



Implementation of New Accounting Standards and Format of Annual Financial Statements

The Municipal Finance Management Act (56 of 2003) has set the reform agenda in the financial management for local government. The broader reforms have been underpinned by the need for appropriate planning, quality budgeting, the execution and monitoring of plans and budgets, understandable reporting and information that will assist decision makers and the public to measure performance and service delivery.

This circular deals with matters of reporting, specifically in terms of the new accounting standards, the annual financial statements, disclosures and the approach to implementation. The National Treasury in association with other key stakeholders have led the development of accounting reforms since 1998. These reforms have consistently been updated and will continue to be developed as international practices evolve.

The introduction of new accounting standards, recommended by the Accounting Standards Board, and approved by the Minister of Finance, will mark a significant step in municipal financial reforms and will bring local government closer to international standards in financial reporting. These reforms have been under development since 1998 and included the introduction of Generally Accepted Municipal Accounting Practice (GAMAP), providing interim accounting standards for local government while the national standards were developed. A number of national standards, known as Generally Recognised Accounting Practice (GRAP) have been released and are to be implemented over the medium term progressively replacing GAMAP.

The introduction of GRAP will commence with the 2005/06 financial statements for the high capacity municipalities and all municipal entities, followed by the medium and low capacity municipalities progressively complying with the standards from the 2006/07 and 2007/08 financial years, respectively.

This circular includes information on the implementation dates for all municipalities and copies of the formats to be used for financial statements.

Background

Section 216(1)(a) of the Constitution requires the National Treasury to introduce Generally Recognised Accounting Practice (GRAP). To give effect to this provision, the Minister of Finance established the Accounting Standards Board (ASB) in terms of the section 87(1) of the Public Finance Management Act (Act 1 of 1999). Section 122(3) of the Municipal Finance Management Act (MFMA) requires municipalities and municipal entities to prepare financial statements in accordance with GRAP, with this requirement being phased in as stated above.

The Accounting Standards Board (ASB)

In terms of section 89(1) of the PFMA, the primary functions of the ASB are to:

- Set standards of generally recognised accounting practice for the financial statements of departments; public entities; constitutional institutions; municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and Parliament and provincial legislatures,
- Prepare and publish directives and guidelines concerning the standards set above,
- Recommend to the Minister of Finance effective dates of implementation of these standards for the different categories of institutions to which the standards apply and
- Perform any other function incidental to advancing financial reporting in the public sector.

There are thus clear roles of responsibilities for the ASB, the National Treasury and the Auditor-General, which can be summarised as follows:

- The ASB sets the accounting standards,
- National Treasury assist in the implementation of the standards by, for example, developing the appropriate formats, making recommendations and regulating the approach to implementation, providing guidance and rendering support for implementation, including training,
- The Auditor-General audits annual financial statements in line with the standards and the formats.

In August 2002, the (ASB) began the process of reviewing and approving Statements of Generally Accepted Municipal Accounting Practice and developing new GRAP standards. GAMAP was considered as interim standards for municipalities and municipal entities until the national standards of GRAP have been developed and approved by the ASB.

Since 1998, the National Treasury has conducted national capacitation programmes on GAMAP, including workshops, training and guidelines. The capacitation programme was limited to providing a basic understanding of GAMAP due to the fundamental differences between the GAMAP standards and the fund accounting system. It has always been recognised that implementing the new standards is a significant challenge to municipal practitioners and that a realistic timeframe was needed before municipalities are able to fully comply with the GRAP standards. The capacitation programme covered the following areas at a basic level:

- Elements of financial statements like income, expense, assets and liabilities; highlighting differences with fund accounting,
- Acquiring, disposing and recording Property, Plant and Equipment. This included aspects such as cost, depreciation, compiling fixed asset registers and differences between capital expenditure and repairs and maintenance,
- Basic principles of revenue recognition and recording,
- Liabilities and basis for provisions, e.g. that provisions should only be made for current liabilities,
- Inventory recording and
- Basic principles of leases.

The GAMAP standards were primarily based on SA GAAP as at 30 November 1997, which at that point in time was considered fair presentation. Fair presentation evolves over time and will continue to evolve in the future. The GAMAP standards revised, together with the GRAP standards, which have been approved by the Minister of Finance in the last year, do not completely constitute fair presentation in terms of International Public Sector Accounting Standards and will undergo further enhancements (see below for the standards approved by the ASB as at 31 December 2004).

