Cash flow guidance

The purpose of this circular is to provide further guidance to municipalities on the correct use of the municipal standard chart of accounts (*m*SCOA) data strings to populate the cash flows tables in Schedules A, B and C of the Municipal Budget Reporting Regulations (MBRR).

This circular must be read in conjunction within the guidance provided in MFMA Circulars No. 98 and 99 that was issued on 6 December 2019 and 6 March 2020 respectively on the population of the cash flow tables and the National Treasury email dated 24 March 2020 on the revised method of linking the MBRR cash flow tables to the *m*SCOA data strings.

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1. Introduction

Since 01 July 2017, when the *m*SCOA Regulations became effective for all municipalities and municipal entities, the National Treasury had challenges to publish cash flow information from the *m*SCOA data strings. The main contributing factors to this were that:

- Municipalities were not using the *m*SCOA segments correctly to populate their cash flow information;
- A number of municipalities did not use the movement accounts correctly in the *m*SCOA chart which distorts the figures reported in the cash flow tables;
- Some municipalities did not budget, transact or report directly in or from their financial systems; and
- There were errors in the linkages of the MBRR cash flow tables to the *m*SCOA data strings in the segment item: asset and liabilities on the Local Government Database.

It is critical that municipalities undertake balance sheet and cash flow budgeting to provide accurate cash flow information. National Treasury uses a combination of the "funding" and "Item" segments to populate the cash flow information in the MBRR schedules. Cash flow provides information on the cash resources available to the municipality to spend on service delivery from the collection of cash from the community, equitable share and other grants from the national fiscus. Once a municipality has established their various funding sources, it is then through strategic engagement decided how the ***available funding sources*** would be utilised to achieve these strategic objectives. This is achieved through what is known widely as the "Procure to Pay" process.

The underlying principle in cash flow budgeting is that it is done at a cash flow level (A1 Schedule Budget Tables SA30 and A7) and not when billing is done or when invoices are issued (A1 Schedule Budget Table A4: Statement of Financial Performance). Municipalities must apply the budgeted assumed collection rate to determine the cash flow budgets. Therefore, expenditure can only be processed against items with funding in line with the anticipated cash inflow and not billing. Municipalities should therefore identify the relevant source in the funding segment where revenue is received from and identify the funds to be used when payments are made.

If a municipality is not budgeting, transacting or reporting directly in or from their financial system, then the controls that are built into the system to prevent an unauthorised transaction will not be triggered. Unauthorised transactions include those transactions where there is no budget allocation or the transaction exceeds the approved budget allocation.

Guidance on the use of the *m*SCOA segments to populate the cash flow information and the use of movement accounts was provided in MFMA Circulars No. 98 and 99 and municipalities were required to apply the guidance from 01 July 2020. The guidance provided on the movement accounts for cash inflow and outflow transactions is attached as **Annexure A** for ease of reference.

To ensure that the MBRR cash flow tables (A7, SA30, B7 and C7) are linked correctly to the *m*SCOA data strings, the National Treasury corrected the linkages in the segment item: asset and liabilities. The revised linkages were shared with municipalities and system vendors in an email dated 24 March 2020 to enable them to correct it in their

respective financial systems by 01 July 2020. The linkages are attached as **Annexures B1 to B3** for ease of reference.

Based on the guidance that was issued, the National Treasury has analysed the adopted 2020/21 budget (ORGB) and monthly cash flow data strings. However, it is evident that a number of municipalities are still not applying the guidelines that was provided in MFMA Circulars No. 98 and 99 and that the cash flow tables have not been linked correctly to the *m*SCOA chart items. Consequently, the cash flow information is still not populated correctly.

2.   Use of the funding segment to populate cash flow information

The intent with the Funding segment is to assist municipalities in the management of available funds to use in running the municipality (working capital), capital expanding, maintenance programmes and operational projects intended for the benefit of the community. **The underlying principle in recording of transactions in this segment is therefore cash based or funds available to utilise**.

