Departmental Guide

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Managing departmental debt

Contents

1. Purpose

The purpose of this document is to provide guidance on the management of departmental debt; and to guide practitioners in the process of writing off any irrecoverable debt.

2. Definitions

Debt means an amount owing to the department.

Doubtful debt is debt that is due but which might not be recoverable.

Irrecoverable debt is debt that is due but which is not expected to be collected.

3. Legal framework

3.1 In terms of the Public Finance Management Act (PFMA), 1 of 1999, the Accounting Officer:

- 3.1.1 Must ensure that the department has and maintains effective, efficient and transparent systems of financial, risk management and internal control [section 38(1)(a)(i)];
- 3.1.2 Is responsible for the effective, efficient, economical and transparent use of resources of the department [section 38(1)(b)];
- 3.1.3 Must take effective and appropriate steps to collect all money due to the department [section 38(1)(c)(i)];
- 3.1.4 Must keep full and proper records of the financial affairs of the department within prescribed norms and standards [section 40(1)(a)]; and
- 3.1.5 Comply with any regulations issued by the National Treasury [section 76].

3.2 In terms of the Treasury Regulations (TR), the Accounting Officer must:

- 3.2.1 Take effective and appropriate steps to collect all money due to the department including, as necessary [TR 11.2.1]:
  - a) maintenance of proper accounts and records of all debtors, including amounts received in part payment; and
  - b) referral of a matter to the State Attorney, where economical, to consider a legal demand and possible legal proceedings in a court of law.

3.3 Unless otherwise determined by law or agreement, debts owing to the state may, at the discretion of the Accounting Officer, be recovered in instalments [TR 11.3.1];

3.4 Only write-off a debt if he or she is satisfied that:

- 3.4.1 all reasonable steps have been taken to recover the debt, in accordance with a policy determined by the Accounting Officer, and
- 3.4.2 he or she is convinced that recovery of the debt would be uneconomical, the recovery would cause undue hardship to the debtor or his/her dependents or that it would be to the advantage of the state to effect a settlement of its claim or wave the claim [TR 11.4.1].

3.5 Charge interest on debts to the state at the interest rate determined by the Minister of Finance in terms of section 80 of the PFMA [TR 11.5.1].

3.6 If the state suffers a loss or damage and the other person denies liability, the Accounting Officer must, if deemed economical, refer the matter to the State Attorney for legal action [TR 12.3.1].

3.7 All transactions must be supported by authentic and verifiable source documents, clearly indicating the approved accounting allocation [TR 17.1.1].

4. Origin of debt

4.1 In terms of the Prescription Act, 68 of 1969, a debt is only deemed to be due when the creditor (or the department) has knowledge of the identity of the debtor and of the facts from which the debt has arisen [section 12]. This principle requires that the department identifies all debt[1] within a reasonable period, i.e. as soon as practicable, in order to prevent prescription.

4.2 Although the Accounting Officer designates officials with the responsibility for the administration of debts it is the responsibility of each employee of the department to ensure that any debt arising in his/her sphere of work is identified and reported to the appropriate officials for recognition and collection.

4.3 Failure to comply with the above could result in disciplinary steps being taken against the employee including the recovery of any loss the department may have suffered [TR 12.7].

5. Managing debt

5.1 General principles:

5.1.1 Where debtors are managed properly, irrecoverable debts will be minimised. Departments therefore need to have a debt management policy and ensure effective implementation thereof.

5.1.2 Departments should set up and maintain a proper vetting process regarding procurement of goods and services, collection of amounts due by debtors and the recording of outstanding amounts due. This should include the principal as well as the interest where applicable.

5.2 Debt management policy and procedures:

5.2.1 Departments must keep a register (electronic or otherwise) of all debt. Outstanding debtors should be investigated and responsibility determined. The register must include:

a) responsible debtor/official's name/s;

b) type of debt e.g. salary overpayment, theft, damage, breach of contract etc.

c) an age analysis;

d) disclose amounts paid over to the relevant Revenue Fund from collection of debts;

[1] A department may establish internal policies for the identification of the types of expenditure to be recovered and thresholds that may apply.

e) details regarding procedures followed to collect debt;

f) indicate which debts are regarded as doubtful.

