

# **INXUBA YETHEMBA MUNICIPALITY**



## **FINAL ASSET MANAGEMENT POLICY 2020/21**

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# **1 INTRODUCTION**

## **(1) OBJECTIVE**

This policy is aimed at assisting management and employees of the municipality to implement and maintain consistent, effective and efficient asset management principles.

The objective of this policy is:

- To safeguard the fixed assets of the municipality and to ensure the effective use of existing resources
- To emphasise a culture of accountability towards the municipality's fixed assets
- To ensure that effective controls are communicated to management and staff through clear and comprehensive written documentation
- To provide a formal set of financial procedures that can be implemented to ensure that the municipality's financial asset policies are in compliance with the Municipal Finance Management Act 2003, Act 56 of 2003, herein referred to as the MFMA.

## **(2) BACKGROUND**

**(a)** The proper utilisation and management of its assets is one of the prime mechanisms by which a municipality can fulfill the constitutional objects for:

- Delivery of sustainable services
- Promotion of Social and Economic Development
- Promoting a safe and healthy environment and
- Providing for the basic needs to the community.

**(b)** The municipality has a legal and moral obligation to ensure it implements policies to provide for the effective and efficient usage of its assets over the useful life thereof.

**(c)** The Asset Management Policy deals with the municipal rules required to ensure the enforcement of appropriate stewardship of assets.

**(d)** The MFMA stresses the need for good asset management, noting that directorates should hold only those assets that are necessary for the efficient, effective and economical delivery of its programs.

**(e)** The following should be enforced to ensure proper asset control:

- All assets must be properly identified and controlled until they are ultimately disposed of
- The municipality's accounting policies must be reasonable and consistently applied, with specific reference to the provision for depreciation, amortization, ageing and the reduction of the value of the assets
- Assets that exist at a specific date must be reflected as such in the Fixed Assets Register (FAR)
- Ownership of the asset must lie with the municipality and must be included in the FAR
- The value at which the asset is reflected on the balance sheet must be correct and be the reasonable value of the asset
- Assets must be in good working order and when not in use, duly maintained
- All asset transactions must be duly authorised and noted by the relevant authorised personnel
- All assets must be kept safe and properly maintained.

**(f)** This policy replaces / supersedes all financial policy instructions that have previously been issued.

**(g)** Failure to comply with the prescribed procedures will result in disciplinary procedures in terms of the stipulated human resources policies and procedures of the municipality.

### **(3) STATUTORY AND REGULATORY FRAMEWORK**

**(a)** This policy must comply with all relevant legislative requirements including:

- The Constitution of the Republic of South Africa, 1996
- Municipal Structures Act, 1998
- Municipal Systems Act, 2000
- Division of Revenue Act (enacted annually)
- Municipal Finance Management Act No 56 of 2003

- Local Government: Municipal Asset Transfer Regulations, 2008

**(b)** In addition, this policy must comply with the standards specified by the Accounting Standards Board. The relevant generally recognized accounting standards (GRAP) include:

- GRAP 1 Presentation of Financial Statements
- GRAP 3 Accounting Policies, Changes in Accounting Estimates
- GRAP 13 Leases
- GRAP 16 Investment property
- GRAP 17 Property, plant or equipment
- GRAP 31 Intangible Assets
- GRAP 100 Non-current Assets held for Sale and Discontinued Operations
- GRAP 102 Intangible Assets
- GRAP 103 Heritage Assets

## **2 DEFINITIONS**

Consistent definitions are essential to ensure good asset management and reporting.

### **(1) *Assets***

Are resources controlled by the municipality as the result of past events and from which future economic benefits or future service potential are expected to flow to the municipality.

### **(2) *Classification of assets: PPE should be classified into the following definition groups:***

- (a) Infrastructure assets which are defined as assets that usually display some or all of the following characteristics:
  - i. They are part of a system or network,
  - ii. They are specialised in nature and do not have alternative uses,
  - iii. They are immovable, and
  - iv. They may be subject to constraints on disposal
  - v. Examples are road networks, sewer systems, water, electricity networks etc.
- (b) Community assets which are defined as assets that contributes to the community's well-being.

- (c) Heritage assets which are defined as culturally significant resources.
- (d) Investment properties which are defined as properties that are acquired for economic and capital gains, or held by the City under a finance lease to earn rentals.
- (e) Other assets which are defined as assets utilised in the normal operations.
- (f) Intangible assets which are defined as being assets without a physical substance.
- (g) Biological assets are assets acquired for agricultural purposes.

(3) ***Leased assets***

A lease is an agreement whereby the lesser conveys to the lessee in return for 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 of ownership of an asset.

(4) ***Fair value***

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

(5) ***Residual value***

Residual value is the net amount that the enterprises expect to obtain for an asset at the end of its useful life after deducting the expected cost of disposal.

(6) ***Impairment Loss***

An impairment loss is the amount by which the carrying value of an asset exceeds the recoverable amount.

