

TOPIC 6.3: ACCOUNTING FOR INTERNAL FUNDS AND RESERVES IN THE ACCUMULATED SURPLUS/DEFICT

Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, internal funds and reserves should form part of Accumulated Surplus and should not be disclosed on the face of the Statement of Changes in Net Asset. Municipalities can however disclose in a note to the financial statements the internal funds and reserves that are ring-fenced within the accumulated surplus.

In the municipal environment, the following internal funds and reserves were established in the past:

- Capital Replacement Reserve (CRR)
- Self Insurance Reserve (SIR)
- Capitalisation Reserve (CR)
- Reserve established for Compensation for occupational Injuries and Diseases (COID Reserve)
- Government Grant Reserve (GGR) and Donations and Public Contributions Reserve

6.3.1: CAPITAL REPLACEMENT RESERVE (CRR)

This section of the manual sets out the FSOP's that needs to be executed by the municipality regarding the Capital Replacement Reserve (CRR). The FSOP's are drafted in the following categories:

- 6.3.1.1 Overview of the accounting for the CRR**
- 6.3.1.2 Introduction**
- 6.3.1.3 Creating the CRR**
- 6.3.1.4 Procedures for the purchase of assets from the CRR**
- 6.3.1.5 Maintaining the CRR as a funding source.**
- 6.3.1.6 Annual transfers to and from the CRR**
- 6.3.1.7 AFS disclosure requirements**

6.3.1.1 OVERVIEW OF THE ACCOUNTING FOR THE CRR

When accounting for the CRR 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
Introduction. The CRR is established to set aside funds for the financing of property, plant and equipment.	Section 6.3.1.2
Creating the CRR. The CRR is an asset financing source that represents an alternative to the other funding sources available to the municipality namely external loans (interest bearing borrowings) and government grants & subsidies. The balance on the CRR is always represented by cash, which must be held in a separately identifiable bank or investment account.	Section 6.3.1.3
Procedures for the purchase of assets from the CRR. The CRR may only be utilised for the purpose of purchasing items of property, plant and equipment for the municipality and may not be used for the maintenance of these items. Whenever an asset is purchased out of the CRR an amount equal to the cost price of the asset purchased is transferred from the CRR into Accumulated Surplus.	Section 6.3.1.4
Maintaining the CRR as a funding source. The municipality should determine a policy on the revenue sources that will be used to maintain or increase the balance of the CRR. These revenue sources may include the following: <ul style="list-style-type: none"> • Interest earned by the municipality on the CRR investment account • Cash proceeds from the sale of any item of PPE or investment property • An amount equal to the amount that was utilised in the previous financial year for the purchase of items of PPE 	Section 6.3.1.5
Annual transfers to and from the CRR. Ensure that no revenue is directly credited to the CRR or that no expenses are directly debited to the CRR. All transfers to and from the CRR should be made via accumulated surplus.	Section 6.3.1.6
AFS disclosure requirements. Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, internal funds and reserves should form part of Accumulated Surplus and should not be disclosed on the face of the Statement of Changes in Net Asset. Municipalities can however disclose in a note to the financial statements the internal funds and reserves that are ring-fenced within the accumulated surplus.	Section 6.3.1.7

6.3.1.2 INTRODUCTION

Reserves and Funds are not permissible in terms of GRAP. The Capital replacement reserve (CRR), is one of the few funds and reserves that are allowed.

The purpose of the CRR is to set aside funds for the financing of property, plant and equipment. The CRR is therefore an asset financing source that represents an alternative to the other funding sources available to the municipality namely external loans (interest bearing borrowings) and government grants & subsidies.

6.3.1.3 CREATING THE CRR

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	<ul style="list-style-type: none"> The municipality is not required to make compulsory contributions to the CRR. The municipality will determine its future capital financing requirements and transfer sufficient cash to its CRR in terms of this determination. The Integrated Development Plan, the municipality's ability to raise external finance and government grants and subsidies will need to be taken into account in determining the amount, if any, that must be transferred to the CRR. The balance on the CRR is always represented by cash, which must be held in a separately identifiable bank or investment account. 	Identify all funds and reserves that have been established in terms of provincial ordinances and transfer the available cash backed portion of these funds into a CRR. Refer to topic 6.3.5 Capitalization Reserve - Example 1 for detailed NT guidelines on the procedures to be followed when creating the CRR.	AP	Manager: Budget Control	Date of Implementation of GRAP

6.3.1.4 PROCEDURES FOR THE PURCHASE OF ASSETS FROM THE CRR

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	As best practice in the management of the municipality's funds, standard procedures need to be performed for the purchase of PPE funded from the CRR to ensure the validity of this type of accounting transactions.	<ol style="list-style-type: none"> 1) draft or amend the accounting policy on the CRR. Example 1 in the Annexure below is a possible accounting policy note for the CRR. 2) ensure that the accounting software package and chart of accounts is set up to ensure that transactions for the purchase of PPE funded from the CRR are accounted for as per example 2, set out below in the Annexure. 	AP	Manager: Budget Control	30 June each year.

6.3.1.5 PROCEDURES TO MAINTAIN THE CRR AS A FUNDING SOURCE

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	As best practice in the management of the municipality's funds, and to ensure proper internal control, a policy regarding sources of revenue to maintain the CRR needs to be developed.	Determine a policy on the revenue sources that will be used to maintain or increase the balance of the CRR. Examples 3, 4 and 5 in the Annexure below sets out variations of possible policy in this regard.	AP	Manager: Budget Control	30 June each year.

6.3.1.6 PROCEDURES TO RECORD ANNUAL TRANSFERS TO AND FROM THE CRR

a) Transfers from the CRR to accumulated surplus in respect of PPE purchased from the CRR for the financial year.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	To ensure proper internal control and a complete audit trail, standardized procedures need to be performed regarding the annual transfers to and from the CRR.	<ol style="list-style-type: none"> 1) prepare a spreadsheet of invoices kept for the purchase of items of PPE during the financial year. The spreadsheet should show the following for each item of PPE purchased. Acquisition date, ID #, Cost price as per GAMAP 17, Funding source. 2) compare the total cost price of items of PPE purchased during the year as per the spreadsheet in 1 above with the total cost price of acquisitions as per the GL, AR and Appendix B and C of the AFS. 3) ensure that the total cost price of items of PPE funded by the CRR as per the spreadsheet in 1 above equals the transfer made from the CRR to the accumulated surplus in the GL and in the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus. 	FCP	Manager: Budget Control	30 June each year

b) Transfers from the accumulated surplus to the CRR to maintain or increase the balance on the CRR


#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	To ensure proper internal control and a complete audit trail, standardized procedures need to be performed regarding the annual transfers to and from the CRR.	<ol style="list-style-type: none"> 1) perform a calculation of the amount to be transferred from the accumulated surplus to the CRR for the year in accordance with the accounting policy of the municipality. This should be done in accordance with the steps as set out in example 6 below. 2) ensure that an amount equal to the transfer from the accumulated surplus to the CRR is transferred into the CRR bank account. 3) reconcile and amend any differences between the CRR and the CRR Bank account. 4) inspect the general ledger to ensure that no revenue is directly credited to the CRR or that no expenses are debited to the CRR. (The CRR does not accumulate external interest). 5) if interest earned on CRR investments was transferred to the CRR through during the year under review, ensure that it is allowed in terms of the policy. 	<p>FCP/ AP</p> <p>FCP</p>	<p>Manager: Budget Control</p> <p>CFO</p>	<p>30 June each year</p> <p>30 June each year</p>