5.2.2 This register should be inspected and signed off on a monthly basis by the Chief Financial Officer or his/her delegated official and must be available for audit purposes.

5.2.3 The register is both the system generated information and manual documentation such as debtors letters, attorney referrals etc.

5.2.4 A monthly reconciliation should be performed on all outstanding debtors to determine the movement/status of the debt. The reconciliation process should include a comparison between the journal source documentation and information captured on the system.

5.2.5 The investigation of debtors must be segregated from the responsibility for the collection, banking and reconciling of debtors.

5.2.6 A separate file must be kept for each debtor for safekeeping of documentation. The responsible official should sign a declaration certifying that debtor files of the department are regularly updated with scheduled notifications of debt, debtor statements, receipts and documentation, including copies of journals, pertaining to the management of the debtors.

5.2.7 Debtors must be placed in “mora” before collection processes are affected. This requires that the debtor must be informed of the debt and given 30 days to pay the debt.

5.2.8 Interest only starts to accrue after the 30 day “mora“ period. The notice to the debtor must state that interest starts accruing 30 days after the date of the notification or another time period stated in any arrangements.

5.2.9 Interest should be calculated on the decreasing balance of the capital amount of the debt, and must not be capitalized. Interest levied must also not exceed the capital amount (in-duplum rule).

5.2.10 Accounting Officers must assure that interest, where applicable, is calculated and recovered together with the capital amount. Interest is recovered first from all payments and the remainder utilized to redeem the capital.

5.3 The debt management policy needs to include reference to the provisions of the Prescription Act, 1969 (Act 68 of 1969), especially Chapter III (sections 10 to 16). Debt becomes prescribed after certain periods and financial managers need to take these into account. This entails that the debt can no longer be recovered from the debtor and should be written off.

5.4 It is suggested that a Service Level Agreement is entered into with the respective State Attorneys to manage the referral of debt. These agreements should address the issue of materiality as well as the appointment of agencies to recover debt by either the State Attorney or the agency. Procedures regarding this should be specific and clear as it is a source of controversy when debtors are confronted by separate agencies acting on behalf of the collecting party.

5.5 Recovery of debt:

5.5.1 The initial value of the debt should be equal to the value of the goods or services provided or in the case of a lost / damaged asset the value should be the cost to restore or replace the asset.

5.5.2 The department may recover outstanding amounts in installments. The collection period should be realistic taking the financial position of the debtor and potential hardships into account. Realistic refers to a period between twelve (12) and thirty six (36) months.

5.5.3 The debtor should be informed in writing as soon as a decision has been reached on the number of installments due along with any terms and conditions attached thereto. The collection period should be reviewed at least annually and any adjustments should be communicated accordingly.

5.5.4 If a debtor offers to settle the debt at a value less that the current balance, the offer can be considered only if it would be to the advantage of the state to accept the settlement. The settlement agreement should be confirmed in writing with the debtor, without prejudice.

5.5.5 The department can withhold departmental debt from any amount payable to the applicable debtor, such as leave discounting, PDMS, service bonus, overtime, etc.)

5.6 The following minimum debt management procedures must be adhered to before a debt is regarded as irrecoverable debt:

5.6.1 Once a debt has been taken-on a letter of demand is sent to the Debtor (this is when he/she is placed "in mora"). The Debtor is expected to respond by either acknowledging or disputing the debt;

5.6.2 Where no response is received after an appropriate period of for example thirty days, the letter of demand is followed up with a second reminder, giving the debtor another chance to respond;

5.6.3 If a valid response is received, a debtor's statement is forwarded to the debtor or alternatively the debtor's representative in order to initiate the collection process and to specify the terms and conditions of payment;

5.6.4 Where no response is received, procedures for tracing the debtor must be initiated, taking into consideration the economic benefit for government by measuring the cost of tracing the debtor against the debt amount;

5.6.5 If a negative response is received the Accounting Officer can approve an adjustment to the principal amount, negotiate the repayment thereof or refer the matter to the State Attorney for a recommendation;

5.6.6 All outstanding referrals to the State Attorney should be regularly followed up;

5.6.7 Where write-off is advised by either the State Attorney or the Accounting Officer, the debt write-off process in this document must be followed.