(7) ***Carrying value***

Carrying value is the amount at which the asset is recognized in the balance sheet after deducting any accumulated depreciation and accumulated impairment losses thereon.

(8) ***Recoverable value***

Recoverable value is the higher of the asset's net selling price and its value in use.

(9) ***Depreciation***

Depreciation is the decline during the accounting period, in the value of fixed assets as result of physical deterioration, normal obsolescence or normal accidental damage.

During the useful life of the asset, the asset will be depreciated from its actual cost price to its residual value.

(10) ***Depreciable amount***

The depreciable amount of an asset is determined after deducting the residual value of the fixed asset from the cost of the asset.

(11) ***Accumulated depreciation***

Accumulated depreciation refers to the total depreciation allocations over the period of ownership to a certain point with respect to assets still in use.

(12) ***Depreciation Method***

Although various depreciation methods can be used, the municipality uses the straight-line method, which closely reflects the physical wear and tear of the respective assets.

(13) ***Useful life***

The useful life of an asset is defined in terms of the asset's expected utility to the municipality and this is not necessary as long as the economic life. The estimation of the useful life of an asset is a matter of judgment based on experience with similar assets within the organisation. The following factors should be considered when assessing an asset's useful life:

- Expected use
- Expected physical wear and tear
- Technical obsolescence
- Legal or other limits on the use

(14) ***Construction Contracts***

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or inter dependent in terms of their design, technology and function or their ultimate purpose or use.

(14) ***Research and development Cost***

- (a) Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.



- (b) Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

### **3 ROLES AND RESPONSIBILITIES**

#### **(1) ROLE OF MUNICIPAL MANAGER**

As Accounting Officer of the municipality, the Municipal Manager shall be the principal custodian of all the municipality's fixed assets, and shall be responsible for ensuring that the Asset Management Policy is scrupulously applied and adhered to.

#### **(2) ROLE OF CHIEF FINANCIAL OFFICER**

- (a) The Chief Financial Officer (CFO), or his nominee, shall be the fixed asset registrar of the municipality, and shall ensure that a complete, accurate and up-to-date computerised Fixed Asset Register is maintained.
- (b) No amendments, deletions or additions to the Fixed Asset Register shall be made other than by the CFO or by an official acting under the written instruction of the CFO.

#### **(3) ROLE OF MANAGERS**

- (a) Every Director shall be directly responsible for the physical safekeeping of any fixed asset controlled for use by the department in question.
- (b) Every Director in conjunction with Asset Management shall ensure that the asset identification system approved for the municipality is scrupulously

applied in respect of all fixed assets controlled or used by the department in question.

- (c) Every Director in conjunction with Asset Management shall at least once during every financial year undertake a comprehensive verification of all fixed assets controlled or used by the department concerned.

## **4 FINANCIAL MANAGEMENT**

### **(1) PROCUREMENT OF ASSETS**

- (a) A capital budget must be compiled and approved for all capital acquisitions. This capital budget must be drafted in accordance with the MFMA as well as internal budget related policies.
- (b) Money can only be spent on a project/asset if:
  - (i) the money has been appropriated in the capital budget, and the future annual operations and maintenance needs have been calculated and have been budgeted for in the operations budget
  - (ii) the project, including the total cost and funding sources, has been approved by Council
  - (iii) the CFO confirms that funding is available for that specific project and
  - (iv) the Supply Chain Management prescripts/procedures have been adhered to.
- (c) An approved capital project plan must be completed.
- (d) Capitalization forms must be completed for each project indicating the source of funding as well as the completion date.
- (e) Authorisation for procurement should be as per the Directorates delegation of authority and payment for assets should be in accordance with Financial Policies and regulations of the Supply Chain Management Policy.

## **(2) FUNDING**

- (a) The acquisition of assets will not be funded over a period longer than the useful life of that asset.
- (b) As stated in 4(1)(b) above for new asset acquisitions the funding must be approved and available for use to acquire the asset.

## **(3) DISPOSAL OF ASSETS**

### **(a) Assets must be disposed in such a way that –**

- (i) In financial terms, such disposal is always to the benefit of the municipality;  
and
- (ii) During the consideration and acceptance of tenders/quotations or any bid for such assets, the image of the municipality is not impaired.
- (iii) Assets must be disposed of as stipulated in the approved Supply Chain Management Policy of the municipality.
- (iv) Authorisation for disposal should be as per the Directorates delegation of authority.

### **(b) Alienation of fixed Assets**

NOTE: The reference to the asset financing reserve below is based on the assumption that the reserve is allowed.

- (i) In compliance with the principles and prescriptions of the Municipal Finance Management Act, the transfer of ownership of any fixed asset shall

be fair, equitable, transparent, competitive and consistent with the municipality's Supply Chain Management policy.

