Asset Management

Nosipho Mba CA (SA)

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Overview

1. Root cause for some of PPE related audit findings.
2. Objective of Financial Reporting.
3. Asset related Financial Statement Assertions.
4. MFMA Compliance Requirements.
5. Material Irregularity.
6. Key GRAP 17 accounting principles relating to some of the audit findings.
7. Questions/comments.

Root causes for PPE Audit Findings

- Lack of detailed assets project and AFS plan that clearly outlines the preparation and review processes to be followed to ensure validity, accuracy and completeness of FAR, financial information and disclosures in the AFS with timelines.
- Incorrect application of GRAP 17, GRAP 1, GRAP 3, GRAP 21 and GRAP 109.
- Inadequate controls over management and safeguarding of assets i.e. Non-compliance with s63 of the MFMA.
- Inadequate processes over impairment assessment, testing and recognition.
- Late submission of final FAR and working papers for review before submission for audit to the AGSA.

Root causes for PPE Audit Findings

- Inadequate processes over identification and disclosure of projects taking significantly longer complete and halted projects.
- No impairment assessment on projects taking longer to complete.
- No impairment testing and results of thereof on halted projects.
- Budget constraints that adversely impact on timeous completion of projects.
- Inadequate security and safety measures applied by management to avoid vandalism of municipal infrastructure including WIP projects.

Root causes for PPE Audit Findings

- Inadequate processes over identification of assets that are ready for use.
- Inadequate controls over identification, recording and disclosure of commitments in the AFS.
- Inadequate controls over project and contracts management.
- No detailed physical verification methodology, project plan with timelines and close-out report for all immovable and movable assets verified by Asset consultants.
- Lack of funding to update the infrastructure masterplans, asset management, operations, repairs and maintenance and funding plans.

Root causes for PPE Audit Findings

- Inadequate infrastructure development and management key controls.
- Asset Management Steering Committee not in place/ not effective to direct, monitor and evaluate the asset management strategies within the municipality.
- Asset Management Policy not adequately workshopped to municipal officials to guide them on the implementation thereof.

Objective of financial reporting

The Former NT Accountant General Mr. SF Nomvalo simplified the objective of financial reporting as follows:

- “Financial reporting should demonstrate the accountability of the Municipality for the financial affairs and resources entrusted to it and provide information useful for decision making purposes.
- To achieve this objective the financial statements should be prepared in accordance with a suite of standards aimed at providing relevant, understandable, comparable and reliable information i.e., GRAP standards.

Objective of financial reporting

- The information must therefore reflect the truth of all the activities that occur in the municipality, it must be fairly presented”

Asset related Financial Statement

International Auditing Standard (ISA) 315 states that, in representing that the financial statements are in accordance with the applicable financial reporting framework, which is GRAP in this case, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of financial statements and related disclosures. There management assertions are classified into three categories as follows:

- Classes of transactions and events.
- Account balances; and
- Presentation and disclosures.

Asset related Financial Statement

Assertions about **classes of transactions and events** for the period under audit/review:

- **Occurrence** – assets related transactions and events that have been recorded have occurred and pertain to the municipality/entity.
- **Completeness** - all transactions and events related to assets that should have been recorded have been recorded.
- **Accuracy** - amounts and other data relating to recorded assets transactions and events have been recorded appropriately.
- **Cut off** – assets related transactions and events have been recorded in the correct accounting period.

Asset related Financial Statement

Assertions about classes of transactions and events for the period under audit/review:

- **Classification**—assets related transactions and events have been recorded in the proper accounts.

Asset related Financial Statement

Assertions about **account balances** at period end:

- **Existence** – Assets reported on the balance sheet really exist at the reporting date.
- **Rights** – The municipality/entity holds or controls the rights to assets as of reporting date.
- **Completeness** – All assets that should have been recorded have been recorded and all related disclosures that should have been included in the financial statements have been included.

Asset related Financial Statement

- **Accuracy, valuation, and allocation** – Assets have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded and related disclosures have been appropriately measured and described.
- **Classification** – assets have been recorded in the proper accounts.
- **Presentation** – assets are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework (GRAP).

