

**TOPIC 1.2: ACCOUNTING GUIDELINES AND STANDARDS THAT ARE RELEVANT TO THE MUNICIPALITY**

## **INTRODUCTION**

The purpose of this section of the Municipal Accounting and Procedures Manual is to set out a framework of the accounting standards that need to be applied by municipalities in South Africa when they prepare annual financial statements (AFS).

The rules and conventions of accounting are commonly referred to as “principles”. It is therefore important that sound accounting principles should exist. The “pocket Oxford dictionary” defines a principle as a “fundamental truth or law as the basis of reasoning or action”.

Accounting principles may therefore be regarded as specific fundamental tenets which, on the basis of reason, demonstrated performance and general acceptance, are generally essential to effective management control and financial reporting.

The accounting principles, concepts and disclosure requirements are included in the standards of Generally Recognised Accounting Practice (GRAP), also referred to as the accounting standards. The accounting standards give the following guidance to the preparers of AFS when dealing with specific topics:

- they explain the accounting treatment of transactions, in other words the debit and credit entries, including when to recognise these entries.
- they explain the accounting measurement of transactions.
- they explain the presentation and disclosure requirements of transactions in the entity's Annual Financial Statements

In terms of paragraph 63 of the *Framework for the Preparation and Presentation of Annual Financial Statements* the application of GRAP normally results in financial statements that convey what is generally understood as a **fair presentation** of such information.

The National Treasury (NT) in association with other key stakeholders has led the process of the development of accounting reforms in the South African Public Sector since 1998. The key aspects of this process can be summarised as follows:

- 1) New accounting standards called GAMAP, to be utilised by municipalities for the preparation of their AFS, were developed and based on SA GAAP as at 30 November 1997. The envisaged application of these standards would result in the AFS of municipalities more closely resembling those of entities in the private sector.
- 2) GAMAP has since become outdated as substantial changes have taken place to GAAP since 1997. GAAP has changed substantially since 1997 as the international accounting standards, on which SA GAAP is based, have changed since 1997.

3) A process was started by the ASB in August of 2002 to review and amend the existing outdated standards of GAMAP, and also to develop the new standards of GRAP, which will replace the GAMAP standards as GRAP is developed. These standards of GRAP are based on the IPSAS, which did not exist in 1997, when the GAMAP standards were developed. IPSAS are in turn based on the relevant IAS or IFRS.

**IAS**'s are the guidelines that are followed by private sector entities for the preparation of AFS. The IAS's are internationally accepted accounting best practice. In future the International Accounting Standards Board will no longer issue IAS, as the name of these standards has now been changed to **IFRS**.

**SA GAAP** is the set of accounting standards that is followed by private sector entities in SA for the preparation of AFS. In most cases the SA GAAP has been aligned with and very closely resembles the IAS and IFRS.

**GAMAP** standards were developed in 1998 and were based on GAAP at that point in time. It was initially envisaged that these standards would be the guidelines followed by municipalities for the preparation of AFS. Since 1997, however, GAAP and the IAS have changed substantially, resulting in GAMAP being outdated. GAMAP is therefore in a process of being replaced with GRAP.

**GRAP** is being developed in SA and is based on the IPSAS. GRAP is the acceptance and implementation by SA of the IPSAS. Once the GRAP standard relating to a specific topic has been developed the GAMAP equivalent will be withdrawn and be replaced by the newly developed GRAP standard. The outcome of this exercise is that eventually all the GAMAP standards will be withdrawn and we will have one set of GRAP standards that will be utilised by all Public Sector entities in all three spheres of government in SA.

In terms of section 89(1) of the PFMA, the primary functions of the **ASB**, which is a South African body, 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 assists 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.

