National MFMA AFS Consistency workshop

Realizing financial viability, sustainable service delivery and fair presentation of AFS through effective asset management

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GAUTENG
PROVINCIAL GOVERNMENT
REPUBLIC OF SOUTH AFRICA

GGT2030
GROWING GAUTENG TOGETHER

OVERVIEW

1. Why assets?
2. What is effective asset management?
3. What is advanced asset management?
4. What is life cycle management assets?
5. Six what (s) of asset management
6. Objective of financial reporting.
7. MFMA compliance requirements.
8. Summary of transversal assets audit findings, root causes and recommendations to address the root causes and possibly reduce/prevent reoccurrence of the audit findings.

WHY ASSETS?

- Municipal Assets represent the **largest balance** on most municipalities Statement of Financial Position (quantitively material) and are the **foundation for sustainable service delivery** (qualitatively material).
- Furthermore, assets are a **significant public investment** as they are funded through conditional grants, borrowings and own revenue.
- Local Government has been persistently faced with **service delivery protests arising from lack of service delivery** which can often be associated with service delivery interruptions **because of old and dilapidated municipal infrastructure**.

- **Root cause** for these **service delivery failures** are:
- ✓ non- prioritization of asset maintenance,
- ✓ Non-renewal, upgrading and/or replacement of existing assets;
- ✓ which in turn **negatively impacts the quality of life for citizens** and **their attitude towards payment for services**.

- There is also an increasing audit focus on asset:
- ✓ existence,
- ✓ valuation,
- ✓ impairment,
- ✓ work-in-progress,
- ✓ useful lives,
- ✓ disclosures and
- ✓ asset management governance.

WHY ASSETS ?

- Assets are key to:

✓ sustainable service delivery,

✓ financial viability and

✓ sustainability/going concern of municipalities.

- Assets that are well managed and in good condition:

✓ foster good and sustainable service delivery

✓ resulting in happy citizens as they receive uninterrupted service supply.

- Good and **sustainable service delivery** emanating from the effective assets and revenue management processes (including cost reflective and affordable tariffs) will **encourage good citizens to pay for the services they receive**.

✓ This will ultimately improve cashflows, liquidity, financial viability and sustainable service delivery of municipalities.

- Improved cashflows with good current assets and liquidity ratios supported by effective revenue management processes and well managed and maintained assets will

✓ translate to a healthy balance sheet which is attractive to potential investors.

- Good balance sheet underpinned by effective assets and revenue management results

✓ in bankable capital projects; as investor confidence in the municipal processes and ability to repay capital outlay and interest increases.

WHAT IS EFFECTIVE ASSETS MANAGEMENT?

*Dr. Dinos Constantinides defines **effective asset management** as an*:

- ✓ **integrated approach**
- ✓ to **monitoring, operating, maintaining, upgrading**, and **disposing of assets cost-effectively**,
- ✓ **while maintaining a desired level of service and**
- ✓ **improving overall business/municipality's performance**."

WHAT IS ADVANCED ASSETS MANAGEMENT?

Making the

right decisions / adopting the right solutions at the

right time for the

right cost

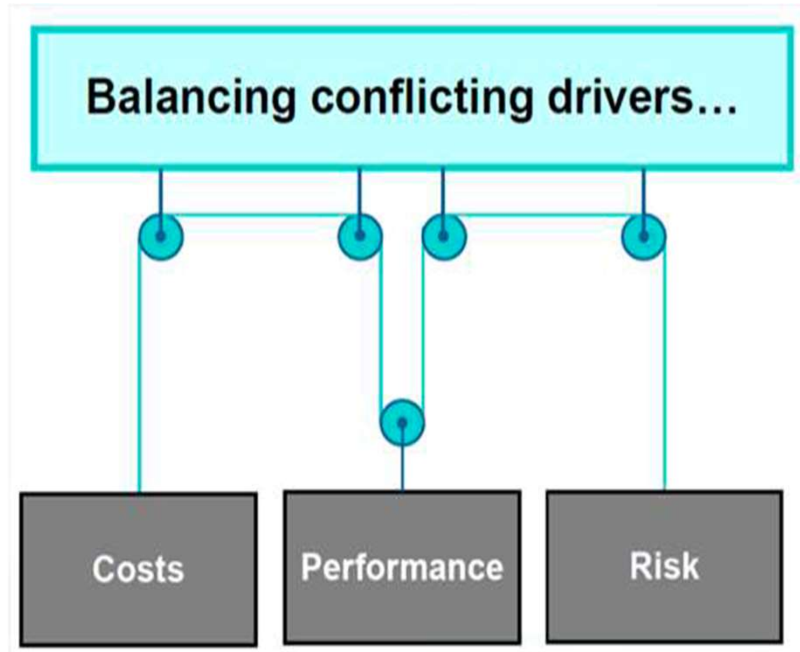
for the right reasons

*Across our **whole portfolio of assets** as just part of the business strategies.*

