NATIONAL TREASURY

Municipal SCOA Circular No. 11

Municipal Finance Management Act No. 56 of 2003

Guidance on the use of the Fund segment

The purpose of this circular is to provide guidance to municipalities on the use of the Fund segment in addition to the guidance that was provided in *m*SCOA Circular No. 10 that was issued on 8 October 2020.

This circular must also be read in conjunction within the guidance provided on the use of the *m*SCOA segments to populate the cash flow information and the use of movement accounts in MFMA Circulars No. 98 and 99 that was issued on 6 December 2019 and 6 March 2020 respectively.

Content

1. Introduction

In *m*SCOA Circular No. 10 (dated 08 October 2020), guidance was provided 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).

Following the guidance provided, a vast improvement in the section 71 cash flow information reported for quarter 1 of the 2020/21 financial year was noted. Despite the improvement in the data, the following cash flow issues still had to be corrected and/or clarified:

- The recording of unallocated deposits;
- The duplication of capital assets other expenditure (trade and other payables – payables and accruals);
- The linking of construction Work-In-Progress (CWIP) to capital assets in Table A9 of the A1 Schedule;
- The linking of advance payments and retentions to the cash flow tables;
- The distinction of and payment between Inventory, Contracted Services and Other Expenditure line items not specifically listed under Liabilities in the *m*SCOA chart; and
- The linking of Income tax receivable, Income tax payables, Value Added Tax (VAT) receivable, VAT payable, Accrued interest on receivables to cash flow/payments.

In addition to the above issues, the introduction of movement accounting in *m*SCOA chart version 6.2 introduced new posting/transacting levels on the Item segment. This impacts mostly on Item: Assets and Item: Liabilities and allows the National Treasury to draw cash flow data as per the movement of cash.

The guidance in this circular is based on extensive consultation with various stakeholders such as municipalities, system vendors and accounting experts.

2. Clarification on unresolved cash flow issues

2.1 Unallocated deposits

Unallocated deposits refer to payments received where the source of funding is not known at the time of receipting. Some municipalities are linking unallocated deposits to non-funding as a funding source as it is difficult to determine the correct funding source or even allocate it to any 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 or that the performance against a particular funding source will be inflated.

In order to populate the cash flow tables, unallocated deposits should be linked to Fund: Operational: Revenue: General Revenue: Service Charges: Unspecified FD001001001008002.

Since municipalities are registered on the cash basis for Value Added Tax (VAT), this transaction should be configured to allocate VAT received to Item Liabilities: Current

Liabilities: Output VAT: Recognised IL001010002. This is as per the VAT 419 Guide from the South African Revenue Services (SARS). if the receipt is for Property rates or if it is identified as a Grant receipt which is Zero rated VAT, the transaction must be reversed via Item Liabilities: Current Liabilities: Output VAT: Transfers IL001010003 when it is allocated to the relevant *Trade and other receivable* account and relevant funding source. The other trading services must also attract the full VAT amount and the system setup/ configuration must be setup in accordance.

Although it is acknowledged that there may be delays in the allocation of payments in the billing system when third party payments such as bank deposits, electronic transfers and payments through supermarket groups are received due to the absence of an account number or reference number, municipalities must ensure that their bank reconciliation are done at month-end as required in terms of Section 62(2)(h) of the MFMA.

2.2 Duplication of capital assets

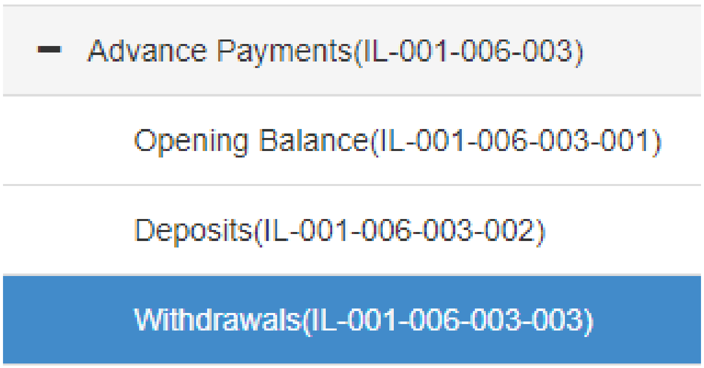
Previously capital assets in the cash flow tables were linked to both *Trade and other payables – payables and accruals* and the *Project capital linked to Bank account* withdrawals. This duplication in the linking of capital assets was corrected. As per the corrected linkages, Project Capital (PC) is now linked to item Assets: Bank: withdrawals (IA001) and Fund: Capital (FD002) is used to populate the cash outflow on capital assets.

