

**NORTHERN
CAPE
EDUCATION
DEPARTMENT**

2008

[This policy outlines the identification, treatment, recording and disclosure of contingent liabilities of the department according to the requirements of the PFMA]

CONTINGENT LIABILITY POLICY

1. GENERAL

In terms of section 38(1) (d) of the PFMA and section 13.1.4 of the Treasury Regulations The accounting officer of a department is responsible for the management, including the safe-guarding and the maintenance of the assets, *and for the management of the liabilities*, of the department.

The accounting officer must report on all known contingent liabilities of the department in its annual report.

CONTINGENT LIABILITIES

DEFINITION

A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the department; or

A contingent liability is a present obligation that arises from past events but is not recognised because:

- It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
- The amount of the obligation cannot be measured with sufficient reliability.

2. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation
- ensure that contingent liabilities are detected, processed and recorded accurately in the annual financial statements.
- identify the circumstances in which contingent liabilities are recognised, measured and disclosed in the annual financial statements.
- to ensure that information on contingent liabilities in the notes to the financial statements to enable users to understand their nature, timing and amount.

3. RECOGNITION

ACCOUNTING POLICY

Contingent liabilities are included in the disclosure notes to the financial statements.

A contingent liability is disclosed, as required by paragraph 110 of GRAP, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.

4. PROCEDURES

The procedures for the treatment of contingent liabilities are described below:

A liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow on resources embodying economic benefits or service potential.

There are two types of obligations:

- A legal obligation is an obligation that derives from a contract (through its explicit or implicit terms, legislation or other operation of law).
- A constructive obligation is an obligation that derives from the department's actions that have created a valid expectation on the part of other parties that it will discharge those responsibilities. This valid expectation could arise as a result of an established pattern of past practice, published policies or sufficiently specific current statement indicating that the department will accept certain responsibilities.

To understand a contingent liability it is important to first understand the concept of a liability.

In an accrual environment, a liability is recognised when it is either *virtually certain* or *probable (more likely than not)* that the department has a present obligation, the settlement of which will require an outflow of economic benefits or service potential from the department.

A contingent liability is disclosed when it is *possible* that economic benefits will flow from the department, or when an outflow of economic benefits or service potential is probable but cannot be measured reliably.

This concept is illustrated in the table below:

Liabilities	Outflow of economic benefits/service potential		
	Probable (more likely than not)	Possible	Remote
Reliable estimate	Liability (consider including in the note on provisions)	Contingent liability (disclose)	Contingent liability (do nothing)
Not reliable estimate	Contingent liability (disclose)	Contingent liability (disclose)	Contingent liability (do nothing)

The type of disclosures required in the note on contingent liabilities in the financial statement are illustrated below:

Motor vehicle guarantees

The amount that must be disclosed in the departments annual financial statements is the lesser of:

- rand value of the amount guaranteed, or
- the amount outstanding on the loan.

as at financial year end. The guarantee will only be settled if a member defaults and the guarantee is called up and is therefore contingent upon that uncertain future event.

This information could be retrieved from Report #7.11.15 on the Persal application. Currently the department did not issue any motor vehicle guarantees and the abovementioned is only applicable for future issued guarantees.

Housing guarantees

The amount that must be disclosed is the rand value of the amount guaranteed as at financial year end.

Statement of financial guarantees issued

The following should be disclosed under each heading in the annexure if applicable:

- **Guarantor institution**

Name of the institution in respect of whose liabilities the guarantee was issued, e.g. Telkom, Land Bank, etc

- **Guarantee in respect of**

Examples would be capital markets loans 1/95, water purification plants, access roads to water project ST5, etc

- **Original guaranteed capital amount**

Capital amount for which the guarantee was issued and which appears on the guarantee documents.

- **Opening balance of guarantee**

The capital amount outstanding at the beginning of the financial year in respect of the guarantee amount is shown here (face value of bond loans). This amount must not include guaranteed interest.

- **Guarantees drawn down during the year**

The total amount in respect of draw downs on a guaranteed loan during the financial year.

- **Guarantees repayments/cancelled/reduced/released during the year**

The amount in respect of a guarantee repaid or realised during the financial year is shown here.

- **Currency revaluation**

The difference due to exchange rate movements on the closing balance. The rate of exchange to be used for the currency translation for foreign guarantees at financial year end will be the *South African Reserve Bank middle rate*.

- **Closing balance of guarantees**

The capital amount outstanding at financial year end in respect of the guarantee amount is shown here (face value of bond loans).

- **Guaranteed interest outstanding as from last date of interest until financial year end**

Where interest is also guaranteed, interest on the guaranteed amount as from the last date of interest paid until financial year end, is shown here. The amount must be disclosed separately in this column and not be included in the closing balance.

- **Realised losses i.r.o. claims paid out**

Losses realised in respect of claims paid out are to be shown here. As in the case of a housing loan to an official, a guarantee claim paid out is not necessarily a loss to the State, seeing that the amount paid can be recovered from the person in question. If such an amount cannot be recovered and has to be written off, it is regarded as a loss.

Note: Where interest is guaranteed, the guaranteed exposure is the sum of capital closing balance and guaranteed interest outstanding, and should be disclosed in the note

It is best practice for the department to agree the value of the guarantee with the guarantor prior to completing the disclosure requirements.

Claims

The amount that must be disclosed in the disclosure note to the annual financial statements of the Department is the estimated settlement value of claims instituted against the Department as at financial year end.

The claim will only be settled when either the court decides that the Department is liable or the Department accepts the liability, both of which are unknown.

Civil claims against the department that have **not** been settled (by a court order or mutually between the parties) must be included in **contingent liabilities**. Claims are normally overstated. The amount disclosed is not necessarily the claim amount, but rather the amount determined as the most likely amount that the court will settle on. "Most likely" must be determined by a qualified legal person (such as the State Attorney) or from departmental/provincial history.

The list of current, pending outstanding legal disputes as at financial year end should be obtained from legal services department internally and externally.

Special considerations

The following categories are used in respect of payments:

- Ex-gratia (excluding vehicle collisions)
- Vehicle collisions: Ex-gratia payments
- Payment of compensation: Other
- Vehicle collisions: Payments of compensation

Regulation 18(a) of the SA Police Service Act (Act No 68 of 1995) is applicable only in those cases where an official suffered a loss or damage to personal belongings, which are usually carried by such officials during the performance of official duties.

The following regulatory framework exists:

- Section 40 & 76 of the Public Finance Management Act, (Act No 1 of 1999)
- Treasury Regulations 12 and 22
- Regulations 18 issued in terms of the SA Police Service Act, (Act No 68 of 1995)
- Section 57 of the SA Police Service Act (Act No 68 of 1995)
- Apportionment of Damages Act, 1956 (Act No 34 of 1956)

Where final settlement was reached and payment was made

These payments will be expensed against the vote. Where final settlement was reached but payment is outstanding as at financial year end, it represents a provision and should be disclosed as such in a disclosure note.

5. ADDITIONAL

The contingent liability sub schedules which agree to the disclosure note should be checked and verified for mathematical errors and unrecorded contingent liabilities by the Chief financial officer.

All applications with its supporting documentation for guarantees by departmental officials should be placed on his/her files.

An interdepartmental unconfirmed balance checklists should be signed off by the Chief Financial Officer and be included in the disclosure note to the financial statements.

A register should be maintained during the financial year for any claims against the department.


CONTINGENT LIABILITY REGISTER

Nature of Liability	Opening Balance R	Liabilities incurred during the year R	Liabilities paid/cancelled/reduced during the year R	Liabilities recoverable(Provide details hereunder) R	Closing Balance R
Details					
Total	-	-	-	-	-

INTERDEPARTMENTAL UNCONFIRMED BALANCE LIABILITIES

Government Entity	Unconfirmed Balance Outstanding at year end R	Description	Total R
Department			
Total			

Head of Department


09/06/08
Approved

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[This policy outlines the identification, recording, disclosure and treatment of appropriated funds of the department according to the requirements of the PFMA]

APPROPRIATED FUNDS POLICY

1. GENERAL

Section 38(1) (a) (i) of the PFMA stipulates the following:

The accounting officer for a department must ensure that the department has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

BUDGETING AND APPROPRIATED FUNDS

DEFINITION

Appropriated funds are funds appropriated in terms of the National/Provincial Appropriation Act (including the National/Provincial Adjustments Appropriation Act) and the annual Division of Revenue Act (DORA).

2. PURPOSE

To outline policy and procedures for officials to have an understanding of budgeting and completion of the appropriation statement of the department in the annual financial statements.

3. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow for budgeting, recording and completion of the budget /appropriation statement;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation

4. RECOGNITION

Appropriated funds are recognised in the financial records on the date the appropriation becomes effective. Adjustments to the appropriated funds made in terms of the adjustments budget process are recognised in the financial records on the date the adjustments become effective.

Total appropriated funds are presented in the statement of financial performance.

Unexpended appropriated funds are surrendered to the Provincial Revenue Fund. Amounts owing to the Provincial Revenue Fund at the end of the financial year are recognised in the statement of financial position.

5. PROCEDURES

The amount to be shown in the Statement of Financial Performance is the “Final appropriation” amount as disclosed in the appropriation statement.

BAS accounting entries

The BAS accounting entries used to record the receipt and use of a department’s annual appropriation are illustrated below.

Once the department knows what its allocation of funds* will be for the year, the following entry is processed:

DR	Exchequer grant account	XXX	
CR	General account of the vote		XXX

** this transaction may also occur after the publication of the adjustments budget for a department*

When a department requests these funds (according to the monthly payment schedule), the following entries are captured*:

DR	Fund requisition account	XXX	
CR	Exchequer grant account		XXX

** the capturing of the fund requisition on BAS represents an accrual based transaction, because an entry is processed without cash actually being received.*

When the funds have been received from the relevant treasury the following entries are captured by the department:

DR	Bank account (departmental PMG account)	XXX	
CR	Bank exception account		XXX

The bank exception account, fund requisition and bank adjustment account are cleared as follows:

DR	Bank exception account	XXX	
CR	Bank adjustment account		XXX

DR	Bank adjustment account	XXX	
CR	Fund requisition account		XXX

Reconciliations should be performed which reconcile payments from the relevant revenue fund into the departmental PMG accounts. Those reconciliations should be part of the

departmental internal control procedures, and should be done monthly when there is still enough knowledge of the transaction to do it correctly.

At the end of the financial year the exchequer grant account is credited with the balance of the general account of the vote:

DR	General account of the vote	XXX	
CR	Exchequer grant account		XXX

All individual expenditure accounts are automatically* closed-off to the exchequer grant account at year-end.

DR	Exchequer grant account	XXX	
CR	Appropriate expenditure accounts		XXX

* These transactions are affected by a special authorised batch run for the March month-closure.

The balance on the exchequer grant account at the end of the financial year is explained below:

Exchequer grant account

Opening journal entry (appropriated amount available to a department)	Requisition of funds made during the year credited to this account (the balance on this account during the year will indicate the drawings still available to the department)
Total expenditure incurred during the year (all expenditure accounts are closed-off to this account)	Closing journal entry of the general account of the vote (representing total final appropriation)
XXX	XXX

DEBIT balance in this account means that the department's expenditure was more than the Appropriation Act. This amount must be journalised to the unauthorised expenditure suspense account.

CREDIT balance in this account means that the department's expenditure was less than the Appropriation Act. This amount must be paid to the relevant revenue fund.