6. Interest on debt

6.1 Debts due to the State resulting from the service relationship between public servants and the State shall be recovered **without interest**, with the exception of the following categories of debt, which shall be levied **with interest** at a rate as determined by the Minister in terms of section 80(1)(b) of the PFMA.

6.1.1 Wrongly granted remuneration, as defined in section 38 of the Public Service Act, 1994 where the person concerned has left the employment of the State, or where the monetary advantage resulted from his or her own fraudulent action; or

6.1.2 Loss and/or damage which originates as a result of circumstances where mala fides (evil intention) or the intentional causing of losses or damage were present, or where the person concerned has left the employment of the State; or

6.1.3 Breach of contract or any delictual claim relating to the contractual relationship.

6.2 Debts due to the State by debtors who are not in the employment of the State are to be recovered **with interest** at a rate as determined by the Minister in terms of section 80(1)(b) of the PFMA, with the exception of the following categories of debt, which are to be recovered **without interest**:

6.2.1 Overpayment of amounts to a debtor for social and unemployment benefits; or

6.2.2 Debts resulting from support provided by State medical institutions to State patients.

6.2.3 Interest only starts to accrue after the 30 day "mora" period. The notice to the debtor must state that interest starts accruing 30 days after the date of the notification or another time period stated in any arrangements.

7. Debt prescription

7.1 Debt prescribes after a certain period of time. The period of prescription varies depending on the debt types. Section 11 of the Prescription Act sets out the following periods:

7.1.1 Thirty (30) years – judgement debt, debt secured by a mortgage bond, taxation debt or levies imposed by law, and or debt relating to mineral rights;

7.1.2 Fifteen (15) years – debt owed to the state and arising out of an advance or loan of money or sale or lease of land by the state (excluding debt mentioned in 7.1.1 above);

7.1.3 Six (6) years – debt arising from a bill of exchange or negotiable instrument (excluding debt mentioned in 7.1.1 and 7.1.2 above); and

7.1.4 Three (3) years – any other debt except where an Act of Parliament provides otherwise.

7.2 Prescription is suspended where the debtor is outside the country and when the debt is the object of dispute subjected to arbitration [section 13].

7.3 Prescription is interrupted by acknowledgement of liability by the debtor and prescription begins to run anew [section 14].

8. Irrecoverable debt

8.1 The following circumstances can be indicative of situations where debt can be regarded as irrecoverable:

- the debtor has no assets or income;

- the Department made all reasonable efforts to trace and inform the debtor of the outstanding debt without success;
- the amount received from an insolvent estate did not cover the debt and interest;
- where a danger exists that the department will be required to make a contribution towards the settlement of an insolvent estate, if the claim is lodged against this estate;
- the department determines that it would be uneconomical to recover the debt; and
- the department determines that assets of a debtor's estate are of little value and cannot be used to recover the debt.

8.2 Where the debt is irrecoverable debt the following steps should be followed:

8.2.1 A submission to the Accounting Officer has to be prepared to obtain approval for the debt to be written off. This submission, authorising the write-off, should confirm that the debt management policy has been followed and detail the reasons for the write-off in the applicable programme; and

8.2.2 When the debt is considered for write-off, the status of the debt is to be changed on the debt functionality from active to doubtful, and interest must continue to be accumulated until the date the write-off is approved.

ANNEXURE A - ACCOUNTING ENTRIES FOR DEBT TAKE ON AND IRRECOVERABLE DEBT

Many of the accounting transactions are affected programmatically by BAS and therefore only the final entries are indicated.

Taking on a debt that originated in an open financial year will register a debt on the system against the specific debtor and debt number. The specific fund, objective, responsibility, item, asset, region, infrastructure and project (where the original payment was made) will be credited and the Debt Account of the specific debtor will be debited.

DR	Debt Account
CR	Relevant expenditure account

Taking on debt that originated in a closed financial year will register a debt on the system against a specific debtor and debt number. The Receivable Income Account will be credited (no disallowance journal can be passed because the financial year is closed) and the Debt Account of the specific debtor will be debited.

