



Accounting Standards Board

P O Box 74129
Lynnwood Ridge
0040
Tel: 012 470 9480
Fax: 012 348 4150

STANDARDS OF GENERALLY ACCEPTED MUNICIPAL ACCOUNTING PRACTICE



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CONTENTS

	Old GAMAP	Reference
PREFACE TO THE STANDARDS OF GAMAP		Page 3-8
THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES	107	Page 9-13
CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING FOR CONTROLLED ENTITIES	105	Page 14-26
ACCOUNTING FOR INVESTMENTS IN ASSOCIATES	105	Page 27-35
FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES	112	Page 36-47
REVENUE	106	Page 48-62
INVENTORIES	104	Page 63-73
PROPERTY, PLANT AND EQUIPMENT	113	Page 74-92
PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS	103	Page 93-113



Preface to the Standards of Generally Accepted Municipal Accounting Practice

This preface is issued to explain the transformation from the existing Statements of Generally Accepted Municipal Accounting Practice to the revised Standards of Generally Accepted Municipal Accounting Practice being issued at present. It also explains the application, scope and authority of the Standards of Generally Accepted Municipal Accounting Practice in relation to Standards of Generally Recognised Accounting Practice. For more guidance, this preface should be read in conjunction with the preface to the Standards of Generally Recognised Accounting Practice.

Background to the existing Statements of Generally Accepted Municipal Accounting Practice (old GAMAP)

1. The National Treasury commissioned a study to develop statements of generally recognised accounting practices for local government in July 1997. The statements that were developed (old GAMAP) were based on the Statements of Generally Accepted Accounting Practice (SA GAAP) as at 30 November 1997 with the exception of GAMAP 114. SA GAAP was in the process of being harmonised with International Accounting Standards at the time that old GAMAP was being developed. A number of the SA GAAP Statements on which old GAMAP is based have subsequently been revised or withdrawn.
2. GAMAP 114, titled Accounting for Statutory Funds, Reserves and Capital Receipts, is the only Statement of old GAMAP that is not based on SA GAAP. It was developed to give recognition to the funding of property, plant and equipment (the old GAMAP accounting model) and the National Treasury's policy on reserving and statutory funds. There is however, no legal framework in place to support the accounting treatment adopted in GAMAP 114.

Process for issuing the revised Standards of Generally Accepted Municipal Accounting Practice (new GAMAP)

3. The Accounting Standards Board has reviewed old GAMAP with a view to amend as appropriate or withdrawing individual Statements if considered to be in conflict with the International Public Sector Accounting Standards (IPSASs) on which the Standards that the Board is developing are based.
4. The broad findings of the review were as follows:
 - a) Most of the SA GAAP Statements that were used as a basis to develop equivalent Statements of old GAMAP have changed.
 - b) As indicated above, there is no comparative SA GAAP for GAMAP 114.
 - c) A number of IPSASs have now been issued that cover topics addressed by old GAMAP Statements.
 - d) There are a number of new accounting statements in SA GAAP for which there are no equivalent old GAMAP Statements.



5. The revised standards issued as a result of this review are known as Standards of Generally Accepted Municipal Accounting Practice (new GAMAP). A table setting out the old Statements and new Standards of GAMAP is attached as Appendix I.

Need for new GAMAP

6. The need to issue and implement new GAMAP is driven, *inter alia*, by the following main factors:
 - Old GAMAP is no longer up to date.
 - Significant capacity building has taken place since the Minister of Finance approved old GAMAP in October 1998, and an anti-GAMAP sentiment has moved to an eagerness to implement it. Momentum to improve financial reporting should not be lost.
 - The enactment of the Municipal Finance Management Act, which requires the different categories of municipalities to base their financial statements on Standards of Generally Recognised Accounting Practice.
7. The Board has therefore decided to reduce the exposure period for new GAMAP to two months in recognition of the process adopted in the development of old GAMAP and the extent of consultation and training that has taken place to date.

Replacement of new GAMAP by GRAP

8. When issued, *Standards of Generally Recognised Accounting Practice* will supersede the equivalent new GAMAP Standard.
9. More information on the Board's strategy and process for the development of Standards of Generally Recognised Accounting Practice is set out in the *Preface to Standards of Generally Recognised Accounting Practice*.

Numbering of new GAMAP

10. The numbering of new GAMAP is based on the numbering of the IPSAS Standards. Thus, a new GAMAP Standard has the same number as the equivalent IPSAS.

Application of new GAMAP

11. New GAMAP is applicable to municipalities. Boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality are encouraged to comply with new GAMAP in order to facilitate the preparation of consolidated financial statements by municipalities.
12. The implementation of new GAMAP will recognise that capacities will differ at the different categories of municipalities. New GAMAP will apply from a date determined in a regulation by the Minister of Finance after consultation with the Board.

Exemptions

13. The Minister may exempt a municipality from compliance with one or Standards of GAMAP or a specific requirement thereof. The National Treasury will administer the process of applying for exemptions.

Guidance on issues not covered by new GAMAP

14. The Board recognises that the scope of new GAMAP is incomplete and that users will seek guidance in respect of those issues not considered. The attention of preparers is drawn to the following paragraph in the exposure draft of the Standard of Generally Recognised Accounting Practice on *Accounting Policies, Changes in Accounting Estimates and Errors*:

“In the absence of a particular Standard of Generally Recognised Accounting Practice that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

- (a) relevant to the economic decision-making needs of users; and***
- (b) reliable in that the financial statements:***
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;***
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;***
 - (iii) are neutral, i.e. free from bias;***
 - (iv) are prudent; and***
 - (v) are complete in all material respects.***

In making the judgement described in the paragraph above, management shall refer to and consider the applicability of the following sources in descending order:

- (a) the requirements and guidance in the Standards of Generally Recognised Accounting Practice, dealing with similar and related issues; and***
- (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, revenue and expenses set out in the Framework for the Preparation and Presentation of Financial Statements.***

In making the judgement prescribed in the paragraph above, management may also consider the most recent pronouncements of other standard-setting bodies and accepted public or private sector practices to the extent, but only to the extent, that these are consistent with the requirements in the paragraph above. For example, pronouncements of, in descending order, the International Federation of Accountants - Public Sector Committee, the



International Accounting Standards Board (including the Framework for the Preparation and Presentation of Financial Statements), the South African Accounting Practices Board and the South African Institute of Chartered Accountants' Accounting Practices Committee."

15. A table of such available sources is set out in Appendix II. The Board has not yet considered the guidance contained in these Standards, nor has it determined the appropriateness of applying these Standards in a municipality. Accordingly, there is no requirement to comply with the guidance in this list to claim compliance with new GAMAP.
16. Fair presentation of financial statements depends, *inter alia*, on the appropriateness and application of the accounting policies adopted in their preparation. Whilst applying GAMAP will assist in achieving fair presentation, the adoption of these Standards will not by itself achieve that objective, as the scope of new GAMAP is not comprehensive.
17. Additional disclosures in the financial statements that are required by legislation are not repeated in new GAMAP.

Effective date

18. New GAMAP is effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 (PFMA), as amended.

Appendix I

New GAMAP

The table below lists the new GAMAP Standards that replaced the old GAMAP Statements. The table sets out the statements that comprised old GAMAP and the status of the topics included under new GAMAP and, where relevant, GRAP where a Standard in the latter series is already being developed.

Old GAMAP reference	Title	New reference
GAMAP 000	Framework for the Preparation and Presentation of Financial Statements	GRAP 0 ¹
GAMAP 100	Presentation of Financial Statements	GRAP 1
GAMAP 101	Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies (now Accounting Policies, Changes in Accounting Estimates and Errors)	GRAP 3
GAMAP 102	Accounting for Leases in the Financial Statements of Lessees	Withdrawn
GAMAP 103	Provisions, Contingent Liabilities and Contingent Assets and Events Occurring After the Balance Sheet Date (now Provisions, Contingent Liabilities and Contingent Assets)	GAMAP 19
Not a separate statement	Events After the Balance Sheet Date	Withdrawn
GAMAP 104	Inventories	GAMAP 12
GAMAP 105	Accounting for Investments in Associates and Subsidiaries (now Accounting for Investments in Associates)	GAMAP 7
Not a separate statement	Consolidated Financial Statements and Accounting for Controlled Entities	GAMAP 6
GAMAP 106	Revenue	GAMAP 9
GAMAP 107	The Effects of Changes in Foreign Exchange Rates	GAMAP 4
GAMAP 108	Lessor Accounting	Withdrawn
GAMAP 109	Research and Development Costs	Withdrawn
GAMAP 110	Retirement Benefit Costs	Withdrawn
GAMAP 111	Cash Flow Statements	GRAP 2
GAMAP 112	Financial Reporting of Interests in Joint Ventures	GAMAP 8
GAMAP 113	Property, Plant and Equipment	GAMAP 17
GAMAP 114	Accounting for Statutory Funds, Reserves and Capital Receipts	Withdrawn

¹ In the process of finalisation



Appendix II ²

Guidance on issues not covered by GAMAP

The table below provides a list of available sources where the items are not covered by the scope of new GAMAP:

Reference	Title
<i>IPSAS 5</i>	<i>Borrowing Costs</i>
<i>IPSAS 11</i>	<i>Construction Contracts</i>
<i>IPSAS 13</i>	<i>Leases</i>
<i>IPSAS 14</i>	<i>Events After the Reporting Date</i>
<i>IPSAS 15</i>	<i>Financial Instruments: Disclosure and Presentation</i>
<i>IPSAS 16</i>	<i>Investment Property</i>
<i>IPSAS 18</i>	<i>Segment Reporting</i>
<i>IPSAS 20</i>	<i>Related Parties</i>
<i>IAS 12</i>	<i>Income Taxes</i>
<i>IAS 19</i>	<i>Employee Benefits</i>
<i>IAS 22</i>	<i>Business Combinations</i>
<i>IAS 35</i>	<i>Discontinuing Operations</i>
<i>IAS 36</i>	<i>Impairment of Assets</i>
<i>IAS 38</i>	<i>Intangible Assets</i>
<i>IAS 39</i>	<i>Financial Instruments: Recognition and Measurement</i>
<i>IAS 41</i>	<i>Agriculture</i>

² There is no requirement to comply with the guidance set out in this appendix to claim compliance with GAMAP



GAMAP 4

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as 'entities' Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.



Objective

An entity may have transactions in foreign currencies. In order to include foreign currency transactions in the financial statements of an entity, transactions must be expressed in the entity's reporting currency.

The principal issues in accounting for foreign currency transactions are to decide which exchange rate to use and how to recognise the financial effect of changes in exchange rates in the financial statements.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for transactions (including the subsequent reporting of monetary and non-monetary items) in foreign currencies.**
- .02 This Standard deals with the presentation of revenue, expenses, liabilities and assets arising from transactions in a foreign currency. It does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency (see the Standard of Generally Recognised Accounting Practice on *Cash Flow Statements*).

Definitions

- .03 The following terms are used in this Standard with the meanings specified:**
- Accrual basis means a basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets, revenue and expenses.**
- Cash flows are inflows and outflows of cash and cash equivalents.**
- Closing rate is the spot exchange rate at the reporting date.**
- Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.**
- Exchange rate is the ratio for exchange of two currencies.**
- Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.**
- Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**



Foreign currency is a currency other than the functional currency of an entity.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Transaction date is the date upon which the entity is irrevocably committed to the transaction.

Reporting currency is the currency used in presenting the financial statements.

Reporting date means the date of the last day of the reporting period to which the financial statements relate.

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners.

Spot rate is the exchange rate at the date of the transaction.

Initial recognition

- .04 Subject to restrictions imposed by legislation, a foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an entity either:
- (a) buys or sells goods or services of which the price is denominated in a foreign currency,
 - (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency,
 - (c) becomes a party to an unperformed foreign exchange contract, or
 - (d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
- .05 ***A foreign currency transaction shall be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.***
- .06 The exchange rate at the date of the transaction is often referred to as the spot rate. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Reporting at subsequent reporting dates

.07 At each reporting date:

- (a) foreign currency monetary items shall be reported using the closing rate,**
- (b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency shall be reported using the exchange rate at the date of the transaction, and**
- (c) non-monetary items which are carried at fair value denominated in a foreign currency shall be reported using the exchange rates that existed when the values were determined.**

- .08 The carrying amount of an item is determined in accordance with the relevant Standard of Generally Accepted Municipal Accounting Practice, the International Public Sector Accounting Practice Standard or the Statement of Generally Accepted Accounting Practice. For example, certain financial instruments and property, plant and equipment may be measured at fair value or at historical cost. Whether the carrying amount is determined based on historical cost or fair value, the amounts so determined for foreign currency items are then reported in the reporting currency in accordance with this Standard.

Recognition of exchange differences

- .09 Paragraphs .10 and .11 set out the accounting treatment required by this Standard in respect of exchange differences on foreign currency transactions. These paragraphs include the benchmark treatment for exchange differences that result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly from the recent acquisition of assets invoiced in a foreign currency. The allowed alternative treatment for such exchange differences is set out in paragraph .13.
- .10 Exchange differences arising on the settlement of monetary items or on reporting an entity's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, shall be recognised as revenue or as expenses in the period in which they arise.**
- .11 An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.



Allowed alternative treatment

- .12 The benchmark treatment for exchange differences dealt with in paragraph .13 is set out in paragraph .10.
- .13 *Exchange differences may result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly from the recent acquisition of an asset invoiced in a foreign currency. Such exchange differences shall be included in the carrying amount of the related asset.***
- .14 Exchange differences are not included in the carrying amount of an asset when the entity is able to settle or hedge the foreign currency liability arising from the acquisition of the asset. However, exchange losses are part of the directly attributable costs of the asset when the liability cannot be settled and there is no practical means of hedging, for example when, as a result of exchange controls, there is a delay in obtaining foreign currency. Therefore, under the allowed alternative treatment, the cost of an asset invoiced in a foreign currency is regarded as the amount of reporting currency that the entity ultimately has to pay to settle its liabilities arising directly from the recent acquisition of the asset.

Disclosure

- .15 *An entity shall disclose the following:***
- (a) *The amount of exchange differences included in the surplus or deficit for the period, distinguishing between those arising from borrowing and operating activities, and***
 - (b) *The amount of exchange differences arising during the period which is included in the carrying amount of an asset in accordance with the allowed alternative treatment in paragraph .13.***

Effective date

- .16 *This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.***



GAMAP 6

CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING FOR CONTROLLED ENTITIES

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

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The above are collectively referred to as ‘entities’ Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.



Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the preparation and presentation of consolidated financial statements for an economic entity.**
- .02 This Standard shall also be applied in accounting for controlled entities in a controlling entity's separate financial statements.**
- .03 Consolidated financial statements are encompassed by the term "financial statements" included in the *Preface to Standards of Generally Accepted Municipal Accounting Practice*. Therefore, consolidated financial statements are prepared in accordance with Standards of Generally Accepted Municipal Accounting Practice.
- .04 This Standard does not deal with:
- (a) methods of accounting for entity combinations and their effects on consolidation, including goodwill arising on an entity combination (guidance on accounting for entity combinations can be found in the International Accounting Standard on *Business Combinations*),
 - (b) accounting for investments in associates (see the of Generally Accepted Municipal Accounting Practice on *Accounting for Investments in Associates*), and
 - (c) accounting for investments in joint ventures (see the Standard of Generally Accepted Municipal Accounting Practice on *Financial Reporting of Interests in Joint Ventures*).

Definitions

- .05 The following terms are used in this Standard with the meanings specified:**
- Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.**

Accrual basis means a basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets, revenue and expenses.

Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Associate is an entity in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Cash comprises cash on hand and demand deposits.

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.

Contributions from owners is future economic benefits or service potential that have been contributed to the entity by parties external to the entity that establish a financial interest in the net assets of the entity, provided that the contributions:

- (a) do not result in liabilities of the entity, and**
- (b) meet the following test, that they:**
 - (i) convey entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions to any excess of assets over liabilities in the event of the entity being wound up, and/or**
 - (ii) can be sold, exchanged, transferred or redeemed.**

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity that is under the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

Distributions to owners is future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Equity method is a method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The statement of financial performance reflects the investor's share of the results of operations of the investee.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Joint control is the agreed sharing of control over an activity by a binding arrangement.

Joint venture is a binding arrangement whereby two or more parties are committed to undertake an activity which is subject to joint control.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Minority interest is that portion of the surplus or deficit and of net assets of a controlled entity attributable to interests that are not owned, directly or indirectly through controlled entities, by the controlling entity.

Net assets is the residual interest in the assets of the entity after deducting all its liabilities.