2.3 Construction Work-In-Progress (CWIP)

The use of the project segment and the capital fund creates a distinction between operational liabilities being paid and payments for capital projects. This use of project capital as a segment enables the linking of construction work-in-progress to capital assets in Table A9 of the A1 Schedule as all CWIP transactions are linked to Project Capital (PC) and Fund: Capital (FD002).

2.4 Linking of advance payments and retentions to the cash flow tables

Advance payments and retentions have a cash flow effect only when it becomes due. As advance payments are recognised and transferred to revenue once service is concluded and the recognition criteria as set out in GRAP 23 and 9 is met, a transfer to revenue posting level has been added to *m*SCOA chart version 6.5 Item liabilities: Current liabilities: Trade and other payable exchange transactions: Advanced payment: Withdrawals as shown below:



2.5 Linking of advance payments and retentions to the cash flow tables

Retention refers to the amount that a municipality will withhold on payments to contractors to ensure that project specifications are concluded and signed off (GRAP 11). Retention is payable after an agreed period but is kept as a liability that is due to the contractor when construction is completed.

The cash flow and payment of retention occurs when all the conditions were met by the contractor and is made at the end of the retention period. This is when the cash will flow out and the Retentions: withdrawals under Item liabilities: Current liabilities: Trade and other payable exchange transactions: Retention will be picked up from the data strings to populate the cash flow as shown below:

- Retentions(IL-001-006-006)
  - Opening Balance(IL-001-006-006-001)
  - Deposits(IL-001-006-006-002)
  - Withdrawals(IL-001-006-006-003)

2.6 Inventory, Contracted Services and Other Expenditure

Currently contracted services, services, inventory and all other trade payables are bundled under trade payables and accruals in *m*SCOA chart version 6.4, but the payment for Inventory and Contractors cannot be separately reported in supporting table SA30 in the A1 Schedule. Towards this end, two new items, namely *Trade and other payables from exchange transactions: Inventory and Trade* and *Other payables from exchange transactions: contractor services* have been added to *mSCOA* chart version 6.5 to differentiate between these two items.

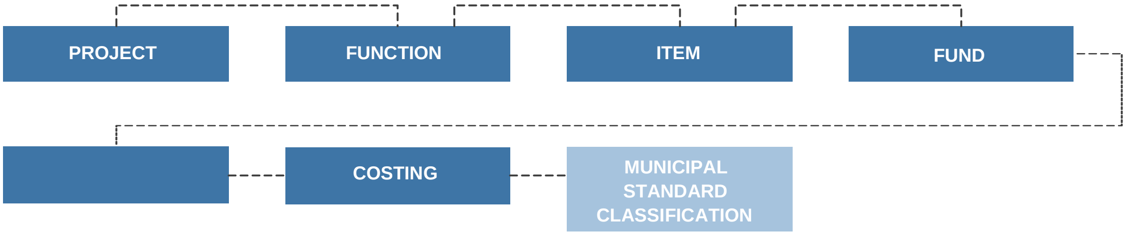
2.7 Income tax and VAT

Income tax receivable, Income tax payables, VAT receivable, VAT payable, and *Accrued interest* was not previously linked to the cash flow tables in the regulated schedules. The matter will be resolved for the 2021/21 MTREF Schedules when the VAT Control (Payable) will be linked as a cash outflow and the VAT Control (Receivables) as a cash inflow. The linkage to *Income tax* line items where the physical payment will be made to SARS will also be added to the regulated schedules.

The updated linkages for the population of the cash flow tables are attached as **Annexure A**.

3. Movement accounting and the fund segment

The introduction of movement accounting in *m*SCOA chart version 6.2 (December 2018), created additional capability to the design principles of the Fund segment. Movement accounting requires that all transactions start with budgeting and specifically budgeting on the regulated *m*SCOA segments. Data strings should follow a specific order of relevance, as indicated below:



Municipal financial systems combine the seven segments in the budget process and the specific combinations of segments is carried through the system for budget control during transacting. This is also referred to as a vote number and segmentation of a vote number can never change. The correct use of the Fund segment will assist municipalities to manage available funds to run its operation. It will also provide valuable information for management reports to ensure that budgets are funded, monitor expenditure against revenue by source, and calculate the net cash flow after creditors and commitments has been accounted for.

The Funding segment distinguishes between operational revenue (taxes, service charges, commercial services, transfers and subsidies, etc.), capital funds (to finance capital projects) and non-funding transactions (any items not classified as operational or capital). Importantly, non-cash transactions such as consumer billing, recording of invoices, depreciation and debt impairment should not be confused with non-funding transaction. Non-cash transactions will not impact the cash flow.

