



**Municipal Financial Systems and Processes requirements in support of the Municipal Standard Chart of Accounts (*m*SCOA).**

***This is a follow-up Circular to MFMA Circular No. 57 that*** replaces MFMA Circular 57 (financial systems and processes) and updates municipalities and municipal entities on the review of local government financial systems and business processes subsequent to the ‘piloting’ of the *m*SCOA classification framework. It is important to read this Circular in conjunction with MFMA Circular No. 57, all the Municipal SCOA Circulars, and all documentation posted on the National Treasury website as it relates to *m*SCOA (i.e. project summary document, presentations of the *m*SCOA Integrated Consultative Forum etc.).

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## 1. Introduction

National Treasury issued MFMA Circular No. 57 with a specific view to stabilise the overall systems of financial management and internal control operationally functional within municipalities; this position necessitated among others:

- Pending regulation of the Municipal Regulations on a Standard Chart of Accounts (*mSCOA*);
- Varying levels of deficiency in the functionality of systems of financial management and internal control which would in all probability impede the implementation of the Regulation on the Standard Chart of Accounts by municipalities; and
- Possibility that municipalities could in the interim be investing in systems of overall financial management and internal control that do not necessarily meet the minimum system functionality in support of a multi-dimensional chart as prescribed by the Municipal Regulations on a Standard of Accounts (*mSCOA*).

The Municipal Regulations on a Standard Chart of Accounts (*mSCOA*) was gazetted by the Minister of Finance on 22 April 2014. The National Treasury then commissioned *mSCOA* Project Phase 4 (Change Management and Piloting). Primary objectives of the piloting phase included:

- a) Piloting of the *mSCOA* classification framework in selected municipalities to refine the Segments and associated detail,
- b) Reviewing and assessing the existing system functionality of service providers operating within municipalities against the broader business requirements of the *mSCOA* Regulation; and
- c) Determining minimum system and business process requirements to effectively operate the multi-dimensional structure of *mSCOA* as envisaged and prescribed by the Regulation and address certain limitations with the implementation of the entire financial management accountability cycle.

The piloting phase of *mSCOA* Project Phase 4 has proved most useful in that detail transactional findings based on the actual piloting has provided for further refinement to the classification framework; since the publication of the Regulation on 22 April 2014, the chart has been revised four times giving rise to *mSCOA* Version 5.4. The National Treasury is in the process of updating Version 5.4 with slight amendments after which *mSCOA* Version 6 will be released and locked down for the first year (2017/18) transacting and auditing. It is anticipated that *mSCOA* Version 6 will be locked down within the next two months; changes between Version 5.4 and Version 6 are anticipated as minimum.

In addition to strengthening the classification framework to meet the transactional requirements of all municipalities, the piloting exercise has also provided an invaluable understanding of the current landscape of systems of financial management and internal control currently operationally functional within municipalities. This research has provided for a clear understanding of what is required from a system of financial management and internal control as it relates to technical and business process functionality in support *m*SCOA and the overall local government financial management accountability cycle.

Chapter 3 of the Municipal Regulations on a Standard Chart of Accounts provides that the Minister of Finance may determine minimum business processes and system requirements through issuing a gazette. This MFMA Circular provides guidance as it relates to these requirements as envisaged by Chapter 3 of the Regulation. Guidance supplied in this Circular will provide the basis for determining the minimum business and system requirements to gazette at a future date as envisaged in the Regulation.

This MFMA Circular therefore provides municipalities with guidance relating to:

- Accountability as it relates to *m*SCOA implementation;
- Outcome of the research into financial management and internal control systems;
- Minimum business processes and system requirements to ensure *m*SCOA compliancy and address business process requirements across the entire local government financial management accountability cycle; and
- The issuing of a request for proposals (RFP) for the appointment of service providers for an integrated financial management and internal control system for local government.

**Annexure A** provides a list of all municipalities and their respective system vendors (service providers) which actively participated and contributed during the piloting phase.

## **2. Accountability for *m*SCOA implementation and compliance**

During the piloting process, the National Treasury's *m*SCOA Project Team experienced, to varying levels, a shift of accountability for *m*SCOA implementation. In some instances, municipalities would shift operational responsibility onto their system vendor; the inverse was also observed. Expectations also include that the National Treasury and provincial treasuries would facilitate the process on behalf of municipalities and even cover the costs associated with *m*SCOA implementation.