Surplus or deficit comprises the following components:

- (a) surplus or deficit from ordinary activities, and***
- (b) extraordinary items.***

Reporting date means the date of the last day of the reporting period to which the financial statements relate.

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

Economic entity

- .06 The term “economic entity” is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.***
- .07 Other terms sometimes used to refer to an economic entity include “administrative entity”, “financial entity”, “consolidated entity” and “group”.***
- .08 An economic entity may include entities with both social policy and commercial objectives.***

Presentation of consolidated financial statements

- .09 A controlling entity shall present consolidated financial statements.***

Scope of consolidated financial statements

- .10 A controlling entity which issues consolidated financial statements shall consolidate all controlled entities, other than those referred to in paragraph .11.***
- .11 A controlled entity shall be excluded from consolidation when:***
 - (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future, or***



(b) it operates under severe external long-term restrictions which prevent the controlling entity from benefiting from its activities.

- .12 Such controlled entities should be accounted for as if they are investments. The International Accounting Standard on *Financial Instruments: Recognition and Measurement* provides guidance on accounting for investments.
- .13 An example of temporary control is where a controlled entity is acquired with a firm plan to dispose of it in the short term. This may occur where an economic entity is acquired and an entity within it is to be disposed of because its activities are dissimilar to those of the acquirer. Temporary control also occurs where the controlling entity intends to cede control over a controlled entity to another entity. For this exemption to apply, the controlling entity must be demonstrably committed to a formal plan to dispose of, or no longer control, the entity that is subject to temporary control. For the exemption to apply at more than one successive reporting date, the controlling entity must demonstrate an ongoing intent to dispose of, or no longer control, the entity that is subject to temporary control. An entity is demonstrably committed to dispose of, or no longer control, another entity when it has a formal plan to do so and there is no realistic possibility of withdrawal from that plan.
- .14 An entity may be subject to severe restrictions outside its control that prevent the other entity from benefiting from its activities. Under the circumstances, control is unlikely to exist and the consolidation procedures in this Standard would no longer apply.

Establishing control of another entity for financial reporting purposes

- .15 Whether an entity controls another entity for financial reporting purposes is a matter of judgement based on the definition of control in this Standard and the particular circumstances of each case. That is, consideration needs to be given to the nature of the relationship between the two entities. In particular, the two elements of the definition of control in this Standard need to be considered. These are the power element (the power to govern the financial and operating policies of another entity) and the benefit element (which represents the ability of the controlling entity to benefit from the activities of the other entity).
- .16 For the purposes of establishing control, the controlling entity needs to benefit from the activities of the other entity. For example, an entity may benefit from the activities of another entity in terms of a distribution of its surpluses (such as a dividend) and is exposed to the risk of a potential loss. In other cases, an entity may not obtain any financial benefits from the other entity but may benefit from its ability to direct the other entity to work with it to achieve its objectives. It may also be possible for an entity to derive both financial and non-financial benefits from the activities of another entity. For example, an entity may provide the controlling entity with a dividend and also enable it to achieve some of its social policy objectives.



Control for financial reporting purposes

- .17 For the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. The power to control is not presently exercisable if it requires changing legislation or renegotiating agreements in order to be effective. This should be distinguished from the fact that the existence of the power to control another entity is not dependent upon the probability or likelihood of that power being exercised.
- .18 Similarly, the existence of control does not require an entity to have responsibility for the management of (or involvement in) the day-to-day operations of the other entity. In many cases, an entity may only exercise its power to control another entity where there is a breach or revocation of an agreement between the controlled entity and its controlling entity.
- .19 The power of one entity to govern decision-making in relation to the financial and operating policies of another entity is insufficient, in itself, to ensure the existence of control as defined in this Standard. The controlling entity needs to be able to govern decision-making so as to be able to benefit from its activities, for example by enabling the other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of a "controlling entity" and "controlled entity" relationships which do not extend beyond, for instance, that of a Municipal Financial Recovery Service and the entity being unable to meet its obligations or financial commitments, and would normally exclude a lender and borrower relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

Regulatory and purchase power

- .20 Governments and their agencies have the power to regulate the behaviour of many entities by use of their sovereign or legislative powers. Regulatory and purchase powers do not constitute control for the purposes of financial reporting. To ensure that the financial statements of entities include only those resources that they control and can benefit from, the meaning of control for the purposes of this Standard does not extend to:
 - (a) the power of the legislature to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations. Such power does not constitute control by an entity of the assets deployed by these entities. For example, a pollution control authority may have the power to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority only has the power to regulate, or



- (b) entities that are economically dependent on a public sector entity. That is, where an entity retains discretion as to whether it will take funding from, or do business with, a public sector entity, that entity has the ultimate power to govern its own financial or operating policies, and accordingly is not controlled by the public sector entity. For example, a municipality may be able to influence the financial and operating policies of a municipal entity which is dependent on it for funding or a profit-orientated entity that is economically dependent on business from it. Accordingly, the entity has some power as a purchaser but not to govern the entity's financial and operating policies.

Determining whether control exists for financial reporting purposes

- .21 Entities may create other entities to achieve some of their objectives. In some cases it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear. Paragraphs .22 and .23 provide guidance to help determine whether or not control exists for financial reporting purposes.
- .22 In examining the relationship between two entities, control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists, unless there is clear evidence of control being held by another entity.

Power indicators

- (a) The entity has, directly or indirectly through controlled entities, ownership of a majority voting interest in the other entity.
- (b) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the governing body of the other entity.
- (c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.
- (d) The entity has the power to cast the majority of votes at meetings of the council or equivalent governing body.

Benefit indicators

- (a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example, the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.
 - (b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.
- .23 When one or more of the circumstances listed in paragraph .22 does not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control.

Power indicators



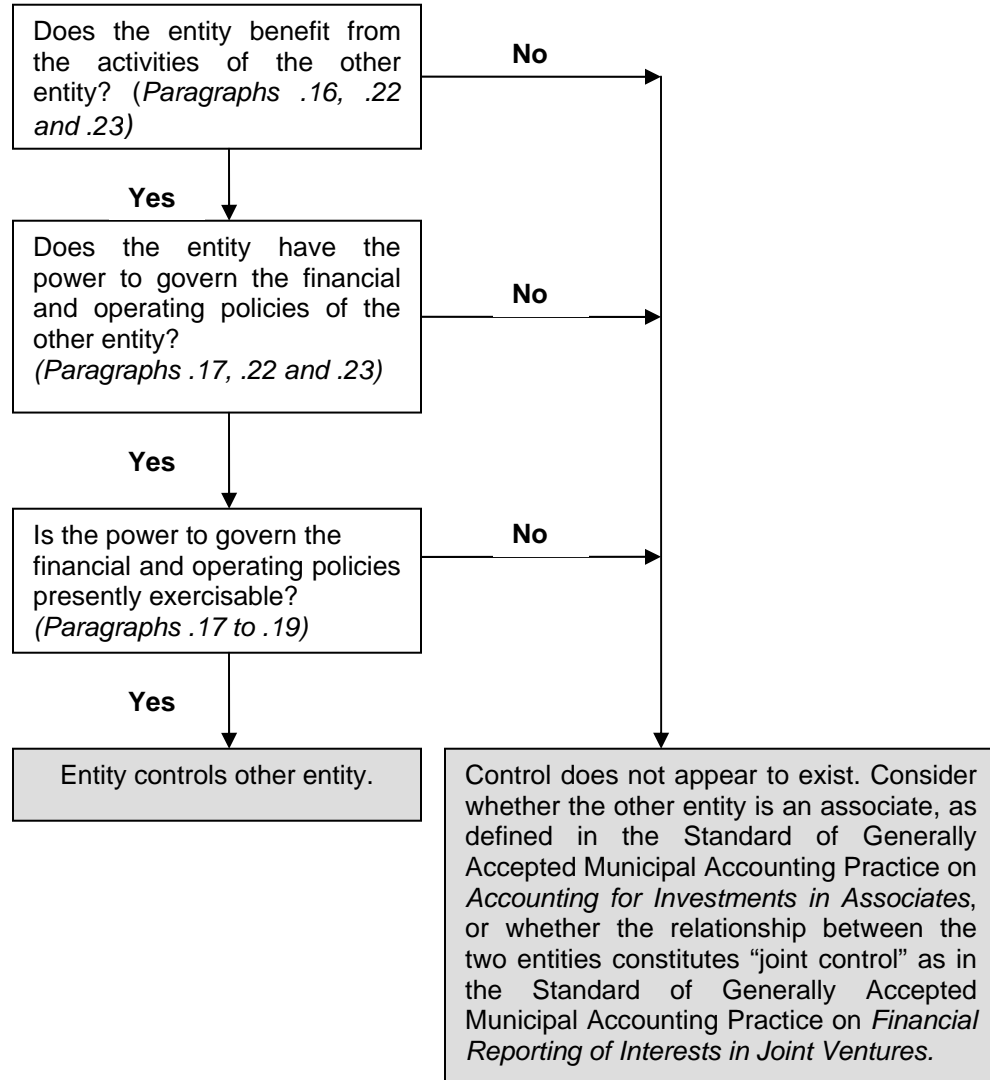
- (a) The entity has the ability to veto operating and capital budgets of the other entity.
- (b) The entity has the ability to veto, overrule, or modify council or equivalent governing body decisions of the other entity.
- (c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.
- (d) The mandate of the other entity is established and limited by legislation.
- (e) The entity holds a “golden share”³ (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

Benefit indicators

- (a) The entity holds direct or indirect title to the net assets of the other entity with an ongoing right to access these.
 - (b) The entity has a right to a significant level of the net assets of the other entity in the event of liquidation or in a distribution other than liquidation.
 - (c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.
 - (d) The entity is exposed to the residual liabilities of the other entity.
- .24 The following diagram indicates the basic steps involved in establishing control of another entity. It should be read in conjunction with paragraphs .15 to .23.

³ “golden share” refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder’s ownership interest or representation on the council or equivalent governing body.

Establishing Control of another Entity for Financial Reporting Purposes



- .25 Sometimes a controlled entity is excluded from consolidation when its activities are dissimilar to those of other entities within the economic entity. Exclusion on these grounds is not justified because better information would be provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities. For example, disaggregated disclosures can help to explain the significance of different activities within the economic entity.

Consolidation procedures

- .26 In preparing consolidated financial statements, the financial statements of the controlling entity and its controlled entities are combined on a line-by-line basis by

adding together like items of assets, liabilities, net assets, revenue and expenses. In order that the consolidated financial statements present financial information about the economic entity as that of a single entity, the following steps are then taken:

- (a) The carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of net assets of each controlled entity are eliminated (the International Accounting Standard on *Business Combinations* provides guidance on the treatment of any resultant goodwill),
- (b) Minority interests in the surplus or deficit of consolidated controlled entities for the reporting period are identified and adjusted against the surplus or deficit of the economic entity in order to arrive at the surplus or deficit attributable to the owners of the controlling entity, and
- (c) Minority interests in the net assets of consolidated controlled entities are identified and presented in the consolidated statement of financial position separately from liabilities and the controlling entity's net assets. Minority interests in the net assets consist of:
 - (i) the amount at the date of the original combination (the International Accounting Standard on *Business Combinations* provides guidance on calculating this amount), and
 - (ii) the minority's share of movements in net assets since the date of combination.

.27 Balances and transactions between entities within the economic entity and resulting unrealised gains shall be eliminated in full. Unrealised losses resulting from transactions within the economic entity shall also be eliminated unless cost cannot be recovered.

.28 Balances and transactions between entities within the economic entity, including sales, transfers and revenues recognised consequent to an appropriation or other budgetary authority, expenses and dividends, are eliminated in full. Unrealised surpluses resulting from transactions within the economic entity that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised deficits resulting from transactions within the economic entity that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

.29 When the financial statements used in the consolidation are drawn up to different reporting dates, adjustments shall be made for the effects of significant transactions or other events that occur between those dates and the date of the controlling entity's financial statements. In any case the difference between reporting dates shall be no more than three months.

.30 The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements are usually drawn up to the same date. When the reporting dates are different, the controlled entity often



prepares, for consolidation purposes, statements as at the same date as the economic entity. When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference is no greater than three months. The consistency principle dictates that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.

- .31 Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies (other than the bases of accounting) in preparing the consolidated financial statements, that fact shall be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.**
- .32 If a member of the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.
- .33 The surplus or deficit of a controlled entity is included in the consolidated financial statements as from the date on which control becomes effective. The surplus or deficit from operating activities of a controlled entity disposed of is included in the consolidated statement of financial performance until the date of disposal, which is the date on which the controlling entity ceases to have control of the controlled entity. The difference between the proceeds from the disposal of the controlled entity and the carrying amount of its assets less liabilities as of the date of disposal is recognised in the consolidated statement of financial performance as the surplus or deficit on the disposal of the controlled entity. In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of controlled entities on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.
- .34 From the date an entity ceases to fall within the definition of a controlled entity and does not become an associate as defined in the Standard of Generally Accepted Municipal Accounting Practice on *Accounting for Investments in Associates*, or a jointly controlled entity as defined in the Standard of Generally Accepted Municipal Accounting Practice on *Financial Reporting of Interests in Joint Ventures*, it should be accounted for as an investment. The International Accounting Standard on *Financial Instruments: Recognition and Measurement* provides guidance on accounting for investments.
- .35 The carrying amount of the investment at the date that it ceases to be a controlled entity is regarded as cost thereafter.



- .36 *Minority interests shall be presented in the statement of changes in net assets, separately from the controlling entity's equity. Minority interests in the surplus or deficit of the economic entity shall also be separately disclosed.***
- .37 The losses applicable to the minority in a consolidated controlled entity may exceed the minority interest in the net assets of the controlled entity. The excess, and any further losses applicable to the minority, is charged against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the controlled entity subsequently reports surpluses, the majority interest is allocated all such surpluses until the minority's share of losses previously absorbed by the majority has been recovered.
- .38 If a controlled entity has outstanding cumulative preferred shares which are held outside the economic entity, the controlling entity computes its share of surpluses and losses after adjusting for the controlled entity's preferred dividends, whether or not dividends have been declared.

Accounting for controlled entities in a controlling entity's separate financial statements

- .39 *In a controlling entity's separate financial statements, controlled entities that are included in the consolidated financial statements shall be either:***
- (a) *accounted for using the equity method as described in the Standard of Generally Accepted Municipal Accounting Practice on Accounting for Investments in Associates, or***
- (b) *accounted for as an investment.***
- .40 *Controlled entities that are excluded from consolidation shall be accounted for as investments in the controlling entity's separate financial statements.***
- .41 Guidance on accounting for investments can be found in the International Accounting Standard on *Financial Instruments: Recognition and Measurement*.
- .42 Separate financial statements are presented by a controlling entity in order to meet legal requirements.

Disclosure

- .43 *The following disclosures shall be made:***
- (a) *In consolidated financial statements, a list of significant controlled entities including the name, the jurisdiction in which it operates (when it is different from that of the controlling entity), proportion of ownership interest and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest),***



- (b) In consolidated financial statements, where applicable, the reasons for not consolidating a controlled entity,**
- (c) In the controlling entity's separate financial statements, a description of the method used to account for controlled entities,**
- (d) Distributions received from or accrued in respect of controlled entities,**
- (e) Gains or losses on the sale of shares or other dilutions in controlled entities by the investor, and**
- (f) Fees charged for administration of the controlled entity.**

Effective date

- .44 This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.**



GAMAP 7

ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as 'entities' Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting by an***

investor for investments in associates where the investment in the associate leads to the holding of an ownership interest in the form of a shareholding or other formal equity structure.

- .02 This Standard provides the basis for accounting for ownership interests in associates. That is, the investment in the other entity confers on the investor the risks and rewards incidental to an ownership interest. The Standard applies only to investments in the formal equity structure (or its equivalent) of an investee. A formal equity structure means share capital or an equivalent form of unitised capital, such as units in a property trust, but may also include other equity structures in which the investor's interest can be measured reliably. Where the equity structure is poorly defined it may not be possible to obtain a reliable measure of the ownership interest.
- .03 Some contributions made by entities may be referred to as an "investment" but may not give rise to an ownership interest. For example, an entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. Whilst such contributions are non-reciprocal in nature, they allow the entity to participate in the operation of the hospital, and the charity is accountable to the entity for its use of public monies. However, the contributions made by the entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the entity from participating in the operation of the hospital. Accordingly, the entity is not exposed to the risks nor does it enjoy the rewards which are incidental to an ownership interest.

Definitions

- .04 ***The following terms are used in this Standard with the meanings specified:***
Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

Accrual basis means a basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets, revenue and expenses.

Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Associate is an entity in which the investor has significant influence and which is neither a controlled entity nor a joint venture of the investor.

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.



Contributions from owners is future economic benefits or service potential that have been contributed to the entity by parties external to the entity that establish a financial interest in the net assets of the entity, provided that the contributions:

- (a) do not result in liabilities of the entity, and
- (b) meet the following test, that they:
 - (i) convey entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions to any excess of assets over liabilities in the event of the entity being wound up, and/or
 - (ii) can be sold, exchanged, transferred or redeemed.

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity that is subject to the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

Cost method is a method of accounting whereby the investment is recorded at cost. The statement of financial performance reflects revenue from the investment only to the extent that the investor receives distributions from accumulated surpluses of the investee arising subsequent to the date of acquisition.

Distributions to owners is future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Equity method is a method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The statement of financial performance reflects the investor's share of the results of operations of the investee.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.

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

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Joint venture is a binding arrangement whereby two or more parties are committed to undertake an activity which is subject to joint control.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Net assets are the residual interest in the assets of the entity after deducting all its liabilities.

Surplus or deficit comprises the following components:

- (a) surplus or deficit from ordinary activities, and***
- (b) extraordinary items.***

Reporting date means the date of the last day of the reporting period to which the financial statements relate.

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets other than increases relating to contributions from owners.

Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control over those policies.

Cost method

- .05 Under the cost method, an investor records its investment in the investee at cost. The investor recognises revenue only to the extent that it is entitled to receive distributions from the accumulated surpluses of the investee arising subsequent to the date of acquisition by the investor. Entitlements due or received in excess of such surpluses are considered a recovery of investment and are recognised as a reduction of the cost of the investment.

Equity method

- .06 Under the equity method, the investment is initially recorded at cost and the carrying amount is increased or decreased to recognise the investor's share of surpluses or deficits of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for alterations in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the statement of financial performance. Such changes include those arising from the revaluation of land.

Significant influence

- .07 Whether an investor has significant influence over the investee is a matter of judgement based on the nature of the relationship between the investor and the



investee, and on the definition of significant influence in this Standard. This Standard applies only to those associates in which an entity holds an ownership interest.

- .08 The existence of significant influence by an investor is usually evidenced in one or more of the following ways:
- (a) representation on the board of directors or equivalent governing body of the investee,
 - (b) participation in policy-making processes,
 - (c) material transactions between the investor and the investee,
 - (d) interchange of managerial personnel, or
 - (e) provision of essential technical information.
- .09 If the investor's ownership interest is in the form of shares and it holds, directly or indirectly through controlled entities, 20% or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through controlled entities, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

Consolidated financial statements

- .10 ***An investment in an associate shall be accounted for in consolidated financial statements under the equity method except when the investment is acquired and held exclusively with a view to its disposal in the near future, in which case it shall be accounted for under the cost method.***
- .11 The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. In particular, where the associate has not-for-profit objectives, investment performance will be determined by factors such as the cost of outputs and overall service delivery. As the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of surpluses or deficits of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated. As a result, the application of the equity method provides more informative reporting of the net assets and surplus or deficit of the investor.
- .12 An investment in an associate is accounted for using the cost method when it operates under severe long-term restrictions that significantly impair its ability to

transfer funds or provide other non-financial benefits to, or on behalf of, the investor. Investment in associates is also accounted for using the cost method when the investment is acquired and held exclusively with a view to its disposal in the near future.

- .13 An investor shall discontinue the use of the equity method from the date that:**
- (a) it ceases to have significant influence in an associate but retains, either in whole or in part, its investment, or**
 - (b) the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to, or on behalf of, the investor.**

The carrying amount of the investment at that date should be regarded as cost thereafter.

- .14** An entity is required to discontinue the equity method where severe long-term restrictions have the effect of preventing, or substantially preventing, the investee from transferring funds or providing other non-financial benefits to the investor. Where the associate does not have a profit objective (such as a social welfare agency) the associate may not be able to transfer funds to the investor but may nonetheless be able to deliver services to beneficiaries, consistent with the objectives of the investor.

Separate financial statements of the investor

- .15 An investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements shall be either:**
- (a) accounted for using the equity method or the cost method, whichever is used for the associate in the investor's consolidated financial statements, or**
 - (b) accounted for as an investment.**
- .16** Guidance on accounting for investments can be found in the International Accounting Standard on *Financial Instruments: Recognition and Measurement*.
- .17** The preparation of consolidated financial statements does not, in itself, obviate the need for separate financial statements for an investor.
- .18 An investment in an associate that is included in the financial statements of an investor that does not issue consolidated financial statements shall be either:**



- (a) accounted for using the equity method or the cost method, whichever would be appropriate for the associate if the investor issued consolidated financial statements, or**
 - (b) accounted for as an investment.**
- .19 Guidance on accounting for investments can be found in the International Accounting Standard on *Financial Instruments: Recognition and Measurement*.
- .20 An investor that has investments in associates may not issue consolidated financial statements because it does not have controlled entities. It is appropriate that such an investor provides the same information about its investments in associates as those entities that issue consolidated financial statements.

Application of the equity method

- .21 Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in the Standard of Generally Accepted Municipal Accounting Practice on *Consolidated Financial Statements and Accounting for Controlled Entities*. Furthermore, the broad concepts underlying the consolidation procedures used in the acquisition of a controlled entity are adopted on the acquisition of an investment in an associate.
- .22 Where an associate is accounted for using the equity method, unrealised surpluses and deficits resulting from all transactions between an investor (or its consolidated controlled entities) and associates shall be eliminated to the extent of the investor's interest in the associate. Unrealised deficits shall not be eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred.**
- .23 An investment in an associate is accounted for under the equity method from the date on which it falls within the definition of an associate. Guidance on accounting for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate can be found in the International Accounting Standard on Business Combinations. Appropriate adjustments to the investor's share of the surpluses or deficits after acquisition are made to account for:**
- (a) depreciation of the depreciable assets, based on their fair values, and**
 - (b) amortisation of the difference between the cost of the investment and the investor's share of the fair values of the net identifiable assets.**
- .24 The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting date of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the



investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle dictates that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.

- .25 When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor and the associate that occur between the date of the associate's financial statements and the date of the investor's financial statements.
- .26 The investor's financial statements are usually prepared using uniform accounting policies for like transactions and events in similar circumstances. In many cases, if an associate uses accounting policies other than those adopted by the investor for like transactions and events in similar circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable for such adjustments to be calculated, that fact is generally disclosed.
- .27 If an associate has outstanding cumulative preferred shares, held by outside interests, the investor computes its share of surpluses or deficits after adjusting for the preferred dividends, whether or not the dividends have been declared.
- .28 If, under the equity method, an investor's share of deficits of an associate equals or exceeds the carrying amount of an investment, the investor discontinues including its share of further losses. The investment is reported at nil value. Additional deficits are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or otherwise committed. If the associate subsequently reports surpluses, the investor resumes including its share of those surpluses only after such share of the surpluses equals the share of net deficits not recognised.

Impairment losses

- .29 If there is an indication that an investment in an associate may be impaired, an entity should consider the International Accounting Standard on *Impairment of Assets*.

Contingencies

- .30 In accordance with the Standard of Generally Accepted Municipal Accounting Practice on *Provisions, Contingent Liabilities and Contingent Assets* and the International Public Sector Accounting Standard on *Events After the Reporting Date*, the investor discloses:
 - (a) its share of the contingencies and capital commitments of an associate for which it is also contingently liable,
 - (b) those contingent liabilities that arise because the investor is severally liable for all the liabilities of the associate, and

- (c) its share of the contingent assets of an associate.

Disclosure

.31 The following disclosures shall be made:

- (c) **An appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held,**
- (d) **The methods used to account for such investments,**
- (e) **The carrying amount of the investment for each significant associate'**
- (f) **Summarised financial information in regard to asset, liabilities and the results of the operations of significant associates presented individually or in aggregate,**
- (g) **The investor's share of cumulative post acquisition reserves or deficits of associates,**
- (h) **The gross amount of loans made to the associate or received from associate by the investor,**
- (i) **Accounting periods for which the financial statement of the associate have been prepared where they are different from that of the investor,**
- (j) **The total market value of the listed investment in associates and the total council's valuation of investments in unlisted associates,**
- (k) **Distribution received from or accrued in respect of associates, and**
- (l) **Gains and losses on the sale of shares or other dilutions in associates by the investor.**

.32 Investments in associates accounted for using the equity method shall be classified as non-current assets and disclosed as a separate item in the statement of financial position. The investor's share of the surpluses or deficits of such investments should be disclosed as a separate item in the statement of financial performance.

- .33 The Standard of Generally Recognised Accounting Practice on *Presentation of Financial Statements* also requires the share of surpluses or deficits of associates accounted for using the equity method of accounting to be presented on the face of the statement of financial performance.

Effective date

.34 This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91 (1) (b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.



GAMAP 8

FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as 'entities' Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, revenue and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.**
- .02 This Standard provides the basis for accounting for interests in joint ventures.**

Definitions

- .03 The following terms are used in this Standard with the meanings specified:**

Accrual basis means a basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets, revenue and expenses.

Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Associate is an entity in which the investor has significant influence and which is neither a controlled entity nor a joint venture of the investor.

Cash comprises cash on hand and demand deposits.

Cash flows are inflows and outflows of cash and cash equivalents.

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.

Contributions from owners is future economic benefits or service potential that have been contributed to the entity by parties external to the entity that establish a financial interest in the net assets of the entity, provided that the contributions:

- (a) do not result in liabilities of the entity, and**
- (b) meet the following test, that they:**
 - (i) convey entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions to any excess of assets over liabilities in the event of the entity being wound up, and / or**
 - (ii) can be sold, exchanged, transferred or redeemed.**



Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity that is under the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

Distributions to owners is future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Joint venture is a binding agreement whereby two or more parties are committed to undertake an activity which is subject to joint control.

Joint control is the agreed sharing of control over an activity by a binding agreement.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Net assets are the residual interest in the assets of the entity after deducting all its liabilities.

Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, revenue and expenses of a jointly controlled entity is combined on a line-by-line basis with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners.

Significant influence is the power to participate in the financial and operating policy decisions of an economic activity but is not control or joint control over those policies.

Venturer is a party to a joint venture, and has joint control over that joint venture.

Binding arrangement

- .04 The existence of a binding arrangement distinguishes interests which involve joint control from investments in associates where the investor has significant influence (see Standard of Generally Accepted Municipal Accounting Practice on *Accounting for Investments in Associates*). For the purposes of this Standard, an arrangement includes all binding arrangements between venturers. That is, in substance, the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract. For instance, two entities may enter into a formal arrangement to undertake a joint venture but the arrangement may not constitute a legal contract because, in that jurisdiction, individual entities may not be separate legal entities with the power to contract. Activities which have no binding arrangement to establish joint control are not joint ventures for the purposes of this Standard.
- .05 The arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers. In some cases, the arrangement is incorporated in the enabling legislation, articles or other by-laws of the joint venture. Whatever its form, the arrangement is usually in writing and deals with such matters as :
- (a) the activity, duration and reporting obligations of the joint venture,
 - (b) the appointment of the council or equivalent governing body of the joint venture and the voting rights of the venturers,
 - (c) capital contributions by the venturers, and
 - (d) the sharing by the venturers of the output, revenue, expenses, surpluses or deficits, or cash flows of the joint venture.
- .06 The arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to unilaterally control the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.
- .07 The arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed by the venturers in accordance with the arrangement and delegated to the operator. If the operator has the power to govern the financial and operating policies of the activity, it controls the venture and the venture is a controlled entity of the operator and not a joint venture.

Forms of joint venture

- .08 Many entities establish joint ventures to undertake a variety of activities. The nature of these activities ranges from commercial undertakings to provision of community services at no charge. The terms of a joint venture are set out in a contract or other binding arrangement and usually specify the initial contribution



from each joint venturer and the share of revenues or other benefits (if any), and expenses of each of the joint venturers.

- .09 Joint ventures take many different forms and structures. This Standard identifies three broad types; jointly controlled operations, jointly controlled assets and jointly controlled entities, which are commonly described as, and meet the definition of, joint ventures. Characteristics common to all joint ventures are that:
- (a) two or more venturers are bound by a arrangement, and
 - (b) the arrangement establishes joint control.

Jointly controlled operations

- .10 The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale of the joint product or service and any expenses incurred in common are shared among the venturers.
- .11 An example of a jointly controlled operation is when two entities combine their operations, resources and expertise in order to jointly deliver a service, such as aged care where, in accordance with an agreement, a local government offers domestic services and a local hospital offers medical care. Each venturer bears its own costs and takes a share of revenue, such as user charges and government grants; such share being determined in accordance with the agreement.
- .12 ***In respect of its interests in jointly controlled operations, a venturer shall recognise in its separate financial statements and consequently in its consolidated financial statements:***
- (a) the assets that it controls and the liabilities that it incurs, and***
 - (b) the expenses that it incurs and its share of the revenue that it earns from the sale or provision of goods or services by the joint venture.***
- .13 Because the assets, liabilities, revenue (if any) and expenses are already recognised in the separate financial statements of the venturer, and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
- .14 Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the

venturers may prepare management accounts so that they may assess the performance of the joint venture.

Jointly controlled assets

- .15 Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the venture and dedicated to the purposes of the joint venture. The assets are used to obtain benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.
- .16 These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of the future economic benefits or service potential through its share in the jointly controlled asset.
- .17 Some activities in the public sector involve jointly controlled assets. For example, an entity may enter into an arrangement with a private sector corporation to construct and operate a toll road. The road provides the citizens with improved access between the local government's industrial estate and its port facilities. The road also provides the private sector corporation with direct access between its manufacturing plant and the port. The agreement between the local authority and the private sector corporation specifies each party's share of revenues and expenses associated with the toll road. Accordingly, each venturer derives economic benefits or service potential from the jointly controlled asset and bears an agreed proportion of the costs of operating the road. Another example of a jointly controlled asset is when two entities jointly control a property, each taking a share of rents received and bearing a share of the expenses.
- .18 ***In respect of its interest in jointly controlled assets, a venturer shall recognise in its separate financial statements and consequently in its consolidated financial statements:***
 - (a) ***its share of the jointly controlled assets, classified according to the nature of the assets,***
 - (b) ***any liabilities that it has incurred,***
 - (c) ***its share of any liabilities incurred jointly with the other venturers in relation to the joint venture,***
 - (d) ***any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture, and***
 - (e) ***any expenses that it has incurred in respect of its interest in the joint venture.***
- .19 In respect of its interest in jointly controlled assets, each venturer includes in its accounting records and recognises in its separate financial statements and consequently in its consolidated financial statements:

- (a) its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment. For example, a share of a jointly controlled property is classified as property, plant and equipment,
 - (b) any liabilities that it has incurred, for example those incurred in financing its share of the assets,
 - (c) its share of any liabilities incurred jointly with other venturers in relation to the joint venture,
 - (d) any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture, and
 - (e) any expenses that it has incurred in respect of its interest in the joint venture; for example, those related to financing the venturer's interest in the assets and selling its share of the output.
- .20 Because the assets, liabilities, revenue and expenses are already recognised in the separate financial statements of the venturer, and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
- .21 The treatment of jointly controlled assets reflects the substance and economic reality and, usually, the legal form of the joint venture. Separate accounting records for the joint venture itself may be limited to those expenses incurred in common by the venturers, and ultimately borne by the venturers according to their agreed shares. Financial statements may not be prepared for the joint venture, although the venturers may prepare management accounts so that they may assess the performance of the joint venture.

Jointly controlled entities

- .22 A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity or service potential of the entity.
- .23 A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns revenue. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the results of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.
- .24 A common example of a jointly controlled entity is when two entities combine their activities in a particular line of service delivery by transferring the relevant assets and liabilities into a jointly controlled entity.

- .25 Many jointly controlled entities are similar in substance to those joint ventures referred to as jointly controlled operations or jointly controlled assets. For example, the venturers may transfer a jointly controlled asset, such as roads, into a jointly controlled entity, for tax or other reasons. Similarly, the venturers may contribute into a jointly controlled entity, assets which will be operated jointly. Some jointly controlled operations also involve the establishment of a jointly controlled entity to deal with particular aspects of the activity, for example, the design, marketing and distribution or after-sale service of the product.
- .26 A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other entities in conformity with the appropriate legal requirements and accounting statements.
- .27 Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in the accounting records of the venturer and recognised in its separate financial statements as an investment in the jointly controlled entity.

