TOPIC 2.1: ACCOUNTING FOR PROPERTY, PLANT AND EQUIPMENT

This section of the manual sets out the FSOP's that need to be executed by the municipality regarding Property, plant and equipment (PPE). The FSOP's are drafted in the following categories:

2.1.1 Overview of the accounting for PPE
2.1.2 Acquisition of PPE procedures
2.1.3 Procedures during the useful life of the PPE
2.1.4 Procedures at the end of the useful life of the PPE
2.1.5 Preparation of a GRAP compliant asset register
2.1.6 Calculation of backlog depreciation and unbundling of loans redeemed and other capital receipts (LROCR)
2.1.7 Identification and unbundling of infrastructure assets on the AR
2.1.8 Asset management policy
2.1.9 Impairment of assets
2.1.10 AFS disclosure requirements
2.1.11 Exemptions related to the implementation of GAMAP 17

2.1.1 OVERVIEW OF THE ACCOUNTING FOR PPE

When accounting for Property, plant and equipment (PPE) the municipality must ensure that the necessary finance standard operating procedures are executed to address the following issues, which are summarised here, but for which the detailed FSOP's are set out in the rest of this section.

	Category	Section FSOP
1.	**Acquisition of PPE procedures.** An item should be regarded as PPE when it meets the definition of assets and PPE as well as the recognition criteria stipulated in GAMAP 17. An item of property, plant and equipment which qualifies for recognition as an asset shall initially be measured at its cost.	**Section 2.1.2**
2.	**Procedures during the useful life of PPE.** The municipality must ensure that every item of property plant and equipment as per the FAR is depreciated separately. The residual value, useful life and depreciation method of an asset must be reviewed annually at year-end. In addition, an assessment should be made at each reporting date whether there is any indication that an asset may be impaired.	**Section 2.1.3**
3.	**Procedures at the end of the useful life of PPE.** The municipality must ensure that any PPE **that is disposed of** is treated in accordance with the requirements of GAMAP 17.	**Section 2.1.4**
4.	**Preliminary procedures** need to be executed to facilitate the move from cash/fund accounting to accrual accounting, which mainly requires the preparation of **a detailed GRAP-compliant fixed asset register** by the municipality.	**Section 2.1.5**
5.	**Calculation of backlog depreciation** and **unbundling of loans redeemed and other capital receipts** are essential steps in the process of implementation of GRAP.	**Section 2.1.6**
6.	Due to historical factors and the use of the fund accounting system, one of the most difficult and time-consuming steps in the process of implementation of GRAP will be the **identification an unbundling of Infrastructure assets** on the FAR.	**Section 2.1.7**
7.	An **asset management policy** should be developed by the municipality.	**Section 2.1.8**
8.	Identification and calculation of **impairment of assets**	**Section 2.1.9**
9.	The municipality must ensure that all **disclosure requirements for PPE as listed in GAMAP 17** are met.	**Section 2.1.10**
10.	**Exemptions related to the implementation of GAMAP 17.** A number of exemptions from the requirements of GAMAP 17 have been offered to high capacity municipalities (HCM), medium capacity municipalities (MCM) and low capacity municipalities (LCM) by NT. The requirements have been discussed in full from section 2.1.2 onwards, but the exemptions are listed here to provide guidance to municipalities implementing this standard on a piecemeal basis:	**Section 2.1.11**

Category	Section FSOP
EXEMPTIONS – 30 JUNE 2008 ➢ Any HCM that prepares its AFS in accordance with GRAP for the year ending 30 June 2008, **need not review useful lives** of items of PPE recognized in the annual financial statements. ➢ Any HCM applying GAMAP 17 in its 30 June 2008 AFS **need not review depreciation methods** applied to PPE recognized in the annual financial statements. ➢ **Impairment** of non-cash generating assets and impairment of cash generating assets have also been **exempted** for any HCM that prepares its AFS in accordance with GRAP for the year ending 30 June 2008, ➢ MCM and LCM can prepare IMFO AFS for 2008, and therefore ignore GAMAP 17 in totality, but if they prepare GRAP AFS the same exemptions listed above apply to them. **EXEMPTIONS – 30 JUNE 2009** ➢ All HCM and MCM must for the year ending 30 June 2009 comply with all the requirements of GRAP 17 and must restate the comparative figures. Transitional provisions discussed in section 2.1.10 may be applied. ➢ LCM can prepare IMFO AFS for 2009 and therefore ignore GAMAP 17 in totality. If however the LCM opts to prepare GRAP AFS for 30 June 2009, it must comply with all the requirements of **GRAP 17** on PPE**.**	

2.1.2 ACQUISITION OF PPE PROCEDURES

a) Defining PPE and the capitalisation rules pertaining to PPE

Property, plant and equipment (PPE) represents a major portion of the asset base of a municipality and is therefore significant in the presentation of its financial position. A municipality's PPE are non-current assets that are held for more than one accounting period for its own use, in order to supply goods or services and for administrative purposes. Infrastructure used in service delivery, motor vehicles driven by staff, buildings occupied by the municipality and administrative equipment such as computers and office furniture are all examples of PPE.

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.

A distinction should be made between owner occupied properties and investment properties. Owner occupied properties are occupied by the municipality itself and used in the provision of goods and services or for administrative purposes. Investment properties are held for capital appreciation and/or to earn rental revenue and are not significantly occupied by the municipality. Owner occupied properties are accounted for in accordance with GRAP 17 (previously GAMAP 17) whereas investment properties are accounted for in accordance with GRAP 16 (previously IAS 40).

For an item to be classified as PPE, it must first meet the definition of an asset and then meet the recognition criteria for classification as PPE which is encompassed in GRAP 17 (previously GAMAP 17).

Definition of an asset

An asset is a resource controlled by an entity as a result of past events and from which future economic benefits or service potential is expected to flow to the entity.

The definition of an asset has three components, relevant to all forms of assets, all of which must be satisfied in order to be classified as "an asset" for accounting purposes.

These components are:

- the entity has the capacity to control the service potential or future economic benefits of the asset;
- the service potential or future economic benefits arose from past transactions or events; and
- the asset has future service potential or economic benefit for the entity.

Each element of the asset definition is discussed in detail below.

Control over assets

Legal title and physical possession are good indicators of control but the right of ownership is not essential to determine whether an entity controls the item.

The capacity of an entity to control benefits is usually the result of legal rights, but it may satisfy the definition of an asset even when there is no legal control.

The concept of control of an asset's economic benefits and/or service potential is a key issue in determining whether that asset should be reported in the financial statements of an entity. Ownership and control however are not synonymous. An analogous situation is a finance lease. A municipality may not have title to a particular asset, but the asset is recognised in its financial statements because the economic benefits and/or service potential embodied in the asset substantially accrue to the municipality.

Furthermore, municipalities that have custody of an item of PPE may not have all the legal powers of ownership, such as the right to sell the item. There may also be restrictions on the municipality's use of the item. However, this does not necessarily mean that the entity does not control the access to future economic benefits or service potential. To satisfy the requirements for control, the entity does not need unlimited power over the physical items. Instead, it is the rights or access to future economic benefits or service potential that need to be controlled.

An arrangement may also convey the right to use an asset by conveying the right to control the use of the asset. Though the best example again is lease agreements, it is not limited to these arrangements. The right to control the use of the asset is conveyed when the following conditions are met:

- the user of an asset has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of output or other utility of the asset;
- the user has the ability or right to control physical assess of the underlying asset while obtaining or controlling more than an insignificant amount of output or other utility of the asset;
- facts and circumstances indicate that it is remote that one or more parties other than the user will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the user will pay for the output is neither contractually fixed per unit of output nor equal to current market price per unit of output as of the time of delivery of the output.

The right to control the use of an asset in itself does not give rise to the responsibility to recognise an asset, but it should be considered in conjunction with the other conditions of the arrangement.

To determine whether a municipality recognises an asset, it is necessary to look at the following indicators of control:

- is the municipality the beneficiary of future economic benefits and/or service potential of the asset?
- does the terms and conditions of legislation or a contract transfer substantially all benefits and risks incidental to ownership of the asset to the municipality?
- was the intention for the asset to be gifted or contributed to the municipality?
- is the municipality responsible for renewal or replacement of the asset?
- does the municipality bear all the risk of obsolescence, environmental liability, uninsured damage or condemnation of the asset?
- has the municipality been using the asset on a continuing bases in the production or supply of goods and services?
- have third parties made significant use of the asset but the municipality is able to restrict such use?
- is the municipality responsible for the construction cost of the asset and the financial or other implications of cost and time overruns caused by events outside of its control during the construction period, or subsequent warranty repairs?
- are there any restrictions on the municipality's use of the item of PPE or the right to sell?

Past transactions or events

Transactions or events expected to occur in the future do not give rise to assets. Assets are recognised from the point when some event or transaction transfers control to an entity. Good indicators are when an entity pays for the asset, when it takes possession of the asset or when it creates an asset.

It is important that the event giving rise to control be identified. There is a close link between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when a municipality incurs expenditure, it may provide evidence that future economic benefits were sought, but are not conclusive proof that an item satisfies the definition of an asset.

For **example**, a municipality acquires computers and pays the whole purchase price on 10 June 20x9. The computers are delivered to the municipality's premises on 31 July 20x9. The sales contract stipulates that the creditor is responsible for the merchandise until date of delivery. Although the whole purchase price is paid before the end of the financial year (30 June 20x9) the municipality does not have control of the computers at that point in time. The past event in this case is the delivery of the computers to the municipality. This is the event that gives rise to control.

Similarly the absence of related expenditure does not preclude an item from satisfying the definition of an asset and thus recognition in the statement of financial position (e.g. exchange or donation of an asset).

Future economic benefit or service potential

In applying the asset definition to the public sector environment, the focus may mostly be on service potential rather than economic benefits (i.e. generation of cash). The concept of "commercial return" is not always applicable to public sector entities, as they provide public services and redistribute wealth for a variety of social and economic purposes.

The future economic benefit embodied in an asset is the potential to contribute directly or indirectly to the flow of cash and cash equivalents to the municipality. The potential may be a productive one that is part of the operating activities of the municipality. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative process lowers the cost of producing a good or service.

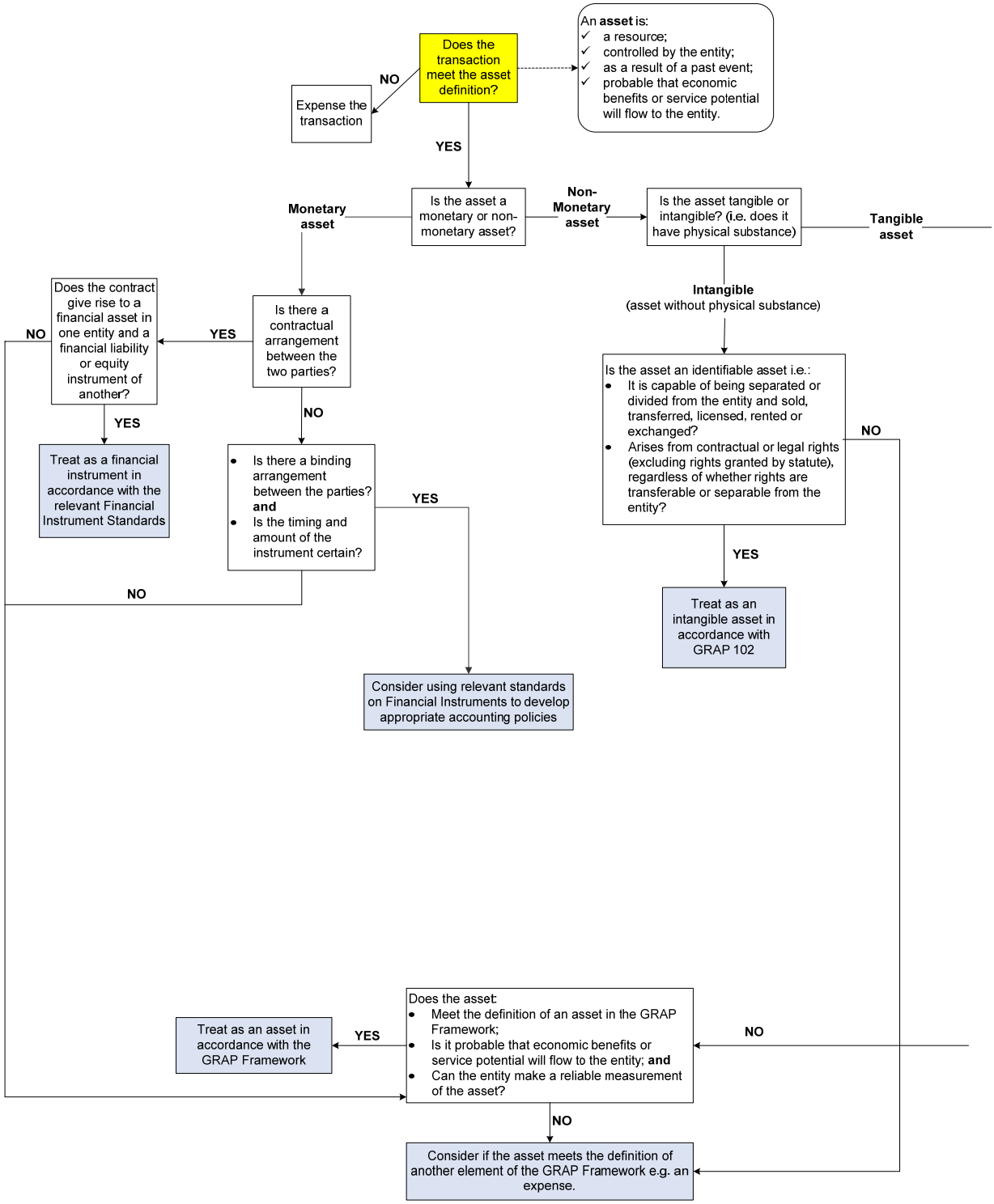
Assets that are used to deliver goods and services in accordance with a municipality's objectives but do not directly generate net cash inflows are often described as embodying "service potential". Service potential is thus the capacity of an asset, singularly or in combination with other assets, to contribute directly or indirectly to the achievement of an objective of a social policy objective of a municipality.

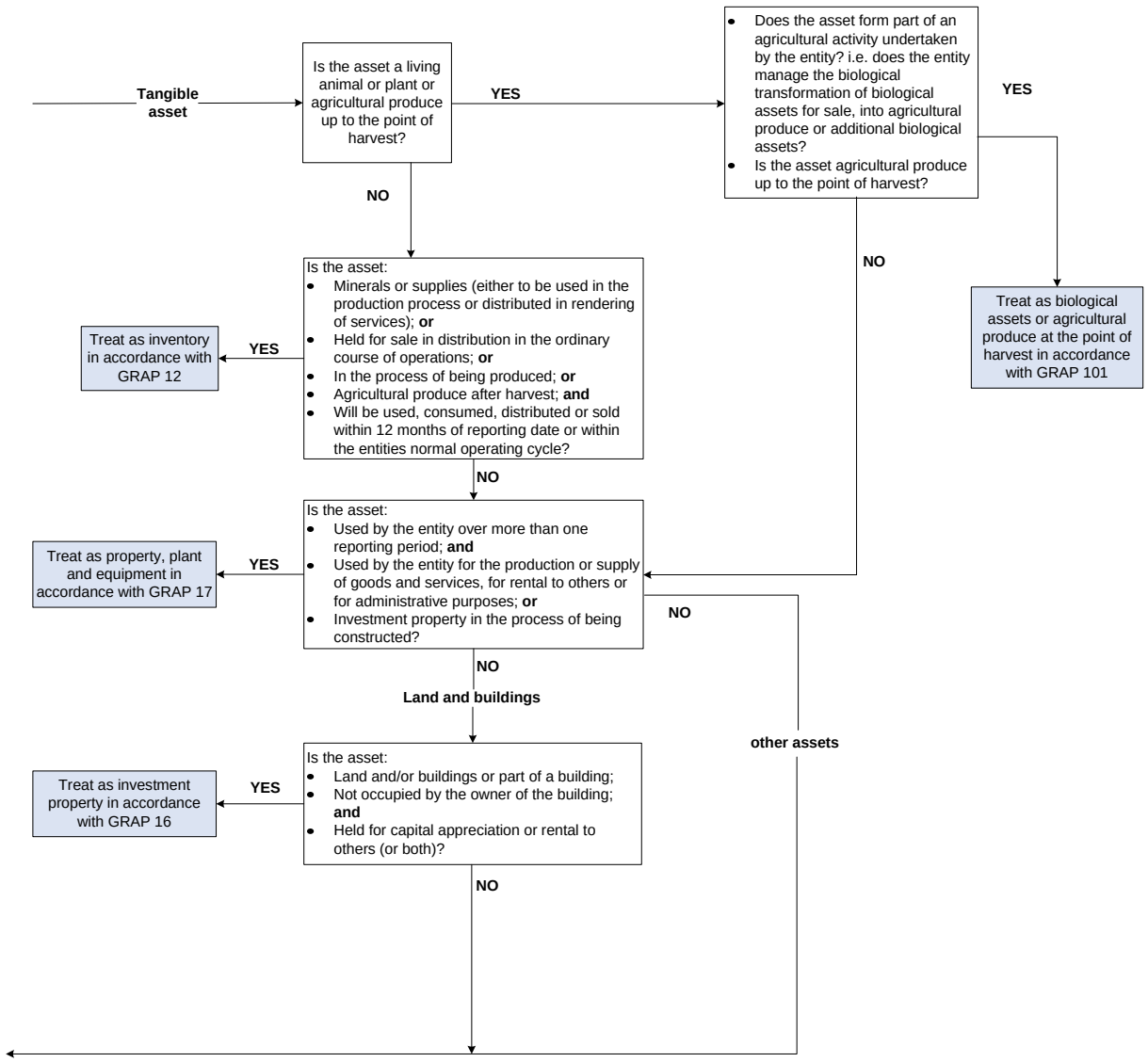
Municipalities may consider the following in assessing the service potential of an asset:

- will the asset provide any benefit to the municipality that controls it?
- does it have potential to support programme delivery?
- does it have a resale value?
- can it be exchanged for something else that is useful to the municipality?
- will it save the municipality money in the future?

In determining whether it is probable that future economic benefits or service potential associated with the asset will flow to the municipality, the municipality 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 at the time of initial recognition. Existence of sufficient certainty that future economic benefits or service potential will flow to the municipality necessitates an assurance that the municipality will receive the rewards associated with the asset and will undertake the related risks. The assurance is usually only available when the risks and rewards incidental to the ownership of the asset have passed to the municipality.

The following decision tree will assist municipalities in distinguishing between the different types of assets to be recognised in its statement of financial position:




Tangible asset
Is the asset a living animal or plant or agricultural produce up to the point of harvest?
YES
Does the asset form part of an agricultural activity undertaken by the entity? i.e. does the entity manage the biological transformation of biological assets for sale, into agricultural produce or additional biological assets?
Is the asset agricultural produce up to the point of harvest?
YES
NO
Treat as biological assets or agricultural produce at the point of harvest in accordance with GRAP 101
Is the asset:
Minerals or supplies (either to be used in the production process or distributed in rendering of services); or
Held for sale in distribution in the ordinary course of operations; or
In the process of being produced; or
Agricultural produce after harvest; and
Will be used, consumed, distributed or sold within 12 months of reporting date or within the entities normal operating cycle?
YES
Treat as inventory in accordance with GRAP 12
NO
Is the asset:
Used by the entity over more than one reporting period; and
Used by the entity for the production or supply of goods and services, for rental to others or for administrative purposes; or
Investment property in the process of being constructed?
YES
Treat as property, plant and equipment in accordance with GRAP 17
NO
Land and buildings
other assets
Is the asset:
Land and/or buildings or part of a building;
Not occupied by the owner of the building; and
Held for capital appreciation or rental to others (or both)?
YES
Treat as investment property in accordance with GRAP 16
NO

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	**According to GRAP 1** assets are resources controlled by the entity as a result of past event and from which future economic benefits are expected to flow to the entity. **GRAP 17 / GAMAP 17** defines PPE as follows: Property, plant and equipment are tangible assets that: ▪ are held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and ▪ are expected to be used during more than one reporting period. **According to GRAP 17.11** (previously **GAMAP 17.10**) an item of property, plant and equipment shall be recognised as an asset when: ▪ it is probable that future economic benefits or service potential associated with the asset will flow to the entity, and ▪ the cost or fair value of the asset to the entity can be measured reliably.	Ensure that an item is be regarded as PPE when it meets the definition of assets and PPE as well as the recognition criteria stipulated in GRAP 17 (previously GAMAP 17). An item of property, plant and equipment which qualifies for recognition as an asset shall initially be measured at its cost. The cost of an item of PPE should comprise its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use. Any trade discounts and rebates should be deducted in arriving at the purchase price. According to **GRAP 17.26** (previously GAMAP **17.28**), the **cost of an item of PPE also includes the estimated cost of dismantling and removing the asset and restoring the site**, as far as provisions has been recognised for these costs. Where an asset is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date of acquisition.	**AP**	**Manager Expenses**	Monthly
2	Ensuring that sufficient funds are available in the budget.	Before purchasing items of PPE, ensure that the prospective purchase of PPE has been budgeted for under a specific vote on the capital budget.	**ACP**	**Manager responsible for asset management**	Date of Purchase of PPE.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
3	SCM policies and procedures	Ensure that all procurement processes of the municipality are done in accordance with the accounting officer's Supply Chain Management System (section 111 of the MFMA)	**LCP**	**CFO**	Date of Purchase of PPE.
4	Internal controls over purchasing and receipting of PPE	Upon the delivery of items of PPE to the municipality, check the incoming PPE against the purchase order and the accompanying documentation before delivery notes and invoices are signed in acceptance. Capture the delivery onto the municipality's asset register and also record it in the accounting system. Ensure that: • The goods received are what were ordered in terms of description, quantity and quality. • The goods received are in agreement with the invoice in terms of description, quantity and quality.	**ACP**	**Manager responsible for asset management**	Date of Purchase of PPE.
5	Internal controls over purchasing and receipting of PPE	At the end of the month a statement from all suppliers will be delivered listing all invoices of the month together with the total cost of PPE delivered. Reconcile these statements with the invoices paid for the month. Check the following details of each invoice against the details of the statement: • Invoice number • Date • Name of supplier • Item, size, quantity, unit price and total price	**ACP**	**Manager Expenditure**	Monthly and at year end

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		• Delivery date • Signature of receiver Follow-up reconciling items with suppliers to ensure that all liabilities are raised in the AFS of the municipality and to highlight incorrect invoices listed on statements.			
6	Internal controls over purchasing and receipting of PPE	Ensure that asset GL accounts are created for all PPE items.	**AP**	**CFO**	Date when GRAP is implemented
7	According to **GRAP 17/GAMAP 17,** property, plant and equipment are tangible assets that: ▪ are held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and ▪ are expected to be used during more than one reporting period.	Identify PPE purchased (expenditure that fits the definition of PPE above) by identifying throughout the month all invoices paid relating to PPE. If PPE purchased is identified, allocate the expense to a capital asset account in the GL in order to capitalise the PPE (the expenditure is therefore not allocated to an expense vote).	**AP**	**Manager responsible for asset management**	Monthly
8	Determining capitalisation thresholds	**Capitalisation thresholds –** Applicable to municipality's with an internal policy concerning a threshold. Ensure that where a number of individual PPE items, with a cost price per item of less than the capitalisation threshold, inclusive of non – claimable VAT, which are purchased in bulk as a single order purchase, and the total value of the purchase exceed the capitalisation threshold, these items are captured on the AR.	**ACP**	**Manager responsible for asset management**	Date of purchase of PPE.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		If the items purchased are uniform in terms of their useful lives and application, ensure that they are capitalised as a single item on the AR. If the items differ in terms of their useful lives and application, ensure that they are capitalised as individual assets on the AR.			
9	Determining capitalisation thresholds	**Capitalisation thresholds –** Applicable to municipalities with an internal policy concerning a threshold. Ensure that PPE items with a cost price per item of less than the capitalisation threshold, inclusive of non – claimable VAT, are not capitalised, but are expensed on delivery. They are not shown on the AR, but are reflected on a list of items kept for control purposes (e.g. an "Asset Control List").	**ACP**	**Manager responsible for asset management**	Date of purchase of PPE.
10	Internal controls over purchasing and receipting of PPE	Ensure that PPE items delivered by year end, not yet paid for are reflected in the AR, GL and AFS. Obtain a "status report" generated by the municipality's accounting system at the end of the year to identify all PPE items delivered but not yet paid for. Journalise these deliveries on to the municipality's accounting system.	**AP**	**Manager responsible for asset management**	30 June each year
11	Internal controls over purchasing and receipting of PPE	Identify PPE items delivered, but not yet recorded in the AR list them on a spreadsheet. Notify the official responsible for asset and the department within the municipality of the details of these PPE items.	**ACP**	**Manager responsible for asset management**	30 June each year
12	Accounting for the acquisition of PPE	Purchases of assets should be debited and creditors should be credited in this regard with the cost price of	**AP**	**Manager responsible**	Date of Purchase of

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		the PPE. When payment is made for the PPE, the payment should be allocated to the creditor raised, i.e. credit bank account, debit accounts payable.		**for asset management**	PPE.
13	Calculation of the cost of PPE (see section (b) below)	The responsible official for asset capitalisation should familiarise him-/ herself of all costs that need to be included in the initial cost price of PPE. Refer to **Annexure 1 below - Example 2** shows the calculation of the initial cost price of items of PPE. The system should be set up in such a way that all these costs are always included in the cost price of the PPE.	**AP**	**Manager responsible for asset management**	Date of Purchase of PPE.
14	Calculation of the cost of PPE	Scrutinise invoices to identify attributable costs that must be capitalised as part of the cost of PPE, as defined in procedure 13 above.	**ACP**	**Manager responsible for asset management**	Date of Delivery of PPE.
15	According to GRAP 13.5 (previously **IAS 17.4):** A **lease** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. A **finance lease** is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Also refer to section **3.5 on Leases**	**Capitalisation of PPE obtained by means of a finance lease.** Ensure the correct accounting treatment of assets obtained by means of finance leases in the financial statements of the lessees: • Assets obtained by means of a finance lease should be capitalised. • Annual depreciation on the leased asset should be expensed. Refer to **Annexure 6:** Example of memo - Assets obtained by means of Finance Leases.	**AP**	**Manager responsible for asset management**	Date of Purchase of PPE.

b) Recording Purchases of PPE on the Asset Register

An item of PPE that satisfies the definition and recognition criteria is initially recognised in the statement of financial position at cost.

PPE is recognised if, and only if:

- it is probable that future economic benefits or service potential associated with the item will flow to the municipality; and
- its cost can be measured reliably.

Where an item of PPE was donated to the municipality its "deemed cost" is its fair value on the date of recognition. The deemed cost will not constitute a revaluation.