Asset related Financial Statement

Assertions about **presentations and disclosure**:

- **Occurrence and rights and obligations** – assets related disclosed events, transactions, and other matters have occurred and pertain to the municipality/entity.
- **Completeness** - all assets related disclosures that should have been included in the financial statements have been included.
- **Classification and understandability** - financial information relating to assets is appropriately presented and described, and disclosures are clearly expressed.

Asset related Financial Statement

- **Accuracy and valuation** - financial and other information relating to assets are disclosed fairly and at appropriate amounts.

MFMA Compliance Requirements

MFMA s19

(1) A municipality may only spend money on a capital project only if:

(a) The money for the project , **excluding the cost of feasibility studies** conducted by or on behalf of the municipality, has been appropriated in the capital budget referred to in section 17(2);

(b) The project, including the total cost, has been approved by the council;

(c) s33 has been complied with, to the extent that that section may be applicable and

MFMA Compliance Requirements

MFMA s19

(1) A municipality may only spend money on a capital project only if:

d) The sources of funding have been considered, are available and have not been committed for other purposes.

(2) Before approving a capital project in terms of subsection (1) (b), the council of a municipality must consider:

(a) The projected cost covering all financial years until the project is operational; and

(b) The future operational costs and revenue on the project, including municipal tax and tariff implications.

MFMA Compliance Requirements

MFMA s63

"(1) The Accounting Officer of a municipality is responsible for the management of –

(a) The assets of the municipality, including the **safeguarding** and the **maintenance** of those assets; and (b) ….

(2) The Accounting Officer must for the purposes of subsection (1) take all reasonable steps to ensure –

(a) That the municipality has and maintains a management, **accounting** and **information system** that accounts for the assets and … of the municipality.

(b) That the municipality's assets and .. are **valued in accordance with standards of GRAP** and

MFMA Compliance Requirements

MFMA s63

"(2) The Accounting Officer of a municipality is responsible for the management of –

c) That the municipality has and maintains a system of **internal control of assets**, including an asset register, as may be prescribed.

MFMA Compliance Requirements

Other legal requirements:

MFMA s14 Disposal of Capital Assets.

MFMA SCM Regulation 40.

MFMA Asset Transfer Regulations.

MFMA Compliance Requirements

CIGFARO Chartered Institute of Government Finance, Audit & Risk Officers
IMFO

MFMA s78

s78(1) Each senior manager of a municipality and each official of a municipality exercising financial management responsibilities must take all reasonable steps within their areas of responsibility to ensure –

(a) That the system of financial management and **internal control** established for the municipality is carried out diligently;

(b) That the financial and other **resources of the municipality are utilized effectively, efficiently, economically and transparently;**

MFMA Compliance Requirements

CIGFARO
Chartered Institute of Government Finance, Audit & Risk Officers
IMFO

MFMA s78

s78(1) Each senior manager of a municipality and each official of a municipality exercising financial management responsibilities must take all reasonable steps within their areas of responsibility to ensure –

c) That any unauthorized, irregular or fruitless and wasteful expenditure and **any other losses are prevented.**

d) …

e) That the assets and liabilities **of the municipality are managed effectively and that assets are safeguarded and maintained to the extent necessary.**

Material Irregularity

Material Irregularity

AO, SMs and other officials' roles and responsibilities:

- Ensure that the municipality complies with the legislation applicable to it.
- Prevent any financial losses resulting from any non-compliance with/contravention of the legislation/fraud/theft/breach of fiducial duty.
- Identify and appropriately address any non-compliance with/contravention of the legislation /fraud/theft/breach of fiducial duty.
- Identify and appropriately address any resultant financial losses in accordance with applicable legislation and the policies of the municipality.
- Make written submissions and provide substantiating documents within 20 working days of notification of an MI or suspected MI.

Implications of MI

ACCOUNTING OFFICER: PAY OR GO TO JAIL UNLESS YOU:

- Have clear and written policies and procedures to ensure compliance with Laws and Regulations.
- Have clear and written delegations of duties to relevant officials.
- Enforce and monitor compliance with laws and regulations.
- Enforce accountability and consequence management.