6.3.1.6 AFS DISCLOSURE REQUIREMENTS

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	<p>GRAP 1.111 requires the presentation in the statement of changes in net assets or in the notes of:</p> <ul style="list-style-type: none"> the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and to the extent that components of net assets are separately disclosed, a reconciliation between the carrying amount of each component of net assets and each reserve at the beginning and the end of the period, separately disclosing each change. 	<p>Ensure that all movements to and from the CRR during the financial year are disclosed in a note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets. The following movements may occur causing a difference between the opening and closing balance on the CRR:</p> <ul style="list-style-type: none"> transfers made to the fund of cash backed surpluses out of the accumulated surplus account. transfers made to the fund of interest earned by the CRR included in the accumulated surplus account. transfers from the CRR to the accumulated surplus in respect of assets purchased out of the CRR. transfers made to the fund of cash realised through the sale of assets. 	AP	Manager: Budget Control	30 June each year.

ANNEXURE 1 – Illustrative examples

Example 1: Possible accounting policy note for the CRR

	<ul style="list-style-type: none">• The purpose of the CRR is to set aside funds for the financing of property, plant and equipment. The CRR is therefore an asset financing source that represents an alternative to the other funding sources available to the municipality namely external loans (interest bearing borrowings) and government grants & subsidies.• The municipality is not required to make compulsory contributions to the CRR. The municipality will determine its future capital financing requirements and transfer sufficient cash to its CRR in terms of this determination. The Integrated Development Plan, the municipality's ability to raise external finance and government grants and subsidies will need to be taken into account in determining the amount, if any, that must be transferred to the CRR.• The balance on the CRR is always be represented by cash, which must be held in a separately identifiable bank or investment account.• Interest earned on the CRR investment is recorded as interest earned in the Statement of financial performance and is then transferred to the CRR in the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus.• The cash proceeds from the sale of any items of PPE are transferred to the CRR once the cash is received by the municipality.• The CRR may only be utilised for the purpose of purchasing items of property, plant and equipment for the municipality and may not be used for the maintenance of these items.• Whenever an asset is purchased out of the CRR an amount equal to the cost price of the asset purchased is transferred from the CRR into Accumulated Surplus on the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus. This is done to accommodate future annual depreciation charges on assets funded from the CRR.
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Example 2: Accounting transactions for the purchase of PPE from CRR

Assume that a municipality has a CRR of R750 000, which is represented by cash. Council decides to use part of these funds to acquire a truck for the refuse service that costs R450 000. On 1 July 1999, the truck is purchased. The estimated life of the truck is 15 years. Council has decided not to re-instate the balance of the statutory fund.

STATUTORY FUND - CRR					
1	Transfer to Accumulated Surplus	450 000		Opening balance	750 000
2	Closing balance	300 000			
	TOTAL	750 000		TOTAL	750 000

CRR - BANK ACCOUNT					
	Opening balance	750 000	1	Transfer to refuse service	450 000
			3	Closing balance	300 000
	TOTAL	750 000		TOTAL	750 000

Explanatory notes*Transactions on 1 July 1999*

1. This is the amount financed out of the CRR and which has been used to finance the purchase of the refuse truck.

Transactions on 30 June 2000

2. This is the closing balance of the statutory fund that is shown on the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus.
3. This is the closing balance of the bank account that will be included in the statement of financial position.

REFUSE SERVICE - BANK ACCOUNT					
1	Transfer from statutory fund	450 000	2	Purchase of refuse truck	450 000
	TOTAL	450 000		TOTAL	450 000

REFUSE SERVICE - PPE					
2	Purchases	450 000	4	Closing balance	450 000
	TOTAL	450 000		TOTAL	450 000

REFUSE SERVICE - ACCUMULATED DEPRECIATION					
5	Closing balance	30 000	3	Annual depreciation	30 000
	TOTAL	30 000		TOTAL	30 000

REFUSE SERVICE - DEPRECIATION EXPENSE					
3	Depreciation	30 000	6	Transfer to surplus/deficit	30 000
	TOTAL	30 000		TOTAL	30 000

Explanatory notes

Transactions on 1 July 1999

1. See explanatory note 1 above
2. Being the payment to the supplier of the refuse truck purchased

Transactions on 30 June 2000

3. The annual depreciation charge of the refuse truck ($R450\,000 \div 15$ years) = R30 000 per annum.
4. The closing balance of PPE is shown on the face of the statement of financial position after the closing balance of the accumulated depreciation account (5) has been deducted.
5. The closing balance is aggregated with the closing balance of fixed assets (4) and the net amount is included on the face of the statement of financial position.
6. The depreciation is included in the determination of the net surplus/deficit for the year.

Example 3: Possible policy on revenue sources utilised by the municipality to maintain the CRR as a funding source


All interest earned by the municipality on the CRR investment account is transferred to the CRR after it is recorded as interest earned in the statement of financial performance. A variation on this policy is for example to transfer a fixed percentage of the interest say 50% on an annual basis to the CRR.

All cash proceeds from the sale of any item of PPE or investment property is transferred to the CRR.

Example 4: Possible policy on revenue sources utilised by the municipality to maintain the CRR as a funding source

The municipality transfers an amount to the CRR annually equal to the amount that was utilised in the previous financial year for the purchase of items of PPE. This policy implies that the municipality can fund the transfer through interest earned on investments, cash proceeds from the sale of assets, and tariff increases if the proceeds from interest earned and cash from sale of assets is not sufficient.

Example 5: Factors affecting the policy on revenue sources utilised to fund the CRR



A municipality is assessing the effect of utilising a CRR to fund the purchase of assets over the next three financial years on its operating and capital budget. It has determined the following:

- It proposes to spend R 90m on capital expenditure over the next three financial years and intends spending R 40 m next year, R 30 m in year 2 and R 20 m in year 3.
- It budgets that it will receive R 20 m per year by way of government grants to fund the capital expenditure. This equates to a total of R 60 m over the next three years. This implies that the remaining R 30 m needs to be financed either by way of external loans or the CRR or a combination of these two sources. This can be shown as follows:

➤ Total Capex for next 3 years	R 90 m
➤ Grant Funding	<u>R 60 m</u>
➤ Remainder / shortfall	R 30 m

The shortfall will be funded out of external loans or the CRR or a combination of the two sources

There are various factors that drive the choice of the funding mix for the municipality, i.e. the choice of how much of the funding is done by way of loans and how much is done by way of the CRR. The following factors will affect this decision:

- The current level of debt finance utilised by the municipality. If a municipality is currently very highly geared (uses a high level of debt finance) banks may be unwilling to grant further loans to the municipality.
- Political influence regarding the setting of tariffs. If a municipality decides to utilise the CRR, but does not have enough cash the CRR will have to be built up by way of generating cash backed surpluses. This will definitely affect tariffs.
- The existence of cash backed funds that can be transferred to the CRR on the implementation of GRAP. The existence of such funds may place municipalities in the position that they do not have to borrow to fund asset purchases for the next few years.
- The expansion of cities will affect the funding mix decision. A developing municipality will require more funding to acquire new infrastructure than a developed municipality.