Consolidated financial statements of a venturer

- .28 For the purposes of this Standard an economic entity may consist of only a venturer and a jointly controlled entity and consequently consolidated financial statements for such a group are prepared in accordance with the requirements of this Standard.
- .29 *In its consolidated financial statements, a venturer shall report its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation.***
- .30 When reporting an interest in a jointly controlled entity in consolidated financial statements, it is essential that a venturer reflects the substance and economic reality of the arrangement rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits or potential service provision through its share of the assets and liabilities of the venture. This substance and economic reality is reflected in the consolidated financial statements of the venturer when the venture reports its interests in the assets, liabilities, revenue and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation described in paragraph .32.
- .31 The application of proportionate consolidation means that the consolidated statement of financial position of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The consolidated statement of financial performance of the venturer includes its share of the revenue and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in controlled entities, which



are set out in the Standard of Generally Accepted Municipal Accounting Practice on *Consolidated Financial Statements and Accounting for Controlled Entities*.

- .32 Different reporting formats may be used to give effect to proportionate consolidation. The venturer may combine its share of each of the assets, liabilities, revenue and expenses of the jointly controlled entity with the similar items in its consolidated financial statements on a line-by-line basis. For example, it may combine its share of the jointly controlled entity's inventory with the inventory of the economic entity and its share of the jointly controlled entity's property, plant and equipment with the same items of the economic entity. Alternatively, the venturer may include separate line items for its share of the assets, liabilities, revenue and expenses of the jointly controlled entity in its consolidated financial statements. For example, it may show its share of the current assets of the jointly controlled entity separately as part of the current assets of the economic entity; it may show its share of the property, plant and equipment of the jointly controlled entity separately as part of the property, plant and equipment of the economic entity. Both these reporting formats result in the reporting of identical amounts of net revenue and expenses; both formats are acceptable for the purposes of this Standard.
- .33 Whatever format is used to give effect to proportionate consolidation, it is inappropriate to offset any assets or liabilities by the deduction of other liabilities or assets or any revenue or expense by the deduction of other expenses or revenue, unless a legal right of set-off exists and the offsetting represents the expectation as to the realisation of the asset or the settlement of the liability.
- .34 A venturer shall discontinue the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.**
- .35 A venturer discontinues the use of proportionate consolidation from the date on which it ceases to share in the control of a jointly controlled entity. This may happen, for example, when the venturer disposes of its interest, or when external restrictions are placed on the jointly controlled entity so that it can no longer achieve its goals.

Exceptions to proportionate consolidation

- .36 The following interests shall be accounted for as investments:**
- (a) an interest in a jointly controlled entity that is acquired and held exclusively with a view to its subsequent disposal in the near future, and**
 - (b) an interest in a jointly controlled entity which operates under severe long term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to the venturer.**
- .37 Guidance on accounting for investments can be found in the International Accounting Standard on *Financial Instruments: Recognition and Measurement*.



- .38 The use of proportionate consolidation is inappropriate when the interest in a jointly controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future. It is also inappropriate when the jointly controlled entity operates under severe long-term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to the venturer.
- .39 *From the date on which a jointly controlled entity becomes a controlled entity of a venturer, the venturer accounts for its interest in accordance with the Standard of Generally Accepted Municipal Accounting Practice on Consolidated Financial Statements and Accounting for Controlled Entities.***

Separate financial statements of a venturer

- .40 Separate financial statements may be presented by a venturer in order to meet legal or other requirements. Such separate financial statements are prepared in order to meet a variety of needs with the result that different reporting practices are in use. Accordingly, this Standard does not indicate a preference for any particular treatment.

Transactions between a venturer and a joint venture

- .41 *When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain that is attributable to the interest of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.***
- .42 When a venturer purchases assets from a joint venture, the venturer should not recognise its share of the gains of the joint venture from the transaction until it resells the assets to an independent party. A venturer should recognise its share of the losses resulting from these transactions in the same way as gains except that losses should be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.
- .43 To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount of the assets. Guidance is provided in the International Accounting Standard on *Impairment of Assets*. In determining value in use, future cash flows from the asset are estimated based on continuing use of the asset and its ultimate disposal by the joint venture.



Reporting interests in joint ventures in the financial statements of an investor

- .44** *An investor in a joint venture, which does not have joint control, but does have significant influence shall report its interest in a joint venture in accordance with the Standard of Generally Accepted Municipal Accounting Practice on Accounting for Investments in Associates.*
- .45 The International Accounting Standard on *Financial Instruments: Recognition and Measurement* provides guidance on accounting for interests in joint ventures where an investor does not have joint control or significant influence.

Operators of joint ventures

- .46** *Operators or managers of a joint venture shall account for any fees in accordance with the Standard of Generally Accepted Municipal Accounting Practice on Revenue.*
- .47 One or more venturers may act as the operator or manager of a joint venture. Operators are usually paid a management fee for such duties. The fees are accounted for by the joint venture as an expense.

Disclosure

- .48** *In accordance with the Standard of Generally Accepted Municipal Accounting Practice on Provisions, Contingent Liabilities and Contingent Assets, a venturer shall disclose the following:*
- (a) *The aggregate amount of the following contingent liabilities, unless the possibility of any outflow in settlement is remote, separately from the amount of other contingent liabilities:*
- (i) *any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures, and its share in each of the contingent liabilities that have been incurred jointly with other venturers,*
 - (ii) *its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable, and*
 - (iii) *those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture, and*
- (b) *A brief description of the following contingent assets and, where practicable, an estimate of their financial effect, where an inflow of economic benefits or service potential is probable:*
- (i) *any contingent assets of the venturer arising in relation to its interests in joint ventures and its share in each of the contingent assets which have arisen jointly with other venturers, and*
 - (ii) *its share of the contingent assets of the joint ventures themselves.*



- .49 A venturer shall disclose the aggregate amount of the following commitments, in respect of its interests in joint ventures separately from other commitments:**
- (a) any capital commitments of the venturer in relation to its interests in joint ventures, and its share in the capital commitments that have been incurred jointly with other venturers, and**
 - (b) its share of the capital commitments of the joint ventures themselves.**
- .50 A venturer shall disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. A venturer which reports its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation shall disclose the aggregate amounts of each of current assets, non-current assets, current liabilities, non-current liabilities, revenue and expenses related to its interests in joint ventures.**
- .51 A venturer which does not issue consolidated financial statements because it does not have controlled entities, shall disclose the information required in paragraphs .48, .49 and .50 (where applicable).**
- .52 It is appropriate that a venturer which does not prepare consolidated financial statements because it does not have controlled entities provides the same information about its interests in joint ventures as those venturers that issue consolidated financial statements.**

Effective date

- .53 This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.**



GAMAP 9

REVENUE

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as ‘entities’ Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.

Objective

The *Framework for the Preparation and Presentation of Financial Statements* defines revenue as “increases in economic benefits or service potential during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from owners”. Certain specific items to be recognised as revenues are addressed in other statements and are excluded from the scope of this Standard. For example, gains arising on the sale of property, plant and equipment are specifically addressed in the Standard of Generally Accepted Municipal Accounting Practice on *Property, Plant and Equipment* and are not accounted for in accordance with this Standard.

The objective of this Standard is to prescribe the accounting treatment of revenue.

The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provides examples on the application of these criteria.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue including:**
- (a) the rendering of services,**
 - (b) the sale of goods,**
 - (c) the exercising of legal powers and duties, and**
 - (d) the use by others of entity assets thereby yielding interest, royalties and dividends.**
- .02 The rendering of services typically involves the performance by an entity of an agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Examples of services rendered by entities for which revenue is typically received in exchange may include the provision of housing, management of water facilities, and management of transfer payments.
- .03 The exercising of legal powers and duties involves the raising of revenue, such as rates and fines, in terms of legal enactments. Revenue arising from the exercising of legal powers and duties may include the following:
- (a) rates, including collection charges and penalty interest,
 - (b) service charges,
 - (c) application of tariff of charges,



- (d) fines,
 - (e) government grants, and
 - (f) regional council levies.
- .04 Goods include goods produced by the entity for the purpose of sale, such as electricity, and goods purchased for resale, such as merchandise or land and other property held for resale.
- .05 The use by others of entity assets gives rise to revenue in the form of:
- (a) interest – charges for the use of cash or cash equivalents or amounts due to the entity,
 - (b) royalties – charges for the use of long term assets of an entity, for example, patents, trademarks, copyrights and computer software,
 - (c) dividends or equivalents – distributions of surpluses to holders of equity investments in proportion to their holdings of a particular class of capital, and
 - (d) rental income – charges for the use of community halls, sport facilities etc..
- .06 This Standard does not deal with revenues:
- (a) addressed in other Standards of Generally Accepted Municipal Accounting Practice or International Public Sector Accounting Standards or International Accounting Standards, including:
 - (i) lease agreements (see the International Public Sector Accounting Standard on *Leases* for guidance),
 - (ii) dividends arising from investments that are accounted for under the equity method (see the Standard of Generally Accepted Municipal Accounting Practice on *Accounting for Investments in Associates*), and
 - (iii) gains from the sale of property, plant and equipment (which are dealt with in the Standard of Generally Accepted Municipal Accounting Practice on *Property, Plant and Equipment*),
 - (b) arising from changes in the fair value of financial assets and financial liabilities or their disposal (guidance on accounting for financial instruments can be found in the International Accounting Standard on *Financial Instruments: Recognition and Measurement*),
 - (c) arising from changes in the value of other current assets (see the International Accounting Standard on *Financial Instruments: Recognition and Measurement* for guidance), (d) arising from natural increases in herds, and agricultural and forest products (see the International Accounting Standard on *Agriculture* for guidance), and
 - (d) arising from the extraction of mineral ores (currently no guidance exists).

Definitions

- .07 The following terms are used in this Standard with the meanings specified:**

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

Revenue is the gross inflows of economic benefits or service potential during the reporting period when those inflows result in increases in net assets, other than increases relating to contributions from owners.

Contributions from owners is future economic benefits or service potential that have been contributed to the entity by parties external to the entity that establish a financial interest in the net assets of the entity, provided that the contributions:

(a) do not result in liabilities of the entity, and

(b) meet the following test, that they:

(i) convey entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or

(ii) can be sold, exchanged, transferred or redeemed.

Revenue

.08 Revenue includes only the gross inflows of economic benefits or service potential received and receivable by the entity on its own account. Amounts collected as agent of the government or another government organisation or on behalf of other third parties, for example the collection of licence fees by the entity on behalf of the Department of Transport or value-added taxes, are not economic benefits or service potential which flow to the entity and do not result in increases in assets or decreases in liabilities. Therefore, they are excluded from revenue. Similarly, in a custodial or agency relationship, the gross inflows of economic benefits or service potential include amounts collected on behalf of the principal that do not result in increases in net assets for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission received or receivable for the collection or handling of the gross flows.

.09 Financing inflows, notably borrowings, do not meet the definition of revenue, because they result in an equal change in both assets and liabilities and have no impact upon net assets. Financing inflows are taken directly to the statement of financial position and added to the balances of assets and liabilities.

Measurement of revenue

.10 Revenue shall be measured at the fair value of the consideration received or receivable.

.11 The amount of revenue arising on a transaction is usually determined by agreement between the entity and the purchaser or user of the asset or set out in

legal enactment. It is measured at the fair value of the consideration received or receivable taking into account the amount of any discounts and rebates allowed by the entity.

- .12 In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the purchaser or accept a note receivable bearing below-market interest rate from the purchaser as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:
- (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or
 - (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs .55 and .56. Where an agreement is entered into between the entity and a defaulting ratepayer to settle arrears, no additional revenue is recognised unless interest is charged on arrears.

- .13 When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. This is often the case with commodities like oil or milk where suppliers exchange or swap inventories in various locations to fulfil demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Identification of the transaction

- .14 The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or

more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

Rendering of services

- .15 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the reporting date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:**
- (a) the amount of revenue can be measured reliably,**
 - (b) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,**
 - (c) the stage of completion of the transaction at the reporting date can be measured reliably, and**
 - (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.**

This principle also applies to tariff of charges.

- .16** The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognised in the reporting periods in which the services are rendered.
- .17** Revenue is recognised only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.
- .18** An entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:
- (a) each party's enforceable rights regarding the service to be provided and received by the parties,
 - (b) the consideration to be exchanged, and
 - (c) the manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of revenue as the service is performed. The need for such revisions

does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

- .19 The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:
- (a) surveys of work performed,
 - (b) services performed to date as a percentage of total services to be performed, or
 - (c) the proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.

Progress payments and advances received from customers often do not reflect the services performed.

- .20 For practical purposes, when services are performed by an indeterminate number of acts over a specified time frame, revenue is recognised on a straight-line basis over the specified time frame unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

- .21 *When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable.***

- .22 During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the transaction costs incurred. Therefore, revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no surplus is recognised.

- .23 When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, revenue is not recognised and the costs incurred are recognised as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognised in accordance with paragraph .15 rather than in accordance with paragraph .21.

Sale of goods

- .24 *Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:***
- (a) *the entity has transferred to the purchaser the significant risks and rewards of ownership of the goods,***

- (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold,**
 - (c) the amount of revenue can be measured reliably,**
 - (d) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, and**
 - (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.**
- .25 The assessment of when an entity has transferred the significant risks and rewards of ownership to the purchaser requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the purchaser, for example the sale of prepaid electricity cards. This is the case for most sales. However, in certain other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.
- .26 If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. An entity may retain a significant risk of ownership in a number of ways. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:
- (a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions,
 - (b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the purchaser from its sale of the goods,
 - (c) when the goods are shipped subject to installation and the installation is a significant part of the contract, which has not yet been completed by the entity, and
 - (d) when the purchaser has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.
- .27 If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised. For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognised. Another example of an entity retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided that the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

- .28 Revenue is recognised, only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. For example, the revenue may be dependent upon the ability of another entity to supply goods as part of the contract and if there is any doubt that this will occur, recognition may be delayed until it has occurred, or it may be uncertain that a foreign governmental authority will grant permission to remit the consideration from a sale in a foreign country. When the goods are supplied, or permission is granted the uncertainty is removed and revenue is recognised. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

Rates, including collection charges and penalty interest

- .29 Revenue from rates, including collection charges and penalty interest, shall be recognised when:**
- (a) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,**
 - (b) the amount of the revenue can be measured reliably, and**
 - (c) there has been compliance with the relevant legal requirements.**
- .30 Changes to property values during a reporting period, which are referred to as “interims”, are valued by a suitably qualified valuator and adjustments are made to rates revenue, based on a time proportion basis. Adjustments to rates revenue already recognised are processed or additional rates revenue is recognised.
- .31 In certain circumstances, interim rates revenue adjustments will relate to previous accounting periods. If such adjustments are significant, the Standard of Generally Recognised Accounting Practice on *Accounting Policies, Changes in Accounting Estimates and Errors* will apply.
- .32 Collection charges should be recognised once the period legally prescribed for the levying of the charge has elapsed. Legal fees actually incurred in recovering non-payment of rates should be recognised as an expense and not offset against revenue from collection charges.
- .33 A second collection is levied once a court order has been obtained to attach a defaulting ratepayer’s property. This collection charge should be recognised when the due legal processes have been performed.
- .34 Penalty interest is levied on unpaid amounts each month. This revenue should be recognised when leviable in terms of law.
- .35 When uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has

ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

Service charges

- .36 There are two types of service charges: flat rate service charges and services based on consumption. Flat rate service charges relate to the levying of a fixed amount for the rendering of services, regardless of consumption. Consumption-based service charges are based on the consumption by consumers/users.
- .37 *Flat rate service charges and consumption-based service charges shall be recognised when:***
- (a) *it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, and***
 - (b) *the amount of the revenue can be measured reliably.***
- .38 Usually consumption-based service charges are based on meter readings. Where meter readings are done frequently, the revenue can be measured reliably. However, it is common practice for entities to read meters on a quarterly or less frequent basis. Consumers are invoiced based on estimates of consumption where no meter reading has taken place during the billing period. These invoices are best estimates and enable revenue to be measured reliably. Ideally, internal records should be maintained whereby actual consumption is compared to estimated consumption to provide additional assurance that significant adjustments are not required to reverse excessive estimates.

Fines

- .39 *Revenue from the issuing of fines shall be recognised when:***
- (a) *it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, and***
 - (b) *the amount of the revenue can be measured reliably.***
- .40 There are two types of fines: spot fines and summonses. Municipalities will usually issue both types of fines. There is uncertainty regarding the probability of the flow of economic benefits or service potential in respect of spot fines as these fines are usually not given directly to an offender. Further legal processes have to be undertaken before the spot fine is enforceable.
- .41 In respect of summonses the public prosecutor can decide whether to waive the fine, reduce it or prosecute for non-payment by the offender. An estimate should be made for the revenue amount collected from spot fines and summonses based on past experience of amounts collected. Where a reliable estimate cannot be made of revenue from summonses, the revenue from summonses should be recognised when the public prosecutor pays over to the entity the cash actually collected on summonses issued.