Elements of cost

The cost price of an item of PPE includes the purchase price as well as other costs directly attributable to getting the asset to the location and in the condition necessary for it to operate in the manner intended by management. These include external costs such as initial delivery and installation, professional fees and import duties.

Decommissioning costs

In some cases the preparation and use of the asset creates an obligation to incur expenditure when operations cease. For **example**, when a municipality starts a landfill site, it causes damage to the environment, which generally has to be rehabilitated at the end of the site's useful life. The cost price of an asset includes the initial estimate of the costs of rehabilitating the site on which it is located. The liability for these costs is recognised in terms of GRAP 19 *Provisions, contingent liabilities and contingent assets*. The accounting entry is as follows:

DR	Item of PPE (cost) – statement of financial position	xxx
CR	Decommissioning liability – statement of financial position	xxx

As mentioned above, the obligation arises either as a consequence of acquiring/installing the item or as a consequence of having used the item during a period for purposes other than producing inventory. Decommissioning and restoration costs incurred by the production of inventory should be included as part of inventory costs and not capitalised to the cost of PPE.

The decommissioning liability is initially recognised at the best estimate of the present value of the required expenditure. GRAP 19 provides guidance on how to account for the effect of subsequent changes in the measurement of such existing liabilities. These include:

- a change in the estimated outflow of resources embodying economic benefits or service potential required to settle the liability;
- a change in the current market-based discount rate; and
- an increase that reflects the passage of time (also referred to as unwinding of the discount).

A change in the liability may require a corresponding change in the value of the asset as well. Depending on its nature, a change in the liability can either:

- be recognised in the surplus/deficit in the current period; or
- be added/deducted from the cost of the asset.

The above accounting treatment will be dependent on the measurement basis adopted by the entity.

If the related asset is measured using the **cost model**:

- changes in the liability are added to or deducted from the cost of the related asset in the current financial period;
- the amount deducted from the cost of the asset cannot exceed its carrying amount. Any excess is recognised immediately in the surplus/deficit of the municipality since the asset cannot have a negative carrying value;
- an increase in the cost of an asset may require consideration of whether there is an indication of impairment (the carrying amount cannot exceed its recoverable amount or the recoverable service amount).

If the related asset is measured using the **revaluation model**:

Under the revaluation model, valuations must be kept sufficiently up to date such that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. A change in the decommissioning liability does not, of itself, affect the valuation of the asset because the value of the liability should be excluded from the asset valuation.

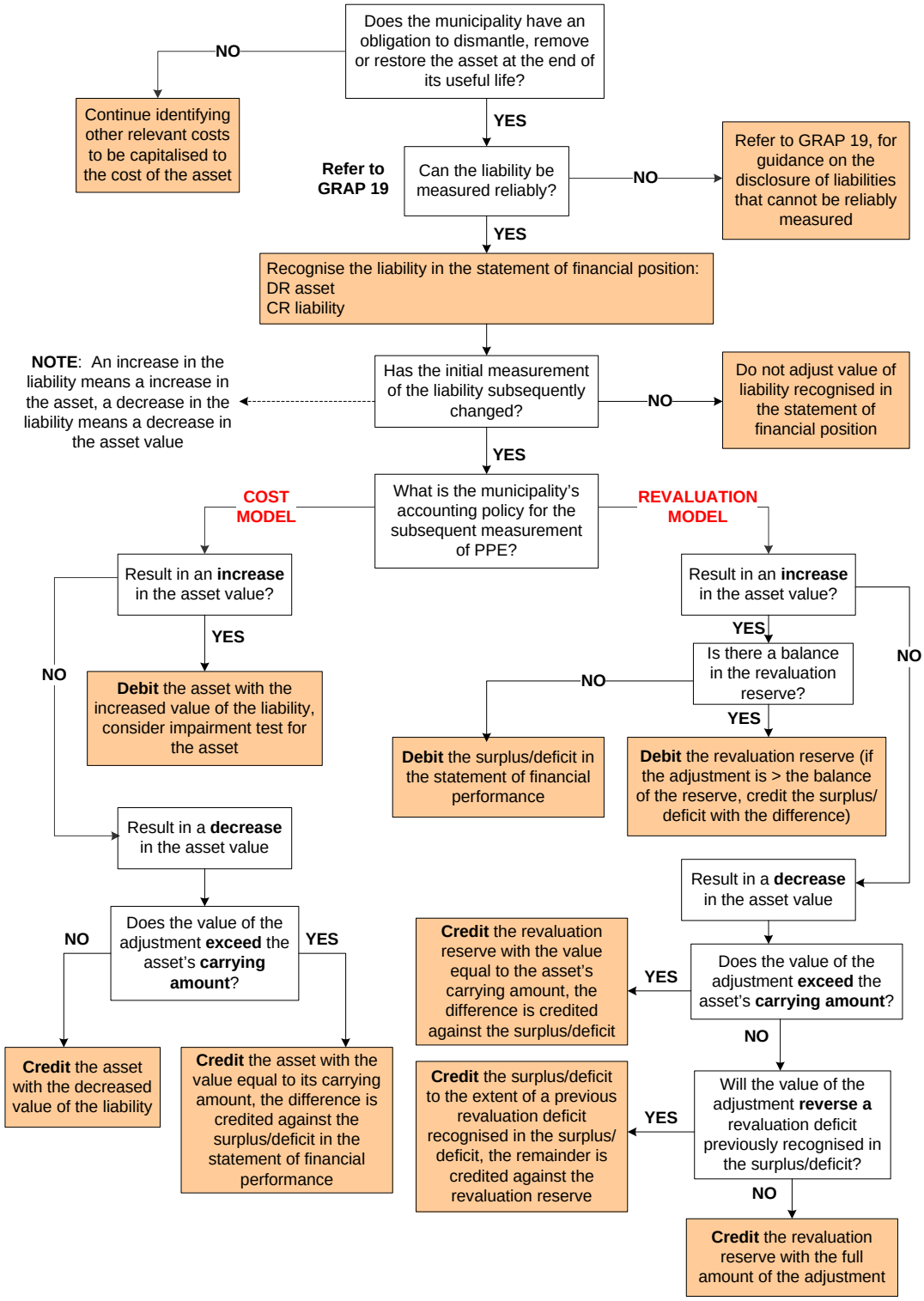
The change in the decommissioning liability affects the difference between the valuation and what would have been recognised under the cost model (i.e. the revaluation reserve). Therefore changes in the decommissioning liability will be recognised as follows:

- a decrease in the liability is credited directly to the revaluation reserve except when it reverses a revaluation deficit recognised previously in the surplus/deficit of the municipality or when it would result in the depreciated cost of the asset being negative;
- an increase in the liability is recognised in the surplus/deficit of the municipality, except when any credit balance remains in the revaluation reserve.

A decrease in the decommissioning liability should not exceed the carrying amount that would have been recognised had the asset been carried under the cost model otherwise the excess is immediately recognised in the surplus/deficit of the municipality.

A change in the liability may also change the market value of the asset therefore the municipality should consider whether a revaluation is required. If a revaluation is required then all other assets in the same class must be revalued.

Decision tree to assist in the initial recognition and subsequent measurement of the decommission liability (focusing on the impact on PPE):



Overhead costs

Overhead costs are only included in the cost price of an asset if it is directly attributable to bringing the asset to its working condition. For **example**, where a municipality constructs an asset, the cost of preparing the site before commencing with construction will be included in the cost price of the item. Costs incurred during the planning stages such as the identification of an appropriate site, feasibility studies etc are can be included in the cost price of the asset if the asset is constructed.

Cost relating to conducting business in a new location, e.g. new office building, and administration and other general overheads should not be included in the cost of an asset, but should be recognised as expenses. These costs are excluded as they were not directly incurred in the process of brining the asset to its location and to the condition necessary for it to operate effectively.

Other costs not included in the cost of an item of PPE include:

- costs incurred while an item capable of operating in a manner intended by management has yet to be brought into use or is operated at less than full capacity;
- abnormal amounts of wasted material, labour or other resources;
- initial operating losses, such as those incurred while demand for the item's output builds up; and
- costs of relocating or reorganising part or all of the municipality's operations.

For **example**, if a municipality runs a new facility at half capacity for a month while staff are being trained in how to use the asset effectively and as a result the municipality incurs an operating loss during that month. The loss should be recognised in the statement of financial performance and not capitalised to the cost of the facility.

In determining what is considered "abnormal" amounts of wastage is subjective but factors to consider include:

- the level of technical difficulty involved with the construction;
- the scale of the project;
- the estimates and timelines included in the project planning; and
- the usual construction process for that type of asset.

Some operations occur in connection with the construction or development of an item of PPE but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These "incidental operations" may occur before or during the construction or development activities.

For **example**, a municipality could earn income using an empty building site as a car park until construction starts. The costs incurred in earning the rental income are not capitalised.

Because incidental operations are not always necessary for the development / construction of an item of PPE, the income and related expenses are immediately recognised in the surplus/deficit of the municipality.

Example: A municipality commenced with the construction of a new production line. The following assumptions are relevant:

⇒ material costs of R6,270,000 (including VAT and excluding trade discount of 5 %) were paid to the local suppliers during April 2009

⇒ 5 staff members were dedicated to the construction process for 3 months. The total cost to company for the 5 employees, per month was R50,000 (this includes contributions to the defined contribution pension fund paid by the municipality or R10,000 and an accrued portion of the employees annual leave of R5,000)

⇒ on 1 August 2009, the municipality commenced testing the production line and sample products are produced. During testing, 125,000 units were produced, but were not in accordance with specifications. These units were sold as rejects, generating proceeds of R0.4 per unit. The testing costs were R75,000

On 1 September, the production line was considered to be operational according to the specifications established by management.

Manufacturing commenced on 1 October 2009. From 1 October 2009 to 30 November 2009, staff were being trained on how to use the production line. During this time the production line only operated at 40 % capacity. In addition to staff training costs of R100,000 the municipality incurred a further R750,000 in production losses.

From 1 December 2009, the production line was operating at the optimal level of 80 % capacity, as intended by management.

The municipality expects to use the production line for 25 years, after which it is expected to have a scrap value of R1,500,000. The current scrap value (i.e. if the production line were to be scrapped during 2009) is R500,000.

What is the cost of the asset in terms of GRAP as well as the depreciation charge for the year ending 30 June 2010?

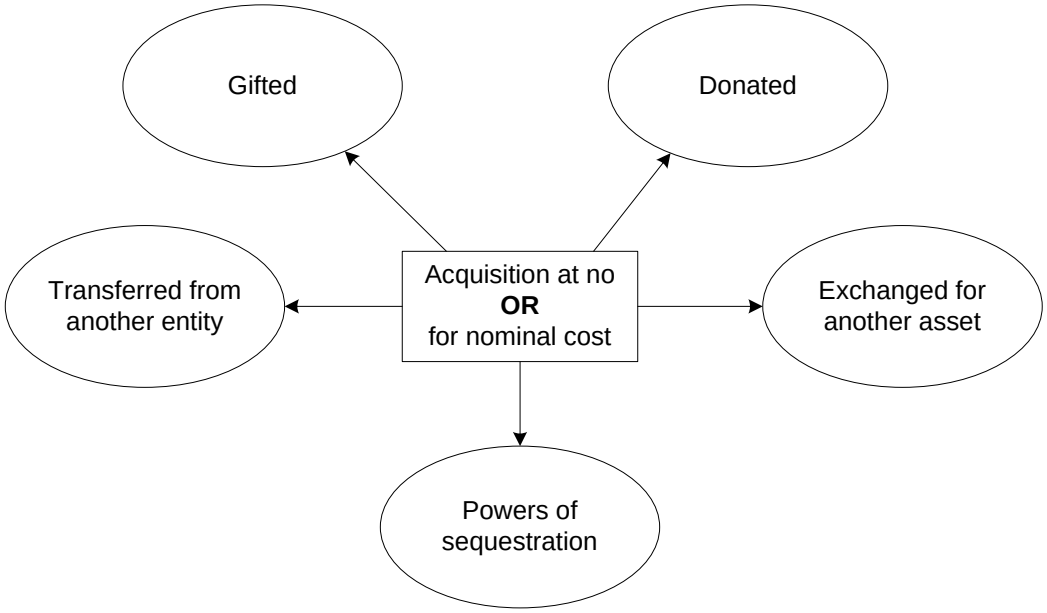
The following costs should be capitalised:

Material costs (R6,270,000 x 100/114) – excluding VAT	5,500,000
Trade discount (R5,500,000 x 5 %)	(275,000)
Staff costs (R50,000 x 3)	150,000
Staff training costs – *are not capitalised as they are not directly attributable to bringing the asset to its working condition*	-
Testing costs	75,000
Production losses – *are excluded as they were incurred after the asset was ready for use*	-
Proceeds from the sale of test products (R0.4 x 125,000)	(50,000)
TOTAL COST	**5,400,000**
Residual value	(500,000)
Depreciable amount	**4,900,000**
Depreciation for the year ended 30 June 2010:	
4,900,000/25 years x 10/12 months (1 September to 30 June)	163,333

Assets acquired at no cost or for nominal cost

GRAP 17 (previously GAMAP 17) requires that where an asset is acquired at no cost, or for a nominal cost, it should be recognised by the municipality at its fair value as at the date of acquisition.

The different methods of acquisition at no or for nominal cost are show below:



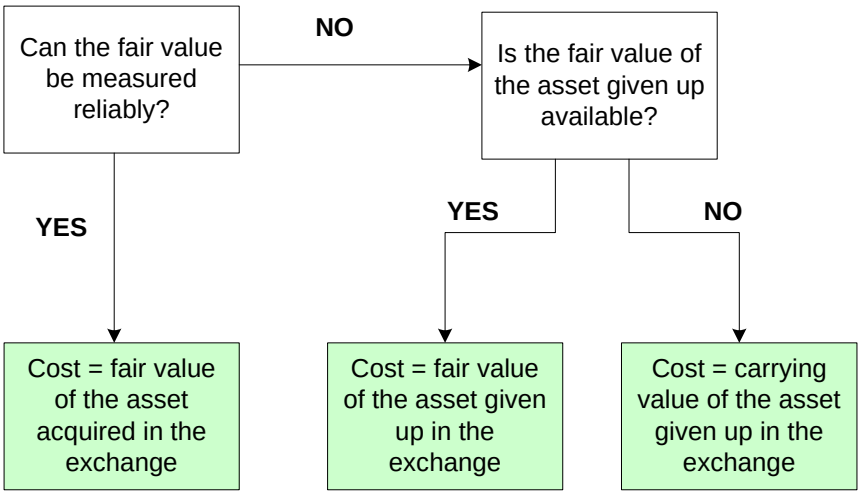
Note: the municipality must first ensure that the item meets the definition of the asset before recognising the asset at its fair value on the date of acquisition or receipt. Accounting for an exchange of an asset is discussed in more detail below.

Exchange of assets

One or more items of PPE may be acquired in exchange for a non-monetary asset or a monetary asset (e.g. cash), or for a combination of both monetary and non-monetary assets. The cost of such an item of PPE is measured its fair value unless the fair value of neither the asset received nor the asset given up is reliably measurable.

The acquired item is measured in this way even if the municipality cannot immediately derecognise the asset given up. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Decision tree to determine the value of asset acquired in an exchange transaction:



Deferred settlement terms

If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period until payment.

For **example**, a municipality purchases equipment at a price of R1,000,000 on 1 July 2009. The supplier agrees to postpone payment as follows: payment of two equal installments of R500,000 on 30 June 2010 and 30 June 2011. A market related interest rate for similar borrowings is 8 %.

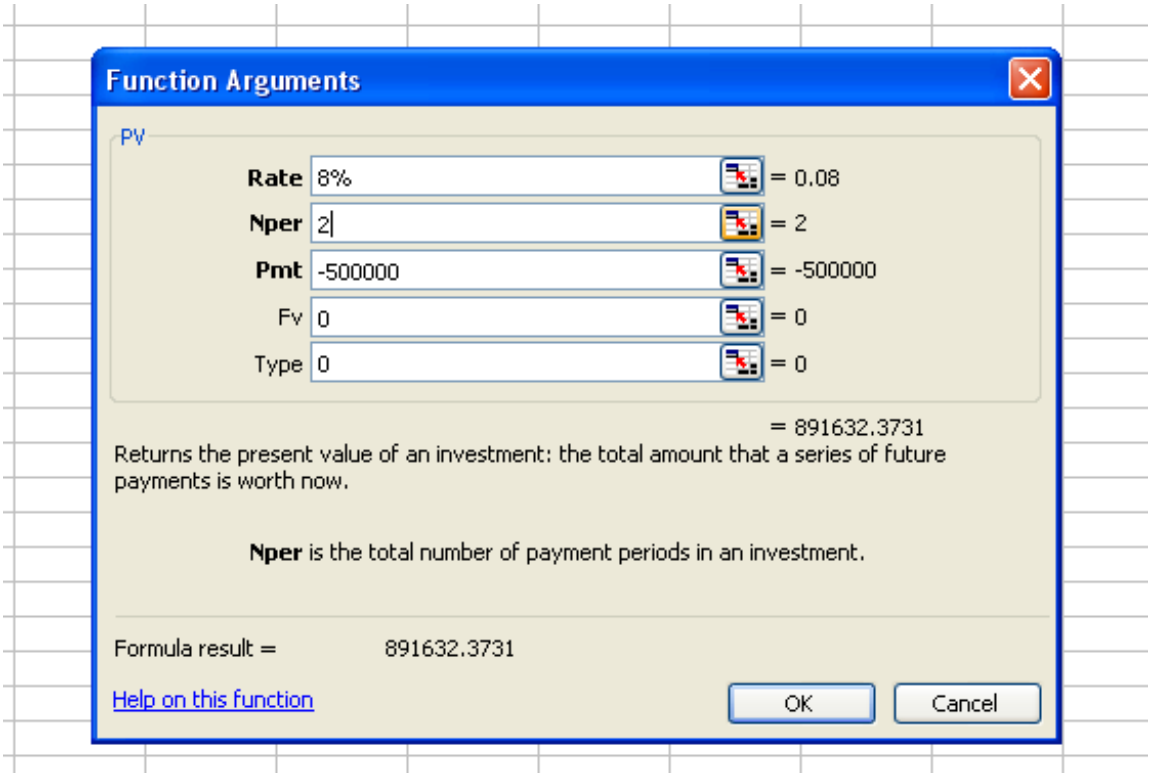
The cost of the equipment at 1 July 2009 is calculated as follows:

Cash equivalent	891,633
Cost of equipment	**891,633**

Using a calculator:

1 payment per year, n = 2, interest rate per year = 8 %, payment = (500,000)
Calculate PV

Using excel:



Separating an item of PPE into its components

The nature of some assets may be such that they comprise of one or two significant components together with other smaller elements. The useful lives of these components may be different to that of the asset as a whole or require replacement at regular intervals.

For **example** assume that an electricity power station consists of transformers, switchgear and a couple of other insignificant components. The total cost of the power station should be allocated to the significant components, being the transformers and switchgear with the remaining components being treated as a separate asset. Each component is then depreciated over its expected useful life. In addition, the remaining portion is also depreciated separately in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

A component may be either:

- a physical component; or
- a non-physical component that represents a major inspection or overhaul.

Although component accounting is compulsory a municipality need not split its assets into an infinite number of components if the effect on the financial statements would be immaterial. In assessing whether certain parts or costs should be identified as a separate component, the cost-benefit principle should be applied along with a consideration of the municipality's asset management policies.

For **example**, a municipality owns and operates a large quantity of computer equipment. A computer consists of the hard drive, keyboard, screen and operational software. Even though the screen may be a significant component of the computer, its useful life rarely differs from the other components and is therefore not depreciated separately from the computer as a whole.

In another **example**, a municipality operates an electricity power station which originally cost R30 million inclusive of a transformer with a cost of R10 million. The economic life of the electricity power station is 20 years, and it is expected to render a constant production for the whole period with no residual value. The transformer has a useful life of 15 years and at the end of its useful life it will have no residual value.

The power station was completed on 30 September 2004 and brought into use on the same date. The following is applicable for the year ended 30 June 2005:

Carrying value of the network (excluding the transformer)	
Cost - Power station excluding transformer	20,000,000
Depreciation to 30 June 2005 (20 million/20 years x 9/12 months)	(750,000)
	19,250,000
Carrying value of the transformer	
Cost – transformer	10,000,000
Depreciation to 30 June 2005 (10 million/15 years x 9/12 months)	(500,000)
	9,500,000

Depreciation for the year ended 30 June 2005	
- Power station (excluding the transformer)	750,000
- Transformer	500,000

A significant part of an item of PPE may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

This approach does however often pose some difficulties in the application, being either practical or time vs. value added. Many entities therefore adopt an approach not to review all the individual assets. A municipality should decide what a significant component of an item of PPE is for each class of PPE taking into account the total value and the nature of the PPE.

When the component is a physical component the carrying value of the component is determined by reference to its cost. In many cases, an asset may be acquired for a fixed sum, without the municipality knowing the cost of the individual components. In this instance, the cost of the individual components could be estimated either by:

- reference to current market prices (if possible), in consultation with the seller or contractor; or
- using some other reasonable method of approximation.

Major inspections and overhauls are identified and accounted for as a separate component if that component is used over more than one period. When a major inspection or overhaul cost is embedded in the cost of an item of PPE, it is necessary to estimate the carrying amount of the component because the cost of the asset should not include any amount attributable to the inspection or overhaul. The carrying amount of the component should be determined by reference to the current market price of such overhauls and not the expected future price.

Component accounting for inspection or overhaul cost is intended to be used only for major expenditure that occurs at regular intervals over the life of the asset. Costs associated with routine repairs and maintenance should be expensed as incurred.

For **example**, equipment with a cost of R1,000,000 on 1 July 2004, has a useful life of 20 years. The asset undergoes a major inspection every 5 years. The last inspection was performed on 1 July 2009, at a cost of R500,000

The estimated cost of the major inspection (estimated at 1 July 2004) was R200,000. There are no other components. The estimated cost of the initial inspection has been fully written off at 30 June 2009.

Carrying value of equipment at 30 June 2010 (after 6 years)	**Cost**	**Acc Depr**	**Carrying value**
Main component Cost = 100,000,000 – 200,000 Accumulated depreciation = 800,000/20 x 6	800,000	(240,000)	560,000
Major inspection component Cost of inspection on 1 July 2009 = 500,000 Accumulated depreciation = 500,000/5 x 1	500,000	(100,000)	400,000
Total adjusted carrying value at end of 6 years			**960,000**

The remaining portion of the component that is replaced by a new component should be derecognised. The remaining carrying amount that is replaced should be written off immediately because the component effectively has been disposed of.

Spare parts, stand-by and servicing equipment

Spare parts, stand-by and servicing equipment are usually carried as inventory and are recognised in the surplus/deficit when consumed. However, they are carried as PPE if:

- they are major spare parts and stand-by equipment, that are expected to be used during more than one period; or
- they can only be used in connection with a specific item of PPE.

Depreciation on spare parts should commence when the item is available for use (regardless of whether or not it is being used). The spare part should be depreciated over the useful life of the current part.

Classification of property, plant and equipment

GAMAP 17 requires certain information to be disclosed for each *class* of PPE. A class of PPE is described as "….the grouping of assets of a similar nature or function…." Grouping assets for financial statement purposes according to their nature or function assist users in understanding the nature of the assets and activities of the municipality.

Basically, four broad categories of PPE exist in the municipal environment, namely –

a) Infrastructure

Infrastructure assets are those assets that form part of a network in delivering basic services to consumers, e.g. electricity transformers which form part of an electricity network. General characteristics of infrastructure assets are that they are:

- part of a system or network;
- specialised in nature and have not alternative uses;
- immovable; and
- subject to constraints on disposal.

An easy way to determine whether an asset represents infrastructure is to determine whether more than one consumer will be affected when the service is not rendered. When more then one consumer is affected, the asset will usually qualify as infrastructure. When only one customer is affected the asset most probably does not represent infrastructure e.g. a delivery vehicle.

b) Heritage assets

Some assets are described as heritage assets because of their cultural, historical or environmental significance, such as historical buildings, monuments, works of art and conservation areas. The following characteristics are usually displayed by heritage assets –

- their intrinsic value is unlikely to be reflected in financial terms based on a market price;
- prohibitions and restrictions may be placed on the disposal thereof;
- they are often irreplaceable and their value increases over time; and

- it may be difficult to estimate their useful lives.

There are some heritage assets with a service potential other than their heritage value, for example historical buildings used as office accommodation. In such cases, the heritage assets may be recognised, measured and disclosed on the same basis as other items of PPE. Heritage assets for which the service potential is limited to the heritage characteristics need not be recognised in the financial statements. Disclosure of its existence and physical condition is encouraged.

c) Community assets

Community assets represent those assets utilized to the social well-being of the community, e.g. libraries, old age homes, parks, recreational facilities etc.

d) Other assets

Other assets can be described as those assets utilised in the administrative function of the municipality, e.g. office buildings, furniture, office equipment etc.

Within the broader categories of PPE items should be classified further according to their nature or function. For example infrastructure assets can further be classified as water reticulation network, electricity sub-station, roads etc.