Example 6: Steps to be followed when calculating the transfer from accumulated surplus to the CRR**Step 1: Prepare a spreadsheet showing the following:**

- **Opening balance** on the CRR at the start of the financial year.
- **Plus** interest earned on the CRR investment as per the relevant GL account if the policy is to allocate interest earned on the CRR investment to the CRR.
- **Plus** cash proceeds from the sale of PPE as per the FAR and relevant GL account if the policy is to allocate cash proceeds on the sale of PPE to the CRR.
- **Minus** Transfers from the CRR to accumulated surplus for the purchase of items of PPE as discussed above.
- **Equals** the closing balance on the CRR.

Step 2: Complete the detail in the spreadsheet as follows:

- The opening balance on the CRR at the start of the financial year must agree to the closing balance as per the previous year's audited AFS.
- The interest earned on the CRR investment must agree to the interest earned on the GL account and reconcile to interest earned in the investments register.
- The cash proceeds from the sale of PPE must agree to the cash proceeds as recorded on the FAR and the note on cash proceeds from the sale of PPE as per the Cash Flow Statement.
- The transfers from the CRR to accumulated surplus to record assets purchased from the CRR must equal the amount on the spreadsheet prepared as part of FSOP 1 under the procedures followed to record **transfers from the CRR to accumulated surplus in respect of PPE purchased from the CRR for the financial year as listed above.**

6.3.2: GOVERNMENT GRANT RESERVE (GGR) AND DONATIONS AND PUBLIC CONTRIBUTIONS RESERVE (DPCR)

This section of the manual sets out the FSOP's that needs to be executed by the municipality regarding the Government Grant Reserve. The FSOP's are drafted in the following categories:

- 6.3.2.1 Overview of the accounting for the GGR and DPCR**
- 6.3.2.2 Introduction / background**
- 6.3.2.3 Accounting for government grants and public contributions and donations related to non-current assets in the absence of the GGR and DPCR**

6.3.2.1 OVERVIEW OF THE ACCOUNTING FOR THE GOVERNMENT GRANT RESERVE AND DONATIONS AND PUBLIC CONTRIBUTIONS RESERVE

When accounting for the Government Grant Reserve and the Donations and Public Contributions Reserve, 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
<p>Introduction. Municipalities falling under the modified GRAP, GAMAP & GAAP basis of accounting were allowed an accounting policy choice between the principles in GAMAP 9 and the principles in IAS 20 for the year ended 30 June 2007. Municipalities that chose to account for government grants related to non-current assets in accordance with GAMAP 9 created a Government Grant Reserve and Donations and Public Contributions Reserve on the face of the Statement of Financial Position.</p>	<p>Section 6.3.2.2</p>
<p>Accounting for Government Grants and Public Contributions and Donations related to non-current assets in the absence of a GGR and DPCR. According to the APPLICATION OF ACCOUNTING STANDARDS GUIDE (updated by NT and issued on 17 August 2007) that provided updated guidance to municipalities and municipal entities on the accounting implications of the Exemption Gazette 30013, dated 29 June 2007, government grants related to a non-current asset with a useful life, must be presented in the statement of financial position as deferred income that is recognised as income on a systematic and rational basis over the useful life of the asset; i.e. in accordance with IAS 20.26.</p> <p>Municipalities are therefore no longer allowed to account for a GGR and DPCR in the Statement of Changes in Net Assets</p>	<p>Section 6.3.2.3</p>

6.3.2.2 INTRODUCTION

Under the modified GRAP, GAMAP & GAAP basis of accounting the following standards and paragraphs, dealing with grants related to assets, are applicable:

- GAMAP 9 *Revenue*, paragraphs 42 – 46
- IAS 20 (AC134) *Accounting for Government Grants and Disclosure of Government Assistance*, paragraphs 24 and 26

In terms of GAMAP 9 (paragraphs 42 and 43) government grants can be in the form of grants to acquire or construct fixed assets. Such grants are referred to as capital grants and are recognised as revenue in the statement of financial performance when:

- it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,
- the amount of the revenue can be measured reliably, and
- to the extent that there has been compliance with any restrictions associated with the grant.

To the extent that the above three conditions are met, **the full grant amount will be recognised immediately** in the statement of financial performance. Thereafter an equal amount is transferred from the Accumulated Surplus to the Government Grant Reserve (GGR) on the statement of changes in Net assets. The GGR will be used to offset the future depreciation relating to the item of PPE financed by way of the government grant. The annual offset of depreciation will be processed until the item of PPE is fully depreciated.

6.3.2.3 ACCOUNTING FOR GOVERNMENT GRANTS AND PUBLIC CONTRIBUTIONS AND DONATIONS RELATED TO NON CURRENT ASSETS IN THE ABSENCE OF A GGR AND DPCR

IAS 20 (paragraphs 24 and 26) requires government grants related to assets to be presented in the statement of financial position by **setting up the grant as deferred income that is recognised as income on a systematic** and rational basis over the useful life of the asset. No Government Grant Reserve is therefore created.

The modified GRAP, GAMAP & GAAP basis of accounting, include two contradictory principles in respect of government grants related to assets:

- **GAMAP 9:**

Recognise the full grant amount immediately in the statement of financial performance. (To the extent that the criteria in GAMAP 9.43 are met)


- **IAS 20:**

Defer the grant amount in the statement of financial position and release to the statement of financial performance on a systematic basis over the useful life of the asset.

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	According to the APPLICATION OF ACCOUNTING STANDARDS GUIDE (updated by NT and issued on 17 August 2007) that provided updated guidance to municipalities and municipal entities on the accounting implications of the Exemption Gazette 30013, dated 29 June 2007, government grants related to a non-current asset with a useful life, must be presented in the statement of financial position as deferred income that is recognised as income on a systematic and rational basis over the useful life of the asset; i.e. in accordance with IAS 20.26. Government grants related to a current asset (e.g. Inventory, etc.), including non-monetary grants at fair value, must be accounted for in accordance with GAMAP 9.43.	<p>Municipalities falling under the modified GRAP, GAMAP & GAAP basis of accounting were allowed an accounting policy choice between the principles in GAMAP 9 and the principles in IAS 20 for the year ended 30 June 2007. Municipalities that chose to account for government grants related to non-current assets in accordance with GAMAP 9 created a Government Grant Reserve and Donations and Public Contributions Reserve on the face of the Statement of Financial Position.</p> <p>Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, municipalities are no longer allowed to account for a GGR and DPCR in the Statement of Changes in Net Assets. Government grants related to a non-current asset with a useful life must be presented in the statement of financial position as deferred income that is recognised as income on a systematic and rational basis over the useful life of the asset. Example 1 illustrates the journals entries to correct transactions previously posted to the GGR and DPCR.</p>	AP	CFO	30 June 2008

ANNEXURE 1 – Illustrative example

Example 1: Correction of transactions previously posted to the GGR and DPCR

	<p>Protea Municipality accounted for government grants and public contributions and donations related to non-current assets in accordance with GAMAP 9 for the year ended 30 June 2007. Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, the municipality must account for government grants and public contributions and donations related to non-current assets in accordance with IAS 20.26 for the year ended 30 June 2008.</p>
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The following transactions between the GGR, DPCR and Accumulated Surplus were disclosed in Protea Municipality's Statement of Changes in Net Assets in the municipality's AFS for the year ended 30 June 2007.

STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED 30 JUNE 2007

Description	Donations And Public Contribution Reserve R	Government Grant Reserve R	Accumulated Surplus/ (Deficit) R	Total R
2007				
Balance at 1 July 2006	30,000	120,000	50,000	200,000
Surplus/(deficit) for the year	-	-	(6,000)	(6,000)
Capital Grants used to purchase PPE	5,000	44,500	(49,500)	-
Offsetting of depreciation	(1,000)	(5,000)	6,000	-
Balance at 30 June 2007	34,000	159,500	500	194,000

The following journal entries needs to be processed to correct transactions posted to the GGR and the DPCR for the year ended 30 June 2007:

TRANSACTION DETAIL	Rand	Rand
1. Dr Government Grant Reserve	120,000	
Dr Donations and Public Contributions Reserve	30,000	
Cr Deferred income		150,000
(Correction of an error as at 1 July 2006 – Transfer of the opening balance of the GGR and DPCR to Deferred income)		
2. Dr Government Grant Reserve	44,500	
Dr Donations and Public Contributions Reserve	5,000	
Cr Accumulated surplus		49,500
(Correction of transfers form accumulated surplus to the GGR and DPCR for the year ended 30 June 2007)		

6.3.3: HOUSING DEVELOPMENT FUND (HDF)

This section of the manual sets out the FSOP's that needs to be executed by the municipality regarding the Housing development Fund (HDF). The FSOP's are drafted in the following categories:

- 6.3.3.1 Overview of the accounting for the Housing Development Fund (HDF)**
- 6.3.3.2 Introduction**
- 6.3.3.3 Accounting procedures relating to the HDF during its useful life**
- 6.3.3.4 Other procedures over the useful life of the HDF**
- 6.3.3.5 HDF disclosure requirements**

6.3.3.1 OVERVIEW OF THE ACCOUNTING FOR THE HDF

When accounting for the HDF 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
Introduction. The Housing Development fund was established in terms of the Housing Act, (Act No 107 of 1997).	Section 6.3.3.2
Accounting procedures relating to the HDF during its useful life. The municipality should ensure that all contributions to or from the HDF are shown as transfers in the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets.	Section 6.3.3.3
Other procedures over the useful life of the HDF. The municipality should ensure that a separate housing operating account (known as the HDF) is maintained by the municipality as required by sections 15(5) and 16 of the Housing Act, no 107 of 1997.	Section 6.3.3.4
AFS disclosure requirements. The municipality should ensure that an analysis of the composition of the HDF is disclosed in a note to the AFS, i.e. disclose the portions attributable to the Accumulated Surplus and to Loans Extinguished by Government on 1 April 1998 and also an analysis of the assets and liabilities of the HDF.	Section 6.3.3.5

INTRODUCTION / BACKGROUND

The Housing Development fund was established in terms of the Housing Act, (Act No 107 of 1997). Loans from national and provincial government used to finance housing selling schemes undertaken by the Municipality were extinguished on 1 April 1998 and transferred to a Housing Development Fund. Housing selling schemes both complete and in progress as at 1 April 1998, were also transferred to the Housing Development Fund. In terms of the Housing Act, all proceeds from housing developments which include rental income and sale of houses must be paid into the Housing Development Fund. Monies standing to credit of the Housing Development Fund can be used only to finance housing developments within the municipal areas subject to the approval of the Provincial MEC responsible for housing.

It should be noted that the Housing operating account is included in the Statement of Financial Performance. The net result of the Housing Operating Account is then transferred from/to the accumulated surplus/(deficit).

Note that since the HDF was established in terms of legislation it may be reported separately in the statement of financial position and the statement of changes in net assets.

The accumulated fund of the HDF includes the following:

- Accumulated surplus/(deficit)
- Loans extinguished on 1 April 1998

6.3.3.3 ACCOUNTING PROCEDURES RELATING TO THE HDF DURING ITS USEFUL LIFE

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	GRAP 1.111 requires the presentation in the statement of changes in net assets or in the notes of: <ul style="list-style-type: none"> the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and to the extent that components of net assets are separately disclosed, a reconciliation between the carrying amount of each component of net assets and each reserve at the beginning and the end of the period, separately disclosing each change. 	Ensure that any contributions to or from the HDF are shown as transfers to and from accumulated surplus on the statement of changes in net assets.	AP	Manager Budget Control	Monthly
2.	As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity of this type of accounting transactions.	1) Interest earned on the investments backing up this fund is recorded as part of interest earned in the Statement of Financial Performance and is then transferred via the statement of changes in net assets from the accumulated surplus to the Housing Development Fund. An Example of the journal that needs to be passed by the municipality to account for the interest earned on these investments is set out below in the Annexure.	AP	Manager Budget Control	End of financial year Monthly

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		<p>2) Ensure that only expenditure that relates to the HDF is charged to the housing operating account.</p> <p>3) Ensure that the net surplus or deficit on the Housing Operating Account is either credited or debited to the HDF respectively.</p>			30 June each year

6.3.3.4 OTHER PROCEDURES OVER THE USEFUL LIFE OF THE HDF

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	Section 15(5) and 16 of the Housing Act, (Act 107 of 1997), which came into operation on 1 April 1998, requires that the municipality ensures that a separate housing operating account (known as the HDF) is maintained by the municipality as required by sections 15(5) and 16 of the Housing Act, no 107 of 1997.	<p>1) Ensure that the Housing Fund is backed by cash and debtors and any other housing assets that are linked to the fund such as PPE.</p> <p>2) Ensure that the proceeds in the HDF are utilised for housing developments in accordance with the National Housing Policy and also for housing development projects approved by the MEC responsible for housing.</p>	LCP	CFO	<p>Date of implementation of GRAP</p> <p>Monthly</p>
2	In terms of sections 14(4) (d) (ii) (aa) read with, <i>inter alia</i> , section 16(2) of the Housing Act, net	Ensure that the net proceeds of any letting, sale of property or alienation, financed previously	LCP	CFO	Monthly


#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	proceeds of any letting, sale of property or alienation, financed previously from government housing funds, must be paid into a separate operating account (HDF) and utilised by the municipality for housing development in accordance with the National Housing Policy	from government housing funds, is paid into a separate operating account (HDF) and that it is utilised by the municipality for housing development in accordance with the National Housing Policy.			
5	As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity and correct valuation of this type of accounting transactions.	Ensure that the assets and liabilities of the HDF are valid and appropriately valued.	FCP	CFO	Date of Implementation of GRAP and each year end thereafter