Municipalities are reminded that the National Treasury is constitutionally mandated to set norms and standards to ensure both transparency and internal control of the financial affairs of all three spheres of government. In addition, the National Treasury must execute against its constitutional monitoring and oversight role over municipalities as it relates to adherence and compliance to the legislative framework governing local government. While the National Treasury acknowledges that municipalities would require guidance with the implementation of a strategic financial management reform of this nature, and the National Treasury will continue to provide such, ***the municipality and municipal entity remains ultimately responsible and accountable to implement mSCOA across its organisation.*** In this regard, your attention is drawn to Chapter 5 (Responsibilities of Municipal Functionaries) of the mSCOA Regulation of which section 12 and 13 reads as follows:

**“Responsibilities of municipal councils and boards of directors**

12. The municipal council of a municipality and the board of directors of a municipal entity must take the necessary steps to ensure that these Regulations are implemented by the adoption of any resolutions, policies and budgetary provisions necessary for the implementation of these Regulations.

**Responsibilities of accounting officers**

13. The accounting officer of a municipality or municipal entity must take all necessary steps to ensure that these Regulations are implemented by at least—
- (a) delegating the necessary powers and duties to the appropriate officials;
  - (b) ensuring that the responsible officials have the necessary capacity by providing for training and ensuring that they attend training or workshops provided by the National Treasury;
  - (c) ensuring that the financial and business applications of the municipality or municipal entity have the capacity to accommodate the implementation of these Regulations and that the required modifications or upgrades are implemented; and
  - (d) submitting reports and recommendations to the municipal council or the board of directors, as the case may be, that provide for the adoption of any resolutions, policies and budgetary provisions necessary for the implementation of these Regulations.”

In terms of compliancy with the Regulation, the ordinary regulatory and oversight bodies (i.e. the Auditor General of South Africa, National Treasury, DCoG, South African Revenue Service, Department of Water Affairs, National Energy Regulator of South Africa, etc.) will

review the municipality's and municipal entity's embrace of *m*SCOA as part of their normal oversight and monitoring activities.

Notwithstanding the accountability that vests with municipalities themselves to ensure compliance with the entire local government legislative framework, including the Municipal Regulations on a Standard Chart of Accounts, many municipalities have requested assistance from the National Treasury and respective provincial treasuries in dealing with some technical aspects of *m*SCOA implementation. Challenges and concerns relating to financial management and internal control systems have undoubtedly been top of the list. **While it is acknowledged that financial management and systems of internal control is a key consideration with the implementation of the *m*SCOA, it is only one aspect. *m*SCOA implementation cannot be considered solely an ICT or finance reform; on the contrary it is a complete organisation reform and must be approached as such for it to be successfully implemented at a municipal level.**

### **3. Research into Systems of Financial Management and Internal Control – MFMA Circular No. 57**

MFMA Circular No. 57 was released on 20 October 2011 with the primary objective of informing municipalities of the investigation into local government financial systems and processes and to outline the procedure that municipalities need to comply with when considering a replacement of their core financial systems. Importantly, MFMA Circular No. 57 was issued 31 months prior to the gazetting of the Municipal Regulations on Standard Chart of Accounts (22 April 2014) as the National Treasury understood that the *m*SCOA would have to be supported by appropriate systems of financial management and internal control. This was considered a prerequisite for *m*SCOA implementation and consequently MFMA Circular No. 57 placed limitations on the replacement of systems of financial management and internal control.

Section 5 of the MFMA enables National Treasury to investigate any system of financial management and internal control in a municipality or municipal entity and recommend appropriate improvements. Since the release of MFMA Circular No. 57, the National Treasury has continued with the commissioning of a project into the research and assessment of various financial applications and related software; this project has culminated into five years' worth of research and development. Unlike the national and provincial sphere, local government has its own peculiarities, such as operating a host of different systems of financial management and internal control. In dealing with this challenge it was considered appropriate

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to review not only the system functionality as it relates to *m*SCOA compliancy, but also the business processes required to optimally manage the business of local government.