6. Legislation

s43(1) (PFMA)	<p>In terms of section 43(1) of the PFMA, an accounting officer is empowered to utilise a saving in the amount appropriated under a main division within a vote, towards the defrayment of excess expenditure under another main division within the same vote, unless the relevant treasury directs otherwise.</p>
TR 6.3.1	<p>With the issuing of Treasury Regulation 6.3.1, National Treasury has directed that the utilisation of savings towards the defrayment of certain categories of excess expenditure be subject to treasury approval. In this regard, this regulation indicates that:</p> <ul style="list-style-type: none"> • Compensation of employees and transfers and subsidies to other institutions excluding transfers of regional service council levies and municipal rates and taxes may not be increased without approval of the relevant treasury; • New transfers and subsidies may not be introduced without the approval of the relevant treasury; and • Allocations earmarked by the relevant treasury for a specific purpose (excluding compensation of employees) may not be used for other purposes, except with its approval. • Virement of funds from compensation of employees to transfers and subsidies for the payment of severance/exit packages are excluded from the provisions of (a) and (b).
s43(2) (PFMA)	<p>Section 43(2) of the PFMA places a proviso that the amount of the saving in section 43(1) may not exceed 8 per cent of the amount appropriated under that main division.</p> <p>The intention of the Legislature regarding section 43(2) was not primarily to limit virements but rather to:</p> <ul style="list-style-type: none"> • Ensure proper planning and allocation of funds to various programmes in accordance with government's policies and priorities; and • Ensure that spending by departments is in accordance with appropriations made by legislatures so as to address the specific needs of communities. <p>The Act, however, does not make provision for the relevant treasury to approve amounts in excess of 8 per cent.</p>
s43(4) (PFMA)	<p>Further, section 43(4) of the PFMA does not authorise the utilisation of a saving on:</p> <ul style="list-style-type: none"> • an amount specifically and exclusively appropriated for a purpose mentioned under a main division within a vote; • an amount appropriated for transfer to another institution; and • an amount appropriated for capital expenditure to defray current expenditure <p>Although the 8% limitation and other virement limitations may seem impractical, the relevant sections</p>

	<p>in the PFMA relating to the shifting of funds and appropriation processes were drafted in such a manner so as to allow sufficient flexibility for accounting officers to deal with such. This approach is consistent with one of the objectives of the PFMA, which is to enable public sector managers to manage, but at the same time be more accountable</p>
s43 (PFMA)	<p>Section 43 of the PFMA should be applied as follows:</p> <p>After approval of the Appropriation Bill by the legislature, the accounting officer can shift up to 8% savings under a programme (subject to transfer and capital limitations) towards the defrayment of excess expenditure under another programme.</p>
s31(2)(f) (PFMA)	<p>In terms of section 31(2) (f) of the PFMA, shifting of funds by the accounting officer between programmes must be reflected in the Adjustments Estimate.</p>
s31(2)(e) (PFMA)	<p>Apart from the aforementioned adjustments and in terms of section 31(2)(e) of the PFMA, the Adjustments Estimate can provide for the further shifting of funds (unlimited) between and within votes for approval by <u>the legislature</u>.</p> <p>After the finalisation of the Adjustments Estimate appropriation process, the accounting officer can <u>again</u> shift up to 8% of savings under a programme to defray excess expenditure under another programme. The accounting officer's authority to shift funds after appropriation by the legislature is therefore not limited to appropriations in the main budget.</p> <p>The shifting of funds by the accounting officer after the Adjustments Estimate must be reflected in the annual financial statements, which must be tabled in the legislature for discussion.</p> <p>The aforementioned application of virement emphasises the importance of proper planning in the allocation of funds, effective in-year management of expenditure and taking corrective actions in instances of variances between actual and budgeted expenditure. These issues have become crucial in order to comply with the PFMA and have been dealt with in the 'Guidelines for Accounting Officers' and the best practice guideline on 'In Year Management, Monitoring and Reporting'. The aforementioned documents are available on National Treasury's PFMA web page http://www.treasury.gov.za/pfma</p>

7. ADDITIONAL

- The comparative figures for appropriated funds should at all times agree to the prior year as indicated in the annual report.
- The final appropriation as stated should agree to the adjustment estimates of the department
- The figures as completed on the appropriation statement should agree to the BAS expenditure reports and correctly classified between current, capital, transfers etc
- Any variances between the final appropriation and actual funds received for the financial year should be followed up with Provincial Treasury. Rollover of funds could be considered.

- Expenditure which exceeds the final appropriation budget should be accounted for in accordance with the unauthorised expenditure policy.
- The department considers any amount in excess of **5% of the appropriated funds as material**. Therefore all variances in excess of 5% are explained.
- After the finalisation of the budget, the budget unit must record the budget on BAS.
- The budget should be reviewed by the Chief Financial Officer after it has been loaded onto BAS.
- The monthly In Year Monitoring report must be submitted to Provincial Treasury by the fifteen of each month. If the fifteen falls on a weekend, it must be submitted on the first working day of the following week.
- The In year Monitoring report must at the least contain with the following:
 - a) Prescribed format;
 - b) Include actual revenue and expenditure for the preceding month;
 - c) Include actual revenue and expenditure for the current month;
 - d) Submitted to both Provincial Treasury and the executive authority;
 - e) Includes projections on the remainder of the financial year;
 - f) Includes explanations on material variances;
 - g) Includes summary steps to be taken to ensure projections remain within the budget.

Rollover of funds

- All rollovers incurred by the department should be approved by the accounting officer or his/her delegate.
- Rollover of funds should only be used for the purpose of which the rollover was requested for.
- Request for rollover of funds should be submitted to Treasury on or before the last working day of April of each year.
- Rollover of funds should not be request for more than two consecutive financial years, unless approved by Treasury

Virement


- All virements conducted during the financial year, should be approved by the accounting officer or his/her delegate.
- The amount of saving under a programme of a vote that may be utilised to defray over-expenditure in another program may not exceed eight percent of the amount appropriated under that programme. Virement in excess of 8% must be approved by Provincial Treasury.

- A schedule of virements must be submitted to Provincial Treasury within 7 working days after financial year end.
- Savings may not be utilised for the following:
 - a) an amount specifically and exclusively appropriated for a purpose mentioned under the programme within a vote;
 - b) an amount appropriated for transfer to another institution; and
 - c) an amount appropriated for capital expenditure in order to defray over-expenditure on current expenditure.
- Personnel expenditure and transfers to other institutions must not be increased without approval of Provincial Treasury;
- New transfers must not be introduced without the approval of the Provincial Treasury
- Virement of funds from employee costs to transfers and subsidies for the payment of severance/exit packages are allowed.

Shifting of funds

- Shifting of funds between programmes during the financial year end/adjustment estimates should be approved by the accounting officer or his/her delegate.
- The shifting of funds and virement schedules must at all times agree to the appropriation statement.

Approved

 09/06/08

Head of Department

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[This policy outlines the identification, treatment, recording and disclosure of employee benefits of the department according to the requirements of the PFMA]

EMPLOYEE BENEFITS POLICY

1. GENERAL

In terms of section 38(1) (d) of the PFMA and section 13.1.4 of the Treasury Regulations The accounting officer of a department is responsible for the management, including the safe-guarding and the maintenance of the assets, and for the management of the liabilities, of the department.

EMPLOYEE BENEFITS

2. DEFINITION

Employee benefits can be defined as benefits that employees accumulate as a result of rendering their services to an employer up to the reporting date.

3. PURPOSE

To outline policy and procedures for officials to have an understanding of employee benefits and the accounting treatment thereof in the annual financial statements.

4. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Department's resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation
- ensure that employee benefits are adequately disclosed in the annual financial statements.

5. RECOGNITION

ACCOUNTING POLICY

Short-term employee benefits that give rise to a present legal or constructive obligation are disclosed in the disclosure notes to the financial statements. These amounts are not recognised in the statement of financial performance or the statement of financial position..

6. PROCEDURES

The procedures for the treatment of employee benefits are described below:

Not all employee benefits are recognised under the cash basis of accounting. Therefore certain benefits that give rise to a present legal or constructive obligation is shown in the disclosure notes to the annual financial statements.

Employee benefits should be made up of the following accrual amounts:

- Leave entitlement (see calculations below) *(Report #7.11.13)
- Thirteenth cheque (amounts payable as at year-end) *(Report #7.11.14)
- Performance bonuses (amounts payable as at year-end) *(Manual report prepared by the Human Resource Development Unit)

** Reports per the Persal application*

The following types of leave payouts have to be disclosed:

Leave payouts in the event of death, retirement and medical boarding

Officials are entitled to payouts of capped leave credits as well as leave credits in respect of the current and previous leave cycle.

Calculation:

$$\frac{\{(A - B) + (C - D) + E\} \times F}{261}$$

Where

A	=	Full annual or pro rata leave entitlement in a leave cycle
B	=	Leave taken in the previous leave cycle
C	=	Pro rata leave entitlement in the new leave cycle
D	=	Leave taken in the new leave cycle
E	=	Capped leave
F	=	Employee's annual basic salary as at the last day of duty

Leave payouts in the event of Casual Employees

Employees who have been in employment for longer than 4 months are entitled to payments in respect of any unused annual leave credits in event of termination of their services.

With effect of 1 June 2000 casual employees are entitled to one (1) day annual leave for every 17 days worked.

Calculation:

Hourly rate:	Daily rate:	Monthly rate
$A \times 8 \times B$	$C \times B$	$D \times B$
		----- 22

Where

A	=	The total remuneration per hour
B	=	The number of days of annual leave credits
C	=	The total remuneration per day
D	=	The total remuneration per month

Leave payouts in the event of service termination

Officials are only entitled to a payout in respect of leave credits accumulated for the current and the previous leave cycle, to a maximum of 22 days.

All capped leave is forfeited.

Calculation:

$$\frac{\{(A - B) + (C - D)\} \times F}{261}$$

Where –

A	=	Full annual or pro rata leave entitlement in a leave cycle
B	=	Leave taken in the previous leave cycle
C	=	Pro rata leave entitlement in the new leave cycle

D	=	Leave taken in the new leave cycle
F	=	Employee's annual basic salary as at the last day of duty

Leave payouts in the event of employer denying and not rescheduling leave as a result of service delivery requirements/ operational requirements.

Such leave must be paid out to the employer at the end of 18 months leave cycle taking into consideration the leave policy of the department.

Calculation:

$$\frac{A \times F}{261}$$

Where

A	=	Leave days denied
F	=	Employee's annual basic salary

Leave payouts in the event of long service recognition

- A. Employee who has rendered 20 years of continuous and consistently satisfactory service for the government. Ten days vacation leave at the employee's current salary, if the employee has accrued that much leave and wishes to exchange it for cash.
- B. Employee who has rendered 30 years of continuous and consistently satisfactory service for the government. Fifteen days vacation leave at the employee's current salary, if the employee has accrued that much leave and wishes to exchange it for cash.

Definitions:

Leave cycle: 1 January to 31 December of the same year.

18 month period: An additional six (6) months is added to the leave cycle (12 months) during which

remaining leave days must be taken,
thereafter credits are forfeited.

Capped leave: Leave credits due to employees as at 30 June 2000, in terms of the provisions that were in place at that time. The relevant credits must be audited and capped on PERSAL.

Casual employees: Employees appointed on an hourly, daily or monthly basis.


Basic Salary: Basic salary with the exclusion of benefits.

Total remuneration of casual employees: Basic salary, benefits any payment in kind, excluding any discretionary payment that are not related to her or his work performance.

7. ADDITIONAL

- Leave transactions must be captured on a timely basis before financial year end.
- Leave entitlement reports must be requested on PERSAL and all negative leave balances must be investigated and rectified before financial year end.
- Note that in this note, only the accrual amount is shown and not the amount that was actually/physically paid. The paid part is shown under compensation of employees as discussed under the statement of financial performance. Amounts are calculated according to criteria, formulas and conditions as prescribed by DPSA frameworks, practice notes and circulars.
- A schedule of employee benefits must be drawn and submitted to the Chief Financial Officer for review purposes, before the figures are disclosed in the annual financial statements.
- The schedule drawn up should agree to the disclosure note of the annual financial statements.

Approved

 09/06/08

Head of Department

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[This policy outlines the identification, recording, disclosure and treatment of key management personnel expenditure of the department according to the requirements of the PFMA]

**KEY MANAGEMENT PERSONNEL
EXPENDITURE POLICY**

1. GENERAL

Section 38(1) (a) (i) of the PFMA stipulates the following:

The accounting officer for a department must ensure that the department has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

KEY MANAGEMENT PERSONNEL

DEFINITION

Key management personnel are:

- (a) all senior managers of the department;
- (b) other persons having the authority and responsibility for planning, directing and controlling the activities of the department. Where they meet this requirement key management personnel include:
 - (i) where there is a member of the governing body of a whole-of-government entity who has the authority and responsibility for planning, directing and controlling the activities of the reporting entity, that member [e.g. MEC];
 - (ii) any key advisors of that member; and

unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity e.g. Accounting Officer

2. PURPOSE

To outline policy and procedures for officials to have an understanding of key management personnel expenditure and the accounting treatment thereof in the annual financial statements.

3. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow for key management personnel expenditure transactions;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation
- ensure that key management personnel expenditure is detected, processed and recorded timeously.

4. RECOGNITION

ACCOUNTING POLICY

Compensation paid to key management personnel including their family members where relevant, is included in the disclosure notes.

5. PROCEDURES

The procedures for the treatment and disclosure of key management personnel expenditure are described below:

Key management members are those persons having the authority and responsibility for planning, directing and controlling the activities of the department. Senior management, from level 14 and above, is included in the disclosure note to the financial statements.

This may include the MEC and Deputy Director General responsible for the department, the Chief Financial Officer (CFO) and any key advisors. It is unlikely that all members of the Senior Management Service are also key management. Where any key personnel is below level 14, his/her remuneration should be included with the level 14 values.

Remuneration includes:

Short term employee benefits such as salaries, contributions to unemployment insurance and workmen's compensation funds, paid annual leave and paid sick leave, profit sharing and bonuses and non-monetary benefits such as medical benefits, housing, cars and free or subsidised goods and services,

Post employment benefits such as pensions, other retirement benefits, post-employment life insurance and medical care,

Other long term employee benefits, including long-service leave or sabbatical leave, long term disability benefits and deferred compensation,

Termination benefits, and

Remuneration to close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity (where these individuals are paid by the department).

The aggregate compensation of the senior management of the department and the number of individuals determined on a full time equivalent basis received remuneration within this category, showing separately major levels of senior management must be disclosed.