The key question in finding the appropriate classification code for this segment is: "against which source of funding is the payment allocated and against which source is revenue received?"

The primary sources of funding for a municipality are property rates, service charges, equitable share and own revenue. Further to these sources of revenue a municipality also spend funds transferred from other sectors within government, namely transfers and subsidies such as appropriated by national and provincial government in terms of the Division of Revenue Act (DORA). A further source of fund available for utilisation is "cash backed reserves" as directed by the municipality's financial policy on the utilisation of the reserves.

The projects as defined within the Project segment together with the "funding" and "Item" segments provide information on how funds have been spent and on what.

The Funding segment's structure distinguishes between "Operational, Capital and Non-Funding Transactions".

Operational: Operational revenue provides for funds from all other sources of income such as taxes, service charges, commercial services, transfer and subsidies, etc.

Capital: Funds to finance capital projects.

Non-funding Transactions: This is items that does not relate to a cash transaction. Examples of non-funding transactions are:
•   Billing for services on consumer accounts issued;
•   Recording of invoices;
•   Depreciation; and
•   Debt provision.

3.   Ongoing cash flow challenges

The ongoing challenges with the population of the cash flow tables can be attributed to the following:

1.   Balance sheet budgeting has not been implemented in accordance with the *m*SCOA Regulation to prepare the 2020/21 MTREF budget data strings (ORGB);
2.   Movement accounting is not correctly used;
3.   Cash receipts and payments are not populating due to the incorrect use of the *m*SCOA segments and the combination thereof;
4.   Non-Funding (FD003) is used as a funding source; and
5.   Some of the cash flow information is linked incorrectly on the Local Government Database and the municipal financial systems.

Balance sheet budgeting
Balance sheet budgeting includes the result of a transaction. Where the municipality plans to receive revenue from billing, the debit transaction to *Trade and other receivables* and the credit to Revenue equates to balance sheet budgeting.

This is a billing transaction and does not impact on cash flow. A second transaction must be listed in the balance sheet budgeting that will constitute the payment of the account. This will be the debiting of the Bank account: Deposits and the crediting of the Trade and other receivables.

The third transaction will be the accrual of the unpaid Trade and other Receivables.

In illustration, if a municipality budget for electricity revenue (billings) of R6 million based on the projections by the financial system and historical data. Historically this ward has a 85 per cent payment rate (In table A7, the cash flow should be for at 85 per cent of the R6 million). The transaction should be posted as follows:

Billing (A4):

Segment	Debit	Credit
Project	Default	Default
Function	Function: Energy Sources: Core Function: Electricity	Function: Energy Sources: Core Function: Electricity
Item	**Assets:Current Assets**:Trade and other Receivables from Exchange Transactions:Trading Service and Customer Service Debtors:Electricity:**Monthly Billing**	**Revenue**:Exchange Revenue:Service Charges:Electricity:**Electricity Sales:Domestic High:Conventional**
Funding	Fund: Non Funding	Fund: Non Funding
Region	Ward 2	Ward 2
Costing	Default	Default
Amount	R6 000 000	R6 000 000
Note	**This data string will populate A6**	**This data string will populate A4**