Government grants

- .42 Government grants can be in the form of grants to acquire or construct fixed assets (capital grants), grants for the furtherance of national and provincial government policy objectives and general grants to subsidise the cost incurred by entities in rendering services. Capital grants and general grants for the furtherance of government policy objectives are usually restricted revenue in that stipulations are imposed on their use.
- .43 Government grants are recognised as revenue when:**
- (a) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,**
 - (b) the amount of the revenue can be measured reliably, and**
 - (c) to the extent that there has been compliance with any restrictions associated with the grant.**
- .44 An entity needs to assess the degree of certainty attached to the flow of future economic benefits of service potential on the basis of the available evidence. Certain grants payable by one level of government to another are subject to the availability of funds. Revenue from these grants should only be recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. An announcement at the beginning of a financial year that grants may be available for qualifying entities in accordance with an agreed programme may not be sufficient evidence of the probability of the flow. Revenue should only be recognised once evidence of the probability of the flow becomes available.
- .45 Restrictions on government grants may result in such revenue being recognised on a time proportion basis. For example, equitable share grants per the Division of Revenue Act where the period of use of such funds is stated, should be recognised on a time proportion basis, i.e. over the stated period. Where there is no restriction on the period, such revenue should be recognised on receipt or when the Act becomes effective, which-ever is earlier.
- .46 In certain circumstances government will only remit grants on a re-imburement basis. Revenue should therefore be recognised when the qualifying expense has been incurred and to the extent that any other restrictions have been complied with and not when the grant is received.

Other grants and donations received

- .47 Other grants and donations shall be recognised as revenue when:**
- (a) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,**
 - (b) the amount of the revenue can be measured reliably, and**
 - (c) to the extent that there has been compliance with any restrictions associated with the grant.**

- .48 Grants funded by public contributions should only be recognised when it is probable that economic benefits or service potential associated with the transaction will flow to the entity. For example, a manufacturer may require a road to be built to his/her factory. The municipality may not have sufficient funds to build the road or because the road will be for the primary benefit of the manufacturer, may enter into an agreement whereby it will construct the road only if the manufacturer pays a portion of the construction. The grant received from the manufacturer to construct the road, should only be recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, the amount of the grant can be measured reliably, and to the extent that the entity has complied with the agreement to construct the road.
- .49 Donations should be measured at the fair value of the consideration received or receivable when the amount of the revenue can be measured reliably. For example, a developer donates land for a community hall in the development of a new suburb on condition that the land is rezoned from agricultural to residential. The donation is recognised when the restrictions have been met, i.e the land has been rezoned.

Levies

- .50 ***Levies shall be recognised as revenue when:***
- (a) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, and***
 - (b) the amount of the revenue can be measured reliably.***
- .51 Levies are based on declarations completed by levy payers. Levies are payable one month in arrears, for example levies based on a levy payer's February payroll are payable by the end of March.
- .52 A reliable measurement of levies can usually only be made on the due date of payment. The revenue will be determined from declarations actually received by due date of the payment, together with an estimate of levies due when a levy payer has not submitted a declaration in the reporting period where payment was due.
- .53 The estimate of levies revenue when a levy payer has not submitted a declaration will need to be made taking into account the following factors:
- (a) the extent and success of procedures to investigate the non-submission of a declaration by defaulting levy payers,
 - (b) internal records maintained of historical comparisons of estimated levies with actual levies received from individual levy payers,
 - (c) historical information on declarations previously submitted by defaulting levy payers, and

- (d) the accuracy of the database of levy payers as well as the frequency by which it is updated for changes.
- .54 Changes to estimates made when more reliable information becomes available should be processed as an adjustment to levies revenue. Where such changes are significant and relate to different reporting periods, reference should be made to the Standard of Generally Recognised Accounting Practice on *Accounting Policies, Changes in Accounting Estimates and Errors*.
- Interest, royalties and dividends**
- .55 *Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases set out in paragraph .56 when:***
- (a) *it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, and***
- (b) *the amount of the revenue can be measured reliably.***
- .56 *Revenue shall be recognised using the following accounting treatment:***
- (a) *interest shall be recognised on a time proportion basis that takes into account the effective yield on the asset,***
- (b) *royalties shall be recognised as they are earned in accordance with the substance of the relevant agreement, and***
- (c) *dividends or their equivalents shall be recognised when the shareholder's right or the entity's right to receive payment is established.***
- .57 The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to equate to the initial carrying amount of the asset. Interest revenue includes the amount of amortisation of any discount, premium or other difference between the initial carrying amount of a debt security and its amount at maturity.
- .58 When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods, and only the post-acquisition portion is recognised as revenue. When dividends on equity securities are declared from pre-acquisition net retained surpluses, those dividends are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis, dividends are recognised as revenue unless they clearly represent a recovery of part of the cost of the equity securities.
- .59 Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise revenue on some other systematic and rational basis.

- .60 Revenue is recognised only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

Disclosure

- .61 An entity shall disclose the following:**
- (a) The accounting policies adopted for the recognition of revenue including the methods adopted to determine the stage of completion of transactions involving the rendering of services,**
 - (b) The amount of each significant category of revenue recognised during the period including revenue arising from:**
 - (i) the rendering of services,**
 - (ii) the sale of goods,**
 - (iii) assessment rates,**
 - (iv) service charges,**
 - (v) application of tariff of charges,**
 - (vi) fines,**
 - (vii) government grants,**
 - (viii) other grants and donations received,**
 - (ix) levies,**
 - (x) interest,**
 - (xi) royalties, and**
 - (xii) dividends or their equivalents, and**
 - (c) The amount of revenue arising from the exchange of goods or services included in each significant category of revenue.**
- .62 The financial statements shall also disclose:**
- (a) unfulfilled conditions and restrictions attaching to transfers and government grants, and**
 - (b) significant decreases expected in the level of government grants.**
- .63 Guidance on disclosure of any contingent assets and contingent liabilities can be found in the Standard of Generally Accepted Municipal Accounting Practice on *Provisions, Contingent Liabilities and Contingent Assets*. Contingent assets and contingent liabilities may arise from items such as warranty costs, claims, penalties or possible losses.



Transitional Provisions

- .64** *On the occasion of first-time application of this Standard all provisions of the Standard shall be applied prospectively. However, when the first-time application of this Standard results in a change in accounting policy or estimate, reference shall be made to the Standard of Generally Recognised Accounting Practice on Accounting Policies, Changes in Accounting Estimates and Errors.*

Effective date

- .65** *This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.*



GAMAP 12

INVENTORIES

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as ‘entities’ Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.

Objective

The objective of this Standard is to prescribe the accounting treatment for inventories under the historical cost system. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward



until the related revenues are recognised. This Standard provides practical guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the context of the historical cost system in accounting for inventories other than:**
- (a) Work in progress arising under the construction contracts, including directly related service contracts (see the International Public Sector Accounting Standard on Construction Contracts for guidance),**
 - (b) Financial instruments (see the International Accounting Standard on Financial Instruments: Recognition and Measurement for guidance),**
 - (c) Producers' inventories of livestock, agricultural and forest products, and mineral ores to the extent that they are measured at net realisable value in accordance with well established practices in certain industries (see the International Accounting Standard on Agriculture for guidance), and**
 - (d) Work in progress of services to be provided for no or nominal consideration directly in return from the recipients.**
- .02** The inventories referred to in paragraph .01(d) are not encompassed by the International Public Sector Accounting Standard on *Inventories* and are excluded from the scope of this Standard because they involve specific public sector issues that require further consideration.

Definitions

- .03 The following terms are used in this Standard with the meanings specified:**
- Current replacement cost is the cost the entity would incur to acquire the asset on the reporting date.**
- Inventories are assets:**
- (a) in the form of materials or supplies to be consumed in the production process,**
 - (b) in the form of materials or supplies to be consumed or distributed in the rendering of services,**
 - (c) held for sale or distribution in the ordinary course of operations, or**
 - (d) in the process of production for sale or distribution.**

Net realisable value is the estimated selling price in the ordinary course of operations less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.

- .04 Inventories encompass goods purchased and held for resale including, for example, refuse bags purchased by the entity and held for resale, or land held for sale, water, and other property held for sale. Inventories encompass finished goods produced, or work in progress being produced by the entity. Inventories also include materials and supplies awaiting use in the production process and goods purchased or produced by the entity, which are for distribution to other parties for no charge or for a nominal charge. In many entities inventories will be held for the consumption in the provision of service. In the case of a service provider, inventories include the costs of the service, as described in paragraph .23, for which the entity has not yet recognised the related revenue.
05. Inventories in the public sector may include:
- (a) ammunition,
 - (b) consumable stores,
 - (c) maintenance materials,
 - (d) spare parts for plant and equipment other than those dealt with under the Standard of Generally Accepted Municipal Accounting Practice on *Property, Plant and Equipment*,
 - (e) strategic stockpiles,
 - (f) work in progress, and
 - (g) land/property held for sale.
06. When the entity maintains strategic stockpiles of various reserves, such as energy reserves or minimum water reserves for use in emergency or other situations (for example, natural disasters or other civil defence emergencies), these stockpiles are recognised as inventories for the purposes of this Standard and treated accordingly.

Measurement of inventories

- .07 *Inventories shall be measured at the lower of cost and net realisable value, except where paragraph .08 applies.***
- .08 *Inventories shall be measured at the lower of cost and current replacement cost where they are held for:***
- (a) *distribution at no charge or for a nominal charge, or***
 - (b) *consumption in the production process of goods to be distributed at no charge or for a nominal charge.***

Cost of inventories

- .09 *The cost of inventories shall comprise all costs of purchase, costs of development, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.***

Costs of purchase

- .10 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and supplies. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
- .11 The costs of purchase may include foreign exchange differences which arise directly on the recent acquisition of inventories invoiced in a foreign currency in the circumstance permitted in the allowed alternative treatment in the Standard of Generally Accepted Municipal Accounting Practice on *The Effects of Changes in Foreign Exchange Rates*. These exchange differences are limited to those resulting from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise on the recent acquisition of the inventories.

Costs of development

- .12 The cost of land development for housing or similar developments which are acquired or developed for resale will include costs directly related to the development. These direct costs will include the purchase price of land acquired for such developments, surveying and conveyancing costs and the provision of certain infrastructure. They also include an allocation of development overheads that are incurred in facilitating such developments. The allocation of costs, both fixed and variable, incurred in the development of undeveloped land held for sale into residential or commercial landholdings, could include costs relating to landscaping, drainage, pipe laying for utility connection, etc. Infrastructure costs that relate to extending the capacity of existing infrastructure would be excluded from development costs. For example, the extension of the road network to link up to the roads constructed on the land being developed cannot be included as a cost of development. A further example would be the extension of a water purification plant to handle the increased consumption expected from a housing development; it would be inappropriate to include such amounts as development costs. A factor to take into account when determining the cost of providing infrastructure will be ownership and right of use. If the entity retains the risk and rewards of ownership of infrastructure developed, then the costs of this infrastructure should not be treated as a cost of development.
- .13 It is only appropriate to allocate development overhead costs where these costs are separately identifiable and development occurs on a frequent basis. It would be inappropriate to allocate overheads to developments where overheads would normally be treated as a normal operational expense.

- .14 When entity owned land is used for housing or other developments, the book value of such land should be transferred from property, plant and equipment to inventory. No adjustments to the carrying value of the land should be made. If such land had previously been revalued, the revaluation reserve relating to such land should be retained until the land has been sold.
- .15 The classification between land included under inventory, land included under property, plant and equipment and investment properties requires careful consideration. Where an entity owns undeveloped land, usually this will be classified as property, plant and equipment. Where there is an intention to develop such land and to sell or transfer or contract it to a third party it should be classified as inventory rather than property, plant and equipment.
- .16 Where an entity develops land in anticipation of encouraging or facilitating economic or housing development, and it is probable that such developed land will not be sold or transferred to a third party within the short term, then the land and subsequent costs of development should be classified in terms of the Standard of Generally Accepted Municipal Accounting Practice on *Property, Plant and Equipment* until construction or development is complete where after it should be classified as an investment property (see the International Public Sector Accounting Standard on *Investment Property* for guidance).
- .17 The purchase of land or buildings for resale should be classified as inventory if the land or buildings is held for short-term sale in the ordinary course of operations. If the land or buildings are held for long-term capital appreciation, the land and buildings should be classified as investment properties (see the International Public Sector Accounting Standard on *Investment Property* for guidance).

Costs of conversion

- .18 The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment, for example energy produced from coal. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.
- .19 The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from

planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed production overheads allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

- .20 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other costs

- .21 Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.
- .22 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:
- (a) abnormal amounts of wasted materials, labour or other production costs,
 - (b) storage costs, unless those costs are necessary in the production process prior to a further production stage,
 - (c) administrative overheads that do not contribute to bringing inventories to their present location and condition, and
 - (d) selling costs.

Cost of inventories of a service provider

- .23 The cost of inventories of a service provider consists primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. The costs of labour not engaged in providing the service are not included. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred.

Techniques for the measurement of cost

- .24 Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.
- .25 The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items that have similar margins, and for which it is impractical to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to below its original selling price. An average percentage for each retail department is often used.

Cost formulas

- .26 *The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.***
- .27 Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by using specific identification of their individual costs. However, specific identification of costs is inappropriate when there are large numbers of items of inventory which are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on the surplus or deficit for the period.
- .28 *When applying paragraph .29 an entity shall use the same cost formula for all inventories having similar nature and use to the entity. For inventories with different nature or use (for example, certain commodities used in one segment and the same type of commodities used in another segment), different cost formulas may be justified. A difference in geographical location of inventories (and in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.***
- .29 *The cost of inventories, other than those dealt with in paragraph .26 shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas.***
- .30 The FIFO formula assumes that the items of inventory that were purchased first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted



average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Net realisable value

- .31 The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale, exchange or distribution have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of the future economic benefits or service potential expected to be realised from their sale, exchange, distribution or use.
- .32 Inventories are usually written down to net realisable value on an item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory that have similar purposes or end uses and cannot practicably be evaluated separately from other items in that product line. It is not appropriate to write inventories down based on a classification of inventory, for example, finished goods or all the inventories in a particular operation or geographical segment. Service providers generally accumulate costs in respect of each service for which a separate selling price may be charged. Therefore, each such service is treated as a separate item.
- .33 Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.
- .34 Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices. Guidance on the treatment of provisions or contingent liabilities, such as those arising from firm sales contracts in excess of inventory quantities held, and on firm purchase contracts can be found in the Standard of Generally Accepted Municipal Accounting Practice on *Provisions, Contingent Liabilities and Contingent Assets*.
- .35 Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold, exchanged or distributed at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable

value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

- .36 A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory, which is carried at net realisable value because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

Distributing goods at no charge or for a nominal charge

- .37 An entity may hold inventories whose future economic benefits or service potential are not directly related to their ability to generate net cash inflows, for example medicine for children in a clinic. These types of inventories may arise when the entity has determined to distribute certain goods at no charge or for a nominal amount. In these cases, the future economic benefits or service potential of the inventory for financial reporting purposes is reflected by the amount the entity would need to pay to acquire the economic benefits or service potential if this was necessary to achieve the objectives of the entity. Where the economic benefits or service potential cannot be acquired in the market, an estimate of replacement cost will need to be made. If the purpose for which the inventory is held changes, then the inventory is valued using the provisions of paragraph .04.

Recognition as an expense

- .38 ***When inventories are sold, exchanged or distributed the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. If there is no related revenue, the expense is recognised when the goods are distributed or related service is rendered. The amount of any write-down of inventories and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.***
- .39 The process of recognising as an expense the carrying amount of inventories sold, exchange or distributed results in the matching of costs and revenues. For a service provider, the point when inventories are recognised as expenses normally occurs when services are rendered, or upon billing for chargeable services.
- .40 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

Disclosure

- .41 The financial statements shall disclose the following:**
- (a) The accounting policies adopted in measuring inventories, including the cost formula used,**
 - (b) The total carrying amount of inventories and the carrying amount in classifications appropriate to the entity,**
 - (c) The amount of any reversal of any write-down which is recognised as revenue in the period in accordance with paragraph .38,**
 - (d) The circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph .38, and**
 - (e) The carrying amount of inventories pledged as security for liabilities.**
- .42 Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may simply be described as work in progress.
- .43 The financial statements shall disclose either:**
- (a) the cost of inventories recognised as an expense during the period, or**
 - (b) the operating costs applicable to revenues, recognised as an expense during the period, classified by their nature.**
- .44 The cost of inventories recognised as an expense during the period consists of those costs previously included in the measurement of the items of inventory sold, exchanged or distributed, and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other costs, such as distribution costs.
- .45 Some entities adopt a different format for the statement of financial performance, which results in different amounts being disclosed instead of the cost of inventories recognised as an expense during the period. Under this different format, an entity discloses the amounts of operating costs applicable to revenues for the period, classified by their nature. In this case, the entity discloses the costs recognised as an expense for raw materials and consumables, labour costs and other operating costs together with the amount of the net change in inventories for the period.
- .46 A write-down to net realisable value may be of such size, incidence or nature to require disclosure under the Standard of Generally Recognised Accounting Practice on *Accounting Policies, Changes in Accounting Estimates and Errors*.