'Making good investment decisions'

WHAT IS LIFE CYCLE MANAGEMENT OF ASSETS?

ISO 55000 highlights the need of managing assets during their entire lifecycle as reflected in the diagram below and also trying to balance 3 main conflicting drivers:



SIX WHAT(S) OF ASSETS MANAGEMENT by Vanier, D.J., NRCC, 2000?

- What does the municipality own? Rights (Control)
- What is it worth? Valuation (Carrying amount at reporting date)
- What is its condition? Valuation (Depreciation and impairment considerations)
- What is the backlog maintenance? (Depreciation, impairment, risk management and budget considerations)
- What is the remaining service life? (Depreciation, risk management, going concern and budget considerations)
- What do you fix first? (Risk management, going concern and budget prioritization)

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 that is 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.

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

- To achieve fair presentation, **ALL audit assertions** for

✓ Classes of transactions and events: Occurrence, completeness, accuracy, cut off and classification.

✓ Account balances: Rights, existence, valuation, completeness, classification.

✓ and Presentation and disclosures

Must be tested satisfactorily.

LEGISLATIVE REQUIREMENTS

*According to Chapter 7 of the Constitution, Section 152, ensuring the provision of services to communities in **a sustainable manner** and in a **safe and healthy environment** are some of the **key objectives of local government.***

LEGISLATIVE REQUIREMENTS (Continued)

MFMA s19

(1) A municipality may **ONLY spend money on a capital project** 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

(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 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 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

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

LEGISLATIVE REQUIREMENTS (Continued)

Other legal requirements:

- MFMA s14 Disposal of Capital Assets.
- MFMA SCM Regulation 40.
- MFMA Asset Transfer Regulations.

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.**

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.**

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
1.	**Variances between AFS, GL, TB, FAR and Expert's reports (where applicable).**	✓ Lack of **detailed assets project** and **AFS preparation plans** ✓ that clearly outlines the preparation and review processes to be followed ✓ to ensure validity, accuracy and completeness of the FAR, financial information and PPE disclosures in the AFS, ✓ with timelines.
2.	**Unjustifiable prior period errors.**	✓ Inadequate supporting documents, calculations and working paper files ✓ to support prior period errors.

RECOMMENDATIONS

1. To **address the variances and unjustifiable adjustments** to assets figures, the following should be done:
   - Assets material misstatement risk assessment and IFS reviews to identify key risks, MFMA and GRAP compliance deficiencies.
   - A detailed physical verification and FAR update methodology and project plan that considers all the risks identified and
   - IFS review findings; and complies with MFMA and GRAP for all immovable and movable assets to be verified by Asset consultants/municipality; with timelines.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

1. To **address the variances and unjustifiable adjustments** to assets figures, the following should be done continued…:

- A detailed AFS plan that clearly outlines the preparation and review processes to be followed to ensure validity, accuracy and completeness of the FAR, financial information and PPE disclosures in the AFS, with timelines.

- The detailed physical verification and FAR update methodology and project plan must align with the detailed AFS plan and timelines.

- A detailed physical verification and FAR update implementation close-out report outlining

✓ key GRAP and MFMA compliance processes and

✓ supporting documentation thereof.

