



PROVINCIAL TREASURY

Provincial Government of the Western Cape

LOCAL GOVERNMENT ACCOUNTING

Smatayi@pgwc.gov.za
tel: +27 21 483 8594 fax: +27 21 483 3707
4 Dorp Street, Room 1.08, Cape Town, 8001
www.capegateway.gov.za

REFERENCE: T7/2/7
ENQUIRIES: S. Matayi

TREASURY CIRCULAR MUN 38 / 2010

THE MAYOR, CITY OF CAPE TOWN: MR D PLATO
THE MAYOR, WEST COAST DISTRICT: MRS H KITSHOFF
THE MAYOR, MATZIKAMA MUNICIPALITY: MR P BOK
THE MAYOR, CEDERBERG MUNICIPALITY: MS J MOUTON
THE MAYOR, BERGRIVIER MUNICIPALITY: MR J LIEBENBERG
THE MAYOR, SALDANHA BAY MUNICIPALITY: MR J SKEI
THE MAYOR, SWARTLAND MUNICIPALITY: MR T VAN ESSEN
THE MAYOR, CAPE WINELANDS DISTRICT: MR B CHABAAN
THE MAYOR, WITZENBERG MUNICIPALITY: MS NB MHLATI
THE MAYOR, DRAKENSTEIN MUNICIPALITY: MS C MANUEL
THE MAYOR, STELLENBOSCH MUNICIPALITY: ALDERMAN PM SWARTZ
THE MAYOR, BREEDE VALLEY MUNICIPALITY: MR C NTSOMI
THE MAYOR, BREEDE RIVER/WINELANDS MUNICIPALITY: MR SJ NGONYAMA
THE MAYOR, OVERBERG DISTRICT: MS M GILLION
THE MAYOR, THEEWATERSKLOOF MUNICIPALITY: MR C PUNT
THE MAYOR, OVERSTRAND MUNICIPALITY: MR T BEYLEVELDT
THE MAYOR, CAPE AGULHAS MUNICIPALITY: MR R MITCHELL
THE MAYOR, SWELLENDAM MUNICIPALITY: MR J JANSEN
THE MAYOR, EDEN DISTRICT: MR S TEMNET
THE MAYOR, KANNALAND MUNICIPALITY: MR N VALENTYN
THE MAYOR, HESSEQUA MUNICIPALITY: MR CP TAUTE
THE MAYOR, MOSSEL BAY MUNICIPALITY: ALDERLADY M FERREIRA
THE MAYOR, GEORGE MUNICIPALITY: MR B PETRUS
THE MAYOR, OUDTSHOORN MUNICIPALITY: MS D DE JAGER
THE MAYOR, BITOU MUNICIPALITY: MR LL MVIMBI
THE MAYOR, KNYSNA MUNICIPALITY: MS E BOUW-SPIES
THE MAYOR, CENTRAL KAROO DISTRICT: MR T PRINCE
THE MAYOR, LAINGSBURG MUNICIPALITY: MS R MEYER
THE MAYOR, PRINCE ALBERT MUNICIPALITY: MS M BENJAMIN
THE MAYOR, BEAUFORT WEST MUNICIPALITY: MS J JONAS

THE MUNICIPAL MANAGER, CITY OF CAPE TOWN: MR A EBRAHIM
THE MUNICIPAL MANAGER, WEST COAST DISTRICT: MR H PRINS
THE MUNICIPAL MANAGER, MATZIKAMA MUNICIPALITY: MR DG O'NEILL
THE MUNICIPAL MANAGER, CEDERBERG MUNICIPALITY: MR G MATHYSE
THE MUNICIPAL MANAGER, BERGRIVIER MUNICIPALITY: MS C LE ROUX
THE MUNICIPAL MANAGER, SALDANHA BAY MUNICIPALITY: MR J FORTUIN
THE MUNICIPAL MANAGER, SWARTLAND MUNICIPALITY: MR J SCHOLTZ
THE MUNICIPAL MANAGER, CAPE WINELANDS DISTRICT: MR M MGAJO
THE MUNICIPAL MANAGER, WITZENBERG MUNICIPALITY: MR D NASSON
THE MUNICIPAL MANAGER, DRAKENSTEIN MUNICIPALITY: DR S KABANYANE
THE MUNICIPAL MANAGER, STELLENBOSCH MUNICIPALITY: MR D DANIELS
THE MUNICIPAL MANAGER, BREEDE VALLEY MUNICIPALITY: MR A PAULSE
THE MUNICIPAL MANAGER, BREEDE RIVER/WINELANDS: MR SA MOKWENI
THE MUNICIPAL MANAGER, OVERBERG DISTRICT: MR D VAN DER HEEVER (ACTING)

THE MUNICIPAL MANAGER, THEEWATERSKLOOF MUNICIPALITY: MR HSD WALLACE
THE MUNICIPAL MANAGER, OVERSTRAND MUNICIPALITY: ADV W ZYBRANDT
THE MUNICIPAL MANAGER, CAPE AGULHAS MUNICIPALITY: MR R STEPHENS
THE MUNICIPAL MANAGER, SWELLENLHAM MUNICIPALITY: MR M STEENKAMP (ACTING)
THE MUNICIPAL MANAGER, EDEN DISTRICT: MR M HOOGBAARD (ACTING)
THE MUNICIPAL MANAGER, KANNALAND MUNICIPALITY: MR KR DE LANGE
THE MUNICIPAL MANAGER, HESSEQUA MUNICIPALITY: MR J JACOBS
THE MUNICIPAL MANAGER, MOSSEL BAY MUNICIPALITY: DR M GRATZ
THE MUNICIPAL MANAGER, GEORGE MUNICIPALITY: MR G RAS (ACTING)
THE MUNICIPAL MANAGER, OUDTSHOORN MUNICIPALITY: MR N PIETERSEN
THE MUNICIPAL MANAGER, BITOU MUNICIPALITY: MR L NGOQO
THE MUNICIPAL MANAGER, KNYSNA MUNICIPALITY: MR J DOUGLAS
THE MUNICIPAL MANAGER, CENTRAL KAROO DISTRICT: MR S JOOSTE
THE MUNICIPAL MANAGER, LAINGSBURG MUNICIPALITY: MR P WILLIAMS
THE MUNICIPAL MANAGER, PRINCE ALBERT MUNICIPALITY: MS J FORTUIN
THE MUNICIPAL MANAGER, BEAUFORT WEST MUNICIPALITY: MR J BOOYSEN

THE CHIEF FINANCIAL OFFICER, CITY OF CAPE TOWN: MR M RICHARDSON
THE CHIEF FINANCIAL OFFICER, WEST COAST DISTRICT: MR J KOEKEMOER
THE CHIEF FINANCIAL OFFICER, MATZIKAMA MUNICIPALITY: MR LJ BRUWER
THE CHIEF FINANCIAL OFFICER, CEDERBERG MUNICIPALITY: MR F LÖTTER
THE CHIEF FINANCIAL OFFICER, BERGRIVIER MUNICIPALITY: MR JA VAN NIEKERK
THE CHIEF FINANCIAL OFFICER, SALDANHA BAY MUNICIPALITY: MR J VAN COLLER (ACTING)
THE CHIEF FINANCIAL OFFICER, SWARTLAND MUNICIPALITY: MR K COOPER
THE CHIEF FINANCIAL OFFICER, CAPE WINELANDS DISTRICT: MR JG MARAIS
THE CHIEF FINANCIAL OFFICER, WITZENBERG MUNICIPALITY: MR R ESAU
THE CHIEF FINANCIAL OFFICER, DRAKENSTEIN MUNICIPALITY: MR CM PETERSEN
THE CHIEF FINANCIAL OFFICER, STELLENBOSCH MUNICIPALITY: MR M BOLTON
THE CHIEF FINANCIAL OFFICER, BREEDE VALLEY MUNICIPALITY: MR D McTHOMAS
THE CHIEF FINANCIAL OFFICER, BREEDE RIVER/WINELANDS: MR CF HOFFMANN
THE CHIEF FINANCIAL OFFICER, OVERBERG DISTRICT: MR O MCKENZIE (ACTING)
THE CHIEF FINANCIAL OFFICER, THEEWATERSKLOOF MUNICIPALITY: MR S JACOBS
THE CHIEF FINANCIAL OFFICER, OVERSTRAND MUNICIPALITY: MR H KLEINLOOG
THE CHIEF FINANCIAL OFFICER, CAPE AGULHAS MUNICIPALITY: MR H SCHLEBUSCH
THE CHIEF FINANCIAL OFFICER, SWELLENLHAM MUNICIPALITY: MR J KRAPOHL
THE CHIEF FINANCIAL OFFICER, EDEN DISTRICT: MR NB DELO
THE CHIEF FINANCIAL OFFICER, KANNALAND MUNICIPALITY: MR BT LALOR
THE CHIEF FINANCIAL OFFICER, HESSEQUA MUNICIPALITY: MS HJ VILJOEN
THE CHIEF FINANCIAL OFFICER, MOSSEL BAY MUNICIPALITY: MR HF BOTHA
THE CHIEF FINANCIAL OFFICER, GEORGE MUNICIPALITY: MR M CUPIDO (ACTING)
THE CHIEF FINANCIAL OFFICER, OUDTSHOORN MUNICIPALITY: MR K JORDAAN
THE CHIEF FINANCIAL OFFICER, BITOU MUNICIPALITY: MR D LOTT
THE CHIEF FINANCIAL OFFICER, KNYSNA MUNICIPALITY: MR G EASTON
THE CHIEF FINANCIAL OFFICER, CENTRAL KAROO DISTRICT: MR CJ KYMDELL
THE CHIEF FINANCIAL OFFICER, LAINGSBURG MUNICIPALITY: MS A GROENEWALD
THE CHIEF FINANCIAL OFFICER, PRINCE ALBERT MUNICIPALITY: MR J NEETHLING (ACTING)
THE CHIEF FINANCIAL OFFICER, BEAUFORT WEST MUNICIPALITY: MR D LOUW

THE HEAD OFFICIAL: PROVINCIAL TREASURY (DR JC STEGMANN)
THE HEAD: BRANCH FISCAL AND ECONOMIC SERVICES (MR H MALILA)
THE HEAD: BRANCH GOVERNANCE AND ASSET MANAGEMENT (MR TC ARENDSE)
THE HEAD: PUBLIC POLICY SERVICES (MR A PHILLIPS)

THE HEAD: PUBLIC FINANCE (MR H MALILA) (PRO TEM)
THE HEAD: FINANCIAL GOVERNANCE (MR A REDDY) (ACTING)
THE HEAD: ASSET MANAGEMENT (MR TD PILLAY)
THE CHIEF AUDIT EXECUTIVE (MS H ROBSON)
THE CHIEF FINANCIAL OFFICER (MR A GILDENHUYS)
THE SENIOR MANAGER: ACCOUNTING SERVICES: PROVINCIAL GOVERNMENT (MR N VAN NIEKERK) (ACTING)
THE SENIOR MANAGER: ACCOUNTING SERVICES: LOCAL GOVERNMENT (MR A REDDY) (ACTING)
THE SENIOR MANAGER: CORPORATE GOVERNANCE (MR B VINK)
THE SENIOR MANAGER: INTERNAL AUDIT: GOVERNANCE AND ADMINISTRATION CLUSTER (MS B CAIRNCROSS)
THE SENIOR MANAGER: INTERNAL AUDIT: SOCIAL CLUSTER (MR M MALULEKA)
THE SENIOR MANAGER: INTERNAL AUDIT: ECONOMIC CLUSTER (MR J RADEBE)
THE SENIOR MANAGER: BUDGET MANAGEMENT: PROVINCIAL GOVERNMENT (MS M SHERATON)
THE SENIOR MANAGER: BUDGET MANAGEMENT: LOCAL GOVERNMENT (MR ML BOOYSEN)
THE SENIOR MANAGER: PROVINCIAL GOVERNMENT FINANCE (MS A PICK)
THE SENIOR MANAGER: LOCAL GOVERNMENT FINANCE (GROUP ONE) (MR E JOHANNES) (ACTING)
THE SENIOR MANAGER: LOCAL GOVERNMENT FINANCE (GROUP TWO) (MR M SIGABI)
THE SENIOR MANAGER: PUBLIC FINANCE POLICY RESEARCH AND MODELLING (MS C HORTON)
THE SENIOR MANAGER: IMMOVEABLE ASSET MANAGEMENT (MR NB LANGENHOVEN)
THE SENIOR MANAGER: MOVEABLE ASSET MANAGEMENT (MS N EBRAHIM)
THE SENIOR MANAGER: SUPPORTING AND INTERLINKED FINANCIAL SYSTEMS (MR A BASTIAANSE)
THE HEAD: OFFICE OF THE MINISTRY (MS A SMIT)

THE PROVINCIAL AUDITOR

MASTER RECORDS OFFICIAL: FINANCIAL MANAGEMENT

THE HEAD OF DEPARTMENT: LOCAL GOVERNMENT

THE CHIEF DIRECTOR: LOCAL GOVERNMENT BUDGET ANALYSIS - NATIONAL TREASURY (MR J HATTINGH)

ACCOUNTING STANDARDS BOARD (ASB): FREQUENTLY ASKED QUESTIONS (FAQ'S).

1. Purpose

1.1 To inform Municipalities that the Accounting Standards Board (ASB) have issued an updated version of the Frequently Asked Questions on 29 October 2010 and this can be accessed via the following link <http://www.asb.co.za>

1.2 The main additions are:

- The application of the transitional provisions to assets acquired after the effective date of the Standards of GRAP
- The treatment of library books.
- Whether an arrangement is an agent - principal, supplier or grant transaction.
- The treatment of revenue from licences and similar fees.

2. Background

- 2.1 The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, (PFMA), to determine Standards of Generally Recognised Accounting Practice (GRAP). In developing those standards, the Board frequently consults with users of those standards as to their appropriateness for transactions undertaken in the South African public sector.

3. Disclaimer

- 3.1 These frequently asked questions have been prepared by the secretariat of the Accounting Standard Board in consultation with the technical division of the Auditor – General of South Africa (AGSA) and the Office of the Accountant – General at National Treasury (OAG). These frequently asked questions have not been approved by the Board. Consequently, they are not authorised to form part of the Standard of Generally Recognised Accounting Practise.
- 3.2 The questions and responses outlined in this document are based on queries commonly received by the Secretariat, the AGSA and the OAG and have been compiled to assist the preparer of the financial statements. The questions and response provide a summarised analysis of topical issues and are not comprehensive. Any examples provided are illustrative only, are not prescriptive, and should not be used by analogy to other circumstances. In all instances, readers are encouraged to refer to the relevant Standards of Generally Recognised Accounting Practise (GRAP), Interpretation or Directives.
- 3.3 The questions and responses focused on issues that are of interest to municipalities for the 2010/2011 reporting period.

4. Enquiries

Any further enquiries in this regard may be directed to:

- Ms Micheline Fortuin: Mifortui@pgwc.gov.za - West Coast, Overberg & Central Karoo Districts.
- Mr Thobelani Madondile: Tmadondi@pgwc.gov.za - Cape Winelands & Eden Districts and Metro.