Implications of MI

SENIOR AND OTHER OFFICIALS: FACE DISCIPLINARY ACTIONS, PAY OR GO TO JAIL UNLESS YOU:

- Ensure compliance with laws and regulations in performing your duties.
- Ensure compliance with council policies and procedures.
- Have clear and written delegations of duties, allocation of responsibilities to your staff including updating JDs.
- Monitor staff performance.
- Hold them accountable and enforce consequence management.

Overview of GRAP 17 principles

1. Asset definition as per GRAP conceptual framework.
2. Recognition criteria for assets.
3. Classification/identification criteria.
4. WIP: Indicators of assets that are ready for use/capitalization.
5. Measurement of PPE items at initial recognition.
6. Subsequent measurement including depreciation and review of useful life.
7. GRAP 3 requirement on accounting for change in depreciation figures.
8. GRAP requirement for presentation and disclosure of PPE items including WIP.

Definition of an Asset

An asset is:

*A **resource presently controlled** by the entity as a result of a **past event**.*

Resource:

A resource is an item with **service potential or the ability to generate economic benefits**.

The **service potential or ability to generate economic benefits** can arise directly from the resource itself, from the rights to use the resource or the entity's ability to direct how it may be used by denying or restricting access to that resource.

Definition of an Asset

Service potential is the capacity to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

Presently controlled:

An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

Definition of an Asset

Indicators of control

(i) Legal ownership.

(ii) Access to the resource, or the ability to deny or restrict access to the resource.

(iii) The means to ensure that the resource is used to achieve its objectives; and

(iv) The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

Past event:

The definition of an asset requires that a resource that an entity presently controls must have arisen **from a past transaction or other past event**.

Definition of an Asset

The past transactions or other events that result in an entity gaining control of a resource and therefore an asset may differ.

Events that may result in gaining control are as follows:

(i) A general ability to establish a power.
(ii) Establishment of a power through a statute.
(iii) Exercising the power to create a right, and
(iv) The event which gives rise to the right to receive resources from an external party. An asset arises when the power is exercised, and the rights exist to receive resources.

Recognition Criteria

An asset shall be recognized when, and only when:

(a) it is ***probable that the future economic benefits or service potential*** *that are associated with the asset* ***will flow to the entity****; and*

(b) the ***cost or fair value of the asset can be measured reliably****.*

In determining whether an item satisfies the first criterion for recognition, an entity needs to assess the degree of certainty attaching to the flow of future economic benefits or service potential on the basis of the available evidence at the time of initial recognition.

Recognition Criteria

The second criterion for recognition is usually readily satisfied because the exchange transaction evidencing the purchase of the asset identifies its cost. Where assets are acquired through a non-exchange transaction, cost is the asset’s fair value as at the date of acquisition.

Classification Criteria

Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one reporting period.

Owner-occupied property , includes (among other things):

- Property held for future use as owner-occupied property.

Classification Criteria

Owner-occupied property , includes (among other things) continued…:

- ❑Property held for future development and subsequent use as owner-occupied property.
- ❑Property occupied by employees such as officials or similar personnel which are required as part of their employment to be located in a specific area (whether or not the employees pay rent at market rates); and
- ❑Owner-occupied property awaiting disposal.

Classification Criteria

- Property held to provide services and which also generates revenue. These properties are typically used by the municipality to fulfil its mandated function to provide certain services rather than for rentals or capital appreciation. Rental revenue generated from these properties is incidental to the purposes for which the property is held.
- Property held for strategic purposes, where, in terms of the municipality's spatial planning, this land could be used to develop housing, or it could be used to expand the current infrastructure network.

WIP Capitalization Criteria

A project included in WIP can only be capitalized when it is ready for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

The following can be used as a guide in determining whether the project is ready for capitalization:

- ❑A certificate of practical completion is received. This certificate indicates that all construction work has been done.
- ❑The end user of the asset has taken occupation of the capital asset and is operating from or in the premises.