Depending on the way in which the municipality is managed, land and buildings can either represent a separate category of assets along with the broad categories or it can represent a sub-category of the above categories.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	**Section 63 (2)(c) of the MFMA stipulates:** The accounting officer must take all reasonable steps to ensure that the municipality has and maintains a system of internal control of assets and liabilities, including an asset and liabilities register as may be prescribed.	The compilation of a asset register is therefore a legislative requirement. Management should ensure that it contains, as a minimum, the following: • Acquisition dates of all items of property, plant and equipment. • Clear descriptions of individual items of property, plant and equipment • Expected useful lives of individual item of PPE • Depreciation rates determined in accordance with the principles set out in GAMAP 17. Historical cost or fair value of individual items of property, plant and equipment or the fair value of assets received as donations. • The location of he asset • Department or Service that use or controls the item of PPE. • Identification reference for physical verification and asset management purposes. (bar code) • Accumulated depreciation attributable to individual items of PPE. • Impairment losses attributable to individual items of PPE. • Carrying value of the asset • Funding sources of individual items of PPE. • Where land and buildings are revalued, the revalued amount attributable to individual items of land and buildings as well as the date and basis of such valuation. • Residual values • Insurance arrangements • Whether the asset is pledged as security for any external loan or other obligation.	**ACP**	**Manager responsible for asset management**	Date at which GRAP is implemented.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
2		Ensure that PPE are capitalised and recorded in the AR, as soon as acquired. If the asset is constructed over a period of time, ensure that it is recorded as work-in-progress until it is available for use, where after it shall be appropriately capitalised as an item of PPE.	**AP**	**Manager responsible for asset management**	Date on which PPE is acquired.
3	**GAMAP 17.17 stipulates** that, in addition to classifications of assets between property, plant and equipment, there also needs to be further classifications in a public sector environment. Property, plant and equipment should also be classified into infrastructure assets, community assets, heritage assets and investment properties. The purpose of this classification is to develop a benchmark accounting treatment to assist in the measurement of property, plant and equipment and to assist users to understand better the nature of the assets included as property, plant and equipment.	Ensure that the asset register is able to present information on asset on an **annual** basis by: • **Class of property, plant and equipment**. This information will be used to prepare the notes to the AFS on property, plant and equipment as well as the required Appendix B. • **Funding source**. This will enable the accounting entries relating to the EFF, CRR, Government Grant Reserve, Capitalisation Reserve as well as the Public Contributions and Donations Reserve to be easily prepared. • **Department or function**. This will enable management to report on the Segmental Analysis of property, plant and equipment.	**AP**	**CFO**	30 June each year.
4	According to the **MFMA 63 (2) (c),** an accounting officer must take all reasonable steps to ensure that the municipality has and maintains a system of internal control over assets.	Ensure that adequate bar codes and equipment to exercise the function relating to asset identification are available at all times.	**ACP**	**CFO**	Date at which GRAP is implemented.
5	Recognition in the asset register	Ensure that all items of PPE are bar coded with a unique identification number as soon as they are delivered to the municipality and after procedure 4 of	**ACP**	**Manager responsible for asset**	Date on which PPE is delivered to

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		"Defining PPE and the capitalisation rules pertaining to PPE", as mentioned above, has been performed.		**management**	the municipality.
6	According to **GRAP 17.23** (previously **GAMAP 17.26**) an item of property, plant and equipment may be gifted or contributed to the entity. For example, land may be contributed to an entity by a developer at nil or nominal consideration, to enable the entity to develop parks, roads and paths in the development. An asset may also be acquired at nil or nominal consideration through the exercise of powers of sequestration. Under these circumstances the cost of the item is its fair value as at the date it is acquired, contributed or gifted.	Issue a memo to all managers of departments within the municipality at the end of each month, requesting them to inform the Manager Budget Control of any items of PPE that have been donated to the municipality. The Manager Budget Control should determine the fair value of items of PPE donated to the municipality. Refer to **Annexure 2:** Example of memo - Donated items of PPE	**AP**	**Manager responsible for asset management**	Monthly
7	Recognition in the asset register	Provide the official responsible for bar-coding of PPE items with information relating to donated items of PPE. Ensure that all items of donated PPE are bar coded with a unique identification number as soon as they are delivered to the municipality.	**ACP**	**Manager responsible for asset management**	Monthly

2.1.3 PROCEDURES DURING THE USEFUL LIFE OF THE PPE

Initially an item of PPE is recognised at cost. After the asset has been brought into use, the carrying value of the asset reflected in the statement of financial position must be adjusted to reflect the past usage of the asset. Such adjustment must be made at each subsequent reporting date.

GRAP 17 (previously GAMAP 17) allows for two measurement models to determine the carrying value of PPE, being the cost or the revaluation model. The selected model must be applied to an entire class of PPE.

The cost model

All items of PPE measured in accordance with the cost model, are carried at cost less accumulated depreciation and impairment losses. In other words, the historical cost of an asset is written-off over the expected useful life of the asset. No adjustments, other than the capitalisation of subsequent expenditure and the amendments to the decommissioning liability are made for increases in the value of the asset.

The revaluation model

According to GAMAP 17, only land and buildings may be measured according to the revaluation model. GRAP 17 has no such restriction. Under the revaluation model the asset is carried at its fair value on the date of revaluation less subsequent accumulated depreciation and subsequent impairment losses.

The frequency of revaluations depends on the volatility of the fair value of the asset but have to be performed with such regularity that the carrying amount does not differ materially from what the fair value at the reporting date would have been. Generally a revaluation of land and buildings every three to five years will be sufficient.

A revaluation is performed by comparing the carrying value of the asset with its market value, which is determined by a professional valuer. The carrying value is adjusted upwards and the resulting increase is transferred to the revaluation reserve which forms part of the net assets of the municipality.

Any deficit on revaluation is recognised in surplus/defict except to the extent that it reverses a previous revaluation surplus on the same asset, in which case it is taken directly to the revaluation reserve. Revaluation increases and/or decreases cannot be offset, even within a class of assets.

When PPE is revalued, a municipality should make a policy election, which should be applied consistently to all revaluations, to either:

- restate both the gross carrying amount of the asset and the related accumulated depreciation proportionately; or
- eliminate the accumulated depreciation against the gross carrying amount of the asset.

The municipality should follow the same approach when fully depreciated assets are revalued.

For **example**, an office building with a cost price of R3,000,000 and accumulated depreciation of R500,000 is revalued when the fair value is R2,800,000. The asset was acquired 5 years ago and its original estimated useful life was 30 years. The building had no residual value.

Remaining useful life of the building (30 – 5 years)	25 years
Carrying value of building prior to revaluation (3,000,000 x 25/30 years)	2,500,000
Fair value at date of revaluation	2,800,000
Revaluation surplus (2,800,000 – 2,500,000)	300,000

Gross basis to restate accumulated depreciation:

The fair value of the building with a remaining useful life of 25 years is R2,800,000. This is equal to a building with the original cost of R3,360,000 (2,800,000 x 30/25) and accumulated depreciation of R560,000 (3,360,000 – 2,800,000). When applying the gross basis, both the original cost and accumulated depreciation should be restated proportionately.

	Debit	Credit
Building (3,360,000 – 3,000,000)	360,000	
Accumulated depreciation (560,000 – 500,000)		60,000
Revaluation reserve		300,000

The carrying value is shown as follows in the financial statements:

Gross carrying amount	3,360,000
Accumulated depreciation	(560,000)
Carrying amount	2,800,000

Net basis to restate accumulated depreciation:

The accumulated surplus prior to the revaluation is eliminated against the carrying value of the asset, which is then increased to the fair value.

	Debit	Credit
Accumulated depreciation	500,000	
Building		500,000
Building (2,800,000 – (3,000,000 – 500,000))	300,000	
Revaluation reserve		300,000

The carrying value is shown as follows in the financial statements:

Gross carrying amount	2,800,000
Accumulated depreciation	-
Carrying amount	2,800,000

The treatment of the accumulated depreciation has no effect on the revaluation reserve (as is evident in the example above), however the information provided in the notes to the financial statements is different. The net basis may create the impression that the asset was new as there is no opening balance for accumulated depreciation. Users of the financial statements are therefore likely to find the gross basis more meaningful.

The revaluation reserve is realised through the usage or disposal of the asset. The portion of the increased depreciation as a result of the revaluation is realized from the revaluation reserve to the accumulated surplus/deficit. If the asset is disposed of, the remaining balance of the revaluation reserve is transferred to accumulated surplus/deficit. Movement in the revaluation reserve will not affect the statement of financial performance; these movements are recorded in the statement of changes in net assets.

The building in the previous **example** had a remaining useful life of 25 years, after being revalued to the fair value of R2,800,000. Therefore the depreciation expense recognised in the statement of financial performance in the following year would amount to R122,000 (R2,800,000 / 25 years). It would be acceptable to transfer some of the revaluation surplus if the municipality's policy is to release the revaluation reserve as the asset is depreciated. The following entry is required:

	Debit	Credit
Depreciation	112,000	
Accumulated depreciation		112,000
Revaluation reserve (112,000 – (300,000/30))	12,000	
Accumulated surplus/deficit		12,000

OR (R12,000 = R300,000 / 25)

The R12,000 is calculated as the difference in depreciation based on the revalued amount and its historical cost price. This implies that the revaluation reserve is released to the accumulated surplus/deficit as the asset is used.

As mentioned previously revaluations must be kept up to date, such that the carrying amount of an asset at the reporting date does not differ materially from its fair value. The frequency of revaluations therefore depends upon the changes in the fair value of the item of PPE. When the fair value of the revalued asset differs materially from its carrying amount, a revaluation is required. Some items of PPE experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of PPE with only insignificant changes in fair value.

The fair value of items of PPE is usually their market value determined by appraisal. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. Current prices can usually be obtained for land, non-specialised buildings and motor vehicles. For some assets it may be difficult to establish their market value because of the absence of market transactions for these assets.

Depending on the nature of the assets, the following can be used to determine the fair value of the asset:

Market value

The fair value of PPE is its market value, which has a similar meaning to fair value. Disposal costs are not deducted in determining market value. The fair value of items of land and buildings is usually determined from market-based evidence by appraisal. Market value is the highest possible price that could be obtained for the item of PPE, without regard to its existing use.

Where no evidence is available to determine the market value in an active and liquid market of an item of PPE, the fair value of the item may be established by reference to other items with similar characteristics and location. This might occur when the asset is specialized and rarely sold except as part of a continuing business or function.

Depreciated replacement cost

In the case of specialised assets and other man-made structures, an entity may need to estimate fair value using a depreciated replacement cost (DRC) approach. In many cases, the depreciated replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active liquid market.

a) Depreciation of items of PPE

Items of PPE have economic benefits or service potential embodied in the usage of the assets. As these assets are used in the provision of goods and services, the economic benefits or service potential is consumed, implying that these benefits or service potential are limited and can be exhausted. Consequently, the value of these assets should be reduced to illustrate the consumption of benefits and service potential. Consumption of economic benefits or service potential or PPE other than land, is reflected by a depreciation charge.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of the asset, or other substitute for cost, less its residual value.

Useful life is :

a) the period over which an asset is expected to be available for use by an entity; or

b) the number of production or similar units expected to be obtained from the asset by the entity.

The depreciation charge for each period is recognised as an expense in surplus/deficit, unless it is included in the carrying amount of another asset. Sometimes the future economic benefit or service potential embodied in the asset is absorbed in producing other assets and hence the depreciation charge should be allocated to the cost of that asset.

The determination of depreciation may involve a degree of estimation and is determined annually based on the following estimates –

- pattern in which economic benefits or service potential is consumed;
- expected residual value;
- useful life or production capacity of the asset.

These estimates should be revised when circumstances change or when new information becomes available. Changes in these estimates represent a change in accounting estimate and should be accounted for according to the requirements of GRAP 3.

Depreciation methods

The depreciation method is the basis on which the carrying value is reduced to the residual value over the asset's useful life. The method chosen should reflect the pattern in which the economic benefits or service potential is consumed. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.

These methods are described in the table below:

Method	Main characteristic
Straight-line	• allocation of depreciation in fixed installments • benefits or service potential is function of time and not usage • repairs and maintenance charges are fairly constant over useful life.
Diminishing balance	• greater consumption of benefits in earlier periods • decreasing depreciation expense over useful life as there may be uncertainty over the benefits or service potential in the later years • effectiveness of asset is expected to gradually decline • repairs and maintenance charges are expected to increase as asset ages, therefore depreciation charges decrease
Units of production	• depreciation charge is based on expected use of the asset • provides best approximation of consumption of benefits or service potential • eliminate the depreciation of an asset while it has not been brought into use

The difference between the above three methods are best illustrated through an example.

	Straight-line	Diminishing balance	Units of production
Cost of the asset	120,000	120,000	120,000
Residual value	20,000	20,000	20,000
Expected useful life	5 years		
Expected depreciation rate		10 %	
Expected total number of production units			50,000
Actual units - year 1 - year 2 - year 3			 15,000 20,000 5,000
Depreciation charge – **Year 1**	**20,000**	**10,000**	**30,000**
	(120,000 – 20,000) / 5 years	(120,000 – 20,000) x 10 %	(120,000 – 20,000) x 15,000/50,000 units
Depreciation charge – **Year 2**	**20,000**	**9,000**	**40,000**
	(120,000 – 20,000) / 5 years	[(120,000 – 20,000) – 10,000] x 10 %	(120,000 – 20,000) x 20,000/50,000 units
Depreciation charge – **Year 3**	**20,000**	**8,100**	**10,000**
	(120,000 – 20,000) / 5 years	[(120,000 – 20,000) – 10,000 – 9,000] x 10 %	(120,000 – 20,000) x 5,000/50,000 units

The method of depreciation should be reviewed at least annually at the reporting date. If there has been a change in the pattern of consuming the benefits, the method should be changed to be more appropriate.

Estimated useful life

An asset's useful life is the period over which the municipality expects to consume economic benefits or service potential from the asset. The economic life of an asset is the period over which the asset is capable of providing economic benefits or service potential, regardless of whether it is to be the municipality or another owner. The useful life of an asset will therefore often be less than the economic life.

For **example** a municipality is leasing a building through a finance lease for a period of 10 years and the extension of the lease agreement is unlikely. The furniture and fittings in the building have an economic life of 15 years. For depreciation purposes, the useful

life of the furniture and fittings is only 10 years as the municipality is unlikely to use them after the lease expires.

As the useful life is estimated when an asset is acquired, management should apply their professional judgment so that the estimate takes into account all relevant information available at the time, including past experience. Factors that may be considered when estimating the useful life of an asset are:

- expected capacity or output of the asset;
- expected physical wear and tear on the asset, taking into account maintenance plans;
- expected usage of the asset;
- improvements in the technical capabilities of new machines; and
- whether the asset is subjected to a time- limit, i.e. lease period.

As discussed earlier, the estimated useful life should be reviewed at least annually, taking into account changing circumstances. The effect of the change is recognised evenly over the current and future years using spreading method or in the year in which the estimate is reviewed so that in subsequent years the depreciation cost is consistent with the revised remaining useful life of the asset. The latter is referred to as the catch-up method.

For **example**, a machine with a cost price of R80,000 is expected to be used for 8 years. Using the straight-line method to calculate depreciation, the depreciation charge is R10,000 per annum. Just before the end of the 3rd financial year it became known that the machine is outdated and is expected to be used only for another 2 years. The effect of the change in estimate can be illustrated as follows:

	Originally	**Spreading method**	**Catch-up method**
Cost price	R80,000		
Estimated useful life	8 years		
Depreciation expense per annum	R10,000 (80,000 / 10 years)		
Carrying amount after the end of the 2nd year	R60,000 [80,000 – (10,000 x 2yrs)]	R60,000	R60,000
Remaining useful life	6 years	3 years (current year + 2yrs)	3 years (current year + 2yrs)
Depreciation expense in 3rd year	R10,000	R20,000 (60,000 / 3 years)	R28,000 (see calc below)
Depreciation expense in 4th year		R20,000	R16,000 (see calc below)
Depreciation expense in 5th year		R20,000	R16,000 (see calc below)

Spreading method:

As the remaining useful life has been revised before the end of the third year, the effect of the change in the estimated useful life should be spread evenly over the remaining 3 years. The depreciation expense is based on the carrying value at the end of the 2nd year over the remaining 3 years, therefore the statement of financial performance will show a depreciation charge of R20,000 per annum.

Catch-up method:

Under the catch-up method, the revised useful life is applied to the original cost price of the asset, being R80,000 as if it always had been the useful life. Annual depreciation would have been R16,000 (80,000 / 5 years).

At the end of the 3rd year, accumulated depreciation would have been:	R48,000
(16,000 x 3)	
The carrying value of the machine would have been:	R32,000
(80,000 – 48,000)	
As this is not the case, an adjustment should be made to align the original carrying value of R60,000 and accumulated depreciation of R20,000 with the revised carrying value and accumulated depreciation.	
Therefore, the depreciation charge at the end of the 3rd financial year is:	R28,000
(60,000 – 32,000)	
Thereafter the annual depreciation charge is:	R16,000

Residual value

The residual value is the estimated proceeds from the disposal of an asset after taking into account the costs of disposal. The estimate is based on what would currently be obtained from an asset of the same age and condition expected at the end of its useful life. The residual value should be estimated at the date of acquisition and should be reviewed at each subsequent reporting date. Any revision to the residual value will result in a change in the depreciation expense, which should be treated as a change in accounting estimate and applied prospectively.

Some important aspects to bear in mind when calculating the residual value:

- residual value does not include expected future inflation;
- a change in residual values would result in a change in estimate and not a change in accounting policy;
- the estimated residual value is based on similar assets that have reached the end of their useful lives at the date that the estimate is made;
- if the asset is to be scrapped, the residual value would be zero;
- residual values must be reviewed at least at each reporting date;
- if the residual value of an asset increases it an amount equal to or more than the asset's carrying value, then the asset's depreciation charge will be zero.

Commencement of depreciation

Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in a manner intended by management. Therefore in some cases, depreciation may commence before the asset is actually brought into use.

Discontinuing depreciation

Depreciation of an asset ceases at the earlier of:

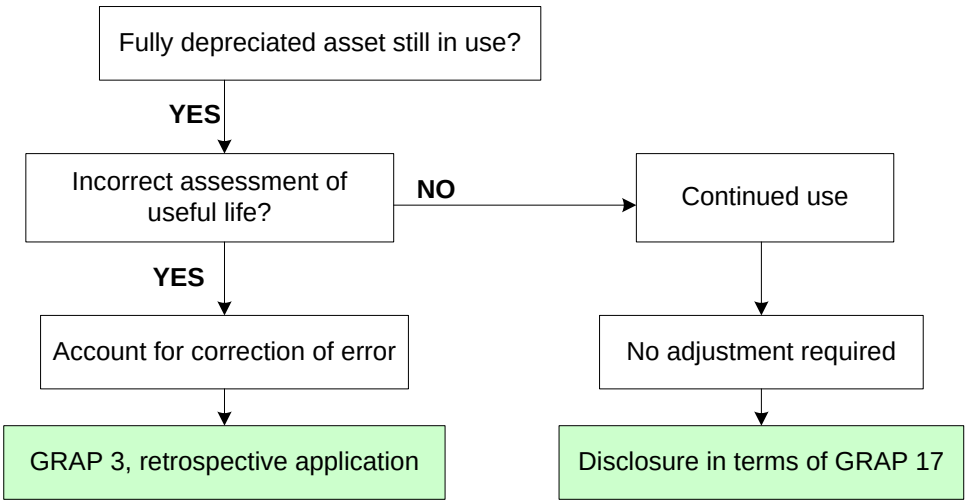
- the date the asset is classified as *held for sale*; and
- the date the asset is *derecognised* (i.e. sold, scrapped etc).

Depreciation does therefore not cease when the asset becomes idle or is retired from active use unless it is fully depreciated or is classified as *held for sale*.

Fully depreciated assets

Many entities still have assets in use that have been fully depreciated. This may indicate that the depreciation methods and or the useful lives were not reviewed at each reporting date or that the asset is still being used after it has reached the end of its useful life.

A municipality will have to consider whether the facts and circumstances existed that indicated that the useful life or the depreciation method needed to be revised. If this is the case, then misapplication of the facts and circumstances would result in a correction of an error. If however, a municipality can prove that the useful life and depreciation method represented its best estimate at the time then it should not be accounted for as an error. In such instances, GRAP 17 requires disclosure of the gross carrying amount of any fully depreciated PPE that is still in use in the notes to the annual financial statements.



#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	Identify items of PPE to be depreciated	Ensure that every item of property plant and equipment as per the AR is depreciated separately. Therefore each PPE item should be depreciated individually. (Please note that land is not depreciated)	**AP**	**Manager responsible for asset management**	Date at which GRAP is implemented.
2	According to GRAP 17 / GAMAP 17, the residual value is the net amount which the entity expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal. **GRAP 17.63 (previously GAMAP 17.56)** states that the depreciable amount of an asset is determined after deducting the residual value of the asset. In practice, the residual value of an asset is often insignificant and, therefore, is immaterial in the calculation of the depreciable amount. When the benchmark treatment is adopted and the residual value is likely to be significant, the residual value is estimated at the date of acquisition and is not subsequently increased for changes in prices.	Ensure that the residual value of an asset is taken into account when determining the depreciable amount of the asset.	**AP**	**Manager responsible for asset management**	Date at which GRAP is implemented.
3	Reconciling AR with statement of financial performance	Perform reconciliation between the depreciation charge as per the AR and the depreciation charge as per the GL account balance for depreciation. Obtain reasons for any differences and effect the necessary adjustments to correct either the AFS or the AR.	**ACP**	**Manager responsible for asset management**	Monthly

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
4	Recording depreciation and accumulated depreciation in the GL	Ensure that a depreciation GL account is created. Ensure that, for each category of PPE, corresponding accumulated depreciation accounts are created. (The accumulated depreciation account is a statement of financial position item (it is an asset provision). This account balance reflects the depreciation charge that has been expensed or capitalised since the asset was brought into use. The balance on the accumulated depreciation account can never exceed the cost or valuation of the specific item of PPE to which it relates).	**AP**	**Manager responsible for asset management**	Date at which GRAP is implemented.
5	Calculating depreciation charge	Ensure that the actual depreciation charge for the financial year is calculated using the AR as a basis and that it takes into account the following: • Full depreciation on assets that are controlled by the municipality for the entire year. • Pro – rata depreciation on assets that are sold or purchased during the financial year. • Accelerated depreciation on assets where their useful lives are reviewed during the financial year and they are written off more quickly than originally anticipated.	**AP**	**Manager responsible for asset management**	30 June each year.
6	**GRAP 17.61** (previously **GAMAP 17.59**) states that useful life of an item of property, plant and equipment shall be reviewed periodically and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods shall be adjusted.	Issue a memo to all department managers at year end to request them to ensure that the remaining useful life of all items of PPE is reviewed at 30 June to identify items with a shorter remaining useful life than the one reflected on the AR. The manager responsible for assets management should be notified of items of PPE with remaining useful lives shorter than those reflected on the AR at year end.	**AP**	**Manager responsible for asset management**	30 June each year

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		Refer to **Annexure 3:** Example of memo - Review of the remaining useful life of items of PPE			
7	Updating useful life	Amend the useful life in the asset register for items identified above as a result of previous procedure and ensure that the depreciation charge for these items for future periods is adjusted.	**AP**	**Manager responsible for asset management**	30 June each year
8	Accounting for change in estimate	Obtain sufficient details of the above-mentioned change in accounting estimate from official responsible for asset management to disclose the nature of the change in estimate, the amounts involved and the effect on future periods (if practicable to do so and also if the amounts involved are material). Ensure that this information is disclosed as a non-adjusting post balance sheet event in a note to the AFS. Also, this information needs to be disclosed as a change in estimate in the next year's AFS if the amounts involved are material.	**AP**	**CFO**	30 June each year
9	According to GRAP 17, depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.	Be aware that assets need to be depreciated from the date the asset is available for use (and not from the date that the asset is put into use) and that depreciation ceases at the earlier of the date the asset is classified as held for sale or the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless it s fully depreciated. Ensure that the CFO is made aware of the date on which assets are available for use.	**AP**	**CFO**	Date at which assets are put into use

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
10	Depreciation on assets bought during the month	Ensure that the AR parameters are set up in such a way that broken periods, which can be calculated on a days or months basis, are taken into account when calculating depreciation. For example, if an asset is brought into use on 26 April, then depreciation for the financial year will be apportioned based on the number of days between 26 April and 30 June (64 days/365 days) or 2 months/12 months, which is the number of months between 26 April and 30 June.	**AP**	**Manager responsible for asset management**	Date at which GRAP is implemented.
11	According to **GRAP 17.60** (previously **GAMAP 17.51**), the depreciable amount of an item of property, plant and equipment shall be allocated on a systematic basis over its useful life. The depreciation method used shall reflect the pattern in which the asset's economic benefits or service potential is consumed by the entity. The depreciation charge for each period shall be recognised as an expense. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. The methods include the straight-line method, the diminishing balance method or sum of the unit's method, according to **GRAP 17.63** (previously **GAMAP 17.56**)	Develop an accounting policy on the method and period over which the different assets should be depreciated. (There are three methods of depreciation permitted in terms of GRAP. **Firstly**, the straight line method whereby items of PPE are depreciated on a constant or uniform amount over their estimated useful life. This is likely to apply to the majority of the municipality's assets. For example, if a PPE is purchased and has an estimated useful life of 5 years, each year one-fifth of the PPE will be depreciated. **Secondly**, the units of production method of depreciation is also permitted. In terms of this method, the estimated life of the item of PPE is measured in terms of usage rather than time periods. The **third** method is the diminishing balance method, in terms of which the depreciation charge reduces over the useful life of the item of PPE. The municipality selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected	**AP**	**CFO**	Date at which GRAP is implemented.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		pattern of consumption of those future economic benefits). Ensure that the depreciation rates calculated as per the AR apply the method and period of depreciation as per the accounting policies of the municipality.			
12	Residual values should be considered when an asset's depreciable amount is calculated. According to GRAP 17 the residual value is the net amount which the entity expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal if the asset was already of the age and in the condition expected **at the end of its useful life**. In practice, the residual value of an asset is often insignificant and, therefore, is immaterial in the calculation of the depreciable amount. When the benchmark treatment is adopted and the residual value is likely to be significant, the residual value is estimated at the date of acquisition and is not subsequently increased for changes in prices.	The residual value of an asset must be reviewed annually at year-end and if expectations differ from previous estimates, the change are accounted for as changes in accounting estimates in terms of GRAP 3. Motor vehicles are a good example of municipal assets whose residual values should be considered and reviewed annually to ensure that annual carrying amounts equals the recoverable amounts.	**AP**	**Manager responsible for asset management**	30 June each year
13	Calculating residual values	The following points need to be taken into account when developing a methodology for the calculation of residual values – especially motor vehicles: • In theory, the residual value should be estimated for each asset individually on an asset per asset basis and should be reviewed at	**AP**	**CFO**	Date at which GRAP is implemented.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		least at each financial year-end. • Vehicles should be classified into categories according to the type of vehicle, make, model and engine capacity. These categories will definitely have an effect on the residual value. • Residual values will need to be reviewed annually for each vehicle, taking the condition of the vehicle and the future market conditions into account. Any change in residual values will have to be accounted for as a change in estimate and dealt with prospectively in future. • It is probably not pragmatic or practicable to review residual values for each asset annually on an individual basis. Therefore as a minimum, indicators will have to be developed and applied to all assets (on a class by class basis) to highlight those assets for which the residual needs to be reassessed.			
14	**GRAP 17 does not require** entities to revalue items of property, plant and equipment. **It does, however, permit** entities to revalue assets if they wish to do so. In other words, voluntary revaluation of land and buildings, and other assets for which there is an active market, is permitted.	A decision should be reached and accepted by council whether to revalue any class of PPE. Ensure that accounting policy is drafted and accepted to revalue certain classes of PPE. Ensure that all PPE items within a specific class of PPE are revalued annually. **It should be noted that GAMAP 17, only allows for revaluation of land and buildings.** Revaluation of land and buildings can only be used subsequent to initial recognition (recording in books of account). The revaluation reserve will be retained until the relevant property, plant and equipment is disposed of.	**AP**	**CFO**	Date at which GRAP is implemented.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
15	**GRAP 17.40** (previously **GAMAP 17.42**) stipulates that an appraisal of the value of an asset is normally undertaken by a member of the valuation profession who holds a recognised and relevant professional qualification.	Determine the basis of revaluation of PPE items and consider using a specialist accredited valuator to revalue the PPE items annually.	**ACP**	**CFO**	30 June each year
16	Accounting for revaluations	Revalue the PPE items affected in the accounting records as follows: • Determine the difference between the revalued amount and the carrying amount of the PPE item; • Debit the PPE item with this difference and credit a non distributable reserve (NDR) with the same amount; • Ensure that this adjustment is reflected in the AFS.	**AP**	**CFO**	30 June each year
17	Adjusting depreciation after revaluations	Adjust the depreciation charge for revalued items by taking the increased carrying amounts of PPE items into consideration.	**AP**	**CFO**	30 June each year
18	Annual procedures	A municipality must at the end of each reporting date (30 June): ▪ Review the useful life of an item of PPE GRAP 17.61(previously GAMAP 17.59); ▪ Review the depreciation method applied to PPE GRAP 17.71 (previously GAMAP 17.62); ▪ Assess whether there is any indication that an asset may be impaired – if so, the municipality should determine the asset's recoverable amount (GAMAP 17.66); ▪ Review the residual values of an item of PPE	**AP**	**Manager responsible for asset management**	30 June each year

b) Subsequent expenditure

Expenses incurred subsequent to the initial recognition are only capitalised if they meet the definition and recognition criteria of an asset. Subsequent expenditure can be incurred to either maintain the asset's original capacity and ensure the continued inflow of economic benefits or service potential or to improve the capacity or output of the asset. Examples of expenditure that could meet the definition and recognition criteria of an asset and therefore may be capitalised:

- an increase in the capacity of plant and machinery;
- the rehabilitation of a road resulting in a substantial reduction in maintenance cost;
- a modification to extend the remaining useful life; or
- the upgrading of certain parts, resulting in a substantial improvement in the quality of outputs.