A. REDDY

ACTING SENIOR MANAGER: LOCAL GOVERNMENT ACCOUNTING

DATE: 9/11/2010



Frequently Asked Questions

Initial adoption of the Standards of GRAP by municipalities and municipal entities for the 2009/10 reporting period

Disclaimer

These frequently asked questions have been prepared by the Secretariat of the Accounting Standards Board in consultation with the technical division of the Auditor-General of South Africa (AGSA) and the Office of the Accountant-General at National Treasury (OAG). These frequently asked questions have not been approved by the Board. Consequently, they are not authoritative and do not form part of the Standards of Generally Recognised Accounting Practice (GRAP).

The questions and responses outlined in this document are based on queries commonly received by the Secretariat, the AGSA and the OAG and have been compiled to assist preparers of the financial statements. The questions and responses provide a summarised analysis of topical issues and are not comprehensive.

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. In all instances, readers are encouraged to refer to the relevant Standard of Generally Recognised Accounting Practice (GRAP), Interpretation or Directive.

The Standards of GRAP apply only to material items. Consequently, the FAQs have been drafted on the basis that a particular issue is material. When considering the application of the FAQs, municipalities should apply judgement in determining whether an issue outlined in the FAQs is material to its operations.

The questions and responses focus on issues that are of interest to municipalities and municipal entities (collectively called "municipalities" or "municipality" in this document (unless indicated otherwise) for the 2009/10 reporting period. Note: Section 2 and 3 have limited applicability to municipal entities.

	Date	Action
Issued:	6 April 2010	Initial publication of FAQs for entities
Updated:	21 April 2010	Revised as follows: <ul style="list-style-type: none"> • Added question 1.7 – Impairment of assets • Added question 1.8 – Heritage assets • Added question 1.9 – Formulating an accounting policy • Added question 4.12 – Distinguishing heritage assets from other assets • Amended question 5.4 – Treatment of other taxes collected as an agent • Added question 5.6 – Treatment of prepayments • Added question 6 - Guidance on accounting for exchange



Accounting Standards Board

		and non-exchange revenue
Updated:	18 August 2010	Revised as follows: <ul style="list-style-type: none">• Revised disclaimer.• Added question 5.7.1 on the treatment of leave.• Added question 5.7.2 on the use of an actuary.• Added question 5.8 on the inclusion of accounting policies in a municipality's financial statements.
Updated	22 October 2010	Revised as follows: <ul style="list-style-type: none">• Added question 2.10 on the application of the transitional provisions to assets acquired after the effective date of the Standards of GRAP.• Added question 4.13 on the treatment of library books.• Added question 5.9 on whether an arrangement is an agent-principal, supplier or grant transaction.• Added question 5.10 on the treatment of revenue from license and similar fees.
Updated	25 October 2010	Revised as follows: <ul style="list-style-type: none">• Question 2.10 removed; pending approval of revised text.
Updated	29 October 2010	Revised as follows: <ul style="list-style-type: none">• Revised question 2.10 added.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Section 1 – Reporting Framework and Related Issues

1.1 *What reporting framework should be used by municipalities for the 2009/10 reporting period?*

Municipalities use Directive 5 on *Determining the GRAP Reporting Framework* in preparing their financial statements for the year ended 30 June 2010. The Appendix to Directive 5 which is titled "Appendix: 1 April 2009" lists the Standards of GRAP and other pronouncements that should be used to prepare their financial statements for 30 June 2010.

1.2 *Are municipalities allowed to early adopt Standards of GRAP for which the Minister of Finance has determined an effective date?*

Municipalities are not prohibited from early adopting the Standards of GRAP for which the Minister of Finance has determined an effective date. Municipalities wanting to early adopt the Standards of GRAP should however submit an application to the Office of the Accountant-General at National Treasury, (if appropriate via the relevant Provincial Treasury).

Municipalities may not early adopt Standards of GRAP if the Minister of Finance has not determined an effective date for that Standard.

1.3 *What Standards of GRAP have been issued by the Board but are not yet effective and, what effect do these Standards have on the GRAP Reporting Framework?*

Standards of GRAP that have been issued by the Board but which are not yet effective cannot be early adopted. They should however be used to formulate an appropriate accounting policy, but only if a specific IPSAS or IFRS has not been included in the Appendix to be applied for a particular reporting period.

For the 2009/10 reporting period, the following Standards of GRAP have been issued but are not yet effective:

No.	Title of Standard	Impact on GRAP Reporting Framework
GRAP 18	Segment Reporting	No segment reporting required for the 2009/10 reporting period (see response to 1.4 below)
GRAP 21	Impairment of Non-cash-generating Assets	Full compliance to GRAP 21 not required. Municipalities may use GRAP 21 to formulate an accounting policy for the impairment of non-cash-generating assets.
GRAP 23	Revenue from Non-exchange Transactions (Taxes and Transfers)	Full compliance to GRAP 23 not required (see response to 1.5 below).
GRAP 24	Presentation of Budget Information	Full compliance to GRAP 24 not required (see response to 1.6 below).
GRAP 25	Employee Benefits	GRAP 25 was issued by the Board after publishing the GRAP Reporting Framework for 2009/10. Municipalities are therefore required to apply IAS 19 and IFRIC 14 for the 2009/10 reporting period.
GRAP 26	Impairment of Cash-generating Assets	Full compliance to GRAP 26 not required. Municipalities may use GRAP 26 to formulate an accounting policy for the impairment of cash-generating assets.
GRAP 103	Heritage Assets	Full compliance to GRAP 103 not required.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

		Entities may use GRAP 103 to formulate an accounting policy for heritage assets.
GRAP 104	Financial Instruments	GRAP 104 was issued by the Board after publishing the GRAP Reporting Framework for 2009/10. Municipalities are therefore required to apply IAS 32, IAS 39, IFRS 7 and IFRIC 2 and 9 for the 2009/10 reporting period.

1.4 Are municipalities required to apply GRAP 18 on Segment Reporting?

Municipalities are not required to apply GRAP 18 or IFRS 8 on *Operating Segments*. The Minister of Finance delayed the effective date of GRAP 18 as municipalities (and other entities) are not yet ready to comply with segment reporting.

1.5 Do municipalities use IAS 20 on Government Grants to account for grants, transfers and other types of non-exchange revenue?

No, municipalities use paragraphs .29-.35, .39-.54, .61(b)(iii), (vi), (viii), (ix) and .62(a) and (b) of GAMAP 9 on *Revenue* (see paragraph .44 of GRAP 9) to account for government grants, transfers, equitable share allocations, property rates, fines and donations received by a municipality.

To the extent that a transaction or event is not adequately addressed in GAMAP 9, a municipality uses GRAP 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers)* to develop an appropriate accounting policy.

Paragraphs .20 and .21 of Directive 5 indicate that IFRSs should not be applied if they are in conflict with the ASB's *Framework for the Preparation and Presentation of Financial Statements* or existing Standards of GRAP or IPSASs. As a result, IAS 20 may not be applied.

1.6 Do municipalities have to apply GRAP 24 on Presentation of Budget Information in Financial Statements?

Municipalities do not need to comply in full with GRAP 24 for the 2009/10 reporting period as the Minister of Finance has not determined an effective date for GRAP 24. Municipalities may however use the principles outlined in GRAP 24 as guidance to inform compliance with the requirements of GRAP 1 paragraphs .11-.15. (see question 5.5 below).

1.7 Do municipalities need to assess its assets for impairment for the 2009/10 reporting period, if yes, what Standards are used?

Municipalities should assess their assets for impairment and account for any resulting losses for the 2009/10 reporting period. Municipalities do however have the following choices to account for impairment losses.

Impairment of cash-generating assets

- Some municipalities may have previously applied IAS 36 on *Impairment of Assets*. These municipalities may continue to use IAS 36.
- Municipalities can use GRAP 26 on *Impairment of Cash-generating Assets* to formulate an accounting policy.
- Where a municipality did not previously have an accounting policy for impairing its assets, it may use GRAP 26 to formulate an accounting policy for the impairment of cash-generating assets.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Impairment of non-cash-generating assets

Municipalities may formulate an accounting policy on the impairment of non-cash-generating assets using GRAP 21 *Impairment of Non-cash-generating Assets* (unless they previously used IPSAS 21 to formulate their policy; in which case they can continue to apply such a policy).

1.8 Do municipalities have to apply GRAP 103 to account for heritage assets?

Municipalities are required to apply GRAP 17 on *Property, Plant and Equipment*. GRAP 17 provides limited guidance to entities on the treatment of heritage assets and allows, but does not require, entities to recognise heritage assets. Where entities recognise heritage assets, they are required to provide disclosure about such assets.

Municipalities may, but are not required to, formulate an accounting policy based on GRAP 103.

Where entities do hold heritage assets and they have not accounted for such assets using GRAP 17 or using an accounting policy based on GRAP 103, it may be appropriate for municipalities to consider whether disclosure, including a description of the nature and extent, of these assets is useful to the users of the financial statements.

1.9 Per Directive 5, what does it mean to formulate an accounting policy?

To formulate an accounting policy using Standards of GRAP that are not yet effective means that:

- Municipalities use the Standards of GRAP that are not yet effective (as outlined in 1.3 above) to determine the recognition, measurement and presentation of a transaction or event (accounting policies should describe, depending on the nature of the item, transaction or event, classification, recognition, initial and subsequent measurement and derecognition).
- It considers the disclosure requirements in the Standards of GRAP that are not yet effective for disclosing a particular transaction or event. Wherever possible, entities are encouraged to comply in full with the disclosure requirements of those Standards.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Section 2 – Transitional Provisions

2.1 Which directive does a medium or low capacity municipality apply if it early adopted the (eight) Standards of GAMAP, (three) Standards of GRAP and Statements of GAAP (or a variation thereof) in the previous reporting period?

A medium or low capacity municipality applies the transitional provisions in Directive 4, even though it applied the high capacity municipality reporting framework in previous reporting periods.

2.2 What is the effect of the three year transitional period granted in Directive 4 for the initial adoption of GRAP 12, 16, 17 and 102?

Medium and low capacity municipalities are granted a period of three years, from the initial adoption of the Standards of GRAP, to measure their assets in accordance with the principles of the relevant Standards. This means that, in the year that these municipalities initially adopt the Standards of GRAP, they should have:

- identified and correctly classified their assets between inventories, investment properties, property, plant and equipment or intangible assets;
- recognised these assets using the principles in the Standards of GRAP; and
- measured these assets either using the principles in the Standards of GRAP or at provisional amounts using the relief allowed in Directive 4.

The three year period relates to both the initial and subsequent measurement of assets. Although medium and low capacity municipalities are allowed a three year period to comply with the measurement of assets, they need to ensure that this implementation is sensible, particularly in relation to subsequent measurement. For example: In determining the depreciation for an asset, a municipality should consider all the related elements of the depreciation calculation (depreciation method, useful life and residual value) when measuring the asset in the financial statements. Using this example, it would not be appropriate for a municipality to recognise depreciation in the financial statements if it has not considered whether the asset has a residual value.

Refer to section 3 which provides detailed guidance on assets and the adoption of Standards of GRAP.

2.3 On initial adoption of GRAP 17, can a medium or low capacity municipality initially recognise assets at “global” amounts using the transitional provisions for the Standard in Directive 4?

The transitional provision for GRAP 17 in Directive 4 allows medium and low capacity municipalities three years to comply with the measurement requirements of GRAP 17; this includes initial and subsequent measurement. The componentisation of assets ensures that significant components of individual assets are identified and separately depreciated.

Componentisation is therefore an essential part of the measurement of an asset. Municipalities are permitted to recognise assets when they initially adopt the Standards of GRAP at “global” amounts, but must have separated these assets into significant components within the three year measurement period allowed in the transitional provisions. For example, a municipality may recognise “water infrastructure” on initial adoption of the Standards of GRAP, but by the end of the three year must have analysed this asset into its component parts, including pipes, pumps etc.

Note: Municipalities must have appropriately classified their assets into inventory, property, plant and equipment, investment property or intangible assets. This example refers to “global” amounts of assets that have already been appropriately classified and deals with the componentisation of those assets.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

2.4 What does it mean for a medium or low capacity municipality to initially recognise assets, e.g. infrastructure assets, at a “provisional amount”?

When a medium or low capacity municipality uses the transitional provisions in Directive 4 for GRAP 12, 16, 17, 101 or 102, it initially recognises assets using “provisional amounts”. A provisional amount may, for example, be:

- The carrying amount of an asset that was recognised under a previous basis of accounting (which may include assets recognised at R1.00).
- Zero, if a municipality is in the process of establishing an appropriate value for an asset.

Where the “provisional amount” for an asset is zero, it is appropriate for a municipality to provide disclosures about the existence of the assets and the steps taken to establish values for the assets.

2.5 Biological assets that form part of an agricultural activity, GRAP 101 – Directive 4

2.5.1 Do the transitional provisions for GRAP 101 in Directive 4 allow medium and low capacity municipalities three years to recognise and measure biological assets related to an agricultural activity?

Yes, the transitional provisions for GRAP 101 in Directive 4 allow medium and low capacity municipalities three years to recognise and measure biological assets that form part of an agricultural activity. The transitional provision for GRAP 101 is different to GRAP 12, 16, 17 and 102 which allows three years for measurement only.

2.5.2 Is a low or medium capacity municipality required to recognise and measure biological assets simultaneously (in the same year)?

No. If a medium or low capacity municipality has identified biological assets, it can recognise them at provisional amounts. For example, a municipality may have identified that it has 100 species of plants that should be recognised using GRAP 101 in the first year of the three year transitional period. However, it has not determined an appropriate fair value for these plants. The municipality could recognise the assets at a provisional amount of R0, and provide a narrative description in the notes to the financial statements of the nature and quantities of assets that have been identified, as well as the steps being taken by the municipality to measure them appropriately.

2.6 When does the three year transitional period for GRAP 12, 16, 17, 101 and 102 expire for medium and low capacity municipalities?

The three year transitional period allowed in Directive 4 commences on the date that a medium or low capacity municipality initially adopts the Standards of GRAP, i.e. at the beginning of a reporting period. For example, if a municipality adopts the Standards of GRAP from 1 July 2008, the transitional period ends on 30 June 2011.

2.7 When is medium or low capacity municipality deemed to have adopted the Standards of GRAP if it takes advantage of the transitional provisions in Directive 4?

If a medium or low capacity municipality takes advantage of the transitional provisions in Directive 4, it is deemed to have initially adopted the Standards of GRAP in the year that it first prepares its financial statements “...in accordance with the Standards of GRAP...” as set out in its accounting policies. The date of adoption is not influenced by any transitional provisions that a municipality may apply in Directive 4.

For example: Medium capacity municipalities are required to apply the Standards of GRAP from 1 July 2008. From this date, medium capacity municipalities are required to prepare their financial statements “in accordance with the Standards of GRAP”. Directive 4 does however allow medium and low

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

capacity municipalities a three-year period to comply with certain aspects of the Standards of GRAP, e.g. relief is provided from the measurement requirements of GRAP 17 on *Property, Plant and Equipment*. Even though the municipality only fully complies with GRAP 17 at a later date, it is deemed to initially adopt the Standards of GRAP at 1 July 2008.