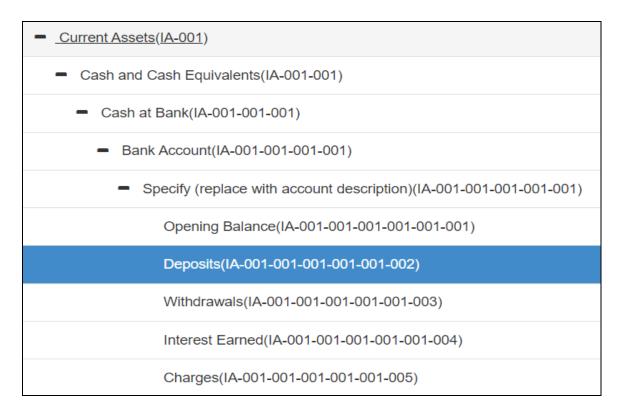| Segment	Debit	Credit
Project	Default	Default
Function	Function: Energy Sources: Core Function: Electricity	Function: Energy Sources: Core Function: Electricity
Item	Assets: Current Assets: Cash and Cash Equivalents: Cash at Bank: Bank Account: Primary Bank account: **Deposits**	Assets: Current Assets: Trade and other Receivables from Exchange Transactions: Trading Service and Customer Service Debtors: Electricity**: Collections**
Funding	Fund: Operational: Revenue: General Revenue: Service Charges: Electricity	Fund: Operational: Revenue: General Revenue: Service Charges: Electricity
Region	Ward 2	Ward 2
Costing	Default	Default
Amount	R5 100 000	R5 100 000
Note	This data string will populate A7	This data string will populate A6

The remaining R900 000 is the outstanding Trade Receivable balance that will be impaired.

Segment	Debit	Credit
Project	Default	Default
Function	Function: Energy Sources: Core Function: Electricity	Function: Energy Sources: Core Function: Electricity
Item	Gains and losses: Impairment loss: Trade and other Receivables from Exchange Transactions: Electricity	Assets: Current Assets: Trade and other Receivables from Exchange Transactions: Trading Service and Customer Service Debtors: Electricity**: Impairment: Recognised**
Funding	Fund: Non-Funding	Fund: Non- Funding
Region	Ward 2	Ward 2
Costing	Default	Default
Amount	R900 000	R900 000
Note	This data string will populate A4	This data string will populate A6

Movement accounting

The movement accounting in *m*SCOA refers to the correct allocation of a transaction to the posting level. As shown in the screen shot of the chart tree below, where the deposits on the Bank Account will be the posting level for all monies received, withdrawals will show payments and Interest earned will be for interest received.

Where the payments in Trade and other Payables will be the withdrawals as the relevant movement posting level and the deposits refers to the accrual of the control account, as shown in the screen shot below.

Municipalities should also note that in Item Liabilities: Deposits (cr) increase the liability and Withdrawals reduces (dt) the liability. If applied incorrectly, the cash flow tables will not populate correctly.

Incorrect use of the *m*SCOA segments
When municipalities are not using the *m*SCOA segments correctly, then the cash flow information will not be reflected correctly as a combination of segments are used to link cash flow information. Some of the common errors that was identified in the data strings and that is impacting on the accuracy of the cash flow information included the following:

- Incorrect posting against line items are used, e.g. bank account – deposits are used instead of interest for interest earned;

- Interest on outstanding debtors is incorrectly included in the cash flow but it is not a cash flow item;
- Banks is not specified or created on the financial system. In accordance with Section 8 of the MFMA, municipalities must have one primary bank account. mSCOA requires that the details of the bank account must be added in the "specify account" of the chart to easily identify the balance of a specific account for the use of the accounts and for annual audits; and
- The repayment of borrowing is recorded incorrectly. The correct recording of borrowing repayments on the *m*SCOA chart is explained in the example below.

If a municipality received a loan of R10 million from the Development Bank of South Africa (DBSA) that is payable over a period of 10 years, then the cash received from taking up the loan will increase the bank balance and cash inflow of the municipality. The receiving of the loan is shown below. The cash inflow is picked up from the long term funding source combined with bank deposits.