6.3.3.5 AFS DISCLOSURE REQUIREMENTS

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity of this type of accounting transactions, and compliance with the Housing Act.	Ensure that an accounting policy exists, which states that the HDF may be utilised for housing developments in accordance with the national housing policy as well as housing projects approved by the MEC.	AP	CFO	30 June each year
2	GRAP 1.111 requires the presentation in the statement of changes in net assets or in the notes of: <ul style="list-style-type: none"> the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and to the extent that components of net assets are separately disclosed, a reconciliation between the carrying amount of each component of net assets and each reserve at the beginning and the end of the period, separately disclosing each change. 	<p>1) Ensure that an analysis of the composition of the HDF is disclosed, i.e. disclose the portions attributable to the Accumulated Surplus and to Loans Extinguished by Government on 1 April 1998.</p> <p>2) Ensure that the analysis of the assets and liabilities of the HDF is disclosed in the note to the AFS.</p>	AP	CFO	30 June each year

ANNEXURE 1 – Illustrative example

Example 1: Journalising interest pertaining to the HDF

	<p>The following example illustrates the journals that need to be passed by the municipality to accurately reflect the interest earned on investments backing up the HDF</p> <p>Municipality A has a HDF account balance of R6,100,000.00. Investments backing up this fund earn interest on an annual basis. Interest of R480,000.00 had been earned during the current financial year.</p>
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This interest represents revenue as defined in GAMAP 9: Revenue, thus initially it has to be presented in the Statement on Financial Performance, illustrated as follows:

		Rand	Rand
Dr	Bank	480,000	
	Cr Interest Received		480,000
(Recording of interest received on HDF investments)			

Hereafter it can be transferred from the Accumulated Surplus/ Deficit account to the HDF account via the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus, illustrated as follows:

		480,000	
Dr	Accumulated Surplus/ Deficit	480,000	
	Cr HDF		480,000
(Transfer of interest earned on investments backing up the HDF from the Accumulated Surplus/Deficit account to the HDF account)			

6.3.4: SELF INSURANCE RESERVE (SIR)

This section of the manual sets out the FSOP's that needs to be executed by the municipality regarding the Self Insurance Reserve (SIR). The FSOP's are drafted in the following categories:

- 6.3.4.1 Overview of the accounting for the Self Insurance Reserve (SIR)**
- 6.3.4.2 Introduction**
- 6.3.4.3 Accounting procedures relating to the SIR during its useful life**
- 6.3.4.4 Other procedures over the useful life of the SIR**
- 6.3.4.5 AFS disclosure requirements**

6.3.4.1 OVERVIEW OF THE ACCOUNTING FOR THE SIR

When accounting for the SIR 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
Introduction. Self-Insurance Reserves are created at municipalities to set aside amounts to offset potential losses or claims that cannot be insured externally.	Section 6.3.4.2
Accounting procedures relating to the SIR during its useful life. The municipality should ensure that all contributions to or from the SIR are shown as transfers between the SIR and Accumulated Surplus.	Section 6.3.4.3
Other procedures over the useful life of the SIR. The municipality should ensure that it has a basis of quantifying the risk it carries from a self-insurance perspective and that the balance of the reserve is adequate to mitigate such risks.	Section 6.3.4.4
AFS disclosure requirements. The SIR should be included as part of Accumulated Surplus on the Statement of Financial Position. All movements on the SIR for the financial year should be reflected in a note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets.	Section 6.3.4.5

6.3.4.2 INTRODUCTION

Municipalities have Self-Insurance Reserves to set aside amounts to offset potential losses or claims that cannot be insured externally. The balance of the Self-Insurance Reserve is determined based on insurance risk carried by the municipality and past claims history and is increased by a transfer from the accumulated surplus/(deficit). Claims are settled by transferring a corresponding amount from the self-insurance reserve to the accumulated surplus.

Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, the SIR should form part of Accumulated Surplus and should not be disclosed on the face of the Statement of Financial Position. Municipalities can however disclose in a note to the financial statements the internal funds and reserves (including the SIR) that is ring fenced within accumulated surplus.

6.3.4.3 ACCOUNTING PROCEDURES RELATING TO THE SIR DURING ITS USEFUL LIFE

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	To ensure proper internal control and a complete audit trail, standardized procedures need to be performed regarding the annual transfers to and from the SIR.	<p>1) The SIR does not have to be cash backed, however if it is to be effectively utilised by the municipality to offset losses that are not externally insured, ensure that the SIR is backed by cash.</p> <p>2) Contributions to the SIR by Business Units are transferred via accumulated surplus in the note to the AFS disclosing internal funds and reserves that are ring-fenced within accumulated surplus and not on the statement of changes in net assets.</p> <p>3) Ensure that contributions to the SIR by departments within the municipality are transferred via note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets.</p> <p>Examples of the journals that need to be passed by the municipality to account for the SIR are set out below in the Annexure: Example of Journals pertaining to the SIR.</p>	AP	Manager Budget Control	Date of Implementation of GRAP and annually thereafter

6.3.4.4 OTHER PROCEDURES OVER THE USEFUL LIFE OF THE SIR

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	To ensure proper internal control and a complete audit trail, standardized procedures need to be performed regarding the annual transfers to and from the SIR.	<ol style="list-style-type: none"> 1) Ensure that insurance premiums paid to external insurers are allocated as an expense and are recorded as such in the GL and Statement of Financial performance. Ensure that a transfer is made to the Accumulated Surplus from the SIR at year end to offset the external insurance premium paid, if the contributions to the SIR by departments are calculated taking the external insurance premium into account. See example 2 in the Annexure below. 2) Ensure that "repair and replacement costs" not covered by the external insurers, are financed from the self insurance reserve. See example 3 & 4 in the Annexure below. 3) The municipality may transfer additional amounts from the accumulated surplus/deficit to the SIR to both offset self-insured losses included in the Statement of Financial Performance and to ensure that the balance of the self-insurance reserve is adequate. 4) Ensure that the municipality has a basis of quantifying the risk it carries from a self-insurance perspective and that the balance of the reserve is adequate to mitigate such risks. 	AP	<p>Manager Budget control</p> <p>Manager Budget control</p> <p>CFO</p> <p>CFO</p>	<p>Monthly and at year end</p> <p>Monthly</p> <p>Each financial year end</p> <p>Date of Implementation of GRAP</p>


6.3.4.5 AFS DISCLOSURE REQUIREMENTS

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	<p>GRAP 1.111 requires the presentation in the statement of changes in net assets or in the notes of:</p> <ul style="list-style-type: none"> the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and to the extent that components of net assets are separately disclosed, a reconciliation between the carrying amount of each component of net assets and each reserve at the beginning and the end of the period, separately disclosing each change. <p>As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity of this type of accounting transactions.</p>	<p>Ensure that the following is disclosed in the AFS in respect of the SIR:</p> <ul style="list-style-type: none"> The SIR should be included as part of Accumulated Surplus on the Statement of Financial Position. All movements on the SIR for the financial year should be reflected in a note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets. An accounting policy note needs to be drafted for the SIR setting out the nature of the SIR, its accounting treatment and whether it is cash backed. 	AP	CFO	Each year end

ANNEXURE 1 – Illustrative examples

The following examples illustrate journals that need to be passed by the municipality to accurately record transactions in the SIR


Example 1: Transfer to the SIR

	<p>The municipality budgets to make a transfer to the SIR for the year ended 30 June 2005 of R 100 000 and makes this transfer on 30 June 2005.</p>
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The accounting entry is that a transfer will be made from the Accumulated surplus Account to the SIR and be reflected on the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus, as a reduction in the Accumulated surplus and an increase in the SIR. Furthermore a transfer will have to be made from the General Bank Account to an investment account if the municipality's policy is that the SIR is cash backed.