6. ADDITIONAL

- **Close members of the family of an individual** are presumed to be included:
 - (a) A spouse, domestic partner, dependent child or relative living in a common household;
 - (b) A grandparent, parent, nondependent child, grandchild, brother or sister; and
- The spouse or domestic partner of a child, a parent-in-law, a brother-in-law or a sister-in-law.
- A report on remuneration from persal should be requested of all officials on level 14 and above for inclusion in the financial statements.
- A schedule of all key management personnel identified should be drawn up from the information provided on the persal reports with the remuneration details.
- This schedule should be reviewed by the chief financial officer to ensure that all identified key management personnel are recorded and that the schedule is accurate.
- Only remuneration from April to March of a financial year should be recorded in the schedule. Members of key management personnel that commenced duties during the reported financial period, his/her remuneration should be recorded from the commencement date to the year-end month and NOT the entire period equivalent for 12 months.
- The schedule drawn up should agree to the disclosure note of the annual financial statements.

Approved

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DEPARTMENT

2008

[This policy outlines the identification, recording, disclosure and treatment of unauthorized expenditure of the department according to the requirements of the PFMA]

UNAUTHORISED EXPENDITURE POLICY

1. GENERAL

Section 38(1) (a) (i) of the PFMA stipulates the following:

The accounting officer for a department must ensure that the department has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Section 9.1.1 of the Treasury Regulations stipulates the following:

The accounting officer of an institution must exercise all reasonable care to prevent and detect unauthorised, irregular, fruitless and wasteful expenditure, and must for this purpose implement effective, efficient and transparent processes of financial and risk management.

UNAUTHORISED EXPENDITURE

DEFINITION

Unauthorised Expenditure is the overspending of a vote or a main division within a vote; or expenditure that was not made in accordance with the purpose of a vote or, in the case of a main division, not in accordance with the purpose of the main division.

2. PURPOSE

To outline policy and procedures for officials to have an understanding of unauthorised expenditure and the accounting treatment thereof.

3. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow for unauthorised expenditure transactions;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation
- ensure that unauthorised expenditure is detected, processed and recorded timeously.

4. RECOGNITION

ACCOUNTING POLICY

When discovered unauthorised expenditure is recognised as an asset in the Statement of Financial Position until such time as the expenditure is either approved by the relevant authority, recovered from the responsible person or written off as irrecoverable in the Statement of Financial Performance.

Unauthorised expenditure approved with funding is recognised in the Statement of Financial Performance when the unauthorised expenditure is approved and the related funds are received.

Where the amount is approved without funding it is recognised as expenditure, subject to availability of savings, in the Statement of Financial Performance on the date of approval

5. PROCEDURES

The procedures for the treatment of unauthorised expenditure are described below:

When unauthorised expenditure occurs the rand value of the unauthorised expenditure must be surrendered to Provincial treasury (i.e. the expenditure of the department is reduced with the unauthorised expenditure and paid back to Treasury, refer to step (f) below). The remainder of the vote may be utilised for authorised expenditure (except for where it is utilised to clear prior year unauthorised expenditure approved without funding).

5.1 Discovery, investigation and reporting of unauthorised expenditure

- (a) any employee who becomes aware of or suspects the occurrence of unauthorised expenditure should immediately report, in writing, such expenditure to the Accounting Officer or his/her delegate;
- (b) on discovery of alleged unauthorised expenditure, such expenditure should be left in the expense account and the Accounting Officer or his/her delegate should record the details of the expenditure in an unauthorised expenditure register
- (c) the Accounting Officer or his/her delegate should investigate the alleged unauthorised expenditure to determine whether the expenditure meets the definition of unauthorised expenditure. During the period of the investigation the expenditure must remain in the expense account. The results of the investigation will determine the appropriate action to be taken regarding this expenditure;
- (d) should the investigation reveal that the expenditure is in fact valid expenditure and therefore does not constitute unauthorised expenditure the details of the expenditure should be retained in the register for the purposes of completion (and to provide an appropriate audit trail). The register should therefore be updated to reflect the outcome of the investigation;
- (e) once an investigation has been concluded and the results verify that the expenditure constitutes unauthorised expenditure, the Accounting Officer must immediately

report, in writing, the particulars of the unauthorised expenditure to Provincial Treasury;

- (f) valid unauthorised expenditure must be disallowed by reducing the total expenditure in the statement of financial performance and creating a corresponding receivable/debt account in the statement of financial position. This entry must be recorded as soon as the investigation reveals that the expenditure meets the definition of unauthorised expenditure. The register should be updated to reflect the outcome of the investigation;
- (g) in addition to (f) above the unauthorised expenditure should also be included in the entity's monthly report on revenue and expenditure as submitted by the Accounting Officer to Provincial Treasury. (The monthly report on revenue and expenditure is separate from the special report prepared by the Accounting Officer dealing with the specific occurrence of unauthorised expenditure);

5.2 Obtaining approval for unauthorised expenditure

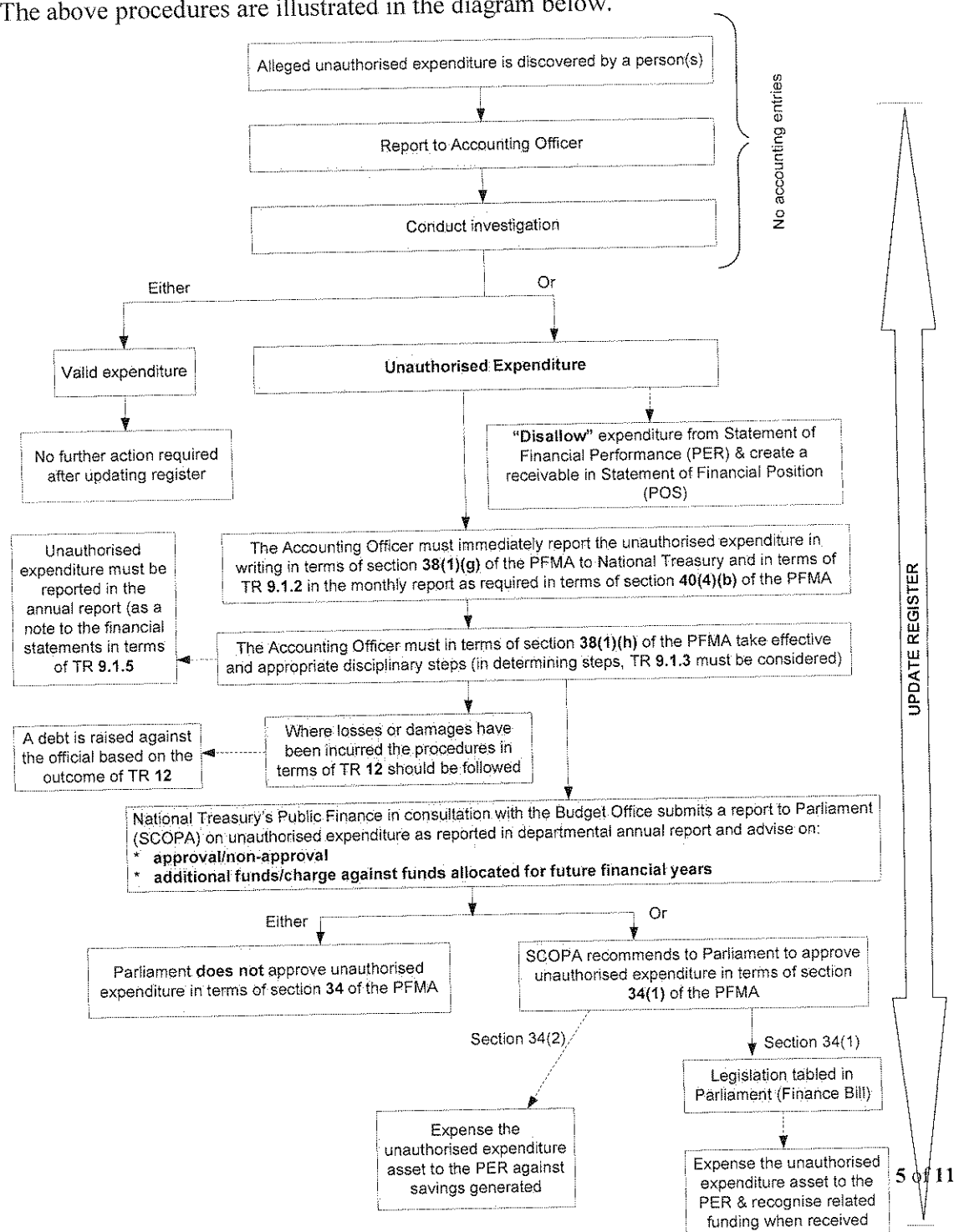
- (h) based on the reports submitted by the Accounting Officer, the relevant Auditor-General's audit reports and other sources of information, National Treasury prepares a report detailing the various instances of unauthorised expenditure relating to all entities. The report on unauthorised expenditure is submitted to the Standing Committee on Public Accounts (SCOPA) and advises on:
 - i. Approval/non-approval of the unauthorised expenditure; and
 - ii. How the unauthorised expenditure should be funded.
- (i) based on the report submitted to it in terms of (h), SCOPA will make a recommendation to Parliament whether or not to approve the unauthorised expenditure. If SCOPA recommends the approval of the unauthorised expenditure it must also recommend whether the unauthorised expenditure should be treated as a direct charge against a Revenue Fund or a charge against the funds allocated for the next or future years under a relevant vote;
- (j) SCOPA then presents the report to Parliament for consideration. If Parliament approves the unauthorised expenditure the report is sent to the Minister of Finance for inclusion in the Finance Bill. The Minister of Finance tables the Finance Bill in Parliament. Only once the Finance Bill has been passed by Parliament is the unauthorised expenditure formally approved;

Take Note: The necessary transaction to be passed in the accounting records of the department is only required once the cash has been received (refer to accounting policy and (l) below). If the funds have not been received before year-end the department should disclose this fact in the notes.

- (k) if Parliament approves the amount of unauthorised expenditure but does not approve an additional amount for the overspending, that amount becomes a charge against the funds allocated for the next or future financial years under the relevant vote. In other words the overspending must be funded by a department's future savings achieved against its vote or funds available due to reprioritisation of expenditure;

- (l) if the unauthorised expenditure was approved with funding prior to or at the end of the financial year but the funds were only received after 31 March, the department must disclose this fact in the unauthorised expenditure note. The accounting entries can only be passed once the funds have been received.
- (m) The approval for the unauthorised expenditure of the department of Education vests with the Provincial Legislature.

The above procedures are illustrated in the diagram below.



The BAS accounting entries used to record the transactions relating to unauthorised expenditure are illustrated below.

If the unauthorised expenditure relates to the current financial year:

If any expenditure meets the definition of unauthorised expenditure (after an investigation):

DR	Unauthorised expenditure (POS)*	XXX	
CR	Unauthorised expenditure (PER)*		XXX

** POS = Statement of Financial Position & PER = Statement of Financial Performance*

A current asset is created on the statement of financial position, and the expenditure is “reversed” and presented on the statement of financial performance as ‘Add back unauthorised expenditure’.

If the unauthorised expenditure relates to a previous financial year

If any expenditure meets the definition of unauthorised expenditure (after an investigation):

DR	Unauthorised expenditure (POS)	XXX	
CR	Exchequer grant account		XXX

A current asset is created on the statement of financial position, and the available voted funds are reduced. The unauthorised expenditure is presented on the face of the statement of position and performance using the ‘Add back unauthorised expenditure’.

Unauthorised expenditure is approved by Parliament – with funding

When the department receives the funds from the relevant treasury:

DR	Unauthorised expenditure (PER)^	XXX	
CR	Unauthorised expenditure (POS)		XXX

^ This amount is disclosed as ‘Unauthorised Expenditure Approved’ on the statement of financial performance and classified as either as current, capital or transfers & subsidies.

Because the expenditure was approved, it is removed (credited) from the current asset that was created and included under unauthorised expenditure approved.

The increase in the vote is recorded as follows:

DR	Exchequer grant account	XXX	
CR	General account of the vote [#]		XXX

[#] The additional funds received is presented on the statement of financial performance as ‘Appropriation for unauthorised expenditure approved’.

Unauthorised expenditure to be written off against savings

DR	Unauthorised expenditure (PER) ^	XXX	
CR	Unauthorised expenditure (POS)		XXX

^ This amount is disclosed as 'Unauthorised Expenditure Approved' on the statement of financial performance and classified as either as current, capital or transfers & subsidies.

The amount written-off is limited to any savings utilised.