Expenditure relating to the day-to-day servicing of an asset should not be capitalised. This includes repairs and maintenance as well as the replacement and renewal of immaterial components of an asset.

MATRIX 1: Distinguishing capital expenditure from maintenance expenditure

Capital Expenditure	Maintenance
▪ Acquiring a new asset ▪ Replacing an existing asset ▪ Enhancing an existing asset so that its use is expanded ▪ Further developing an existing asset so that its original useful life is extended	▪ Restoring an asset so that it can continue to be used for its intended purpose ▪ Maintaining an asset so that it can be used for the period for which it was initially intended.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	**MFMA 63 (1) (a)** stipulates: The accounting officer of a municipality is responsible for the management of the assets of the municipality, including the safeguarding and the maintenance of those assets.	Design and implement a comprehensive maintenance plan for the maintenance of all items of PPE of the municipality. A process (pro active and retrospective) should be developed through which PPE that should be serviced within the next month should be identified and followed up to ensure that the warranty is not lost and to ensure that the PPE is properly maintained.	**ACP**	**CFO**	Date at which GRAP is implemented.
2	According to **GRAP 17.18 (previously GAMAP 17.35)**, subsequent expenditure relating to an item of property, plant and equipment that has already been recognised shall be added to the carrying amount of the asset when it is probable that future economic benefits or service potential over the total life of the asset **in excess of the most recently assessed standard of performance of the existing asset**, will flow to the entity. All other subsequent expenditure shall be recognised as an expense in the period in which it is incurred. According to **GRAP 17.19 (previously GAMAP 17.36)** subsequent expenditure on property, plant and equipment is only recognised as an asset when the expenditure improves the condition of the asset, measured over its total life, beyond its most recently assessed standard of performance.	Finance should be aware of the criteria that should be used to differentiate between capital expenditure and repairs and maintenance. See matrix above for assistance in distinguishing capital expenditure from maintenance expenditure: Matrix 1 - distinguishing capital expenditure from maintenance expenditure. Using the details as per the matrix as a guideline, all invoices need to be scrutinised throughout the year to identify and allocate maintenance expenditure to operating expenditure and to identify and properly allocate capital expenditure. These expenses should be reconciled to the bank statements and then journalized to the expenses categories.	**AP**	**Manager responsible for asset management**	Date at which subsequent expenditure is incurred.

2.1.4 PROCEDURES AT THE END OF THE USEFUL LIFE OF THE PPE

When an item of PPE ceases to satisfy the definition or recognition criteria for an asset, it should no longer be recognized as an asset. Where an asset has been disposed of whether through sale or scrapping, the asset should be depreciated up to the date of disposal. The difference between the carrying value at the date of disposal and the proceeds from the disposal (if any) represents a gain or loss on disposal and is recognised in the statement of financial performance.

Calculation of gains/loss on disposal

Proceeds	Sales value, trade-in value or proceeds received from insurance if the asset was damaged or stolen.
Less: Carrying value	Cost, or if valued, revaluation amount, less accumulated depreciation up to the date of sale or when asset can no longer be used for its intended purpose.
Equals GAIN or	If proceeds greater than carrying value, or
Equals LOSS	If proceeds less than carrying value.

When an item of PPE is disposed of or written off, then the cost or valuation of the item, together with the accumulated depreciation, must be written out the accounting records. This can be illustrated by using the following example. Assume that an asset originally costing R5 000 and with accumulated depreciation of R3 500 at the date of disposal is sold for R4 000. The journal entries to record this would be as follows:

Description	**Debit**	**Credit**
Debit: Bank	4 000	
Credit: Gain and Loss of Assets		4 000
Being the recording of the proceeds in the Gain and loss of assets account		

Description	**Debit**	**Credit**
Debit Accumulated depreciation	3 500	
Credit Asset		5 000
Debit Gain and Loss of Assets	1 500	
Being removal of asset from selling municipality's records		

The gain of R 2 500 being the difference between the proceeds (R4 000 and the carrying value of R1 500) will be the balance on the Gain and Loss of Assets account after the journal entry above is processed.

Gains and/or losses on the sale of assets are a disclosure item in the annual financial statements of the municipality. In the case of a gain that was realised, the gain should not be included in revenue, but should be recorded as other income.

The date of disposal is regarded as the date on which the risks and rewards associated with ownership of the asset have been transferred to the buyer.

When part of an asset is disposed of or permanently withdrawn from use, the carrying value of that part is derecognised.

The consideration receivable on disposal of an item of PPE is recognised initially at its fair value. If payment for the item is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with GRAP 9, *Revenue from exchange transactions* (previously GAMAP 9) reflecting the effective yield on the receivable.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	An item of property, plant and equipment shall be eliminated from the statement of financial position on disposal or when the asset is permanently withdrawn from use and no future economic benefits or service potential are expected from its disposal.	Notify the official responsible for asset management immediately when assets are disposed of or when no future economic benefits are expected from the use or disposal of an asset. Derecognise these assets in the AR and AFS of the municipality. The cost price of the asset should be credited and accumulated depreciation debited to derecognize the asset in the AFS of the municipality. Inform the CFO when PPE has been identified that will have no future benefits.	**AP**	**Manager responsible for asset management**	Date of disposal of PPE item
2	**GRAP 17.77** (previously **GAMAP 17.71**) states that gains or losses arising from the retirement or disposal of an item of property, plant and equipment shall be determined as the difference between estimated net disposal proceeds and the carrying amount of the assets. For the purposes of display in the financial statements, the gain or loss shall be included in the statement of financial performance as an item of revenue or expense, as appropriate.	On the sale of assets, perform the following steps: • the official responsible for asset management and the CFO should be notified of the details of the PPE sold as well as the proceeds on the sale of the assets; • the cost price of the mentioned assets as well as its accumulated depreciation up to the time of the disposal should be written out of the accounting records of the municipality and a gain or loss on the sale of the asset should be calculated and recorded in the applicable GL account (the calculation of the gain or loss on the sale of assets will be calculated by using a formula, as indicated below);	**AP**	**Manager responsible for asset management**	Date of disposal of PPE item
3	**Section 90 of the MFMA – Disposal of capital assets** (a) A municipal entity may not transfer ownership as a result of sale or other	Ensure compliance with section 90 of the MFMA.	**LCP**	**CFO**	30 June each year

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	transaction or otherwise dispose of a capital asset needed to provide the minimum level of basic municipal services. (b) A municipal entity may transfer ownership or otherwise dispose of a capital asset other than an asset contemplated in subsection (a) above but only after the council, in a meeting open to the public- • has decided on reasonable grounds that the asset is not needed to provide the minimum level of basic municipal services • has considered the fair market value of the asset and the economic and community value to be received in exchange for the asset. (c) Any transfer of ownership of a capital asset must be fair, equitable, transparent and competitive and consistent with the supply chain management policy which the municipal entity have and maintained in terms of section 111.				
4	Transfers of PPE	The official responsible for asset management should be notified when assets are going to be transferred from this municipality to another municipality. A list must be drawn up of the assets to be	**AP/ACP**	**Manager responsible for asset management**	Date on which PPE items are transferred

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		transferred indicating the description, acquisition date, remaining useful life, cost price, accumulated depreciation as well as book value of the assets. Write these assets out of the AR of the municipality. The listing of the assets must be provided to the CFO once the transfer is approved so that the transfer can be recorded on the accounting records of the municipality			
5	Transfers of PPE	In a scenario where the municipality is receiving PPE items, the municipality should insist on a listing of the assets that supplies a description, acquisition date, remaining useful life, cost price, accumulated depreciation and book value to be supplied by the transferring department. On receipt of the assets, record the assets in the AR of the municipality record these assets in the accounting records of the municipality.	**AP**	**Manager responsible for asset management**	Date on which PPE items are received.
6	Transfers of PPE	The transferring municipality as well as the receiving municipality must sign the PPE transferred listings on receipt of the PPE after the actual PPE received is compared to the listing to confirm its accuracy.	**ACP**	**Manager responsible for asset management**	Date on which PPE items are received/ transferred.

2.1.5 PREPARATION OF A GRAP COMPLIANT ASSET REGISTER

Section 122 (3) of the Municipal Finance Management Act (MFMA) requires municipalities and municipal entities to prepare financial statements in accordance with **generally recognised accounting practice** (GRAP), with this requirement being phased in. During the process of implementation of GRAP, **preliminary procedures** need to be executed to facilitate the move from cash/fund accounting to accrual accounting.

a) Compile a GRAP compliant asset register

b) Ensure that the functionality exists to enable the AR to annually present information contained per:

- **Class** of property plant and equipment (PPE must be categorised into infrastructure, community, heritage, and other assets as set out in GAMAP 17)
- **Funding source** (i.e.: internal & external loans, revenue, public contributions and donations and grants)
- **Department**

c) Update **incomplete and missing acquisition dates** on the AR.

d) Assets with **vague descriptions** on the AR should be investigated.

e) Asset with **no values** on the AR should be investigated.

f) Decide if the municipality is going to have a **capitalization threshold** and determine the threshold amount. Identify all assets below the threshold and reclassify them as control list items on the AR. Although these assets are expensed upon acquisition and therefore have a zero value in the AR, they are recorded and bar-coded for control purposes.

g) Ensure that the AR calculates **depreciation** and the carrying values of assets correctly according to the municipality's GRAP accounting policies relating to PPE.

h) Ensure that the AR allows alternative **depreciation methods** and not only the straight line method. Other depreciation methods such as the sum of the digits method or the diminishing balance method could for some assets be more appropriate and have to be considered.

i) Identify **intangible assets** on the AR. These assets will have to be written out of the AR and recorded in a separate Intangible Asset Register.

j) Identify **biological assets** on the AR. These assets will have to be written out of the AR and recorded in a separate Biological Asset Register.

k) Ensure that the AR is able to deal with:

- The recognition of **impairment losses**.
- **Residual values** and the recalculation of depreciation for current and future periods if residual values are recalculated.
- The **review of remaining useful lives** and the recalculation of depreciation for current and future periods.

- The **review of depreciation methods** and the recalculation of depreciation for current and future periods.
- **Revaluation** of land and buildings and separate disclosures of depreciation on the original cost and revalued portion of the revalued asset.

l) Identify all **land and buildings** owned by the municipality and ensure that they are correctly classified as owner occupied property or investment property. The following procedures can be performed:

- Prepare a list of all possible names under which property belonging to the municipality could have been registered in the past.
- Perform a title deeds search using all these names mentioned above to identify all land and buildings under the control of the municipality.
- Compare the results of the title deeds search to the Asset Register and the Valuation roll and adjust the AR to reflect all land and buildings under the control of the municipality.
- Value all land and buildings, which were previously not reflected on the AR at fair value where historical cost prices and acquisition dates are unknown.
- Reclassify land and buildings as owner-occupied property or investment property (IP).

m) Identify and unbundle **infrastructure assets** on the AR

The asset register is not only a very important ledger within the accounting system - it is also one of the cornerstones for the implementation of GRAP. The following needs to be done to ensure a GRAP compliant asset register.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	**Section 63 (2)(c) of the MFMA** stipulates that **t**he accounting officer must take all reasonable steps to ensure that the municipality has and maintains a system of internal control of assets and liabilities, including an **asset** and liabilities **register** as may be prescribed.	The compilation of a Asset register is a legislative requirement. Management should ensure that it contains, as a minimum, the following: • Acquisition dates of all items of property, plant and equipment. • Clear descriptions of individual items of property, plant and equipment • Expected useful lives of individual item of PPE • Depreciation rates determined in accordance with the principles set out in GAMAP 17. Refer to **Annexure 8:** Useful lives of assets according to the original appendix to GAMAP 113 • Historical cost or fair value of individual items of property, plant and equipment or the fair value of assets received as donations. • The location of the asset • Department or Service that use or controls the item of PPE. • Identification reference for physical verification and asset management purposes. (bar code) • Accumulated depreciation attributable to individual items of PPE. • Impairment losses attributable to individual items of PPE. • Carrying value of the asset • Funding sources of individual items of PPE. • Where land and buildings are revalued, the revalued amount attributable to individual items of land and buildings as well as the date and basis of such valuation.	**ACP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		• Residual values • Insurance arrangements • Whether the asset is pledged as security for any external loan or other obligation.			
2	Annual requirements of an AR	To facilitate the preparation of GRAP compliant AFS, ensure that the AR is able to provide the following information on an **annual** basis: • A summary of all **acquisitions** of property, plant and equipment. • A summary of all **disposals** or write-offs of property, plant and equipment during the year. The disposals or write-offs information should include both cost and accumulated depreciation. • The aggregate **depreciation expense** for the year • Initial estimated **useful life** and reassessed useful life of each asset at reporting date. • Any **impairment losses** incurred during the year. • The **opening and closing balances** of property, plant and equipment at cost. • The opening and closing balances of **accumulated depreciation.** • **Movements in the revalued portion** of property, plant and equipment.	**AP**	**Manager responsible for asset management**	Implementation of GRAP
3	In addition to classifications of assets between property, plant and equipment, there also needs to be further classifications in a public sector environment. PPE should also be **classified into infrastructure assets,**	In addition, the information referred to above should be presented annually by: • **Class of property, plant and equipment**. This information will be used to prepare the notes to the AFS on property, plant and equipment **Funding source**. This will enable the	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	community assets, heritage assets and investment properties. The purpose of this classification is to develop a benchmark accounting treatment to assist in the measurement of property, plant and equipment and to assist users to understand better the nature of the assets included as property, plant and equipment.	accounting entries relating to the EFF, CRR, Government Grant Reserve, Capitalisation Reserve as well as the Public Contributions and Donations Reserve to be easily prepared. • **Department or function**. This will enable management to report on the Segmental Analysis of property, plant and equipment.			
4	The definition and examples of infrastructure, community, heritage and other assets are as follows: **Infrastructure assets** are assets that are part of a network of similar assets. Examples of infrastructure assets are roads, water reticulation schemes, sewerage purification and trunk mains. **Community assets** are any assets that contribute to the community's well-being. Examples are parks, libraries and fire stations. **Heritage assets** are culturally significant resources. Examples are works of art, historical buildings and statues. **Other assets** are assets utilised in operations. Examples are plant and equipment, motor vehicles and furniture and fittings.	Property, plant and equipment must also be categorised into infrastructure, community, heritage, and other assets. These categories are important from a disclosure perspective. A municipality need not recognise heritage assets that also meet the definition of PPE. However, if a municipality does recognise heritage assets, it: • Must apply the **disclosure** requirements in GRAP 17 (previously GAMAP 17) • Need not apply the **measurement** requirements in GRAP 17 (previously GAMAP 17)	**AP**	**Manager responsible for asset management**	30 June each year

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
5	Physical verification of assets	The AR should be the end result of the physical verification of assets. All assets listed in the AR should contain a clear cryptic description of the asset as well as a unique identifiable asset number (bar code). A certificate should be issued by the team involved in establishing the AR to the extent that all assets contained on the AR have been physically verified. The ideal is that a physical verification is performed at year-end (30 June). Alternatively a physical verification can be done on 31 March, with the movements in carrying value of PPE (such as additions, disposals and depreciation) between 31 March and 30 June being well documented.	**ACP**	**Manager responsible for asset management**	Implementation of GRAP
6	**GRAP 17.40** (previously **GAMAP 17.42**) states that the fair value of land and buildings is usually their market value, determined by appraisal. An appraisal of the value of an asset is normally undertaken by a member of the valuation profession who holds a recognised and relevant professional qualification.	Ensure that all land and buildings owned by the municipality are reflected on the AR. Information from the Deeds Office should be obtained and compared to other available information to facilitate this process. The fair value of land and buildings identified for inclusion on the AR should be identified and recorded on the AR. The fair value of land and buildings is usually their market value, determined by appraisal. An appraisal of the value of an asset is normally undertaken by a member of the valuation profession who holds a recognised and relevant professional qualification. A project plan should be prepared that states that the municipality will reflect all land and buildings	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		never accounted for before at fair value amounts (depending on the accounting policy) and how the fair values will be established.			
7	According to **GRAP 17.15** (previously **GAMAP 17.22**) some assets are commonly described as "infrastructure assets". While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics: (a) They are part of a system or network, (b) They are specialised in nature and do not have alternative uses, (c) They are immovable, and (d) They may be subject to constraints on disposal.	Ensure that all infrastructure assets are recorded and valued in the AR. Such assets must be separately identifiable as they might have different life-expectancy periods and need to be depreciated over different periods. (For example, all roads should be specifically identified and listed in the AR.) A project plan should be prepared that includes a motivation on how to determine the GRAP compliant book values of infrastructure assets that have global amounts.	**AP**	**Manager responsible for asset management**	Implementation of GRAP
8	According to **GRAP 17.61** (previously **GAMAP 17.59**) the useful life of an item of property, plant and equipment shall be reviewed periodically and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods shall be adjusted.	Prepare a schedule of the remaining useful life for each asset. This schedule can be automatically prepared by manipulating the data in the AR. Perform steps to identify assets that may have shorter remaining useful lives than their calculated remaining useful lives and override and amend the useful life column in the AR**.**	**AP**	**Manager responsible for asset management**	Implementation of GRAP
9	Identification of investment property	Identify and classify Investment Properties (IP) and align the values of the IP to the selected accounting policies for IP, i.e. IP should be carried at fair value or cost minus accumulated depreciation.	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
10	Identification of intangible assets	Identify and classify Intangible Assets (IA) and align the values of the IA to the selected accounting policies for IA, i.e. IA should be carried at fair value or cost minus accumulated depreciation. Intangible Assets should be **l**isted in a separate Intangible Asset Register.	**AP**	**Manager responsible for asset management**	Implementation of GRAP
11	Impairment of assets recorded in asset register	The AR should reveal assets that have been or should be impaired as well as the related impairment expense and accumulated impairment.	**AP**	**Manager responsible for asset management**	Implementation of GRAP
12	Completeness of the asset register	Management to review the AR for completeness once the above steps have taken place	**AP**	**Manager responsible for asset management**	30 June each year
13	According to GAMAP 17.84 & 86 the transitional provision should be applied as follows: If an entity controls **assets not previously recognized** in the statement of financial position, the entity has a **three year grace period** within which to recognize such assets. This transitional provision is not applicable to assets that were previously recognized in the statement of financial position.	Ensure that the transitional provisions in GAMAP 17 are correctly applied. When an entity takes advantage of the transitional provision in GAMAP 17 it must be disclosed. Refer to section **2.1.7** for the **AFS disclosure requirements**.	**AP**	**Manager responsible for asset management**	30 June each year
14	**GRAP 17.60** (previously **GAMAP 17.51**) states that the depreciable amount of an item of property, plant and equipment shall be allocated on a systematic basis over its useful life. The depreciation method used shall reflect the pattern in which the asset's economic benefits or	**Capitalization thresholds** The implication of having a capitalization threshold is that assets below the threshold are depreciated over one year and not on a systematic basis over the asset's useful life. This practice is not in line with the accounting standards (GAMAP 17).	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	service potential is consumed by the entity.	Municipalities have two options: • Option A - To have an **internal policy** concerning a threshold. • Option B – To depreciate assets correctly according to depreciation periods per asset classification. **Option A:** 1) If a municipality wishes to have an internal policy concerning a threshold for recognizing capital assets they may do so. This should however not be included as part of the disclosed accounting policy in the annual financial statements because it's not in line with GAMAP 17. 2) The assets below the threshold should be listed and carried forward from year to year. The external auditors will measure the cumulative figure against materiality on an annual basis. In other words, they will annually calculate the correct carrying value for these assets and if the omission thereof in the Statement of Financial Position is material, it would lead to a qualification. **Option B:** 1) The correction of assets previously expensed over one year, should be treated as a prior period error and corrected retrospectively, as GAMAP 17 had previously been incorrectly applied.			

Challenges that may be encountered in preparing an asset register

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
15	Global amounts	Some Asset Registers may show global amounts, such as office furniture rather than a detailed listing of individual assets included in the global amount. Municipalities have a number of options to consider when dealing with this challenge: ▪ Firstly, the municipality can perform an asset count and allocate historical costs on a pro-rata basis, taking into account age and physical appearance of the assets that are assumed to be included in the global amounts. This will be a time consuming exercise and is unlikely to be completed before the planned implementation date. There is also a cost implication to this option and the risk of audit query due to the subjective nature of determining asset values. ▪ An alternative option is to write-off these assets on the basis that these assets are likely to have exceeded their useful lives from a depreciation perspective. It is therefore unlikely that the statement of financial position will be materially misstated. Whilst this option is likely to result in audit queries, it will be easy to implement from a timing perspective and will not have significant cost implications. ▪ A third option is to revalue all assets and then use the revaluation amount to record assets at depreciated replacement cost. This will be a once-off revaluation for implementation purposes. Any adjustment to the amount of property, plant and equipment included in the statement of financial position should be adjusted against the opening balance of the accumulated	**AP**	**CFO**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		surplus/deficit in the Statement of Changes in Net Assets. Municipalities should select the option that is appropriate to their individual circumstances, cost effective and pragmatic. An approach should be documented that should be discussed with the Auditor-General and submitted to Council for approval.			
16	Incomplete or missing acquisition dates	Acquisition dates are crucial to the calculation of the carrying values of property, plant and equipment at the date of implementing accounting standards. Acquisition dates are paramount to the calculation of accumulated depreciation to date. A number of options may be considered when the acquisition dates of some items of property, plant and equipment are not known: • Where acquisition dates are not known, a process to check old accounting records, such as internal advances registers, external loan registers and approved budgets, to ascertain whether such information is available, should be investigated. Whilst this option will provide accurate information to determine acquisition dates, it could take considerable time. There will also be a likely cost implication due to a lack of capacity. • A second option is to physically identify the items of property, plant and equipment in question and, based on visual evaluation, determine a likely acquisition date. This approach may be criticised from an audit perspective, will be time consuming and costly due to the need to in-source capacity. It may also be difficult to identify the specific item of property, plant and equipment to undertake a	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		visual evaluation. • The third option is to assume that the municipality has owned these assets for periods that are longer than their useful lives for depreciation purposes. This will certainly result in audit queries but will be easy to implement and will have no cost implications from a capacity perspective. Municipalities should select the option that is appropriate to their individual circumstances, cost effective and pragmatic. An approach should be documented that should be discussed with the Auditor-General and submitted to Council for approval.			
17	Vague asset descriptions	Municipalities may discover that descriptions of some individual items in the Assets Register are vague. The implication of these vague descriptions is that it will be difficult to categorise these items of property, plant and equipment and to determine appropriate depreciation rates that will have to be applied to such items. A detailed review of the asset register should be done and vague descriptions investigated. If further information is not available, then such items should be written off. Municipalities should maintain proper information on such write-offs, obtain Council approval and provide suitable evidence to the Auditor-General.	**AP**	**Manager responsible for asset management**	Implementation of GRAP
18	Incomplete financing sources	Municipalities must record the financing sources of all property, plant and equipment to facilitate the implementation process. The reason is that Loans Redeemed and Other Capital Receipts must be unbundled on the date of implementation. Furthermore account balances such as internal	**AP**	**CFO**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		loans must also be reversed. Municipalities that are unable to easily determine the original source of financing have a number of options to consider when dealing with the above-mentioned challenges: • Firstly, a process to check old accounting records to ascertain whether such information is available can be followed. Whilst this option will provide accurate information, it will take considerable time. There will also be a likely cost implication due to capacity constraints. However, it should be noted that municipalities were required to include a reconciliation of the financing of property, plant and equipment in their financial statements up to 30 June 1996, so in certain instances it will not be too difficult to obtain this information. It should also be noted that information on external loans as well as government grant funded items of property, plant and equipment may be relatively easy to obtain in relation to other financing sources as these are typically project linked and in respect of government grants, the majority of transactions will have only occurred in recent years. • An alternative option is to allocate assets to the different financing sources that constitute Loans Redeemed and Other Capital Receipts by using the description of the asset to determine a likely financing source based on general practice in the past. For example, office furniture is likely to have been funded by Revenue Contributions			

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		whereas major infrastructure is likely to have been funded from External Loans or government grants. This approach may be criticised from an audit perspective, will be time consuming and may be costly due to the need to in-source capacity. Municipalities should select the option that is appropriate to their individual circumstances, cost effective and pragmatic. An approach should be documented that should be discussed with the Auditor-General and submitted to Council for approval.			
19	According to **GRAP 17.15** (previously **GAMAP 17.22**) some assets are commonly described as "infrastructure assets". While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics: ▪ They are part of a system or network, ▪ They are specialised in nature and do not have alternative uses, ▪ They are immovable, and ▪ They may be subject to constraints on disposal.	Most municipal Assets Registers in respect of infrastructure assets are inadequate. This is due to historical factors and the use of the fund accounting system. Property, plant and equipment that are classified as "Infrastructure Assets" will typically be long-life assets. It is likely that such assets will need to be re-valued on a regular basis when accounting standards are updated, as depreciation is not an appropriate measure of the consumption of such assets.	**AP**	**Manager responsible for asset management**	Implementation of GRAP

2.1.6 CALCULATION OF BACKLOG DEPRECIATION AND UNBUNDLING OF LOANS REDEEMED AND OTHER CAPITAL RECEIPTS (LROCR)

The following steps need to be implemented to calculate backlog depreciation and unbundle the loans redeemed and other capital receipts (LROCR) during the process of implementation of GRAP:

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	Reconciliation of assets	Reconcile the total cost of assets per the general ledger to the sum of: ➢ Internal loans outstanding ➢ External loans outstanding ➢ Loans redeemed ➢ Revenue contributions ➢ Grants ➢ Public contributions / donations ➢ NDR revaluation of land ➢ NDR take on valuation of land and buildings	**AP**	**CFO**	Implementation of GRAP
2	Link asset to source of funding	Ensure that each asset per the asset register is linked to its funding source/s.	**AP**	**CFO**	Implementation of GRAP
3	Classify assets	Classify the assets into the various funding categories and obtain a total cost for each of these funding categories. Ensure that the total cost of the asset allocated per funding source on the asset register reconciles with the information as per the general ledger.	**AP**	**CFO**	Implementation of GRAP
4	Calculate backlog depreciation	Perform a calculation of the backlog depreciation for each asset, from the date of acquisition to the date of the standard implementation, by using the following formula:	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		Cost price of asset * (time period between acquisition date and 30 June 20xx) /Useful life of the asset			
5	Loans Redeemed and Other Capital Receipts must be used to fund backlog depreciation and used to establish the Government Grants Reserve/Deferred income and the Public Contributions and Donations Reserve that are now an integral part of the accounting for property, plant and equipment. If a municipality accounts for government grants in accordance with GRAP 9 (previously GAMAP 9) the GGR will be established. If a municipality accounts for government grants according to IAS 20 the grant should be set up as deferred income that is recognised as income on a systematic basis. The Asset Register must include information on the financing sources of property, plant and equipment. It should therefore be possible to reconcile Loans Redeemed and Other Capital Receipts to the total of property, plant and equipment. The following reconciliation should be performed to prove that Loans Redeemed and Other Capital Receipts do reconcile to property, plant and	Should the reconciliation of Loans Redeemed and Other Capital Receipts to property, plant and equipment not equal zero, then an adjustment must be made to Loans Redeemed and Other Capital Receipts to balance the reconciliation to zero. The corresponding entry will be processed to the accumulated surplus/deficit. Unbundle the LROCR, by preparing necessary journal entries, according to the steps set out in the following matrix: The unbundling process of LROCR is best explained by means of practical examples. Refer to **Annexure 1:** Examples 1(a) to 1(f) - Unbundling of Loans redeemed and Other Capital Receipts	**AP**	**CFO**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	equipment: **Total Property, Plant and Equipment** **Less: Loans Redeemed and Other Capital** **Receipts (LROCR)** **Less: External loans outstanding** **Less: Internal loans or advances outstanding** **Equals Zero**				

Component of Loans Redeemed and Other Capital Receipts	Process for assets thus funded	Convert to accumulated depreciation	Treatment of residual balance
Revenue Contributions	Determine backlog accumulated depreciation	Allocate corresponding balance of revenue contributions to accumulated depreciation	Balance of revenue contributions to unappropriated surplus.
Public contributions/ donations	Determine backlog accumulated depreciation	Allocate corresponding balance of public contributions/ donations to accumulated depreciation to prevent double taxation	Balance of public contributions/ donations to Public Contributions and Donations Reserve.
External Loans Redeemed	Determine backlog accumulated depreciation (should be in agreement with balance on external loans redeemed account if loan period corresponds with asset lives)	Allocate external loans redeemed to accumulated depreciation to prevent double taxation	Not applicable
Internal Loans Redeemed	Determine backlog accumulated depreciation (should be in agreement with balance on internal loans redeemed account if loan period corresponds with asset life)	Allocate internal loans redeemed to accumulated depreciation	Not applicable
Government grants	Determine backlog accumulated depreciation	Allocate corresponding balance of government grants to accumulated depreciation	Balance of government grants to Government Grants Reserve
Other sources of funding	Determine backlog depreciation	Allocate balance of funding to accumulated depreciation	Balance to accumulated surplus

2.1.7 IDENTIFICATION AND UNBUNDLING OF INFRASTRUCTURE ASSETS IN THE ASSET REGISTER

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	According to **(GRAP 17.15** (previously **GAMAP 17.22**) some assets are commonly described as "infrastructure assets". While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics: ▪ They are part of a system or network, ▪ They are specialised in nature and do not have alternative uses, ▪ They are immovable, and ▪ They may be subject to constraints on disposal.	**Infrastructure assets at historical cost amounts** It will always be necessary to depreciate infrastructure assets. What this means is that such assets must be separately identifiable in the Assets Register. For example, all roads should be specifically identified and listed in the Asset Register. Unfortunately, only global amounts are currently recorded in the current Asset Register. Acquisition dates and historical cost prices for each infrastructure asset will need to be recorded to enable the calculation of depreciation. This may not be possible to undertake when standards are implemented. Instead an average cost and age may need to be applied to infrastructure assets based on historical budget and financial statement information where available. Unfortunately, this will result in audit qualification until this information is provided. However, it will be paramount to prepare a process map to obtain this information over a number of years. Internationally, it has taken municipalities up to 8 years to prepare this detailed asset information. National Treasury encourages municipalities to address this matter as soon as possible for it does take cognisance of the challenges involved. Realistic timeframes must be set to obtain this information but cognisance should be taken of the transitional provisions of the PPE standard that require the recognition of property, plant and equipment for reporting periods beginning on a date within three years following the date of	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		first adoption of this standard. Most municipalities will not be able to list all infrastructure assets in the Asset Register due to the vast extent of the infrastructure. For example, listing every single road and sets of traffic lights will make the Asset Register unusable. Instead, consideration should be given to dividing the municipal area up into areas, each having a master plan detailing the cost and age of infrastructure in the area. These master plans will be summarised into the Asset Register. Typically, the engineering and operational departments of the municipality will have technical plans detailing the infrastructure, as these will be used for maintenance purposes. The challenge is to aggregate such plans as a holistic representation of all infrastructures in a specific area. Once "infrastructure areas" have been demarcated, the process of allocating historical costs to infrastructure can commence. Initially this can be done using recent budgets and financial statements. However, due to the lack of detailed information, assumptions will have to be made with regard to older assets. Again, by using the detailed plans maintained by the engineering and operational departments, subjective estimates of the age of these assets can be made. The global historical cost in the Asset Register will then need to be allocated to infrastructure. The easiest way to do this will be to allocate costs where accurate information is available and			

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		thereafter to pro-rata historical costs to infrastructure based on an averaging method. An example of the averaging method is where road costs are determined on a per kilometre basis (total historical cost of roads divided by the total length of roads). Each road is then measured and the calculated cost per kilometre is then applied. Adjustments to accumulated depreciation determined at the implementation date can then be made taking into account age of the assets based on the subjective assessment referred to above. Project plans should be prepared and responsibility assigned to officials. The importance of such a plan is that whilst the Auditor-General may have to qualify the financial statements of the municipality because infrastructure assets are not separately listed and identified, cognisance will have to be taken of this plan.			
2	Methodology to address the problems experienced with Infrastructure Assets shown at global amounts	1. Identify all Infrastructural assets owned by the municipality. This can be done by using master plans of infrastructural assets that the entity might have or infrastructural assets can be identified by means of GPS or other alternatives available to the municipality. 2. Identify the significant components of the various infrastructural assets identified in step 1. For example the water reticulation system of a municipality will have to be broken down in reservoirs, pipe lines, pump houses, water pumps, etc.	**AP**	**Manager responsible for asset management**	Implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		3. Obtain a valuation for the various significant components of the infrastructural assets. This can be done by obtaining the current replacement costs of the various components of the infrastructural assets. In the example of the water reticulation system, replacement costs should be obtained for the individual components such as the reservoirs, pipelines, pump houses, water pumps, etc. 4. Perform a physical inspection of all the significant components of the infrastructural assets of the municipality as was identified in step 2 of the framework. The purpose of the physical inspection is to establish the physical condition of the assets and to assess the remaining useful life of the individual components of the assets.			
	Depreciated Replacement Cost Approach Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. The replacement cost of an asset is the cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the existing asset or through replacement of its gross service potential. The depreciated replacement cost is measured as the	5. By using the results obtained in steps 3 and 4, the depreciated replacement cost of the various components of the infrastructural assets can be calculated. The difference between the replacement cost for each component of the infrastructure assets that was established in step 3 and the calculated depreciated replacement cost will be the accumulated depreciation of the asset as at that date. 6. Perform a detailed review of the existing AR to identify all Infrastructural assets that are recorded at global amounts. These assets will have to be written out of the AR.			

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost, to reflect the already consumed or expired service potential of the asset.	7. Update the AR with all the infrastructural assets identified in step 1, broken down in its significant components as identified in step 2. The replacement cost will be shown as the cost price and the depreciated replacement cost will be shown as the carrying amount (book value) of the asset. The asset will in future be depreciated over its remaining useful life (as was identified in step 4). 8. Adjust the General/Ledger account for Infrastructural assets to align the accounts with the AR after the action steps above have been concluded. 9. Correct the Annual Financial Statements as at 30 June 20xx in accordance with the requirements of GRAP 3. Refer to **Annexure 7:** Example of unbundling of infrastructure assets.			

2.1.8 ASSET MANAGEMENT POLICY

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	Develop an asset management policy	a) Ensure that the *asset management policy* is developed for the municipality and that it includes as a minimum the following aspects: • Objective of the asset management policy • Functional responsibilities of departments and individuals regarding PPE • GRAP accounting policies relating to PPE • Funding sources of items of PPE • Administrative requirements • Legislative requirements • Maintenance policy • Insurance policy b) Ensure that the AR complies with all the requirements of the asset management policy.	**AP**	**CFO/ Manager responsible for asset management**	Implementation of GRAP

2.1.9 IMPAIRMENT OF ASSETS

he availability of assets for use by municipalities to provide goods and services is one of the key drivers for success. Any assessment of assets should therefore consistently reflect their worth to the municipality. An asset recognised in the statement of financial position should not be reported at a value above the amount that could be recovered from using or selling the asset.

It is important that all assets utilised within the municipality are considered, e.g. some intangible assets which are highly technical in nature may attract premium valuations which may not be recoverable as technology continues to be developed or competitors enter the market.

Whenever an asset's recoverable amount falls to an amount less than its carrying amount, it is said to be impaired. Its value on the statement of financial position is therefore reduced to this recoverable amount and, in most instances an expense is recognised in the statement of financial performance. Impairment is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits through depreciation.

Distinguishing between cash-generating and non-cash-generating assets

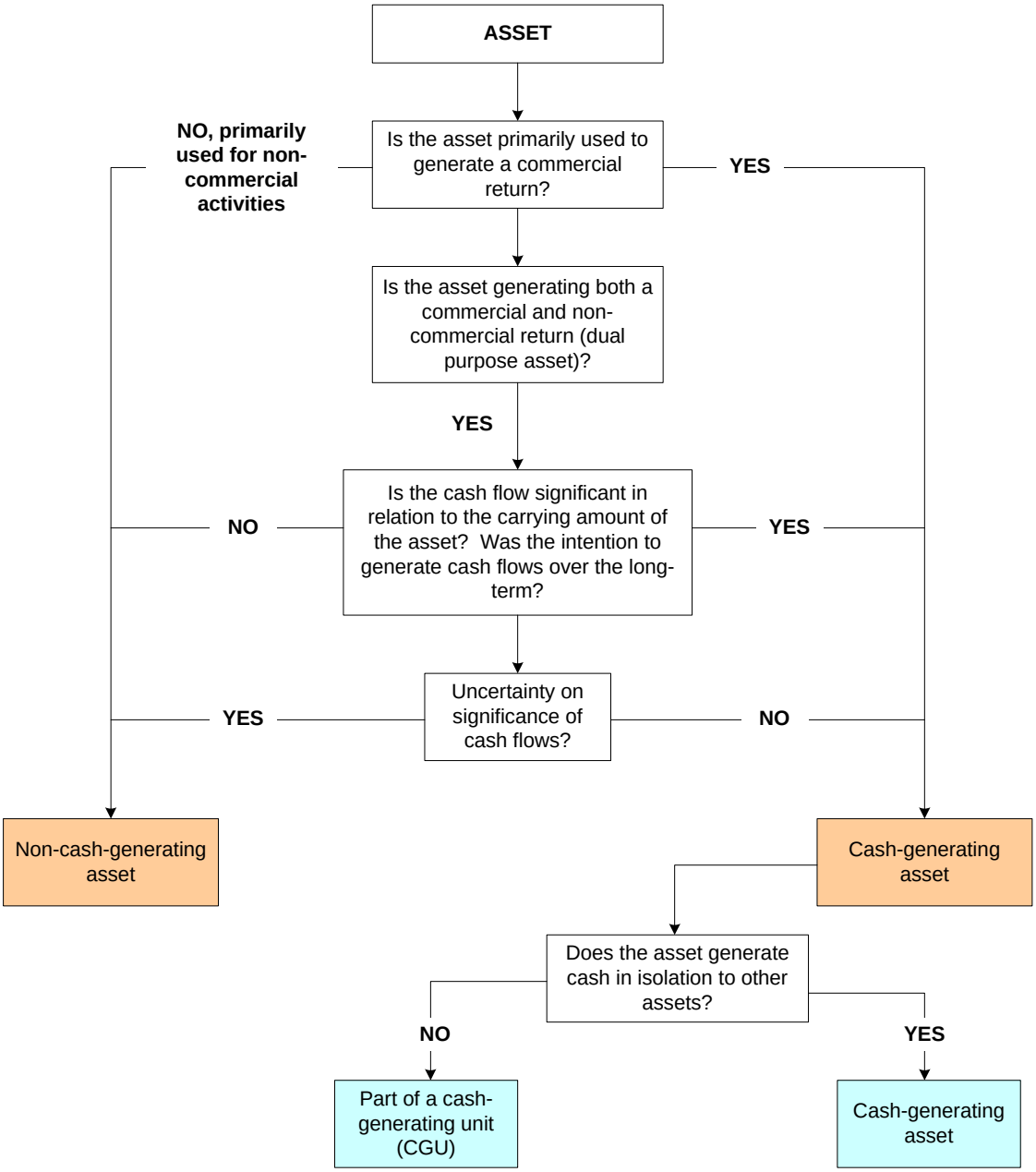
	Cash-generating assets are assets held with the primary objective of generating a commercial return. Non-cash-generating assets are assets other than cash-generating assets.

An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-orientated entity. Holding an asset to generate a "commercial return" indicates that an entity intends to generate positive cash inflows from the asset (or from the unit of which the asset is a part) and earn a return that reflects the risks involved in holding the asset. A non-cash-generating asset is an asset other than a cash-generating asset.

Some public sector entities, such as government business enterprises (GBE's), operate to make a profit. Therefore it is assumed that the assets held by these entities are primarily cash-generating assets. Similarly, it can be assumed that the assets of non-GBE's are non-cash-generating assets.

However in some instances the intended use of the asset may differ from the overall objective of the entity.

Distinguishing between cash-generating and non-cash-generating-assets:



The basic principle is that all assets not identified as cash-generating are regarded as non-cash-generating. As mentioned previously an asset generates a commercial return, and is thus a cash-generating-asset when it is used in a way that profit oriented entities would use the asset, earning a return that reflects the risk of holding the asset. An asset could be held with the primary objective of generating a commercial return even though it does not meet the objective during a particular reporting period.

In some cases, it may not be clear whether the primary objective of holding an asset is to generate a commercial return as it is used for more than one purpose. In such cases, it is necessary to evaluate the significance of the cash flows. Refer to the decision tree above.

	An impairment is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

Key stages in the impairment process

The stages in the process of identifying and accounting for an impairment loss are as follows:

- **STEP 1:** Assess whether there is an indication that an asset may be impaired. Note that if there is no such indication then no further action is required[1].
- **STEP 2:** If there is an indication of impairment, then measure the asset's recoverable amount or recoverable service amount;
- **STEP 3:** Reduce the asset's carrying value to its recoverable amount or recoverable service amount, usually by treating the loss as a separately disclosed expense in the statement of financial performance. Indicators of impairment:
- **STEP 4:** If there is an indication that an impairment loss recognised in the prior periods may no longer exist or may have decreased, the recoverable amount or recoverable service amount must be determined;

[1] An exception to this rule is an intangible asset with an indefinite useful life

STEP 1 – *Indicators of impairment/identifying assets that may be impaired*

Two sources of information that may indicate that an impairment has occurred are identified in the table below:

External sources (cash-generating asset)	**External sources (non-cash-generating asset)**
• decline in the asset's market value that is significantly greater than would be expected as a result of passage of time or normal use;	• cessation, or near cessation, of the demand or need for services provided by the asset
• significant adverse changes in the technological market, economic or legal environment in which the municipality operates or in its markets or expected in the near future	• significant long-term changes with an adverse effect on the entity have taken place during the period or will take place in the near future, in the technological, legal or government policy environment in which the municipality operates
• increases in interest rates or market rates of return that may materially affect the discount rate used in calculating the asset's recoverable amount	

Internal sources (cash-generating asset)	**Internal sources (non-cash-generating asset)**
• obsolescence or physical damage affecting the asset;	• evidence is available of physical damage of an asset;
• significant adverse changes in the extent to which, or in the way that an asset is used or expected to be used, including plans to discontinue or reorganize the operation to which the asset belongs or to dispose of the asset;	• significant long-term changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, or plans to dispose of an asset before the previously expected date;
• re-assessing the useful life of an asset as finite rather than indefinite;	• a decision to halt the construction of the asset before it is complete or in a usable condition;
• management's own forecasts of future net cash flows or operating profits may show a significant decline from previous budgets and forecasts;	• evidence is available from internal reporting that indicates that the service performance of an asset is, or will be significantly worse than expected.
• actual net cash outflows or operating profit or loss may be significantly worse than budgeted;	

Internal sources (cash-generating asset)	**Internal sources (non-cash-generating asset)**
• operating losses or net cash outflows, when current period figures are aggregated with budgeted figures for the future;	
• deterioration in the expected level of the asset's performance;	
• cash flows for acquiring the asset or for maintaining or operating it are significantly higher than those budgeted.	

The above list is not intended to be exhaustive and it is important to not ignore the obvious. Other indicators may be apparent that are relevant to the municipality's particular circumstances.

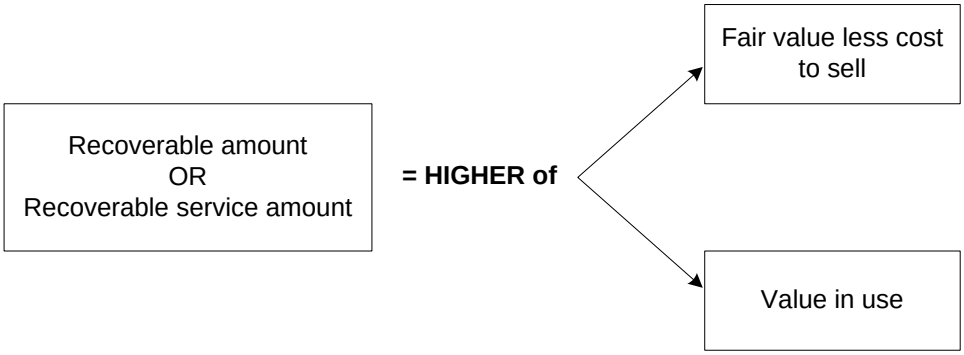
The materiality concept applies in determining whether an impairment review is required. If previous reviews indicated a significant excess of carrying amount over the recoverable amount or recoverable service amount no review would be necessary in the absence of any event that would eliminate the excess. Similarly previous reviews may have shown that an asset's recoverable amount or recoverable service amount is not sensitive to one or more of the impairment indicators listed above.

Indicators may assume more significance over time, perhaps as general market conditions worsen or as performance gradually deteriorates. These trends need to be monitored and their potential for impairment acknowledged.

STEP 2 – *Calculating the recoverable amount or recoverable service amount*

If the carrying amount of an asset is greater than its recoverable amount or recoverable service amount, then impairment has taken place – there has been a loss in the value of the asset.

The recoverable amount or recoverable service amount is the **higher** of its fair value less cost to sell and its "value-in-use". The calculation of "value-in-use" depends on the nature of the asset:	
Value in use – of a cash generating asset:	**Value in use – of a non-cash-generating asset**
The value in use is the present value of the future cash flows expected to be derived from an individual asset or a cash-generating unit	The value in use is the present value of the assets remaining service potential.



a) Calculation of recoverable amount in terms of IAS 36 (i.e. cash-generating assets)

Identifying the asset or the cash-generating unit

The recoverable amount is determined for an individual asset or the lowest aggregation of assets that generate independent cash flows

When the future cash flows of an asset cannot be attributed to a single asset to establish the recoverable amount on a reasonable basis, it is necessary to identify the smallest cash-generating unit to which such cash flows can be attributed. A cash generating unit is therefore the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

For **example**, a municipality runs a waste disposal entity that owns a crushing plant to support its waste disposal activities. The crushing plant could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the waste disposal entity. The entity will therefore estimate the recoverable amount of the cash-generating unit to which the crushing plant belongs, e.g. the waste disposal entity as a whole.

The identification of cash-generating units is a subjective matter based on professional judgment and may therefore be open to manipulation. Once a cash-generating unit has been identified, the units should be used consistently unless changes in assets groupings can be justified. In these instances specific disclosures on the changes in composition of cash-generating units should be included in the financial statements.

In recognising cash-generating units the lowest aggregation of assets that generate independent cash flows is recognised. Normally the cash inflows from the continuing use of the asset or group of assets refer to the cash and cash equivalents received from parties outside the reporting entity. These cash flows should be independent of the cash flows of other assets or cash-generating units.

To establish the independence of these cash flows, consideration is given to factors such as:

- how management monitors and controls operations, e.g. by product line, business, locations; or
- how management makes decisions to continue to sell parts of the entity's assets or operations.

In certain instances cash-generating units may be identified where all or a portion of the cash flows are from internal sources. Internal cash flows refer to cash flows within the entity's operations itself such as the transfer of products between departments, branches and businesses. These cash flows qualify for the recognition of cash-generating units only if active markets exit for the output.

In calculating the recoverable amount for these cash-generating-units, management should use its best estimate of future arm's length prices for the output as the actual transfer prices used for internal transfers may not be market related.

Calculating the carrying amount of the asset or cash-generating unit

Carrying amount is the amount at which an asset is recognised (in the statement of financial position) after deducting any accumulated depreciation or amortisation and accumulated impairment losses thereon.

In determining whether an asset or cash-generating unit is impaired, the first step is to calculate the carrying amount of the identified asset(s). The carrying amount of a cash-generating unit:

- includes those assets that can be attributed directly or allocated on a reasonable and consistent basis (such as goodwill and corporate assets in some cases) and that will generate future cash inflows used in determining the value-in-use of the cash-generating unit;
- excludes the carrying amount of recognised liabilities, unless the recoverable amount of the cash-generating unit cannot be determined without the liability (where a purchaser is required to take over the liability);
- excludes assets that cannot be allocated on a reasonable basis such as goodwill and coporate assets in some cases;
- excludes assets that will not produce the estimated future cash inflows.

It is crucial, where assets are grouped together to determine their recoverability, that all assets that generate or are used to generate the relevant stream of cash inflows be included in the cash-generating unit.

In some cases certain assets such as goodwill or corporate assets, e.g. head office building, may contribute to the estimated future cash flows of a cash-generating unit, but these assets cannot be allocated to the cash-generating unit on a reasonable and consistent basis.

Sometimes the recoverable amount of a cash-generating unit may include some recognised liabilities where such liabilities are directly associated with the cash-generating unit. To perform a meaningful comparison between the carrying amount and

recoverable amount of a cash-generating unit, the carrying amount of the liability should be deducted when calculating the value-in-use and the fair value less costs of sale. This may be relevant where a municipality has an obligation to restore a site to its original condition once activities have ceased. If the site is sold, the liability in respect of the restoration will attach to the site and therefore if its recoverable amount is to be determined, this liability will be included in the calculation.

For **example**, a municipality operates a waste disposal site and is required to restore the site on completion of its operations. The cost of restoration includes the replacement of the top soil, which must be removed before waste disposal operations commence. A provision for the costs to replace the top soil was recognised as soon as the top soil was removed. The amount provided was recognised as part of the cost of the site and is being depreciated over the site's useful life. The carrying amount of the provision for restoration costs is R500,000 which is equal to the present value of the restoration costs.

The municipality is testing the site for impairment. The cash-generating unit for the site is the site as a whole. The government has received various offers to buy the site at a price of around R800,000. This price reflects the fact that the buyer will assume the obligation to restore the top soil. Disposal costs for the site are negligible. The value-in-use of the site is approximately R1,200,000 excluding restoration costs. The carrying amount of the waste disposal site is R1,000,000.

The cash-generating unit's fair value less costs to sell is R800,000. This amount includes restoration costs that have already been provided for. As a consequence, the recoverable amount for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be R700,000 (R1,200,000 less R500,000). The carrying amount of the cash-generating unit is R500,000 which is the carrying amount of the site (R1,000,000) less the carrying amount of the provision for restoration costs (R500,000). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.

Measuring the recoverable amount

It is not always necessary to determine both the fair value less costs to sell and the value-in-use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value-in-use as its recoverable amount.

If there is no reason to believe that an asset's value-in-use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. This is because the value-in-use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

Recoverable amount is determined for an individual asset, unless the asset does not generate cash-inflows that are largely independent of those from other assets or groups

of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs, unless either:

- the asset's fair value less costs to sell is higher than its carrying amount; or
- the asset's value-in-use can be estimated to be close to its fair value less costs to sell and fair value less costs to sell can be determined.

In some cases, estimates, averages and computational shortcuts may provide reasonable approximations of the detailed computations for determining fair value less costs to sell or value-in-use.

Fair value less costs to sell

The fair value less cost to sell is the amount obtained from the sale of an asset or cash-generating unit in an arm's length transaction between a willing buyer and seller, less the costs of disposal. [refer to ANNEXURE 8]

The costs of disposal are the incremental costs that are directly attributable to the disposal of the asset. It excludes however, finance costs and income tax expense.

The best evidence of an asset's fair value less costs to sell is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal.

The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.

If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, consideration is given to the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale, unless management is compelled to sell immediately.

Costs of disposal, other than those that have been recognised as liabilities, are deducted in determining fair value less costs to sell, e.g. such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

Sometimes, the disposal of an asset would require the buyer to assume a liability and only a single fair value less costs to sell is available for both the asset and the liability.

Value-in-use

The value-in-use [of a cash-generating asset or cash-generating unit] is the present value of future cash flows expected to be derived from an asset or cash-generating unit.

Note that these cash flows will include those from continuing use of the asset and from its disposal at the end of its useful life.