**Determining which accounting standards to follow when relevant guidance is not found in the existing GAMAP and GRAP standards**

**Prior to the approval and publication of the Government Gazette 30013 (which is discussed in detail below), dated 29 June 2007, high capacity municipalities that were required to comply with section 122(3) of the Municipal Finance Management Act (MFMA), 56 of 2003 had to utilize the following accounting standards for financial reporting purposes for the year ended 30 June 2006:**

- The effective Standards of Generally Recognised Accounting Practices (GRAP);
- The effective Standards of Generally Accepted Municipal Accounting Practices (GAMAP); and
- The effective Standards of South African Generally Accepted Accounting Practice (SA GAAP) including any interpretations and circulars issued by the Accounting Practices Board and SAICA respectively.

The effective GRAP, GAMAP and GAAP standards as at 29 June 2007 were as follows:

- GRAP 1 Presentation of financial statements
- GRAP 2 Cash Flow Statements
- GRAP 3 Accounting policies, changes in accounting estimates
- GAMAP 4 Foreign exchange
- GAMAP 6 Consolidations
- GAMAP 7 Associates
- GAMAP 8 Joint Ventures
- GAMAP 9 Revenue
- GAMAP 12 Inventories
- GAMAP 17 PPE
- GAMAP 19 Provisions

**GAAP standards - List of standards as set out on page 43 to 47 of the NT APPLICATION OF ACCOUNTING STANDARDS GUIDE (updated by NT and issued on 17 August 2007)**

Although the MFMA requires the use of generally recognised accounting practice (GRAP) for the preparation and presentation of financial statements, not all transactions at a municipal level for the year ended 30 June 2006, were addressed by the effective GRAP/GAMAP standards and therefore before 29 June 2007 municipalities were expected to comply with GAAP, where transactions were not addressed by the GRAP or GAMAP standards.

**The purpose of Government Gazette 30013** and the resulting NT APPLICATION OF ACCOUNTING STANDARDS GUIDE was to ease the burden resting on municipalities to comply with all relevant GAAP standards by allowing a phased in approach by exempting municipalities for a specific time period from complying with either the full GAAP standard or with specific portions thereof.

It is important to note that the GAMAP and GAAP standards, which are relevant to municipalities, will eventually be replaced by GRAP standards once these standards are developed and become effective.

**Treasury guidelines relating to accounting are explained**

The National Treasury (NT) has issued various circulars, application guidelines and municipal specimen sets of annual financial statements to assist municipalities and municipal entities in compiling GRAP compliant annual financial statements. These documents are discussed briefly below.

**NT MFMA Circular No. 18 – Implementation of new accounting standards and Format of annual financial statements (Issued 23 June 2005)**

The objective of NT MFMA circular no. 18 was to give municipalities and municipal entities a background on National Treasury's mandate to introduce Generally Recognised Accounting Practice (GRAP) in terms of section 216(1)(a) of the Constitution. This circular specifically addressed the following issues:

- the role of the Accounting Standards Board (ASB) in setting the accounting standards which municipalities and municipal entities have to comply with;
- introduction of the 3 GRAP and 8 GAMAP standards that are the minimum standards to be complied with by high capacity municipalities and all municipal entities for the year ended 30 June 2005. These standards were listed earlier in this section.
- the concept of mandatory and encouraged accounting standards, meaning that municipalities and municipal entities should apply their mind to transactions and events that are not covered by the existing GRAP and GAMAP standards, as set out above (implying application of the International Public Sector Accounting Standards

(IPSAS) and the International Financial Reporting Standards (IFRS) for areas of accounting not covered by GRAP or GAMAP);

- implementation of GRAP by capacity, i.e. the effective dates for producing new GRAP compliant annual financial statements in line with the MFMA phased implementation strategy;
- format of annual financial statements and audit, depending on the capacity level of municipalities (being either on IMFO or GRAP format);
- consistency in application of accounting standards by municipalities and municipal entities;
- key steps to compliance with GRAP and capacity building by municipalities and municipal entities of their officials and early implementation of GRAP compliant accounting and information systems; and
- submission of 2004/05 annual financial statements of municipalities and municipal entities to NT.

**NT MFMA Circular no. 18 is issued with the inclusion of:**

- a specimen set of annual financial statements for application as guideline by municipalities for compiling its annual financial statements in 2005/06, depending on its capacity level; and
- an accounting standards application guide for the implementation of approved standards of GRAP.