REGISTER OF UNAUTHORISED EXPENDITURE (UE)
NORTHERN CAPE EDUCATION DEPARTMENT

Date of discovery	Reported to Accounting Officer (date)	Transaction details				Responsible person (committed the UE)	Status (refer to key)				General comments
		Payment date	Payment number	Amount	Incident description		UI	DP	AA	A	

Key: UI - Unauthorised expenditure Under Investigation
 DP - Disciplinary process initiated against responsible person
 AA - Awaiting approval by Legislature
 A - Approved by Legislature

6. APPLICABLE LEGISLATION

<p>s34(1)2 (1) (PFMA)</p>	<p>Unauthorised expenditure does not become a charge against a Revenue Fund except when-</p> <ul style="list-style-type: none"> (a) the expenditure is an overspending of a vote and Parliament or a provincial legislature, as may be appropriate, approves, as a direct charge against the Relevant Fund, an additional amount for that vote which covers the overspending; or (b) the expenditure is unauthorised for another reason and Parliament or a provincial legislature, as may be appropriate, authorises the expenditure as a direct charge against the relevant Revenue Fund. <p>(2) If parliament or a provincial legislature does not approve in terms of subsection (1)(a) an additional amount for the amount of any overspending, that amount becomes a charge against the funds allocated for the next or future financial years under the relevant vote.</p>
<p>TR 9.1.1</p>	<p>The accounting officer of an institution must exercise all reasonable care to prevent and detect unauthorised, irregular, fruitless and wasteful expenditure, and must for this purpose implement effective, efficient and transparent processes of financial and risk management.</p>
<p>TR 9.1.2</p>	<p>When an official of an institution discovers unauthorised, irregular or fruitless and wasteful expenditure, that official must immediately report such expenditure to the accounting officer. In the case of a department, such expenditure must also be reported in the monthly report, as required by section 40(4)(b) of the Act. Irregular expenditure incurred by a department in contravention of tender procedures must also be brought to the notice of the relevant tender board or procurement authority, whichever applicable.</p>
<p>TR 9.1.3</p>	<p>When an accounting officer determines the appropriateness of disciplinary steps against an official in terms of section 38(1)(g) of the Act, the accounting officer must take into account –</p> <ul style="list-style-type: none"> (a) the circumstances of the transgression; (b) the extent of the expenditure involved; and (c) the nature and seriousness of the transgression.
<p>TR 9.1.4</p>	<p>The recovery of losses or damages resulting from unauthorised, irregular or fruitless and wasteful expenditure must be dealt with in accordance with regulation 12.</p>
<p>TR 9.1.5</p>	<p>The amount of the unauthorised, irregular, fruitless and wasteful expenditure must be disclosed as a note to the annual financial</p>

statements of the institution.

TR	An accounting officer may only write off debts owed to the State if he or she is satisfied that –
	(a) all reasonable steps have been taken to recover the debt and the debt is irrecoverable, or,
	(b) he or she is convinced that –
	(i) recovery of the debt would be uneconomical;
	(ii) recovery would cause undue hardship to the debtor or his or her dependants; or
	(iii) it would be to the advantage of the state to effect a settlement of its claim or to waive the claim.
TR 11.4.2	An accounting officer must ensure that all debts written off are done in accordance with a write off policy determined by the accounting officer.
TR 11.4.3	All debts written off must be disclosed in the annual financial statements, indicating the policy in terms of which the debt was written off.

TR 12.7.1	Losses or damages suffered by an institution because of an act committed or omitted by an official, must be recovered from such an official if that official is liable in law.
TR 12.7.2	The accounting officer must determine the amount of the loss or damage and, in writing, request that official to pay the amount within 30 days or in reasonable installments. If the official fails to comply with the request, the matter must be handed to the State Attorney for the recovery of the loss or damage.
TR 12.7.3	A claim against an official must be waived if the conditions in paragraph 12.2.1(a) to (g) are not applicable.
TR 12.7.4	If in doubt, the accounting officer of the institution must consult the State Attorney on questions of law in the implementation of paragraphs 12.7.1 and 12.7.3.

7. **ADDITIONAL**

- All expenditure identified as unauthorised expenditure in terms of the definition should be recorded in the departmental unauthorised expenditure register by the Supply chain management and Finance units.
- The Financial accounting unit should complete the pre-audit and post audit checklists to ensure that all payments complies with the relevant laws and regulations and investigate any payments that are not in accordance with the purpose of the main divisions or vote of the department.
- Payments incurred which are not in accordance with the purpose of the main divisions or vote of the department should be disclosed in the register of the department.
- The precise amount as stated on the invoice/payment batch should be recorded in the unauthorised expenditure register.
- The unauthorised expenditure register should be reviewed by the Chief Financial Officer of the department. This review will ensure that unauthorised expenditure is adequately disclosed and dealt with, ensuring that no mathematical errors exists etc
- Unauthorised expenditure identified during one financial period, but not paid in that specific period should be recorded and accounted for in the following financial year.
- The opening balance of unauthorised expenditure in the financial statements should at all times agree to the closing balance of the prior year's financial statements.
- The unauthorised expenditure approved during the current financial year should be correctly allocated between current, capital, transfers and subsidies etc
- The accumulative unauthorised expenditure incurred at financial year end should be adequately and appropriately disclosed in the financial statements of the department. The figures should at all times agree to the general ledger on BAS.

Approved



09/06/08

Head of Department

NORTHERN
CAPE
EDUCATION
DEPARTMENT

2008

[This policy outlines the identification, recording, disclosure and treatment of fruitless and wasteful expenditure of the department according to the requirements of the PFMA]

**FRUITLESS AND WASTEFUL
EXPENDITURE POLICY**

1. GENERAL

Section 38(1) (a) (i) of the PFMA stipulates the following:

The accounting officer for a department must ensure that the department has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Section 9.1.1 of the Treasury Regulations stipulates the following:

The accounting officer of an institution must exercise all reasonable care to prevent and detect unauthorised, irregular, fruitless and wasteful expenditure, and must for this purpose implement effective, efficient and transparent processes of financial and risk management.

FRUITLESS AND WASTEFULL EXPENDITURE

DEFINITION

Fruitless and wasteful expenditure means expenditure which was made in vain and would have been avoided had reasonable care been exercised.

2. PURPOSE

To outline policy and procedures for officials to have an understanding of fruitless and wasteful expenditure and the accounting treatment thereof.

3. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow for fruitless and wasteful expenditure transactions;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation
- ensure that fruitless and wasteful expenditure is detected, processed and recorded timeously.

4. RECOGNITION

ACCOUNTING POLICY

Fruitless and wasteful expenditure is recognised as an asset in the Statement of Financial Position until such time as the expenditure is recovered from the responsible person or written off as irrecoverable in the Statement of Financial Performance.

5. PROCEDURES

The procedures for the treatment of fruitless and wasteful expenditure are described below:

Fruitless and wasteful expenditure should not be a charge against the vote of a department. Therefore, when fruitless and wasteful expenditure occurs the rand value is subtracted (paid back to provincial treasury) from the amount to the department by provincial legislature. The remainder of the vote may be utilised for authorised expenditure.

The procedures for the treatment of fruitless and wasteful expenditure are described below:

5.1 Discovery, investigation and reporting of fruitless and wasteful expenditure

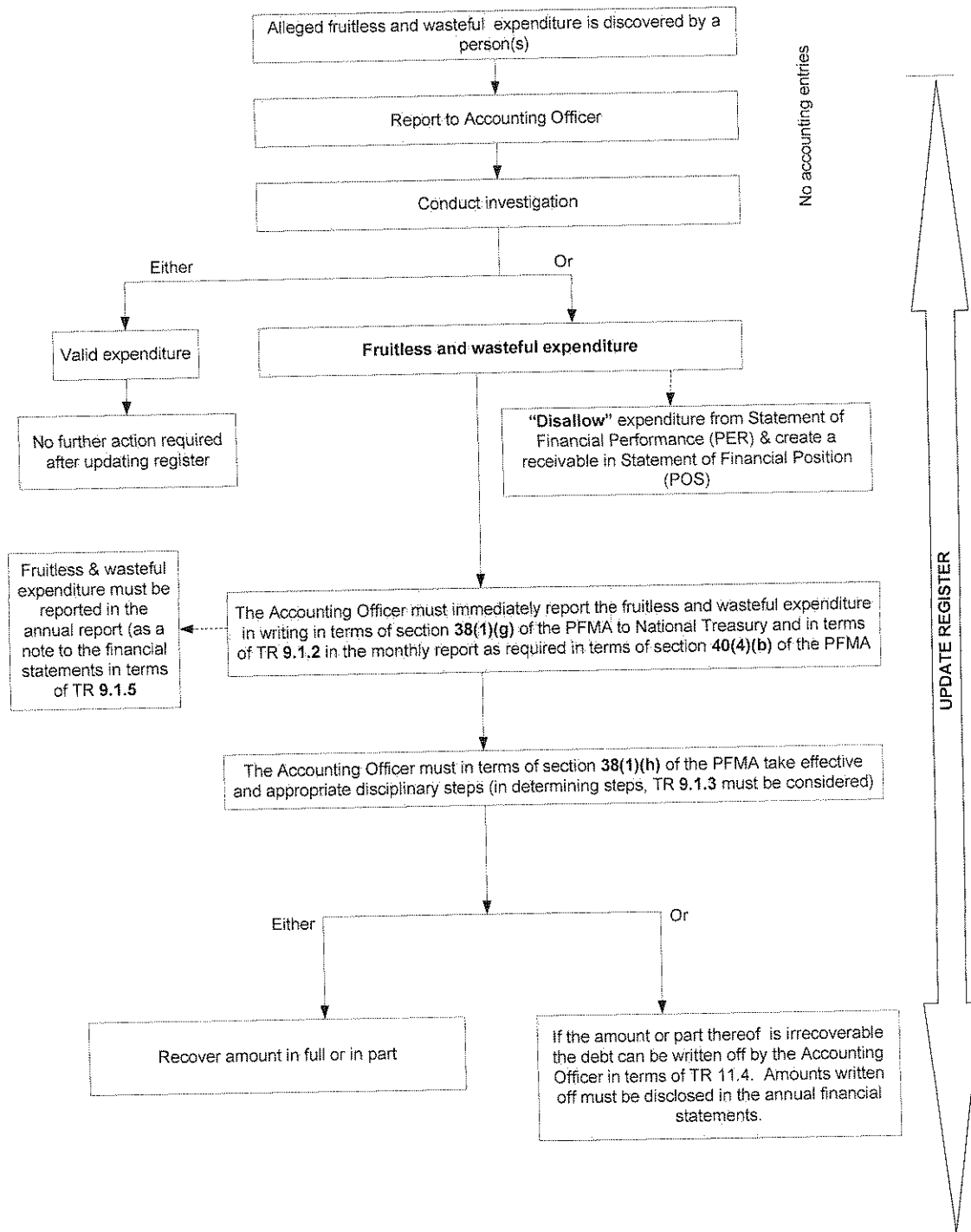
- (a) any employee who becomes aware of or suspects the occurrence of fruitless and wasteful expenditure should immediately report, in writing, such expenditure to the Accounting Officer or his/her delegate;
- (b) on discovery of alleged fruitless and wasteful expenditure, such expenditure should be left in the expense account and the Accounting Officer or his/her delegate should record the details of the expenditure in an fruitless and wasteful expenditure register;
- (c) the Accounting Officer or his/her delegate should investigate the alleged fruitless and wasteful expenditure to determine whether the expenditure meets the definition of fruitless and wasteful expenditure. During the period of the investigation the expenditure must remain in the expense account. The results of the investigation will determine the appropriate action to be taken regarding this expenditure;
- (d) should the investigation reveal that the expenditure is in fact valid expenditure and therefore does not constitute fruitless and wasteful expenditure the details of the expenditure should be retained in the register for the purposes of completion (and to provide an appropriate audit trail). The register should therefore be updated to reflect the outcome of the investigation;
- (e) once an investigation has been concluded and the results verify that the expenditure constitutes fruitless and wasteful expenditure, the Accounting Officer must immediately report, in writing, the particulars of the fruitless and wasteful expenditure to the Provincial Treasury;
- (f) valid fruitless and wasteful expenditure must be disallowed by reducing the total expenditure in the statement of financial performance and creating a corresponding receivable/debt account in the statement of financial position. This entry must be

recorded as soon as the investigation reveals that the expenditure meets the definition of fruitless and wasteful expenditure. The register should be updated to reflect the outcome of the investigation;

- (g) in addition to (f) above the fruitless and wasteful expenditure should also be included in the entity's monthly report on revenue and expenditure as submitted by the Accounting Officer to Provincial Treasury. (The monthly report on revenue and expenditure is separate from the special report prepared by the Accounting Officer dealing with the specific occurrence of fruitless and wasteful expenditure);

5.2 Recovery of fruitless and wasteful expenditure

- (h) the Accounting Officer (or his/her delegate) must determine who the responsible part is from whom the amount should be recovered. This information would normally become evident while performing the investigation;
- (i) the Accounting Officer (or his/her delegate) must in writing request that the official pay the amount within 30 days or in reasonable instalments. If the official fails to comply with the request, the matter may be handed to the state Attorney for the recovery of the debt;
- (j) If the amount is not recoverable the Accounting Officer may write the debt off in terms of TR section 11.4;



The BAS accounting entries used to record the transactions relating to fruitless & wasteful expenditure are illustrated below.

