outcomes announced by the Department of Performance Monitoring and Evaluation are as follows:[18]

Outcome 6 is: "efficient, competitive and responsive economic infrastructure network,"[19] and DPE's contribution is specifically with respect to outcome 2 (Ensure reliable generation, distribution of electricity) and output 3 (To ensure the maintenance and strategic expansion of roads and rail network, and operational efficiency, capacity and competitiveness of sea ports) dealing with energy and transport, respectively.

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[14] Public Enterprises (2011), Strategic Plan
[15] Ibid.
[16] Public Enterprises (2011)
[17] Ibid.
[18] Public Enterprises (2011)
[19] Public Enterprises (2011)

Transnet has invested over 18, 4 billion in infrastructure replacement and capacity expansion, bringing this to a total of over R71, 8 billion in the past five years. Major achievements in the rail environment include the completion of 536 of the 800 jumbo wagons built for the coal line operation.

In Ports, Transnet Ports Terminals achieved improvements in crane productivity, the Durban container terminal achieved an average of 30 cranes moves per hour, which is expected to continue throughout 2012.

The department took the lead in developing a funding model for Eskom's build programme to ensure security of supply. Cabinet noted the hybrid funding solution comprising the R20 billion equity injection to Eskom and R174 billion additional guarantees, bringing the total guarantee framework to R350 billion.

The department performed all its shareholder functions including the evaluation of State-owned companies' corporate plans, development of shareholder compacts (including shareholder strategic intent statements), quarterly and annual reporting, as well as approval of significant and material transactions were achieved.[20]

6.2 Challenges

The Department's overall objectives are to provide an effective shareholder management system and to support and promote economic efficiency within each of the State-owned companies (SOCs).[21] The performance of State-owned companies for the 2010/11 financial year has been a mixture of struggling State-owned companies and those who are relatively doing well.

6.1 Alexkor

Alexkor's performance has been hampered by the implementation of the Deed of Settlement - in particular the court interdict intended to preserve the resources and attendant benefits on behalf of the Richtersveld Community. Subsequent to this, land mining activities were placed under care and maintenance and as a result Alexkor posted losses for the 2010/11 financial year.[22]

6.2 Denel

Denel continues to post losses due mainly to one of its divisions; Denel Aerostructures. The division has been making heavy losses that had a negative impact on Denel's overall financial performance.

[20] Ibid.
[21] National Treasury (2009)
[22] Alexkor (2011)

6.3 Safcol

Safcol has been struggling to resolve land-claim issues affecting about 60% of their plantations. This process has also affected Safcol's future prospects as the entity's role in the forestry industry remains uncertain; either to continue to make investments or to exit the industry.

6.4 Broadband Infraco

Broadband Infraco received a qualified audit opinion from independent auditors. The basis for the qualified audit opinion is as a result of auditors being unable to obtain sufficient appropriate evidence to support Infraco's claim of fruitless and wasteful expenditure of R1.9 million and an irregular expenditure of R151.1 million.[23]

6.5 South African Express

South African Express not only received a qualified audit opinion but also the airline's financial statements for 2010/11, were withdrawn from Parliament few months after being tabled for being incorrectly stated. The incident has led to the resignation of SAX's Board members as requested by the Minister.

6.6 South African Airways

South African Airways' financial position has become a matter of concern as the airline's weak balance sheet has proved too weak for the airline to raise capital for its operations. The airline's management indicated during the tabling of their 2010/11 annual report in parliament that they're in need of further funding that could amount to R6, 4 billion from government.