- (ii) Every Manager shall report in writing to the CFO on 30 April of each financial year on all fixed assets controlled or used by the department concerned which such Manager wishes to alienate by public auction or public tender. The CFO shall thereafter consolidate the requests received from the various directorates, and shall promptly report such consolidated information to the Council or the Municipal Manager of the municipality, as the case may be, recommending the process of alienation to be adopted.
- (iii) The Council shall delegate to the Municipal Manager the authority to approve the alienation of any fixed asset with an anticipated carrying value less than R200 000 (two hundred thousand rand).
- (iv) The Council shall ensure that the alienation of any fixed asset with a carrying value equal to or in excess of R200 000 (two hundred thousand rand) takes place in compliance with Section 14 of the Municipal Finance Management Act, 2004 which states:

*“(1) A municipality may not alienate any capital asset required to provide a minimum level of basic municipal services.*

*(2) A municipality may alienate any other capital asset, but provided*

- (a) The Council, in a meeting open to the public, has first determined that the asset is not required to provide a minimum level of basic municipal services, and*
- (b) The Council has considered the fair market value of the asset and the economic and community value to be received in exchange for the asset.”*

- (v) Once the fixed assets are alienated, the CFO shall delete the relevant records from the Fixed Asset Register.
- (vi) If the proceeds of the alienation are less than the carrying value recorded in the Fixed Asset Register, such difference shall be recognised as a loss in the Statement of Financial Performance of the department or vote concerned. If the proceeds of the alienation, on the other hand, are more than the carrying value of the fixed asset concerned, the difference shall be recognised as a gain in the Statement of Financial Performance of the department or vote concerned.
- (vii) Transfer of fixed assets to other municipalities, municipal entities (whether or not under the municipality's sole or partial control) or other organs of state shall take place in accordance with the above procedures, except that the process of alienation shall be by private treaty.

**(c) Other write-offs of fixed assets**

- (i) A fixed asset even though fully depreciated shall be written off only on the recommendation of the Director controlling or using the asset concerned, and with the approval of the Council of the municipality.
- (ii) Every Director shall report to the CFO by no later than 30 April (or when the need arises) of each financial year on any fixed assets which such Director wishes to have written off, stating in full the reason for such recommendation. The CFO shall consolidate all such reports, and shall promptly submit a recommendation to the Council of the municipality on the fixed assets to be written off.

- (iii) The only reasons for writing off fixed assets, other than the alienation of such fixed assets, shall be the loss, theft, destruction or material impairment of the fixed asset in question.
- (iv) In every instance where a not fully depreciated fixed asset is written off, the CFO shall immediately debit to such department or vote in the Statement of Financial Performance, as additional depreciation expenses, the full carrying value of the asset concerned.

**(d) In case of loss, theft, destruction or impairment**

- (i) This section must be implemented in conjunction with the approved Loss Control Policy approved by Council.
- (ii) Every Director shall ensure that any incident of loss, theft, destruction, or material impairment of any fixed asset controlled or used by the department in question is promptly reported in writing to the CFO and – in cases of suspected theft or malicious damage – also to the South African Police Service.
- (iii) Asset risk management shall be performed by the municipality's established risk committee and risk unit. In absence of such committee, the municipality's management team shall be assume the responsibilities of an asset risk management committee.
- (iv) When a vehicle is involved in an accident, a report must be immediately submitted to the CFO for insurance purposes.
- (v) Quotations should be obtained to establish the extent and value of the damage.
- (vi) The CFO or his nominee will submit a claim to the insurance company.

- (vii) When it is suspected that an employee abuses assets, this action should be reported to the assets risk management committee. A hearing should be held to determine if this is the case. If found guilty the employee should be subject to the procedure as described in terms of the Standard Conditions of Service.
- (viii) Assets/consumables lost or stolen should be reported to the CFO as soon as they are discovered. The following documents must be submitted
- A full report of the incident
  - Asset/bar code numbers
  - Police case number
  - Quotations for the replacement of the item

**(e) Replacement of assets**

- (i) Each department is responsible for motivating (keeping in mind the useful lives of the different asset types) the possible replacement of motor vehicles, furniture and fittings, computer equipment and any other appropriate operational items. This will include the replacement of fixed assets which are required for service delivery but which have become uneconomical to maintain. These requests will be handled during the capital budget process where Council, the Budget Committee and relevant officials are involved.

NOTE: See Annexure A attached for the fixed asset life table.

## **5 INTERNAL CONTROLS**

**(1) SAFEKEEPING OF ASSETS**

- (a) Every Director shall be directly responsible for the physical safekeeping of any fixed asset controlled for use by the department in question.

- (b) In exercising this responsibility, every Director shall adhere to any written directives issued by the Municipal Manager to the department in question, or generally to all departments, in regard to the control of or safekeeping of the municipality's fixed assets.
- (c) All assets should be kept in a secure location, maintained regularly, insured against theft or destruction, utilised economically and efficiently.