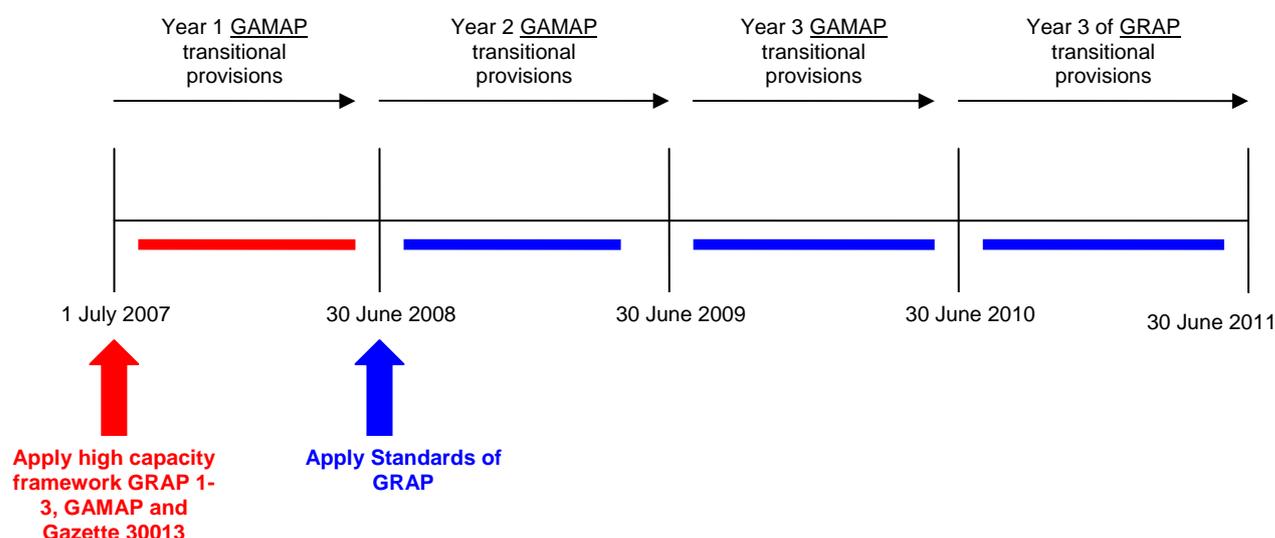
2.8 What is the interaction between the transitional provisions in GAMAP 17 and GRAP 17 on Property, Plant and Equipment as set out in Directive 4?

A medium or low capacity municipality may have applied the high capacity reporting framework in previous reporting periods. This may have resulted in it applying the transitional provisions in GAMAP 17 which provided relief from recognising assets that were not recognised under a previous basis of accounting.

Despite the fact that a medium or low capacity municipality may have taken advantage of the GAMAP 17 transitional provisions, when it adopts the Standards of GRAP, it may also take advantage of the transitional provisions for GRAP 17, as set out in Directive 4. This means that a medium or low capacity municipality has three years from the date of adoption of GRAP 17 to comply with the measurement requirements of the Standard.

Where there is additional time remaining on the GAMAP transitional provisions, a municipality may complete the remaining period of those transitional provisions (which provides relief from the recognition of certain assets) and then apply the remaining period of GRAP 17 transitional provisions (which provides relief from the measurement of certain assets). The GAMAP transitional provisions and GRAP transitional provisions would however run concurrently. This means that from the date of adoption of GRAP 17, a municipality has three years to comply in full with all the requirements of the Standard. An illustrative example is shown below.

Example: A low capacity municipality early adopted the high capacity reporting framework on 1 July 2007 (i.e. it applied GRAP 1 to 3, Standards of GAMAP and Gazette 30013). It is required to adopt the Standards of GRAP from 1 July 2009, but elects to early adopt the Standards of GRAP from 1 July 2008. It previously took advantage of the three year transitional period in GAMAP 17, although it only applied these transitional provisions to infrastructure assets as these assets had not been recognised under its previous basis of accounting. (See diagram 1 below). The municipality intends to continue with the GAMAP 17 transitional provisions until they expire, and then apply the remaining period of the GRAP 17 transitional provisions.



FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

It is important to note the following variations on the above discussion:

- Instead of waiting for the GAMAP transitional provisions to expire, a municipality may apply the transitional provisions in GRAP 17 when it adopts the Standard. It should however be mindful of the fact that the transitional provisions in GAMAP 17 relate to the recognition of assets and GRAP 17 transitional provisions relates to the measurement of assets.
- Different transitional provisions (i.e. GAMAP or GRAP) may be applied to different classes of property, plant and equipment.

It is important to note that a municipality should provide sufficient disclosure in the financial statements about:

- the transitional provisions it has applied, or intends to apply (if for example, it currently takes advantage of the GAMAP 17 transitional provisions and also intends to take advantage of the remaining period of the GRAP 17 transitional provisions in future);
- which classes of assets are affected;
- by what date it expects full compliance (which cannot be more than three years after the date of adoption of the Standards of GRAP); and
- what steps it is taking to fully comply with the Standard and report on any progress made from the prior year.

2.9 Do the transitional provisions in directive 4 apply if a municipality recognised and measured its property, plant and equipment in accordance with the requirements of GAMAP 17?

The transitional provisions in directive 4 are not mandatory. A municipality may elect to take advantage of the relief provided in directive 4 but only "If the initial accounting for property, plant and equipment is incomplete by the end of a reporting period in which the Standard becomes effective..." [Directive 4 paragraph .79].

Three scenarios exist:

1. The municipality early adopted GAMAP 17 in prior periods, but did not comply with the measurement requirements of GAMAP 17 at the time it adopted GRAP 17.
2. The municipality early adopted GAMAP 17 in prior periods, and did comply with the measurement requirements of GAMAP 17 at the time it adopted GRAP 17.
3. The municipality early adopted GAMAP 17 in prior periods, and partially complied with the measurement requirements of GAMAP 17 at the time it adopted GRAP 17.

In scenario 1, because the municipality did not comply with the measurement requirements of GAMAP 17, it is likely that it cannot comply with the measurement requirements in GRAP 17 on initial adoption. Therefore a municipality may elect to take advantage of the three year transitional period in Directive 4. This effectively means that municipalities had three years under GAMAP 17 to recognise assets and three years under GRAP 17 to measure assets (assuming that the three-year GAMAP 17 transitional provision expires before GRAP 17 is adopted).

In scenario 2, a municipality that has complied with GAMAP 17 in previous reporting periods, complies with most of the requirements of GRAP 17, as the recognition and measurement principles of GAMAP 17 and GRAP 17 are similar. Therefore a municipality cannot apply blanket relief from measuring assets, based on the transitional provisions in Directive 4. A municipality can only apply the transitional provisions for those measurement requirements of GRAP 17 that are not required in GAMAP 17. For example, GAMAP 17 requires the assessment of residual values on a periodic basis, whereas GRAP 17 requires the assessment of residual values annually. If a municipality is unable to comply with this

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

requirement when it adopts the Standards of GRAP, it may take advantage of the transitional provisions granted in Directive 4.

Similarly, in scenario 3, a municipality may only take advantage of the transitional provisions for those measurement requirements where GRAP 17 and GAMAP 17 differ and/or to the extent that the municipality did not comply with the measurement requirements of GAMAP 17.

2.10 Do the transitional provisions in Directive 4 apply to assets acquired after the effective date of the Standards of GRAP?

Paragraphs .77 and .79 of the transitional provisions for GRAP 17 on *Property, Plant and Equipment* in Directive 4, state the following:

- .77entities are not required to measure property, plant and equipment for reporting periods beginning on or after a date within three years following the date of initial adoption of the Standard of GRAP on *Property, Plant and Equipment* subject to the provisions of paragraphs .79 and .80 below.
- .79 If the initial accounting for property, plant and equipment is incomplete by the end of a reporting period in which the Standard becomes effective or the transfer occurs, whichever is later, the entity shall report in its financial statements provisional amounts for those property, plant and equipment for which the accounting is incomplete....

Assets acquired after the effective date of the Standards

Municipalities that acquired assets after the effective date of the Standard should have appropriate information regarding the initial cost of those assets (either using cost, if acquired in an exchange transaction or, using fair value if acquired in a non-exchange transaction). They should therefore recognise and initially measure such assets using the Standards of GRAP.

The transitional provisions allow entities additional time to comply with the subsequent measurement of those assets, e.g. determining the residual values, useful lives and depreciation methods. Municipalities are however encouraged to comply in full with the subsequent measurement requirements of the Standards as soon as possible.

Municipalities should disclose that they have initially recognised and initially measured assets, acquired after the effective date of the Standards in accordance with the Standards of GRAP, and the steps they are taking to comply with the subsequent measurement aspects of the relevant Standards (to the extent that they have not complied with such requirements at reporting date).

Assets acquired before the effective date of the Standards

For those assets acquired before the effective date of the Standards, municipalities have three years from the effective date of the Standards of GRAP to comply with the initial and subsequent measurement requirements of the Standards. Where municipalities have not complied with the initial or subsequent measurement of assets using the Standards of GRAP, such assets may be measured at provisional amounts.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Section 3 – Initial Recognition of Assets using GAMAP 17 and GRAP 17

3.1 *How should assets have been recognised and measured by high capacity municipalities on the initial adoption of GAMAP 17 and GRAP 17?*

The information outlined below is based on the most common scenarios. In all instances, municipalities are encouraged to consult the relevant Standards of GRAP and legislation.

Background

High capacity municipalities were required to adopt the 8 Standards of GAMAP and GRAP 1, 2 and 3 from 1 July 2005.

The transitional provisions in GAMAP 17 allowed municipalities a period of three years to recognise any assets that it previously had not recognised using another basis of accounting. Where municipalities took advantage of this transitional provision, they were not required to comply with the measurement and disclosure requirements of GAMAP 17 until these assets were recognised.

The transitional provisions in GAMAP 17.85 also prescribed that, where entities had previously not recognised assets and the historical cost information of such assets was not available at the initial adoption of GAMAP 17, entities could use fair value at initial recognition:

When applying this Standard for the first time, an entity may control assets that it has not previously recognised. When the recognition criteria as determined in paragraph 10 have been met, the asset needs to be recognised in the statement of financial position at fair value.

In 2006, the National Treasury issued Government Gazette 30013 which exempted municipalities from applying certain requirements of the Standards of GAMAP, GRAP and Statements of GAAP. Application of these exemptions was not mandatory. Gazette 30013 specifically exempted municipalities from the following requirements of GAMAP 17:

- Review of useful lives of assets. This exemption applied only to the reassessment of useful lives. Municipalities should have made an initial assessment of the useful lives of an asset in determining the depreciable amount of an asset.
- Review of residual values of assets. This exemption applied only to the reassessment of residual values. Municipalities should have made an initial assessment of the residual values of an asset in determining the depreciable amount of an asset.
- Assessing whether assets are impaired.

The exemptions were available for high capacity municipalities for the 2006/07 and 2007/08 reporting periods.

3.1.1 **Recognising and measuring assets on the adoption of GAMAP 17**

The effect of the transitional provisions in GAMAP 17 and the exemptions in Gazette 30013 is that municipalities should have accounted for property, plant and equipment as follows:

- All items of property, plant and equipment should have been recognised by 30 June 2008, i.e. the asset register and financial statements should be complete and reflect all assets that should be accounted for by a municipality.
- All items of property, plant and equipment should be initially and subsequently measured using GAMAP 17 by 30 June 2008, except to the extent that the exemptions granted in Gazette 30013 were adopted.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

The specific recognition and measurement requirements are outlined below:

3.1.1.1 Initial recognition and initial measurement

- At 30 June 2008, municipalities should have recognised all classes of property, plant and equipment, and allocated items of property, plant and equipment into their component parts.

Assets acquired before 1 July 2005, not previously recognised

- Where municipalities acquired assets before 1 July 2005 and these were not recognised under a previous basis of accounting, municipalities were allowed a period of three years to comply with the recognition requirements of GAMAP 17. This meant that in the three year period, municipalities also did not need to comply with the measurement or disclosure requirements of GAMAP 17. However, at 30 June 2008, when the three year transitional provision under GAMAP 17 expired, municipalities should have recognised, measured and disclosed these assets in accordance with GAMAP 17 (except for any exemptions adopted in Gazette 30013).
- The opening balance of assets acquired before 1 July 2005 should have been determined by measuring the assets at historical cost (if cost information was available) or, using a deemed cost (if no cost information was available) which represents:
 - fair value or depreciated replacement cost at the date the asset was acquired, if the acquisition date is known; or
 - the fair value or depreciated replacement cost of the asset at the date of adoption of GAMAP (i.e. 1 July 2004 or 1 July 2005¹), if the asset's acquisition date is unknown.
- The recognition of previously unrecognised property, plant and equipment, represents a change in accounting policy. The initial recognition of property, plant and equipment that was not recognised under a previous basis of accounting results in an adjustment to the opening balance of the accumulated surplus or deficit for the earliest period presented.

Assets acquired after 1 July 2005

- The three year transitional provision in GAMAP 17 does not apply to assets acquired after 1 July 2005. Assets acquired after 1 July 2005 should have been recognised at acquisition date and measured in accordance with the requirements of GAMAP 17; i.e. measured initially at cost if they were purchased in an exchange transaction, or at fair value if they were acquired in a non-exchange transaction.

Disposals of assets after 1 July 2005

- Disposals of assets after 1 July 2005 should be accounted for in accordance with the requirements of GAMAP 17.

¹ GAMAP 17 was not prescriptive about the date at which "fair value" should be determined for assets that were not previously recognised. "Fair value" could thus have been determined at the start of the year in which GAMAP 17 was adopted, i.e. 1 July 2005 for HCM; at the start of the first reporting period in which financial statements were prepared using GAMAP (which would be the comparative period's financial statements), i.e. at 1 July 2004; or at the date the asset was acquired, if this date is known or could have been estimated.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

3.2.1.2 Subsequent measurement

- Classes of assets would subsequently be measured using either cost or the revaluation model (limited to land and buildings).
- Municipalities should have assessed the useful lives and residual values of assets in determining their “depreciable amount”. Depreciation should have been recorded for the 2005/06, 2006/07 and 2007/08 reporting period for all assets. Entities were not required to reassess the residual values and useful lives of assets for the 2006/07 and 2007/08 reporting periods if they took advantage of the exemptions in Gazette 30013.
- Municipalities were not required to assess whether items of property, plant and equipment were impaired for the 2006/07 and 2007/08 reporting periods.

If a high capacity municipality did not comply in full with GAMAP 17 at 30 June 2008 (except where a municipality took advantage of the exemptions in Gazette 30013), this would have resulted in *non-compliance* with GAMAP 17.

Notes on recognising assets that were previously not recognised – GAMAP 17

The use of fair value or depreciated replacement cost as a substitute for historical cost on the initial adoption of the Standards of GAMAP is not deemed to be a revaluation.

If an municipality undertakes an asset verification and valuation to reconstruct its asset register, the following should be noted:

The verification should distinguish between those assets that were acquired before 1 July 2005 and those acquired after 1 July 2005. This is important as those assets that were acquired before 1 July 2005 can be measured using cost or deemed cost (if historical information is not available). Those assets acquired after 1 July 2005 must be measured using cost (if acquired in an exchange transaction) or fair value (if acquired in a non-exchange transaction).

