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| Description: Description: Letter Head |
| STANDARD CHART OF ACCOUNT SPECIFIC TO LOCAL GOVERNMENT  *[SCOA for MUNICIPALITIES]* |
| Project Detail:  Section 6 – Item Segment Introduction |
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| November 2016 (Version 6.1) |

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# SECTION 6: ITEM SEGMENT - INTRODUCTION

## Overview of the Item Segment

1. The Item segment is the mSCOA segment most local government practitioners are traditionally familiar with since it enables traditional financial reporting and reconciliations that municipalities have been doing before the introduction of Municipal SCOA. This segment therefore identifies the nature of the transaction to be recorded, namely: Revenue/ Expenditure/ Gains and losses/ Liabilities/ Net Assets.
2. The decisions that are taken by users of financial statements require an evaluation of the ability of the municipality to implement sustainable service-delivery as informed by the timing and certainty of the service delivery.
3. Information about the financial performance of the municipality provides an account of stewardship of management and is useful in assessing the past and anticipated financial performance of the municipality. Information about variability of financial performance is important in this respect.
4. Information about financial performance is useful in holding management accountable for the safekeeping of the municipality’s resources and for the proper and efficient use thereof. It is also useful in forming judgements about the effectiveness with which the municipality might employ additional resources.
5. The financial position of the municipality is affected by the resources it controls, its financial structure, its liquidity and sustainability, and its capacity to adapt to changes in the environment in which it operates.
6. Information about the resources controlled by the municipality and its capacity in the past to modify these resources is useful in predicting the ability of the municipality to sustain its service-delivery in the future. Information about financial structure is useful in predicting future financing and borrowing needs; it is useful in assessing the municipality’s ability to raise further finance. Sustainability refers to the ability to continue to provide the services in the longer term.
7. The liquidity and sustainability of a national or provincial department is very much dependent on their budget allocation. Their financial position is therefore primarily affected by the budget whereas a municipality relies largely on their own revenue in the form of rates and taxes and other service charges.
8. Information concerning changes in the cash flows of the municipality is useful in order to assess its investing, financing and operating activities during the reporting period.
9. This information is useful in providing the user with a basis to assess the ability of the municipality to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.
10. Information about financial position is primarily provided in a statement of financial position. Information about financial performance is primarily provided in a statement of financial performance. Information about cash flows is provided in the financial statements by means of a statement of cash flows. Changes in the residual (after deducting liabilities from assets) are provided in the statement of net assets.
11. The component parts of the financial statements interrelate because they reflect different aspects of the same transactions or other events. Although each statement provides information that is different from the others, none is likely to serve only a single purpose or provide all the information necessary for particular needs of users. For example, a statement of financial performance provides an incomplete picture of financial performance unless it is used in conjunction with the statement of changes in net assets and the statement of cash flows.
12. The Item Segment of SCOA consists of four parts being:
    * + - Revenue [Section 6.1]
        - Expenditure [Section 6.2]
        - Gains and Losses [Section 6.3]
        - Assets, Liabilities and Net Assets Section [6.4]]
13. At the highest-level, the Item Segment supports the reporting done in terms of the budget reporting formats[[1]](#footnote-1) and annual financial statements. The detail levels in this segment provide the more detailed information presented in supporting schedules and notes to the budget reporting formats and annual financial statements.
14. This mSCOA project resulted in alignment between the budget reporting format and annual financial statements that will greatly assist the reporting on budgeted versus actual information.
15. Important to note is that the accounting policies, methodologies and principles applied in determining budgetary information need to be consistent to those applied in preparing annual financial statements.
16. The components of the Item Segment are discussed in separate sections in the body of the sections.
17. The use of the information collected through the standard classification process is not confined to budget and annual financial statements but need to address the needs of a wide group of users of local government information.
18. Consultation with various users took place throughout the research and development phase resulting in populating the mSCOA charts to assist in extracting the required information.
19. The expansion of detail within SCOA will continue as more “users” appreciate the value from this process. Standardisation of classifications adds immense value to the quality of information and consistency in reporting.
20. Because municipal functions and activities vary and consequently transactions and other events differ in terms of the impact on its ability to meet its service-delivery obligations, disclosing the components of financial performance assists in an understanding of the financial performance achieved and in making projections of future results.
21. Additional line items are included on the face of the statement of financial performance, the descriptions used and the ordering of items are amended when this is necessary to explain the elements of performance.
22. Factors considered include materiality and the nature and function of the components of revenue and expenses.