## **(2) ASSET IDENTIFICATION**

- (a) The Municipal Manager shall ensure that the municipality maintains a fixed asset identification system which shall be operated in conjunction with its computerised Fixed Asset Register.
- (b) The identification system shall be determined by the Municipal Manager, acting in consultation with the CFO and other directors, and shall comply with any legal prescriptions, as well as any recommendations of the Auditor-General as indicated in the municipality's audit report(s), and shall be decided upon within the context of the municipality's budgetary and human resources.
- (c) Every Director in conjunction with Asset Management shall ensure that the asset identification system approved for the municipality is scrupulously applied in respect of all fixed assets controlled or used by the department in question.
- (d) A fixed assets and inventory register should be maintained, and all fixed assets should be tagged for reference to the fixed assets register.
- (e) The Municipality should hold title to all assets.



### **(3) VERIFICATION**

- (a) Every Director in conjunction with the Asset Management Unit shall at least once during every financial year undertake a comprehensive verification of all fixed assets controlled or used by the department concerned.
- (b) Every Director shall promptly and fully report in writing to the CFO in the format determined by the CFO, all relevant results of such fixed asset verification, provided that each such asset verification shall be undertaken and completed as closely as possible to the end of each financial year, and that the resultant report shall be submitted to the CFO not later than 30 June of the year in question.
- (c) A Statement of Existence (SOE) must be issued for assets declaring that all assets listed are on hand and are in a useful working condition. The SOE must be sent to the CFO. This function is handled by the Asset Management Unit.
- (d) All fixed assets used by employees leaving the employment of the company must be verified on the day such employees leave. To this effect the Human Resources Department must inform the Asset Management Unit in writing of any persons leaving the employment of the municipality.
- (e) It is the responsibility of the Asset Management Unit to initiate and facilitate the annual fixed asset verification process.

#### **(4) MOVEMENT / MONITORING OF ASSETS**

- (a) Any disposal, movement, impairment or any change in the nature of the asset must be monitored and communicated to the Asset Management Unit and other role players as the communication channel may prescribe.
- (b) A responsible occupant will sign-off on the assets under his/her control and thus become the custodian thereof. Any movement or changes to said list of items must be communicated to the Asset Management Unit.
- (c) Assets that are used by officials outside of their workplace (e.g. laptops taken home) must be approved by the relevant Director.

#### **(5) INSURANCE COVER**

- (a) The Municipal Manager shall ensure that all movable fixed assets are insured at least against fire and theft, and that all municipal buildings are insured at least against fire and allied perils.
- (b) If the municipality operates a self-insurance reserve (assuming such reserve to be allowed), the CFO shall annually determine the premiums payable by the directorates or votes after having received a list of the fixed assets and insurable values of all relevant fixed assets from the directors concerned.
- (c) The Municipal Manager shall recommend to the Council of the municipality, after consulting with the CFO, the basis of the insurance to be applied to each type of fixed asset: either the carrying value or the replacement value of the fixed assets concerned. Such recommendation shall take due cognisance of the budgetary resources of the municipality.

- (d) The CFO shall annually submit a report to the Council of the municipality on any reinsurance cover, which it is deemed necessary to procure for the municipality's self-insurance reserve

## **(6) MAINTENANCE OF ASSETS**

### **(a) Maintenance Plans**

- (i) Every Manager shall ensure that a maintenance plan in respect of every new infrastructure asset with a value of R100 000 (one hundred thousand rand) or more is promptly prepared and submitted to the Council of the municipality for approval.
- (ii) If so directed by the Municipal Manager, the maintenance plan shall be submitted to the Council prior to any approval being granted for the acquisition or construction of the infrastructure asset concerned.
- (iii) The Director controlling or using the infrastructure asset in question, shall annually report to the Council, not later than in July, of the extent to which the relevant maintenance plan has been complied with, and of the likely effect which any non-compliance may have on the useful operating life of the asset concerned.

### **(b) Deferred Maintenance**

- (i) If there is material variation between the actual maintenance expenses incurred and the expenses reasonably envisaged in the approved maintenance plan for any infrastructure asset the CFO shall disclose the extent of and possible implications of such deferred maintenance in an appropriate note to the financial statements. Such note shall also indicate

any plans which the Council of the municipality has approved in order to redress such deferral of the maintenance requirements concerned.

- (ii) If no such plans have been formulated or are likely to be implemented, the CFO shall re-determine the useful operating life of the fixed asset in question, if necessary in consultation with the Director controlling or using such asset, and shall recalculate the annual depreciation expenses accordingly.

**(c) General Maintenance of Fixed Assets**

- (i) Every Director shall be directly responsible for ensuring that all assets (other than infrastructure assets which are dealt with in section 5(6)(a) above) are properly maintained and in a manner which will ensure that such assets attain their useful operating lives.