- The close-out report should also cover how assets existence, completeness, valuation and allocation assertions were addressed for assets that were not included in the asset verification plan for the reporting period e.g. results Asset Annual Review Session Results.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

2. Where external consultants or Experts or internal experts are engaged/used by the municipality, the following should be done:

- Verification of relevant qualifications, skills and experience of the consultants/experts.
- Clear deliverables that align with the detailed Assets verification, FAR update and AFS plan including timelines for preparation and review of their reports.
- Detailed review of the consultants/experts reports for compliance with GRAP and MFMA, where applicable.
- Ensure that the final figures per the consultant/expert's reports are consistent with the figures per the FAR, GL, TB and AFS.
- Ensure there is a detailed working paper file with supporting documents for all adjustments to the asset figures including prior period adjustments.
- Ensure that the journals supporting the adjustments are reviewed and authorized by the relevant senior personnel and signed as evidence.
- Ensure that the figures per the working paper files, experts reports, journals and disclosure notes including change in estimate and prior period errors are ***consistent.***

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
3.	**Incorrect recognition and derecognition of PPE items (Land).**	Inadequate processes to ensure correct application of iGRAP 18 and/or incorrect application of iGRAP 18.

RECOMMENDATIONS

3. To **ensure correct application of iGRAP 18,** the following must be done:
   - Reconciliation of the FAR, deeds report and valuation roll.
   - Review of all Department of Human Settlements Housing Arrangements/funding MOUs for details regarding land availability clauses i.e. who is proving the land for the housing development.
   - Review minutes of the section 80 committees on Infrastructure, Housing and Community services and council resolutions for evidence of donations of land to or from the municipality.
   - Engage with property management/economic development departments within the municipalities on supporting documents for land belonging to the municipality but not reflecting in the deeds report and FAR e.g. Surveyor Generals Reports, Demarcation/amalgamation proclamations, permission to occupy for tribal land, donation letters, council resolutions and other relevant documents supporting the transfer of control to the municipality.
   - For land donated by the municipality for housing development or any other purposes, obtain council resolutions, MOUs with the relevant departments/organizations.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
4.	**Incorrect classification of PPE items** at <u>initial recognition</u> and <u>disclosure level</u> specifically; ✓ WIP, land, buildings, major spare parts, infrastructure and community assets, ✓ PPE vs Investment property/Inventory/Heritage Assets/Intangible Assets/Living Resources/Biological Assets).	Incorrect application of ✓ GRAP **1**, GRAP **16**, GRAP **17**, GRAP **27**, GRAP **31**, GRAP **103**, GRAP **110** and ✓ CIDMs principles with regards to classification of assets .

RECOMMENDATIONS

4. For correct classification of PPE items in line with the requirements of:

- ✓ GRAP 1 paragraph 85 and 86(a),
- ✓ GRAP 16 paragraphs 18 to 25,
- ✓ GRAP 17 paragraphs 8 to 12, 42 and 69,
- ✓ GRAP 27 paragraph 3 (a) and (aA),
- ✓ GRAP 31 paragraph 5,
- ✓ GRAP 32 paragraph 10,
- ✓ GRAP 103 paragraphs 9, 10 and 19 and
- ✓ GRAP 110 paragraphs 2 (a) (iA) and (b)(i), <u>the following should be done</u>:
  - Use of CIDMs Module 3 Annexure 3A separating land, buildings, servitudes and movable assets for financial reporting purposes to comply with GRAP.
  - Classifying work in progress (WIP) into the different classes of assets as per CIDMs and GRAP 17 paragraph 42.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

4. For **correct classification** of PPE items in line with the requirements of GRAP…continued:
   - Assessing land used for biological assets whether it meets the definition and recognition criteria for property, plant and equipment.
   - Differentiating bearer plants from biological assets.
   - Assessing land and other assets used for support and/or functioning of heritage assets and living resources whether they meet the definition and recognition criteria for property, plant and equipment.
   - Assessing intangible assets that can not perform/function separable from property, plant and equipment items for recognition as PPE.
   - Assess the ownership/control of water and electricity meters by reviewing municipal by-laws and/or credit control and debt collection policies, lease and other arrangements to determine classification as either PPE or inventory.
   - Assess/review all lease agreements for compliance with GRAP 13 and 16 using principles of iGRAP 14 and GRAP 16 paragraphs 6 to 25 to determine the correct classification of related assets especially land and buildings.
   - Review all public private partnerships agreements/SLAs, lease agreements, private developers and grant funding arrangements including latest progress and/or close report reports to determine assets that should be recognized or reclassified.
   - Review the latest Spatial Development Framework, land zoning and sub-divisions to identify possible reclassifications/transfers and/or change in use of land.
   - Review heritage sites proclamations to determine which assets are excluded from the proclamations and assess whether they qualify as PPE, IP, Inventory or other assets classes.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
5.	**Incorrect measurement of PPE items** (at initial recognition specifically WIP, donations and assets prior year omissions).	Incorrect budgeting at project stage, FV of donations not determined or assessed and incorrect valuation method for prior year assets omissions.