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## Design Principles

1. The design principles defined in the Item segment: Revenue, Expenditure, Gains and Losses, Assets, Liabilities and Net Assets need to be considered together with the following general principles:
2. *Principle 1: mSCOA* - The segment outline and detail classification provide for all possibilities as a “master mSCOA” from which each municipality selects the accounts needed to “populate” their chart of accounts.
3. *Principle 2: Municipal Entities and Agencies -* Recording of transactions in this segment would be done according to the principles determined for municipalities. References made to “municipalities” must be read as also referring to “municipal entities”, unless indicated otherwise.
4. *Principle 3: Legislative and Regulatory Requirements -* The research and development into the Item segment, categories and detail accounts were guided by the legislation and regulations read with circulars and guidelines issued by the National Treasury and summarised in the table below. Furthermore, brief comments on any changes to a circular or guideline (issued by National Treasury) following the mSCOA regulation are included in the “Proposed Changes Column” of the table.
5. *Principle 4: Linking Transaction by Business Process to mSCOA -* Business processes is the set of activities taking place from the initiation of a process to the completion thereof. Typical in the context of financial reporting a source document from an activity within a business process initiates the activity to flow through a defined business processes ultimately resulting in the transaction to be captured within a financial model in the municipality’s system and updating the general ledger. The mSCOA provides a classification structure within the general ledger to “record” transaction information within “fields” within the database functioning in the background of the financial application.
6. *Principle 5: Category Links and Programming Rules -* Category links and business rules refer to programming rules that system developers of financial and business applications for local government are required to provide for in their applications. The considerations listed may not be complete, considering the development stage of this project, and might need to be enhanced as the consultation with the various stakeholder groups evolves.
7. *Principle 6: mSCOA Detail Accounts -* Labels and accounts are defined to have readily available the information needed for local government budgeting (annual budgets, adjustment budgets and SDBIP’s[[2]](#footnote-2)) and reporting (monthly, mid-year performance assessment and annual financial statements).
8. *Principle 7: mSCOA Definitions -* The master mSCOA provides definitions for all accounts and reporting levels, to assist practitioners in achieving consistency in recording transactions of a similar type or nature between municipalities, to enhance the comparability of information and report extraction.
9. Principle 8: *Annual Financial Statements and Budget Reporting Formats* – mSCOA Aligns with the Municipal Budget and Reporting Regulations, 2009 (budget and reporting formats) and with the Standards of GRAP applicable to the different categories of municipality, especially recognising that local government uniquely operates in an accrual accounting and accrual budgeting environment.
10. *Principle 9: The Standards of GRAP -* The mSCOA Classification provides for sufficient classification to, amongst other reporting requirements, present annual financial statements as required in terms of the Standards of GRAP Reporting Framework, outlined in Directive 5 determining the GRAP Reporting Framework[[3]](#footnote-3) (2017/2018) issued by the Accounting Standards Board. The work plan of the mSCOA Technical Committee will be informed by the changes made to the Reporting Framework and resultant Standards of GRAP for annual consideration in updating the mSCOA Classification and Reports.
11. *Principle 10: Economic Reporting Format -* The Economic Reporting Format, September 2009 identifies the categories for transfers as being transfers received from other governmental units (national, provincial and local government (specific in the context of municipalities, district municipalities), higher educational institutions, foreign government and international organisations, public corporations, private enterprises, households and non-profit institutions. The Municipal Budget and Reporting Regulations, 2009 distinguish between transfers recognised operational and capital, contributions and public donations and contributed assets replaced in mSCOA with these categories.
12. *Principle 11: NERSA Regulatory Reporting Requirements -* NERSA as explained in the ‘*Regulatory Reporting Manual Volume 2: Electricity’* prescribes and provides guidance to the regulated entities in the electricity Supply Industry on the format, content, preparation and submission to the Energy Regulator of required information to enable NERSA to perform its functions. To avoid a dual accounting process for recording transactions for reporting to NERSA and another set of accounts for financial and budgetary reporting to the National Treasury, provided for in the mSCOA is the information needed in terms of the NERSA Regulation. NERSA is the custodian of the NERSA Regulatory Reporting Requirements and will oversee and enforce their requirements included in the relevant sets of legislation.
13. *Principle 12: Department of Water and Sanitation (DWS) Reporting Requirements –* The Department was instrumental in guiding and informing the setting-up of the classification requirements for the water and waste water functions municipalities provide. Important in the selection of accounts to be activated within the system application is the municipality’s readiness to comply with the DWS Reporting Requirements. DWS is the custodian of the Reporting Requirements and thus will oversee and enforce their requirements included in the relevant sets of legislation.
14. *Principle 13: Level of Detail -* Municipalities may add detail breakdown-levels in addition to that provided in the chart of accounts at their discretion. However, adding detail need to be carefully considered, being the exception rather than the principle. The indicators provided to guide on the posting level and breakdown required reflect the minimum requirements from the National Treasury’s perspective.