**(7) FIXED ASSET REGISTER**

- a) The Fixed Asset Register shall be maintained in the format determined by the CFO, which format shall comply with the requirements of generally recognised accounting practice (GRAP) and any other accounting requirements, which may be prescribed.
- b) The Fixed Asset Register shall reflect the following information:
  - (i) a brief but meaningful description of each asset;
  - (ii) the date on which the asset was acquired or brought into use;
  - (iii) the location of the asset;
  - (iv) the department(s) or vote(s) within which the assets will be used;
  - (v) the title deed number, in the case of fixed property;

- (vi) the stand number, in the case of fixed property;
  - (vii) where applicable, the identification number,
  - (viii) the original cost, the revalued amount or the fair value if no costs are available;
  - (ix) the (last) revaluation date of the fixed assets subject to revaluation;
  - (x) the revalued value of such fixed assets;
  - (xi) accumulated depreciation to date;
  - (xii) the depreciation charge for the current financial year;
  - (xiii) the carrying value of the asset;
  - (xiv) the method and rate of depreciation;
  - (xv) impairment losses incurred during the financial year (and the reversal of such losses, where applicable);
  - (xvi) the date on which the asset is disposed of;
  - (xvii) the disposal price; and
  - (xviii) the date on which the asset is retired from use, if not disposed of.
- c) All directors under whose control any fixed asset falls shall promptly provide the CFO in writing with any information required to compile the Fixed Asset Register, and shall promptly advise the CFO in writing of any material change which may occur in respect of such information.
- d) A fixed asset shall be capitalised, that is, recorded in the fixed assets register, as soon as it is acquired. If the asset is constructed over a period of time, it shall be recorded as work-in-progress until it is available for use, where after it shall be appropriately capitalised as a fixed asset.
- e) A fixed asset shall remain in the fixed assets register for as long as it is in physical existence. The fact that a fixed asset has been fully depreciated shall not in itself be a reason for writing-off such an asset.

## **6 CLASSIFICATION OF FIXED ASSETS**

**(1)** In compliance with the requirements of the National Treasury, the CFO shall ensure that all fixed assets are classified under the following headings in the fixed assets register, and directors shall in writing provide the CFO with such information or assistance as is required to compile a proper classification:

**(2) CLASSIFICATION TYPES**

**(a) PROPERTY, PLANT AND EQUIPMENT**

- land (not held as investment assets);
- infrastructure assets (assets which are part of a network of similar assets);
- community assets (resources contributing to the general well-being of the community);
- heritage assets (culturally significant resources);
- other assets (ordinary operational resources).

**(b) INVENTORY**

- housing (rental stock or housing stock not held for capital gain).

**(c) INVESTMENT PROPERTY**

- investment assets (resources held for capital or operational gain)
- land

**(d) INTANGIBLE ASSETS**

- Assets without physical substance such as computer software

The CFO shall adhere to the classifications indicated in the annexure on fixed asset lives (see Annexure A), and in the case of a fixed asset not appearing in the annexure shall use the classification applicable to the asset most closely comparable to the asset in question.

**(3) CLASSIFICATION DESCRIPTIONS**

**(a) Investment Property**

- (i) Investment assets shall be accounted for in terms of GRAP 16 and shall not be classified as property, plant and equipment for purposes of preparing the municipality's statement of position.

- (ii) Investment assets shall comprise land or buildings (or parts of buildings) or both held by the municipality, as owner or as lessee under a finance lease, to earn rental revenues or for capital appreciation or both.
- (iii) Investment assets shall be recorded in the fixed assets register in the same manner as other fixed assets, but a separate section of the fixed assets register shall be maintained for this purpose.
- (iv) An expert valuer shall be engaged by the municipality to undertake any valuations the municipality may require. Internally or externally appointed valuers may be used.
- (v) If the Council resolves to construct or develop a property for future use as an investment property, such property shall in every respect be accounted for as an ordinary fixed asset until it is ready for its intended use – where after it shall be reclassified as an investment asset.

**(b) Fixed Assets treated as inventory**

- (i) Any land or buildings owned or acquired by the municipality with the intention of selling such property in the ordinary course of business, or any land or buildings owned or acquired by the municipality with the intention of developing such property for the purpose of selling it in the ordinary course of business, shall be accounted for as inventory, and not included in either property, plant and equipment or investment property in the municipality's statement of financial position.

- (ii) Such inventories shall, however, be recorded in the fixed assets register in the same manner as other fixed assets, but a separate section of the fixed assets register shall be maintained for this purpose.

**(c) Recognition of Heritage Assets in the Fixed Asset Register**

- (i) Heritage Assets are recognised and measured in accordance with GRAP 103.

**(d) Recognition of donated assets**

- (i) Where a fixed asset is donated to the municipality, or a fixed asset is acquired by means of an exchange of assets between the municipality and one or more other parties, the asset concerned shall be recorded in the Fixed Asset Register at its fair value, as determined by the CFO with reference to the guidance set out in GRAP.

**(e) Biological assets**

- (i) Accounting for biological assets shall take place in accordance with the requirements of GRAP 101.
- (ii) The CFO, in consultation with the head(s) of department concerned, shall ensure that all biological assets, such as livestock and crops, are valued at 30 June each year at fair value less estimated point-of-sales costs. Such valuation shall be undertaken by a recognised valuer in the line of the biological assets concerned. Any losses on such valuation shall be debited to the department or vote concerned as an operating expense, and any increase in the valuation shall be credited to the department or vote concerned as operating revenue.