Transitional Provisions

- .47 On the occasion of first-time application of this Standard all provisions of the Standard shall be applied prospectively. However, when the first time application of this Standard results in a change in accounting policy or**



estimate, reference shall be made to the Standard of Generally Recognised Accounting Practice on Accounting Policies, Changes in Accounting Estimates and Errors.

Effective date

- .48 *This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.***



GAMAP 17

PROPERTY, PLANT AND EQUIPMENT

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as 'entities' Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.

Objective

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them, and the determination and accounting treatment of impairments to the carrying amounts.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for property, plant and equipment, except:**
- (a) When a different accounting treatment has been adopted in accordance with another Standard of Generally Accepted Municipal Accounting Practice or International Public Sector Accounting Standard or a Statement of Generally Accepted Accounting Practice.**
 - (b) Investment property as this is dealt with in the International Public Sector Accounting Standard on Investment Property, and**
 - (c) Heritage assets. However, the disclosure requirements of paragraph .75, .76 and .79 apply to those heritage assets that are recognised.**
- .02 This Standard applies to property, plant and equipment including infrastructure assets and community assets.
- .03 This Standard does not apply to:
- (a) forests and similar regenerative natural resources, and
 - (b) mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard does apply to property, plant and equipment used to develop or maintain the activities or assets covered in par .03(a) or (b) but which are separable from those activities or assets.

- .04 This Standard also does not apply where other Standards of Generally Accepted Municipal Accounting Practice or an International Public Sector Accounting Standard or a Statement of Generally Accepted Accounting Practice applies. For example, the International Public Sector Accounting Standard on *Investment Property* provides guidance on valuing of investment property.

Heritage Assets

- .05 This Standard does not require an entity to recognise heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognise heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.

- .06 Some assets are described as “heritage assets” because of their cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):
- (a) Their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price,
 - (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale,
 - (c) They are often irreplaceable and their value may increase over time even if their physical condition deteriorates, and
 - (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.

Entities may have large holdings of heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.

- .07 Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation. In these cases, they may be recognised and measured on the same basis as other items of property, plant and equipment. For other heritage assets, their service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base.
- .08 The disclosure requirements in paragraphs .75 to .81 require entities to make disclosures about recognised assets. Therefore, entities that recognise heritage assets are required to disclose in respect of those assets such matters as, for example:
- (a) the measurement basis used,
 - (b) the depreciation method used, if any,
 - (c) the gross carrying amount,
 - (d) the accumulated depreciation at the end of the period, if any, and
 - (e) a reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

Definitions

- .09 *The following terms are used in this Standard with the meanings specified:***

Class of property, plant and equipment means a grouping of assets of a similar nature or function in an entity's operation, that is shown as a single item for the purpose of disclosure in the financial statements.

Property, plant and equipment are tangible assets that:

- (a) are held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and
- (b) are expected to be used during more than one reporting period.

Investment properties are defined in the International Public Sector Accounting Standard on Investment Property.

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

Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

Useful life is either:

- (a) the period of time over which an asset is expected to be used by the entity, or
- (b) the number of production or similar units expected to be obtained from the asset by the entity.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

Residual value is the net amount which the entity expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

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

Carrying amount is the amount at which an asset is included in the statement of financial position after deducting any accumulated depreciation and any impairment losses thereon.

Recoverable amount is the amount that the entity expects to recover from the future use of an asset, including residual value on disposal.

Recognition of property, plant and equipment

.10 An item of property, plant and equipment shall be recognised as an asset when:

- (a) it is probable that future economic benefits or service potential associated with the asset will flow to the entity, and
- (b) the cost or fair value of the asset to the entity can be measured reliably.

- .11 Property, plant and equipment is often a major portion of the total assets of an entity and, therefore, is significant in the presentation of its financial position. Furthermore, the determination of whether an expenditure represents an asset or an expense can have a significant effect on an entity's reported surplus or deficit from operating activities.
- .12 In determining whether an item satisfies the first criterion for recognition, an entity needs to assess the degree of certainty attached to the flow of future economic benefits or service potential on the basis of the available evidence at the time of initial recognition. Existence of sufficient certainty that the future economic benefits or service potential will flow to the entity necessitates an assurance that the entity will receive the rewards attached to the asset and will undertake the associated risks. This assurance is usually only available when the risks and rewards have passed to the entity. Before this occurs, the transaction to acquire the asset can usually be cancelled without significant penalty and, therefore, the asset is not recognised.
- .13 The second criterion for recognition is usually readily satisfied because the exchange transaction evidencing the purchase of the asset identifies its cost. In the case of a self-constructed asset, a relevant and reliable measurement of the cost can be made from the transactions with parties external to the entity for the acquisition of the materials, labour and other inputs used during the construction process. In addition, as outlined in paragraphs .24 to .27 of this Standard, under certain circumstances cost is determined by reference to fair value.
- .14 In identifying what constitutes a separate item of property, plant and equipment, judgement is required in applying the criteria in the definition to specific circumstances. It may be appropriate to aggregate individually insignificant items, such as mowers and brushcutters, and to apply the criteria to the aggregate value. Most spare parts and servicing equipment are usually carried as inventory and recognised as an expense as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when the entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment and their use is expected to be irregular, they are accounted for as property, plant and equipment and are depreciated over a time period not exceeding the useful life of the related asset.
- .15 In certain circumstances, it is appropriate to allocate the total expenditure on an asset to its component parts and account for each component separately. This is the case when the component assets have different useful lives or provide benefits to the entity in a different pattern, thus necessitating the use of different depreciation rates and methods. For example, a sewerage purification works and the sewerage reticulation network may need to be treated as separate depreciable assets if they have different useful lives.

- .16 Property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, while not directly increasing the future economic benefits or service potential of any particular existing asset, may be necessary in order for the entity to obtain the future economic benefits or service potential from its other assets. When this is the case, such acquisitions of property, plant and equipment qualify for recognition as assets, in that they enable future economic benefits or service potential from related assets to be derived by the entity in excess of what it could derive if they had not been acquired. However, such assets are only recognised to the extent that the resulting carrying amount of such an asset and related assets does not exceed the total economic benefits or service potential that the entity expects to recover from their continued use and ultimate disposal. For example, an entity may have to install new plant in respect of its effluent treatment processes in order to comply with environmental requirements. The related plant enhancements are recognised as an asset to the extent they are recoverable because, without them, the entity is unable to treat and dispose of effluent.

Classification of property, plant and equipment

- .17 Not only does there need to be classifications of assets between property, plant and equipment, there also needs to be further classifications in a public sector environment. Property, plant and equipment should also be classified into infrastructure assets, community assets, heritage assets and investment properties. The purpose of this classification is to develop a benchmark accounting treatment to assist in the measurement of property, plant and equipment and to assist users to understand better the nature of the assets included as property, plant and equipment.
- .18 Infrastructure assets are any assets that are part of a network of similar assets. Examples of infrastructure assets are roads, water reticulation schemes, sewerage purification and trunk mains.
- .19 Community assets are any assets that contribute to the community's well-being. Examples are parks, libraries and fire stations.
- .20 Heritage assets are culturally significant resources. Examples are works of art, historical buildings and statues.
- .21 Other assets are assets utilised in operations. Examples are plant and equipment, motor vehicles and furniture and fittings.
- .22 Some assets are commonly described as "infrastructure assets". While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics:
- (a) They are part of a system or network,
 - (b) They are specialised in nature and do not have alternative uses,
 - (c) They are immovable, and

(d) They may be subject to constraints on disposal.

- .23 Although ownership of infrastructure assets is not confined to entities, significant infrastructure assets are frequently found in the public sector. Infrastructure assets meet the definition of property, plant and equipment and should be accounted for in accordance with this Standard.

Initial measurement of property, plant and equipment

- .24 *An item of property, plant and equipment which qualifies for recognition as an asset shall initially be measured at its cost.***
- .25 *Where an asset is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date of acquisition.***
- .26 An item of property, plant and equipment may be gifted or contributed to the entity. For example, land may be contributed to an entity by a developer at nil or nominal consideration, to enable the entity to develop parks, roads and paths in the development. An asset may also be acquired at nil or nominal consideration through the exercise of powers of sequestration. Under these circumstances the cost of the item is its fair value as at the date it is acquired, contributed or gifted.
- .27 For the purposes of this Standard, the initial recognition of an item of property, plant and equipment, acquired at no or nominal cost, at its fair value consistent with the requirements of paragraph.25, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph .41, and the supporting commentary in paragraphs .42 to .44, only apply where an entity elects to revalue an item of property, plant and equipment in subsequent reporting periods.

Components of cost

- .28 The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use. Any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs are:
- (a) the cost of site preparation,
 - (b) initial delivery and handling costs,
 - (c) installation costs,
 - (d) professional fees such as for architects and engineers, and
 - (e) the estimated cost of dismantling the asset and restoring the site, to the extent that it is recognised as a provision. Guidance on accounting for provisions is found in the Standard of Generally Accepted Municipal Accounting Practice on *Provisions, Contingent Assets and Contingent Liabilities*.

- .29 When payment for an item of property, plant and equipment is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as an interest expense over the period of credit. Reference should be made to the International Public Sector Accounting Standard on *Borrowing Costs* for guidance.
- .30 Administration and other general overhead costs are not a component of the cost of property, plant and equipment unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start-up and similar costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition. Initial operating losses incurred prior to an asset achieving planned performance are recognised as an expense.
- .31 The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of producing the assets for sale (see the Standard of Generally Accepted Municipal Accounting Practice on *Inventories*). Therefore, any internal surpluses are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour or other resources incurred in the production of a self-constructed asset is not included in the cost of the asset.
- .32 The cost of an asset held by a lessee under a finance lease is determined using the principles set out in the International Public Sector Accounting Standard on *Leases*.

Exchanges of assets

- .33 An item of property, plant and equipment may be acquired in exchange or part exchange for a dissimilar item of property, plant and equipment or other asset. The cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up adjusted by the amount of any cash or cash equivalents transferred.
- .34 An item of property, plant and equipment may be acquired in exchange for a similar asset that has a similar use in the same line of operations and which has a similar fair value. An item of property, plant and equipment may also be sold in exchange for an equity interest in a similar asset. In both cases, no gain or loss is recognised on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up. However, the fair value of the asset received may provide evidence of an impairment in the asset given up. Under these circumstances the asset given up is written down and this written-down value is assigned to the new asset. Examples of exchanges of similar assets include the exchange of aircraft, hostels and other real estate properties. If other assets such as cash are included as part of the exchange transaction this may indicate that the items exchanged do not have a similar value.

Subsequent expenditure

- .35 *Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised shall be added to the carrying amount of the asset when it is probable that future economic benefits or service potential over the total life of the asset in excess of the most recently assessed standard of performance of the existing asset, will flow to the entity. All other subsequent expenditure shall be recognised as an expense in the period in which it is incurred.***
- .36 Subsequent expenditure on property, plant and equipment is only recognised as an asset when the expenditure improves the condition of the asset, measured over its total life, beyond its most recently assessed standard of performance. Examples of improvements that result in increased future economic benefits or service potential include the following:
- (a) Modification of an item of plant to extend its useful life, including an increase in its capacity,
 - (b) Upgrading machine parts to achieve a substantial improvement in the quality of output, and
 - (c) Rehabilitation of a road enabling a substantial reduction in previously assessed maintenance costs.
- .37 Expenditure related to repairs or maintenance of property, plant and equipment are made to restore or maintain the future economic benefits or service potential that an entity can expect from the most recently assessed standard of performance of the asset. As such, they are usually recognised as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the most recently assessed standard of performance.
- .38 The appropriate accounting treatment for expenditure incurred subsequent to the acquisition of an item of property, plant and equipment depends on the circumstances, which were taken into account on the initial measurement and recognition of the related item of property, plant and equipment and whether the subsequent expenditure is recoverable. For instance, when the carrying amount of the item of property, plant and equipment already takes into account a loss in economic benefits or service potential, the subsequent expenditure to restore the future economic benefits or service potential expected from the asset is capitalised, provided that the carrying amount does not exceed the total economic benefits or service potential that the entity expects to recover from the continued use and ultimate disposal of the item. This is also the case when the purchase price of an asset already reflects the entity's obligation to incur expenditure in the future, which is necessary to bring the asset to its working condition. An example of this might be the acquisition of a building requiring renovation. In such circumstances, the subsequent expenditure is added to the carrying amount of the asset to the extent that it can be recovered from future use of the asset.

- .39 Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a reservoir may require relining after a specified number of hours of usage or components of a sewerage purification works may need replacing during the lifetime of the works, or a road may need resurfacing every few years, a furnace may require relining after a specified number of hours of usage. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph .10 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the replaced asset is written off.

Measurement subsequent to initial recognition

Benchmark treatment

- .40 *Subsequent to initial recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.***

Allowed alternative treatment for property

- .41 *Subsequent to initial recognition as an asset, an item of land and buildings shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent impairment losses. Revaluations shall be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. The accounting treatment for revaluations is set out in paragraphs .48 and .49.***

Revaluations of land and buildings

- .42 The fair value of land and buildings is usually their market value, determined by appraisal. An appraisal of the value of an asset is normally undertaken by a member of the valuation profession who holds a recognised and relevant professional qualification. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land and non-specialised buildings.
- .43 The frequency of revaluations depends upon the movements in the fair values of land and buildings being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some land and buildings may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for land and buildings with only insignificant movements in fair value. Instead, revaluation every three or five years may be sufficient.
- .44 When land and buildings are revalued, any accumulated depreciation at the date of the revaluation is either:

- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of an index to its depreciated replacement cost, or
- (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. . For example, this method is used for buildings which are revalued to their market value.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount which is dealt with in accordance with paragraphs .48 and .49.

.45 When land and buildings are revalued, the entire class of property to which that asset belongs shall be revalued. In other words, if land is revalued, then all land within that classification must be revalued. If land and buildings within that classification are revalued, then all land and buildings must be revalued.

.46 A class is a grouping of assets of a similar nature or function in an entity's operations. The following are examples of separate classes:

- (a) Land,
- (b) Operational buildings,
- (c) Office buildings,
- (d) Roads,
- (e) Machinery,
- (f) Electricity transmission networks,
- (g) Motor vehicles,
- (h) Furniture and fixtures, and
- (i) Office equipment.

.47 The items within the class are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements which are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period of time and provided the revaluations are kept up to date.

.48 When an asset's carrying amount of a class of assets is increased as a result of a revaluation, the increase shall be credited directly to non-distributable reserves under the heading revaluation surplus. However, a revaluation increase shall be recognised as revenue to the extent that it reverses a revaluation decrease of the same class of assets previously recognised as an expense.

- .49 When the carrying amount of a class of assets is decreased as a result of a revaluation the decrease shall be recognised as an expense. However, a revaluation decrease shall be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same class of assets.**
- .50 Some or all of the revaluation surplus included in net assets may be transferred directly to the accumulated surpluses or deficits when the surplus is realised. The surplus may be realised, in part or in whole, on the retirement or disposal of some or all of the assets within the land and buildings to which the surplus relates. However, some of the surplus may be realised as the land and buildings are used by the entity, in such a case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the land and buildings and depreciation based on the land and building's original cost. The transfer from revaluation surplus to the accumulated surpluses or deficits is not made through the statement of financial performance.