Discretionary breakdowns added by the municipality as explained ARE NOT INFORMATION National Treasury has an interest in and thus will not be part of the string downloaded for upload by the National Treasury: Local Government Database and Reporting System.

Breakdown required however, provides for information that MUST BE ADDED BY THE MUNICIPALITY and National Treasury has an interest therein.

Hence the table below explain the indicators used in the columns provided in the mSCOA Tables:

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| **Indicator** | **Yes** | **No** |
| **Posting Level** | Defines the level of capturing the transaction. | Not a posting level, therefore follows the guidance for breakdown required and the principle as explained for detail to be added. |
| **Breakdown Required** | The municipality is required to define the level for capturing the transaction, expand the parent-child code structure and adopt the guide of the parent. . | National Treasury is not interested in further detail, but the municipality may add detail at own discretion. This will not be extracted for reporting to National Treasury. |

1. *Principle 14: Applicability* - This column indicates the minimum requirements a municipality need to comply with in the implementation of this Item segment. If more information is needed than currently provided, please consult with the mSCOA Technical Committee to expand the existing segment detail to accommodate specific needs in this regard.
2. *Principle 15: Internal Billings, Departmental Charges and Activity Based Recoveries -* these elements are provided for in the Segment for Financial Modelling (the Costing segment). The cost collectors provided for are in accordance with the costing methodologies guideline proposed by the National Treasury. The allocations are based on the proposed standard and serve as guide on the minimum requirements for costs to be allocated. Due to the nature and complexity of internal charges and municipalities being in different stages of implementation this group of accounts would require customisation according to system requirements and the municipality’s progressive implementation thereof.
3. *Principle 16: Secondary Costing –* Secondary costing elements are to be extracted based on the departments charged for the use of municipal services and functions. The cost collectors provided for are in accordance with the costing methodologies guideline proposed by the National Treasury. The allocations provided are based on the proposed standard and serves as a guide on the minimum requirements for costs to be allocated. Due to the nature and complexity of secondary cost and municipalities being in different stages of implementation this group of accounts would require customisation according to system requirements and respective municipalities’ progressive implementation thereof.
4. *Principle 17: Account Number Structure –* The account structure comprises 13 levels of which the first level contains alphanumerical characters to identify the segment followed by capital, operational and default projects. The levels thereafter are based on the reporting structure providing for codes to be created by the municipality for projects which will be the posting level.

1. The Municipal Budget and Reporting Regulations, 2009. [↑](#footnote-ref-1)
2. Service Delivery- and Budget Implementation Plan. [↑](#footnote-ref-2)
3. Compliance to the Standard of GRAP in terms of presentation to be confirmed through mSCOA Project Phase 2 described in the Position Paper on Reporting. [↑](#footnote-ref-3)