- (iii) If any biological asset is lost, stolen or destroyed, the matter – if material – shall be reported in writing by the Director concerned in exactly the same manner as though the asset were an ordinary fixed asset.
- (iv) Records of the details of biological assets shall be kept in a separate section of the fixed assets register or in a separate accounting record altogether and such details shall reflect the information which the CFO, in consultation with the Director concerned and the internal auditor, deems necessary for accounting and control purposes.
- (v) The CFO shall annually insure the municipality's biological assets, in consultation with the directors concerned, provided the Council considers such insurance desirable and affordable.

## **7 ACCOUNTING FOR ASSETS**

### **(1) RECOGNITION OF AN ASSET**

#### **(a) Fixed Assets**

- (i) A fixed asset is an asset with a useful life of more than one year and is used in the business of the municipality. Characteristics of a depreciable fixed asset are the following:
  - It is estimated that the asset will be used for more than one financial period;
  - It has a limited useful life;
  - It is used in a process of delivering services;
  - The resource should provide future economic benefits;

- The future economic benefits should accrue to the municipality;
  - The event giving rise to the municipality's right to the recourse and control over the future economic benefits must already have occurred; and
  - It should be possible to determine the cost of the asset reliably.
- (ii) A fixed asset is defined in GRAP 17 as a tangible item of property, plant or equipment held by a municipality for use in the productions or supply of goods or services, for rental to others, or for administrative purposes, and which is expected to be used during more than one reporting period (financial year).
- (iii) A fixed asset is thus an asset, either movable or immovable, under the control of the municipality, and from which the municipality derives economic benefits, or reasonably expects to use in service delivery, over a period extending beyond one financial year.

To be recognised as a fixed asset, an asset must also meet the criteria referred to in section 6(3).

**(b) Accounting for leases**

- (i) An asset held under a finance lease, shall be recognised as a fixed asset, as the municipality has control over such an asset even though it does not own the asset.
- (ii) Examples of situations that would normally lead to a lease being classified as finance lease are:
- The lease transfers ownership of the asset to the lessee by the end of the lease term;

- The lessee has the option to purchase the asset at a price which is expected to be significantly lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred; and
- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

(iii) Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are born by the lessee,
- Gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease), and
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

## **(2) MEASUREMENT**

### **(a) Cost of an asset**

Cost of a fixed asset includes the cost of activities (cash or equivalent) necessarily incurred to bring the fixed asset to the condition and location essential for its intended use (e.g. purchase price plus transport and installation).

The following are examples of costs that should be capitalized if it can be directly attributed to the acquisition of the asset or bringing the asset to its working condition:

- Administration and other general overhead costs;
- Start-up and other pre-production costs;
- Interest paid if part of a capital project; and
- Any trade discount and rebates are to be deducted in arriving at the purchase price.

(i) Contract costs

Contract costs should comprise:

- Costs that relate directly to the specific contract,
- Costs that are attributable to contract activity in general and can be allocated to the contract, and
- Such other costs are specifically chargeable to the customer under terms of the contract.

Examples of costs that relate directly to a specific contract include:

- Site labour costs, including site supervision,
- Costs of materials used in construction
- Depreciation of plant and equipment used on a contract,
- Costs of moving plant, and equipment to and from the contract site,
- Costs of hiring plant and equipment,
- Costs of design and technical assistance that is directly related to the contract,
- The estimated costs of rectification and guarantee work, including expected warranty costs, and
- Claims from third parties.

Examples of costs that relate to the contract activity in general and can be allocated to specific contracts include:

- Insurance
- Cost of design and technical assistance that are not directly related to a specific contract, and
- Construction overheads.

(ii) Research costs

Research costs should be recognized as an expense in the period in which they are incurred and should not be recognized as an asset.

Examples of activities typically included in research are:

- Activities aimed at obtaining new knowledge,
- The search for applications of research findings or other knowledge,
- The search for product or process alternatives, and
- The formulation and design of possible new or improved product or process alternatives.

(iii) Development costs

The development costs of a project should be recognized as an expense in the period in which they are incurred, unless all of the following criteria are met:

- The product or process is clearly defined and the costs attributable to the product or process can be separately identified and reliably measured.
- The technical feasibility of the produce and market or use the product or process.
- The existence of a market for the product or process or, if it is to be used internally rather than sold, its usefulness to the enterprise can be demonstrated.
- Adequate resources exist, or their availability can be demonstrated, to complete the project and market or use the product or process.

Examples of activities typically included in development are:

- The evaluation of product or process alternatives,
- The design, construction and testing of pre-production prototypes and models,
- The design of tools, jigs, moulds and dies involving new technology, and
- The design, construction and operation of a pilot plant that is not of a scale that is economically feasible for commercial production.