The outcome of this research, which was aligned and informed by the 'piloting' of the *m*SCOA classification, has resulted in a comprehensive list of business processes that should be supported by system functionality (systems of financial management and internal control). **Annexure B (System Specifications)** to this Circular includes a detailed list of these business processes and will be further explained in this MFMA Circular. **Importantly, municipalities need to evaluate the functionality of their current financial management and internal control systems against these business processes and technical specifications. If the outcome of the assessment is favourable, then municipalities would not necessarily need to replace their current financial management and internal control system. The service provider would however have to provide the municipality with guarantees to this effect.** Municipalities are also urged to make use of the guidance supplied in *Municipal SCOA Circular 2* in undertaking this assessment.

#### **4. What Constitutes Minimum Compliance to *m*SCOA – Business Processes and System Functionality**

Municipalities must ensure when examining the functionality of their current systems of financial management and internal control that it meets the minimum business processes and system requirements as stated in the objective of the *m*SCOA Regulation, namely; a system of financial management and internal control capable of providing for the uniform recording and classification of both **municipal budget and financial information at a transaction level** in the prescribed municipal standard chart of accounts, for both municipalities and municipal entities.

**Systems of financial management and internal control must, as a minimum, comply with these explicit business process requirements as contained in the *m*SCOA Regulation, in that it:**

- a) **Must provide** for the hosting of the *m*SCOA structure and associated detail as contained in the seven defined Segments;
- b) **Be able to** accommodate and operate the classification framework across all seven segments at a transactional level as defined in the associated detail to the Segments;

- c) **Must provide** for the data extraction functionality as per the segmented transactional string and seamless upload to the Local Government Database as hosted by the National Treasury;
- d) **May not** apply methodologies of data mapping or data extrapolation<sup>1</sup> to provide for the segmented transactional data string at a transactional level above as explained in point c) above;
- e) **Must provide** for full seamless integration between the core financial system representing the general ledger, and any third party system with a direct impact on the general ledger i.e. human resource and payroll third party systems, billing etc.; and
- f) **Must have** access to hardware that is sufficient to run the required software solution.

While the above might be considered to be extremely high level in providing guidance to municipalities, municipalities should remind themselves of the overall objective of the Regulation, which is to ensure the consistent classification of municipal transactional information across the entire local government accountability cycle for all 278 municipalities.

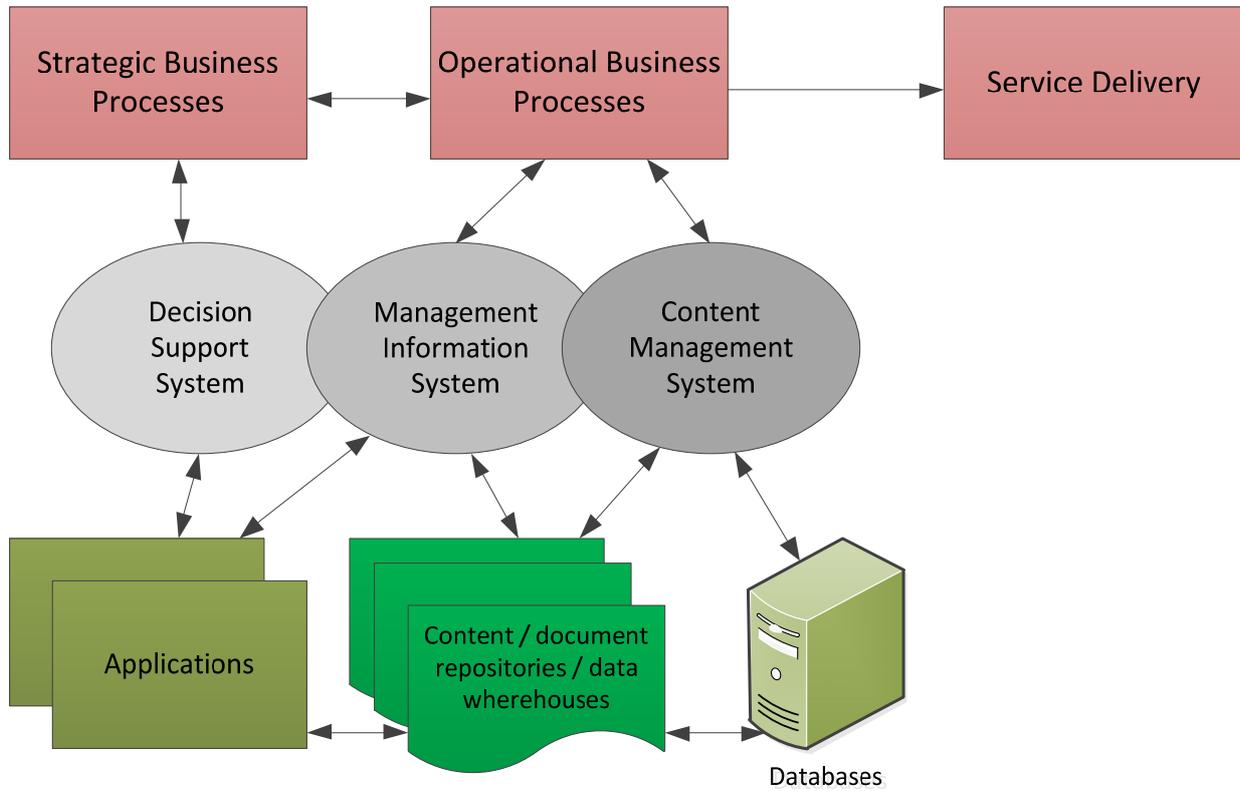
Municipalities need to understand the important linkage between business processes and systems of financial management and internal control i.e. financial applications. There are fundamental business processes which cannot be compromised. The business processes active within an organisation play a critical role in supporting management in generating information for management decision making and accountability for service delivery outcomes.