WIP Capitalization Criteria

The following can be used as a guide in determining whether the project is ready for capitalization:

- ❑The implementing agent/consultant/project manager indicates formally that the construction phase has been completed.
- ❑The budget amount is nearly exhausted and only the retention money remains to be paid under the contract. No problems or issues that could indicate any deviations from plans were experienced.
- ❑Claims from the contractor have stopped and the physical capital asset can be viewed and appears ready for use for the intended purpose, it can be safely accessed.

Initial Measurement

In terms of GRAP 17 par 17, an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Par 18 further state that where an asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.

The elements of cost of PPE items include the following:

- Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- Any costs **<u>directly attributable</u>** to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management;

Initial Measurement

- The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Initial Measurement

Cost Element	Include	Exclude
Directly Attributable Costs	• Costs of employee benefits (as defined in the Standard of GRAP on Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment. • Costs of site preparation. • Initial delivery and handling costs • Installation and assembly costs. • Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition. • Professional fees	• Costs of opening a new facility. • Costs of introducing a new product or service. • Costs of conducting business in a new location or with a new class of customers (including costs of staff training). • Administration and other general overhead costs. • Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity

Initial Measurement

Stage		End-of-stage deliverable
No	Name	
0	Project initiation	An initiation report which outlines the high-level business case together with the estimated project cost and proposed schedule for a single project or a group of projects having a similar high-level scope.
1	Infrastructure planning	An infrastructure plan which identifies and prioritises projects and packages against a forecasted budget over a period of at least five years.
2	Strategic resourcing	A delivery and/or procurement strategy which, for a portfolio of projects, identifies the delivery strategy in respect of each project or package and, where needs are met through own procurement system, a procurement strategy.
3	Prefeasibility	A prefeasibility report which determines whether or not it is worthwhile to proceed to the feasibility stage.
	Preparation and briefing	A strategic brief which defines project objectives, needs, acceptance criteria and client priorities and aspirations, and which sets out the basis for the development of the concept report for one or more packages.
4	Feasibility	A feasibility report which presents sufficient information to determine whether or not the project should be implemented.
	Concept and viability	A concept report which establishes the detailed brief, scope, scale, form, and control budget, and sets out the integrated concept for one or more packages.
5	Design development	A design development report which develops in detail the approved concept to finalise the design and definition criteria, sets out the integrated developed design, and contains the cost plan and schedule for one or more packages.

Initial Measurement

6	Design documentation	6A Production information	Production information which provides the detailing, performance definition, specification, sizing and positioning of all systems and components enabling either construction (where the constructor is able to build directly from the information prepared) or the production of manufacturing and installation information for construction.
		6B Manufacture, fabrication, and construction information	Manufacture, fabrication, and construction information produced by or on behalf of the constructor, based on the production information provided for a package which enables manufacture, fabrication or construction to take place.
7	Works		Completed works which are capable of being occupied or used.
8	Handover		Works which have been taken over by the user or owner complete with record information.
9	Package completion		Works with notified defects corrected, final account settled and the close out report issued.

Subsequent Measurement

- In terms of GRAP 17 par 33, after 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 or Revalued Amount less any accumulated depreciation and any accumulated impairment losses.**
- Depreciation of an asset begins **when it is ready for use**, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Items sitting in WIP should not be subjected to depreciation until they have been capitalized, ready and available for use.

Subsequent Measurement

- Land and buildings are separable assets and are accounted separately, even when they are acquired together. Land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful 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 depreciable amount of the building.
- If the cost of land includes the costs of site dismantlement, removal and restoration, the portion of the land fill asset is depreciated over the period of benefits or service potential obtained by incurring those costs.

Subsequent Measurement (EUL&RUL)

- In terms of GRAP 17 par 55, . the depreciable amount of an asset shall be allocated on a systematic basis over its useful life.
- Par 56 further states that, an entity shall assess at each reporting date whether there is any indication that the entity’s expectations about the residual value and the useful life of an asset have changed since the preceding reporting date. If any such indication exists, the entity shall revise the expected useful life and/or residual value accordingly. The change(s) shall be accounted for as a change in an accounting estimate in accordance with the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (GRAP 3).