The total amount of insurance premiums paid to external insurers are regarded as expenses and must be shown as such in the Statement of Financial Performance. These premiums do not affect the SIR.

Example 2: Transfer to the SIR

	<p>The municipality insures all its motor vehicles internally and externally insures all other assets. During the financial year ended 30 June 2005 the municipality pays an external insurance premium of R 250 000. The municipality also budgets to make a transfer to the SIR for the year ended 30 June 2005 of R 400 000 and makes this transfer on 30 June 2005.</p>
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The accounting entries to account for the transactions in example 2 will be as follows:

TRANSACTION DETAIL	DR	CR
DR External insurance premium	250 000	
CR Bank		250 000
<i>Payment of the external insurance premium</i>		
DR Accumulated surplus	400 000	
CR SIR		400 000
<i>Annual contribution to the SIR</i>		

The expense of R 250 000 will be recorded as an expense in the Statement of Financial Performance. If the municipality includes the cost of the external insurance premium in the calculation of the contribution by departments to the SIR then a transfer will be made to offset the external insurance premium expense charged to the Statement of Financial Performance as follows:

TRANSACTION DETAIL	DR	CR
DR SIR	250 000	
CR Accumulated surplus (AS)		250 000


Transfer from the SIR to the Accumulated Surplus to offset the external insurance premium expense.

The external premium has been budgeted for, charged to departments, and included in the contribution to the SIR.

Claims received from external insurers to meet repairs of damages to assets are recognised as revenue in the Statement of Financial Performance.

Repair and replacement costs not fully covered by external insurance are financed from the SIR. The repair and replacement cost is regarded as an expense and is reflected in the Statement of financial performance. An amount equal to the expense is transferred from the SIR to the Accumulated surplus via note to the AFS disclosing internal funds and reserves that are ring-fenced within accumulated surplus and not on the statement of changes in net assets.

Example 3: Transfer from the SIR

	<p>The municipality is externally insured for damages to buildings. A building is damaged and the cost of the repairs is determined by the municipality as being R 500 000. The external insurers assess that the municipality is covered to an amount of R 350 000. The external insurer pays the amount of R 350 000 to the external contractor for the repairs and the municipality pays the remainder of R 150 000.</p>
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The accounting entries will be as follows:

TRANSACTION DETAIL	DR	CR
DR Repairs and maintenance	150 000	
CR Bank		150 000
<i>Payment of cost of repairs and maintenance</i>		
DR SIR	150 000	
CR Accumulated surplus (US)		150 000
<i>Transfer from SIR to offset repair cost not fully covered by external insurance</i>		

The SIR can only be used to offset or fund external insurance shortfalls for the above type of repairs to damages if the annual contribution to the SIR is calculated taking these shortfalls into account.

Claims received from external insurers are utilised in the calculation of a gain or loss on the scrapping of damaged assets and are therefore effectively recorded in the Statement of Financial Performance. Replacement assets partially purchased out of the Self Insurance Reserve, where the external insurance claim does not fully fund the purchase price, result in a transfer being made from the Self Insurance Reserve to the Accumulated surplus account.

Example 4: Transfer from SIR

	<p>Excess payments with regards to claims made to external insurers may be financed from the Self Insurance Reserve. This will mean that excess payments are recorded as an expense in the Statement of Financial Performance with a transfer being made from the SIR to the Accumulated surplus account to offset this expenditure.</p> <p>Incidental expenditure on assets, not externally insured, and ascribable to abnormal wear and tear may be financed from the Self Insurance Reserve. Abnormal wear and tear is defined as abnormal, insurable, mechanical damage to assets. This will mean that the abnormal expenditure will be recorded as an expense in the Statement of Financial Performance with a transfer being made from the SIR to the Accumulated surplus account to offset this expenditure.</p>
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6.3.5: ACCOUNTING FOR THE CAPITALISATION RESERVE

This section of the manual sets out the FSOP's that needs to be executed by the municipality regarding the Capitalisation Reserve (CR). The FSOP's are drafted in the following categories:

- 6.3.5.1 Overview of the accounting for the Capitalisation Reserve (CR)**
- 6.3.5.2 Introduction**
- 6.3.5.3 Creating the Capitalisation Reserve (CR)**
- 6.3.5.4 Utilisation of the CR over its useful life**
- 6.3.5.5 Annual Financial Statement disclosure requirements**

6.3.5.1 OVERVIEW OF THE ACCOUNTING FOR THE CAPITALISATION RESERVE

When accounting for the CR 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
Introduction. The Capitalisation Reserve represents amounts previously accumulated that were recovered from consumers through rates and tariffs and that have been used to acquire items of Property, Plant and Equipment.	Section 6.3.5.2
Creating the Capitalisation Reserve. In the past in terms of the principles of Fund Accounting, municipalities created various statutory funds in terms of ordinances. As part of the unbundling process of these statutory funds, the Capitalisation Reserve is created. The balance on the Capitalisation Reserve on the implementation of GRAP should equal the book value of assets previously financed by way of internal advances from previously legislated funds.	Section 6.3.5.3
Utilisation of the CR over its useful life. Annually, an amount equal to the depreciation charge for the year as recorded in the Statement of Financial Performance, for assets previously funded by way of internal advances, should be transferred from the CR to accumulated surplus. All items of PPE (previously funded by way of internal advances) that are disposed of during the financial year, the balance in the Capitalisation Reserve relating to such item should also be transferred to the accumulated surplus.	Section 6.3.5.4
AFS disclosure requirements. The CR should be included as part of Accumulated Surplus on the Statement of Financial Position. All transfers from the CR to accumulated surplus should be reflected in a note to the AFS, disclosing internal funds and reserves that are ring fenced within accumulated surplus, and not on the statement of changes in net assets.	Section 6.3.5.5

6.3.5.2 INTRODUCTION

The Capitalisation Reserve represents amounts previously accumulated that were recovered from consumers through rates and tariffs and that have been used to acquire items of Property, Plant and Equipment. These amounts are therefore not available to be used for any other purpose. In addition, this Reserve aims to promote consumer equity by ensuring that consumers are not subject to double taxation when the items of property, plant and equipment acquired through internal loans are depreciated on the introduction of standards. The accounting entries relating to the establishment of the Capitalisation Reserve and the offsetting of depreciation are illustrated below.

Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, the Capitalisation Reserve should form part of Accumulated Surplus and should not be disclosed on the face of the Statement of Financial Position. Municipalities can however disclose in a note to the financial statements the internal funds and reserves (including the CR) that is ring fenced within accumulated surplus.

6.3.5.3 CREATING THE CAPITALISATION RESERVE (CR)

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	<p>In the past in terms of the principles of Fund Accounting municipalities created various statutory funds in terms of ordinances. These funds were then utilized to make internal loans or advances to the various services such as the Electricity, Water and Rate and General Services. These internal loans were repayable and interest was charged on the internal loans.</p> <p>According to the National Treasury guidelines on the implementation of the new GRAP standards dated June 2005 these funds need to be unbundled and a CRR needs to be established. As part of the unbundling process the Capitalisation Reserve is created. The purpose of this Reserve is to promote consumer equity by ensuring that the future depreciation expenses that will be incurred over the useful lives of these items of property, plant and equipment are offset by transfers from this reserve to the accumulated surplus/ (deficit). The balance on the Capitalisation Reserve equals the carrying value of the items of property, plant and equipment financed from the former legislated funds. When items of property, plant and</p>	<p>The steps that are followed to unbundle these funds is set out as follows:</p> <p>Step 1: Aggregate the existing funds into one account called the CRR</p> <p>Step 2: Debit the new account with the amount equal to the internal advances outstanding and credit the Capitalisation Reserve.</p> <p>Step 3: Reverse the internal advances made balance against the advances received balance in the borrowing service.</p> <p>Step 4: Compare the total of the CRR to the value of investments attributable to the CRR. Reverse the unfunded balance to Accumulated Surplus</p> <p>The accounting entries relating to the unbundling exercise are best explained by way of the practical example as reflected in the NT GRAP implementation guidelines. Refer to the example in the Annexure below.</p>	AP	Manager Fixed Assets	On date of implementation of GRAP

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	equipment are depreciated, a transfer is made from the Capitalisation Reserve to the accumulated surplus/ (deficit). When an item of property, plant and equipment is disposed, the balance in the Capitalisation Reserve relating to such item is transferred to the accumulated surplus/ (deficit).				

6.3.5.4 UTILISATION OF THE CR OVER ITS USEFUL LIFE

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	Once the CR has been created by the municipality as set out in section 1 above the balance on the CR must be equal to the carrying amount of all assets funded by way of internal advances from legislated funds in the past (Cost price of assets purchased less internal loans redeemed).	Ensure that the balance on the Capitalisation Reserve on the implementation of GRAP equals the book value (Cost price less internal loans redeemed) of all assets previously financed by way of internal advances from previously legislated funds.	AP	CFO/ Manager Fixed Assets	On date of implementation of GRAP
2.	The annual future depreciation charge in respect of the book value of assets equalling the balance on the CR (i.e. assets previously financed by way of internal advances from previously legislated funds) needs to be reflected as part of the depreciation charge in	Ensure that depreciation charge for the year as recorded in the Statement of Financial Performance includes depreciation on assets previously funded by way of internal advances from legislated funds.	AP	CFO/ Manager Fixed Assets	30 June each year


#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	the Statement of Financial performance of the municipality.				
3.	<p>An annual transfer needs to be made from the CR to Accumulated Surplus (debit reserve and credit surplus) equal to the depreciation charge in respect of assets previously funded by way of internal advances on legislated funds.</p> <p>When an item of property, plant and equipment (previously funded by way of internal advances) is disposed of, the balance in the Capitalisation Reserve relating to such item is transferred to the accumulated surplus/ (deficit).</p>	Ensure that an amount equal to the depreciation charge for the year as recorded in the Statement of Financial Performance for assets previously funded by way of internal advances from legislated funds is transferred from the CR to accumulated surplus via a note to the AFS disclosing internal funds and reserves that are ring-fenced within accumulated surplus.	AP	CFO/ Manager Fixed Assets	30 June each year
4.	As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity and correct valuation of this type of accounting transactions.	Ensure that for all items of PPE (previously funded by way of internal advances) that are disposed of during the financial year, the balance in the Capitalisation Reserve relating to such item is transferred to the accumulated surplus/ (deficit), also via a note to the AFS disclosing internal funds and reserves that are ring-fenced within accumulated surplus.	AP	Manager Fixed Assets	30 June each year
5.	As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity and correct valuation of this type of accounting transactions.	Ensure that, at 30 June, after FSOP # 2, 3 and 4 above have been executed that the book value of assets previously funded by way of internal advances from legislated funds (Cost Price less accumulated depreciation) is equal to the balance on the CR.	FCP	Manager Fixed Assets	30 June each year

6.3.5.5 AFS DISCLOSURE REQUIREMENTS

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	<p>GRAP 1.111 requires the presentation in the statement of changes in net assets or in the notes of:</p> <ul style="list-style-type: none"> the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and to the extent that components of net assets are separately disclosed, a reconciliation between the carrying amount of each component of net assets and each reserve at the beginning and the end of the period, separately disclosing each change. 	Ensure that all movements from the CR to Accumulated Surplus during the financial year are disclosed in a note to the AFS, disclosing internal funds and reserves that are ring-fenced within accumulated surplus, and not on the statement of changes in net assets.	AP	CFO	30 June each year

ANNEXURE 1 – Illustrative example

Example 1: Creating the capitalisation reserve

	<p>Assume that a municipality has a Capital Development Fund (CDF) and a Land Trust Fund (LTF) with balances as shown below.</p>
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These statutory funds have used part of their funds to make internal loans to the borrowing services, which is shown below:

CDF					
	External investments	250		Accumulated fund	1000
	Internal loans made	750			
	TOTAL	1000		TOTAL	1 000

LTF					
	External investments	100		Accumulated Fund	500
	Internal loans made	400			
	TOTAL	500		TOTAL	500

BORROWING SERVICES: INTERNAL LOANS					
				Loan from CDF	750
				Loan from LTF	400
				TOTAL	1150

Step 1: Aggregate the existing funds into one account called the CRR. This is simply a process of accumulating the information in the separate funds into one account. The result of the process will be the following account:

DRAFT CRR					
	External investments	350		Accumulated fund	1500
	Internal loans made	1150			
	TOTAL	1500		TOTAL	1 500

Step 2: Debit the new account with the amount equal to the internal advances outstanding of R 1,150 and credit the Capitalisation Reserve. This results in the CRR having a balance of R 350 equal to the investments.

Step 3: Reverse the internal advances made balance against the advances received balance in the borrowing service.