If the fruitless and wasteful expenditure relates to the current financial year:

If any expenditure meets the definition of fruitless and wasteful expenditure (after an investigation):

DR	Fruitless and Wasteful expenditure (POS)*	XXX	
	or		
	Debt account (staff debt) (POS)		
CR	Fruitless and Wasteful account (PER)*		XXX
	or		
	the relevant expenditure account		

** POS = Statement of Financial Position & PER = Statement of Financial Performance*

A current asset is created on the statement of financial position, and the expenditure is “reversed” and presented on the statement of financial performance as ‘Add back fruitless and wasteful expenditure’.

If the fruitless and wasteful expenditure relates to a previous financial year

If any expenditure meets the definition of fruitless and wasteful expenditure (after an investigation):

DR	Fruitless and Wasteful expenditure (POS)*	XXX	
	or		
	Debt account (staff debt) (POS)		
CR	Recoverable revenue		XXX

A current asset is created on the statement of financial position, and the available voted funds are reduced. The fruitless and wasteful expenditure is presented on the face of the statement of position and performance using the ‘Add back fruitless and wasteful expenditure’.

Fruitless and wasteful recovered

When the department receives the funds from the responsible official:

DR	Bank account	XXX	
CR	Fruitless and Wasteful expenditure (POS)*		XXX
	or		
	Debt account (staff debt) (POS)		

DR	Recoverable revenue	XXX	
CR	Financial transactions in assets & liabilities (recovery of previous year’s expenditure)		XXX

REGISTER OF FRUITLESS AND WASTEFUL (F&W)

[illegible]

Key:	-	Fruitless and wasteful expenditure Under Investigation
UI	-	Disciplinary process initiated against responsible person
DP	-	Transferred to receivables for recovery
TR	-	

6. APPLICABLE LEGISLATION

**s38(1)(g)
(PFMA)** On discovery of any unauthorised, irregular or fruitless and wasteful expenditure, must immediately report, in writing, particulars of the expenditure to the relevant treasury and in the case of irregular expenditure involving the procurement of goods or services, also to the relevant tender board;

**s40(4)(b)
(PFMA)** The accounting officer of a department must-
(b) each month submit information in the prescribed format on actual revenue and expenditure for the preceding month and the amounts anticipated for the month.

TR 9.1.1 The accounting officer of an institution must exercise all reasonable care to prevent and detect unauthorised, irregular, fruitless and wasteful expenditure, and must for this purpose implement effective, efficient and transparent processes of financial and risk management.

TR When an official of an institution discovers unauthorised, irregular or fruitless and wasteful expenditure, that official must immediately report such expenditure to the accounting officer. In the case of a department, such expenditure must also be reported in the monthly report, as required by section 40(4)(b) of the Act. Irregular expenditure incurred by a department in contravention of tender procedures must also be brought to the notice of the relevant tender board or procurement authority, whichever applicable.

TR 9.1.3 When an accounting officer determines the appropriateness of disciplinary steps against an official in terms of section 38(1)(g) of the Act, the accounting officer must take into account –

- (a) the circumstances of the transgression;
- (b) the extent of the expenditure involved; and
- (c) the nature and seriousness of the transgression.

TR 9.1.4 The recovery of losses or damages resulting from unauthorised, irregular or fruitless and wasteful expenditure must be dealt with in accordance with regulation 12.

TR 9.1.5 The amount of the unauthorised, irregular, fruitless and wasteful expenditure must be disclosed as a note to the annual financial statements of the institution.


- TR** An accounting officer may only write off debts owed to the State if he or she is satisfied that –
- (a) all reasonable steps have been taken to recover the debt and the debt is irrecoverable, or,
 - (b) he or she is convinced that –
 - (i) recovery of the debt would be uneconomical;
 - (ii) recovery would cause undue hardship to the debtor or his or her dependants; or
 - (iii) it would be to the advantage of the state to effect a settlement of its claim or to waive the claim.
- TR 11.4.2** An accounting officer must ensure that all debts written off are done in accordance with a write off policy determined by the accounting officer.
- TR 11.4.3** All debts written off must be disclosed in the annual financial statements, indicating the policy in terms of which the debt was written off.

- TR 12.7.1** Losses or damages suffered by an institution because of an act committed or omitted by an official, must be recovered from such an official if that official is liable in law.
- TR 12.7.2** The accounting officer must determine the amount of the loss or damage and, in writing, request that official to pay the amount within 30 days or in reasonable instalments. If the official fails to comply with the request, the matter must be handed to the State Attorney for the recovery of the loss or damage.
- TR 12.7.3** A claim against an official must be waived if the conditions in paragraph 12.2.1(a) to (g) are not applicable.
- TR 12.7.4** If in doubt, the accounting officer of the institution must consult the State Attorney on questions of law in the implementation of paragraphs 12.7.1 and 12.7.3.

7. *ADDITIONAL*

- All expenditure identified as fruitless and wasteful expenditure should be recorded in the departmental fruitless and wasteful expenditure register by the Supply chain management and Finance units.
- The Financial accounting unit should complete the pre-audit and post audit checklist to ensure that all payments comply with the relevant laws and regulations.
- Interest payments made on supplier accounts should be disclosed in the fruitless and wasteful expenditure register of the department.
- The precise amount as stated on the invoice/payment batch should be recorded in the fruitless and wasteful register.
- The fruitless and wasteful expenditure register should be reviewed by the Chief Financial Officer of the department. This review will ensure that fruitless and wasteful expenditure is adequately disclosed and dealt with, ensuring that no mathematical errors exists etc
- Fruitless and wasteful expenditure identified during one financial period, but not paid in the specific period should be recorded in the following financial year.
- The accumulative fruitless and wasteful expenditure incurred at financial year end should be adequately and appropriately disclosed in the financial statements of the department.

Approved

 09/06/08

Head of Department

**NORTHERN
CAPE
EDUCATION
DEPARTMENT**

2008

[This policy outlines the identification, treatment, recognition and reporting of Related party transitions in the department according to the requirements of the PFMA]

RELATED PARTY TRANSACTIONS POLICY

GENERAL

Responsibility of the accounting officer [Section 38(1) (a) (i) of the PFMA] and Treasury regulation section 8.1

The accounting officer of an institution must ensure that internal procedures and internal control measures are in place for all payment approval and processing including related party transactions. These internal controls should provide reasonable assurance that all expenditure is necessary, appropriate, paid promptly and is adequately recorded and reported.

Purpose

The purpose of this policy is to:

- Ensure that related party transactions are recorded accurately and completely in the annual financial statements;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow to record these;
- ensuring that only valid related party transactions are recorded in the annual financial statements

Related party transactions

Definition

Related party transaction is a transfer of resources or obligations between related parties, regardless of whether a price is charged.

Related party – parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control.

Related parties include:

- (a) entities that directly, or indirectly through one or more intermediaries, control or are controlled by the reporting entity;
- (b) associates and joint ventures;
- (c) individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close member of the family of any such individual;
- (d) key management personnel, and close members of the family of key management personnel; and
- (e) entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

Significant influence is the power to participate in the financial and operating policy decision of an entity, but not control those policies.

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Joint control is the agreed sharing of control over an activity by a binding arrangement.

Key management personnel are:

- (a) all directors or members of a governing body of the entity;
- (b) other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting entity. Where they meet this requirement key management personnel include:
 - (i) where there is a member of the governing body of a whole-of-government entity who has the authority and responsibility for planning, directing and controlling the activities of the reporting entity, that member [e.g. MEC];
 - (ii) any key advisors of that member; and

unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity [e.g. Accounting Officer]

Recognition

Accounting policy

Specific information with regards to related party transactions is included in the disclosure notes.

Notes

Information about related party transactions is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the department. The principle issues in disclosing information about related parties is identifying which parties control or significantly influence the department and determining what information should be disclosed about transactions with those parties.

Disclosure of:

- The types of the related party relationship
- The types of transactions that have occurred
- The elements of the transactions necessary to clarify the significance of these transactions to its operations and sufficient to enable the Annual Financial Statements to provide relevant and reliable information for decision-making and accountability purposes.

The above excludes transfer payments and subsidies, as that is disclosed in the annexures to the Financial Statements.

Procedures

Related party relationships may have an impact on the performance of an entity because:

- the department are subject to the direction of Provincial Legislatures to achieve the policies of the provincial government;
- the department sometimes conduct certain activities necessary for the achievement of its objectives through controlled entities.
- the MEC and Accounting Officer exert significant influence over the operations of the department.

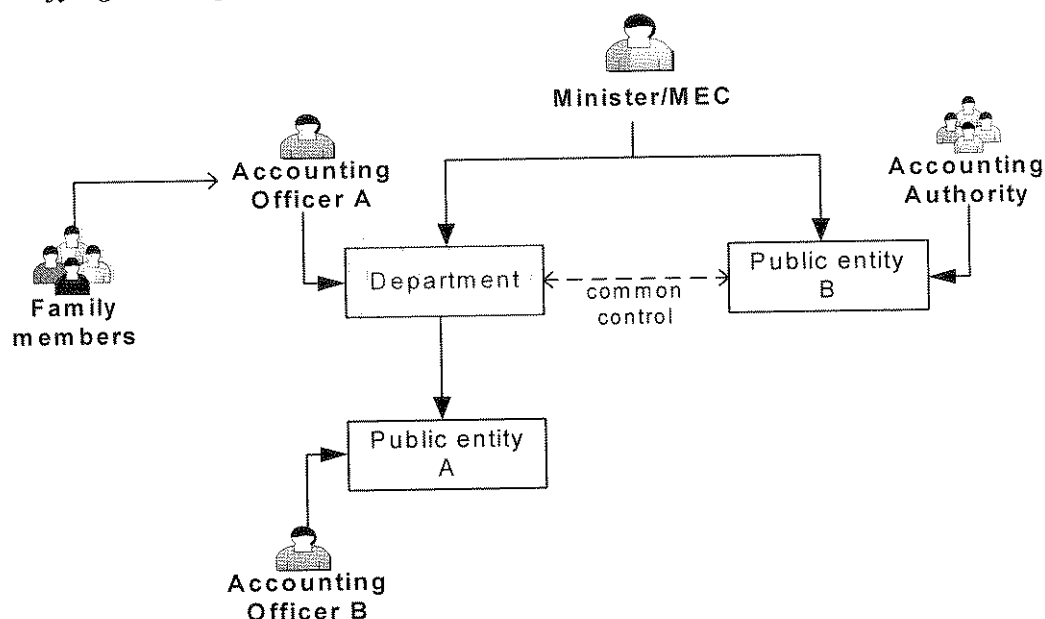
Information about related parties and related party transactions is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the department because:

- related party relationships can influence the way in which an entity operates with other entities in achieving its objectives, and the way in which it co-operates with other entities in achieving common or collective objectives;
- related party relationships might expose an entity to risks or provide opportunities that would not have existed in the absence of the relationship;
- related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties (e.g. sale of goods/services at less than cost).

Refer to Practice Note 4 of 2006/07 issued by the OAG. (Attached as annexure A)

The principle issues in disclosing information about related parties are identifying which parties are controlled or significantly influenced by the department and determining what information should be disclosed about transactions with those parties.

Identifying related parties



EXAMPLE 1: In the illustration above the related parties to the department and public entities are as follows:

Department:

- The MEC – this person is accountable for the way in which a particular policy for which he/she is responsible, has been carried out. He/she has the authority and responsibility for planning, directing and controlling the activities of the department.
- Public entity B – if the MEC can affect the policies of both entities in their mutual dealings then the department and the entity are related parties (i.e. the MEC has control over both the department and public entity B).
- Public entity A – if the department “controls” public entity A or if public entity A is an associate or joint venture of the department then they are related parties.

Ownership control, in relation to an entity, means the ability to exercise any of the following powers to govern the financial and operating policies of the entity in order to obtain benefits from its activities:

- To appoint or remove all, or the majority of, the members of the entity’s board of directors or equivalent governing body;
- to appoint or remove the entity’s chief executive officer;
- to cast all, or the majority of, the votes at meetings of that board of directors or equivalent governing body; or
- to control all, or the majority of, the voting rights at a general meeting of that entity;

In addition to the indicators provided in the above definition, when one or more of the circumstances listed below either individually or collectively can be indicative of the existence of control:

- ✓ the entity has the ability to veto operating and capital budgets of the other entity;
 - ✓ the entity has the ability to veto, overrule, or modify the board of directors or equivalent governing body decisions of the other entity;
 - ✓ the entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity;
 - ✓ the mandate of the other entity is established and limited by legislation;
 - ✓ the entity holds a “golden share” (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that entity;
 - ✓ the entity holds direct or indirect title to the net assets of the other entity;
 - ✓ the entity has a right to a significant level of the net assets of the other entity in the event of a liquidation or in a distribution other than a liquidation;
 - ✓ the entity is able to direct the other entity to co-operate with it in achieving its objectives;
 - ✓ the entity is exposed to the residual liabilities of the other entity.
- Accounting Officer A – this person is responsible to the MEC to manage the resources of the department and for the overall achievement of the department’s service delivery objectives. He/she also has the authority and responsibility for planning, directing and controlling the activities of the department.
 - Family members of Accounting Officer A – these individuals may influence Accounting Officer A with regard to the dealings of the department.
 - These individuals are only considered when there is a related party relationship between the department and the family members. For example a spouse is a member of the key management personnel of the department or a brother-in-law is the accounting officer of a controlled public entity.

