Frequently Asked Questions
On the MCS
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1. Introduction

The Frequently Asked Questions (FAQs) are based on queries commonly received from the stakeholders involved with preparation and finalisation of annual financial statements in accordance with the Modified Cash Standard (MCS).

These FAQs are not authoritative and do not form part of the Modified Cash Standard (MCS). Any examples provided are illustrative only and do not represent a comprehensive list of scenarios or circumstances that may exist in practice. As a result, the examples are not prescriptive and should not be used by analogy to other circumstances unless expressly stated otherwise.

2. FAQs per MCS Chapter

Chapter 1: Preface To The Modified Cash Standard

None identified as at date of publication.

Chapter 2: Concepts and Principles

None identified as at date of publication.

Chapter 3: Financial Statement Presentation

3.1 This Chapter prescribes the broad revenue and expenditure classification structure on the face of the statement of financial performance, where can a department find explanations for the different categories?

The categories were introduced through the Reference Guide to the Economic Reporting Format (ERF). Further discussion and explanation on these can be found in the SCOA Classification Circular on Transfers and Subsidies versus Goods and Services or Capital Assets available on the SCOA website.

3.2 Which portion of an outstanding debt should be classified as current asset and which should be classified as non-current asset if there is no agreement between the department and the debtor?

As part of controls, the department should endeavour to have an arrangement with the debtor for amount owing to the department. The formal arrangement serves as evidence of the repayment period informing the department of which portion of the outstanding debt should be classified as current assets and which portion should be classified as non-current assets. If the department does not have an arrangement ordinarily in a form of an agreement, the amount due on the outstanding debt is expected to be realised within twelve months after the reporting date. Thus the full outstanding debt should be classified as current assets. Controls, policies and procedures should be in place to recover amounts due to the department.

A distinction should be drawn between classifying receivables as either current and non-current assets; and aging of receivables. Aging of receivables is a management tool that categorises debts according to the date ranges showing debts which remained unsettled since they were recognised or recorded. Therefore aging of receivables provides information on how long a debt has been outstanding whereas classifying receivables as either current and non-current assets is based on when the department expects to recover outstanding debt. Aging of receivables is useful when assessing impairment of receivables as it shows the history of effectiveness of recovering receivables.

Impairment on receivables should be assessed at every reporting date. Where there is an indication of impairment, appropriate disclosures should be included in the notes to the financial statements. A receivable is only written off when identified as irrecoverable and approved by the Accounting Officer.
If the amount is irrecoverable, the Accounting Officer may write the debt off after following the necessary requirements and processes.

Chapter 4: Accounting Policies, Estimates and Errors

None identified as at date of publication.

Chapter 5: Appropriation Statement

None identified as at date of publication.

Chapter 6: Cash Flow Statement

None identified as at date of publication.

Chapter 7: Revenue

None identified as at date of publication.

Chapter 8: Expenditure

8.1 If expenditure was misclassified in the previous reporting period, should it be reported as a prior period error?

Yes. The MCS Chapter on Accounting Policies, Estimates and Errors defines prior period error as omissions from, and misstatements in, the department’s financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a) was available when financial statements for those periods were authorised for issue; and

b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements,

whereas the MCS Chapter on Concepts and Principles defines misstatement as the difference between the amount, classification, presentation or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required for the item to be in accordance MCS.

Therefore, a misclassification of expenditure should be reported as a prior period error.

8.2 Is there a difference in the way in which a department recognises expenditure on own and outsourced activities?

Some departments undertake activities relating to the construction of new assets and/or the maintenance, upgrade, rehabilitation of existing assets. These activities are carried out by the department on own account, or are outsourced to a service provider. Definitions and explanations on own account or outsourced activities can be obtained from the SCOA website.

Own account activities – where the department engages in construction, maintenance, upgrade or refurbishment of an asset in its own capacity (or through the use of an Agent as determined through the application of Chapter 16 of the MCS). Thus a department will utilize its own employees (i.e. paid from compensation of employees) to complete the project, will buy all items of inventory itself and will use its own equipment to finalise the project.

Outsourced activities – where the construction, maintenance, upgrade or refurbishment is outsourced to an external service provider. In such arrangements, the department pays the service provider who in turn will use its own employees, inventory, equipment etc.
The classification of transactions incurred on own account and for outsourced activities differ as illustrated in the table below:

**Example: Own account activities**
The Provincial Department of Health upgrades its ambulances in the departmental workshop. The department’s own employees are used for the work, five different pieces of equipment are purchased and installed in each ambulance. Two of the five are worth more than R5 000 whereas three of the five are worth less than R5 000. An existing capital asset is therefore upgraded from own account.