Depreciation

- .51 The depreciable amount of an item of property, plant and equipment shall be allocated on a systematic basis over its useful life. The depreciation method used shall reflect the pattern in which the asset's economic benefits or service potential is consumed by the entity. The depreciation charge for each period shall be recognised as an expense unless it is included in the carrying amount of another asset.**
- .52 As the economic benefits or service potential embodied in an asset are consumed by the entity, the carrying amount of the asset is reduced to reflect this consumption, normally by charging an expense for depreciation. A depreciation charge is made even if the value of the asset exceeds its carrying amount.
- .53 The economic benefits or service potential embodied in an item of property, plant and equipment is consumed by the entity principally through the use of the asset. However, other factors such as technical obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits or service potential that might have been expected to be available from the asset. Consequently, all the following factors need to be considered in determining the useful life of an asset:
- (a) The expected usage of the asset by the entity. Usage is assessed by reference to the asset's expected capacity or physical output,
 - (b) The expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance program of the entity, and the care and maintenance of the asset while idle,

- (c) Technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset, and
 - (d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.
- .54 The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of an entity may involve the disposal of assets after a specified time or after consumption of a certain proportion of the economic benefits or service potential embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of an item of property, plant and equipment is a matter of judgement based on the experience of the entity with similar assets.
- .55 Land and buildings are separable assets and are dealt with separately for accounting purposes, even when they are acquired together. Land normally has an unlimited life and, therefore, is not depreciated. Buildings have a limited life and, therefore, are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the useful life of the building.
- .56 The depreciable amount of an asset is determined after deducting the residual value of the asset. In practice, the residual value of an asset is often insignificant and, therefore, is immaterial in the calculation of the depreciable amount. When the benchmark treatment is adopted and the residual value is likely to be significant, the residual value is estimated at the date of acquisition and is not subsequently increased for changes in prices. However, when the allowed alternative treatment is adopted in respect of property, a new estimate is made at the date of any subsequent revaluation of the asset. The estimate is based on the residual value prevailing at the date of the estimate for similar property assets that have reached the end of their useful lives and have operated under conditions similar to those in which the property asset will be used.
- .57 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. The methods include the straight-line method, the diminishing balance method or sum of the units method. Straight-line depreciation results in a constant charge over the useful life of the asset. The diminishing balance method results in a decreasing charge over the useful life of the asset. The sum of the units method results in a charge based on the expected use or output of the assets. The method used for an asset is selected based on the expected pattern of economic benefits or service potential and is consistently applied from period to period unless there is a change in the expected pattern of economic benefits or service potential from that asset.
- .58 The depreciation charge for a period is usually recognised as an expense. However, in some circumstances, the economic benefits or service potential embodied in an asset are absorbed by the entity in producing other assets rather than giving rise to an expense. In this case the depreciation charge comprises part



of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see the Standard of Generally Accepted Municipal Accounting Practice on *Inventories*).

Review of useful life

- .59** *The useful life of an item of property, plant and equipment shall be reviewed periodically and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods shall be adjusted.*
- .60 During the life of an asset it may become apparent that the estimate of the useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure on the asset which improves the condition of the asset beyond its most recently assessed standard of performance. Alternatively, technological changes or changes in the market for the products may reduce the useful life of the asset. In such cases, the useful life and, therefore, the depreciation rate is adjusted for the current and future periods.
- .61 The repair and maintenance policy of the entity may also affect the useful life of an asset. The policy may result in an extension of the useful life of the asset or an increase in its residual value. However, the adoption of such a policy does not negate the need to charge depreciation. Conversely, some assets may be poorly maintained or maintenance may be deferred indefinitely because of budgetary constraints. Where asset management policies exacerbate the wear and tear of an asset, its useful life should be reassessed and adjusted accordingly.

Review of depreciation method

- .62** *The depreciation method applied to property, plant and equipment shall be reviewed periodically and, if there has been a significant change in the expected pattern of economic benefits or service potential from those assets, the method shall be changed to reflect the changed pattern. When such a change in depreciation method is necessary the change shall be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods shall be adjusted.*

Recovery of the carrying amount

Impairment losses

- .63 To determine whether a cash generating asset is impaired, an entity applies the International Accounting Standard on *Impairment of Assets* that contains guidance on reviewing the carrying amount of assets held for generating positive cash flows, determining the recoverable amount of such assets and the recognition of impairment losses.
- .64 In instances where a non-cash generating asset is impaired, the guidance as set out in paragraphs .66 to .68 should be followed.

- .65 The International Accounting Standard on *Business Combinations* provides guidance on impairment losses recognised on cash generated assets before the end of the first annual accounting period commencing after a business combination that is an acquisition.
- .66 *The carrying amount of an item or a group of identical items of property, plant and equipment shall be reviewed periodically in order to assess whether or not the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount shall be reduced to the recoverable amount. The amount of the reduction shall be recognised as an expense immediately, unless it reverses a previous revaluation in which case it shall be charged to a non-distributable reserve in accordance with paragraph .49.***
- .67 The cost or revalued amount of an item of property, plant and equipment is normally recovered on a systematic basis over the useful life of the asset. If the usefulness of an item or a group of identical items is impaired, for example by damage or technological obsolescence or other economic factors, the recoverable amount may be less than the carrying amount of the asset. In such circumstances, a write-down of the asset is necessary. A write-down may also be necessary when an item of property, plant and equipment remains idle for a considerable period either prior to it being put into use or during its useful life.
- .68 The recoverable amount of individual assets, or group of identical assets, is determined separately and the carrying amount is 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 plant and equipment in a sewerage purification work 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.

Subsequent increase in recoverable amount – benchmark treatment

- .69 *A subsequent increase in the recoverable amount of an asset, dealt with in accordance with the benchmark treatment described in paragraph .66 shall be written back when the circumstances and events that led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. The amount written back shall be reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.***

Retirements and disposals

- .70 *An item of property, plant and equipment shall be eliminated from the statement of financial position on disposal or when the asset is permanently***

withdrawn from use and no future economic benefits or service potential are expected from its disposal.

- .71 Gains or losses arising from the retirement or disposal of an item of property, plant and equipment shall be determined as the difference between estimated net disposal proceeds and the carrying amount of the assets. For the purposes of display in the financial statements, the gain or loss shall be included in the statement of financial performance as an item of revenue or expense, as appropriate.***
- .72 When an item of property, plant and equipment is exchanged for a similar asset, under the circumstances described in paragraph .33, the cost of the acquired asset is equal to the carrying amount of the asset disposed of and no gain or loss results.
- .73 Sale and leaseback transactions are accounted for in accordance with the International Public Sector Accounting Standard on *Leases*.
- .74 Property, plant and equipment that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each reporting date, an entity tests the asset for impairment of assets and recognises any impairment loss either in terms of the International Accounting Standard on *Impairment of Assets* if the asset is of a cash generating nature, or in terms of paragraphs .66 to .69 if the asset is of a non-cash generating nature.

Disclosure

- .75 The financial statements shall disclose, for each class of property, plant and equipment recognised in the financial statements the following:***
- (a) The measurement bases used for determining the gross carrying amount. When more than one basis has been used, the gross carrying amount for that basis in each category shall be disclosed,***
 - (b) The depreciation methods used,***
 - (c) The useful lives or the depreciation rates used,***
 - (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period, and***
 - (e) A reconciliation of the carrying amount at the beginning and end of the period showing:***
 - (i) additions,***
 - (ii) disposals,***
 - (iii) acquisitions through business combinations,***
 - (iv) increases or decreases during the period resulting from revaluations under paragraphs .41, .48 and .49 and from impairment losses (if any) recognised or reversed directly in net assets,***

- (v) ***impairment losses (if any) recognised in the statement of financial performance during the period,***
 - (vi) ***impairment losses (if any) reversed in the statement of financial performance during the period,***
 - (vii) ***depreciation, and***
 - (viii) ***other movements.***
- .76 The financial statements shall also disclose for each class of property, plant and equipment recognised in the financial statements:**
- (a) *the existence and amounts of restrictions on title for property, plant and equipment pledged as security for liabilities,***
 - (b) *the accounting policy for the estimated costs of restoring the site of items of property, plant and equipment,***
 - (c) *the amount of expenditures on account of property, plant and equipment in the course of construction, and***
 - (d) *the amount of commitments for the acquisition of property, plant and equipment.***
- .77 The selection of the depreciation method and the estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates, provides users of financial statements with information, which allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose the depreciation allocated in a period and the accumulated depreciation at the end of that period.
- .78 An entity discloses the nature and effect of a change in an accounting estimate that has a material effect in the current period or which is expected to have a material effect in subsequent periods in accordance with the Standard of Generally Recognised Accounting Practice on *Accounting Policies, Changes in Accounting Estimates and Errors*. Such disclosure may arise from changes in estimate with respect to:
- (a) residual values,
 - (b) the estimated costs of dismantling and removing items of property, plant and equipment,
 - (c) useful lives, and
 - (d) depreciation method.
- .79 When property is stated at revalued amounts, the following shall be disclosed:**
- (a) *the basis used to revalue property,***
 - (b) *the effective date of the revaluation,***
 - (c) *whether an independent valuer was involved,***

- (d) the nature of any indices used to determine replacement cost, and**
- (e) the revaluation surplus, indicating the movement for the period.**

- .80 An entity discloses information on impaired property, plant and equipment under the International Accounting Standard on *Impairment of Assets* in addition to the information required by paragraph .75(e)(iv) to (vi).
- .81 Financial statement users also find the following information relevant to their needs:
- (a) the carrying amount of temporarily idle property, plant and equipment,
 - (b) the cost or fair value of any fully depreciated property, plant and equipment that is still in use,
 - (c) the carrying amount of property, plant and equipment retired from active use and held for disposal, and
 - (d) when the benchmark treatment is used, the fair value of property, plant and equipment when this is materially different to the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

Transitional Provisions

- .82 An entity that adopts accrual accounting for the first time in accordance with this Standard may initially recognise property, plant and equipment at cost or fair value. For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the item's fair value as at the date of acquisition. Any adjustment to the amount of property, plant and equipment included in the statement of financial position shall be adjusted against the opening balance of the accumulated surplus or deficit in the Statement of Changes in Net Assets.**
- .83 Where an asset that was previously recognised by the entity which does not meet the recognition criteria as determined in paragraph .10 of the Standard when applying the Standard for the first time, the asset shall be de-recognised in the statement of financial position. The adjustment to the previous carrying amount shall be reported by adjusting the opening balance of the accumulated surplus or deficit.**
- .84 When applying this Standard for the first time, an entity may control assets that it has not previously recognised. When the recognition criteria as determined in paragraph .10 have been met, the asset needs to be recognised in the statement of financial position at fair value.**
- .85 When the first-time application of this Standard results in a change in accounting policy or estimate, reference shall be made to the Standard of Generally Recognised Accounting Practice on Accounting Policies, Changes in Accounting Estimates and Errors.**



- .86** *Entities are not required to recognise property, plant and equipment for reporting periods beginning on a date within three years following the date of first adoption of the Standard.*
- .87** *When an entity takes advantage of the transitional provision in paragraph .86, that fact should be disclosed. Information on the progress on the major classes of assets that have not been recognised by virtue of paragraph .86 should also be disclosed. When an entity takes advantage of the transitional provision in paragraph .86 for a second reporting period, details of the assets or classes of assets that were not recognised at the previous reporting date but which are now recognised should be disclosed.*

Effective date

- .88** *This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.*



GAMAP 19

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Introduction

Standards of Generally Accepted Municipal Accounting Practice (GAMAP)

The Accounting Standards Board (ASB) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for the following:

- departments (national and provincial);
- public entities;
- constitutional institutions ;
- municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- Parliament and the provincial legislatures.

The above are collectively referred to as ‘entities’ Standards of GRAP.

The Board considers that the Standards of GAMAP constitute GRAP for municipalities.

GAMAP is an interim solution until such time as it is replaced by a Standard of Generally Recognised Accounting Practice.

Any limitation of the applicability of specific Standards is made clear in those Standards. Standards of GAMAP are not meant to apply to immaterial items.

The Standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the Preface to Standards of Generally Recognised Accounting Practice and the Preface to Standards of Generally Accepted Municipal Accounting Practice.

Reference may be made to Standards of GRAP that has not been issued at the time. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors provides guidance on the sources to be used in the absence of a Standard of GRAP.

Objective

The objective of this Standard is to define provisions, contingent liabilities and contingent assets, identify the circumstances in which provisions should be recognised, how they should be measured and the disclosures that should be made about them. The Standard also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users to understand their nature, timing and amount.

Scope

- .01 An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for provisions, contingent liabilities and contingent assets, except:**
- (a) Those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits,**
 - (b) Those resulting from financial instruments that are carried at fair value,**
 - (c) Those resulting from executory contracts, other than where the contract is onerous subject to other provisions of this paragraph,**
 - (d) Those covered by other Standards of Generally Accepted Municipal Accounting Practice, and**
 - (e) Those arising from employee benefits except employee termination benefits that arise as a result of a restructuring as dealt with in this Standard.**
- .02** This Standard applies to financial instruments (including guarantees) that are not carried at fair value.
- .03** This Standard applies to provisions for restructuring (including discontinuing operations). In some cases, a restructuring may meet the definition of a discontinuing operation. Guidance on disclosing information about discontinuing operations is found in the International Accounting Standard on *Discontinuing Operations*.

Social benefits

- .04** For the purposes of this Standard “social benefits” refer to goods, services and other benefits provided in the pursuit of the social policy objectives of an entity. These benefits may include:
- (a)** The delivery of health, education, housing, transport and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services,
 - (b)** Payment of benefits to families, the aged, the disabled, the unemployed, veterans and others. That is, government entities at all levels may provide



- financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income,
- (c) Minimum water supplies and/or electricity supplies to members of the community with no requirement to pay an amount approximately equal to the value of the service, and
 - (d) Waste removal (sanitation and hard refuse) to members of the community with no requirement to pay an amount approximately equal to the value of the service.
- .05 In many cases, obligations to provide social benefits arise as a consequence of a government's commitment to undertake particular activities on an on-going basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy obligations will often depend on a range of demographic and social conditions and are difficult to predict. These benefits generally fall within the "social protection", "education" and "health" classifications under the International Monetary Fund's Government Finance Statistics Framework and often require an actuarial assessment to determine the amount of any liability arising in respect of them.
- .06 For a provision or contingency arising from a social benefit to be excluded from the scope of this Standard, the entity providing the benefit will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of the benefit. This exclusion would encompass those circumstances where a charge is levied in respect of the benefit but there is no direct relationship between the charge and the benefit received. The exclusion of these provisions and contingent liabilities from the scope of this Standard reflects the view that both the determination of what constitutes the "obligating event" and the measurement of the liability require further consideration before proposed Standards are exposed. For example, there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. Similarly, there are differing views about whether the amount of any obligation reflects an estimate of the current period's entitlement or the present value of all expected future benefits determined on an actuarial basis.
- .07 Where an entity elects to recognise a provision for such obligations, the entity discloses the basis on which the provisions have been recognised and the measurement basis adopted. The entity also makes other disclosures required by this Standard in respect of those provisions. The Standard of Generally Recognised Accounting Practice on *Presentation of Financial Statements* provides guidance on dealing with matters not specifically dealt with by another Standard. The Standard of Generally Recognised Accounting Practice on *Presentation of Financial Statements* also includes requirements relating to the selection and disclosure of accounting policies.

- .08 In some cases, social benefits may give rise to a liability for which there is:
- (a) little or no uncertainty as to the amount, and
 - (b) the timing of the obligation is not uncertain.

Accordingly, these are not likely to meet the definition of a provision in this Standard. Where such liabilities for social benefits exist, they are recognised where they satisfy the criteria for recognition as liabilities (refer also to paragraph .15). An example would be a period-end accrual for an amount owing to the existing beneficiaries in respect of aged or disability pensions that have been approved for payment consistent with the provisions of a contract or legislation.

Other exclusions from the scope of the Standard

- .09 This Standard does not apply to executory contracts unless they are onerous. Contracts to provide social benefits entered into with the expectation that the entity will not receive consideration that is approximately equal to the value of goods and services provided directly in return from the recipients of those benefits are excluded from the scope of this Standard.
- .10 Where another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
- (a) leases (see the International Public Sector Accounting Standard on *Leases* for guidance. However, as the Standard on leases contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases).
 - (b) retirement benefit costs (see the International Accounting Standard on *Employee Benefits* for guidance).
- .11 Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. The Standard of Generally Accepted Municipal Accounting Practice on *Revenue* identifies the circumstances in which revenue from exchange transactions is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of the Standard of Generally Accepted Municipal Accounting Practice on *Revenue*.
- .12 This Standard defines provisions as liabilities of uncertain timing or amount. In some instances the term “provision” is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.
- .13 Other Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

Definitions

.14 *The following terms are used in this Standard with the meanings specified:*

A constructive obligation is an obligation that derives from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current Standard, the entity has indicated to other parties that it will accept certain responsibilities, and***
- (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.***

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A contingent liability is:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, or***
- (b) a present obligation that arises from past events but is not recognised because:***
 - (i) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or***
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.***

Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

A legal obligation is an obligation that derives from:

- (a) a contract (through its explicit or implicit terms),***
- (b) legislation, or***
- (c) other operation of law.***

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

An onerous contract is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.