Where deemed cost is determined at the end of the transitional period, i.e. 30 June 2008, municipalities should adjust the fair value or depreciated replacement cost back to the date of adoption of the Standards of GAMAP, or back to the acquisition date of the asset if this date is known or can be determined reliably. Municipalities should also account for depreciation for the 05/06, 06/07 and 07/08 reporting periods for these assets. If municipalities did not make assumptions about useful lives and residual values at the 05/06 reporting dates, municipalities should use the assumptions at the 07/08 reporting period and apply these retrospectively.

Deemed cost can only be used for those assets where cost information is not available. It is inappropriate to use deemed cost if historical cost information is available. For example, municipalities should not use deemed cost for those assets acquired after 1 July 2005 as this would result in municipalities effectively adopting a policy of revaluing assets.

3.1.2 **Recognising and measuring assets on the initial adoption of GRAP 17**

High capacity municipalities are required to adopt GRAP 17 from 1 July 2008. As these municipalities previously applied GAMAP 17, most items of property, plant and equipment would have already been recognised and measured using the principles in GAMAP 17, except for any exemptions granted in Gazette 30013, for example: investment properties may have been included in property, plant and equipment under GAMAP 17, and municipalities may not have reassessed the useful lives and residual values of assets, nor assessed the impairment of assets.

Therefore, at 1 July 2008 a high capacity municipality adopts GRAP 17, classes of property, plant and equipment should be initially recognised, initially measured and subsequently measured in full, except

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

if a municipality took advantage of the exemptions in Gazette 30013 on the reassessment of useful lives and residual values and the assessment of impairment.

On the initial adoption of GRAP 17 and the other asset-related Standards of GRAP on 1 July 2008, a number of scenarios may have existed:

Scenario 1: A municipality complied with the requirements of GAMAP 17 at 30 June 2008

In this scenario, a municipality would have been required to do the following in the 08/09 reporting period when it adopted GRAP 17:

- Determine the appropriate classifications of any assets that were included in property, plant and equipment under GAMAP 17 but should be accounted for using another Standard of GRAP e.g. land and buildings that are investment properties.
- Reassess the useful lives and residual values of property, plant and equipment recognised under GAMAP 17.
- Assess whether any items of property, plant and equipment are impaired.
- Undertaken any other actions that resulted from any exemptions granted in Gazette 30013 that were utilised in 2008/09.

Scenario 2: A municipality did not comply with GAMAP 17 as at 30 June 2008 (either for classes of assets or individual assets). In this instance, a municipality should have done the following in the 2008/09 reporting period:

- Identify classes of property, plant and equipment that are not recognised at 1 July 2008.
- Initially measure these assets using either historical cost (if cost information is available), or use a deemed cost (if cost information is not available) which represents:
 - fair value or depreciated replacement cost at the date the asset was acquired, if this date is known or could have been estimated reliably; or
 - the fair value or depreciated replacement cost of the asset, determined at the earliest date for which a municipality first prepares financial statements that comply with Standards of GRAP, i.e. 1 July 2007², if the asset's acquisition date is unknown.
- As GRAP 17 is applied retrospectively, the opening balance of assets at 1 July 2008 should be separated between those assets that existed at 1 July 2007 and those that were acquired between 1 July 2007 and 30 June 2008. Also, any disposals that occurred between 1 July 2007 and 30 June 2008 are also accounted for separately.
- The initial recognition of assets that were not recognised under a previous basis of accounting represents an adjustment to the accumulated surpluses and deficit for the relevant periods.

² As a municipality is required to apply Standards of GRAP retrospectively, the first set of financial statements that are prepared that comply with Standards of GRAP is the comparative set of financial statements. For example, if a municipality is required to apply Standards of GRAP from 1 July 2008, the first set of financial statements prepared using Standards of GRAP is for the period 1 July 2007 to 30 June 2008.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

- Assets that are acquired between 1 July 2008 and 30 June 2009 are accounted for using the principles in GRAP 17, i.e. at cost (if acquired in an exchange transaction) or fair value (if acquired in a non-exchange transaction). Any disposals of assets that occur between 1 July 2008 and 30 June 2009 are also accounted for separately.
- Assess the residual values and useful lives of assets at 30 June 2009. If a municipality did not assess the useful lives and residual values of assets at 30 June 2008 because of exemptions granted in Gazette 30013, a municipality uses those values to adjust the opening balances and comparative information.
- Assess whether any assets are impaired by using the principles in IPSAS 21 on *Impairment of Non Cash-Generating Assets* or IAS 36 *Impairment of Assets*

Notes on recognising assets that were previously not recognised – GRAP 17

The use of fair value or depreciated replacement cost as a substitute for historical cost on the initial adoption of the Standards of GRAP is not deemed to be a revaluation.

If a municipality undertakes an asset verification and valuation to reconstruct its asset register, the following should be noted:

The verification should distinguish between those assets that were acquired before 1 July 2008 and those acquired after 1 July 2008. This is important as those assets that were acquired before 1 July 2008 can be measured using cost or deemed cost (if historical information is not available). Those assets acquired after 1 July 2008 must be measured using cost (if acquired in an exchange transaction) or fair value (if acquired in a non-exchange transaction).

If deemed cost is determined at the end of the year in which GRAP 17 is adopted, i.e. 30 June 2009, municipalities should adjust the fair value or depreciated replacement cost back to the date of adoption of the Standards of GRAP (1 July 2007), or back to the acquisition date of the asset if this date is known or can be determined reliably. Municipalities should also account for depreciation for the 07/08 and 08/09 reporting periods for these assets. If municipalities did not make assumptions about useful lives and residual values at the 07/08 reporting dates, municipalities should use the assumptions at the 08/09 reporting period and apply these retrospectively.

Deemed cost can only be used for those assets where cost information is not available. It is inappropriate to use deemed cost if historical cost information is available. For example, municipalities should not use deemed cost for those assets acquired after 1 July 2008 as this would result in municipalities effectively adopting a policy of revaluing assets.

3.2 How should assets have been recognised and measured by medium and low capacity municipalities on the initial adoption of GRAP 17 (and GAMAP 17 if early adopted)?

There are a number of different scenarios that exist for the preparation of financial statements as some medium and low capacity municipalities may have early adopted Standards of GAMAP and GRAP, while other may have continued to apply the IMFO framework until the mandatory adoption date of the Standards of GRAP. The most common scenarios are outlined in the discussion that follows; municipalities are encouraged to consult the relevant Standards of GRAP and the relevant legislation.

Background

Medium and low capacity municipalities were required to apply Standards of GRAP from 1 July 2008 and 1 July 2009 respectively. Some medium and low capacity municipalities may have early adopted the "high capacity municipality" reporting framework in that they early adopted Standards of GAMAP and GRAP, and may have applied the exemptions granted to the high capacity municipalities in

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Gazette 30013. Some of these municipalities adopted the GAMAP/GRAP reporting framework in 2005/06, while others adopted the framework in 2006/07.

Other medium and low capacity municipalities may have remained on the IMFO framework and adopted the Standards of GRAP in accordance with Gazette 31021 which prescribed the effective dates of the Standards of GRAP for municipalities.

3.2.1 Scenario 1: A medium or low capacity municipality applied the IMFO framework and adopted the Standards of GRAP in accordance with Gazette 31021 and applied the transitional provisions in Directive 4

When medium and low capacity municipalities adopt GRAP 17, Directive 4 allows these municipalities a period of three years to comply with initial and subsequent measurement requirements of GRAP 17. This means that at the date that the municipality adopts GRAP 17, it must have identified and recognised all classes (and items) of property, plant and equipment. The effect of the transitional provisions is that medium and low capacity municipalities must comply with GRAP 17 in full at 30 June 2011 and 30 June 2012 respectively.

Initial recognition and measurement of assets

Asset acquired before 1 July 2008 (medium capacity municipality) and 1 July 2009 (low capacity municipality)

- Where municipalities acquired assets before 1 July 2008 (medium capacity) and 1 July 2009 (low capacity), they are allowed a period of three years to comply with the measurement requirements of GRAP 17. This means that in the three year period, municipalities should comply with the disclosure requirements of GRAP 17 to the extent possible. However, at 30 June 2011 (medium capacity) and 30 June 2012 (low capacity), when the three year transitional provision under GRAP 17 expires, municipalities should recognise, measure and disclose these assets in accordance with GRAP 17.
- As municipalities have three years to comply with the initial and subsequent measurement requirements of GRAP 17, it recognises its property, plant and equipment at provisional amounts in the financial statements during the transitional period. These provisional amounts may represent the carrying values under the previous basis of accounting (e.g. IMFO), or they may be recognised at R0 (this may mean that municipalities may only have information disclosed in the financial statements about the classes and quantities of assets during the transitional period).
- Assets acquired before 1 July 2008 (medium capacity) and 1 July 2009 (low capacity) are initially measured at historical cost (if cost information was available) or, using a deemed cost (if no cost information was available) which represents:
 - fair value or depreciated replacement cost at the date the asset was acquired, if the acquisition date is known; or
 - the fair value or depreciated replacement cost of the asset determined at the earliest date for which a municipality first prepares financial statements that comply with Standards of

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

GRAP, i.e. 1 July 2007 (medium capacity) or 1 July 2008 (low capacity)³, if the asset's acquisition date is unknown.

- The recognition and/or change in measurement of property, plant and equipment, represents a change in accounting policy. This result in an adjustment to the opening balance of the accumulated surplus or deficit for the earliest period presented.

Assets acquired after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity)

- The three year transitional provision in GAMAP 17 does not apply to assets acquired after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity). Assets acquired after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity) should have been recognised at acquisition date and measured in accordance with the requirements of GRAP 17; i.e. measured initially at cost if they were purchased in an exchange transaction, or at fair value if they were acquired in a non-exchange transaction.

Disposals of assets after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity)

Disposals of assets after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity) should be accounted for in accordance with the requirements of GRAP 17.

Subsequent measurement of assets

- For assets acquired before and after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity), municipalities have three years from the date of adopting the Standards of GRAP to comply with the subsequent measurement requirements of GRAP 17. This means that a municipality needs to have assessed the residual values and useful lives of assets, and considered whether any assets are impaired, by 30 June 2011 (medium capacity) and 30 June 2012 (low capacity).

Disclosure

- At 30 June 2011 (medium capacity) and 30 June 2012 (low capacity), medium and low capacity municipalities are required to comply in full with the disclosure requirements of GRAP 17.
- During the transitional period, municipalities should disclose in their accounting policies and notes to the financial statements:
 - The fact that they have taken advantage of the three year transitional period in Directive 4.
 - In their accounting policies indicate that they apply Standards of GRAP in recognising and measuring assets (and provide an indication of the policy adopted), but explain that amounts reflected for assets in the transitional period have been determined on a different basis (e.g. using the previous basis of accounting such as IMFO).

³ As a municipality is required to apply Standards of GRAP retrospectively, the first set of financial statements that are prepared that comply with Standards of GRAP is the comparative set of financial statements. For example, if a municipality is required to apply Standards of GRAP from 1 July 2008, the first set of financial statements prepared using Standards of GRAP is for the period 1 July 2007 to 30 June 2008. Likewise, if a municipality is required to apply Standards of GRAP from 1 July 2009, the first set of financial statements prepared using Standards of GRAP is for the period 1 July 2008 to 30 June 2009.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

- In their accounting and/or notes to the financial statements explain the classes of assets that are affected by the transitional provisions, the plans in place to comply with the Standards of GRAP by the required date and progress made to date.

3.2.2 Scenario 2: A medium or low capacity municipality applied the IMFO framework and adopted the Standards of GRAP in accordance with Gazette 31021 and did not apply the transitional provisions in Directive 4

The three-year transitional period offered in Directive 4 is not mandatory. Municipalities can choose to take advantage of this additional time allowed, or it can choose to comply with GRAP 17 in full in the year that it is adopted. The effect of not taking advantage of the transitional provisions is that municipalities have to recognise, measure and disclose all property, plant and equipment at 30 June 2009 (medium capacity) or 30 June 2010 (low capacity).

Where a municipality chooses to adopt GRAP 17 in the full at 1 July 2008 (medium capacity) or 1 July 2009 (low capacity), it is required to undertake the following actions in the year that it adopts GRAP 17:

Initial recognition and initial measurement

Assets acquired before 1 July 2008 (medium capacity) and 1 July 2009 (low capacity)

- Assets acquired before 1 July 2008 (medium capacity) and 1 July 2009 (low capacity) are initially measured at historical cost (if cost information was available) or, using a deemed cost (if no cost information was available) which represents:
 - fair value or depreciated replacement cost at the date the asset was acquired, if the acquisition date is known; or
 - the fair value or depreciated replacement cost of the asset determined at the earliest date for which a municipality first prepares financial statements that comply with Standards of GRAP, i.e. 1 July 2007 (medium capacity) or 1 July 2008 (low capacity)⁴, if the asset's acquisition date is unknown.
- The recognition and/or change in measurement of property, plant and equipment, represents a change in accounting policy. This result in an adjustment to the opening balance of the accumulated surplus or deficit for the earliest period presented.

Assets acquired after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity)

- Assets acquired after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity) are recognised at acquisition date and measured in accordance with the requirements of GRAP 17; i.e. measured initially at cost if they were purchased in an exchange transaction, or at fair value if they were acquired in a non-exchange transaction.

Disposals of assets after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity)

⁴ As a municipality is required to apply Standards of GRAP retrospectively, the first set of financial statements that are prepared that comply with Standards of GRAP is the comparative set of financial statements. For example, if a municipality is required to apply Standards of GRAP from 1 July 2008, the first set of financial statements prepared using Standards of GRAP is for the period 1 July 2007 to 30 June 2008. Likewise, if a municipality is required to apply Standards of GRAP from 1 July 2009, the first set of financial statements prepared using Standards of GRAP is for the period 1 July 2008 to 30 June 2009.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

- Disposals of assets after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity) should be accounted for in accordance with the requirements of GRAP 17.

Subsequent measurement of assets

For assets acquired before and after 1 July 2008 (medium capacity) and 1 July 2009 (low capacity), municipalities have to comply with the subsequent measurement requirements of GRAP 17 at the end of the reporting period in which they adopt GRAP 17 where they do not take advantage of the transitional provisions in Directive 4. This means that a municipality needs to have assessed the residual values and useful lives of assets, and considered whether any assets are impaired, by 30 June 2009 (medium capacity) and 30 June 2010 (low capacity).

3.2.3 Scenario 3: A medium or low capacity municipality early adopted GAMAP 17 and applied the transitional provisions in Directive 4

Where medium and low capacity municipalities early adopted GAMAP 17, they may have taken advantage of the three year transitional provisions in GAMAP 17 that allows municipalities three years to recognise any assets that were not recognised under its previous basis of accounting. When these municipalities adopt GRAP 17, they are allowed, in certain instances, a further three years to comply with the measurement requirements of GRAP 17.

The use of the transitional provisions in GRAP 17 is dependent on whether the municipality:

- a. complied with GAMAP 17 in full at the end of the transitional period allowed under that Standard; or
- b. partially complied with GAMAP 17 at the end of the transitional period allowed under that standard.

The use of the transitional provisions in GRAP under these scenarios is dealt with in 5.2 below.

There may be an overlap between the transitional provisions in GAMAP 17 and the transitional provisions in the GRAP 17. FAQ 2.7 provides guidance on this issue.

In recognising and measuring assets using GAMAP 17 and GRAP 17, municipalities should have applied the process outlined below.