The result of steps 2 and 3 will be that the CRR and Capitalisation Reserve accounts appear as follows:

CRR					
	External investments	350		Accumulated fund	350
	Internal loans made	0			
	TOTAL	350		TOTAL	350

CAPITALISATION RESERVE					
				Transfer from CRR	1150
				TOTAL	1 150

Step 4: Compare the total of the CRR to the value of investments attributable to the CRR. Reverse the unfunded balance to Accumulated Surplus

6.3.6: RESERVE ESTABLISHED FOR COMPENSATION FOR OCCUPATIONAL INJURIES AND DISEASES (COID RESERVE)

This section of the manual sets out the FSOP's that needs to be executed by the municipality regarding the Reserve established for Compensation for Occupational Injuries and Diseases (COID Reserve). The FSOP's are drafted in the following categories:

- 6.3.6.1 Overview of the accounting for the COID Reserve**
- 6.3.6.2 Introduction**
- 6.3.6.3 Creating and utilising the COID Reserve**
- 6.3.6.4 Annual Financial Statement disclosure requirements.**



6.3.6.1 OVERVIEW OF THE ACCOUNTING FOR THE COID RESERVE

When accounting for the COID reserve, 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
Introduction / background. The COID reserve is established for Compensation for Occupational Injuries and Diseases where permission to retain contributions has been obtained from the Compensation Commissioner.	Section 6.3.6.2
Creating and utilising the COID reserve. The COID reserve can only be created if a municipality has been exempted from making contributions to the Compensation Commissioner for Occupational Injuries and Diseases. The municipality should ensure that all contributions to or from the COID reserve are shown as transfers between the COID reserve and Accumulated Surplus.	Section 6.3.6.3
AFS disclosure requirements. The COID reserve should be included as part of Accumulated Surplus on the Statement of Financial Position. All movements on the COID reserve for the financial year should be reflected in a note to the AFS, disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets.	Section 6.3.6.4

6.3.6.2 INTRODUCTION / BACKGROUND

The COID reserve is established for Compensation for Occupational Injuries and Diseases where permission to retain contributions has been obtained from the Compensation Commissioner. In terms of the exemption from the Compensation Commissioner, the COID reserve is established to offset claims from employees.

Amounts are transferred to the COID reserve from the accumulated surplus based on the statutory rate of contributions set out in the Compensation for Occupational Injuries and Diseases Act, (Act No 130 of 1993) as well as additional amounts deemed necessary to ensure that the balance of the reserve is adequate to offset potential claims.

Since fund accounting is not allowed in terms of GRAP / GAMAP / GAAP, the COID reserve should form part of Accumulated Surplus and should not be disclosed on the face of the Statement of Financial Position. Municipalities can however disclose in a note to the financial statements the internal funds and reserves (including the COID reserve) that are ring fenced within accumulated surplus.

6.3.6.3 CREATING AND UTILISING THE COID RESERVE

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	<p>The COID reserve is established for Compensation for Occupational Injuries and Diseases where permission to retain contributions has been obtained from the Compensation Commissioner.</p> <p>The municipality is obliged to pay occupational injuries and disease to employees in terms of the Compensation for Occupational Injuries and Diseases Act. These municipalities are not obligated to pay contributions but instead assume the risk arising from COID.</p>	<p>Ensure that the municipality has been exempted from making contributions to the Compensation Commissioner for Occupational Injuries and Diseases.</p>	LCP	CFO	Date of Implementation of GRAP and annually thereafter
2.	<p>As best practice in the management of the municipality's funds, standard procedures need to be performed to ensure the validity of this type of accounting transactions, and compliance with the relevant legislation.</p>	<p>From an accounting perspective, this reserve should be accounted for on the same basis as the Self-Insurance Reserve.</p> <p>The COID Reserve does not have to be cash backed, however if it is to be effectively utilised by the municipality to offset claims from employee that are not externally insured, ensure that the COID Reserve is backed by cash. Contributions to the COID Reserve are transferred via the note to the AFS, disclosing internal funds and reserves that are ring-fenced within accumulated surplus, to the COID Reserve in line with the statutory rate of contributions set out in the Compensation for</p>	AP	CFO	Date of Implementation of GRAP and annually thereafter


#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
		<p>occupational Injuries and Diseases Act, (act no 130 of 1993) as well as additional amounts deemed necessary to ensure that the balance of the Reserve is adequate to offset potential claims.</p> <p>Examples of the journals that need to be passed by the municipality to account for the COID reserve are set out below in the Annexure: Example of Journals pertaining to the COID reserve.</p>			
3.	To ensure proper internal control and a complete audit trail, standardized procedures need to be performed regarding the annual transactions and transfers to and from the COID reserve.	<p>Ensure that compensation for occupational injuries and diseases, paid to employees, are allocated as an expense and are recorded as such in the GL and Statement of Financial Performance.</p> <p>Ensure that a transfer is made to the Accumulated Surplus from the COID Reserve at year end to offset the expense incurred by the municipality.</p>	AP	Manager Budget control	Monthly and at year end

6.3.6.4 AFS DISCLOSURE REQUIREMENTS

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1.	<p>GRAP 1.111 requires the presentation in the statement of changes in net assets or in the notes of:</p> <ul style="list-style-type: none"> the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and to the extent that components of net assets are separately disclosed, a reconciliation between the carrying amount of each component of net assets and each reserve at the beginning and the end of the period, separately disclosing each change. 	<p>Ensure that the following is disclosed in the AFS in respect of the COID Reserve:</p> <ul style="list-style-type: none"> The COID Reserve should be included as part of Accumulated Surplus on the Statement of Financial Position. All movements on the COID Reserve for the financial year should be reflected in a note to the AFS, disclosing internal funds and reserves that are ring fenced within accumulated surplus and not on the statement of changes in net assets. An accounting policy note needs to be drafted for the COID Reserve setting out the nature of the COID Reserve, its accounting treatment and whether it is cash backed. 	AP	CFO	30 June each year

ANNEXURE 1 – Illustrative example

Example 1: Journals pertaining to the COID reserve

	<p>The following example illustrates the journals that need to be passed by the municipality to accurately record transactions in the COID reserve.</p> <p>The municipality budgets to make a transfer to the COID reserve for the year ended 30 June 2005 of R 100 000 (0.75% of the annual remuneration of employees that qualify for COID benefits) and makes this transfer on 30 June 2005. The accounting entry is that a transfer will be made from the Accumulated surplus Account to the COID Reserve and be reflected on the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus, as a reduction in the Accumulated surplus and an increase in the COID reserve. Furthermore a transfer will have to be made from the General Bank Account to an investment account if the municipality's policy is that the COID reserve is cash backed.</p> <p>Claims from employees to the amount of R 60 000 were paid during the year. These claims are regarded as expenses and must be shown as such in the Statement of Financial Performance. The following transfers will have to be made:</p> <ol style="list-style-type: none"> 1. A transfer from the COID Reserve to the Accumulated Surplus via the note to the AFS disclosing internal funds and reserves that are ring fenced within accumulated surplus. 2. A transfer from the Investment account to the General Bank Accounts if these expenses were paid from the General Bank Account
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The accounting entries to account for these transactions will be as follows:

TRANSACTION DETAIL	Rand	Rand
DR Accumulated surplus	100 000	
CR COID reserve		100 000
Annual contribution to the COID reserve		
DR COID Investment Account	100 000	
CR Bank		100 000
Transfer of moneys from the General Bank Account to the COID Investment Account		
DR Employee cost	60 000	
CR Bank		60 000
Claims from employees paid during the year.		
DR Bank	60 000	
CR COID Investment Account		60 000
Reimbursement of the General Bank Account from the COID Investment Account		