A provision is a liability of uncertain timing or amount.

A restructuring is a programme that is planned and controlled by management, and materially changes either the:

- (a) scope of the entity's activities, or***
- (b) manner in which those activities are carried out.***

Provisions and other liabilities

- .15 Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:
- (a) payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist), and
 - (b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of accounts payable, whereas provisions are reported separately.

Relationship between provisions and contingent liabilities

- .16 In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard the term "contingent" is used for liabilities and assets that are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. In addition, the term "contingent liability" is used for liabilities that do not meet the recognition criteria.
- .17 This Standard distinguishes between:
- (a) provisions — which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations, and
 - (b) contingent liabilities — which are not recognised as liabilities because they are either:

- (i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential, or
- (ii) present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

Recognition

Provisions

.18 A provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event,**
- (b) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, and**
- (c) a reasonable reliable estimate can be made of the amount of the obligation.**

If these conditions are not met, no provision shall be recognised.

Present obligation

.19 In some cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date.

.20 In most cases it will be clear whether a past event has given rise to a present obligation. In other cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such cases, an entity determines whether a present obligation exists at the reporting date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting date. On the basis of such evidence:

- (a) where it is more likely than not that a present obligation exists at the reporting date, the entity recognises a provision (if the recognition criteria are met), and
- (b) where it is more likely that no present obligation exists at the reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph .98).

Past event

- .21 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:
- (a) where the settlement of the obligation can be enforced by law, or
 - (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.
- .22 Sometimes the actions or representations of the entity's management, or changes in the economic environment, directly influence the reasonable expectations or actions of those outside the entity and, although they have no legal entitlement, they have other sanctions that leave the entity with no realistic alternative to settle certain expenses. Such obligations are sometimes called "constructive obligations". A constructive obligation is one arising from the facts in a particular situation; a legal liability arises from the operation of law (e.g. contract or statutes).
- .23 Examples of constructive obligations include:
- (a) an entity that habitually makes grants-in aid to deserving communities but is under no legal obligation to do so, but could not change its policy without incurring unacceptable damage to its reputation, and
 - (b) an entity that has identified contamination in certain land bordering its area of jurisdiction. The entity may not legally be obliged to clean up, but because of concern for its community and because of its published policies or past actions it has no realistic alternative but to do so.
- .24 Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to continue an entity's ongoing activities in the future. The only liabilities recognised in an entity's statement of financial position are those that exist at the reporting date.
- .25 Provisions are not made for general operational risks since they do not give rise to present obligations that exist at the reporting date.
- .26 It is only those obligations arising from past events existing independently of an entity's future actions (that is, the future conduct of its activities) that are recognised as provisions. An example of such obligations is penalties for clean-up costs for unlawful environmental damage imposed by legislation on an entity. These obligations would lead to an outflow of resources embodying economic benefits or service potential in settlement regardless of the future actions of that entity. In contrast, because of legal requirements, pressure from constituents, or a desire to demonstrate community leadership, an entity may intend or need to carry out expenditure to operate in an particular way in the future. An example would be where an entity decides to fit emission controls on certain of its vehicles. Because the entities can avoid the future expenditure by their future actions, for example, by

changing their method of operation, they have no present obligation for that future expenditure and no provision is recognised.

- .27 An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed indeed, the obligation may be to the community at large. Because an obligation always involves a commitment to another party, it follows that a decision by an entity's management, governing body or council does not give rise to a constructive obligation at the reporting date unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.
- .28 An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation.
- .29 Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. However, differences in circumstances surrounding enactment often make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases, it is not possible to judge whether a proposed new law is virtually certain to be enacted as drafted and any decision about the existence of an obligation should await the enactment of the proposed law.

Probable outflow of resources embodying economic benefits or service potential

- .30 For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph .98).
- .31 Where there are a number of similar obligations, the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable estimate of the obligation

- .32 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other assets or liabilities. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision.
- .33 In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph .98).
- .34 For example, in order to remain cost effective the management of an entity may decide to undertake specified capital expenditure in the future. Such a decision does not, of itself, create an obligation. Another example is where an entity needs to spend substantially on the resurfacing of roads every few years in order to maintain the existing level of service. An obligation would arise only when the resurfacing had been performed and the entity was obliged to pay a third party for the work undertaken.

Contingent liabilities

- .35 *An entity shall not recognise a contingent liability.***
- .36 A contingent liability is disclosed, as required by paragraph .98, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.
- .37 Where an entity is jointly and severally liable for an obligation the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint venture debt, that part of the obligation that is to be met by other joint venture participants is treated as a contingent liability. The entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.
- .38 Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made). For example, an entity may have breached an environmental law but it remains unclear whether any damage was caused to the environment. Where, subsequently it becomes clear that damage was caused and

remediation will be required, the entity would recognise a provision, because an outflow of economic benefits is now probable.

Contingent assets

- .39 *An entity shall not recognise a contingent asset.***
- .40 Contingent assets usually arise from unplanned or other unexpected events that are not wholly within the control of the entity and give rise to the possibility of an inflow of economic benefits or service potential to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.
- .41 Contingent assets are not recognised in financial statements, since this may result in the recognition of revenue that may never be realised. However, when the realisation of revenue is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
- .42 A contingent asset is disclosed, as required by paragraph .103, where an inflow of economic benefits or service potential is probable.
- .43 Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits or service potential has become probable, an entity discloses the contingent asset (see paragraph .103).

Measurement

Best estimate

- .44 *The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the reporting date.***
- .45 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the reporting date. However, the estimate of the amount that entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the reporting date.
- .46 The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

- .47 Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is “expected value”. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60% or 90%. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.
- .48 For example, suppose an entity sells goods or performs a service with a warranty under which customers are covered for the cost of repairs of any defects which become apparent within the first six months of purchase. If minor defects are detected in all products sold, repairs costs of R1m would result. If major defects are detected in all products sold repairs costs of R4m would result. The entity’s past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects and 5% of the goods sold will have major defects. The expected value of the cost of repairs is, R400 000 (that is (75% of nil) + (20% of R1m) + (5% of R4m)).
- .49 Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example, if an entity has to rectify a serious fault in a major plant that it has constructed for a customer, the most likely outcome may be for the repair to succeed at the first attempt at a cost of R1 000, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.

Risks and uncertainties

- .50 ***The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.***
- .51 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that revenue or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.
- .52 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph .96(b).



Present value

- .53** *Where the effect of time value of money is material, the amount of a provision shall be the present value of the expenditure expected to be required to settle the obligation.*
- .54 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting date are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.
- .55 When a provision is discounted over a number of years, the present value of the provision will increase each year as the provision comes closer to the expected time of settlement. Paragraph .95(e) of this Standard requires disclosure of the increase during the period in the discounted amount arising from the passage of time.

Future events

- .56** *Future events that may affect the amount required to settle an entity's obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.*
- .57 Expected future events may be particularly important in measuring provisions. If there is sufficient evidence of likely expected rates of inflation this should be reflected in the amount of the provision. For example, an entity may believe that the cost of clearing up a site at the end of its life will be reduced by future changes in technology. The amount provided for reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex cleanup operation that has previously been carried out. However, the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.
- .58 The effect of possible new legislation which may effect the amount of an existing obligation of an entity is taken into consideration in measuring that obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected disposal of assets

- .59 *Gains from the expected disposal of assets shall not be taken into account in measuring a provision.***
- .60 Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an entity recognises gains on expected disposals of assets at the time specified by the Standard of Generally Accepted Municipal Accounting Practice on *Property, Plant and Equipment*.

Reimbursements

- .61 *Where some or all of the expense required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.***
- .62 *In the statement of financial performance, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.***
- .63 Sometimes an entity is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the entity or pay the amounts directly.
- .64 In most cases the entity will remain primarily liable for the whole of the amount in question so that the entity would have to settle the full amount if the third party failed to pay for any reason. In this situation a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the entity settles the liability. However, occasionally the entity will not remain primarily liable for the costs in question so that, if the third party failed to pay, the entity would not be liable. In such a circumstance the entity no longer has a liability for those costs to be met by the third party and the financial statements reflect this fact.
- .65 In some cases, the entity will not be liable for the costs in question if the third party fails to pay. In such a case, the entity has no liability for those costs and they are not included in the provision.
- .66 As noted in paragraph .37, an obligation for which an entity is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in provisions

- .67 Provisions shall be reviewed at each reporting rate and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, the provision shall be reversed.**
- .68 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as an interest expense.

Use of provisions

- .69 A provision shall be used only for expenditure for which the provision was originally recognised.**
- .70 Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

Application of the recognition and measurement rules

Future operating net deficits

- .71 Provisions shall not be recognised for net deficits from future operating deficits.**
- .72 Net deficits from future operating activities do not meet the definition of liabilities in paragraph .14 and the general recognition criteria set out for provisions in paragraph .18.
- .73 An expectation of net deficits from future operating activities is an indication that certain assets used in these activities may be impaired. An entity tests these assets for impairment. Guidance on accounting for impairment is found in the International Accounting Standard on *Impairment of Assets*.

Onerous contracts

- .74 If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract shall be recognised and measured as a provision.**
- .75 Paragraph .74 of this Standard applies only to contracts that are onerous. Contracts to provide social benefits entered into with the expectation that the entity does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits are excluded from the scope of this Standard.
- .76 Many contracts evidencing exchange transactions (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and

obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

- .77 This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it which includes amounts recoverable. Therefore, it is the present obligation net of recoveries that is recognised as a provision under paragraph .74. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.
- .78 Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract.

Restructuring

- .79 The following are examples of events that may fall under the definition of restructuring:
- (a) Sale, termination or the transfer to another government body or council of a service,
 - (b) The closure of locations where operations are carried on and the relocation of operational activities,
 - (c) Changes in management structure, for example, eliminating a layer of management, and
 - (d) Fundamental reorganisations (i.e. those that have a material effect on the nature and focus of the entity's operations).
- .80 A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph .18 are met. Paragraphs .81 to .94 set out how the general recognition criteria apply to restructurings.
- .81 A constructive obligation to restructure arises only when an entity:**
- (a) has a detailed formal plan for the restructuring identifying at least:**
 - (i) the activity/operating unit or part of an activity/operating unit concerned,**
 - (ii) the principal locations affected,**
 - (iii) the location, function, and approximate number of employees who will be compensated for determining their services,**
 - (iv) the expenditures that will be undertaken, and**
 - (v) when the plan will be implemented.**

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

- .82 A public announcement by itself would not constitute a commitment unless it obliges the entity to pay out resources or dispose of assets. A commitment only arises if the announcement is made in such a way and in sufficient detail for other parties, such as customers or suppliers, to be expected to act on the basis that the reorganisation will proceed and, in so doing, remove the realistic possibility of the entity withdrawing. The announcement would normally specify the service operations or part of a service operation that is affected, the locations in question, the total number of employees affected and the total costs, and indicate the timing of the reorganisation. Communication of the plan to employees would have to be made at a reasonable level of detail to staff involved or their representatives. The effect of the communication must be such that withdrawal by the entity is not realistic in view of the damage it would cause to relationships with employees and the community in which the entity operates and the fact that some employees will have found other jobs.
- .83 Examples of implementation include dismantling plant, selling assets, notifying external parties (such as notifying ratepayers that services will be discontinued) and communication to employees.
- .84 For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the entity is at present committed to restructuring, because the timeframe allows opportunities for the entity to change its plans.
- .85 A decision by the council or the governing body to restructure taken before the reporting date does not give rise to a constructive obligation at the reporting date unless the entity has, before the reporting date:
- (a) started to implement the restructuring plan, or
 - (b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

In some cases, an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting date. Disclosure may be required under the International Public Sector Accounting Standard on *Events After the Reporting Date*, if the restructuring is of such importance that its non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.



- .86 Although a constructive obligation is not created solely by council or governing body decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale or transfer of an operation, may have been concluded subject only to governing body or council approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure, if the conditions of paragraph .81 are met.
- .87 The ultimate authority for decision making about an entity is vested in a governing body or council whose membership includes representatives of interests other than those of management (e.g. employees) or notification to these representatives may be necessary before the governing body or council decision is taken. Because a decision by such a governing body or council involves communication to these representatives, it may result in a constructive obligation.

Sale and transfer of operations

- .88 *No obligation arises as a consequence of the sale and transfer of an operation until the entity is committed to the sale or transfer, that is, there is a binding agreement.***
- .89 Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.
- .90 Restructuring within the public sector often involves the transfer of operations from one controlled entity to another and may involve the transfer of operations at no or nominal consideration. Such transfers will often take place under a government directive and will not involve binding agreements as described in paragraph .89. An obligation exists only when there is a binding agreement. Even where proposed transfers do not lead to the recognition of a provision, the planned transaction may require disclosure under other Standards of Generally Accepted Municipal Accounting Practice or International Public Sector Accounting Standards or Statements of Generally Accepted Accounting Practice, such as the International Public Sector Accounting Standard on *Events After the Reporting Date*.

Restructuring Provisions

- .91 *A restructuring provision shall include only the direct expenditure arising from restructuring, which are those that are both:***
- (a) *necessarily entailed by a restructuring, and***
 - (b) *not associated with the ongoing activities of the entity.***

- .92 A restructuring provision does not include such costs as:
- (a) retraining or relocating continuing staff,
 - (b) marketing, and
 - (c) investment in new systems and distribution networks.

These expenditure relate to the future conduct of an activity and are not liabilities for restructuring at the reporting date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

- .93 Identifiable future operating net deficits up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph .14.
- .94 As required by paragraph .59, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure

- .95 For each class of provision, an entity shall disclose:**
- (a) The carrying amount at the beginning and end of the period,**
 - (b) Additional provisions made in the period, including increases to existing provisions,**
 - (c) Amounts used (that is, incurred and charged against the provision) during the period,**
 - (d) Unused amounts reversed during the period, and**
 - (e) The increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.**

Comparative information is not required.

- .96 An entity shall disclose the following for each class of provision:**
- (a) A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential,**
 - (b) An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph .56, and**
 - (c) The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.**
- .97 Where an entity elects to recognise in its financial statements provisions for social benefits for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, it shall make the disclosures required in paragraphs .95 and .96 in respect of those provisions.**

- .98 Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:**
- (a) an estimate of its financial effect, measured under paragraphs .44 to .60,**
 - (b) an indication of the uncertainties relating to the amount or timing of any outflow, and**
 - (c) the possibility of any reimbursement.**
- .99 In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single Standard about them to fulfil the requirements of paragraphs .96(a) and (b) and .98(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to one type of obligation, but it would not be appropriate to treat as a single class amounts relating to environmental restoration costs and amounts that are subject to legal proceedings.
- .100 Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs .95, .96 and .98 in a way that shows the link between the provision and the contingent liability.
- .101 An entity may in certain circumstances use external valuation to measure a provision. In such cases, information relating to the valuation can usefully be disclosed.
- .102 The disclosure requirements in paragraph .98 do not apply to contingent liabilities that arise from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods or services provided, directly in return from the recipients of those benefits (see paragraphs .01(a) and .04 to .08 for a discussion of the exclusion of social benefits from this Standard).
- .103 Where an inflow of economic benefits or service potential is probable, an entity shall disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs .44 to .60.**
- .104 The disclosure requirements in paragraph .103 are only intended to apply to those contingent assets where there is a reasonable expectation that benefits will flow to the entity. That is, there is no requirement to disclose this information about all contingent assets (see paragraphs .39 to .43 for a discussion of contingent assets). It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising. For example, a contingent asset would arise from a contract where an entity allows a private sector company to



mine one of its properties in exchange for a royalty based on a set price per ton extracted and the company has commenced mining. In addition to disclosing the nature of the arrangement, the contingent asset should be quantified where a reasonable estimate can be made of the quantity of mineral to be extracted and the timing of the expected cash inflows. If there were no proven reserves or some other circumstances prevailed that indicated that it would be unlikely that any minerals would be extracted, the entity would not disclose information required by paragraph .103 as there is no probable flow of benefits.

- .105 Where any of the information required by paragraphs .98 and .103 is not disclosed because it is not practicable to do so, that fact shall be stated.***
- .106 In extremely rare cases, disclosure of some or all of the information required by paragraph .95 to .104 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent assets. In such cases, an entity need not disclose the information, but should disclose the general nature of the dispute together with the fact that, and reason why, the information has not been disclosed.***

Effective date

- .107 This Standard of Generally Accepted Municipal Accounting Practice becomes effective for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 as amended.***