Subsequent Measurement (EUL&RUL)

- In assessing whether there is any indication that the expected useful life of an asset has changed, an entity considers the following indications:
  a) The composition of the asset changed during the reporting period, i.e. the significant components of the asset changed.
  b) The use of the asset has changed, because of the following:
     (i) The entity has changed the manner in which the asset is used.
     (ii) The entity has changed the utilisation rate of the asset.

Subsequent Measurement (EUL&RUL)

(iii) The entity has made a decision to dispose of the asset in a future reporting period(s) such that this decision changes the expected period over which the asset will be used.

(iv) Technological, environmental, commercial or other changes that occurred during the reporting period that have, or will, change the use of the asset.

(v) Legal or similar limits placed on the use of the asset have changed.

(vi) The asset was idle or retired from use during during the reporting period.

c) The asset is approaching the end of its previously expected useful life.

Subsequent Measurement (EUL&RUL)

d) Planned repairs and maintenance on, or refurbishments of, the asset and/or its significant components either being undertaken or delayed.

e) Environmental factors, e.g. increased rainfall or humidity, adverse changes in temperatures or increased exposure to pollution.

f) There is evidence that the condition of the asset improved or declined based on assessments undertaken during the reporting period.

g) The asset is assessed as being impaired in accordance with GRAP 21 and GRAP 26.

Subsequent Measurement (EUL&RUL)

CONDITION GRADE	DESCRIPTION	DETAILED DESCRIPTION	INDICATIVE RUL
1	Very good	Sound structure well maintained. Only normal maintenance required.	71 - 100% EUL
2	Good	Serves needs but minor deterioration (< 5%).Minor repairs required.	46 - 70% EUL
3	Fair	Marginal, clearly evident deterioration (10-20%).Some repairs required.	26 - 45 % EUL
4	Poor	Significant deterioration of structure and/or appearance. Risk of degradation of performance (20-40%). Possible escalation of frequency/ intensity or replacement.	11 - 25% EUL
5	Very poor	Unsound, failed - needs reconstruction/ replacement (> 50% needs replacement).	0 - 10% EUL