The following elements shall be reflected in the calculation of an asset's value-in-use:

- an estimate of the future cash flows the entity expects to derive from the asset;
- expectations about possible variations in the amount or timing of those future cash flows;
- the time value of money, represented by the current market risk free rate of interest;
- the price for bearing the uncertainty inherent in the asset; and
- other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

Estimating the value-in-use of an asset involves the following steps:

- estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
- applying the appropriate discount rate to those future cash flows.

The elements identified can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, e.g. the weighted average of all possible outcomes.

In measuring the estimates of future cash flows the following should be considered:

- base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.
- base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the

asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.

- estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.

Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information rate is zero or negative.

When conditions are favourable, competitors may enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used.

In using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

The composition of estimates of future cash flows shall include:

- projections of cash inflows from the continuing use of the asset;
- projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and
- net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate

includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the affect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale, e.g. this is the case for a building under construction or for a development project that is not yet completed.

To avoid double-counting, estimates of future cash flows do not include:

- cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (e.g., financial assets such as receivables); and
- cash outflows that relate to obligations that have been recognised as liabilities (for example, payables, pensions or provisions).

Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

- a future restructuring to which an entity is not yet committed; or
- improving or enhancing the asset's performance.

Because future cash flows are estimated for the asset in its current condition, value-in-use does not reflect:

- future cash outflows or related cost savings (e.g., reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or
- future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

A restructuring is a program that is planned and controlled by management and materially changes either the scope of the business undertaken by an entity or the manner in which the business is conducted.

When an entity becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the entity is committed to the restructuring:

- its estimates of future cash inflows and cash outflows for the purpose of determining value-in-use reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts approved by management); and
- its estimates of future cash outflows for the restructuring are included in a restructuring provision.

Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits associated with the cash outflow.

Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-today servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

Estimates of future cash flows shall not include:

- cash inflows or outflows from financing activities; or
- income tax receipts or payments.

Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also determined on a pre-tax basis.

The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.

The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's fair value less costs to sell, except that, in estimating those net cash flows:

- an entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used; and
- the entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

The discount rate

The discount rate (rates) shall be a pre-tax rate(s) that reflect(s) current market assessments of:

- the time value of money; and
- the risks specific to the asset for which the future cash flow estimates have not been adjusted.

A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the entity expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets.

However, the discount rate(s) used to measure an asset's value-in-use shall not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate.

b) Calculation of recoverable service amount in terms of IPSAS 21 (i.e. non-cash-generating assets)

The demand or need for services may fluctuate over time, which will affect the extent to which non-cash-generating assets are used in providing those services. Negative fluctuations in demand however, are not necessarily indications of impairment. Where demand for services ceases, or nearly ceases, the assets used to provide those services may be impaired. Demand may be considered to have "nearly" ceased when it is so low that no attempt has been made to respond to that demand, or would not have acquired the asset being considered for impairment testing.

There may be other indications that an asset may be impaired. The existence of other indications may result in estimating the asset's recoverable service amount, e.g. any of the following may be an indication of impairment:

- during the period, that an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use; or
- a significant long-term decline (but not necessarily a cessation or near cessation) in the demand for or need for services provided by the asset.

The events or circumstances that may indicate an impairment of an asset will be significant and will often have prompted discussion by the management or media. A change in a parameter such as demand for the service, extent or manner of use, legal environment or government policy environment would indicate impairment only if such a change was significant and had or was anticipated to have a long-term adverse effect. A change in the technological environment may indicate that an asset is obsolete, and requires testing for impairment. A change in the use of an asset during the period may also be an indication of impairment. This may occur when, e.g. a building used as a school undergoes a change in use and is used for storage. In assessing whether

impairment has occurred, the municipality needs to assess changes in service potential over the long term. This underlines the fact that the changes are seen within the context of the anticipated long-term use of the asset. However, the expectations of long-term use can change and the entity's assessments would be reconsidered at each reporting date

In assessing whether a halt in construction would trigger an impairment test, consideration needs to be given to whether or not construction has been delayed or postponed, whether there is an intention to resume construction in the near future or whether the construction work will not be completed in the foreseeable future. Where construction is delayed or postponed to a specific future date, the project may be treated as work in progress and is not considered as halted.

Evidence from internal reporting that indicates that an asset may be impaired, relates to the ability of the asset to provide goods or services rather than to a decline in the demand for the goods or services provided by the asset. This includes the existence of:

- significantly higher costs of operating or maintaining the asset, compared with those originally budgeted; and
- significantly lower service or output levels provided by the asset compared with those originally expected due to poor operating performance.

A significant increase in operating costs of an asset may indicate that the asset is not as efficient or productive as initially anticipated in output standards set by the manufacturer, in accordance with which the operating budget was drawn-up. Similarly, a significant increase in maintenance costs may indicate that higher costs need to be incurred to maintain the asset's performance at a level indicated by its most recently assessed standard of performance. In other cases, direct quantitative evidence of impairment may be indicated by a significant long-term fall in the expected service or output levels provided by the asset.

The concept of materiality applies in identifying whether the recoverable service amount of an asset needs to be estimated, e.g. if previous assessments show that an asset's recoverable service amount is significantly greater than its carrying amount, the municipality need not re-estimate the asset's recoverable service amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable service amount is not sensitive to one (or more) of the indicators.

If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset needs to be reviewed and adjusted, even if no impairment loss is recognised for the asset.

Measuring the recoverable service amount

Recoverable service amount is the higher of an asset's fair value less costs to sell and its value-in-use. It is not always necessary to determine both an asset's fair value less costs to sell and its value-in-use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the municipality may use the asset's value-in-use as its recoverable service amount.

If there is no reason to believe that an asset's value-in-use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable service amount. This will often be the case for an asset that is held for disposal. This is because the value-in-use of an asset held for disposal will consist mainly of the net disposal proceeds. However, for many public sector non-cash generating assets which are held on an ongoing basis to provide specialised services or public goods to the community, the value-in-use of the asset is likely to be greater than its fair value less costs to sell.

In some cases, estimates, averages and computational shortcuts may provide reasonable approximations of the detailed computations for determining fair value less costs to sell or value-in-use.

Fair value less costs to sell

The fair value less cost to sell is the amount obtained from the sale of an asset or cash-generating unit in an arm's length transaction between a willing buyer and seller, less the costs of disposal. [refer to ANNEXURE 8]

The costs of disposal are the incremental costs that are directly attributable to the disposal of the asset. It excludes however, finance costs and income tax expense.

The best evidence of an asset's fair value less costs to sell is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.

If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that could be obtained, at reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, consideration could be given to the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale, unless management is compelled to sell immediately.

Costs of disposal, other than those that have been recognised as liabilities, are deducted in determining fair value less costs to sell, e.g. such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganising an activity following the disposal of an asset are not direct incremental costs to dispose of the asset.

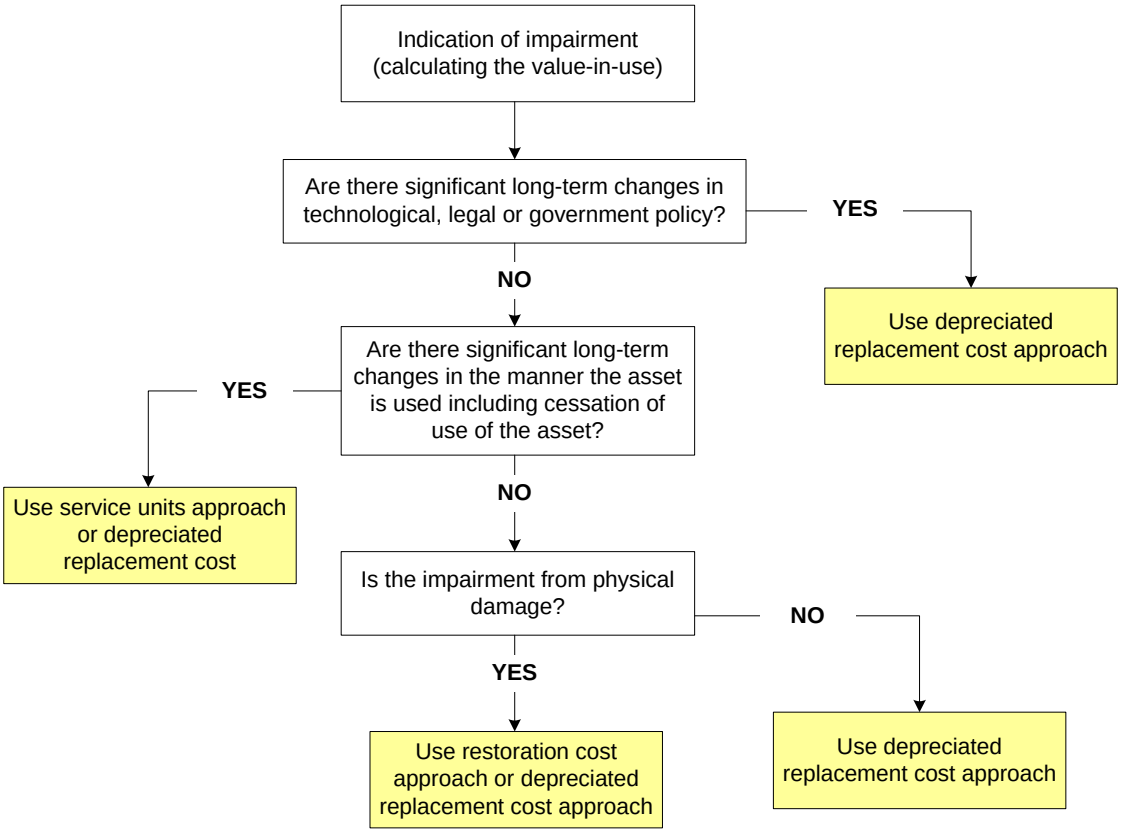
Value-in-use

	The value-in-use [of a non-cash-generating-asset] is the present value of the non-cash-generating asset's remaining service potential.

There are three approaches that may be used to determine the value-in-use. The approach to be selected depends on the availability of data and the nature of the impairment. The three approaches are:

- depreciated replacement cost approach;
- restoration cost approach; or
- service units approach

Decision tree on selecting the appropriate approach:



Depreciated replacement cost approach

Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. The replacement cost of an asset is the cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the existing asset or through replacement of its gross service potential. The depreciated replacement cost is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost, to reflect the already consumed or expired service potential of the asset.

The replacement cost and reproduction cost of an asset are determined on an "optimised" basis. The rationale is that the asset would not be replaced or reproduced with a like asset if the asset to be replaced or reproduced is an overdesigned or overcapacity asset. Overdesigned assets contain features which are unnecessary for the goods or services the asset provides. Overcapacity assets are assets that have a greater capacity than is necessary to meet the demand for goods or services the asset provides. The determination of the replacement cost or reproduction cost of an asset on an optimised basis thus reflects the service potential required of the asset.

In certain cases, standby or surplus capacity is held for safety or other reasons. This arises from the need to ensure that adequate service capacity is available in the particular circumstances of the entity, e.g. the fire department needs to have fire engines on standby to deliver services in emergencies. Such surplus or standby capacity is part of the required service potential of the asset.

Restoration cost approach

Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment.

The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset, whichever is lower.

Service units approach

Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment, to conform to the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.

STEP 3 - *Recognising the impairment loss*

a) Recognising the impairment loss in terms of IAS 36 (i.e. cash-generating assets)

Allocating goodwill to cash-generating units

For the purpose of performing impairment tests, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units (or groups of cash-generating units) that are expected to benefit from the synergies of the business combination. This is done irrespective of whether the acquirer allocates other assets of the acquiree to those cash-generating units or groups of cash-generating units. Each such cash-generating unit to which the goodwill is allocated shall:

- represent the lowest level within the entity at which goodwill is monitored for internal management purposes; and
- not be larger than a primary or secondary segment.

Goodwill will not usually generate cash flows independently of other assets or groups of assets and often contributes to the cash flows of several cash-generating units. Consequently it may sometimes not be possible to reasonably and on a consistent basis allocate goodwill to individual cash-generating units, but it may be possible to allocate the goodwill to groups of cash-generating units.

In view of the above, goodwill will be tested for impairment at a level that reflects the way the entity manages its operations and with which the goodwill would naturally be associated. The recognition of the impairment of goodwill has become significantly more important as a result of the discontinuation of the amortisation of goodwill.

If goodwill has been allocated to a cash-generating unit and the entity disposes of a portion of the cash-generating unit, the associated goodwill for the portion of the cash-generating unit disposed of shall be:

included in the carrying amount of the operation disposed of when determining the gain or loss on disposal; and

- included in the carrying amount of the operation disposed of when determining the gain or loss on disposal; and
- measured on the basis of the split between the relative value of the operation disposed of and the portion of the cash-generating unit retained. This basis is used, unless another method better reflects the goodwill associated with the operation disposed of.

The principle applied when disposing of a portion of a cash-generating unit, will also be applied when an entity reorganises its reporting structure to change the composition of one or more cash-generating units to which goodwill has been allocated. The goodwill shall thus be reallocated to the cash-generating units affected. The reallocation will take place on the same basis as that used when disposing of part of a cash-generating unit.

Cash-generating units with no goodwill allocated to them

Sometimes goodwill can not be allocated to a cash-generating unit on a reasonable and consistent basis, even though goodwill relates to such a cash-generating unit. Goodwill will under these circumstances be allocated to a group of cash-generating units which contains, amongst others, the cash-generating unit to which goodwill could not be allocated.

For the smaller cash-generating units (not including allocated goodwill), testing for impairment will only take place whenever there is an indication that the cash-generating may be impaired, by comparing its carrying amount (excluding goodwill) with its recoverable amount. Any impairment loss will be allocated to the assets of this smaller cash-generating pro-rata, based on the carrying amounts of the assets in the assets in the cash-generating unit. Note that since there is no goodwill in the cash-generating unit, the impairment loss need not first be allocated to the goodwill contained in the cash-generating unit.

Cash-generating units to which goodwill has been allocated

A cash-generating unit to which goodwill has been allocated (it may comprise several smaller cash-generating units to which goodwill could not be allocated on a reasonable and consistent bases) shall be tested for impairment annually and also whenever there is an indication that the cash-generating unit may be impaired. The impairment testing is done by comparing the carrying amount of the cash-generating unit including goodwill, with the recoverable amount of the unit. The basic principals being:

- if the recoverable amount of the cash-generating unit exceeds the carrying amount of the cash-generating unit, the cash generating unit and the goodwill allocated to the cash-generating unit shall be regarded as not being impaired.
- if the carrying amount of the cash-generating exceeds the recoverable amount of the cash-generating unit, the cash-generating unit and the goodwill allocated to the cash-generating unit shall be regarded as impaired. Consequently the entity shall recognise the resulting impairment loss in the following manner:
    - firstly against the goodwill allocated to the cash-generating unit; and
    - secondly to the other assets in the cash-generating unit, pro-rata on the basis of the carrying amount of each asset.

When both tests are required, the cash-generating unit without the allocation of goodwill (smaller cash generating unit) will be tested for impairment first, provided there is an indication of impairment. The carrying amounts of the assets in the smaller cash-generating units are adjusted for impairment and included in the bigger cash-generating units (including allocated goodwill) and this cash-generating unit is then tested for impairment.

Recognition of an impairment loss for cash-generating units and the allocation thereof

An impairment loss for a cash-generating unit to which goodwill (or corporate asset if applicable) has been allocated, will arise when the carrying amount of the cash-generating unit exceeds the recoverable amount of the cash-generating unit or put differently, if the recoverable amount is less than the carrying amount of the cash-generating unit (our groups of cash-generating units).

The impairment loss identified will be allocated to reduce the carrying amounts of the assets in the cash-generating unit in the following order:

- firstly to reduce the amount of goodwill allocated to the cash-generating unit (or group of units); and
- secondly to other assets of the unit (or group of units) pro-rata on the basis of the carrying amount of each asset in the unit (or group of units).

The above reduction in carrying amounts will be treated as impairment losses on individual assets and recognised in profit or loss or revaluation surplus.

If an impairment loss has been allocated, it is necessary to test that the carrying amount of any individual asset in the cash-generating unit is not reduced to below the highest of:

- its fair value less costs to sell;
- its value-in-use (if applicable); and
- nil.

Should the allocation of an impairment loss result in a carrying amount of an individual asset in the cash-generating unit being reduced below any of the above limits, the excess should be reallocated to the other assets in the cash-generating unit or group of cash-generating units on a pro-rata basis.

Where a non-cash-generating asset contributes to a cash generating unit a proportion of the carrying amount of that non-cash generating asset shall be allocated to the carrying amount of the cash generating unit prior to estimation of the recoverable amount of the cash-generating unit. The carrying amount of the non-cash-generating asset shall reflect any impairment losses at the reporting date which have been determined.

If the recoverable amount of an individual asset cannot be determined:

- an impairment loss is recognised for the asset if its carrying amount is greater than the higher of its fair value less costs to sell; and
- no impairment loss is recognised for the asset if the related cash generating unit is not impaired. This applies even if the asset's fair value less costs to sell is less than its carrying amount.

For **example**, a holding tank at a water purification plant has suffered physical damage but is still working, although not as well as before it was damaged. The holding tank's fair value less costs to sell is less than its carrying amount. The holding tank does not generate independent cash inflows. The smallest identifiable group of assets that includes the holding tank and generates cash inflows that are largely independent of the cash inflows from other assets is the plant to which the holding tank belongs.

The recoverable amount of the plant shows that the plant taken as a whole is not impaired.

Assumption 1:

Budgets/forecasts approved by management reflect no commitment of management to replace the holding tank. The recoverable amount of the holding tank alone cannot be estimated because the holding tank's value-in-use may differ from its fair value less costs to sell and can be determined only for the cash-generating unit to which the holding tank belongs (the water purification plant).

The plant is not impaired. Therefore no impairment loss is recognised for the holding tank. The depreciation period may need to be reassessed or the depreciation method for the holding tank. Perhaps a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the holding tank or the pattern in which economic benefits are expected to be consumed by the entity.

Assumption 2:

Budgets/forecasts approved by management reflect a commitment of management to replace the holding tank and sell it in the near future. Cash flows from continuing use of the holding tank until its disposal are estimated to be negligible.

The holding tank's value-in-use can be estimated to be close to its fair value less costs to sell. Therefore, the recoverable amount of the holding tank can be determined and no consideration is given to the cash-generating unit to which the holding tank belongs (i.e. the production line). Because the holding tank's fair value less costs to sell is less than its carrying amount, an impairment loss is recognised for the holding tank.

In some cases non-cash-generating assets contribute to cash-generating units. Where a cash-generating unit subject to an impairment test contains a non-cash-generating asset, that non-cash generating asset is firstly tested for impairment. A proportion of the carrying amount of that non-cash-generating asset, following that impairment test, is included in the carrying amount of the cash-generating unit. The proportion reflects the extent to which the service potential of the non-cash-generating asset contributes to the cash-generating unit. The allocation of any impairment loss for the cash-generating unit is then made on a pro-rata basis to all cash-generating-assets in the cash-generating unit. The non-cash generating asset is not subject to a further impairment loss beyond that which has been determined.

Timing of impairment test for a cash-generating unit

The basic rules in respect of the timing of impairment tests for cash-generating units are the following:

- The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during the annual period provided the test is performed at the same time every year. This means that if the year-end of a cash-generating unit falls on 30 June, the impairment test need not be performed on 30 June, but may be performed at any other time during the year, e.g. 31 May. However, if it is decided to perform the test on 31 May, the test must be performed consistently on 31 May.
- Different cash-generating units may be tested at different times in the year, for instance some cash-generating units may be tested on 31 May, some on 30 April and some on 30 June, although all of these cash-generating units may be part of the same group of entities.
- If some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current financial year, that cash-generating unit shall be tested for impairment before the end of the current financial year, e.g. if the cash-generating unit was acquired on 31 October 20x7 and the year end is 30 June 20x8, the cash-generating must be tested for impairment for the first time on 30 June 20x8.
- If the individual assets constituting a cash-generating unit to which goodwill has been allocated are tested for impairment because there are indications of impairment for those individual assets and at the same time the unit containing the goodwill is tested for impairment, the individual assets shall be tested for impairment before the cash-

generating unit containing the goodwill is tested. This obviously implies that the carrying amounts of the individual assets are reduced by their related impairment losses before calculating the impairment loss of the cash-generating unit.

b) Recognising the impairment loss in terms of IPSAS 21 (i.e. non-cash-generating assets)

If, the recoverable service amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable service amount. This reduction is an impairment loss. The municipality is required to make a formal estimate of recoverable service amount only if an indication of a potential impairment loss is present. An impairment loss shall be recognised immediately in surplus or deficit.

Where the estimated impairment loss is greater than the carrying amount of the asset, the carrying amount of the asset is reduced to zero with a corresponding amount recognised in surplus or deficit. After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

STEP 4 – *Calculating the recoverable amount or recoverable service amount when there is an indication that the prior years impairment may need to be reversed*

In assessing whether there is an indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, the following indications should be considered:

External sources (cash-generating asset)	**External sources (non-cash-generating asset)**
• the asset's market value has increased significantly during the period;	• resurgence of demand or need for services provided by the asset;
• significant changes with a favourable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;	• significant long-term changes with a favourable effect on the entity have taken place during the period, or will take place in the near future, in the technological, legal or government policy environment in which the entity operates;
• market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value-in-use and increase the asset's recoverable amount materially.	

Internal sources (cash-generating asset)	**Internal sources (non-cash-generating asset)**
• significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs;	• significant long-term changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or in a manner in which, the asset used or is expected to be used. These changes include costs incurred during the period to improve or enhance an asset's performance or restructure the operation to which the asset belongs;
• evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.	• a decision to resume construction of the asset that was previously halted before it was completed or in a usable condition;
	• evidence is available from internal reporting that indicates that the service performance of the asset is, or will be, significantly better than expected.

If there is an indication that an impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted.

An impairment loss recognised in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount or recoverable service amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount or recoverable service amount. This increase is a reversal of the impairment loss.

A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or from sale, since the date of the last recognised an impairment loss for that asset. The changes in estimates needs to be identified that that causes the increase in estimated service potential. Examples of changes in estimates include:

- a change in the basis for recoverable amount or recoverable service amount (e.g. whether recoverable amount is based on fair value less costs to sell or value-in-use);
- if recoverable amount was based on value-in-use, a change in the amount or timing of estimated future cash flows or in the discount rate;
- if recoverable amount or recoverable service amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell;

An asset's value-in-use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

a) Reversing the impairment loss in terms of IAS 36 (i.e. cash-generating assets)

Reversing an impairment loss for an individual asset

The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

Any increase in the carrying amount of an asset above the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognised for the asset in prior years is a revaluation.

A reversal of an impairment loss for an asset shall be recognised immediately in surplus or deficit.

After a reversal of an impairment loss is recognised, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversing an impairment loss for a cash-generating unit

The reversal of impairment losses for cash-generating units is similar to that of individual assets. However, due to problems particular to cash-generating units, some additional guidance is necessary.

When the impairment loss of a cash-generating unit is reversed, the reversal should be allocated to the carrying amounts of the assets in the unit, except for goodwill as follows:

- assets other than goodwill are increased on a pro-rata basis, based on their carrying amounts in the units; and
- goodwill that is allocated to the unit is never reinstated. This is to avoid recognising internally generated goodwill which is prohibited.

When the reversal of an impairment loss for a cash-generating unit is allocated to the assets in the unit, the carrying amounts of the assets should not increase above the lower of:

- its recoverable amount; and
- the carrying amount that would have been determined had no impairment loss been recognised in prior periods.

If the carrying amount of individual asset's increases above the amount stated above, the residual is allocated to the remaining assets (except goodwill) in the unit on a pro-rata basis.

Where goodwill has been written down to recoverable amount in the interim financial statements the amount may not be reversed in the second part of the financial year.

Corporate assets

Corporate assets that relate to cash-generating units, e.g. head office buildings, computer centres or research facilities should be identified and the appropriate proportion allocated to individual cash-generating units that are being reviewed for impairment.

	Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.

The structure of the municipality determines whether an asset meets this definition for a particular cash-generating unit. The key characteristics of corporate assets are that they do not generate cash inflows independently of other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit that is being reviewed for impairment.

Corporate assets do not generate cash flows independently, it is not possible to determine their recoverable amount and therefore whether or not such assets are impaired. This is only possible where management has decided to dispose of them and there is external evidence of their fair values less costs to sell available form third parties. Thus, where there is no intention to dispose of the asset, an impairment review can only be done in conjunction with a review of the cash-generating unit or those the corporate asset relate.

An approach to allocate corporate assets similar to that of goodwill is:

- If the carrying amount of the corporate asset can be allocated to the cash-generating unit on a reasonable and consistent basis the entity should compare the recoverable amount of the cash-generating unit, with the carrying amount of the cash-generating unit including the portion of corporate assets. Any impairment loss arising is then recognised.
- If corporate assets cannot be allocated on a reasonable and consistent basis to the cash-generating unit, the entity should apply a two-stage test, firstly comparing the recoverable amount of the cash-generating unit with the carrying value of its net assets (excluding any allocation of corporate assets) and recognises any impairment loss resulting from the comparison and then identifies the next smallest group of cash-generating units that contains the cash-generating unit under review and to which corporate assets can be allocated on a reasonable and consistent basis, compares the recoverable amount of their net assets (including the allocation of corporate assets) and recognises any further impairment loss resulting from that comparison.

b) Reversing the impairment loss in terms of IPSAS 21 (i.e. non-cash-generating assets)

Indications of a potential decrease in an impairment loss mainly mirror the indications of a potential impairment loss. Other indications may be identified of a reversal of an impairment loss that would also require the re-estimate of the asset's recoverable service amount, e.g. either of the following may be an indication that the impairment loss may have reversed:

- a significant rise in an asset's market value; or
- a significant long-term increase in the demand or need for the services provided by the asset.

A commitment to discontinue or restructure an operation in the near future is an indication of a reversal of an impairment loss of an asset belonging to the operation where such a commitment constitutes a significant long-term change, with a favourable effect, in the extent or manner of use of the asset. Circumstances where such a commitment would be an indication of reversal of impairment often relate to cases where the expected discontinuance or restructuring of the operation would create opportunities to enhance the use of the asset.

If there is an indication that an impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted, even if no impairment loss is reversed for the asset.

An impairment loss recognised in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable service amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, be increased to its recoverable service amount. That increase is a reversal of an impairment loss.

The municipality is required to make a formal estimate of recoverable service amount only if an indication of a reversal of an impairment loss is present. A reversal of an impairment loss reflects an increase in the estimated recoverable service amount of an asset, either from use or from sale, since the date when an entity last recognised an impairment loss for that asset.

Examples of changes in estimates include:

- a change in the basis for recoverable service amount (e.g. whether recoverable service amount is based on fair value less costs to sell or value-in-use);
- if a recoverable service amount was based on value-in-use, a change in estimate of the components of value-in-use; or
- if recoverable service amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.

The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised for the asset in prior periods.