<table>
<thead>
<tr>
<th>Item Segment</th>
<th>Asset Segment</th>
<th>Infrastructure Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Compensation of employees</td>
<td>✓ Emergency vehicles</td>
<td>✓ Capital: Upgrade and additions other machinery and equipment</td>
</tr>
<tr>
<td>✓ Expenditure for capital assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery and Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assistive Device, Medical and allied equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>✓ Goods and services:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery and Equipment &lt; R5 000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assistive Device, Medical and allied equipment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Example 2**: The department outsourced the repair of its office building, to a private construction company. The work is issued as one contract and the bill of quantities specifies the replacement of the air-conditioning system to the value of R9 million and the painting of walls and fixing of door handles to the value of R1 million. The total cost for the contract amounts to R10 million for a building valued at R50 million, belonging to a Private Company. In terms of the 20 year lease agreement, the department is entitled to repair the office building at own cost if so required. In this instance the project is viewed as consisting of the one contract, as it is issued to one contractor and consists of related work within the one contract. The total amount of R10 million will be capitalized as a capital rehabilitation project.

<table>
<thead>
<tr>
<th>Item Segment</th>
<th>Asset Segment</th>
<th>Infrastructure Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Refurbishment / rehabilitation of buildings : Contractors (under expenditure for capital assets)</td>
<td>✓ Office buildings</td>
<td>✓ Capital: Refurbishment / rehabilitation of existing buildings</td>
</tr>
</tbody>
</table>

*The above table only illustrates three of the eight segments and does not provide all the non-posting level details.*

**Chapter 9: General Departmental Assets and Liabilities**

9.1 **Should the additional disclosure requirement on prepayments and advances be applied prospectively or retrospectively?**

Users of financial statements should be provided with information on movement of prepayments and advances. Therefore a reconciliation disclosure requirement was added to Paragraph .34a) of the MCS Chapter on General Departmental Assets and Liabilities as shown by the underlined words:

A department shall disclose the following in its notes with regard to prepayments and advances:
per significant category of the prepayments and advances, a reconciliation of the opening balance and the closing balance at the end of the reporting period.

This additional requirement on prepayments and advances should be applied prospectively with effect from the financial year beginning 1 April 2017.

Chapter 10: Treasury Financial Instruments

None identified as at date of publication.

Chapter 11: Capital Assets

11.1 Why has the chapter been amended to remove the recording of capital work-in-progress in specific instances?

The requirements in the chapter were designed around user departments funding capital works undertaken by custodians. User departments recognise the capital expenditure and the capital work-in-progress.

However it came to light that in certain instances there is a duplication of reporting capital work-in-progress by user departments and custodians, in that both reflect the same capital work-in-progress. This may mislead users of the financial statements. The OAG further noted that in these instances additional costs emanating from reviewing two sets of financial statements instead of one, such as audit costs. Accordingly the MCS was amended through the inclusion of paragraph .91A in the Chapter on Capital Assets.

Chapter 12: Inventories

None identified as at date of publication.

Chapter 13: Lease

13.1 How should RT15 of 2016 transversal contract be accounted for in the financial statements of a participating department?

Although RT 15 of 2016 is the master contract on mobile communication services, every department that participates in RT 15 of 2016 on mobile communication services is expected to have its own participating contract that may include unique terms and conditions to that department. Therefore the terms of the arrangement in one department will not be identical to those of another.

The treatment of the monthly subscription and the hardware devices utilised by officials in departments is no different than what would be applied under any other prior arrangement. Guidance on measurement and disclosure of cell phone contracts in the AMD Chapter on Leases.

With regard to the hardware fund, it is understood that on inception there are no expected cash outflows required by the department and as such no corresponding accounting entities are required.

Departments may provide a narrative stating that they participate in RT 15 of 2016 transversal contract.

13.2 Should a department record any lease commitments if the lease has expired at year-end?

A lease is defined as an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. A department records its outstanding lease commitments in the notes to the financial statement to indicate amounts that the department is obligated to pay the lessor. The obligation arises out of the lease agreement.
For a lease to exist there must be an agreement between the lessor and the lessee on the asset, the period of use and the amounts due. This agreement can be in writing, verbally or in legislation. The MCS does not specify that a lease agreement must be in writing.

If there is no agreement at year-end on any of the three conditions mentioned above, it has no lease commitment to disclose. Instead, the department will continue to lease the asset on a month-to-month basis with the lessor. In these instances a department may disclose this fact in the lease note to the financial statements.