Segment	Debit	Credit
Project	Default	Default
Function	Function: Finance: Core: Finance	Function: Finance: Core: Finance
Item	Assets: Current Assets: Cash and Cash Equivalents: Cash at Bank: Bank Account: Primary Bank account: **Deposits**	Liabilities: Non-current Liabilities: Financial Liabilities: Borrowings: Annuity and Bullet loans: Development Bank of South Africa: Specify: **Advances**
Funding	Fund: Capital: Borrowing: Non-current: Annuity and Bullet loans: Development Bank of South Africa	Fund: Capital: Borrowing: Non-current: Annuity and Bullet loans: Development Bank of South Africa
Region	Administration and Head Office	Administration and Head Office
Costing	Default	Default
Amount	R10 000 000	R10 000 000
Note	**This data string will populate A7**	**This data string will populate A6**

The annual repayment of the loan must be budgeted for as follows:

The repayment will reduce the bank balance with R1 million per year as per the two transactions below. The municipality will transfer the amount payable within the next financial year out of Non-current liabilities to Current liabilities. Cash flow is <u>not</u> picked up under Non-Current liabilities.

Segment	Debit	Credit
Item	Liabilities: Non-current Liabilities: Financial Liabilities: Borrowings: Annuity and Bullet loans: Development Bank of South Africa: Specify: **Transferred to Current liabilities**	Liabilities: Current Liabilities: Financial Liabilities: Current portion of Non- Current borrowings: Annuity and bullet loans: Development Bank of South Africa: Specify: **Deposits**

The payment of the loan is where the cash flow will be picked up using the transactions from the Current liabilities on the movement accounts at the Withdrawals level as shown below.

Segment	Debit	Credit
Item	Liabilities: Current Liabilities: Financial Liabilities: <u>Current portion of Non- Current borrowings:</u> Annuity and bullet loans: Development Bank of South Africa: Specify: **Withdrawals**	Assets: Current Assets: Cash and Cash Equivalents: Cash at Bank: Bank Account: Primary Bank account: **Withdrawals**

Use of non-funding as a funding source

The cash flow will not populate any transaction where 'non-funding' is used as the funding source. As shown in the diagram below, no payments or receipts linked to a 'non-funding' source will populate in the cash flow.

System vendors should ensure that a business validation rule is built into the financial system to prevent payments and receipts being linked to a 'non-funding' source if this is not already in place.

Linking of cash flow information

In terms of the revised linking of the MBRR cash flow tables (A7, SA30, B7 and C7) and the *m*SCOA data strings (refer to Annexures B1 to B4), the National Treasury corrected the linkages in the segment item: asset and liabilities. With effect from 01 July 2020, the linking of **Cash Payments** was changed to use the withdrawals in Item Liabilities. Municipalities are required to use the different levels of Trade and Other Payables from Exchange Transactions as listed below.

- Trade and Other Payable Exchange Transactions(IL-001-006)

  + Affiliates, Related Parties and Associated Companies(IL-001-006-001)

  + Accrued Interest(IL-001-006-002)

  + Advance Payments(IL-001-006-003)

  + Control, Clearing and Interface Accounts(IL-001-006-004)

  + Leave Accrual(IL-001-006-005)

  + Retentions(IL-001-006-006)

  + Dividends Declared not Paid(IL-001-006-007)

  + Electricity Bulk Purchase(IL-001-006-008)

  + Long Service Award(IL-001-006-009)

  + Auditor-General of South Africa(IL-001-006-010)

  + Payables and Accruals(IL-001-006-011)

  + Pension and Retirement Contributions(IL-001-006-012)

  + PAYE Deductions(IL-001-006-013)

  + Bulk Water(IL-001-006-014)

  + Unallocated Deposits(IL-001-006-015)

  + Intercompany/Parent-subsidiary Transactions(IL-001-006-016)

  + Bonus(IL-001-006-017)

  + Agency Fees Payable(IL-001-006-018)

  + Compensation Commission (COID)(IL-001-006-019)

  + Fair Value Adjustment(IL-001-006-020)

  + Overtime(IL-001-006-021)

  + Standby(IL-001-006-022)

The posting level of withdrawals equates to the movement accounting as is needed. This is where the cash flow is recorded.

It is noted that the revised linkages were not effected in the financial systems of some municipalities and consequently the cash flow information is not pulling through correctly in the data strings that are submitted to the Local Government portal. These linkages became effective on 01 July 2020 and those municipalities that have not implemented the revised linkages must do so immediately.