A reversal of an impairment loss for an asset shall be recognised immediately in surplus or deficit. After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Redesignation of assets

The redesignation of assets from cash-generating assets to non-cash-generating assets or vice versa only occurs when there is clear evidence that such a redesignation is appropriate. A redesignation does not necessarily trigger an impairment test or a reversal of an impairment loss. The indication for an impairment test or a reversal of an impairment loss arises from, the listed indications applicable to the asset after redesignation.

For **example**, there are circumstances in which the municipality may decide that it is appropriate to redesignate a non-cash-generating asset as a cash-generating asset, e.g. an effluent treatment plant was constructed primarily to treat industrial effluent from a social housing unit, for which no charge is made. The social housing unit has been demolished and the site will be redeveloped for industrial and retail purposes. It is intended that, in future, the plant will be used to treat industrial effluent at commercial rates. In the light of this decision, the entity decides to redesignate the effluent treatment plant as a cash-generating-asset.

2.1.10 AFS DISCLOSURE REQUIREMENTS

Ensure that the following is disclosed in the AFS:

- the measurement bases used for determining the gross carrying amount of PPE;
- the depreciation methods used;
- the useful lives or the depreciation rates used;
- the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- a reconciliation of the carrying amount at the beginning and end of the period showing:
  - additions;
  - assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;
  - increases or decreases resulting from revaluations and from impairment losses recognised or reversed directly in equity in accordance with http://handbook.saica.co.za/nxt/gateway.dll/7hda/2amba/8hda/63d3/z6d3/t7d3 - 0IAS 36;
  - impairment losses recognised in profit or loss in accordance with http://handbook.saica.co.za/nxt/gateway.dll/7hda/2amba/8hda/63d3/z6d3/t7d3 - 0 IAS 36;
  - impairment losses reversed in profit or loss in accordance with http://handbook.saica.co.za/nxt/gateway.dll/7hda/2amba/8hda/63d3/z6d3/t7d3 - 0 IAS 36;
  - depreciation; and
  - other changes.
- the existence and amounts of restrictions on title, and PPE pledged as security for liabilities;
- the amount of expenditures recognised in the carrying amount of an item of PPE in the course of its construction;
- the amount of contractual commitments for the acquisition of PPE; and
- if it is not disclosed separately on the face of the statement of financial performance, the amount of compensation from third parties for items of PPE that were impaired, lost or given up that is included in profit or loss.

Identify the amount of contractual commitments for PPE at each year-end. The orders placed and contracts entered into by the municipality that was not delivered and provided for at year end should be identified and quantified and disclosed in a note to the financial statements.

Disclosure requirements: cash-generating assets vs non-cash-generating assets

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
1.	**Statement of financial performance**		
1.1	[2]The amount of an impairment losses recognised in the statement of financial performance during the period, and the line item(s) of the statement of financial performance in which those impairment losses are included.	Yes	Yes
1.2	[3]The amount of reversals of impairment losses recognised in the statement of financial performance during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed.	Yes	Yes
2.	**Statement of changes in net assets**		
	The amount of impairment losses recognised directly in equity during the period.		
	The amount of reversals of impairment losses recognised directly in equity during the period.		
3.	**Notes to the financial statements**		
3.1	If the impairment loss recognised or reversed on an individual asset or cash-generating unit is material, the following additional information is provided for an individual asset, including goodwill, or a cash-generating unit:	Yes	Yes
3.1.1	A description of the events and circumstance that led to the recognition or reversal of the impairment loss.	Yes	Yes
3.1.2	The amount of the impairment loss recognised or reversed.	Yes	Yes
3.1.3	The nature of the asset.		Yes

[2] A class of assets, is a grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements. This information may be presented with other information disclosed for the class of assets, e.g. this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period.

[3] Refer to Foot note 1.

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
3.1.4	Whether the recoverable amount of the asset or cash-generating unit is its fair value less costs to sell or its value-in-use.	Yes	Yes
3.1.5	If the recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell.	Yes	Yes
3.1.6	If the recoverable amount is value-in-use, the discount rate(s) used in the current estimate and previous estimate (if any) or value-in-use.	Yes	Yes
3.1.7	For a cash-generating asset: • the nature of the asset; and • if the entity reports segment information in accordance with IPSAS 18, the reported segment to which the asset belongs, based on the entity's reporting format.	Yes	
3.1.8	For a cash-generating unit: • a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reported segment); • the amount of the impairment loss recognized or reversed by class of assets, and, if the entity reports segment information in accordance with IPSAS 18, by reported segment based on the entity's reporting format; and • if the aggregation of assets for identifying the cash generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), a description of the current and former way of aggregating assets and the reasons for changing the way the cash generating unit is identified.	Yes	

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
3.2	If impairment losses recognised (reversed) during the period are not material in aggregate to the financial statements of the reporting entity as a whole, disclosure of the following:	Yes	Yes
3.2.1	The main classes of assets affected by impairment a loss (reversals of impairment losses) for which no information is disclosed in terms of the above.	Yes	Yes
3.2.2	The main events and circumstances that led to the recognition (reversal) of these impairment losses for which no information is disclosed in terms of the above.	Yes	Yes
3.2.3	An entity is encouraged to disclose the key assumptions used to determine the recoverable amount of assets/cash-generating units in the period.	Yes	Yes
3.2.4	If an initial allocation of goodwill, any portion of good will has not been allocated to a cash-generating unit or group of cash-generating units at the reporting date, the amount of unallocated goodwill shall be disclosed together with reasons why the amount remains unallocated.	Yes	Yes
3.3	In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return and judgement may be needed to distinguish. In such cases the disclosure of the criteria used for distinguishing cash-generating and non-cash-generating assets is required.	Yes	
4.	**Accounting policy**		
4.1	Disclosure of the criteria developed by the entity to distinguish non-cash-generating assets from cash-generating assets.	Yes	
4.2	An entity shall disclose the information required above for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives.	Yes	
4.2.1	The carrying amount of goodwill allocated to the unit (group of unit);	Yes	
4.2.2	the carrying amount of intangible assets with indefinite useful lives allocated to	Yes	

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
	the unit (group of units);		
4.2.3	the basis on which the unit's (group of units') recoverable amount has been determined, e.g. value-in-use or fair value less costs to sell;	Yes	
4.2.4	if the unit's (group of units) recoverable amount is based on value-in-use: • a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive; • a description of management's approach to determining the value(s) assigned to each key assumption, whether those values reflect past experience or, if appropriate are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information; • the period over which management has projected cash flows based on financial budgets/forecasts approved by management and when a period greater than five years is used for cash-generating unit (group of units), and explanation of why that longer period is justified; • the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or	Yes	

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
	for the market to which the unit (group of units) is dedicated; and • the discount rate(s) applied to the cash flow projections.		
4.3	If the unit's (group of units) recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit (group of units), the following information shall also be disclosed:	Yes	
4.3.1	a description of each key assumption on which management has based its determination of fair value less costs to sell; and	Yes	
4.3.2	a description of management's approach to determining the value(s) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.	Yes	
4.4	If a reasonable possible change in a key assumption on which management has based its determination of the unit's (group of units) recoverable amount would cause the unit's (group of units') carrying amount to exceeds its recoverable amount: • the amount by which the unit's (group of units') recoverable amount exceeds its carrying amount; • the value assigned to the key assumption; and • the amount by which the value assigned to the key assumptions must change, after incorporating any consequential effects of that change on the other variables used to measure the recoverable amount, in order for the unit's (group of units) recoverable amount to be equal to its carrying amount.	Yes	

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
4.5	If some or all of the carrying amount of goodwill or intangible assets with indefinite useful lives is allocated across multiple cash-generating units (groups of units), and the amount so allocated to each unit (group of units) is not significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units). In addition, the recoverable amounts of any of those units (groups of units) are based on the same key assumption(s) and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose the fact, together with: a. the aggregate carrying amount of goodwill allocated to those unites (groups of units); b. the aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units (groups of units); c. a description of the key assumption(s); d. a description of management's approach to determining the value(s) assigned to the key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information; and e. if a reasonably possible change in the key assumption(s) would cause the aggregate of the unit's (group of units') carrying amounts to exceed the aggregate of their recoverable amounts:	Yes	

	Disclosure requirement	Cash-generating assets	Non-cash-generating assets
	• the amount by which the aggregate of the unit's (group of units') recoverable amount exceeds the aggregate of their carrying amounts; • the value(s) assigned to the key assumption(s); and • the amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variable used to measure the recoverable amount, in order for the aggregate of the unit's (group of units') recoverable amounts to the aggregate of their carrying amounts.		
4.6	The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit may, be carried forward and used in the impairment test for that unit in the current period provided specified criteria are met. When this is the case, the information for that unit that is incorporated into the disclosures relate to the carried forward calculation of recoverable amount.	Yes	
5.	**Segment reporting**		
5.1	An entity that reports segment information in accordance with the Standard of GRAP on Segment Reporting shall disclose the following for each segment reported by the entity:	Yes	Yes
5.1.1	The amount of impairment losses recognised in surplus or deficit during the period.	Yes	Yes
5.1.2	The amount of reversals of impairment losses recognised in surplus or deficit during the period.	Yes	Yes

When an entity takes advantage of the transitional provision **in GAMAP 17 it must disclose the following:**

- The fact that it has taken advantage of the transitional provision in GAMAP 17
- Information on the progress made on the major classes of assets that have not been recognised by virtue of GAMAP 17 transitional provision.

When an entity takes advantage of GAMAP 17 transitional provision for a second reporting period, details of the classes of assets that were not recognised at the previous reporting date but which are now recognised.

2.1.11 EXEMPTIONS RELATED TO THE IMPLEMENTATION OF GAMAP 17

Refer to section 2.1.1 Overview of the accounting for PPE, for a discussion on the exemptions related to the implementation of GAMAP 17.

For **municipalities making use of the exemptions** granted for GAMAP 17, the interim requirements applicable during the exemption period are as follows:

- Previous adjustments to depreciation charges due to revised estimations of useful lives may not be reversed.
- Previous adjustments to depreciation charges due to revised depreciation methods may not be reversed.
- Regarding the exemption of impairment of non-cash generating assets, voluntary narrative disclosure may be included in the 'PPE' note about impaired items of PPE.
- Regarding the exemption of impairment of cash generating assets, voluntary narrative disclosure may be included in the 'PPE' note if the entity is aware that an item of PPE is impaired.
- Certain disclosures, set out in the communication from National Treasury, titled 'Application of accounting standards (updated August 2007)', must be made as part of the 'Property, plant and equipment' accounting policy in respect of each of the PPE exemptions.

From 1 July 2008 (reporting date 30 June 2009) **GRAP 17, on Property, plant and equipment,** becomes effective for High capacity and Medium capacity municipalities, while for Low capacity municipalities it becomes effective from 1 July 2009 (reporting date 30 June 2010).

The **transitional provisions** of GRAP 17 states that all changes resulting from the application of the Standard of GRAP on Property, Plant and Equipment shall be accounted for in accordance with the requirements of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (therefore **retrospectively**).

Entities that applied the **transitional provisions in GAMAP 17** on Property, Plant and Equipment (refer to section 2.1.2 (b)) may continue to take advantage of those transitional provisions until they expire.

- **Low and medium capacity** municipalities are however allowed **three years** from the date of initial adoption of GRAP 17 to comply with the measurement requirements of the Standard.
- Certain **disclosures**, as set out in Directives 3 and 4 of the ASB, are required if transitional provisions of GRAP 17 are applied.

ANNEXURE 1: Examples with regard to accounting treatment of assets

Example 1a: Unbundling of loans redeemed and other capital receipts

Assume that a Municipality has reconciled its Loans Redeemed and Other Capital Receipts to the Fixed Assets Register. The total of Loans Redeemed and Other Capital Receipts is listed in Table 1 below. Backlog depreciation has been calculated on the items of property, plant and equipment and appears in Table 2 below. The backlog depreciation is funded from the Loans Redeemed and Other Capital Receipts through the accumulated surplus/deficit and the residual transferred to either Government Grants Reserve or Public Contributions and Donations Reserve or the Accumulated Surplus/Deficit.

Table 1: Summary of Loans Redeemed and Other Capital Receipts

External Loans Redeemed	50,000
Contributions from Revenue	10,000
Government Grants	250,000
Public Contributions	25,000

Table 2: Summary of Backlog Depreciation

External Loans Redeemed	45,000
Contributions from Revenue	6,000
Government Grants	40,000
Public Contributions	18,000

The following journal entries will be processed against the various Loans Redeemed and Other Capital Receipts accounts:

External Loans Redeemed	**Debit**	**Credit**
Loans Redeemed (internal)	50,000	
Accumulated surplus/deficit		50,000
Accumulated surplus/deficit	45,000	
Accumulated Depreciation		45,000

Contributions from Revenue	**Debit**	**Credit**
Contributions from revenue	10,000	
Accumulated surplus/deficit		10,000
Accumulated surplus/deficit	6,000	
Accumulated Depreciation		6,000

Government Grants	**Debit**	**Credit**
Government Grants	250,000	
Accumulated surplus/deficit		250,000
Accumulated surplus/deficit	250,000	
Government Grants Reserve (Carrying value of assets funded from Grants)		210,000
Accumulated Depreciation		40,000

Public Contributions	**Debit**	**Credit**
Public Contributions	25,000	
Accumulated surplus/deficit		25,000
Accumulated surplus/deficit	25,000	
Public Contributions and Donations Reserve (Carrying value of assets funded from Public Contributions and Donations)		18,000
Accumulated Depreciation		7,000

Once these journal entries have been processed:

- Loans Redeemed and Other Capital Receipts will have a zero balance;
- Backlog depreciation will have been created; and
- The various Reserves required in terms of the principles of accounting for Property, Plant and Equipment will have been created.

Example 1b: Assets funded from revenue contributions

	Previously assets funded from revenue contributions were expensed through the Statement of Financial Performance once they were purchased (Debit the income statement & credit Bank). On raising the asset the corresponding asset cost was credited to a revenue contributions fund account (Debit asset & Credit Revenue contributions). Assume that a municipality has an item of PPE, purchased on 1 July 1994 at a cost of R 1500 000.

The backlog or accumulated depreciation will be calculated as follows as at 30 June 2003 based on straight line depreciation and a useful life of 20 years:

(R 1500 000 / 20 years) * 9 years = R 675 000. This means that the asset should be reflected at a book value of R 825 000 at 30 June 2003. (Cost R 1500 000 less accumulated depreciation of R 675 000).

A transfer of R 675 000 needs to be made from Revenue Contributions to Accumulated Depreciation (Revenue Contributions Debit & Accumulated Depreciation Credit).The remaining R 825 000 needs to be transferred to Accumulated Surplus as this represents the depreciation that will still be written off via the income statement i.r.o. this asset. This credit to the accumulated surplus will offset future depreciation and will not affect tariffs as consumers have already paid for this asset.

Example 1c: Assets funded public contributions/donations

	Previously assets funded from public contributions/ donations were raised by debiting an asset account and crediting a public contributions/ donations account. Assume that a municipality has an item of PPE donated to it on 1 July 1994 at a cost of R 1500 000.

The backlog or accumulated depreciation will be calculated as follows as at 30 June 2003 based on straight line depreciation and a useful life of 20 years:

(R 1500 000 / 20 years) * 9 years = R 675 000.

This means that the asset should be reflected at a book value of R 825 000 at 30 June 2003. (Cost R 1500 000 less accumulated depreciation of R 675 000). A transfer of R 675 000 needs to be made from Public Contributions to Accumulated Depreciation

(Public Contributions Debit & Accumulated Depreciation Credit).The remaining R 825 000 needs to be transferred to a Donations and Public Contributions Reserve as this represents the depreciation that will still be written off via the income statement i.r.o. this asset. An amount equal to each future year's depreciation that will be written off on this asset of R 75 000 (R 875 000 / 11 years) needs to be transferred annually from the Reserve to the Accumulated Surplus on the Statement of Changes in Net Assets.

Example 1d: Assets funded by external loans

The previous accounting treatment of assets funded by external loans is best explained by way of a practical example. Assume that a number of ambulances were purchased at a cost of R1 000 000 on I July 1999 and were financed by way of an external loan. The lifespan of the assets and the loan was originally estimated at 10 years. The loan is repayable at a fixed instalment of R 100 000 per annum in arrears commencing on 30 June 2000. Interest is calculated on the outstanding balance for the year before payment of the instalment at 10 % per annum. Furthermore we will assume that GAMAP will be implemented on 30 June 2003.

The journal entries to record the above transactions would have been as follows:

1/07/99	Bank Dr	R 1000 000	
	External Loan Cr		R 1000 000
	Being the receipt of the proceeds of the loan.		
1/07/99	PPE Dr	R 1000 000	
	Bank Cr		R 1000 000
	Being the purchase of the ambulances.		
30/06/00	I & E Dr	R 200 000	
	Bank Cr		R 200 000
	Being the redemption of the capital and interest portion of the loan.		
	(R100 000 capital and R 100 000 interest(R 1000 000 * 10%))		
30/06/00	External loan Dr	R 100 000	
	External loans redeemed Cr		R 100 000
	Being the recognition of the redemption of the external loan		

The net effect of the above entries on the balance sheet at 30 June 2000 is that the book value of the asset will be R 900 000.(PPE R 1000 000 less external loans redeemed of R 10 000)

The last two journal entries will be repeated for the years ended 30 June 2001, 2002 and 2003, with the only difference per year being the interest on the external loan as follows:

2001: R 900 000 * 10 % = R 90 000
2002: R 800 000 * 10 % = R 80 000
2003: R 700 000 * 10 % = R 70 000

The net effect of the above entries on the balance sheet at 30 June 2003 is that the book value of the asset will be R 600 000.(PPE R 1000 000 less external loans redeemed of R 400 000(R 100 000 per annum redemption * 4 years.)

The backlog or accumulated depreciation will be calculated as follows as at 30 June 2003 based on straight line depreciation and a useful life of 10 years:

(R 1000 000 / 10 years) * 4 years = R 400 000. This means that the asset should be reflected at a book value of R 600 000 at 30 June 2003. (Cost R 1000 000 less accumulated depreciation of R 400 000).

A transfer of R 400 000 needs to be made from External loans redeemed to Accumulated Depreciation (External loans redeemed Debit & Accumulated Depreciation Credit). The result is that the full balance on the external loans redeemed account will be transferred to accumulated depreciation as the lifespan of the loan and the lifespan of the asset are equal.

If the total lifespan of the asset, as estimated at 30 June 2003, is less than the original estimate of 10 years because of inadequate maintenance then the backlog depreciation will be calculated as follows at 30 June 2003 based on straight line depreciation and a total estimated useful life of eight years:

R 1000 000 / 8 years) * 4 years = R 500 000 = accumulated or backlog depreciation. This means that the asset should be reflected at a book value of R 500 000 at 30 June 2003. (Cost R 100 000 less accumulated depreciation of R 50 000).

A transfer of R 400 000 needs to be made from external loans redeemed to Accumulated Depreciation (External loans redeemed Debit & Accumulated Depreciation Credit). The result is that the full balance on the external loans redeemed account will be transferred to accumulated depreciation. An additional R 100 000 will need to be journalised (Depreciation Dr and Accumulated depreciation Cr.) as depreciation so that the accumulated depreciation balance will be correctly stated at R 500 000. (External loans redeemed of R 400 000 plus depreciation of R 100 000 = R 500 000 = Accumulated depreciation)

The book value of R 500 000 will now be depreciated over the remaining useful life of the asset of 4 years at R 125 000 per year. For future instalments on the loan the capital portion of each instalment will be set off against the external loan account and the interest portion through the statement of financial performance.

Example 1e: Assets funded by internal loans

The previous accounting treatment of assets funded by internal loans is best explained by way of a practical example. Assume that office furniture at a cost of R 100 000 was financed by way of an internal loan for the traffic department and was purchased on 1 July 1999. The lifespan of the asset and the loan was originally estimated at 10 years. The loan is repayable at a fixed instalment of R 10 000 per annum in arrears commencing on 30 June 2000.Interest is calculated on the average outstanding balance at year end at 10 % per annum. Furthermore we will assume that GAMAP will be implemented on 30 June 2003.

The journal entries to record the above transactions would have been as follows:

1/07/99	PPE Dr	R 100 000	
	Bank Cr		R 100 000
	Being the purchase of the office furniture.		
1/07/99	Advances to Traffic Dept.	R 100 000	
	Advances from CLF		R 100 000
	Being the advance of the internal loan.		
30/06/00	I & E Dr	R 10 000	
	Internal loans redeemed		R 10 000
	Being the redemption of the capital portion of the loan.		
30/06/00	Advances from CLF Dr	R 10 000	
	Advances to Traffic dept		R 10 000
	Being the recording of the repayment of the advance		
30/06/00	Interest internal advances (I&E)	R 9500	
	Interest CLF (I&E)		R 9500
	Being interest on the internal advance ((R 100 000 + 90 000)/2) * 10%		

The net effect of the above entries on the balance sheet at 30 June 2000 is that the book value of the asset will be R 90 000.(PPE R 100 000 less internal loans redeemed of R 10 000)

The last three journal entries will be repeated for the years ended 30 June 2001, 2002 and 2003, with the only difference per year being the interest on the internal advance as follows:

2001: ((R 90 000 + R 80 000)/2) * 10 % = R 8500
2002: ((R 80 000 + R 70 000)/2) * 10 % = R 7500
2003: ((R 70 000 + R 60 000)/2) * 10 % = R 6500

The net effect of the above entries on the balance sheet at 30 June 2003 is that the book value of the asset will be R 60 000.(PPE R 100 000 less internal loans redeemed of R 40 000(R 10 000 per annum redemption * 4 years.)

The backlog or accumulated depreciation will be calculated as follows as at 30 June 2003 based on straight line depreciation and a useful life of 10 years:

(R 100 000 / 10 years) * 4 years = R 40 000. This means that the asset should be reflected at a book value of R 60 000 at 30 June 2003. (Cost R 100 000 less accumulated depreciation of R 40 000).

A transfer of R 40 000 needs to be made from Internal loans redeemed to Accumulated Depreciation (Internal loans redeemed Debit & Accumulated Depreciation Credit). The result is that the full balance on the internal loans redeemed account will be transferred to accumulated depreciation as the lifespan of the loan and the lifespan of the asset are equal.

If the total lifespan of the asset, as estimated at 30 June 2003, is less than the original estimate of 10 years because of inadequate maintenance then the backlog depreciation will be calculated as follows at 30 June 2003 based on straight line depreciation and a total estimated useful life of eight years:

R 100 000 / 8 years) * 4 years = R 50 000 = accumulated or backlog depreciation. This means that the asset should be reflected at a book value of R 50 000 at 30 June 2003. (Cost R 100 000 less accumulated depreciation of R 50 000).

A transfer of R 40 000 needs to be made from Internal loans redeemed to Accumulated Depreciation (Internal loans redeemed Debit & Accumulated Depreciation Credit). The result is that the full balance on the internal loans redeemed account will be transferred to accumulated depreciation. An additional R 10 000 will need to be journalised (Depreciation Dr and Accumulated depreciation Cr.) as depreciation so that the accumulated depreciation balance will be correctly stated at R 50 000. (Internal loans redeemed of R 40 000 plus depreciation of R 10 000 = R 50 000 = Accumulated depreciation)

Example 1f: Assets funded from government grants

Previously assets funded from government grants were raised by debiting an asset account and crediting a government grant account. Assume that a municipality has an item of PPE, purchased on 1 July 1994 at a cost of R 1500 000 and funded by way of a CMIP grant.

The backlog or accumulated depreciation will be calculated as follows as at 30 June 2003 based on straight line depreciation and a useful life of 20 years:

(R 1500 000 / 20 years) * 9 years = R 675 000. This means that the asset should be reflected at a book value of R 825 000 at 30 June 2003. (Cost R 1500 000 less accumulated depreciation of R 675 000). The journal entries that **would have been passed** by the municipality would have been as follows:

Bank Dr	R 1500 000	
CMIP Vote (Suspense) Cr		R 1500 000
Being receipt of grant		
CMIP Vote (Suspense) Dr	R 1500 000	
Bank Cr		R 1500 000
Being purchase of the asset		
Asset Dr	R 1500 000	
CMIP Contributions Cr		R 1500 000
Being recognition of the asset and Capital receipt (Fund)		

A transfer of R 675 000 needs to be made from CMIP Contributions to Accumulated Depreciation (CMIP Contributions Debit & Accumulated Depreciation Credit).The remaining R 825 000 needs to be transferred to a Government Grant Reserve (GGR) as this represents the depreciation that will still be written off via the income statement i.r.o. this asset. An amount equal to each future year's depreciation that will be written off on this asset of R 75 000 (R 875 000 / 11 years) needs to be transferred from the GGR to the Accumulated Surplus Account on the Statement of changes in net Assets as the asset is depreciated. This will prevent double taxation as this transfer will equal and offset the depreciation charge.

Example 2: Calculation of initial cost of items of PPE

The initial recording of an item of PPE is dealt with as follows:

An item of PPE that qualifies for recognition as an asset should initially be measured at its cost. The cost of an item of PPE comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use. Any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs are:

(a) The cost of site preparation,

(b) Initial delivery and handling costs,

(c) Installation costs, and

(d) Professional fees such as for architects and engineers.

When payment for an item of PPE is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as an interest expense over the period of credit. An example of deferred payment is the following:

	Municipality A buys a modified fire engine costing R5m. This amount is only payable after 3 years from the purchase date. The applicable discount rate is 20%.

The journal entries would look as follows:

Purchase date

Dr	PPE		2,893,519.00	
	Cr	Creditors		2,893,519.00

(Cost of PPE on purchase date, payment after 3 years and discount rate of 20% pa)

R 5 000 000 / (1.2) (1.2) (1.2) = R 2 893 519

End of year 1

Dr	Interest expense		578,704.00	
	Cr	Creditors		578,704.00

(Unwinding of discount at 20% pa)

End of year 2 and 3

Same journals as at end of year 1

The cost relating to feasibility studies on a project which will result in PPE is capitalised if it can be reliably measured and if it is probable that a future economic benefit or service potential will flow to the municipality. The municipality should be able to prove that the cost is a directly attributable cost of bringing the asset to its working condition for its intended use.

To illustrate principles of impairment of non cash generating assets, examples 3 – 5 were extracted from IPSAS 21 on Property, plant and equipment, and adapted)

Example 3: Application of the depreciated replacement cost approach

	In 1999, the City of Tshwane purchased a new mainframe computer at a cost of R 10 million. The municipality estimated that the useful life of the computer would be seven years and that on average 90 percent of central processing unit (CPU) capacity would be used by the various departments. A buffer of excess CPU time of 10 percent was expected and needed to accommodate scheduling jobs to meet peak period deadlines. Within a few months after acquisition, CPU usage reached 90 percent, but declined to 20 percent in 2003 because many applications of the departments were converted to run on desktop computers or servers. A computer is available on the market at a price of R 500,000 that can provide the remaining service potential of the mainframe computer using the remaining applications.