Increasingly, entities are using technology to automate, simplify and streamline particular tasks and functions. In this way, commercial or bespoke solutions are meant to assist officials within an organisation to generate information for management control and decision making purposes. As illustrated in the diagram below there is a direct correlation between management performance and information availability within any organisation.

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<sup>1</sup> Manual intervention or interpretation of data.

The following diagram provides an illustrative perspective of the complete information management system and linkage to business processes:

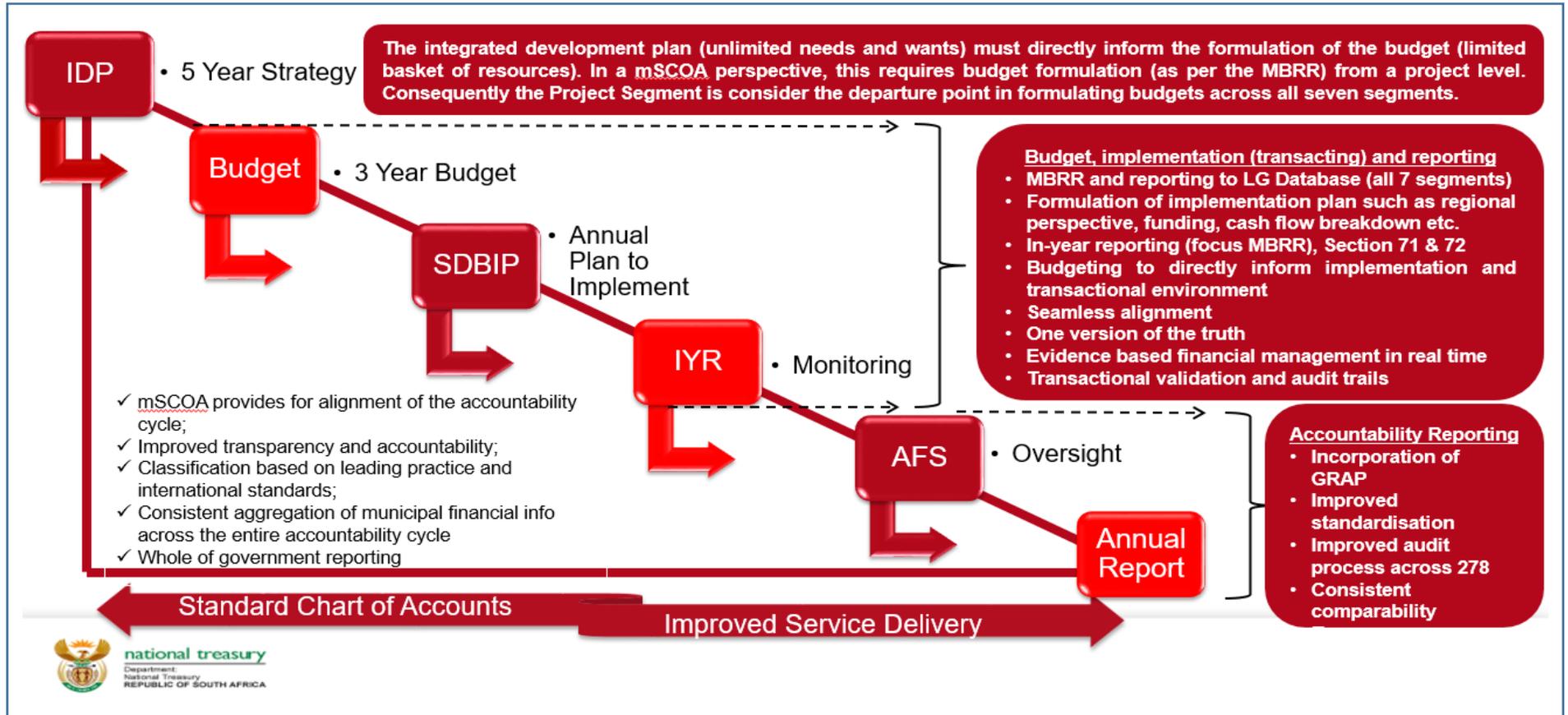


The diagram below provides an illustrative perspective of the linkage between the local government financial management accountability cycle and *m*SCOA. The diagram clearly demonstrates how business processes, system functionality and management decision making need to be considered in a seamless manner and that these cannot be considered in isolation:

Acronym used in the diagram:	Refer to the:
MBRR	Municipal Budget and Reporting Regulations, 2009
IDP	<a href="#">Integrated Development Plan</a>
SDBIP	Service Delivery- and Budget Implementation Plan
IYR	<a href="#">MFMA section 71 and 72 in-year reporting</a>
AFS	Annual Financial Statements



**The Local Government Financial Management Accountability Cycle and linkage with mSCOA:**





## **5. Detail Business Process Requirements and Associated System Functionality**

Any system of financial management and internal control, as a minimum, must comply with the seven main business and process components. The seven components must integrate seamlessly with the *mSCOA* general ledger and comply at a posting level to the *mSCOA* Regulations and GRAP. The seven main components are defined as follows:

1. General Ledger;
2. Billing;
3. Supply chain management;
4. Assets management;
5. Inventory and stores;
6. Budgeting and planning; and
7. Human Resources and payroll.

Directly aligned to the defined components as listed above, fifteen major business processes have been defined within Local Government. These fifteen business processes are as follows:

- i. Corporate Governance;
- ii. Municipal Budgeting, Planning and Modelling;