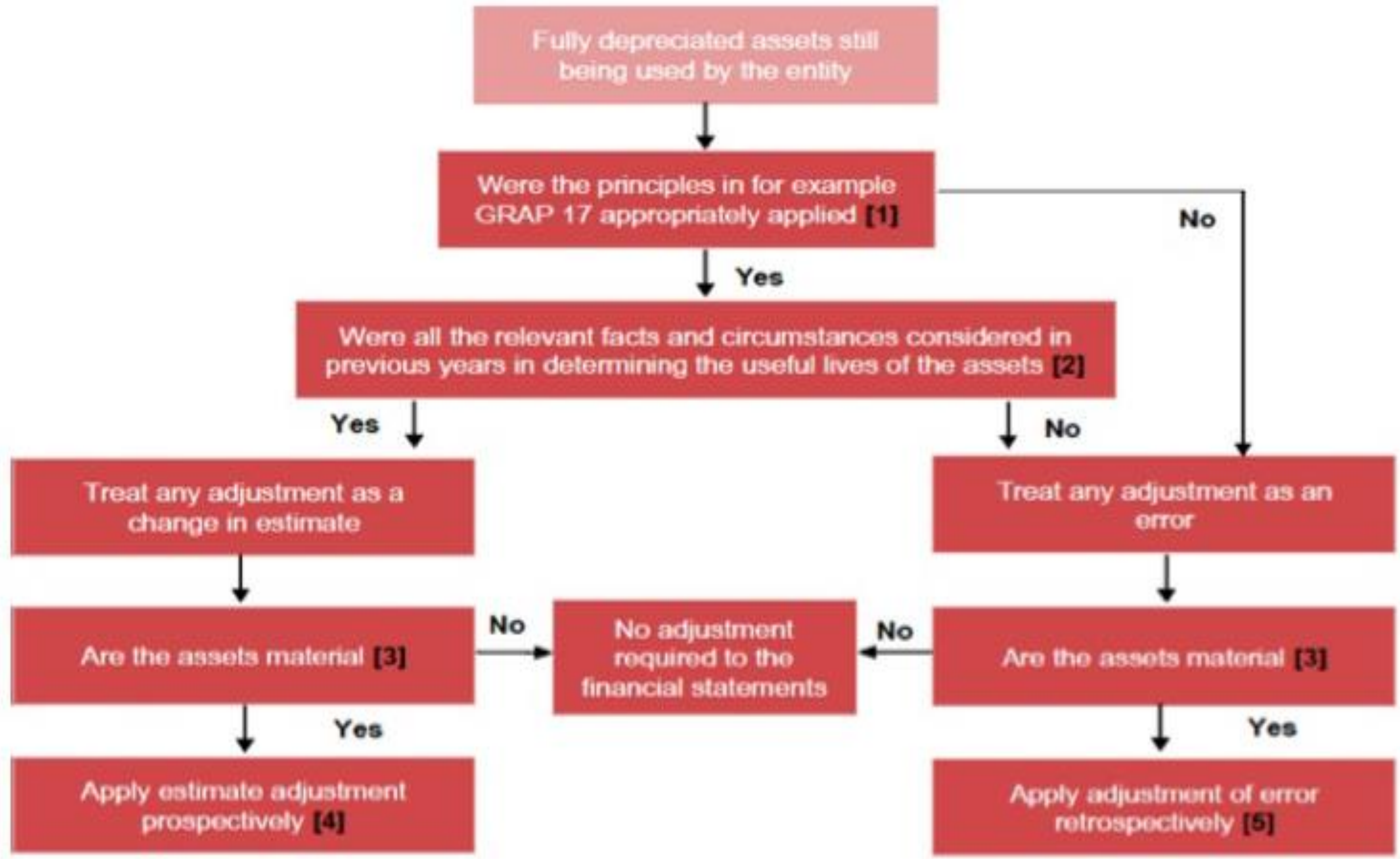
Accounting for change in EUL/RUL

- **Prior period errors** - are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that was available when financial statements for those periods were authorized for issue; and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
- **Change in accounting estimate** - is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