Where the department continues on a month-to-month basis it will also continue to recognise the lease expenditure in the same manner unless there is objective evidence that the nature of the lease will be amended at a future date. Therefore, if the department continues on a month-to-month basis and is in the process of renegotiating the operating lease agreement, it shall continue to recognise the monthly expenditure incurred as operating lease payments.

The lease commitment will be disclosed if there is objective evidence that the lease will concluded. An example of objective evidence is minutes of meeting indication that those authorised to approve the lease have indicated that the lease should be approved.

Chapter 14: Provisions and Contingents

None identified as at date of publication.

Chapter 15: Related Party Disclosures

15.1 Which method should is appropriate to determine if individuals have significant influence to qualify to be disclosed as Key Management Personnel?

A related party is a person or an entity with the ability to control or jointly control the other party, or exercise significant influence over the other party. Significant influence involves the power to participate in the financial and operating policy decision of an entity. Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the activities of the department. Key management personnel are related parties which means they can exercise significant influence over other parties.

Practically determining significant influence can involve subjectivity which may lead to inconsistent application and challenges with comparability. Salary levels may be used as a guide in determining individuals who have significant influence in the department. However, departments should include other individuals who are not at executive management level yet exercise significant influence.

Chapter 16: Accounting by Principals and Agents

16.1 How should a department approach the application of Chapter 16?

When an entity directs another entity to undertake an activity on its behalf, it must consider whether it is a party to a principal-agent arrangement. The definition of a principal-agent arrangement refers to an entity (an agent) undertaking transactions with third parties acting on behalf of, and for the benefit of, another entity (the principal). In the absence of transactions with third parties, the arrangement is not a principal-agent arrangement, and the entity then acts in another capacity rather than as an agent.

Accordingly, the following approach should be followed in applying the MCS requirements in accounting by principals and agents:

a) Is there a binding arrangement between the two parties? [consider paragraphs .19 - .21 to identify a binding arrangement]
b) If there is a binding arrangement, does it require one entity to undertake transactions with third parties on behalf of the other party to the arrangement? [consider paragraph .10 to identify transactions with third parties]

c) Where there are transactions with third parties, identify the agent. [consider paragraph .26 for the criteria to identify which party is the agent and the explanations in paragraphs .27 - .42]

Chapter 17: Events After The Reporting Date

None identified as at date of publication.

Chapter 18: Consolidated Financial Statements

None identified as at date of publication.
Template and Specimen Annual Financial Statements

19.1 *Is there an easier was to complete the Appropriation Statement in the Specimen AFS other than typing every number manually?*

Included at the top of the AFS Template Appropriation Statement sheet (Approp Stat) is a button called “Export App.Stat” to assist departments with the completion of the Specimen AFS.

Once the department has completed the Appropriation Statement in the AFS Template, they can click on this button so that the entire appropriation statement is exported to a new file in the required vertical format. This file does not include formulas, only the numbers as they appear in the AFS Template used to create the separate file.

Departments can then copy and paste the required information from this new file into the Specimen AFS. This eliminates the typing of each number into the Specimen AFS before submission.

The department will still have the responsibility to check that the numbers are correct in the Specimen AFS before submission.

If there are any changes to the appropriation statement in the AFS Template, the process will need to be redone to ensure the Specimen AFS is correct.

19.2 *How should the prepayments and advances notes be populated in the Specimen AFS?*

The prospective application of the prepayments and advances reconciliations means that the closing balances per the audited annual financial statements as at 31 March 2017 for the prepayments and advances sub-notes should be used as the opening balances in the prepayments and advances sub-notes for the year ended 31 March 2018.

The amounts for the current year column should be the prepayments and advances balance as at 31 March 2018 where there are items or services still outstanding and not prepayments or advances that were made and for which the goods/services, etc. have been received.

Where there are any other reasons for the advances and prepayments balances to be reduced (for example if these payments resulted in fruitless and wasteful expenditure) these should be done in the available columns and an explanation included in the available narrative blocks below the sub-notes.

An illustrative example of this is as follows:

**Scenario**

Department X had recognised and recorded amounts in the AFS for 2016/17 for prepayments and advances per the relevant prior year subnotes below. From these amounts goods and services to the value of R1 500 000 for advances and R700 000 for prepayments were received.