- iii. Financial Accounting;
- iv. Costing and reporting;
- v. Project Accounting;
- vi. Treasury and Cash Management;
- vii. Procurement Cycle: Supply Chain Management, Expenditure Management, Contract Management and Accounts Payable;
- viii. Grant Management;
- ix. Full Asset Life Cycle Management including Maintenance Management;
- x. Real Estate and Resources Management;
- xi. Human Resource and Payroll Management;
- xii. Customer Care, Credit Control and Debt Collection;
- xiii. Valuation Roll Management;
- xiv. Land Use Building Control; and

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xv. Revenue Cycle Billing.

Directly aligned to the research outcomes into systems of financial management and internal control, the outcome of the *m*SCOA piloting process, and legislative requirements across the entire local government accountability cycle, these fifteen high level business processes have been further defined into sub-processes as contained in **Annexure B**. These sub-processes represent the business and technical requirements to ensure not only *m*SCOA compliancy, but also address the broader requirements of a system of financial management and internal control within a South African local government context.

## 6. Commercial-Off-The-Shelf Tier 1 Integrated Financial Management Systems versus Local, Bespoke and Third Party Systems

Observers have commented that only Commercial-Off-The-Shelf (COTS) Tier 1 Solutions will provide for *m*SCOA compliancy; [the National Treasury position](#), informed by its five-year research in this regard, [is set-out below](#):

The *m*SCOA pilot process confirmed that traditional locally designed systems and solutions can, similar to COTS, also provide the functionality in dealing with the business and technical requirements associated with *m*SCOA; in some cases, these locally designed systems also represent what has commonly been referred to as an integrated financial management system and incorporate best-of-breed and internationally accepted standards as it relates to financial management and internal control systems. In addition, some municipalities are operating on a core financial system supported by integrated third party solutions which also achieved the objectives and definition of an integrated financial management system.