RECOMMENDATIONS

5. Processes to address measurement of PPE items at initial recognition:

5.1. **Assets under construction/Work in progress (WIP)**

To correctly measure WIP at initial recognition, the following should be done by the municipality:

- Ensure compliance with MFMA s19 and MFMA Budget and Reporting Regulation 6 when preparing the budget for capital expenditure, repairs and maintenance.

- Clearly separate operating costs, repairs and maintenance, refurbishments, rehabilitation, upgrading and replacement of existing assets from construction of new assets at budget level.
    - Apply principles of GRAP 17 para. 14 to identify operational costs, repairs and maintenance.
    - Apply principles of GRAP 17 para. 15 and 16 to identify costs that can be capitalized.
    - **Repairs and maintenance** are activities aimed at maintaining the capacity and effectiveness of an asset at its designed level. The maintenance action implies that there is **an attempt to restore the asset to its original condition and there is no significant enhancement to its capacity, or the value of the assets.**

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

- Clearly separate operating costs, repairs and maintenance, refurbishments, rehabilitation, upgrading and replacement of existing assets from construction of new assets at budget level…continued.

  - **Upgrades and additions** are activities aimed at improving the capacity and effectiveness of an asset **above that of the initial design purpose**. The decision to renovate, reconstruct or enlarge an asset is a deliberate investment decision which may be undertaken at any time and is not dictated by the condition of the asset, but rather in response to a change in demand and or change in service requirements. Projects that in the past were identified as capital maintenance should be included in this item, as the decision to capitalize implies that the capacity of the asset will be improved beyond its initial design.

  - **Rehabilitation and refurbishments** are activities that are required **due to neglect or unsatisfactory maintenance or degeneration of an asset**. The action implies that the asset **is restored to its originally intended condition**, **thereby enhancing the capacity and value of an existing asset that has become inoperative due to the deterioration of the asset**.

- **Consider the project stages when preparing the capital budget as per the following table** i.e. stages **0 to 5** should form part of operational budget and stages **6 to 9** should form part of capital budget:

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

Table 1: End-of-stage deliverables

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

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

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
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

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

5.1. Assets under construction/Work in progress (WIP)…continued…

To correctly measure WIP at initial recognition, the following should be done by the municipality:

- Perform market price analysis on the project BOQ of the recommended bidder to identify excessive or below market pricing

✓ (**excessive pricing** may incur fruitless and wasteful expenditure hence overstating the related asset),

✓ **underpricing** may result in poor performance of contractors and significantly delayed or halted projects which may attract impairment loss and/or write-offs.

- Perform claims analysis on each project by reviewing all invoices/payment certificates and consultant's invoices and fee statement to identify claims that do not qualify for capitalization.

- Scrutinize the standing time claims to identify abnormal claims that could have been avoided if proper project management controls were in place. These claims inflate the cost of the asset and should be expensed.

- Scrutinize consultant costs per project stage to confirm alignment of payments to the project stage and confirm proper classification of consultant costs per project stage.

- Compare the cumulative project costs per the GL/TB to the cumulative project costs per the project register from PMU/End User and supporting documents.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

5.2. Measurement of donations at initial recognition

To correctly measure donations at initial recognition, the following should be done by the municipality:

- Donation certificate/letter should be supported by valid documentation to support the cost of the donation.

- Donation certificate/letter for infrastructure assets should be supported by:

✓ final account for the contractor (all payment certificates),
✓ final fee statement for all consultants who formed part of the project (all invoices paid to consultants),
✓ completion certificate,
✓ occupational certificate for building projects,
✓ as built drawings/original drawings,
✓ GIS shape files/GPS co-ordinates etc.