Evaluation of Impairment

The indication of impairment is the significant long-term change in the technological environment resulting in conversion of applications from the mainframe to other platforms and therefore decreased usage of the mainframe computer. An impairment loss is determined using the depreciated replacement cost approach as follows:

a	Acquisition cost, 1999	10,000,000
	Accumulated depreciation, 2003 (a × 4 ÷ 7)	5,714,286
b	Carrying amount, 2003	4,285,714
c	Replacement cost	500,000
	Accumulated depreciation (c × 4 ÷ 7)	285,714
d	Recoverable Service Amount	214,286
Impairment loss (b – d)		4,071,428

Example 4: Application of the restoration cost approach

Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment. The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset whichever is lower.

In 1984, the City of Moorland built an office building at a cost of R 50 million. The building was expected to provide service for 40 years. In 2003, after 19 years of use, fire caused severe structural problems. Due to safety reasons, the office building is closed and structural repairs costing R 35.5 million are to be made to restore the office building to an occupiable condition. The replacement cost of a new office building is R 100 million.

Evaluation of Impairment

Impairment is indicated because the office building has sustained physical damage due to the fire. Impairment loss using a restoration cost approach would be determined as follows:

a	Acquisition cost, 1984	50,000,000
	Accumulated depreciation, 2003 (a × 19 ÷ 40)	23,750,000
b	Carrying amount, 2003	26,250,000
c	Replacement cost (of a new building)	100,000,000
d	Accumulated depreciation (c × 19 ÷ 40)	47,500,000
	Depreciated replacement cost (undamaged)	52,500,000
	Less: restoration cost	35,500,000
e	Recoverable Service Amount	17,000,000
Impairment loss (b– e)		9,250,000

Example 5: Application of the service units approach

Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.

In 1988, Klerksdorp City Council constructed a 20 story office building for use by the Council at a cost of R 80 million. The building was expected to have a useful life of 40 years. In 2003, National Safety Regulations required that the top 4 stories of high rise buildings should be left unoccupied for the foreseeable future. The building has a fair value less costs to sell of R 45 million in 2003 after regulations came into force. The current replacement cost of a similar 20 story building is R 85 million.

Evaluation of Impairment

Impairment is indicated because the extent of use of the office building has changed from 20 floors to 16 floors as the result of new National Safety Regulations. The reduction in the extent of use is significant and the occupation of the building is expected to remain at the reduced level (16 floors) for the foreseeable future. Impairment loss using the service units approach would be determined as follows:

a	Acquisition cost, 1988	80,000,000
	Accumulated depreciation, 2003 (a × 15 ÷ 40)	30,000,000
b	Carrying amount, 2003	50,000,000
c	Replacement cost (20 story building)	85,000,000
	Accumulated depreciation (c × 15 ÷ 40)	31,875,000
d	Depreciated replacement cost before Adjustment for remaining service units	53,125,000
e	Value in Use of the building after the regulation came into force (d × 16 ÷ 20)	42,500,000
f	Fair value less costs to sell of the building after regulation came into force	45,000,000
g	Recoverable service amount (higher of e and f)	45,000,000
Impairment loss (b - g)		5,000,000

ANNEXURE 2: Example of Memo – Donated items of PPE to the municipality

<Name of municipality>
INTERNAL MEMO

TO: **ALL DEPARTMENT MANAGERS**
FROM: **MANAGER RESPONSIBLE FOR ASSET MANAGEMENT**
DATE: **MONTHLY**
DONATED ITEMS OF PPE TO THE MUNICIPALITY

Kindly inform us of any items of PPE that have been donated to the municipality during the month of.....

We need this information to update the Municipality's accounting records as well as the Asset Register. We also need to determine the fair value of the donated items of PPE and would appreciate it if you could assist us in this regard.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Do not hesitate to contact me, should you require any information in this regard.

Pease forward this information to my office no later than.....

Your co-operation is appreciated

_____
MANAGER ASSET MANAGEMENT

ANNEXURE 3: Example of Memo – Review of the remaining useful life of items of PPE

<Name of municipality>
INTERNAL MEMO

TO: **ALL DEPARTMENT MANAGERS**
FROM: **MANAGER RESPONSIBLE FOR ASSET MANAGEMENT**
DATE: **30 JUNE 20XX**

REVIEW OF THE REMAING USEFUL LIFE OF ALL ITEMS OF PPE

Attached please find a copy of the fixed asset register as at 30 June 20xx per your department.

Kindly review the remaining useful lives of all items of PPE as at 30 June to identify items with a shorter remaining useful life than the one reflected on the Asset Register. Please notify me of the items of PPE with the remaining useful lives shorter than those reflected on the AR.

We need this information to adjust the Municipality's accounting records as well as the Fixed Asset Register.

Do not hesitate to contact me, should you require any information in this regard.

Pease forward this information to my office no later than.....

Your co-operation is appreciated

_____
MANAGER ASSET MANAGEMENT

ANNEXURE 4: Example of Memo – Impairment of items of PPE

<Name of municipality>
INTERNAL MEMO

TO: **ALL DEPARTMENT MANAGERS**
FROM: **MANAGER RESPONSIBLE FOR ASSET MANAGEMENT**
DATE: **30 June 20xx**

IMPAIRMENT OF ITEMS OF PPE

To enable us to account for impairment losses in the Annual Financial Statements of the Municipality we need to identify assets that:

- Are in a state of permanent damage at year end;
- Are stolen at year end;
- Are technologically obsolete at year end;
- Have remained idle for a considerable period either prior to them being put into use at year end or during their useful life;

Attached please find a copy of the Asset Register as at 30 June 20xx per your department. Kindly identify any assets on the Asset Register that fall into one of the categories as set out in the bullet points above.

We need this information to adjust the Municipality's accounting records as well as the Asset Register.

Do not hesitate to contact me, should you require any information in this regard.

Pease forward this information to my office no later than.....

Your co-operation is appreciated

_____
MANAGER ASSET MANAGEMENT

ANNEXURE 5: Example of Memo – Theft, losses and damage to PPE

<Name of municipality>
INTERNAL MEMO

TO: **ALL DEPARTMENT MANAGERS**
FROM: **MANAGER RESPONSIBLE FOR ASSET MANAGEMENT**
DATE: **30 June 20xx**

THEFT LOSSES AND DAMAGE OF PPE

Please ensure that any incident of loss, theft or destruction of any PPE item is promptly reported in writing to the Manager responsible for asset management and also to the South African Police Service.

Do not hesitate to contact me, should you require any information in this regard.

Your co-operation is appreciated

_____
MANAGER – ASSET MANAGEMENT

ANNEXURE 6: Example of Memo – Assets obtained by means of a finance lease

<Name of municipality>
INTERNAL MEMO

TO: **MANAGER CORPORATE SERVICES**
FROM: **MANAGER RESPONSIBLE FOR ASSET MANAGEMENT**
DATE: **30 June 20xx**

FINANCE LEASES

We are currently in a process of updating the Asset Register and need to identify all Finance Leases in the name of <NAME OF MUNICIPALITY> and where the municipality is the lessee.

A **Finance Lease** is a lease that transfers all the risks and rewards incident to ownership of an asset to the lessee. The lease term is normally for the major part of the economic life of the asset.

Please note that **operating leases** should not be included. An operating lease is a lease where the ownership of the asset will never be transferred to the lessee. (For example the lease of a photocopy machines)

The correct accounting treatment is to capitaliSe these assets obtained by means of a finance lease.

Please compile a list of all these Finance Leases including the following information:

- Detailed description of the asset;
- Cost price of the assets (the outstanding capital at the start of the Finance Lease);
- Acquisition date;
- Department;
- Location where the asset is kept (room number)

Sign the list as it would be kept on file for audit purposes. Do not hesitate to contact me should you require any further information regarding Finance Leases.

Please forward the information to my office no later than ……

Your co-operation is appreciated.

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MANAGER – ASSET MANAGEMENT

ANNEXURE 7: Example of unbundling of infrastructure assets

The infrastructural assets, as well as other immovable assets, of Protea municipality are bundled in the Fixed Asset Register (FAR) and have to be itemised in terms of GRAP. A consulting firm has been appointed to unbundle the infrastructural assets. The consulting firm has to determine the "*Depreciated Replacement Cost*" (DRC) of these itemised assets.

The following assets are contained in the AR:

Description	Purchase Date	Life Span	Original Value	Accumulated Depreciation	Book Value 30/06/2007	Funding Source
Water Pumping Station	01/07/1997	20	20,000,000	10,000,000	10,000,000	Loans
Sewer Filtration Plant	01/07/2002	15	15,000,000	5,000,000	10,000,000	Grants

The following assets are contained in the Consulting firm's Report:

Description	Purchase Date	Original Value	Depreciated Replacement	Total Value	Remaining Life
Water Pumping Station:	01/07/1997	20,000,000		9,000,000	
Land			500,000		-
Building			7,500,000		20
Water Pump			750,000		10
Water Pipe			250,000		5
Sewer Filtration Plant:	01/07/2002	15,000,000		11,000,000	
Land			500,000		-
Building			4,500,000		20
Sewerage Dam			5,000,000		15
Sewerage Pump			500,000		10
Sewerage Pipe			500,000		5
Electricity Substation	01/01/1975	5,000,000		1,500,000	
Land			500,000		-
Building			750,000		5
Electrical Motors			150,000		2
Electrical Cabling			100,000		1

The two registers now need to be matched. For purposes of the exercise, it is assumed that the "water pumping station" and the "sewer filtration plant" match. The "electricity substation" is not in the AR and further investigation reveals that this asset was funded from an external loan over 15 years. The asset was written off upon full redemption of the loan, explaining why it is not in the AR.

A comparison of the two registers is as follows:

Asset	**Book Value**	**DRC**	**Difference**
Water Pumping Station	R10,000,000	R 9,000,000	R 1,000,000
Sewer Filtration Plant	R10,000,000	R11,000,000	R(1,000,000)
Electricity Substation	No Asset	R 1,500,000	R(1,500,000)

The AR must now be adjusted to reflect the various components of the assets, together with the adjustment life expectancy and values. However, remember that an asset is disclosed at the lower of its depreciated value or its depreciated replacement cost. Thus, the total value of the Sewer Filtration Plant will not be affected. In the case of the Electricity Substation, the asset must be brought into the AR.

The following assumptions are made and will have to be taken up in the municipality's accounting policy for impairment and DRC:

(1) Apportionment of original values:

Most certainly the original values of the various components will not be known, thus the original values will be calculated by apportioning them as shown below in the case scenarios.

However, if the original values are known, this will not be necessary and such known values will be used for the original values of each component, totalling to the value of the original bundled asset.

(2) Allocation of impairment values:

Should the asset be impaired, the impairment value will be allocated to the component(s) with the longest life span, usually the building.

If the original values are known, depreciation will be calculated for each component enabling the municipality to impair each component if applicable.

(3) Assets not previously disclosed:

Should any asset previously not have been recorded at all in the AR, the DRC must be used as the Depreciated Value and Depreciation will be calculated as the difference between the two values.

The following adjustments must be made in the AR for Water Pumping Station:

Description	Life Span	Rem Life	Original Value **R'000**	Acc Depr **R'000**	Impairment Loss **R'000**	Book Value 30/06/2007 **R'000**	Funding Source
Water Pumping Station:			- 20,000	- 10,000	0	- 10,000	Loans
Land	-	-	500	0	0	**500**	Loans
Building	30	20	17,206	8,706	1,000	**7,500**	Loans
Water Pump	15	10	1,721	971	0	**750**	Loans
Water Pipe	15	5	574	324	0	**250**	Loans
Total Adjustment			0	0	1,000	- 1,000	

***Notes**:*

(i) The Book Value (Carrying Value) is based on the DRC value from the consultants report, being the lower value..

(ii) The Impairment Loss is allocated to the component with the longest life span.

(iii) The Original Value is calculated using DRC as the base value.

(iv) Accumulated Depreciation is determined using these calculated values.

(v) The value of Land is based on the value from the Africon Report.

The original values of the various components are not known, thus the original values are calculated by apportioning them as follows:

Building: R7 500 000/(9 000 000 – 500 000) x (20 000 000 – 500 000)
= R17 205 882

(The value of land is deducted from the values since it is not depreciated)

The following adjustments must be made in the AR for Sewer Filtration Plant:

Description	Life Span	Rem Life	Original Value **R'000**	Acc Depr **R'000**	Impairment Loss **R'000**	Book Value 30/06/2007 **R'000**	Funding Source
Sewer Filtration Plant:			- 15,000	- 5 000	0	- 10,000	Loans
Land	-	-	500	0	0	500	Loans
Building	30	20	6,214	2 143	0	4 071	Loans
Sewerage Dam	15	15	6,905	2 381	0	4 524	Loans
Sewerage Pump	15	10	690	238	0	452	Loans
Sewerage Pipe	15	5	690	238	0	452	Loans
Total Adjustment			0	0	0	0	

***Notes**:*

(i) The Book Value (Carrying Value) is based on the FAR value, being the lower value.

(ii) The Original Value is calculated using DRC as the base value.

(iii) Accumulated Depreciation is determined using these calculated values.

(iv) The value of Land is based on the value from the Africon Report.

The book value (carrying value) of the components are not known, thus the carrying values are calculated using the DRC as the base value

Building: R4 500 000/(11 000 000 – 500 000) x (10 000 000 – 500 000)
= R4 071 428
(The value of land is deducted from the values since it is not depreciated

The original values of the various components are not known, thus the original values are calculated by apportioning them as follows:

Building: R4 500 000/(11 000 000 – 500 000) x (15 000 000 – 500 000)
= R6 214 286
(The value of land is deducted from the values since it is not depreciated)

Because the DRC is higher than the Depreciated Value, the asset must be disclosed at the lower value, being the Depreciated Value. Therefore Accumulated Depreciation must be apportioned as per the formula above.

Building: R4 500 000/(11 000 000 – 500 000) x 5 000 000
= R2 142 858
(The value of land is deducted from the value of original value only)

The Remaining Life of the asset components must be adjusted to the values certified in the consultant's report.

The following adjustments must be made in the FAR for Electricity Substation:

Description	Life Span	Rem Life	Original Value **R'000**	Acc Depr **R'000**	Impairment Loss **R'000**	Book Value 30/06/2007 **R'000**	Funding Source
Electricity Substation:							
Land	-	-	500	0	0	500	Loans
Building	30	5	3 375	2 625	0	750	Loans
Electrical Motors	20	2	675	525	0	150	Loans
Electrical Cabling	20	1	450	350	0	100	Loans
Total Adjustment			5 000	3 500	0	1 500	

The original values of the various components are not known, thus the original values are calculated by apportioning them as follows:

Building: R750 000/(1 500 000 – 500 000) x (5 000 000 – 500 000)
= R3 375 000

(The value of land is deducted from the values since it is not depreciated)

Because the asset was not recorded at all in the FAR, the DRC must be used as the Depreciated Value and Depreciation will be calculated as the difference between the two values. This must be taken up in the accounting policy of the municipality.

The Remaining Life of the asset components must be adjusted to the values certified in the consultant's report.

If the original cost price is not known, the DRC value from the consultant's report will be used as the Original Value for the asset with no amount for Accumulated Depreciation and the asset will be depreciated from this point forward over its Remaining Life.

UPDATING THE GENERAL LEDGER

The General Ledger (GL) must now be updated to reflect the adjustments made to the FAR. The results from the previous section are used to illustrate the adjustments required to update the GL.

The following adjustments have been made in the AR for Water Pumping Station:

Description	Life Span	Rem Life	Original Value **R'000**	Acc Depr **R'000**	Impairment Loss **R'000**	Book Value 30/06/2007 **R'000**	Funding Source
Water Pumping Station:			- 20,000	- 10,000	0	- 10,000	Loans
Land	-	-	500	0	0	500	Loans
Building	30	20	17,206	8,706	1,000	7,500	Loans
Water Pump	15	10	1,721	971	0	750	Loans
Water Pipe	15	5	574	324	0	250	Loans
Total Adjustment			0	0	1,000	- 1,000	

The GL must be updated as follows as at 30 June 20xx:

Dt Water Department: Impairment Losses R1 000 000
Cr Accumulated Impairment Losses: Water R1 000 000

(Recording of Impairment Loss incurred in the adjustment of asset to the lower of Depreciated Value and Depreciated Replacement Cost as at 30/06/2007)

The following adjustments have been made in the AR for Sewer Filtration Plant:

Description	Life Span	Rem Life	Original Value **R'000**	Acc Depr **R'000**	Impairment Loss **R'000**	Book Value 30/06/2007 **R'000**	Funding Source
Sewer Filtration Plant:			- 15,000	- 5,000	0	- 10,000	Loans
Land	-	-	500	0	0	500	Loans
Building	30	20	6,214	2,143	0	4,071	Loans
Sewerage Dam	15	15	6,905	2,381	0	4,524	Loans
Sewerage Pump	15	10	690	238	0	452	Loans
Sewerage Pipe	15	5	690	238	0	452	Loans
Total Adjustment			0	0	0	0	

No adjustments are required in the GL.

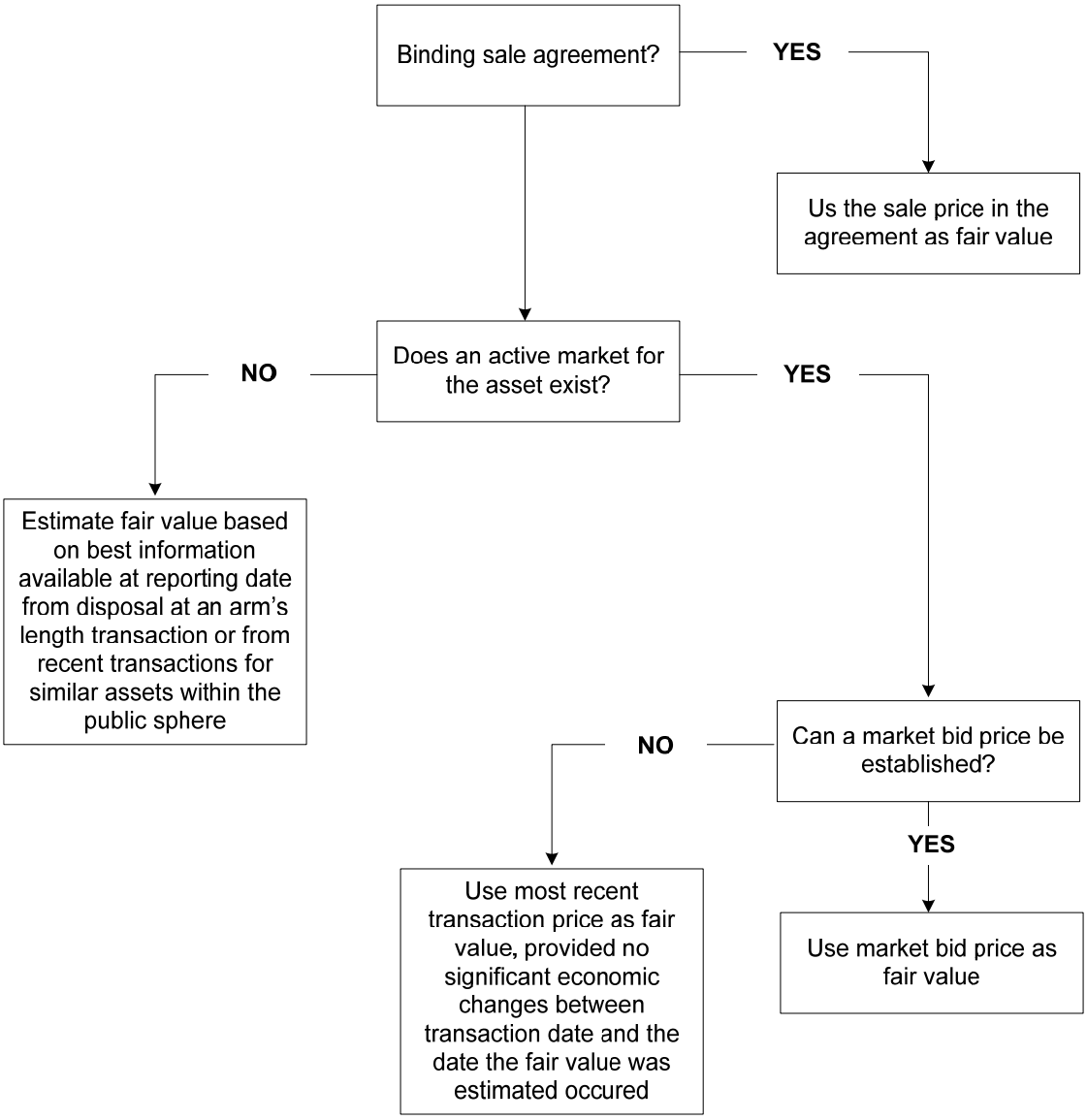
The following adjustments have been made in the FAR for Electricity Substation:

Description	Life Span	Rem Life	Original Value **R'000**	Acc Depr **R'000**	Impairment Loss **R'000**	Book Value 30/06/2007 **R'000**	Funding Source
Electricity Substation:							
Land	-	-	500	0	0	500	Loans
Building	30	5	3,375	2,625	0	750	Loans
Electrical Motors	20	2	675	525	0	150	Loans
Electrical Cabling	20	1	450	350	0	100	Loans
Total Adjustment			5 000	3 500	0	1,500	

The GL must be updated as follows as at 30 June 20xx:

Dt Assets – Historical Cost: Electricity R5 000 000
Cr Accumulated Depreciation: Electricity R3 500 000
Cr Accumulated Surplus: Errors R1 500 000
(Recording assets not previously disclosed in the FAR and GL as at 30/06/20xx)

ANNEXURE 8: Determining fair value



ANNEXURE 9: Understanding the difference between depreciation and impairment losses

The difference between depreciation and impairment is explained in IPSAS 21.18 and 19 as follows:

Depreciation

Depreciation and amortization are the systematic allocation of the depreciable amount of an asset over its useful life. In the case of an intangible asset, the term “amortization” is generally used instead of “depreciation”. Both terms have the same meaning.

Impairment

This Standard defines “impairment” as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service potential through depreciation (amortization). Impairment, therefore, reflects a decline in the utility of an asset to the entity that controls it. For example, an entity may have a purpose-built military storage facility that it no longer uses. In addition, because of the specialized nature of the facility and its location, it is unlikely that it can be leased out or sold and therefore the entity is unable to generate cash flows from leasing or disposing of the asset. The asset is regarded as impaired as it is no longer capable of providing the entity with service potential – it has little, or no, utility for the entity in contributing to the achievement of its objectives.

1. Residual Value is specifically:

(a) Scrap value.

(b) The net cash amount that you will receive from the ultimate sale of the asset, at the end of its life.

(c) The gross cash amount that you will receive from the ultimate sale of the asset, at the end of its life.

2. Spare parts and servicing equipment are usually accounted for as:

(a) Expenses written off to the income statement on buy.

(b) Inventory.

(c) A separate class of fixed assets.

3. Major spare parts and stand-by equipment qualify as property, plant and equipment when:

(a) They are expected to be used during more than one period.

(b) The firm is in the oil industry.

(c) The parts cost more than 20% of the equipment they are supporting.

4. Repairs and maintenance costs are normally:

(a) Capitalized.

(b) Expensed in the income statement as incurred.

(c) Recorded as deferred expense.

5. If the costs of a major inspection (e.g. aircraft) are capitalized:

(a) They must be shown as a separate asset.

(b) Any remaining costs of a previous inspection must be written off.

(c) The board of directors must be notified immediately.

6. If the costs of a major inspection (e.g.) are capitalized, and there was no cost for the initial major inspection in the asset cost:

(a) No cost should be deducted from the asset.

(b) An estimate of the initial inspection cost should be made.

(c) The cost of the new inspection must be expensed.

7. Recognition of costs (to be capitalized) ceases when:

(a) The accounting period ends.

(b) The item is in the location and capable of operating.

(c) Full production capacity has been reached.

8. If payment for a fixed asset is deferred beyond normal credit terms, any additional payment above the cash cost of the asset will be accounted for as:

(a) Cost of fixed asset.

(b) Borrowing cost.

(c) Repairs and maintenance.

9. The carrying value of your asset is R10. its fair value is R12. Do you continue depreciation?

(a) No.

(b) Yes, until the end of its useful life.

(c) Yes, but at half the previous rate.

10. Land and buildings are separate assets, as:

(a) They van always be sold separately.

(b) Land usually has an unlimited life, but buildings do not.

(c) Buildings can be revalued, but land cannot.

11. An asset is impaired if:

(a) Its carrying amount equals the amount to be recovered through use (or sale) of the asset.

(b) Its carrying amount exceeds the amount to be recovered through use (or sale of the asset.

(c) The amount to be recovered through use (or sale) of the asset exceeds its carrying amount.

12. After the revaluation requirements have been applied, it is:

(a) Unlikely that the revalued asset is impaired.

(b) Probable that the revalued asset is impaired.

(c) The recoverable amount needs to be estimated.

13. Costs of disposal are:

(a) Incremental costs, directly attributable to the disposal of an asset, excluding finance costs and income tax.

(b) Incremental costs, directly attributable to the disposal of an asset, (or cash-generating unit), plus finance costs, but excluding income tax expense.

(c) Incremental costs, directly attributable to the disposal of an asset, (or cash-generating unit), plus finance costs, band income tax.

14. An intangible asset with an indefinite useful life, or an intangible asset not yet available for use:

(a) Will not be impaired.

(b) Should be tested annually, at different times of the year.

(c) Should be tested annually, at the same time each year.

15. If previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount:

(a) Its value in use should be recalculated.

(b) The undertaking need not re-estimate its recoverable amount, if no events have occurred that would eliminate that difference.

(c) It should be tested for impairment.

16. "Fair value less costs to see" and its "value in use". if either of these amounts exceeds the asset's carrying amount:

(a) The asset is not impaired, and it is not necessary to estimate the other amount.

(b) The other must be calculated.

(c) The asset is impaired.

17. If an asset, carried at cost, is decreased by impairment, the decrease should be:

(a) Capitalized.

(b) Expensed.

(c) An extraordinary item.

18. The recoverable amount of a cash-generating unit is:

(a) The lower of the unit's fair value less costs to sell and its value in use.

(b) The higher of the unit's fair value less costs to sell and its value in use.

(c) The average of the unit's fair value less costs to sell and its value in use.

19. The undertaking impairment tests:

(a) The asset first and records any impairment loss for that asset, before testing for impairment in the unit containing the goodwill.

(b) The unit containing the goodwill first, and records any impairment loss for that unit, before testing for impairment asset.

(c) At the same time.

20. Corporate assets:

(a) Cannot be impaired.

(b) Cannot generate separate cash flows.

(c) Carrying amounts can be fully attributed to a cash-generating unit.