Recognising and measuring assets on the adoption of GAMAP 17

Where a medium or low capacity municipality early adopted GAMAP 17, it follows a similar process to that set out in 3.1 paragraphs 3.1.1.1 and 3.1.1.2 (the relevant dates would however need to be adjusted to reflect the date that the municipality adopted GAMAP 17).

Recognising and measuring assets on the adoption of GRAP 17

Directive 4 allows medium and low capacity municipalities three years from the date of adopting GRAP 17 to comply with the measurement requirements of GRAP 17. Where medium and low capacity municipalities early adopted GAMAP 17, they can take advantage of the additional three years granted in Directive 4 if:

- (i) they did not comply, either partially or in full with GAMAP 17 at the end of the transitional period in that Standard; or
- (ii) they cannot comply with aspects of GRAP 17, for example the annual review of residual values and useful lives of property, plant and equipment.

FAQ 2.9 provides guidance on when a municipality that applied GAMAP 17 can take advantage of the transitional provisions in GRAP 17.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

As the circumstances may vary from municipality to municipality, they cannot all be addressed in the frequently asked questions; municipalities should therefore consult the relevant Standards of GRAP and Directives.

Where medium and low capacity municipalities early adopted GAMAP 17 and did not comply with the requirements of GAMAP 17, in full, they may take advantage of the transitional provisions in GRAP 17. These medium and low capacity municipalities should apply similar actions to those outlined in 3.2.1.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Section 4 – Asset Related Accounting Issues (GRAP 16, 17, 101 and 102)

4.1 Should a municipality apply impairment testing retrospectively when it adopts the Standards of GRAP if it was exempted from these requirements in Gazette 30013?

No, if a municipality did not apply IAS 36 last year or because it applied the exemptions in Gazette 30013, a municipality only assesses impairment for the current financial year.

4.2 Should a municipality assess useful lives and residual values of assets retrospectively when it adopts the Standards of GRAP if it was exempted from these requirements in Gazette 30013?

If a municipality did not perform an assessment of the residual values or useful lives of an asset because of the exemptions allowed in Gazette 30013, a municipality should:

- Assess the residual values and useful lives of the assets in this financial year; and
- Adjust the opening balances and comparative information using those values.

4.3 When should a municipality start depreciating major spare parts and stand-by equipment?

A municipality starts depreciating major spare parts and stand-by equipment when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operation in the manner intended by management. This implies that depreciation may commence while the item is held in storage. Under a usage based depreciation, the depreciation of items held in storage will be zero.

If major installation of the spare part is however required, it may be argued that the spare parts are not immediately available for use in the manner intended by management. In these instances, depreciation may only commence once the installation is complete.

Management should exercise judgement in applying the requirements in GRAP 17 regarding the depreciation of major spare parts and standby equipment.

4.4 Must an asset always have a residual value?

No, an asset does not always have a residual value. There are also different requirements for residual values of tangible assets and intangible assets.

For tangible assets, such as property, plant and equipment or investment property, an asset only has a residual value when the useful life of an asset (the period the asset is used or available for use by the municipality) is shorter than the economic life of an asset (the period(s) the asset is used or available for use by all users or owners of the asset). As municipalities in the public sector often plan to use an asset for its entire economic life, the residual value may be negligible or even zero.

For intangible assets with a finite useful life, the residual value is always deemed to be zero unless:

- (a) a third party has committed to purchase the asset at the end of its useful life; or
- (b) there is an active market for the asset and:
 - (i) the residual value can be determined by reference to that market; and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.

4.5 Treatment of fully depreciated assets still in use (other than on the initial adoption of the Standards of GRAP)

It may happen that a municipality has fully depreciated assets that are still being used. A question that is commonly asked is whether this results in a prior period error or not.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* defines estimates and errors as follows:

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Prior period errors are omissions from, and misstatements in, the entity'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.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

If a municipality made an appropriate estimate of the useful lives, residual values and depreciation of an asset based on the information available at the previous reporting dates, it continues to measure the assets at RO, and discloses the fact that it has fully depreciated assets still in use. An example of such an instance may be as follows: A municipality has a policy of replacing assets at specified intervals. At the end of a reporting period, a municipality fully depreciates certain assets knowing that in the following year, it is scheduled to replace these assets in accordance with its policy. In the subsequent period however, management changes its policy of replacing assets, resulting in it holding fully depreciated assets that are still being used by the municipality.

Where a municipality has fully depreciated assets because it did not appropriately apply the principles of GRAP 17 on *Property, Plant and Equipment*, e.g. because it did not review the useful lives or residual values of assets at previous reporting dates, or because it did not use information that it had available at previous reporting dates appropriately, this results in an error in accordance with GRAP 3.

Note: This response assumes that the assets in question are used for their full economic life by the municipality and thus have no residual value.

4.6 What should a municipality consider in classifying land and buildings as investment property or property, plant and equipment?

Land and buildings that are held for capital appreciation and for rental to others (i.e. it is not owner occupied) is classified as investment property. Land held for a currently undetermined future use is always classified as investment property.

The classification of land and buildings as either investment property or property, plant and equipment poses many practical difficulties. A key distinction between investment property and property, plant and equipment is that property, plant and equipment is held to provide goods and services.

Land and/or buildings used to provide social services, for example, free or low cost housing are deemed to be property, plant and equipment as they are used in the provision of goods and services. Land and/or buildings used to provide employee housing are also deemed to be property, plant and equipment as they contribute towards a municipality's provision of goods and services.

Arrangements are often entered into where a municipality leases property to another party and agrees to provide certain services, for example, security, maintenance, cleaning etc. In determining how land and buildings should be classified, a municipality would consider the significance of the goods and services provided in relation to the arrangement as a whole. If the goods and services provided are

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

more than an insignificant part of the arrangement, the land and/or buildings is treated as property, plant and equipment.

Municipalities may also own land and buildings and enter into outsourcing arrangements with third parties to provide certain services. In these instances, a municipality would consider the underlying nature of the arrangement and determine appropriate criteria to distinguish investment property from property, plant and equipment (which should be disclosed in the financial statements). For example: The owner of a property enters into an outsourcing arrangement with a third party to operate a hostel in one of its buildings. If the owner of the property is exposed to risks related to the provision of goods and services by the third party (e.g. the owner sets the prices charged for rental and other services, specifies the terms and conditions of occupation and services provided, shares in profits etc.), the owner may still be deemed to be using the property for the provision of goods and services. If this is the case, the building is classified as property, plant and equipment. If in such an arrangement the owner is not exposed to any risks related to the provision of goods and services by the third party (e.g. it receives rental determined using a fixed or variable rate based on the property value, location, use etc.), the building may be classified as investment property.

4.7 How should cell phone contracts be accounted for?

Cell phone contracts are negotiated for a period of time with mobile phone operators, and often include the provision of a handset as well as a specified amount of talk-time or SMSs. A municipality must assess each contract to determine the appropriate accounting treatment. In particular, a municipality assesses whether:

- the arrangement involves the use of an asset over a period of time, considering the principles in GRAP 13 on *Leases*, or
- the contract involves the purchase of an asset and related services for an agreed period of time.

The accounting may vary between municipalities.

4.8 How should municipalities account for conventional or pre-paid electricity meters?

A municipality considers whether meters meet the definition of inventory (an asset held for sale, distribution or consumption in the provision of services) or property, plant and equipment (an asset that is used in the production or supply of goods or services and is expected to be used during more than one reporting period). The accounting may vary between municipalities.

4.9 Is the cost of preparing a valuation roll an intangible asset?

Municipalities are required, in terms of the Property Rates Act, to prepare valuation rolls. These valuation rolls enable municipalities to legally levy property rates.

Legislation and not the valuation roll, provides municipalities with the right to levy taxes. The valuation roll is prepared to execute the rights conferred on municipalities in legislation.

Consequently, the valuation roll does not generate any economic benefit or service potential for the municipality and is similar to an internally generated customer list. Customer lists may not be capitalised under GRAP 102.

The cost of preparing a valuation should be accounted for as an expense using the principles in the *Framework for the Preparation and Presentation of Financial Statements*.

Where a municipality has applied a different policy, it applies the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors*.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

4.10 Are all biological assets accounted for using GRAP 101 on Agriculture?

No, a municipality only uses GRAP 101 to account for biological assets if they are part of an agricultural activity (see paragraphs .09 - .11 of GRAP 101).

For biological assets that do not form part of an agricultural activity, a municipality assesses whether they meet the definition of property, plant and equipment in GRAP 17 or the definition of inventory in GRAP 12.

If a biological asset does not meet either of these definitions, a municipality assesses whether they meet any of the elements in the *Framework for the Preparation and Presentation of Financial Statements*.

4.11 How should a municipality account for servitudes?

Servitudes may be acquired in a number of ways including through expropriation, township establishment conditions, agreement between parties, court order, statute or other means.

In the public sector, servitudes are usually acquired in connection with infrastructure such as roads, water reticulation systems, power lines, substations etc.

Servitudes are rights granted by a property owner to another person or entity to use the land for certain purposes, e.g. to construct assets on or over a specific property or the right to access to a property. As servitudes are rights attached to property, a municipality should consider whether the definition and recognition criteria in GRAP 102 on *Intangible Assets* are met.

An intangible asset is an identifiable non-monetary asset without physical substance.

An "identifiable" intangible asset can be explained as follows: "An asset meets the identifiability criterion in the definition of an intangible asset when it:

- (a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
- (b) arises from contractual rights (including rights arising from binding arrangements) or other legal rights (excluding rights granted by statute), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations."

Creation of servitudes through the exercise of legislation

In terms of legislation, municipalities are granted certain rights regarding the creation of servitudes. For example, in proclaiming townships, a municipality may declare that servitudes are to be registered over certain parts of the land falling within the boundaries of the proclaimed township so that it is able to install infrastructure to provide basic services.

A key feature of servitudes created using rights granted in legislation, is that no compensation is paid to the landowner for the acquisition of these rights. Costs may however be incurred to register the servitude with the Deeds Office.

Servitudes granted under these conditions do not meet the "identifiability" criteria above for the following reasons:

- They cannot be sold, transferred, rented or exchanged freely and are not separable from the municipality.
- They arise from rights granted to a municipality in statute and are specifically excluded from GRAP 102 as they are "internally generated rights".

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Consequently, a municipality would not treat these rights as intangible assets. Costs incurred to register these servitudes (if any) are expensed.

Creation of servitudes through acquisition (including by way of expropriation or agreement)

A municipality may need to acquire the rights associated with a specific piece of land, e.g. to span power cables related to an electricity distribution network. When a municipality acquires rights associated with land and registers a servitude, the landowner is usually compensated.

Servitudes granted under these conditions are distinguished from those that are created through the exercise of legislation. These servitudes meet the definition of an “identifiable” intangible asset because they arise from contractual or other legal rights that are acquired through a specific arrangement, rather than through rights conferred on a municipality in statute.

In these instances, a municipality would recognise the servitude as an intangible asset at cost.

The cost of these servitudes on initial recognition is usually the transaction price, i.e. the compensation paid to the landowner and any other costs that can be capitalised to the cost of the asset in terms of GRAP 102.

Alternatively, a municipality may argue that even though a servitude may meet the definition of an intangible asset, it is essential to the operation of a tangible asset. For example, a municipality would not be able to construct or operate infrastructure on land that it does not own without acquiring certain rights from the landowner. In these instances, it may be appropriate to include the cost of the servitude in the cost of the tangible asset rather than recognising a separate intangible asset.

4.12 How does an entity distinguish heritage assets from “old assets”?

Municipalities frequently own items of property, plant and equipment, intangible assets, inventories and other types of assets that are old but are still being used functionally. For example, a municipality may own old furniture such as desks and chairs that are being used for administrative purposes and meet the definition of property, plant and equipment.

“Old assets” are not the same as “heritage assets”. “Heritage assets”, as defined in GRAP 103 on *Heritage Assets* are assets that have cultural, historical, environmental, natural, scientific or technological significance that are held indefinitely for the benefit of present and future generations.

One of the key features of heritage assets is that they are held indefinitely for the purposes of preserving such assets for the benefit of present and future generations. This means that municipalities often incur expenditure to preserve and extend the life of an asset so that it can be enjoyed by future generations. As a result of the preservation of heritage assets, their value often increases over time, making the effect of depreciation negligible.

The purpose of holding items of property, plant and equipment and other assets is for them to be used in executing a municipality’s activities. As a result, these assets are “consumed” over time or as they are used.

Municipalities should therefore ascertain what the purpose is of holding various assets in determining whether they should be treated as “heritage assets” or as other assets in accordance with the relevant Standards of GRAP.

4.13 How should a municipality account for library books?

Municipalities provide community libraries within their respective jurisdictions. Library books are an integral part of these libraries.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Step 1: Who should account for the library books?

As a starting point, municipalities should assess whether the library books are their assets or whether they are another party's assets. A municipality should only account for those assets they control. Control means that a municipality has the ability to exclude or regulate the access of others to the benefits of an asset. In assessing control, a municipality would consider, amongst others, legislation or any other binding arrangement that may indicate:

- whether the municipality controls the library books; and
- its role and responsibility in providing community libraries.

If a municipality has determined that it controls the library books, then it should account for those books using step 2.

Step 2: How should library books be accounted for?

Library books may differ in nature and use both within and between municipalities. Each municipality should therefore carefully consider the nature of its books (e.g. fiction, non-fiction, periodicals, reference books) and their use (e.g. certain books may have a finite life if they are revised regularly).

A municipality should consider the following definitions in formulating an appropriate accounting policy⁵:

Property, plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and*
- (b) are expected to be used during more than one reporting period.*

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.

Heritage assets are assets that have a cultural, environmental, historical, natural, scientific, technological or artistic significance and are held indefinitely for the benefit of present and future generations.

Library books are held to provide a service to the community; they therefore generally meet part (a) of the definition of property, plant and equipment. Certain library books may be expected to be used over more than one reporting period. As circumstances may differ both within and between municipalities, an assessment should be made of which library books are expected to be used over more than one reporting period.

Library books that are expected to be used over more than one reporting period should be classified as property, plant and equipment and accounted for using the principles in GRAP 17 on *Property, Plant and Equipment*.

Where a municipality does not expect to use library books over more than one reporting period, they are recognised as an expense in accordance with the *Framework for the Preparation and Presentation of Financial Statements*.

Apart from the treatment of library books as either property, plant and equipment or an expense, a municipality should consider whether any library books meet the definition of a heritage asset (see

⁵ Note: This list is not comprehensive. A municipality should assess whether any other Standards of GRAP are relevant based on its circumstances.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

also FAQ 4.12). Where a municipality holds library books that meet the definition of a heritage asset, they can, for the 2009/10 reporting period, either be accounted for using GRAP 17 on *Property, Plant and Equipment* or using GRAP 103 on *Heritage Assets*.

As library books differ in both nature and use, it may not be possible for a municipality to apply a single approach to all its books. It may need to capitalise certain books using GRAP 17 or GRAP 103, and expense certain books that are used for less than one reporting period.

Using the principles in GRAP 1 and GRAP 3, a municipality should provide sufficient information in the accounting policies and notes to the financial statements regarding the treatment of library books.