**NT MFMA Circular no. 18 did not provide guidance on the following issues:**

- the treatment of transactions and events that are not covered by the existing GRAP and GAMAP standards;
- the specimen set of annual financial statements accompanying the circular did not illustrate the treatment of transactions and events that are not covered by the existing GRAP and GAMAP standards;
- the accounting standards application guide addressed the accounting treatment of property, plant and equipment (PPE), the unbundling of loans redeemed and other capital receipts, the process to establish the Capitalization Reserve (CR), the Capital Replacement Reserve (CRR) and the External Financing Fund (EFF) and certain other accounting issues. It is important to note here that although the NT guideline allowed for the creation of the CR and the CRR, there is no local government accounting standard that allows the creation of these reserves.
- the accounting standards and related topics covered in the accounting standards application guide did not adequately address all of the accounting issues underlying these topics, e.g. Chapter 3 deals with determining the values of PPE at the date of implementation of GRAP, but does not give guidance on determining these fair

values (considering that the fair value of PPE is often not generally available for public sector assets).

**NT MFMA Circular No. 36 – Annual financial statements for 2005/06 for municipalities and municipal entities (*Issued 11 July 2006*)**

The objective of NT MFMA circular no. 36 is to provide guidance to municipalities on the preparation and timely submission of the annual financial statements for municipalities and entities for the 2005/06 financial year.

The following issues relating to the annual financial statements are clarified in this circular:

- applicable accounting standards and formats;
- specimen municipal annual financial statements;
- consolidated specimen financial statements;
- timing and implementation by capacity;
- withdrawal and resubmission of financial statements;
- the municipal audit file;
- additional disclosures; and
- non-compliance with Chapter 12 of the MFMA.

NT MFMA Circular no. 36 is issued with the inclusion of:

- a specimen set of annual financial statements for application as guideline by municipalities for compiling its annual financial statements in 2005/06 for small, medium and large municipalities;
- a consolidated specimen set of annual financial statements for application as guideline by municipalities for compiling its consolidated annual financial statements in 2005/06; and
- basis of preparation for municipal entities.

**NT MFMA Circular no. 36 does not provide guidance on the following issues:**

- the treatment of transactions and events that are not covered by the existing GRAP and GAMAP standards; and
- the specimen sets of annual financial statements accompanying the circular did not illustrate the treatment of transactions and events that are not covered by the existing GRAP and GAMAP standards.

**NT MFMA Circular No. 44 – Preparation of annual financial statements based on the Exemption Gazette 30013 (Issued 25 July 2007)**

The objective of NT MFMA circular no. 44 is to provide guidance on the implementation and interpretation of the above-mentioned Gazette (this Gazette is discussed below) and the preparation and submission of annual financial statements as required by the MFMA. This circular specifically addressed the following issues and was relevant for municipalities preparing AFS for the year ended 30 June 2007:

- the exemptions granted in terms of the Government Gazette No. 30013, dated 29 June 2007;
- new GRAP compliance dates for municipalities and municipal entities due to the extension granted in the above-mentioned Gazette;
- impact of these exemptions on the preparation and submission of annual financial statements on municipalities municipal entities as per its capacity level;
- application process to be followed by municipalities and municipal entities for deviation from the exemptions granted in the above-mentioned Gazette; and
- the submission of implementation plans by municipalities and municipal entities to NT and Provincial Treasury (PT).

NT MFMA Circular no. 44 is issued with the inclusion of:

- a template implementation plan for accounting standard reforms for high capacity municipalities for completion and submission to PT and NT; and
- a template implementation plan for accounting standard reforms for medium and low capacity municipalities for completion and submission to PT and NT.

**GOVERNMENT GAZETTE 30013 (issued 29 June 2007)**

The purpose of this Gazette is to grant exemption to municipalities and municipal entities from certain GRAP accounting standards and the requirement to compile consolidated annual financial statements. These exemptions are granted for a specific period, subject to conditions contained in the Gazette and the Annexure thereto. Municipalities are required in terms of the Gazette to submit implementation plans for accounting standard reforms to NT and PT before specified dates. The exemptions contained in the annexure to the Gazette are not sufficiently detailed, are sometimes ambiguous and certain exemptions are unclear. To address these shortcomings and to assist municipalities and municipal entities in applying the exemptions as per the Gazette, NT issued the below-mentioned two application of accounting standards guides.