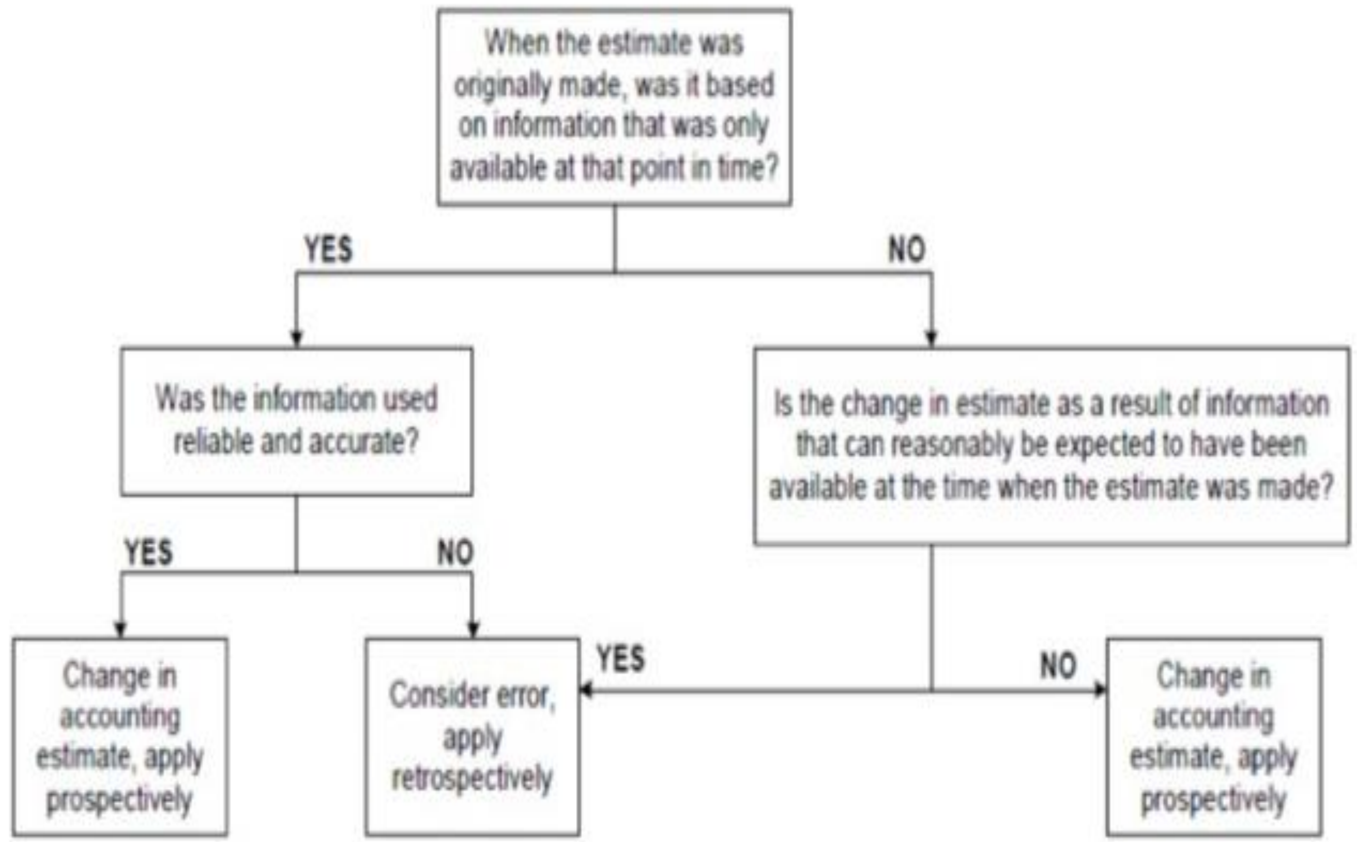
Accounting for change in EUL/RUL

- **Prospective application** - of a change in an accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.
- **Retrospective application** - is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
- **Retrospective restatement** - is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occulted.