National Treasury will provide more detailed guidance on the treatment of library books in its GRAP guides.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Section 5 – Other Issues

5.1 *How does a municipality account for arrangements for the construction of RDP houses?*

Municipalities are frequently involved in the construction of houses as part of the reconstruction and development programme. A municipality determines the appropriate accounting treatment by examining the specific contracts concluded with the relevant parties and considering any applicable legislation.

A municipality would specifically consider whether:

- It acts as a contractor and the construction of the RDP houses meets the definition of a construction contract in terms of GRAP 11 on *Construction Contracts*. In this scenario, the municipality must have been appointed as the contractor, i.e. it must have been appointed to provide services related to the construction of an asset (in this case, the RDP houses).
- It is selling or distributing inventory, either directly to beneficiaries in a housing programme or to another public sector entity. In these instances, a municipality would also consider whether any revenue generated from these arrangements is exchange or non-exchange in nature.

5.2 *How does a municipality account for rainwater?*

One of the recognition criteria for an asset is that "...it is a resource controlled by an entity". Control is demonstrated by an entity's ability to access and regulate the benefits of an asset. It may be difficult to argue that naturally occurring resources are always under all circumstances under the control of a municipality.

A municipality would therefore only recognise inventory once it can demonstrate that it controls the resource, for example, once the water enters the purification process, and that the recognition criteria in GRAP 12 have been met. Once the municipality can demonstrate that it controls the water, it is recognised and initially measured as follows:

- As a gain, using a replacement cost model; plus
- Costs of conversion and other costs incurred to bring the inventory to its current location and condition.

The water is initially recognised as a gain and not as non-exchange revenue because no transaction has occurred. A municipality has however obtained control of an asset which gives rise to a gain.

Note: The example is illustrative only; other circumstances may indicate that control exists and that the recognition criteria have been met.

5.3 *When should revenue be recognised for the sale of pre-paid electricity?*

The sale of electricity constitutes a sale of goods. GRAP 9.29 states that revenue from the sale of goods should be recognised when:

- (a) the entity has transferred to the purchaser the significant risks and rewards of ownership of the goods;
- (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- (c) the amount of revenue can be measured reliably;
- (d) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and
- (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

In the case of prepaid electricity, the significant risks and rewards of ownership only transfer to the consumer at the time of consumption of the electricity. Consequently, the revenue received from prepaid electricity sales should be deferred and recognised as revenue on the consumption basis, commencing on the date of purchase. The consumption of pre-paid electricity is determined by using actual consumption information (if available) or, consumption is measured using a trend analysis and other historical data about electricity usage, including how often an electricity card is purchased or additional units of electricity loaded onto a pre-paid card.

Revenue from pre-paid electricity can only be recognised on a cash basis if a municipality can demonstrate that it is unable to make a reliable estimate of revenue using the methods described in the preceding paragraph or using other accrual based measures. Municipalities should however be able to demonstrate that they have made every reasonable effort to gather appropriate information to enable the recognition of revenue from pre-paid electricity based on consumption by users.

5.4 Is VAT receivable or payable an exchange or a non-exchange receivable or payable?

GRAP 1.79(g),(h),(j) and (k), requires an entity to separately disclose receivables and payables from exchange and non-exchange transactions on the statement of financial position.

VAT is an indirect tax based on consumption of goods and services in the economy. Revenue is raised for the government by requiring certain traders or vendors to register and to charge VAT on taxable supplies of goods or services. The essential characteristics of VAT are:

- it is charged at each stage of the production and distribution process;
- the taxable person (vendor) may deduct the tax paid during the preceding stages; and the burden of the tax is on the final consumer.

The non-exchange transaction is the transaction concluded between the person or entity imposing the tax (national government) and the consumer of goods and services in the South African economy. As a municipality sells final goods and services to consumers, e.g. electricity, it is responsible to collect taxes from its consumers. In collecting and remitting VAT to the national government, the municipality acts as an agent. Consequently, VAT receivable or payable is deemed to be an exchange rather than a non-exchange transaction.

Similarly, other types of taxes which are collected by municipalities as agents, for example, employees' tax and UIF contributions, can be seen as exchange rather than non-exchange transactions.

5.5 Do municipalities have to present a comparison between their budgeted and actual results for the 2009/10 reporting period? (Also see question 1.6 above)

GRAP 1 requires entities to provide information about whether resources were obtained and used in accordance with the legally adopted budget (paragraph .11) and outlines how this requirement may be met (paragraphs .12-.14).

GRAP 24 on *Presentation of Budget Information in Financial Statements*, which is not yet effective, prescribes detailed requirements for comparing actual and budgeted information. Once GRAP 24 becomes effective, paragraphs .11-.14 of GRAP 1 will be repealed and superseded by the requirements of GRAP 24.

However, until GRAP 24 becomes effective entities are required to comply with GRAP 1.11-.14. The requirement to provide information about whether resources acquired were used in accordance with the legally adopted budget, is typically met by presenting a comparison of budgeted and actual information. GRAP 1 currently states that this can be done in two ways:

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

- Where the financial statements and budget are on the same basis of accounting, a comparison of the budget and actual amounts for the reporting period shall be included in the financial statements (paragraph .12).
- Where the financial statements and budget are not on the same basis of accounting, a reconciliation between the statement of financial performance and the budget shall be included in the financial statements (paragraph 14).

A direct comparison between the financial statements and budget as described in paragraph .12 is only useful if the financial statements and budget use exactly the same classification and accounting basis.

The approach in paragraph .14 can be met by preparing a reconciliation of the budget and the statement of financial performance in the notes to the financial statements. GRAP 24 can be used as guidance to assist entities in preparing this reconciliation.

The Office of the Accountant-General at National Treasury will issue guidance on the recommended disclosure for the 2009/10 reporting period.

5.6 *How are prepayments for goods and services accounted for?*

Municipalities may frequently make payments to third parties for goods and services to be provided to them. Often, these prepayments may be settled over a number of years.

The substance of the arrangement is that by making an advance payment to a third party, a municipality has a right to the receipt of goods and services in the future. As these arrangements involve a right to receive goods and services rather than cash or a financial asset, they are not financial assets and consequently cannot be accounted for using IAS 32, 39 and IFRS 7.

While GRAP 102 on *Intangible Assets* deals with the accounting treatment of rights created through contracts and other means, it is not specific about the treatment of prepayments for goods and services.

As no standard or pronouncement within Directive 5 deals directly with the treatment of prepayments for goods and services, municipalities should formulate an accounting policy based on:

- Standards of GRAP for which similar transactions exist;
- The *Framework for the Preparation and Presentation of Financial Statements*.

As prepayments are assets, municipalities should consider whether principles such as discounting (for example, where the prepayment will be settled over more than one reporting period) and impairment (if there is uncertainty about whether the goods and services will in fact be received) need to be considered in formulating an accounting policy.

5.7 *Accounting for employee benefits*

5.7.1 *How should vacation leave be accounted for?*

(Important: Examples have been used to illustrate the explanations below. They are illustrative only and should not be applied to situations without careful consideration of the facts and circumstances as they may differ)

A. Recognising and measuring liabilities

Vacation or annual leave is a short-term employee benefit. Vacation leave can either be vested or non-vested⁶. "Vested" vacation leave means that the employee is entitled to a cash payment for

⁶ For purposes of this discussion, it is assumed that vacation leave is accumulating.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

unused leave, e.g. after a certain period of time has elapsed or on resignation. “Non-vested” leave means that if employees do not use their leave, it is forfeited. The effect of vested and non-vested leave is illustrated below through the use of examples.

Example 1

Municipality X grants its employees 20 days leave a year (assume that the leave cycle and the financial year are the same). At the end of the leave cycle, employees can either elect to have any unused leave paid out or, they can elect to carry the leave days forward to the next leave cycle. If employees resign, they are entitled to a cash payment for any leave due. At the end of the year, a total of 500 leave days have not been used.

In terms of the policy, the municipality has an obligation to either pay out unused leave or allow employees to carry over unused leave to future cycles. As a result it has a present obligation for the full 500 unused days at year end.

Example 2

Municipality A provides its employees 20 days leave a year (assume that the leave cycle and the financial year are the same). Any unused leave at year end must be used within a 6 month period, otherwise it is forfeited. Based on past history, employees forfeit 10% of their unused leave. At year end, the municipality has 300 unused leave days.

At year end, the municipality has an obligation of 300 leave days. However, it knows that based on history, 10% is forfeited. Therefore in measuring the obligation, it considers the percentage leave that is not utilised. A liability of 270 days is recognised [$300 - (300 \times 10\%)$].

B. Classification of leave as a current or non-current

Consider the following example:

Municipality X grants its employees 30 days leave a year (assume that the leave cycle and the financial year are the same). Employees can elect to have leave paid out or carried over to future leave cycles. There is no restriction on the number of leave days that can be accumulated.

Policies such as this may result in leave being utilised or paid out in the future, often more than 12 months after the reporting date.

Short term benefits are those benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service.

Unless a municipality has an enforceable right to defer the encashment or utilisation of leave, the liability is treated as a current liability. E.g. A municipality does not have an unconditional right to defer settlement if employees can utilise their leave due at any time or demand that their unused leave be paid.

If a municipality has an unconditional right to defer the encashment or utilisation of leave, it may be appropriate to treat the liability, or a portion thereof, as a non-current liability. It is important to note that in these instances, entities should consider the guidance in IAS 19 on “long term benefits” in measuring such liabilities.

Example 3

A municipality may have allowed employees historically to accumulate unused leave. At a point in time it amends the conditions of service to state that:

- going forward, employees will forfeit leave not utilised within a specified time frame; and

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

- the balance of any unused leave at the date of changing the conditions of service can either (a) be paid out or used immediately or (b) paid out on retirement. The choice made by employees is irrevocable.

Where employees choose to use or have the leave paid out immediately, this portion of the leave liability is treated as a current liability. Where employees elect to have the leave paid out on retirement, this portion of the leave liability should be treated as a non-current liability (assuming that retirement will not occur within 12 months after the reporting date).

C. Classification of leave as an accrual or a provision

Per GRAP 19 on *Provisions, Contingent Liabilities and Contingent Assets*, provisions are liabilities of uncertain timing or amount. Although there is no formal definition of an accrual, GRAP 19 explains the following: “accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.” The following two examples illustrate when classification of a leave liability as an accrual and/or provision may be appropriate (a combination of both may also be appropriate):

- A municipality does not have an unconditional right to defer settlement of its leave liabilities and its policies allow leave to be carried forward or paid out without any restrictions. In this case, the timing is certain (i.e. used or due on demand) and the amount is certain (i.e. the value of all leave outstanding). In this instance, classification as an accrual may be appropriate.
- A municipality does not have an unconditional right to defer settlement of its leave liabilities and its policies stipulate that leave is forfeited if not used within 6 months after the reporting date. In this case, the timing is certain (i.e. used on demand) but the amount may be uncertain (i.e. an estimate of the leave that will be forfeited should be made in measuring the liability). If uncertainty arises in the measurement, classification as a provision may be appropriate. Note: Where leave is classified as a provision, the disclosure requirements in GRAP 19.107 must be adhered to.

5.7.2 Must a municipality appoint an actuary at every reporting date to measure its defined benefit obligations?

IAS 19.57 states the following: “The Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations.”

IAS 19 does not require the use of an actuary; it is merely encouraged. Given the complexity of these calculations, management needs to ensure that whoever performs the valuation of the defined benefit obligations has the necessary skill and expertise.

Entities frequently implement policies that involve the use of external actuaries and internal staff. As an example, a municipality may appoint an actuary to carry out valuations periodically, e.g. every 5 years, and then use internal staff to “roll forward” the valuations in the years that an external valuation is not performed.

These types of techniques are acceptable if they comply with the requirements of IAS 19.56 which states that: “An entity shall determine the present value of the defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period”.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

5.8 How does a municipality decide which accounting policies should be included in its financial statements?

A municipality includes accounting policies in its financial statements for those material transactions or events included in the municipality's financial statements for the current or prior years (either recognised or included in a specific component of the financial statements, e.g. the statement of financial position or the comparison of budget and actual information, or disclosed in the notes to the financial statements).

A municipality would not include accounting policies in its financial statements that are not relevant to the transactions and events undertaken for the current or prior years. For example, a municipality would not include an accounting policy in its financial statements for internally generated intangible assets if it has not undertaken such transactions in the current or prior years.

5.9 Distinguishing agent-principal, supplier and grant arrangements

Entities frequently receive resources from other public sector entities in relation to the provision of certain goods and services, or the undertaking of certain activities. In practice, it may be difficult to identify the relationship between the various parties because one entity may:

1. Provides goods or services to third parties on behalf of another public sector entity, i.e. it acts as an agent.
2. Provides goods or services directly to the other public sector, i.e. it acts as a supplier or service provider.
3. Is mandated to provide goods or services to third parties and those goods or services are subsidised by another entity.

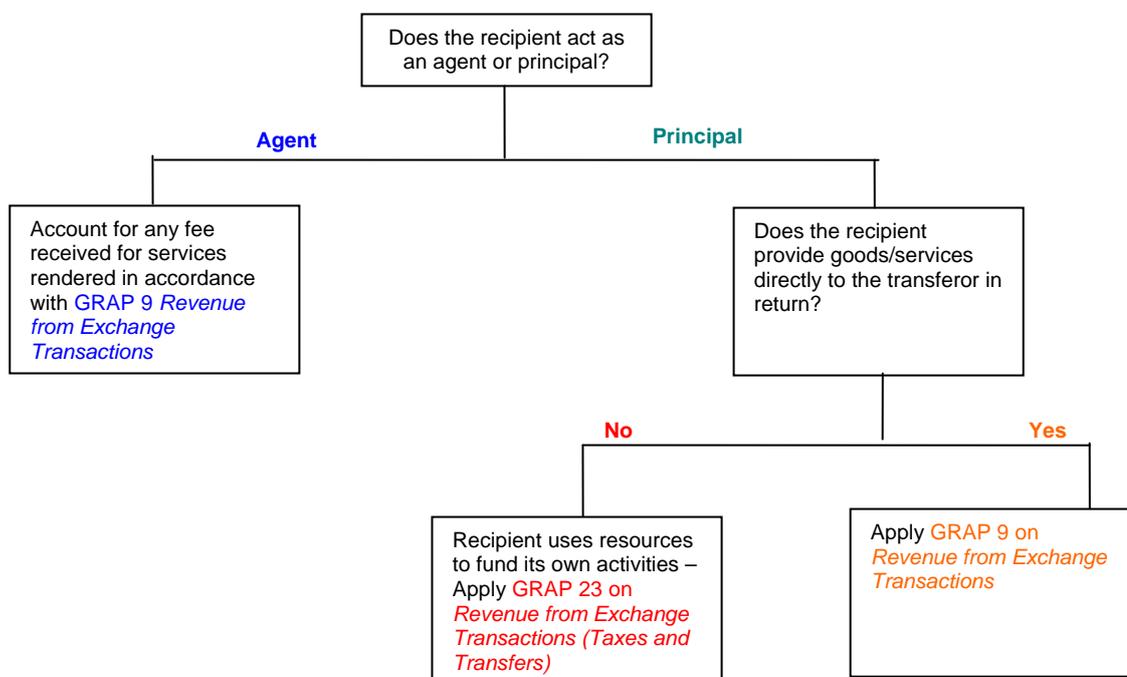
Examples of arrangements that could meet the three scenarios outlined above are: the construction of assets, collection of revenue or the management of projects.