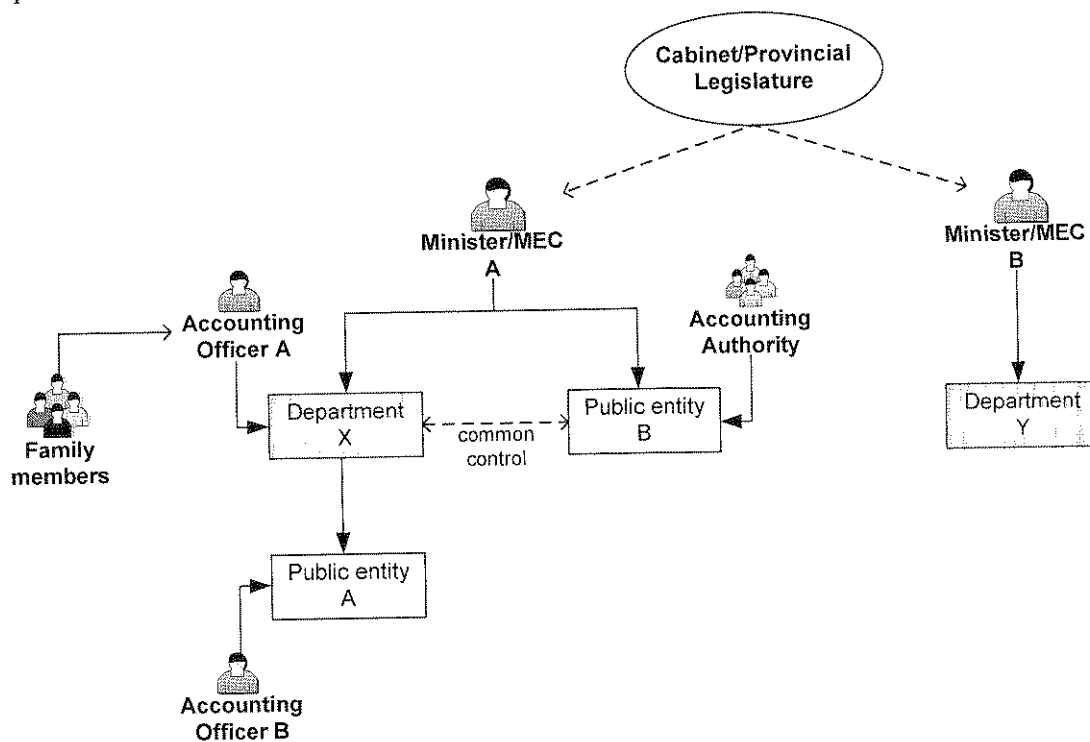
Public entity A:

- The MEC – if this person is able to affect the operating and financial policies (i.e. directly or indirectly controls the entity) then he/she is a related party;
- The Department – if the department controls or has significant influence or joint control over the public entity;
- Accounting Officer B - this person is responsible manage the resources of the entity and for the overall achievement of the entity’s objectives. He/she also has the authority and responsibility for planning, directing and controlling the activities of the department;
- Public Entity B – both public entities are commonly controlled and are therefore related parties;

Public entity B:

- The MEC – He/she has the authority and responsibility for planning, directing and controlling the activities of the department.
- The department – if the MEC can affect the policies of both entities in their mutual dealings then the department and the entity are related parties (i.e. the MEC has control over both the department and public entity B).
- The Accounting Authority – this body is responsible to the MEC to manage the resources of the entity and for the overall achievement of the entity's objectives. This body also has the authority and responsibility for planning, directing and controlling the activities of the department.
- Public Entity A - both public entities are commonly controlled and are therefore related parties;

EXAMPLE 2: Consider the illustration below, is there a related party relationship between Department X and Department Y?



Departments are related parties because they are subject to common control (they operate together to achieve common objectives determined by Provincial Legislature). However, a department in one province is not “related” to another department in a different province. In addition a municipality is not a related party to a department.

All departments and public entities in each province are related parties. Provincial Treasury will provide a list of the related parties in the provincial sphere of government.

Related party disclosures – related party relationships

As a general rule ALL related party relationships should be disclosed irrespective of whether there has been any transactions between the department and the related party. However, for the 2008/09 financial year the following applies:

- (a) the disclosure of the related party relationships of a department shall be limited to the entities falling under the MEC's portfolio (e.g. the National Institute for Higher Education); **but**
- (b) where a department transacts with another party other than those under (a) above and these transactions were not at arms length (see ***Related party disclosures – related party transactions***) then the relationship must be disclosed.

Related party disclosures – related party transactions

As a general rule, a department should disclose all transactions with its related parties other than those undertaken at arm's length (i.e. where the transactions are consistent with a normal supplier or client/recipient relationship and are undertaken on terms and conditions that are normal for such transactions in the circumstances). For example, a provincial department would not need to disclose the total amount paid to Telkom for 2008/09 for its telephone lines and calls unless the department was granted a discount that's not ordinarily available to other entities.

However for the 2008/09 financial year the following applies:

- (a) the department will only disclose those related party transactions that in terms of the above qualify for disclosure, between itself and the public entities falling under its MEC's portfolio. The disclosures exclude transfers & subsidies paid to public entities where these have been included in the annexures to the financial statements. However, the fact that the public entity is a related party should be included in this note; **but**
- (b) where the department transacts with another party other than those under (a) above and these transactions were not at arms length then the relationship and the transaction must be disclosed.

The disclosure of any related party transactions is limited to transactions between the department and another related party and will not include transactions between the related parties of the department.

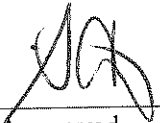
Examples of indications of related party transactions:

- ✓ arrangements where one party expenses on behalf of another party (these costs may or may not be recovered);
- ✓ lease arrangements at more or less than market value or for no consideration;
- ✓ sales without substance (funds are transferred to an entity for goods or services that were never rendered/delivered);
- ✓ services or goods are purchased at nominal or no cost;
- ✓ transactions that have abnormal terms of trade, such as unusual prices, interest rates, guarantees and repayment terms;

- ✓ transactions that lack an apparent logical business reason for their occurrence;
- ✓ transactions in which substance differs from form;
- ✓ transactions processed in an unusual manner;
- ✓ high volume or significant transactions with certain customers or suppliers as compared with others; and
- ✓ unrecorded transactions such as the receipt or provision of management services at no charge.

Additional

- ✓ Related party transactions recorded on the schedule supporting the financial statements should agree to supporting documentation
- ✓ The aforementioned scheduled should be reviewed by the Chief Financial Officer for the complete and accurate recording of related party transactions.
- ✓ The schedule drawn up should agree to the disclosure note of the annual financial statements.



Approved
Head of Department

Date 09/06/08

Annexure A

All Accounting Officers

All Accounting Authorities

All Chief Financial Officers

All Heads of Provincial Treasuries

All Provincial Accountants-General

OFFICE OF THE ACCOUNTANT-GENERAL PRACTICE NOTE 4 OF 2006/07

ILLEGAL USE OF RESOURCES BY DEPARTMENTS AND PUBLIC ENTITIES

1. Purpose

The purpose of this practice note is to provide a policy framework for the transfer of funds between a public entity and its parent department.

2. Background

2.1 Departments receive funding through the budget process whereby funds are appropriated by the relevant legislature. The relevant legislature approves such appropriations per vote and per main division/programme within the vote in order for these departments to deliver on their legislative mandates within such appropriations.

2.2 The Adjustment Budget process may be utilised where departments experience the incurrence of unforeseen and unavoidable expenditure during a specific financial year for which additional funds may be required to meet such expenditure.

2.3 Public entities either receive their funds:-

- Through the budgetary process, in which case funds are made available by means of transfers from the votes of their parent departments; or
- By way of a tax, levy or money imposed in terms of legislation; or
- Through the sale of goods or rendering of services.

2.4 These revenue streams are meant for public entities to effectively deliver on their legislative mandates and to exercise functions related to these mandates.

3. Public entities effecting payments on behalf of departments

3.1 Whilst it is incumbent on departments and public entities to spend in accordance with their legal mandate and approved budgets, it has come to light that certain departments are making use of public entities reporting to their executive authority to fund departmental functions (over and above those provided for in budgetary appropriations) and to employ personnel on their behalf, the personnel costs related thereto is met by the public entity.

3.2 By performing departmental functions and employing personnel on their behalf, these public entities are in essence funding departmental programmes for which money was not appropriated and which might have resulted in unauthorised expenditure for the department, which is not permitted in terms of the Public Finance Management Act, 1 of 1999 (PFMA).

3.3 Further, by making use of their funds to perform departmental functions, these public entities are also not spending in accordance with their legal mandate and budgets as approved by their respective executive authorities.

3.4 Such expenditure amounts to irregular expenditure for the public entity as defined in section 1 of the PFMA. The PFMA defines irregular expenditure as being expenditure that is incurred in contravention of or that is not in accordance with a requirement of any applicable legislation.

4. Gifts, donations and sponsorships

4.1 In terms of Treasury Regulation (TR) 21.2.1, only the Accounting Officers may approve the acceptance of gifts, donations and sponsorships to the state, whether such donations are offered in cash or in kind.

4.2 The intention of the aforementioned Treasury Regulation was to make provision for external bodies to grant gifts, donations and sponsorships to departments not accommodated within the budget process and to allow these departments to adhere to requests of the donors in furthering interests of the State. In all instances, gifts, donations and sponsorships received in cash is required to be deposited either into the Reconstruction and Development (RDP) Fund or the relevant Revenue Fund. Money surrendered to the relevant Revenue Fund will be dealt in the normal budget process whereas RDP money will be treated in terms of the RDP Act and established prescripts.

4.3 It has, however come to light that public entities are making donations or granting sponsorships to their parent departments with a view to augmenting the budgets of these departments. In this regard, it must be emphasized that although not legislated or regulated against, it was never intended that public entities make donations or grant sponsorships to their parent departments, whether in cash or in kind, to augment the budget of the respective department.

5. Illegal transfer payments by departments

5.1 In terms of Treasury Regulation 15.10.3.1, departments may not open bank accounts without written approval of the relevant treasury. The Regulation further states that only bank accounts approved after 1 April 2001 shall be considered as being valid.

5.2 Despite the aforementioned Treasury Regulation, it has come to light that departments are still operating bank accounts that have not been approved by the relevant treasury. It would appear that some departments are transferring funds to these unauthorised bank accounts to circumvent the PFMA and Treasury Regulation requirements that unspent funds or money received be deposited into the relevant Revenue Fund.

5.3 In the past few years a trend of excessive spending in the last month of the financial year has been noticeable. This expenditure often relates to transfer payments that are intended to create an impression that actual expenditure has been incurred when in fact no goods and services are received in return. Such payments are sometimes for goods and services receivable in the future which conceals under-spending by a department.

5.4 This arrangement supports TR 15.10.1.2(b) & (c) which discourages the use of funds earlier than necessary and the payment for goods/services in advance.

5.5 These practices do not only constitute bad financial management but also contravene an essential principle in the PFMA that is of transparency.

6. PFMA and Treasury Regulations

6.1 Whilst the relevant legislation does not cover every eventuality, departments, public entities, constitutional institutions and other government institutions should not devise strategies or schemes to circumvent the norms and standards set out in the PFMA and the Treasury Regulations. Such practices are in conflict with the ethos and spirit of the PFMA and are therefore illegal.

7. Policy

7.1 This practice note therefore serves to inform stakeholders that:

- Departments may not request public entities to undertake departmental functions on their behalf nor shall they request public entities to employ personnel on their behalf, the expenses for which are to be met by the public entity;
- Public entities may not grant donations and sponsorships to departments, whether in cash or in kind, to augment the budget of the department;
- Departments may not transfer funds to a bank account that has not been approved by the relevant treasury and only bank accounts approved after 1 April 2001 shall be regarded as valid, as per Treasury Regulation 15.10.3.1; and

- Departments may not transfer funds to another department, public entity, constitutional institution and any other government institution other than as prescribed by Parliament through the Appropriation Act or through the virement process.
- Any irregular expenditure must be dealt with in accordance with the prescripts issued by the National and provincial treasuries.

8. Auditor-General

8.1 This practice note will be brought to the attention of the Auditor-General for inclusion in their audit scope.

8.2 The National Treasury may request the Auditor-General to conduct special investigations on any matter dealt with in this practice note.

9. Effective date

9.1 This practice note applies to all National and Provincial Departments and Public Entities (including Constitutional Institutions) and takes effect immediately.