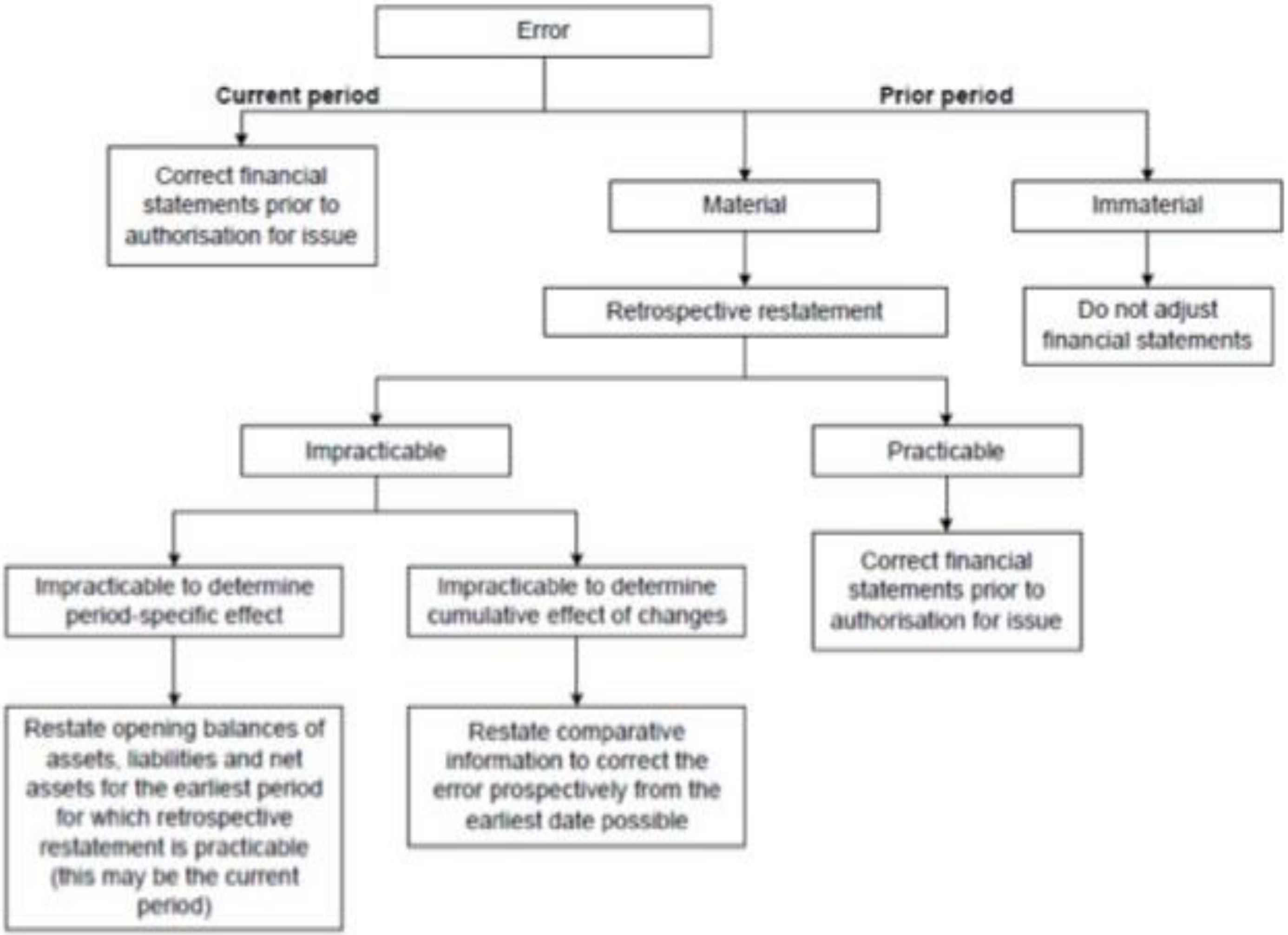
Accounting for change in EUL/RUL



Change in estimate



Prior period error



Change in EUL/RUL Disclosures

Change in Accounting Policy	Change in Estimate	Prior Period Error
New Standard Application/Voluntary Change • Title of the standards • transitional provisions. • Nature of the change in accounting policy. • Reasons why applying the new accounting policy provides reliable and more relevant information. • Current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected. • Amount of the adjustment relating to periods before those presented, to the extent practicable	• An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect. • If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.	• The nature of the prior period error. • For each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected. • The amount of the correction at the beginning of the earliest prior period presented. • If retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected

GRAP 17 WIP Disclosure requirements

The municipality shall disclose the following in the notes to the financial statements in relation to property, plant and equipment which is in the process of being constructed or developed GRAP 17 paragraph 87:

a) The cumulative expenditure recognized in the carrying value of property, plant and equipment. These expenditures shall be disclosed in aggregate per class of asset.
b) The carrying value of property, plant and equipment that is taking a significantly longer period of time to complete than expected, including reasons for any delays.

GRAP 17 WIP Disclosure requirements

(c) The carrying value of property, plant and equipment where construction or development has been halted either during the current or previous reporting period(s). The entity shall also disclose reasons for halting the construction or development of the asset and indicate whether any impairment losses have been recognized in relation to these assets. In providing the disclosures in paragraphs .87(b) and (c) an entity shall decide how to present the information required, i.e. individually or in aggregate, for example per project, per class or another relevant basis.

Other PPE Disclosure requirements

- Par 85 (a) to (c) accounting policy.
- Par 85 (d) and (e) main note and reconciliation note.
- Par 86 (a) Restrictions on title, pledged as security.
- Par 86 (b) Contractual commitments.
- Par 86 (c) Compensation from third parties.
- Par 87 (a) to (c) WIP.
- Par 88 to 90 PPE repairs and maintenance.
- Par 91 changes in estimate/or prior period errors i.e. Review of Useful Lives and depreciation.
- Par 92 Revaluation disclosures i.e. date of revaluation, methods and assumptions, availability of active market or other valuation method and the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to owners of net assets.

Thank You!

CIGFARO
Chartered Institute of
Government Finance, Audit & Risk Officers
IMFO