However, irrespective of the municipality's preferred option (COTS/ or locally designed/ and including integrated third party solutions) it is crucial to maximise the cost savings and associated *m*SCOA implementation benefits offered to the municipality or municipal entity when making a decision in this regard. All municipalities are therefore advised to consider and compare the various service offerings in the transversal *Local Government Integrated Financial Management and Internal Control* tender, discussed in paragraph 8 below.

In our experience, it is more cost effective for a municipality to use an ICT system(s) solution which support and system updates are Rand based. Furthermore, it *appears* that local solutions are *generally* flexible to allow manual and excel integration at municipalities that do

not have the capital and/ or skills to operate COTS Tier 1 Solutions with their associated architectural configuration requirements.

## 7. Legislative Framework – Procurement of Systems of Financial Management and Internal Control

The MFMA (in particular chapter 11), the Municipal Supply Chain Management (SCM) Regulations and the Municipal Regulations on a Standard Chart of Accounts (*mSCOA*) apply to any system(s) conversion. In this regard, it is important that a municipality and municipal entity note that:

**SCM Regulation, Section 31** - allowed the State Information Technology Agency (SITA) to assist a municipality to procure IT related goods or services through a competitive bidding process. Owing to the technical nature of the *mSCOA* classification framework, associated business processes and system requirements, the National Treasury recommends that municipalities ensure these minimum requirements as contained in this Circular are adequately addressed should they choose to proceed with Section 31 of the SCM Regulations.

**SCM Regulation Section 32** - allows for procurement of goods and services under contracts secured by other organs of state but only if:

- a) the contract has been secured by that other organ of state ***by means of a competitive bidding process applicable to that organ of state***;
- b) the municipality has ***no reason to believe*** that such ***contract was not validly procured***;
- c) There are ***demonstrable discounts or benefits*** for the municipality to do so; and
- d) That the ***other organ of state and the provider*** have ***consented to such procurement in writing.***

In addition to the explicit requirements indicated above, municipalities need to comply with the following as it relates to **SCM Regulation Section 32**, namely:

- a) The scope of the services or works or the quantities of the goods in terms of specifications **must be exactly the same as those included in the contract** awarded by the other organ of the State;

- b) The contract entered into between the municipality and the service provider/ supplier **must be exactly the same** as the one that was originally secured by the other organ of the State; and
- c) The tender price that is included in the contract of the municipality **must be exactly the same** as the price that was included in the contract secured by the other organ of the State.

A municipality considering using a contract secured by another organ of the State for the procurement of a financial management and internal control system at this point in time would in all probability not meet the criteria as listed above. This owing to the fact that the National Treasury is unaware of any procurement that has recently been successfully concluded based on the business processes and technical requirements that would give effect to *mSCOA* compliancy. On the contrary, the National Treasury has only recently concluded the piloting of the classification framework which has resulted in the release of *mSCOA* Version 5.4 in December 2015 as explained in the introduction to this Circular.

To support municipalities in this regard, a transversal contract for the supply of *an integrated financial management and internal control system for local government* was issued and is discussed below in paragraph 8. Municipalities can use this transversal contract freely in terms of SCM Regulation 32 since it already meets all the criteria as discussed above.

## **8. Transversal Contract for the Supply of an Integrated Financial Management and Internal Control System for Local Government**

As mentioned earlier in the Circular, one of the pressing concerns consistently raised by municipalities with the implementation of the *mSCOA* has been the functionality of current financial management and internal control systems to effectively operate on the multi-dimensional classification framework as represented by the seven segments and associated detail. Concerns raised have included:

- Limited technical skills within municipalities to effectively assess and evaluate system functionality aligned to the requirements of the *mSCOA* Regulation;
- It is difficult to determine actual requirements versus nice to haves;
- While municipalities undertake a supply management process, the technical assessment of actual service offerings is difficult owing to the technical nature of system evaluations; and

- Municipalities aren't necessarily getting value for money in relation to the service offering they receive.