Additional errors in the linkages of the MBRR cash flow tables to the *m*SCOA data strings have also been identified after 01 July 2020. Some of the cash flow challenges will be corrected in the current financial year and others in version 6.5 of the chart. Key challenges that will be looked at and addressed in *m*SCOA chart version 6.5 include:

- Unallocated deposits: Huge amounts are lying in Item: Liabilities: Current liabilities: Unallocated deposits. Some Municipalities have linked unallocated deposits to non-funding as a funding source as it is difficult to determine the correct funding source. This will mean that the cash flow in the C7 will not be populated as non-funding does not populate the cash flow. One municipality used Electricity Sales as the funding source, this is also creating a wrong cash flow picture. Unallocated deposits is not currently linked to the cash flow as it is not budgeted for. However, there is a cash flow element linked to it during the transacting on a monthly basis. Although National Treasury will investigate this further, it should be emphasized that municipalities must ensure that their bank reconciliation are done at month-end as required in terms of Section 62(2)(h) of the MFMA;
- Inventory is not linked to the cash flow. The cash flow impacts on the Acquisition stage. It should be noted that material issued is a non-cash transaction;
- Income tax receivable, Income tax payables, VAT receivable, VAT payable, Accrued interest will be linked to cash flow/payments;
- Capital assets are duplicated under employee related cost (trade and other payables – payables and accruals) and a separate line might have to be opened for the payment of assets for control purposes;
- Construction Work-In-Progress (CWIP) is not linked as part of capital assets in the A9, this will be corrected;
- Contracted services should be shown separately – currently it is part of trade payables and accruals; and
- Advance payments and retentions do not have a cash flow effect on the operations of the municipality the link on the cash flow tables will be transferred from other expenditure to other cash flow/payments.

The changes that will impact the 2021/22 MTREF will be communicated in the MFMA Budget Circular to be issued in December 2020.

The following additional changes to the cash flow linkages will be made in the current financial year:

- Dividends declared: the linkage will be removed as it is not a cash flow item.
- Allocations in kind: the linkage will be removed as it is not a cash flow item.

It is acknowledged that the changes to linkages in the cash flow tables that will be made in the current financial year on the Local Government Database might only be effected in municipal systems in 2021/22 where systematic changes are required. These systematic changes will be done in line with the annual system upgrades by system vendors.

4.   Way forward to resolve cash flow challenges

The *m*SCOA data strings for September 2020 are due by 14 October 2020, where after the data will be verified and signed off by the Municipal Manager and Chief Financial Officer of the respective municipality. Thereafter the Local Government Database will be locked for any further submission of the 2020/21 budget (ORGB), adjustments budget (ADJB) and monthly Section 71 information for quarter 1 of 2020/21. Municipalities must therefore ensure that they populate the cash flow data strings correctly, as per the guidance provided by the National Treasury and that the linkages between the *m*SCOA data strings and A, B and C schedules as per the guidance provided on 24 March 2020 (also refer to Annexures B1 to B4) are corrected when they submit their *m*SCOA data strings by 14 October 2020.

The intended changes to *m*SCOA chart version 6.5 must also be noted and further details on those changes will be communicated in the MFMA Budget Circular for the 2021/22 MTREF. This circular will be issued in December 2020.

5.   Conclusion

Municipalities that require training on balance sheet budgeting, movement accounting and cash flow population should arrange this with their respective Provincial Treasuries (in the case of delegated municipalities) or the LGBA director responsible for the oversight of their municipality (in the case of non-delegated municipalities).

Any queries relating to the guidance provided in this circular must be logged on the *m*SCOA Frequently Asked Questions (*m*SCOA FAQ) Database. The database can be accessed on the *m*SCOA website on the following link:

http://mfma.treasury.gov.za/RegulationsandGazettes/MunicipalRegulationsOnAStandard ChartOfAccountsFinal/Pages/default.aspx

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