**APPLICATION OF ACCOUNTING STANDARDS GUIDE (issued by NT on 30 July 2007)**

The purpose of this document is to provide guidance to municipalities and municipal entities on the accounting implications of the Exemption Gazette 30013, dated 29 June 2007. This document should be read in conjunction with NT MFMA Circular 44, discussed above.

**APPLICATION OF ACCOUNTING STANDARDS GUIDE (updated by NT and issued on 17 August 2007)**

The purpose of this document is to provide updated guidance to municipalities and municipal entities on the accounting implications of the Exemption Gazette 30013, dated 29 June 2007. The information contained in the initial application of accounting guidance document issued 30 July 2007 was cluttered, whereas the updated guide issued 17 August 2007 was formatted systematically and gave more clarity on specific application of the exemptions contained in the Gazette referred to above. This document should be read in conjunction with NT MFMA Circular 44, discussed above.

**ACCOUNTING IMPLICATIONS OF THE EXEMPTION GAZETTE 30013 DATED 29 JUNE 2007**

Standard no.	Standard Title	GRAP, GAMAP, and or SA GAAP requirement(s), exempted in terms of General notice 552 of 2007, that have been early adopted
GRAP 03	Accounting policies, changes in accounting estimates and errors	<ul style="list-style-type: none"> <li>▪ Identification and impact of GRAP standards that have been issued but are not yet effective (GRAP 3.30 – 31)</li> </ul>
		<ul style="list-style-type: none"> <li>▪ Changes in accounting policies (GRAP 3.14,19)</li> </ul>
GAMAP 09	Revenue	<ul style="list-style-type: none"> <li>▪ Initial measurement of fair value; discounting all future receipts using an imputed rate of return (GAMAP 9.12 and SAICA circular 9/06)</li> </ul>
GAMAP 12	Inventories	<ul style="list-style-type: none"> <li>▪ The entire standard as far as it relates to immovable capital assets inventory that is accounted for in terms of GAMAP 17</li> </ul>
		<ul style="list-style-type: none"> <li>▪ The entire standard as far as it relates to water stock that was not purchased by the municipality.</li> </ul>
GAMAP17	Property, Plant and Equipment	<ul style="list-style-type: none"> <li>▪ Review of useful life of items of PPE recognised in the annual financial statements (GAMAP 17.69 – 61, 77)</li> </ul>
		<ul style="list-style-type: none"> <li>▪ Review of the depreciation method applied to PPE recognised in the annual financial statements (GAMAP 17.62. 77)</li> </ul>
		<ul style="list-style-type: none"> <li>▪ Impairment of non-cash generating assets (GAMAP 17.64 – 69, 75 (e)(v) – (vi))</li> </ul>
		<ul style="list-style-type: none"> <li>▪ Impairment of cash generating assets (GAMAP 17.63, 75(e)(v) – (vi))</li> </ul>
IAS 11 (AC 109)	Construction contracts	<ul style="list-style-type: none"> <li>▪ Entire standard</li> </ul>
IAS 14 (AC 115)	Segment reporting	<ul style="list-style-type: none"> <li>▪ Entire standard</li> </ul>
IAS 17 (AC 105)	Leases	<ul style="list-style-type: none"> <li>▪ Recognising operating lease payments / receipts on a straight-line basis if the amounts are recognised on the basis of the cash flows in the lease agreement (IAS 17.33 – 34 and 50 – 51, SAICA circular 12/06.8 – 11)</li> </ul>
IAS 19 (AC 116)	Employee benefits	<ul style="list-style-type: none"> <li>▪ Defined benefit accounting as far as it relates to defined benefit plans accounted for as defined contribution plans and defined benefit obligation disclosed by narrative information (IAS 19.29 48 – 119 and 120A(c) - (q))</li> </ul>