Considering the challenges experienced by municipalities, the National Treasury, through the Office of the Chief Procurement Officer, advertised a Request for Proposal (RFP) on 4 March 2016 for the appointment of service providers for *an integrated financial management and internal control system for local government* (RT25-2016 on page 115 of Tender Bulletin No. 2906). The process has been structured as a transversal contract and differentiation applied to the technical specifications and business process in accommodating for all categories of municipalities i.e. metropolitan municipalities, secondary cities, large towns, small towns, district municipalities with billing, and districts without billing.

Municipalities are urged to review all the tender documentation in familiarising themselves with the content and structure of the RFP. The documentation can be accessed at:

<http://www.etenders.gov.za/content/rt25-2016-appointment-service-providers-integrated-financial-management-and-internal-control>

The objective of this tender process is not only to save municipalities' time and effort with the procurement process, but also to provide clear guidance with the appointment of services providers. Once the tender process has been completed, which is envisaged for the latter part of May 2016, municipalities will be able to make use of the panel of services providers in entering into service level agreements for the supply of financial management and internal control systems.

Importantly, while the National Treasury will facilitate the transversal tender process and provide a panel of service providers for the supply of financial management and internal control systems to local government, ***municipalities will remain responsible for entering into service level agreements (SLA's), management of the SLA's, providing budget and the settlement of all invoices within the legislative framework governing local government.*** Municipalities are also reminded that ICT, financial management and internal control systems, and associated expenditure already forms part of existing budgets. Municipalities will have to reprioritise existing budget allocations to provide funding for the implementation of this strategic and necessary financial management reform. Municipalities are reminded that the Financial Management Grant (FMG) can also be used over the MTREF to support mSCOA implementation.

The National Treasury acknowledges that metropolitan municipalities and secondary cities, in most instances, have the necessary skills and ability to deal with not only procurement but also highly technical aspects of financial management and internal control systems. ***In this regard, and with the exception of metropolitan municipalities and secondary cities, all other municipalities are highly recommended to make use of the transversal contract and associated panel of service providers for the supply of financial management and internal control systems once finalised. Should a municipality decide not to do so, it is required of them to formally write to the National Treasury (Chief Directorate: Local Government Budget Analysis) prior to going out on a supply chain management process, supplying clear reasons and motivation in support of the decision after which National Treasury will provide a written response and clear recommendations.***

## 9. MFMA Circular No. 57

This Circular replaces MFMA Circular No. 57 with immediate effect and does not apply retrospectively. Any system changes from 20 September 2011 to date, without following the guidance of the National Treasury could constitute fruitless and wasteful expenditure. The municipality and municipal entity is obliged to investigate any such system procurements/ changes and follow due governance in dealing with and reporting such, including appropriate disciplinary measures and recovering the costs of such system changes/ procurement from the person(s)/ official(s) responsible.

The National Treasury will not entertain any condonation of such fruitless and wasteful expenditure in the context of the clear guidance provided by MFMA Circular No. 57.

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**08 March 2016**

**Annexure A – List of all municipalities and their respective system vendors (service providers) which actively participated and contributed during the mSCOA piloting phase.**

<b>Municipalities / Metro's</b>	<b>ICT System</b>
Buffalo City	Solar
Camdeboo Local Municipality	Promun
City of Cape Town Metro	SAP
City Of Johannesburg	SAP
City of Tswane	SAP
Drakenstein Local Municipality	Solar
Ekurhuleni Metro	eVenus
Elias Motsoaledi Local Municipality	Munsoft
eThekwini	JD EDWARDS
Greater Giyani Local Municipality	Sage Evolution
Hessequa Local Municipality	Venus
Knysna Local Municipality	ProMun
Mangahung	Solar
Nala Local Municipality	BIQ
Nelson Mandela Bay	Sebata
Nkangala District Municipality	Munsoft
Overstrand Local Municipality	Samras
Richmond Local Municipality	Abakus <sup>2</sup>
Senqu Local Municipality	Sebata
Setsoto Local Municipality	Munsoft
Sol Plaatje Local Municipality	eVenus
Tlokwe Local Municipality	Phoenix
uMgungundlovu District Municipality	Sage Evolution
uMhlathuze Local Municipality	ProMIS <sup>2</sup>
Victor Khanye Local Municipality	Sebata