GAMAP and GRAP Standards

The GRAP and GAMAP standards approved by the ASB as at 31 December 2004 are tabled below: The tables exclude new standards approved after 31 December 2004. As mentioned above, the standards will evolve over time as old standards are repealed/ updated and new ones are developed.

3 GRAP Standards

	Preface to Standards of Generally Recognised Accounting Practice
GRAP 1	Presentation of financial statements
GRAP 2	Cash Flow statements
GRAP 3	Accounting policies, changes in accounting estimates and errors

8 GAMAP Standards

GAMAP 4	Effects of changes in foreign exchange rates
GAMAP 6	Consolidated financial statements and accounting for controlled entities
GAMAP 7	Accounting for investments in associates
GAMAP 8	Financial reporting of interests in joint ventures
GAMAP 9	Revenue
GAMAP 12	Inventories
GAMAP 17	Property, Plant and Equipment
GAMAP 19	Provisions, contingent liabilities and contingent assets

These 3 GRAP and 8 GAMAP standards in the tables above are the minimum standards to be complied with by municipalities (categorised as high capacity) and all municipal entities. The specimen municipal annual financial statements and the implementation guide attached (Annexures B and C) were developed based on these standards. As more standards are issued, the specimen and the guide will be updated to reflect the new reporting requirements.

Any new standards will be implemented in a structured manner, offering sufficient time for municipalities to comply, and will be communicated by the National Treasury.

Mandatory and encouraged accounting policies

Compliance with the above accounting standards is mandatory for the 50 high capacity municipalities who are expected to implement earlier for the municipal financial year ending 30 June 2006. The medium and low capacity municipalities will be required to comply with the standards, that would be applicable at that time, for the financial years ending 30 June 2007 and 30 June 2008, respectively. The requirements of future standards and amendments will be reflected in the specimen annual financial statements and implementation guide, which will be published timeously by the National Treasury.

Although, compliance with emerging accounting standards is encouraged in the specimen annual financial statements, it is **not mandatory**. Municipalities should apply their mind to transactions and events that are **not** covered by the existing GRAP and GAMAP standards. Where municipalities have any events or transactions that are not covered by either the mandatory or encouraged accounting policies, municipalities must draft appropriate accounting policies setting out how they recognise and measure such transactions, balances and events in line with paragraphs 7, 11 and 12 of GRAP 3: Accounting policies, changes in accounting estimates and errors. The advantages of this approach are as follows:

- The applicability of the scope of accounting standards to municipalities is defined and leaves little room for misinterpretation. This will benefit municipal practitioners,
- The scope of GRAP will increase over time, thereby improving fair presentation. As GRAP standards are issued, municipalities and their entities will need to comply with such standards. Over time, municipalities will reach the level of presentation of their financials that can be truly classified as being within the international recognised definition of “fair presentation”,
- The capacitation of municipalities can proceed in a structured and realistic manner. Appropriate timeframes can be established for capacitation to be undertaken nationally as skills are being built, and
- This approach will also assist consistent interpretation of applicability of standards to municipalities as they have been categorized.

The approach is consistent with Section 122 (1)(a) of the Municipal Finance Management Act. The Auditor-General, when issuing audit reports on municipalities, will therefore make reference to GRAP and GAMAP as a basis of determining fair presentation.

Implementation by capacity

The effective dates for producing new GRAP compliant annual financial statements are in line with the MFMA phased implementation strategy. The dates are as follows for different capacity levels of municipalities.

Capacity level ¹	No. of municipalities	Effective dates
High capacity	50	2005/2006 financial statements
Medium capacity	107	2006/2007 financial statements
Low capacity	127	2007/2008 financial statements

Municipalities that have made significant progress in capacitating officials and changing/acquiring accounting and information systems to produce new GRAP compliant annual financial statements are encouraged to do so even if they are not required by the MFMA phased implementation strategy. Municipalities that are ahead of this schedule and can comply sooner, are requested to inform the National Treasury in advance to ensure that timely communication for the audit to be conducted using the appropriate standards is effected. Early adoption of the standards is commendable and encouraged.

¹ See Annexure C, Gazette 26511 that contains the names of the municipalities in each category.