S F Nomvalo

Accountant-General: National Treasury

Date: 7 September 2006

**NORTHERN
CAPE
EDUCATION
DEPARTMENT**

2008

[This policy outlines the identification, system description and processes involved for the recording of journal transactions of the department according to the requirements of the PFMA]

JOURNALS POLICY

1. GENERAL

Section 38(1) (a) (i) of the PFMA stipulates the following:

The accounting officer for a department must ensure that the department has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Section 17.1.1 of the Treasury Regulations requires that all the transactions of an institution must be supported by authentic and verifiable source documents, clearly indicating the approved accounting allocation.

Officials should ensure that sufficient appropriate supporting documentation is attached to the journal to enable an independent third party to understand the flow of the transaction and to determine its validity.

Every effort should be made to ensure that original transactions are recorded in the proper accounts at the correct amounts. Changes may be necessary in certain circumstances as described within this policy.

A General Journals form should be used for processing the request.

The Journal Entry process is detached from any other functional area. General Journals will mainly be done when an account is incorrectly classified, but only in those functional areas where Special Journals cannot be done. Erroneous allocations must be corrected by doing Journal entries.

These Journal entries can be done by the person who made the error, or it can be done by another person. The General Journals function on the BAS provides a mechanism whereby Journals can be entered into the BAS to perform a corrective or adjusting action. This helps to ensure that the accounting records are always correct.

JOURNAL TRANSACTIONS

2. PURPOSE

To outline policy and procedures for officials to have an understanding of journal transactions and the usage thereof.

3. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for the Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow for journal transactions;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation

- ensuring that journals are used only for the appropriate reasons.
- identify the circumstances in which journals should be affected, how they should be recorded and approved with the relevant supporting documentation attached.

4. POLICY

- To ensure that all journal transactions are recorded in the Basic Accounting System of the department.
- Ensuring that journal transactions are recorded at the appropriate amounts.
- Ensuring that only valid and approved journal transactions are recorded on the Basic Accounting System.
- To ensure that journal transactions are recorded in the correct accounts.
- To ensure that journal transactions are posted to the correct financial year.

5. PROCEDURES

5.1 Journal transactions are utilised for the following purposes:

- Incorrect allocations
- Incorrect amounts captured
- Automatic electronic journals- Year end batch processes.
- Conversion processes
- Clearing suspense/control accounts

5.2 Four types of journals are currently being used by the department:

- Manual journals
- Online journals
- Year end automatic closure journals created by the Basic Accounting System.
- System generated journals- interface journals

6. COMPLETION OF THE JOURNAL FORM

Journal transactions are compiled by various officials within finance. All relevant information must be completed on the journal. The following information should be recorded in detail on the journal form:

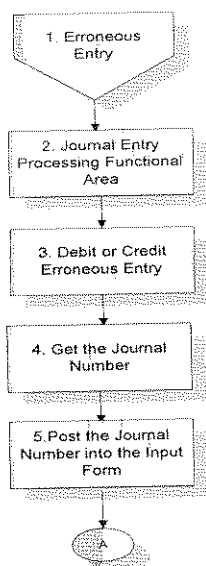
- For each debit entry, a corresponding credit field should be completed and vice versa.
- The relevant Fund, Objective, Project, Net assets, Regional Identifier, Responsibility, Item and Matching fields should be completed on the manual form where applicable.
- The compiler of the manual journal form should complete his/her name, rank, date and sign the journal form.
- A detail description of the journal should be completed on the journal description field.
- The posting date field must be completed.
- The debit and credit entries recorded on the manual form should always correspond. These entries should at all times agree to the supporting documentation attached to the journal.
- After the journal has been approved and captured on the Basic Accounting System, the capturer and approver of the journal should complete the system users field with the information that is generated from BAS.

7. APPROVAL OF JOURNALS

- Manual journal forms should be checked and verified by an official after the information on the journal has been reviewed.
- All relevant details of the verifier should be manually completed on the journal form.
- Segregation of duties should exist between the compiler and check and verifier.

8. RECORDING OF JOURNALS ON THE BASIC ACCOUNTING SYSTEM

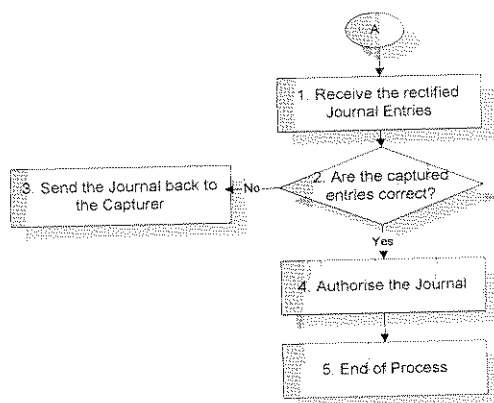
8.1 GENERAL JOURNAL CAPTURING PROCESS FLOW



8.2 GENERAL JOURNAL CAPTURING EVENT PROCESS DESCRIPTION

- The General Journal function can be done both manually and online. In case of the online system (BAS) 'Journal Entry Processing' functional area is used to correct erroneous allocations. This functionality allows the user to debit or credit incorrect entries made.
- In the case of manual journals, after the user has corrected the entry, the system generates the Journal number that must be written into the General Journal Input Form.
- The corrected entries are then sent to the Authoriser for verification and authorisation.

8.3 GENERAL JOURNAL AUTHORISATION PROCESS FLOW



8.4 GENERAL JOURNAL AUTHORISATION EVENT PROCESS DESCRIPTION

- The Supervisor/Authoriser receives the captured Journal from the Capturer. The captured details are then checked for correctness. If the captured details are incorrect, the Authoriser sends them back to the Capturer for correction.
- The correctly captured Journal is authorised and then financial transaction is posted to the relevant accounts.
- Segregation of duties should exist between the capturer and the authoriser of the journal on the Basic Accounting System.
- After the journal is processed it is sent back for filing.

9. ADDITIONAL

9.1 ONLINE JOURNALS

- Online journals is mostly used for clearing unresolved transactions in the group bank accounts, from the Exception to adjustment accounts etc.
- The data capturer resolves all online journals by clearing the adjustment/exception account.
- BAS creates automatic journal entries between the exception and adjustment accounts during the year. This is as a result of differences between serial numbers, unidentified credits etc.

9.2 MONTH/YEAR END CLOSURE

- The capturer will go to the functionality period opening/closing and close the month. This process will be completed/followed for the financial year-end. Thereafter the authoriser approves the month/year-end closure. Thereafter BAS automatically creates closing journals for that year.
- Officials should ensure that the journal transaction posted is recorded at the correct amounts/accounts and in the correct financial period.

Approved

 09/06/08
Head of Department

NORTHERN
CAPE
EDUCATION
DEPARTMENT

2008

[This policy outlines the identification, recording, disclosure and treatment of lease commitments of the department according to the requirements of the PFMA]

LEASE COMMITMENTS POLICY

1. GENERAL

Section 38(1) (a) (i) of the PFMA stipulates the following:

The accounting officer for a department must ensure that the department has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Section 9.1.1 of the Treasury Regulations stipulates the following:

The accounting officer of an institution must exercise all reasonable care to prevent and detect unauthorised, irregular, fruitless and wasteful expenditure, and must for this purpose implement effective, efficient and transparent processes of financial and risk management.

LEASE COMMITMENTS

2. DEFINITION

Lease commitments represent amounts owing from the reporting date to the end of the lease contract.

A **lease** is a contract that gives the lessee (the renter) the right to use an asset for an agreed period of time in return for a payment or series of payments.

A **finance lease** is a lease that transfers substantially all risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

An **operating lease** is a lease other than a finance lease.

Economic life is the period over which an asset is expected to yield economic benefits or service potential to one or more users.

Useful life is the estimated remaining period, from the beginning of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.

3. PURPOSE

To outline policy and procedures for officials to have an understanding of lease commitments and the accounting treatment thereof.

4. OBJECTIVE

The objectives of the policy include -

- emphasising the accountability of employees for Departmental resources;
- ensuring that employees have a clear and comprehensive understanding of the procedures they must follow for lease commitment transactions;
- ensuring that resources made available to employees are utilised efficiently, effectively, economically and for authorised official purposes; and ensuring that the Department's resources are managed in compliance with the Public Finance Management Act, the Treasury Regulations and other relevant legislation
- ensure that lease transactions is detected, processed and recorded appropriately.

5. RECOGNITION

ACCOUNTING POLICY

5.1 Lease commitments are not recognised in the statement of financial position as a liability or as expenditure in the statement of financial performance but are included in the disclosure notes.

5.2 Operating and finance lease commitments are expensed when the payments are made. Assets acquired in terms of finance lease agreements are disclosed in the annexures and disclosure notes to the financial statements.

6. PROCEDURES

The terms of a lease are such that the department is substantially in the same economic position as it had borrowed money to buy the asset (even though legal title may not pass to the lessee). For example, this may be the case if the lease payments effectively are paying for the whole asset or if the lease term is such that the department can use the asset for the major part of its economic life.

Unfortunately the PFMA prohibits borrowing by Provincial Departments and the Treasury Regulations makes it clear that finance leases are deemed to be borrowings and are therefore not permitted.

Although the department is not permitted to enter into finance leases, all finance leases that they do have should be disclosed as finance leases. It will however mean that the department will not be complying with the Treasury Regulations (TR 13). Finance leases may not (incorrectly) be disclosed as operating leases even when the lease is condoned by the National Treasury.

Practice Note 5 of 2007/08 (as indicated in (a) and (b) below), issued by the OAG seeks to provide the following circumstances where the department may enter into finance leases without additional approval required:

- (a) Finance leases where:
 - A Finance lease is more economical than an operating lease; and
 - The period of the finance lease does not exceed 60 months in respect of motor vehicles and 36 months for equipment except with written approval by Treasury; and
 - The finance lease was entered into in terms of RT3 of 2006 or a transversal contract entered into by the National Treasury.
 - For land and buildings, prior approval must have been obtained from the relevant executive authority and treasury. There are no limits to the lease period. authority and treasury.
- (b) Blanket approval for any irregular expenditure incurred as a result of RT3 of 2000 and RT3 of 2003 Transversal contracts entered with various suppliers for the supply, delivery, installation, commissioning and maintenance of office equipment and labour saving devices.

The definition of a lease includes contracts for the hire of an asset, which contain a provision giving the option to acquire title upon the fulfilment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

It is important to note that the payment of a lump sum amount (rather than regular periodic payment such as monthly payments) does not preclude lease accounting; as such arrangements may still meet the definition of a lease.

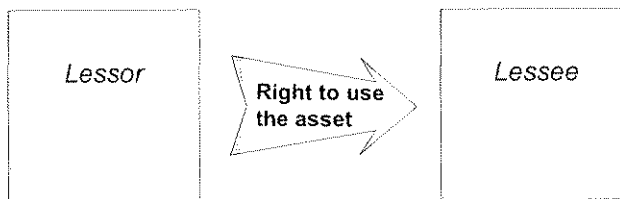
Finance lease vs. Operating lease

FINANCE LEASE



Lease that transfers substantially all the risks and rewards of ownership

OPERATING LEASE



Lease that does not transfer substantially all the risks and rewards of ownership

It is common practice for contracts to be termed rental agreements. This therefore does not mean that this is excluded from being a lease. One still needs to go through the conditions of the contract to determine whether it is a finance lease or an operating lease.

The classification of leases is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee rather than on which party has legal ownership over the asset.

Risks include the possibilities of losses from idle capacity, technological obsolescence or changes in value due to changing economic conditions.

Rewards may be represented by the expectation of service potential or profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

Although the following are examples of situations, which would normally lead to a lease being classified as a finance lease, a lease does not need to meet all these criteria in order to be classified as a finance lease:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;

- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, so that at the inception of the lease it is reasonably certain that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease the present value of the minimum lease payments amounts to at least 90% of the fair value of the asset.
- The minimum lease payments are the payments that the department is, required to make to the lessor over the lease term.

This includes

- Non-cancellable lease payments
- Guaranteed residual value
- Purchase option (if reasonable certainty of exercise)

And excludes:

- Contingent rent
- Cost for services (such as maintenance & insurance)
- Taxes (if paid by and reimbursed to the lessor)

With regard to motor vehicles the value includes the “base” vehicle cost, any accessories, stamp duty and any dealer or delivery charges. VAT, registration costs, insurance, roadside assistance and borrowing costs are excluded.

The interest rate to be used in the calculation of the net present value is the government’s borrowing rate or the rate of the contract.

- The leased assets are of a specialised nature such that only the institution can use the assets without modifications being made;
- The lessor’s losses associated with cancellation of the lease by the lessee is borne by the lessee; or
- The leased assets cannot easily be replaced by another asset.