**(b) Changes in Accounting Estimates**

- (i) As a result of the uncertainties inherent in municipal activities, many financial items cannot be measured but can only be estimated. The estimation process is based on judgments based on the latest financial information available. Estimates may be required, for example bad debts, inventory obsolescence or the useful lives or expected pattern of consumption of economic benefits or depreciable assets.
- (ii) An estimate may need to be revised if changes occur regarding the circumstances on which the estimate was based or as a result of new information, more experience or subsequent developments.
- (iii) In practice the department may decide to revise the useful life of an asset or a group of assets due to certain circumstances.
- (iv) The effect of a change in accounting estimate should be included in the determination of net profit or loss in:
  - The period of the change if the change effects the period only, or
  - The period of change and future periods, if the change affects both.

**(3) THRESHOLD**

- (a) Assets with an initial cost of more than R1000 will be recognised as Property, Plant and Equipment. Items with a cost between R500 and R1000 can be capitalised at the discretion of the CFO. All items above R1000 must be capitalised.
- (b) Fixed assets with a value of less than R1000 (except in the case where the CFO has judged otherwise) as described above will be regarded as inventory and not recorded for financial purposes in the Fixed Asset Register. These assets should still be marked or identified for control purposes and indicated as such in an inventory list. Every Director shall moreover ensure that the existence of items recorded on such inventory sheets is verified from time to time, and at least once in every financial year, and any amendments which are made to such inventory sheets pursuant to such stock verifications shall be retained for audit purposes.

#### **(4) CAPITALISATION**

##### **(a) Subsequent Expenditure**

Subsequent expenditure relating to an *asset* should be capitalised to the net book value when it is determined that the asset has been enhanced.

##### **(b) Normal Expenditure**

- (i) No item with an initial cost or fair value of less than R1 000 (one thousand rand) – or such other amount as the Council of the municipality may from time to time determine on the recommendation of the Municipal Manager – shall be recognised as a fixed asset. If the item has a cost or fair value lower than this capitalisation benchmark, it shall be treated as an ordinary operating expense.

- (ii) Every Director shall, however, ensure that any item with a value of less than a R1 000 with an estimated useful life of more than one year, shall be recorded on an inventory sheet. Every Director shall moreover ensure that the existence of items recorded on such inventory sheets is verified from time to time, and at least once in every financial year, and any amendments which are made to such inventory sheets pursuant to such stock verifications shall be retained for audit purposes.

**(c) Intangible Items**

Intangible assets will be recognized and measured in terms of GRAP 102.

**(d) Reinstatement, maintenance and other expenses**

- (i) Only expenses incurred in the enhancement of a fixed asset (in the form of improved or increased services or benefits flowing from the use of such asset) or in the material extension of the useful operating life of a fixed asset shall be capitalised.
- (ii) Expenses incurred in the maintenance or reinstatement of a fixed asset shall be considered as operating expenses incurred in ensuring that the useful operating life of the asset concerned is attained, and shall not be capitalised, irrespective of the quantum of the expenses concerned.
- (iii) Expenses which are reasonably ancillary to the bringing into operation of a fixed asset may be capitalised as part of such fixed asset. Such expenses may include but need not be limited to import duties, forward cover costs, transportation costs, installation, assembly and communication costs.



## **(5) USEFUL LIFE**

- (a) The parameters set for the useful lives of assets are based on best practice as issued by National Treasury in the Local Government Asset Management Guideline.
- (b) These guidelines for the useful lives of assets may be adapted based on past experience and specific municipal preference.
- (c) The useful life set out for a specific asset will determine the depreciation on the asset.
- (d) It is necessary to review the *useful life* annually of assets as the original estimate of *useful life* may become inappropriate. Such an adjustment is deemed to be a change in estimate and the *depreciation* charge for the current and future periods should be adjusted.

NOTE: See attached Annexure A for the useful life table.

## **(6) DEPRECIATION**

- (a) **Depreciation of fixed assets**
  - (i) All fixed assets, except land and heritage assets, shall be depreciated – or amortised in the case of intangible assets.
  - (ii) Depreciation may be defined as the monetary quantification of the extent to which a fixed asset is used or consumed in the provision of economic benefits or the delivery of services.

- (iii) Depreciation shall generally take the form of an expense both calculated and debited on a monthly basis against the appropriate line item in the directorate or vote in which the asset is used or consumed.
- (iv) However, depreciation shall initially be calculated from the commissioning date as per the electronic fixed register in place. Thereafter, depreciation charges shall be calculated monthly.
- (v) Each Director, acting in consultation with the CFO, shall ensure that reasonable budgetary provision is made annually for the depreciation of all applicable fixed assets controlled or used by the directorate in question or expected to be so controlled or used during the ensuing financial year.
- (vi) The procedures to be followed in accounting and budgeting for the amortisation of intangible assets shall be identical to those applying to the depreciation of other fixed assets.

(b) **Rate of depreciation**

- (i) The CFO shall assign a useful operating life to each depreciable asset recorded on the municipality's Fixed Asset Register. In determining such a useful life the CFO shall adhere to the useful lives set out in the annexure to this document (see Annexure A).
- (ii) In the case of a fixed asset that is not listed in this annexure, the CFO shall determine a useful operating life, in consultation with the Director who shall control or use the fixed asset in question, and shall be guided in determining such useful life by the likely pattern in which the asset's economic benefits or service potential will be consumed.