They also had prepayments and advances in the current year 2017/18 as follows:

1. Advances made to national departments of R800 000, public entities of R150 000 and R220 000 to other entities. From this the goods/services, etc. that are still outstanding at 31 March 2018 are valued at R300 000 for national departments, R100 000 for the public entities and R200 000 for other entities.

2. Prepayments were made for goods and services and expensed in the Statement of Financial Performance to the value of R600 000. At 31 March 2018 goods/services, etc. to the value of R350 000 were not yet received by the department.

For the scenarios above the amounts should be reflected as follows:
**1. Advances paid (not expensed)**

**Prior year AFS**

The note 14.1 of the department in its final audited annual financial statements for 2016/17 was as follows:

**14.1 Advances paid (Not expensed)**

<table>
<thead>
<tr>
<th>Note 14</th>
<th>2016/17 R’000</th>
<th>2015/16 R’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>National departments</td>
<td>A</td>
<td>760</td>
</tr>
<tr>
<td>Provincial departments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public entities</td>
<td></td>
<td>950</td>
</tr>
<tr>
<td>Other entities</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>1 710</strong></td>
</tr>
</tbody>
</table>

For the 2017/18 financial year the department will use the above information to complete the opening balances column for note 14.1. as follows:

**Current year AFS**

<table>
<thead>
<tr>
<th>Note</th>
<th>Balance as at 1 April 2017 R’000</th>
<th>Less: Amount expensed in current year R’000</th>
<th>Add: Current Year advances R’000</th>
<th>Balance as at 31 March 2018 R’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>A</td>
<td>760</td>
<td>(550)</td>
<td>300</td>
</tr>
<tr>
<td>National departments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provincial departments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public entities</td>
<td></td>
<td>950</td>
<td>(950)</td>
<td>100</td>
</tr>
<tr>
<td>Other entities</td>
<td></td>
<td></td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>1 710</strong></td>
<td><strong>(1 500)</strong></td>
<td><strong>600</strong></td>
</tr>
</tbody>
</table>

From the above:

**A** represents the amounts per the final audited AFS of the prior year. These will be included in the opening balance column of the current year reconciliation.

**B** represents the second column where amounts were expensed in the current year relating to the opening balances column amounts and for which the goods/services, etc. have been received. This amount will reduce the opening balance.

**C** represents the amounts remaining at year end for which the goods/services, etc. have not yet been received by 31 March 2018. These amounts will add to the remaining balances and form part of the closing balance.

Similarly where prepayments were made during the year and not expensed, the note should be completed as for the advances above.
2. Prepayments (expensed)

Prior year AFS

The note 14.3 of the department in its final audited annual financial statements for 2016/17 was as follows:

<table>
<thead>
<tr>
<th>Note</th>
<th>2016/17</th>
<th>2015/16</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R'000</td>
<td>R'000</td>
</tr>
<tr>
<td>Goods and services</td>
<td>700</td>
<td>400</td>
</tr>
<tr>
<td>Interest and rent on land</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfers and subsidies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital assets</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>750</td>
<td>400</td>
</tr>
</tbody>
</table>

For the 2017/18 financial year the department will use the above information to complete the opening balances column for note 14.3 as follows:

Current year AFS

<table>
<thead>
<tr>
<th>14.3 Prepayments (Expensed)</th>
<th>2017/18</th>
<th>2015/16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Note</td>
<td>Amount as at 1 April</td>
<td>Less: Received in the current year</td>
</tr>
<tr>
<td></td>
<td>R'000</td>
<td>R'000</td>
</tr>
<tr>
<td>2017/18</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goods and services</td>
<td>700</td>
<td>(650)</td>
</tr>
<tr>
<td>Interest and rent on land</td>
<td>D</td>
<td></td>
</tr>
<tr>
<td>Transfers and subsidies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital assets</td>
<td>50</td>
<td>(50)</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>750</td>
<td>(700)</td>
</tr>
</tbody>
</table>

From the above:

D represents the amounts per the final audited AFS of the prior year. These will be included in the opening balance column of the current year reconciliation.

E represents the second column where goods/services, etc. were received in the current year relating to the opening balances column amounts. This amount will reduce the opening balance. These amounts were already expensed in the prior year and will not impact the statement of financial performance of the current year.

F represents the amounts remaining at year end for which the goods/services, etc. have not yet been received by 31 March 2018. These amounts will add to the remaining balances and form part of the closing balance.

Similarly where advances were made during the year and expensed, the note should be completed as for the prepayments above.
**Take note:** It is suggested that the departments keep a register of these transactions so that they can be tracked and matched when the goods are received. This will also facilitate end of year completion of the notes.