The Department however continues to implement various measures to stabilise SAA, SAX and Denel, and have embarked on efforts to reposition SAFCOL and Alexkor.[24]

7. Intervention required

There's a need to increase the departments' staff profile in order for the department to effectively oversee SOCs infrastructure programme. Eskom is embarking on a R500 billion capacity expansion programme over five years whereas Transnet's capacity expansion programme is estimated at R300 billion over seven years. The department cannot effectively oversee nor monitor these State-owned companies' capacity expansion programmes if it does not have the staff complement necessary for its oversight responsibilities over SOCs.
Of major concern to State-owned companies such as Transnet is a clear or improved policy and regulatory environment. This will enable State-owned companies to plan ahead if

[23] Broadband Infraco (2011)
[24] Public Enterprises (2012)

policies are clear and the regulatory environment has clear guidelines on tariff applications especially the assessment methodology for increases or decreases.

The department's shareholder role requires specific capacity and capability to enhance the department's technical ability to manage SOC investments, and this means ability to attract and retain specialised skills.

The department is working in establishing the kind of culture that understands, and is responsive to, the often fast-changing and challenging commercial environment within which SOCs operate

The department also awaits the findings and recommendations of the Presidential Review Committee of State-owned companies, which may give guidelines on the role of State-owned companies in a developmental state among other terms of reference.

The department is working to improve interdepartmental coordination and alignment on mandate of SOCs which currently proves to be a challenge

8. Liaison with entities

Effective shareholder oversight for the Department of Public Enterprises will require the existence of a Shareholder Management Model in the form of a legislative tool, to enable the department to coordinate and effectively engage SOCs on their strategic priorities and policy alignments.

The Department of Public Enterprises has established the following structures to enhance its shareholder oversight responsibilities;

- Chief Executive Officers' Forum
- Chief Financial Officers Forum
- Through Annual General Meetings
- Engaging SOCs in the process of signing Shareholder Compacts

are they functional?

9. Outstanding issues to be considered by the Committee

For some reasons Parliament does not have access to the Minister's Service Delivery Agreement with the President nor the Shareholder's Compacts signed with the various State-owned companies. Parliament becomes aware of the latter two only during the tabling of the department's annual report - when they are referred to.

Shareholder compacts signed between a State-owned company and the department often do not include in their targets job creation nor skills development targets. If SOCs fail to meet job and skills development targets, such failure has no bearing to the SOCs performance for that year. Targets that have an impact on the performance of SOCs management often are commercial in nature such as, revenue growth, gearing ratio, review of boards, corporate plans, etc. This is a big challenge to stakeholders such as Parliament as it overlooks immediate government objectives necessary for building a thriving economy (especially skills development and job creation).

The capacity expansion programme by Transnet and Eskom, particularly the latter because of the recent protest strike actions by workers at Medupi's construction sites need to be monitored.

10. Conclusion and recommendations

For the 2012/13 financial year the department of public Enterprises has been allocated R1 249.1 billion, and based on the departments' projections for the Medium Term Expenditure Framework (MTEF) period there will be less funding for the coming year. This must come as a relief to the fiscus as no recapitalisation in future for SOCs is envisaged. And based on the analysis of the department's budget for the year under review, the following recommendations are made:

There's a great need for a legislation that will empower the department to carry out its oversight responsibilities over State-owned companies, and guidelines on how to align SOCs strategic priorities with government policies.

The departments' budget must be able to meet its staff complement's requirements of specialised skills in order to effectively oversee SOCs massive infrastructure programme. The department's staff complement is less than 200, and to effectively monitor SOCs (in their different sectors) the department needs specialists. In the words of the Minister, "It is imperative that the gap between the Department's expanded oversight and management responsibilities and the resources available to it is progressively closed."[25] In other words, the Department's budget should somehow correspond to the role or mandate it is expected to play – that of ensuring that the infrastructure investment programme by the two SOCs does not fail and that growth in the economy is unlocked and the country's manufacturing base through localisation is expanded to boost exports.

The Presidential Review Committee on State-owned companies must release its findings to put to rest some of the speculations on SOCs realignments with other departments.

It would be helpful to Parliament, especially to its oversight responsibilities if the department was to provide this institution with the Shareholder Compacts signed with State-owned companies.

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