Format of Annual Financial Statements and Audit

Capacity level	2005/06	2006/07	2007/08
High capacity	GRAP	GRAP	GRAP
Medium capacity	IMFO	GRAP	GRAP
Low capacity	IMFO	IMFO	GRAP

The 50 high capacity municipalities will be required to prepare their 2005/06 (and onwards) annual financial statements in accordance with the GRAP specimen financial statements in Annexure B. The medium and low capacity municipalities will use the Institute of Municipal Finance Officers' (IMFO) formats for the 2005/06 financial year. These municipalities should then graduate as shown in the table above. However, it is important to note that early implementation is encouraged.

Consistency in application

To maintain consistency in the application of the accounting standards, the implementation guide and the formats, all enquiries, comments and questions on the standards should be directed to the National Treasury at the addresses and telephone numbers below. Where the comments and queries are of an audit nature, communication should still be directed to the National Treasury, which will address the issues with the right representatives in the Office of the Auditor-General.

The 3 GRAP and 8 GAMAP standards will be used by the auditors in auditing the financial statements of municipalities and municipal entities. Where new standards are issued, the specimen will be updated to reflect new reporting requirements. The updated version will then replace the old version for audit purposes.

Key steps to comply

Municipalities are advised to engage in capacity building of their officials and to implement accounting and information systems early so that they can ensure successful implementation of the new standards. The following key steps, not in chronological sequence, are suggested for ensuring compliance:

- Establish the standards implementation team. It is advisable that the Chief Finance Officer of the municipality or municipal entity chairs this team,
- Develop a standards implementation plan with key and clear responsibilities and timeframes. The necessary delegations and sign-offs should be documented,
- Identify the systems and capacitation programmes that are required to assist with implementation,
- Initiate the fixed asset identification and valuation process and update the asset register,
- Team to thoroughly study and understand the accounting standards, guide and formats,
- Develop appropriate accounting policies,
- Reinstate the opening balances of income, expenditure, assets and liabilities.

The list is not exhaustive and each municipality should develop a plan based on its requirements and readiness to implement. The National Treasury will be conducting awareness and training programmes throughout the country. The Office of the Accountant-General can be contacted in this regard. Kindly direct your enquiries on training to Ms Nonhlanhla Khumalo, telephone (012) 315 5334 and/or email: nonhlanhla.khumalo@treasury.gov.za.

Financial Statements for 2004/05

You are reminded that the MFMA requires **municipalities to prepare and submit their financial statements to the Auditor-General within 2 months of year end, ie by 31 August 2005**. This is an important implementation year for municipalities and will be monitored closely. It is therefore, incumbent on the municipalities to provide two copies of the **unaudited** version of the annual financial statements to National Treasury, at the address below, as soon as it is completed.

We have received various correspondence from municipalities wanting to clarify the process with regards the submission of Annual Financial Statements.

It has been noted that there was a previous requirement that annual financial statements be submitted to Council prior to submission to the Office of the Auditor-General for audit. Continuing with these old practices will result in delays in the finalisation of the audits, thereby making it difficult for municipalities to comply with section 126 of the MFMA.

The process outlined in the MFMA, requires that the accounting officer/ municipal manager, prior to submission to the Office of the Auditor-General, sign the annual financial statement. This process replaces old requirement or practices. However, you may still want to submit a copy of the financial statements that was submitted to the Office of the Auditor-General to Council at its next meeting, for noting purposes. This measure will limit any process delays.

Advising the National Treasury of compliance and submission will assist in the implementation of the section 38 of the MFMA. You are reminded that non-compliance can lead to the withholding of national transfers. The reasons for any late submission of unaudited financial statements will have to be fully motivated by the Municipal Manager and a date for submission provided. This motivation must reach the National Treasury by 31 August 2005. Should this explanation be unsatisfactory, the equitable share transfer will be withheld or delayed until such time compliance is achieved.

Conclusion

Although, we recognise that the implementation of the accounting standards may be challenging to some municipalities and municipal entities, the benefits will be significant those institutions able to comply sooner, since their finances are presented in a manner that is better understood by all. There are other positive spin-offs to this reform relating to cheaper funding from financial institutions, leveraging own funds to expand the delivery of municipal services within the municipality. This circular is provided to you one year in advance of effective date to ensure that all processes and procedures can be instituted.

Annexure

- A: List of municipalities in different categories
- B: GRAP - specimen municipal annual financial statements
- C: Accounting standards implementation guide

The latest version of the GRAP and GAMAP accounting standards can be downloaded from the website of the Accounting Standards Board at www.asb.co.za. The latest version of the municipal specimen financial statements and implementation guide are available on the mfma website at www.treasury.gov.za

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