- Determination of the FV of the donated assets should be performed.
- Where market price is available, use market value at donation date.
- Where market price is not available, fair valuation by an internal or external expert should be done.
- Compare the FV with the cost of the donation, if the fair value approximates the cost, then recognize the donation at cost.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

5.3. Measurement of assets omissions at initial recognition

To correctly measure omissions at initial recognition, the following should be done by the municipality:

- Determine whether the omissions were because of completed projects not capitalized in the past/ or not (Operation Manager or staff will know).
- If the omission resulted from uncapitalized completed projects in the past: request project close-out reports with supporting documents and capitalize the assets at the date of completion i.e. clear the related project from the WIP register.
- If the omissions were because of incomplete accounting during demarcation/amalgamation of municipalities, refer to the carrying amount of the asset at the date of demarcation/amalgamation (use the principles of GRAP 105/106/107) whichever is applicable.
- If there is no historic data on the asset:
  - Determine FV/current replacement cost of the asset.
  - Assess the condition of the asset using the CIDMs/National Treasury LG AM Guide principles.
  - Determine the DRC of the asset at the earliest reporting date using the CIDMs condition EUL.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
6.	**PPE subsequent measurement issues** ✓ (Depreciation (EULs and RULs), ✓ Change in useful life vs impairment indicators, ✓ reversal of impairment, ✓ WIP impairment vs WIP write-offs, ✓ revaluations accounting treatment, ✓ capitalization of completed projects, ✓ impact of performance audit findings etc).	Root causes for some of the subsequent measurement issues on assets are as follows: • Incorrect application of: ✓ GRAP 17 paragraph 56 to 62, ✓ GRAP 31 paragraph 104 to 106 and ✓ GRAP 110 paragraph 77 to 83 vs GRAP 21 or 26 paragraph 23. • Inadequate processes to identify impairment and reversal of impairment indicators including supporting documents thereof. • Incorrect impairment and reversal of impairment methodologies. • Inadequate processes to assess and/or differentiate between WIP impairment indicators and WIP write-offs indicators. • Incorrect valuation methodologies and accounting treatment for revaluation of assets.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
6.	**PPE subsequent measurement issues** Continued…	Root causes for some of the subsequent measurement issues...continued…: • Inadequate process to differentiate a completed asset vs a completed project leading to incorrect or non-capitalization of completed assets. • Inadequate processes to assess the impact of performance audit findings on valuation of infrastructure assets.

RECOMMENDATIONS

6. Subsequent measurement issues

6.1. Difference between indicators of change in useful life and indicators of impairment

To correctly account for depreciation change and impairment loss, the following should be done by the municipality:

- Identify the indicators of change in useful life first as follows:
  - ❖ **Change in significant components of the assets** (usually 1st time application of CIDMs or incorrect unbundling in the past) – Results of this will be prior period error where information was available but was not considered.
  - ❖ **Change in use of the asset i.e.** manner of use, utilization rate, decision to dispose or decommission the asset before the end of its useful life, technological, environmental, commercial changes, legal or similar limits, asset is idle or retired from use.
  - ❖ **The asset is approaching the end of its previously expected useful life –** With no replacement plans.
  - ❖ **Planned repairs and maintenance on, or refurbishments of, the asset and/or its significant components either being undertaken or delayed.**
  - ❖ **The asset is assessed as being impaired in accordance with GRAP 21 and GRAP 26.**

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

6.1. Difference between indicators of change in useful life and indicators of impairment… continued…

- Identify the <u>indicators of change in useful life first</u> as follows (Continued):
    - **Environmental factors, e.g. increased rainfall or humidity, adverse changes in temperatures or increased exposure to pollution.**
    - **There is evidence that the condition of the asset improved or declined based on assessments undertaken during the reporting period.**
- These indicators should be backed by evidence, not assumed.

- Checklist with these indicators should be sent to the end users/custodians of assets for completion before the Assets Annual Review Sessions.

✓ The checklist should also be given to the physical verification team to note these on their verification sheet/app.

- Review of operations and maintenance including conditions assessment reports from the technical/operations team to identify any indicators of change in useful life.
- During the Asset Annual Reviews, the indicators should be discussed and assets affected identified.

- A list of assets that are candidate for the useful life review should be compiled with reasons for review.
- Where, indicators of change in useful life require further verification, an expert should accompany the verification team to validate the indicators.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

6.1. Difference between indicators of change in useful life and indicators of impairment… continued…

- A review of age based remaining useful life vs the condition based useful life should be done.
- A review of condition based useful life should only be done if the condition assessment was done during the reporting period.
- The review of useful life should be done before impairment assessments are done.
- Some of the indicators of change in useful life may also be indicators of impairment if they are considered significant e.g. Change in condition of the asset over and above the age-based condition that significantly impact the performance of the asset should also be tested for impairment.
- The key difference between the indicators of change in useful life and indicators of impairment is that impairment indicators must result in a permanent or significant decline in the service potential of the asset to require impairment testing.
- The *following slides show the difference between impairment indicators and events that may not qualify as impairment indicators* and the *recoverable service amount/recoverable amount calculation options*:

SUBJECTIVE INDICATORS OF IMPAIRMENT

CLEAR INDICATORS OF IMPAIRMENT

ADDITIONAL INDICATORS OF IMPAIRMENT

Condition rating table

Grade	Description	Detailed Description	Estimated Remaining Life
1	Very Good	New, sound structure or appearance, well maintained. Continue with planned maintenance.	As estimated
2	Good	Performance acceptable with minor deterioration (<5%). Normal planned maintenance continues.	As estimated
3	Fair	Clearly evident deterioration (10-20%). Significant maintenance required, consider impairment.	Less than estimated
4	Poor	Significant deterioration in structure or appearance. Significant impairment of performance. Significant maintenance required.	Significantly less than estimated
5	Very Poor	Unsound, does not perform. Reconstruction or replacement required (>50% needs replacement).	None or nominal

ADDITIONAL IMPAIRMENT INDICATORS AND VALUE IN USE CALCULATIONS

<table>
<tr><th>IMPAIRMENT INDICATORS</th><th>DATA SOURCES</th><th>TRIGGERS</th><th>VALUE-IN-USE (NON-CASH GENERATING ASSETS)</th><th>VALUE-IN-USE (CASH GENERATING ASSETS)</th></tr>
<tr><td>Utilisation – usage lower than norms/ design expectations, e.g. due to decline or non-realisation of demand</td><td rowspan="3">• Asset Register
• Periodic inspections
• Annual structured reviews with officials familiar with the assets
• Specific site surveys
• Operations reports
• Disaster reports
• Technical reports</td><td>• Assets under/not utilised (Gr 1 or 2) excluding new assets initially under-use according to design expectations, or assets required for strategic redundancy.</td><td>ODRC – eliminate unused components, over-design – expressed as % of DRC (based on unit rates for lower spec).</td><td rowspan="4">The following elements shall be reflected in the value in use calculation:
• An estimate of the future cash flows the entity expects to derive from the asset
• Expectations about possible variations in the amount or timing of those future cash flows
• The time value of money, represented by current market risk-free rate of interest
• The price for bearing the uncertainty inherent in the asset, and
• Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset</td></tr>
<tr><td>Condition – worse than expected from normal wear and tear – e.g. due to damage, theft, vandalism, poor maintenance</td><td>• Condition grade worse than expected due to age (based on condition deterioration model), or where damaged, or unsafe.</td><td>DRC less cost of restoration / rectification - expressed as % of DRC.</td></tr>
<tr><td>Functional performance – impaired core functionality</td><td>• Assets identified as being substantially non-compliant (Gr 5) with the requirements</td><td>Optimised DRC – adjust system configuration for equivalent functionality (based on unit rates for lower performance).</td></tr>
<tr><td>Obsolescence – design no longer fit for purpose, excessive cost of operations</td><td>• Annual structured reviews
• Technical reports
• Stores reports</td><td>• Change in policy or regulatory environment
• Change in national policy or industry norms
• Spares and technical support not readily available
• Cost records and cost norms</td><td>Optimised DRC – eliminate obsolescent technology (DRC based on modern / new required configuration – expressed as % of DRC guided by unit rates for modern spec).</td></tr>
</table>

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

6.1. Difference between indicators of change in useful life and indicators of impairment… continued…

- Other indicators of impairment that should be considered are as follows:

  - ❖ GRAP 17 paragraph 75 states that a plan to dispose of an asset before the previously expected date is an indicator of impairment, which requires the calculation of an asset's recoverable amount or recoverable service amount for the purpose of determining whether the asset is impaired.

  - ❖ GRAP FAQ 3.9 states that, the illegal occupation of land may indicate that an impairment loss should be recognized. An entity should apply the principles in either GRAP 21 or GRAP 26 when these occupations occur (and throughout their duration).