(c) **Method of depreciation**

Except in those cases specifically identified in 7(6)(e) below, the CFO shall depreciate all depreciable assets on the straight-line method of depreciation over the assigned useful operating life of the asset in question.

**(d) Amendment of asset lives and diminution in the value of fixed assets**

- (i) Only the CFO may amend the useful operating life assigned to any fixed asset, and when any material amendment occurs the CFO shall inform the Council of the municipality of such amendment.
- (ii) The CFO shall amend the useful operating life assigned to any fixed asset if it becomes known that such asset has been materially impaired or improperly maintained to such an extent that its useful operating life will not be attained, or any other event has occurred which materially affects the pattern in which the asset's economic benefits or service potential will be consumed.
- (iii) If the value of a fixed asset has been diminished to such an extent that it has no or a negligible further useful operating life or value such fixed asset shall be fully depreciated in the financial year in which such diminution in value occurs.
- (iv) Similarly, if a fixed asset has been lost, stolen or damaged beyond repair, it shall be fully depreciated/impaired in the financial year in which such event occurs, and if the fixed asset has physically ceased to exist, it shall be removed / excluded from the Fixed Asset Register.

(v) In all of the foregoing instances, the additional depreciation expenses shall be debited to the directorate or vote controlling or using the fixed asset in question.

(vi) If any of the a foregoing events arise in the case of a normally non-depreciable fixed asset, and such fixed asset has been capitalised at a value other than a purely nominal value, such fixed asset shall be partially or fully impaired, as the case may be, as though it was an ordinary depreciable asset, and the directorate or vote controlling or using the fixed asset in question shall bear the full depreciation expenses concerned.

(e) **Alternative methods of depreciation in specific instances**

(i) The CFO may employ the sum-of-units method of depreciation in the case of fixed assets which are physically wasted in providing economic benefits or delivering services.

(ii) The CFO shall only employ this method of depreciation if the Director controlling or using the fixed asset in question gives a written undertaking to the Municipal Manager to provide:

- Estimates of statistical information required by the CFO to prepare estimates of depreciation expenses for each financial year; and
- Actual statistical information, for each financial year.

(iii) The Director concerned shall moreover undertake to provide such statistical information at the specific times stipulated by the CFO.

- (iv) Where the CFO decides to employ the sum-of-units method of depreciation and the requirements set out in the preceding paragraph have been adhered to, the CFO shall inform the Council of the municipality of the decision in question.

(f) **Creation of non-distributable reserves for future depreciation**

NOTE: This has been prepared on the assumption that these reserves are allowed.

- (i) The CFO shall ensure that in respect of all fixed assets financed from grants or subsidies or contributions received from other spheres of government or from the public at large, as well as in respect of fixed assets donated to the municipality, a non-distributable reserve for future depreciation is created equal in value to the capitalised value of each fixed asset in question.
- (ii) The CFO shall thereafter ensure that in the case of depreciable fixed assets an amount equal to the monthly depreciation expenses of the fixed asset concerned is transferred each month from such non-distributable reserve to the municipality's appropriation account. Where there is a difference between the budgeted monthly depreciation expenses and the actual total depreciation expenses for each financial year, the CFO shall appropriately adjust the aggregate transfer from the non-distributable reserve for the year concerned.

**(7) CARRYING VALUES OF FIXED ASSETS**

- (i) All fixed assets shall be carried in the Fixed Asset Register, and appropriately recorded in the annual financial statements, at their original cost, deemed cost or fair value less any accumulated depreciation.
- (ii) The only exceptions to this rule shall be revalued assets and heritage assets in respect of which no value is recorded in the Fixed Asset Register.

## **(8) IMPAIRMENT**

- (i) The carrying amount (Book value) of an item or a group of identical items of property, plant and equipment should be reviewed periodically in order to assess whether or not the recoverable amount has declined below the carrying amount.
- (ii) Recoverable amount is the amount that the municipality expects to recover from the future use of an asset, including its residual value on disposal. When such a decline has occurred, the carrying amount should be reduced to the recoverable amount. The amount of the reduction should be recognised as an expense immediately.
- (iii) The recoverable amount of individual assets, or groups of identical assets, is determined separately and the carrying amount reduced to recoverable amount on an individual asset, or group of identical assets, basis. However, there may be circumstances when it may not be possible to assess the recoverable amount of an asset on this basis, for example when all of the recognized assets in a roads network is used for the same purpose. In such circumstances, the carrying amount of each of the related assets is reduced in proportion to the overall decline in recoverable amount of the smallest

grouping of assets for which it is possible to make an assessment of recoverable amount.

(iv) The following may be indicators that an item of PPE has become impaired:

- The asset has been damaged.
- The asset has become technologically obsolete.
- The asset remains idle for a considerable period either prior to it being put into use or during its useful life.
- Land is purchased at market value and is to be utilized for subsidized housing developments, where the subsidy is less than the purchase price.

## **APPENDIX A (Attached)**