DR	Debt Account
CR	Receivable Income Account

On receipt of a payment from a debtor the amount must be credited to the “Debt Receipt Control: CA” account and debited against the relevant system control account such as the Receipt Control Account. A system generated transaction will allocate the receipt against the debt by debiting the “Debt Receipt Control: CA” account and crediting the “Debt Account: CA”. The BAS system will calculate the interest on the capital debt amount (if applicable) during the nightly batch run. This amount will be transferred to the Revenue Objective and the Interest Income Item. This account will be credited and the Receivable Interest Account will be credited, thereby clearing this account.

The revenue, both capital and interest, is accounted for by crediting the “Departmental Revenue” account and debiting the “Debt Receivable Income” account. The “Receipt Control Account” is cleared by crediting this account while the “Bank” account is debited. In the AFS the revenue will be disclosed as “Departmental Revenue” while outstanding debtors will be disclosed as “Receivables”. The balance of the “Debt Receivable Income” account will be disclosed in the “Statement of Changes in Net Assets”.

After the Accounting Officer approved for the writing off of debt, the debt status must first be changed using the Debt functionality to doubtful and then to bad (writing off the debt). The system will now automatically reverse the interest already transferred to the Receivable Interest Account.

Where debts become irrecoverable, the debt write-off should be allocated to the item “Thefts and Losses” under “Financial Transactions in Assets and Liabilities”; against the objective where debt originated. (The total to be written off is the Capital and Interest).

By transferring the receivable interest balance to the Interest Income Account, the Receivable Interest Account will be cleared.

An automatic transaction at year-end clear the Theft and Loss account and debit the Exchequer Grant account.

ANNEXURE B - EXAMPLES

Example 1: Telephone debt raised and recovered in same financial year

Department X's internal policy states that the cost of all private calls made from official cell phone devises must be reimbursed to the department. Charges in respect of private calls can be deducted from the official's salary or paid at the cashier.

Mr. Y indicated that private calls amounting to R170.00 were made for the month of August 2013 and agreed to allow the department to deduct this amount from his October 2013 salary.

The debt is recorded as follows in the accounting records of the department (September 2013):

Dr	Debt account	170.00	
Cr	Communication: cell contract (subscription & calls)		170.00

Note: the expenditure account communication: cell contract (subscription & calls) is credited as private telephone costs should not be funded by the department. The net expenditure amount will reflect the actual cost of calls for official use.

After the October salary run the debt is cleared by the department as follows:

Dr	Salary interface control account	170.00	
Cr	Debt account		170.00

Example 2: Telephone debt raised and recovered in a subsequent financial year

Mr Y's private calls for March 2013 amounted to R230.00. On the 17 May 2013Mr Y indicated that he would settle the amount with the cashier. The money was received and banked by 31 May 2013.

The debt is recorded as follows in the accounting records of the department (April 2013):

Dr	Debt account	230.00	
Cr	Debt receivable income		230.00

Note: the expenditure for the month of March cannot be reduced due to year-end closure. The department therefore credits the debt receivable income control account.

When Mr Y pays settles the debt at the cashiers' office the following entry is passed:

Once the funds are banked:

Dr	Bank*	230.00	
Cr	Debt account		230.00

* *The interface/programmatic entries are not included here.*

Recording of recovery of previous years' expenditure:

Dr	Debt receivable income	230.00	
Cr	Departmental debt / recovery of previous years' exp (transactions in financial assets and liabilities)*		230.00

* *these accounts form part of departmental revenue and will subsequently be surrendered to the relevant revenue fund.*

Example 3: Debt raised and partially recovered in same financial year (remainder written off)

Mrs. P made use of a laptop computer to perform her duties for the department. On the 20 July 2013 she accidentally spilt coffee on the keyboard. The department sent the laptop to the supplier for repairs on 28 July 2013. The laptop was received back on 1 September 2013 with an invoice for the total cost of repairs to the damaged laptop amounting to R 2,500. The invoice was forwarded to the responsible budget manager. The supplier was paid on 30 September 2013. Mrs. P was informed on 5 October she would be responsible for the cost of the repairs and maintenance incurred by the department. Mrs. P lodged an appeal requesting the department to reduce the debt. On 25 October the department agreed to recover only R1,500 from Mrs. P in 5 equal installments of R300 each (to be deducted from monthly salary). The remainder would be written off.