It is often difficult to identify how the entity should account for the resources received and, whether exchange or non-exchange revenue should be recognised.

One of the key factors to consider in assessing the nature of these relationships is the mandate (roles and responsibilities) of the various parties set out in legislation or other binding arrangements such as regulations, ministerial directives, contracts and service level agreements.

The decision tree below may assist in making this distinction. Note: For purposes of the discussion that follows, the entity receiving the resources is the "recipient" and the entity transferring the resources is the "transferor".

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period



Question 1: Does the recipient act as an agent or principal?

In determining whether an entity acts as an agent or a principal, the guidance in the appendix to GRAP 9 *Revenue from Exchange Transactions* (effective 1 April 2011) should be considered:

The following has been extracted from the appendix to GRAP 9:

A25. An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that may indicate that an entity is acting as a principal include (but are not limited to):

- (a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example, by being responsible for the acceptability of the products or services ordered or purchased by the customer or, by being legally responsible for the provision of certain goods or services;
- (b) the entity has inventory risk before or after the customer order, during delivery or on return;
- (c) the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and
- (d) the entity bears the customer's credit risk for the amount receivable from the customer.

An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.

The criteria listed above should not be used as a checklist, as one feature may have more significance than the others in a particular arrangement. Municipalities should therefore apply judgement in identifying whether it acts as a principal or agent, having consideration for the overarching principle of the risks and rewards.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

The following may assist in understanding some of the features listed above:

- (a) Legal responsibility should be considered in the context of applicable legislation and any contracts or agreements concluded between the municipality and other entities.
- (b) Inventory risk relates to the loss an entity would bear as a result of losing inventory through, for example, theft or losses incurred through its operations.
- (c) Credit risk relates to the loss an entity would bear as a result of a customer not settling its outstanding debts.

Recipient acts as an agent

When an entity receives resources from another entity and it acts as an agent, it recognises the following transactions:

- The resources received are recognised as an asset, along with a corresponding liability in the statement of financial position.
- Where resources are expended on behalf of the principal, the asset is reduced along with the corresponding liability in the statement of financial position.
- Any admin fee received is recognised as exchange revenue in the statement of financial performance using GRAP 9 on *Revenue from Exchange Transactions*.

See example 1.

Recipient acts as principal

Question 2: Does the recipient provide goods and/or services directly in return to the transferor?

Where a recipient determines that it acts as a principal, it must determine the nature of the arrangement with the transferor. Most commonly, entities must identify whether it:

- acts as a supplier or service provider to the transferor (exchange transaction); or
- has received resources to fulfil (or subsidise) activities (non-exchange transaction), which may include the provision of goods and services to third parties within its mandate.

The recipient must identify whether the arrangement constitutes an exchange or a non-exchange transaction. Exchange transactions are defined in GRAP 23 as “transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange”.

Where the recipient receives resources and provides approximately equal value directly in return to the transferor through the provision of goods and/or services, it may indicate that it acts as a supplier or service provider in an exchange transaction. In supplier or service provider type relationships, it is usually the transferor's objectives/activities within the transferor's mandate that are being met through the provision of goods and/or services.

Where the recipient does not provide approximately equal value directly in return to the transferor (e.g. through the provision of goods and/or services), the transaction may be a non-exchange transaction. In these types of arrangements, the recipient receives funding to fulfil its own objectives/activities described in its mandate.

Exchange transaction: Where the recipient acts as a supplier or service provider

Where the recipient acts as a supplier or service provider, it recognises revenue using GRAP 9 on *Revenue from Exchange Transactions*.

See example 2.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Non-exchange transaction: Recipient receives funding for its own activities

Where the recipient receives resources to fund its own activities (e.g. through the provision of goods and/or services to third parties), it recognises the resources received from the transferor as revenue using GRAP 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers)*.

See example 3.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Example 1: Recipient acts as an agent

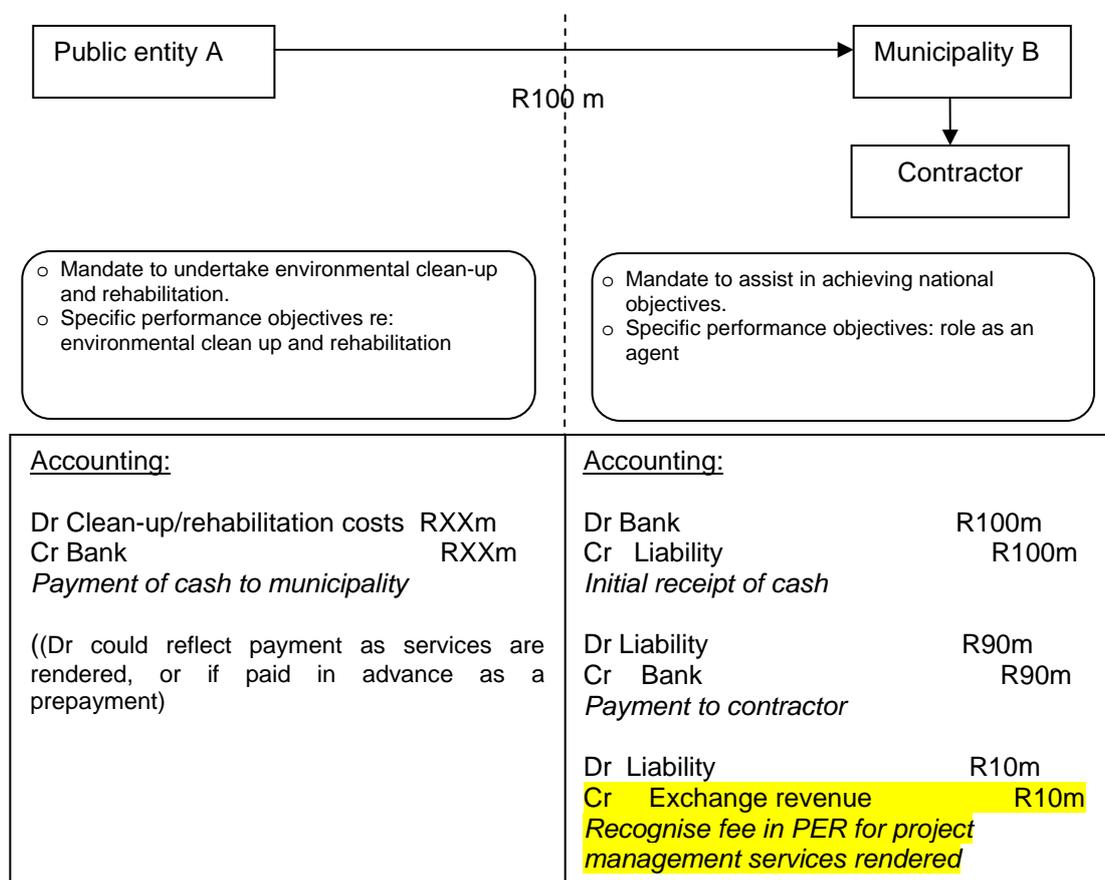
It is within public entity A's mandate to undertake environmental clean-up and rehabilitation activities. Public entity A selects a contractor and agrees the cost. It requests municipality B to oversee the clean-up operations, which entails project managing the clean-up operations and paying the contractor based on the work to date (which is assessed by municipality B). Any difference between the amount transferred to municipality B (R100 million) and the contract price agreed with the contractor (R90 million), is retained by municipality B for **project management** services rendered.

The municipality bears no or little risk in relation to the following:

- It is not responsible in terms of legislation for the ultimate clean-up and rehabilitation.
- It is not responsible for any non-performance by the contractor.
- It bears no credit risk as it only pays the contractor to the extent that the funds have been provided by public entity A.

It is however required to perform the activities/services required by public entity A.

In this scenario it is likely that municipality B acts as an agent. It therefore accounts for the fee received for **project management** services rendered as revenue from exchange transactions in the Statement of Financial Performance and recognises the cash received (inflows), payments made (outflows) and **reflects the net** amounts due to public entity A in the Statement of Financial Position.



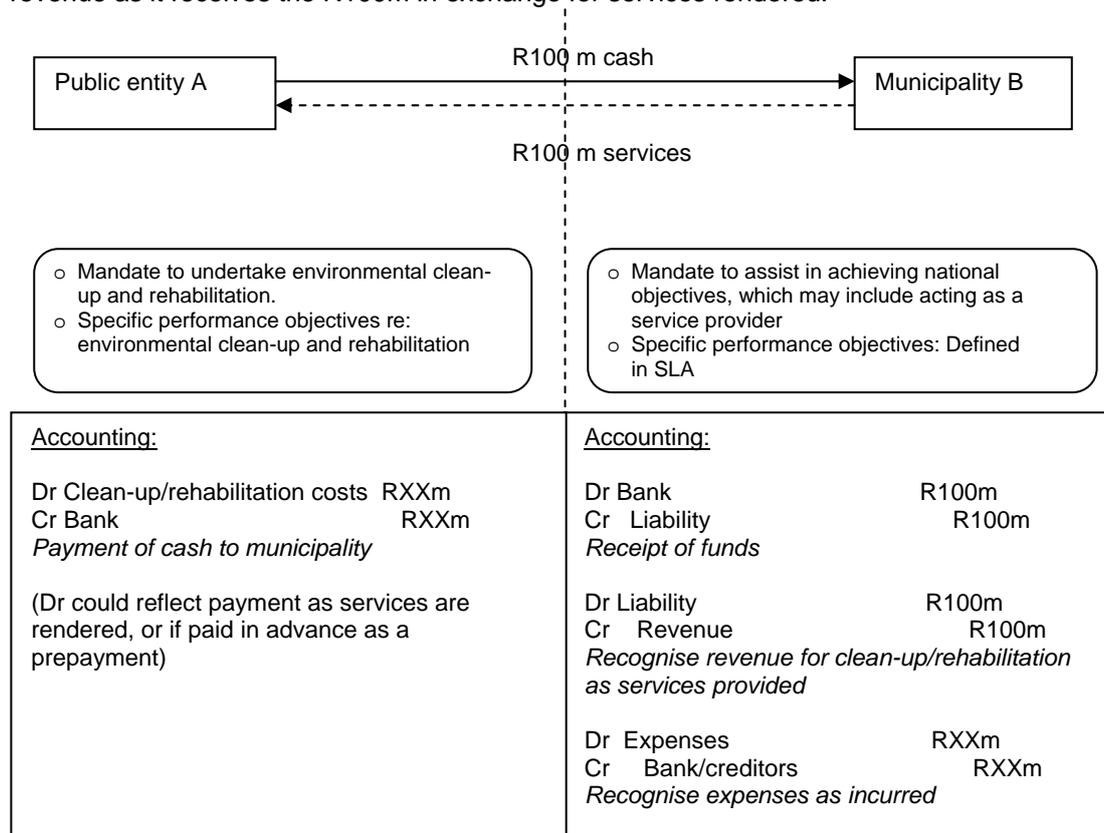
FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Example 2: Recipient is the principal and acts as a supplier or service provider

It is within public entity A's mandate to undertake environmental clean-up and rehabilitation activities. Public entity A appoints Municipality B to undertake the clean-up and rehabilitation of a particular area within the municipality's jurisdiction. Public entity A and municipality B sign a **contract** in which public entity A specifies the following:

- The specific area which **Municipality B is required to clean/rehabilitate**.
- The level/specifications to which the clean-up/rehabilitation must be executed by Municipality B.
- The price at which the clean-up or rehabilitation must be done (R100 million). If the price is exceeded or the clean-up is not performed to the required specifications, any additional costs incurred will be for the municipality's account.

In this scenario, the municipality assumes a significant amount of risk. It is not the municipality's overall responsibility to ensure environmental clean-up and rehabilitation; this responsibility vests with the public entity. The municipality's responsibility is to perform in terms of the contract⁷. Therefore it is likely that municipality B acts as a service provider. The R100m it receives from public entity A is treated as exchange revenue as it receives the R100m in exchange for services rendered.



⁷ Note: Municipalities are often required to include the costs of acting as a service provider in their budget. It will therefore be important to assess the performance objectives identified and developed to assess whether the municipality is acting as a service provider or to fulfil its own mandate/activities. The performance objectives will often be based on the terms and specifications included in the service level agreement where municipalities act as service providers.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

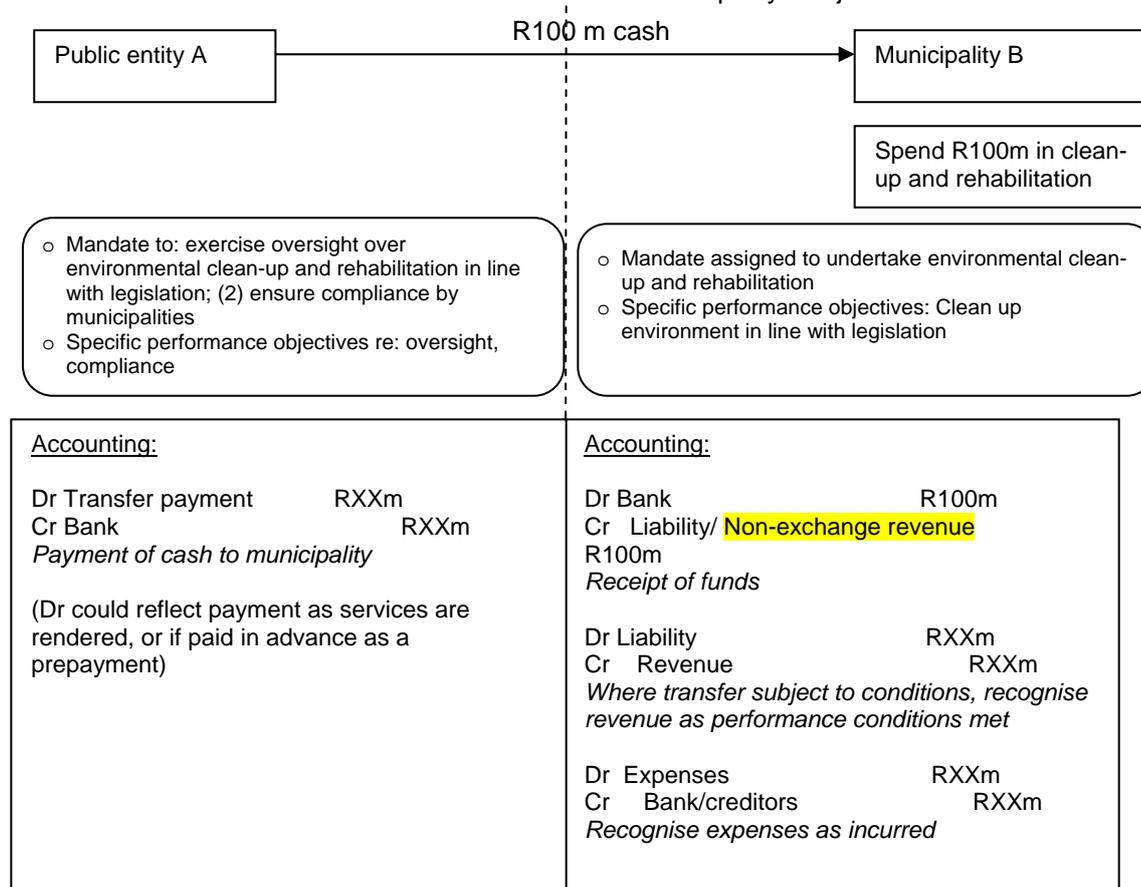
Example 3: Recipient receives resources to fund its activities

It is within public entity A's mandate to undertake environmental clean-up and rehabilitation activities. Public entity A has identified that environmental rehabilitation is required within a particular jurisdiction. The responsibility to undertake the environmental clean-up and rehabilitation is assigned to the municipality which operates within that specific area, Municipality B. Public entity A however retains oversight over the clean-up operations and ensures that the activities are conducted within specified environmental legislation.