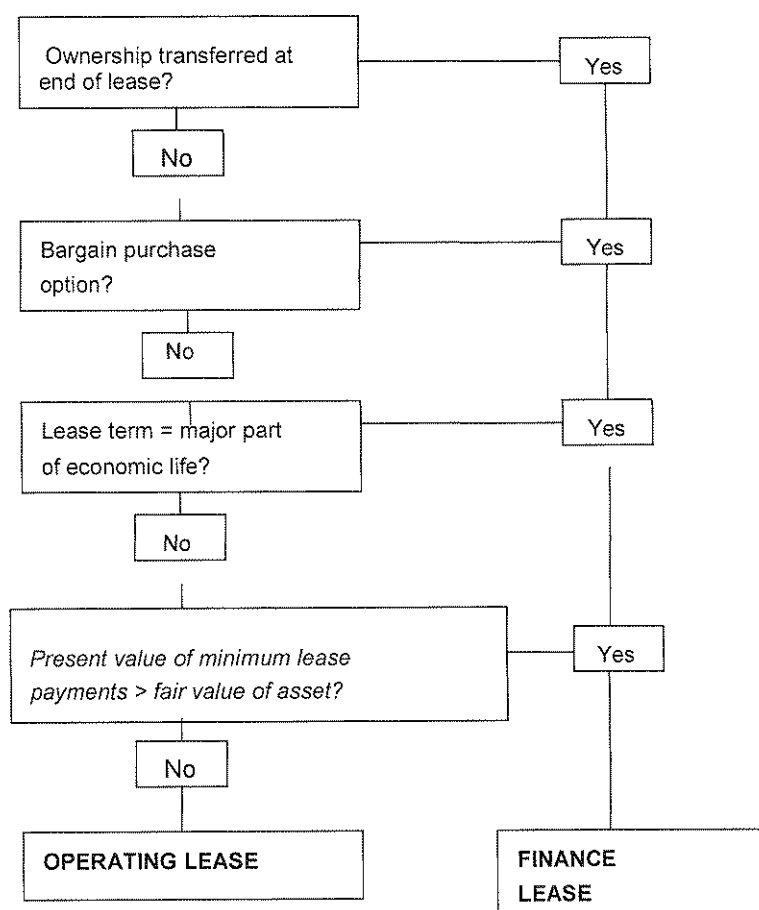
Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance lease the substance and financial reality are that the lessee acquires the economic benefits or service potential of the use of the leased asset for the obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

Leases of land and building are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee does not receive substantially the entire risks and rewards incident to ownership.

Buildings have a finite useful life and therefore may be the subject of either a finance lease or an operating lease. Because land normally has an indefinite economic life, a lease of land usually will be classified as an operating lease if title does not pass to the lessee by the end of the lease and if the benefit of the residual value is not passed to the lessee by other means.

If it is not possible to separate the agreement between land and the buildings, then the entire lease is classified as a finance lease unless it is clear that both elements qualify as operating leases.

Classification of a lease agreement



Finance Leases

The finance lease liability is disclosed in the disclosure notes with a split between amounts payable:

- within 12 months after the reporting date;
- 1 year after the reporting date but not later than 5 years;
- later than 5 years.

This information can be obtained from the amortisation schedules supplied with the lease agreement or calculated from the information within the lease agreement.

7. EXAMPLE

Lease of a photo copier assuming that the lease is a finance lease

The lease term is for 36 months starting 1 April 2006. The contract requires payments of R334.22 to be paid at the beginning of each month. The photo copier's market value is R10, 500. Assume that the interest rate implicit in the lease agreement is 6 %. The net present value is R11, 041.

Calculation of the net present value:

Pmt = 334.22 (payment per month)

i = 6% / 12 (interest rate per month)

n = 36 (number of lease instalments over the period of the lease)

Therefore the net present value = R11, 041

The amortisation schedule is shown below:

Date	Payment	Interest	Capital	Balance		2006/07	2007/08	2008/09
				11,041.08				
1/4/2006 1	334.22		(334.22)	10,706.86	Y1	Expenditure for the 2006/07 financial year		
1/5/2006 2	334.22	53.53	(280.69)	10,426.18				
1/6/2006 3	334.22	52.13	(282.09)	10,144.09				
1/7/2006 4	334.22	50.72	(283.50)	9,860.59				
1/8/2006 5	334.22	49.30	(284.92)	9,575.67				
1/9/2006 6	334.22	47.88	(286.34)	9,289.33				
1/10/2006 7	334.22	46.45	(287.77)	9,001.56				
1/11/2006 8	334.22	45.01	(289.21)	8,712.34				
1/12/2006 9	334.22	43.56	(290.66)	8,421.68				
1/1/2007 10	334.22	42.11	(292.11)	8,129.57				
1/2/2007 11	334.22	40.65	(293.57)	7,836.00	Y2	"Not later than 1 year"	Expenditure for the 2007/08 financial year	
1/3/2007 12	334.22	39.18	(295.04)	7,540.96				
1/4/2007 13	334.22	37.70	(296.52)	7,244.45				
1/5/2007 14	334.22	36.22	(298.00)	6,946.45				
1/6/2007 15	334.22	34.73	(299.49)	6,646.96				
1/7/2007 16	334.22	33.23	(300.99)	6,345.98				
1/8/2007 17	334.22	31.73	(302.49)	6,043.49				
1/9/2007 18	334.22	30.22	(304.00)	5,739.48				
1/10/2007 19	334.22	28.70	(305.52)	5,433.96				
1/11/2007 20	334.22	27.17	(307.05)	5,126.91				
1/12/2007 21	334.22	25.63	(308.59)	4,818.32	Y3	"Later than 1 year and not later than 5 years"	"Not later than 1 year"	Expenditure for the 2008/09 financial year
1/1/2008 22	334.22	24.09	(310.13)	4,508.20				
1/2/2008 23	334.22	22.54	(311.68)	4,196.52				
1/3/2008 24	334.22	20.98	(313.24)	3,883.28				
1/4/2008 25	334.22	19.42	(314.80)	3,568.48				
1/5/2008 26	334.22	17.84	(316.38)	3,252.10				
1/6/2008 27	334.22	16.26	(317.96)	2,934.14				
1/7/2008 28	334.22	14.67	(319.55)	2,614.59				
1/8/2008 29	334.22	13.07	(321.15)	2,293.44				
1/9/2008 30	334.22	11.47	(322.75)	1,970.69				
1/10/2008 31	334.22	9.85	(324.37)	1,646.32				
1/11/2008 32	334.22	8.23	(325.99)	1,320.33				
1/12/2008 33	334.22	6.60	(327.62)	992.72				
1/1/2009 34	334.22	4.96	(329.26)	663.46				
1/2/2009 35	334.22	3.32	(330.90)	332.56				
1/3/2009 36	334.22	1.66	(332.56)	(0.00)				

It is not a requirement for the 2008/09 financial year to include leased assets in the asset register of the department.

Operating Leases

All lease payments are expensed as and when the payment is made in terms of the lease agreement. The note disclosure is similar to the above example.

Statement of Financial Performance

Lease payments are expensed when payment is made for both finance and operating leases.

Statement of Financial Position

No entry is made to the statement of financial position since the transaction is recognised on the cash basis of accounting.

8. LEGISLATION

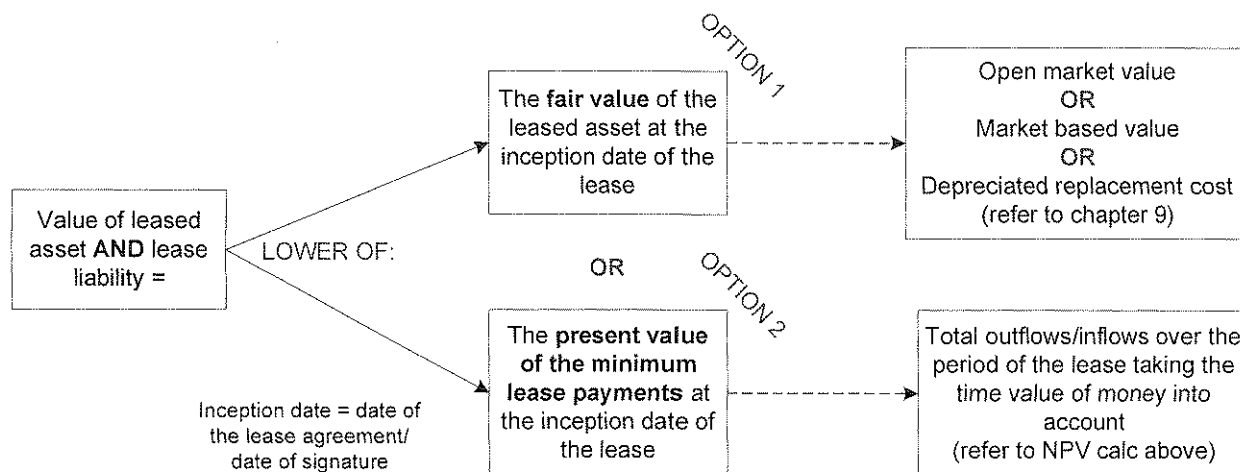
TR 13.2.2	A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.
TR 13.2.4	The accounting officer of an institution may, for the purposes of conducting the institution's business, enter into a lease transaction without any limitations provided that such transactions are limited to operating lease transactions.
TR 13.2.5	With the exception of agreements concluded in terms of Treasury Regulation 16, the accounting officer of an institution may not enter into finance lease transactions.

NORTHERN CAPE EDUCATION DEPARTMENT

[illegible]

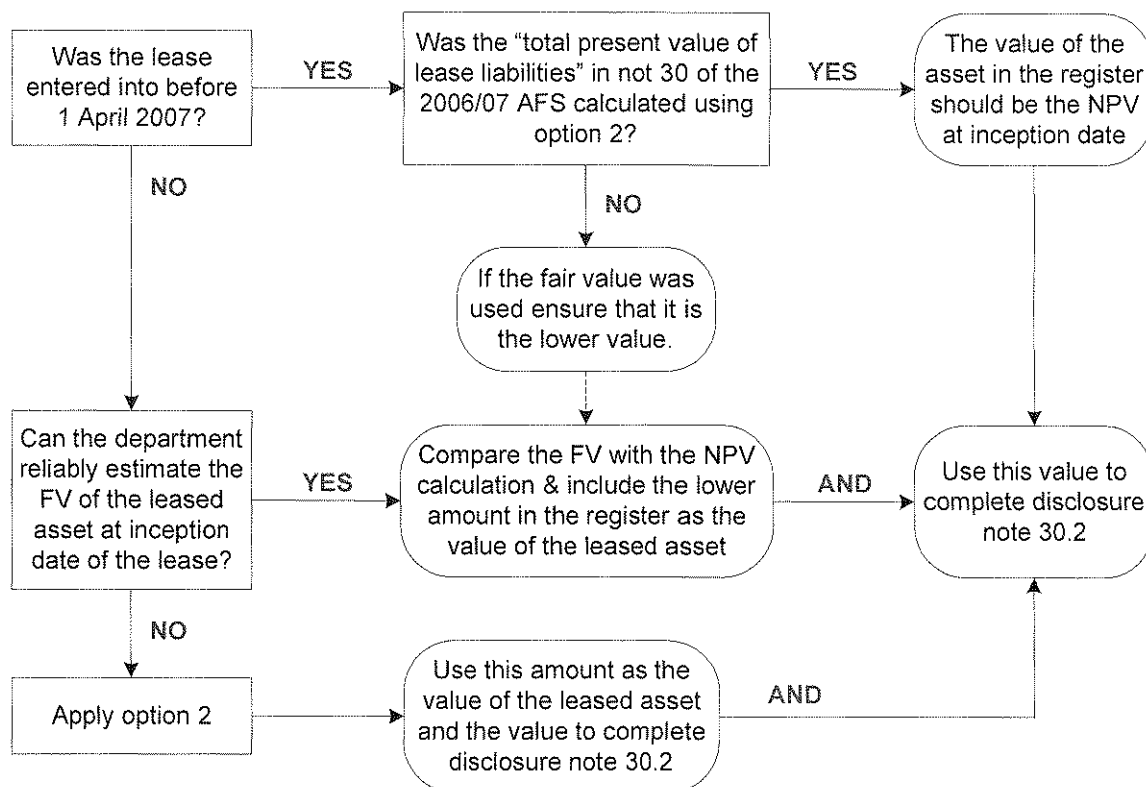
GUIDANCE ON LEASE VALUATION

How is the value of the leased asset determined?



How and when should these options be applied?


Both options should be considered at the inception of the lease agreement. However a concession has been made for lease agreements entered into prior to 1 April 2007 (due to the possible lack of information pertaining to the fair values of these assets at the inception of the lease agreement). Refer to the diagram below:



9. ADDITIONAL

- All leases entered into by the department should be recorded in the departmental lease register by the Supply chain management unit.
- The total of the lease schedules should agree to the leases disclosed in the annual financial statements.
- The lease schedule supporting the figure in the disclosure note should be reviewed by the Chief Financial Officer.
- The opening balance of lease commitments in the financial statements should at all times agree to the closing balance of the prior year's financial statements.
- The accumulative lease commitments incurred at financial year end should be adequately and appropriately disclosed in the financial statements of the department.

Approved

 09/06/08

Head of Department