The examples illustrate the use of the Fund segment:

Example 1
The municipality budget to sell electricity of R6 million to Ward 2:

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: Operational: Revenue: General Revenue: Service Charges: Electricity	Fund: Operational Revenue: General Revenue: Service Charges: Electricity
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**

Example 2
Historically Ward 2 has a 85 per cent payment rate. The municipality therefore has to budget for cash receipts at a 85 per cent payment rate:

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**

Example 3
Based on the 15 per cent non-payment rate, the municipality budget at the end of the financial year for an impairment loss on the budgeted Electricity debtors of R900 000:

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: Operational: Revenue: General Revenue: Service Charges: Electricity	Fund: Operational: Revenue: General Revenue: Service Charges: Electricity
Region	Ward 2	Ward 2
Costing	Default	Default
Amount	R900 000	R900 000
Schedules	A4	A6

A number of queries were received on the example used in *m*SCOA Circular No. 10. It should be clarified that the example was an indication of actual cash movement and not the way that the budget must be set up. The examples used was non-cash transactions that will not be from part of the cash flow and should therefore not be reflected on tables A7, SA30, C7 and SC30.

4. Balance sheet budgeting and the cash flow

A budgeted balance sheet is a report that management uses to predict the levels of assets, liabilities and equity based on the planned revenue and expenditure the current accounting period. The budgeted balance sheet shows where all of the accounts would be at the end of the period if actual performance matched the budgeted estimates. **All revenue and expenditure impacts on the Financial Position of the municipality**. Accurate cash flow information will assist the municipality to calculate the cash available using the historical trends.

The following should be considered when preparing estimations for balance sheet budgeting:

- The estimated revenue billings per month. Importantly, assumptions must be based on historical performance, projected growth, cost drivers and economic factors;
- Information on outstanding debtors, debt impairment and actual debt write offs;
- The roll forward movement accounts to establish opening balances; and
- Historical trends the sale of bulk electricity and water inform the estimation for bulk purchases.

Municipalities must not spend what they do not have available in the bank. It is important to link all revenue and expenditure to a funding source through the Fund segment when budgeting and transacting. The Fund segment must be used correctly for cash receipts and payments (i.e. FD001 and FD002). This will enable budgeting, transacting and reporting **on the same data string** and the identification of the actual cash available per funding source that can be utilised for service delivery. Non funding should not be used.

Furthermore, budgeting, transacting and reporting must be done directly in and from the integrated ERP system solution on the relevant posting levels to sure that the built-in controls are triggered to prevent unauthorised expenditure. The high levels of unauthorized expenditure reported by the Auditor-General is evident that a number of municipalities are still working outside of their ERP systems and bypassing budget control functionality.

5. Way forward on cash flow budgeting

Municipalities should implement balance sheet budgeting and movement accounting to ensure that the cash flow for the 2021/2022 MTREF is populated correctly. If the cash flow is not budget for correctly, transactions will be a challenge.

Municipalities should also ensure that the cash flow linkages to the regulated schedules and the Local Government Database and the municipal financial systems are aligned for the 2021/22 MTREF. The changes to *m*SCOA chart version 6.5 must be utilised when preparing the 2021/22 MTREF. The changes to *m*SCOA chart version 6.5 was communicated in MFMA Circular 107 on 04 December 2020 and is available on the link below:

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

The Fund segment in the Product Summary Document (PSD) will be updated in line with chart 6.5 changes and the principles of movement accounting.

6. Conclusion

One of the key objectives of the *m*SCOA reform is to ensure that municipalities are budgeting, transacting and reporting directly on and from integrated ERP systems to have one version of the truth in terms of the reported financial performance. National Treasury will expand and regulate the business processes and system specifications as articulated in MFMA Circular No. 80 and its Annexure B in the 2021/22 MTREF to ensure that the essence of the *m*SCOA reform is adhered to. The regulation of the business processes and minimum system specifications will include the requirements on cash flow and the use of the Fund segment communicated in this circular, *m*SCOA Circular No. 10 and MFMA Circulars No. 98 and 99.

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/MunicipalRegulationsOnAStandardChartOfAccountsFinal/Pages/default.aspx

Contact

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Post	Private Bag X115, Pretoria 0001
Phone	012 315 5009
Fax	012 395 6553
Website	http://www.treasury.gov.za/default.aspx

JH HATTINGH
CHIEF DIRECTOR: LOCAL GOVERNMENT BUDGET ANALYSIS
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