The municipality is free to choose how the clean-up and rehabilitation will be done, i.e. it may perform the activity itself or it may appoint a contractor. Any additional costs or savings are for the municipality's account.

In order to execute the clean-up and rehabilitation, municipality B includes the costs within its budget and sets specific performance objectives related to the function it has been assigned. Public entity A agrees to fund the clean-up operations which are budgeted at R100m.

In this scenario, the municipality has been assigned responsibility for the clean-up and rehabilitation of a particular area and will be measured on this activity in its performance targets. In this instance, the municipality acts as a principal. As the R100m will be used to fund the municipality's activities, the revenue is treated as a transfer (non-exchange revenue). The public entity receives no or little benefit directly in return for the R100m as the full amount is used to meet the municipality's objectives.



FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

5.10 *Should revenue received from license fees and similar transactions⁸ be accounted for as exchange or non-exchange revenue by the issuer?*

Public sector entities frequently issue licenses to undertake certain activities or operate certain assets, e.g. motor vehicle, drivers', fishing, gambling and similar licenses.

For purposes of the discussion that follows, the entity issuing the license is the issuer and the entity receiving the license is the license holder.

For the issuer of licenses, the consideration received can either be treated as exchange or non-exchange revenue. Whether the revenue is exchange or non-exchange in nature depends on the nature and circumstances of the transaction.

In formulating an appropriate accounting treatment, the following steps should be considered:

- Whether the entity acts as an agent or a principal.
- The definitions of exchange and non-exchange transactions.

Step 1: Agent or principal

An entity should firstly assess whether it acts as an agent or a principal in such arrangements. In making this assessment, it uses the principles in GRAP 9 *Revenue from Exchange Transactions*. When an entity acts as the principle and is the issuer of the license, it considers step 2 below.

Step 2: Exchange or non-exchange revenue

Where an issuer concludes that it acts as principal in the arrangement, it should consider the definitions of both exchange and non-exchange transactions, defined as follows in the Standards of GRAP:

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange (i.e. non-exchange revenue), or gives value to another entity without directly receiving approximately equal value in exchange (i.e. non-exchange transactions such as social benefit transactions)."

In determining whether the revenue is exchange or non-exchange revenue, the following is important:

- Whether the issuer provides goods and services directly to the license holder in return for the consideration received.
- The value of the goods and services provided in relation to the consideration received.

Goods and services provided by the issuer

The goods and/or services provided in an arrangement may vary. Sometimes the goods and/or services provided may be significant in relation to the arrangement as a whole, e.g. the issuer performs regulatory services such as checking competence, compliance, the safe and effective

⁸ This FAQ could be extended to other transactions that might not be called "licenses" but have the same characteristics. As an example, certain industries require the payment of "subscription fees" when in fact these fees are similar to "licenses" (and vice versa).

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

functioning of particular assets and other forms of control, and other times they are not, e.g. an issuer merely registers a particular asset on a database or performs a similar administration function.

Consideration received by the issuer

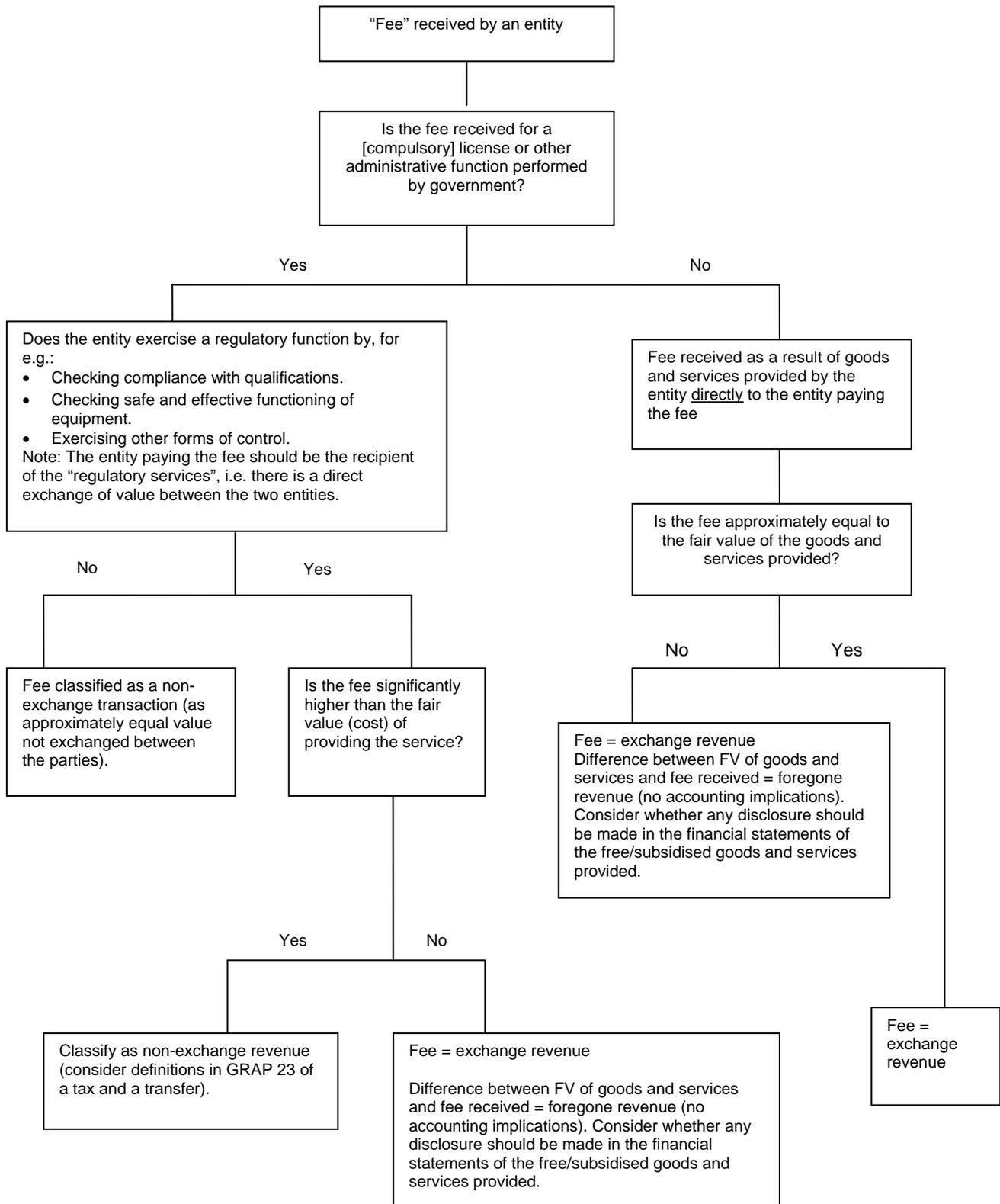
The extent of the consideration received by the issuer for the goods and/or services provided may also vary from arrangement to arrangement. The issuer should therefore consider the value of the goods and/or services provided in relation to the consideration received in assessing whether the transaction results in exchange or non-exchange revenue, using the following basic principle (based on the definition of exchange and non-exchange transactions):

- Where the consideration received by the issuer is significantly greater than the fair value of the goods and/or services provided, the revenue could be non-exchange revenue as it may be tax or similar revenue (the issuer has received consideration and not provided approximately equal value in return)⁹.
- Where the consideration received by the issuer is less than the goods and/or services provided, the revenue could be exchange revenue. Any foregone revenue may be indicative of the provisions of a social benefit (the issuer has provided goods and/or services and has not received approximately equal value in return).

The following decision tree may be useful in classifying revenue received by issuers of licenses, particularly in relation to revenue from compulsory or legislated receipts:

⁹ An entity should apply judgement in these circumstances as it may be that an entity provides goods and/or services at a profit. These arrangements would not necessarily result in non-exchange revenue.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period



FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Section 6 – Accounting for Non-exchange Revenue

6.1 How should a municipality account for equitable share allocations and conditional grants?

Municipalities are required to use the provisions of GAMAP 9.29-.35 and .39-.54 for the recognition, measurement and disclosure of non-exchange revenue¹⁰. GAMAP 9.42-.43 state the following regarding the treatment of government grants:

Government grants

- .42 Government grants can be in the form of grants to acquire or construct fixed assets (capital grants), grants for the furtherance of national and provincial government policy objectives and general grants to subsidise the cost incurred by entities in rendering services. Capital grants and general grants for the furtherance of government policy objectives are usually restricted revenue in that stipulations are imposed on their use.
- .43 Government grants are recognised as revenue when:
 - (a) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,
 - (b) the amount of the revenue can be measured reliably, and
 - (c) to the extent that there has been compliance with any restrictions associated with the grant.
- .44 An entity needs to assess the degree of certainty attached to the flow of future economic benefits or service potential on the basis of the available evidence. Certain grants payable by one level of government to another are subject to the availability of funds. Revenue from these grants should only be recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. An announcement at the beginning of a financial year that grants may be available for qualifying entities in accordance with an agreed programme may not be sufficient evidence of the probability of the flow. Revenue should only be recognised once evidence of the probability of the flow becomes available.
- .45 Restrictions on government grants may result in such revenue being recognised on a time proportion basis. For example, equitable share grants per the Division of Revenue Act where the period of use of such funds is stated, should be recognised on a time proportion basis, i.e. over the stated period. Where there is no restriction on the period, such revenue should be recognised on receipt or when the Act becomes effective, whichever is earlier.
- .46 In certain circumstances government will only remit grants on a re-imburement basis. Revenue should therefore be recognised when the qualifying expense has been incurred and to the extent that any other restrictions have been complied with and not when the grant is received.

While GAMAP 9 refers to restrictions and stipulations, it is not specific about how or if these would give rise to a liability. GRAP 23.12-.23, read with the definitions of “conditions on transferred assets” and “restrictions on transferred assets” in GRAP 23.05, provides guidance on circumstances in which a liability arises from stipulations imposed on grants and other types of transfers. These paragraphs may be used by municipalities in formulating an accounting policy on grants, appropriations and other transfers received in a non-exchange transaction if the guidance in GAMAP 9 is insufficient.

Municipalities are given both equitable share allocations and conditional grants through the annual Division of Revenue Act (DORA). The accounting treatment may be different for equitable share allocations and conditional grants because conditional grants are usually provided to municipalities to achieve specific objectives. As a result, “restrictions” are generally placed on the use of conditional grants in the DORA.

¹⁰ GRAP 9.44 states that: “Until such time as the Standard of GRAP on *Non-exchange Revenue (Taxes and Transfers)* is effective, paragraphs .29 to .35, .39 to .54, .61(b)(iii), (vi), (viii), (ix) and .62 (a) & (b) of GAMAP 9 will form part of this Standard. “ As these paragraphs form part of GRAP 9 they should be applied for non-exchange revenue transactions regardless of whether GAMAP 9 was applied previously by municipalities.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

Equitable share allocations

Note: The discussion that follows is based on legislation and GAMAP 9 only. Municipalities should in all instances assess whether actual circumstances require a different accounting treatment.

The following common features are associated with equitable share allocations:

- The annual DORA outlines the equitable share allocations to be received by municipalities for a particular municipal reporting period, which are published in schedules to the DORA. This provides municipalities with evidence about the amount (measurement) of equitable share allocations for a particular reporting period.
- The DORA indicates that should any shortfall arise in the amount of taxes collected by the revenue fund, such losses will be borne by the revenue fund. This provides municipalities with information about the probability of receipt of equitable share allocations for a particular period.
- The DORA does not impose any restrictions on equitable share allocations granted to municipalities, either in terms of their receipt or use, and does not specify that the equitable share allocations should be used over a specific time period. This provides municipalities with evidence about when revenue should be recognised.

Based on the fact patterns outlined above, municipalities should recognise:

- a receivable at the start of the financial year for equitable share allocations to be received for the reporting period (assuming that the DORA has been enacted and no other indications exist that the receipt of the allocation is not probable or cannot be reliably measured)¹¹; and
- revenue at the start of the financial year if no time-based restrictions exist.

Conditional grants

Note: The discussion that follows is generic and is based on common features associated with conditional grants. As the details and requirements of each grant differ, it is important that entities consider the prescripts of the DORA as well as GAMAP 9 in formulating an appropriate accounting policy.

Conditional grants are paid to municipalities to achieve a variety of objectives. Some of the requirements set out in the DORA regarding conditional grants are that:

- The grants are provided to meet specific objectives. Appropriate performance targets are set by the municipalities and are used by both the municipality and the transferring entity to measure whether the objectives of the grant are being met.
- Any unspent conditional grants revert to the National Revenue Fund unless proof can be provided by the municipality that the excess has been committed to identifiable projects.
- The transfer of funds to municipalities in relation to conditional grants may be suspended under certain circumstances.

Initial recognition

Assuming that a municipality has met the qualifying criteria to receive a conditional grant (if any exist) and the receipt of the grant is probable, conditional grants are recognised at the start of the financial year¹².

¹¹ The DORA often indicates that payments will be made at specified dates (for both equitable share allocations and conditional grants). These dates merely specify the "payment arrangement" between the transferor and recipient.

FAQ's – Adoption and application of the Standards of GRAP municipalities for the 2009/10 reporting period

At initial recognition, a municipality will recognise:

- a receivable for the amount of the conditional grants to be received; and
- a liability or revenue. The circumstances in which a municipality recognises a liability or revenue will depend on whether its accounting policies are based on GAMAP 9, or GAMAP 9 with some consideration of the principles in GRAP 23 (where GAMAP 9 provides insufficient guidance). For example:
 - If a municipality applied GAMAP 9 only, it would recognise a liability if restrictions exist on the use of the resources received.
 - If a municipality applied GAMAP 9 and also considered the requirements of GRAP 23, it may recognise a liability only if restrictions exist on the use of the resources received and it is required to repay any funds not utilised in accordance with those restrictions.

Subsequent measurement

Any liability recognised would be decreased and revenue recognised as and when the municipality complies with the restrictions of the grant.

6.2 How should municipalities account for revenue related to donated assets?

GAMAP 9.47-49 provides guidance on the treatment of “other grants and donations received”. Using the requirements of GAMAP 9.47, a municipality would recognise revenue from a donated asset when it is probable that economic benefits or service potential will flow to the municipality, that the amount of revenue can be measured reliably, and based on the extent to which the municipality has complied with any restrictions on the use of the asset. Assets acquired in non-exchange transactions are measured at fair value.

¹² Note: Some conditional grants are only available to entities through an application process and after satisfying certain “eligibility” criteria. In these instances, a municipality recognises revenue once these criteria have been met and receipt of the conditional grant is probable.