20 July 2013→ No accounting entries

28 July 2013→ No accounting entries

1 September 2013→ No accounting entries

30 September 2013→ the payment was made to the external supplier and recorded as follows:

Dr	Contractors – maintenance and repair of machinery and equipment	2,500.00	
Cr	Bank		2,500.00

5 October 2013→ the debt owing by Mrs P is recognised in the accounting records as follows:

Dr	Debt account	2,500.00	
Cr	Contractors – maintenance and repair of machinery and equipment		2,500.00

25 October 2013→ recording of the write-off

Dr	Thefts and losses	1,000.00	
Cr	Debt account		1,000.00

Each installment would be recovered from Mrs. P salary and recorded as follows:

Dr	Salary interface control account	300.00	
Cr	Debt account		300.00

Net cash position At 31 March:

Total cost incurred by department (unforeseen repairs and maintenance)	2,500.00
Amount recovered from employee	(1,500.00)
Potential cash shortage (i.e. less funds are available to finance the planned operating activities of the department hence the department will need to reprioritize spending to achieve the planned outputs or submit a request for additional funding)	**1,000.00**

Example 4: Debt raised and partially recovered in subsequent financial year (remainder written off)

Mr. R received a three year bursary from the department to obtain a B Com degree. According to the terms and conditions of the bursary the department will fund the studies provided that Mr. R passes each year. Mr. R must submit his exam results within 1 month of receipt. The total value of the bursary is R150, 000 (R50, 000 per annum).

Mr. R commenced his studies in 2010 and successfully completed the first 2 years of the degree. During 2012 Mr. R received 2 exam re-writes and informed the department that the results for the third year would be supplied after the marking of these re-writes. Mr. R re-wrote the exams in January 2013 and was informed in February 2013 that he did not pass. Mr. R notified the department in March that he had not successfully completed his degree and would have to repeat the final year.

The breach in the terms and conditions of the bursary meant that the cost of the final year would be the recovered from Mr. R.

The debt is recorded as follows in the accounting records of the department (April 2013):

Dr	Debt account	50,000.00	
Cr	Debt receivable income		50,000.00

Mr. R and the department agreed to deduct R5, 000 from his salary over a 10 month period to repay the debt.

The installments would be recovered and recorded as follows:

Once the funds are deducted from monthly salary:

Dr	Salary interface control account	5,000.00	
Cr	Debt account		5,000.00

Recording of recovery of previous years' expenditure:

Dr	Debt receivable income	5,000.00	
Cr	Departmental debt (transactions in financial assets and liabilities)		5,000.00

* *this account form part of departmental revenue and will subsequently be surrendered to the relevant revenue fund.*

After 6 months the employee requested the department to review the debt, he claimed that the deductions were placing him under financial distress and that he was unable to fund the 3rd year and pay off his debt to the department. After a thorough review the department agreed to write off the remaining portion of his debt.

Total initial debt	50,000.00
Amount recovered from employee (5,000 x 6)	(30,000.00)
Amount to be written-off	**20,000.00**

The accounting entries are as follows:

Writing off the principle debt:

Dr	Theft and losses	20,000.00	
Cr	Debt account		20,000.00

Reversing recoverable revenue:

Dr	Debt receivable income	20,000.00	
Cr	Departmental debt (transactions in financial assets and liabilities)*		20,000.00

* *the amount reflected as departmental revenue will be surrendered to the relevant revenue fund.*

Net cash position after write-off:

Total amount recovered from employee (cash in the bank)	30,000.00
Amount surrendered (departmental revenue received and the write-off of recoverable revenue against departmental revenue)*	(50,000.00)
Potential cash shortage (i.e. less funds are available to finance the planned operating activities of the department hence the department will need to reprioritize spending to achieve the planned outputs or submit a request for additional funding)	**(20,000.00)**

**It is important to note that the surrender of the departmental revenue will not necessarily result in cash shortages for the department. This is because the write off would only be possible if the department has "savings/underspendingrealised under the respective programme or from other programmes" in which case the voted funds to be surrendered would be absorbed by the debt-write off and the available cash surrendered as departmental revenue.*