## GRAP Implementation Guide for Municipalities

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IAS 20 (AC 134)	Accounting for government grants and disclosure	<ul style="list-style-type: none"> <li>▪ Entire standard excluding paragraphs 24 and 26, replaced by GAMAP 12.8, GAMAP 17.25 and GAMAP 9.42 – 46.</li> </ul>
IAS 36 (AC 128)	Impairment of assets	<ul style="list-style-type: none"> <li>▪ Entire standard</li> </ul>
IAS 38 (AC 129)	Intangible assets	<ul style="list-style-type: none"> <li>▪ The entire standard except for the recognition, measurement and disclosure of computer software and website costs (SIC 32) and all other costs are expensed</li> </ul>
IAS 39 (AC 133)	Financial instruments: recognition and measurement	<ul style="list-style-type: none"> <li>▪ Initially measuring financial assets and liabilities at fair value (IAS 39.43, AG79, AG 64 – AG65 and SAICA circular 9/06)</li> </ul>
IAS 40 (AC 135)	Investment property	<ul style="list-style-type: none"> <li>▪ The entire standard to the extent that the property is accounted for in terms of GAMAP 17</li> </ul>
		<ul style="list-style-type: none"> <li>▪ Disclosure of the fair value of investment property if the cost model is applied and where the municipality has recognised the investment property in terms of this standard (IAS 40.79(e)(i) – (iii))</li> </ul>
IFRS 3 (AC 140)	Business combinations	<ul style="list-style-type: none"> <li>▪ Entire standard</li> </ul>
IFRS 5 (AC 142)	Non-current assets held for sale and discontinued operations	<ul style="list-style-type: none"> <li>▪ Classification, measurement and disclosure of non-current assets held for sale (IFRS 5.6 – 29 (in so far as it relates to non-current assets held for sale) and 38 – 42)</li> </ul>
IFRS 7 (AC 144)	Financial Instruments	<ul style="list-style-type: none"> <li>▪ Entire standard to be replaced by IAS 32 (AC125) issued August 2006 and effective for financial statements covering periods beginning on or after 1 January 1998.</li> </ul>
IFRS 8 (AC 145)	Operating segments	<ul style="list-style-type: none"> <li>▪ Entire standard</li> </ul>

**GOVERNMENT GAZETTE 31021 (issued 9 May 2008)**

The purpose of this Gazette is to prescribe the additional standards of GRAP effective to municipalities and municipal entities. The implementation dates of these standards are subject to the provisions of notice 522 issued in GG 30013 (dated 29 June 2007). These standards are:

Reference	Topic
GRAP 4	The Effect of Changes in Foreign Exchange Rates
GRAP 5	Borrowing Costs
GRAP 6	Consolidated and Separate Financial Statements
GRAP 7	Investments in Associates
GRAP 8	Interests in Joint Ventures
GRAP 9	Revenue from Exchange Transactions
GRAP 10	Financial Reporting in Hyperinflationary Economies
GRAP 11	Construction Contracts
GRAP 12	Inventories
GRAP 13	Leases
GRAP 14	Events After the Reporting Date
GRAP 16	Investment Property
GRAP 17	Property, Plant and Equipment
GRAP 19	Provisions, Contingent Liabilities and Contingent Assets
GRAP 100	Non-Current Assets held for Sale and Discontinued Operations
GRAP 101	Agriculture
GRAP 102	Intangible Assets

## **GRAP Implementation Guide for Municipalities**

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**The effective dates determined for above new standards of GRAP (regarding municipalities) are as follows:**

Type of entity	Standards of GRAP	Effective dates
High capacity Municipalities	GRAP 1-3	From 1 July 2005
	GRAP 4-14,16,17,19,100-102	From 1 July 2008
Medium capacity municipalities	GRAP 1-14,16,17,19,100-102	From 1 July 2008
Low capacity municipalities	GRAP 1-14,16,17,19,100-102	From 1 July 2009
Municipal entities	GRAP 1-14,16,17,19,100-102	From 1 July 2009