  - ❖ iGRAP 2 states that, if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall:

  - ✓ test the asset for impairment by estimating its recoverable amount or recoverable service amount,
  - ✓ and shall account for any impairment loss,
  - ✓ in accordance with the Standards of GRAP on Impairment of Non-cash-generating Assets or Impairment of Cash-generating Assets.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
7.	**PPE disclosure issues:** ✓ (CIDMs vs GRAP 17 par. 42 classification, ✓ WIP classification on the PPE main note, ✓ WIP disclosure requirements (Carrying Amount vs Cumulative expenditure, ✓ WIP taking significantly longer vs halted projects), ✓ other PPE disclosure requirements including commitments, repairs and maintenance).	Root causes for some of the PPE disclosure issues: • Incorrect interpretation of CIDMs asset hierarchies for asset management vs financial reporting purposes. • Non-application or incorrect application GRAP 1 paragraph 85 and 86 (a) read together with GRAP 17 paragraph 42, paragraphs 87 (a) to (c) relating to WIP disclosures. • Omission of GRAP 1 paragraphs 91, 92, 102 and GRAP 17 paragraphs 86 to 93. • Omission of iGRAP 18 and GRAP 17 paragraph 56 to 62 related disclosures. • Failure to reference or incorrect referencing to other related disclosures in the AFS e.g. ✓ Finance Lease Liabilities, ✓ commitments, ✓ cash proceeds on sale of assets, ✓ cash flows from purchase of PPE items etc.)

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

7. Disclosure issues

To correctly address the disclosure pitfalls, the following should be done by the municipality:

- Where the municipality uses CIDMs annexures for asset management purposes, the fixed asset register should be filtered to comply with GRAP 17 paragraph 42 for financial reporting purposes i.e.

✓ land and building relating to office buildings, workshops, infrastructure assets, land fill sites, community assets etc. should be aggregated and disclosed separately,

✓ movable assets e.g. vehicles, furniture and fittings etc should be disclosed as separate line items, servitudes that qualify for recognition should disclosed under intangible assets disclosure note.

- WIP should be allocated to different classes of PPE items e.g. community assets, buildings, infrastructure assets; in the main PPE note and not disclosed as a line item. **WIP is not an asset class**.

- WIP disclosure as per GRAP 17 para. 87 (a) to (c) should:

✓ consider impairment losses,

✓ reversal of impairments,

✓ write-offs and transfers to operating expenditure to ensure correct figures are disclosed.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

7. Disclosure issues continued…

- Significantly delayed projects should be a **separate disclosure** note from halted projects and an **SOP for identifying significantly delayed projects from halted projects should be in place** to guide project managers.

- Change in useful lives results either in change in estimate or prior period errors, these disclosures should comply with GRAP 3.

- Where the municipality has taken a decision to dispose of material or significant assets, the following GRAP 1 disclosures should be done:
  - ❖ A description of the asset(s), group of assets and liabilities or, component.
  - ❖ The carrying values of the assets or, if the disposal involves a group of assets and liabilities or a component of an entity, the carrying amounts of those assets and liabilities.
  - ❖ A description of the facts and circumstances of the disposal, including whether any further approvals are required and, the expected sale or transfer date.
  - ❖ Details of any disposals completed during the year; and
  - ❖ A description of any circumstances that may have resulted in a decision to dispose of an asset being reversed during the reporting period.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
8.	**Other issues affecting PPE valuation:** ✓ (poor record keeping for expenditure incurred on assets, ✓ WWTW not functional, ✓ illegal occupations, ✓ high water and electricity distribution losses, ✓ lack of asset maintenance leading to environment issues, ✓ inadequate contract and project management controls, ✓ procurement irregularities and ✓ poor financial controls – ❑ leading to overpayments, ❑ unrecovered guarantees, ❑ delays,	Other root causes affecting the valuation of PPE items: • Impact of non-functional or poor performing infrastructure assets on depreciation or impairment. • Impact of high water and electricity distribution losses on impairment of assets. • Difference between the CIDMs Expected and estimated useful life vs GRAP 17 paragraphs 1, 63 and 64. • Impact of poor SCM, project risk and contract management on WIP valuation. • No detailed: ✓ physical verification methodology, ✓ project plan with timelines and ✓ close-out report for all immovable and ✓ movable assets verified by Asset consultants.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

NO.	AUDIT FINDING	ROOT CAUSE
8.	**Other issues affecting PPE valuation --- Continued.**	Other root causes affecting the valuation of PPE items …continued • Inadequate review processes over impairment assessment, testing and recognition. • Late submission of the final FAR and working papers for review before submission for audit to the AGSA. • Inadequate processes over identification and disclosure of projects taking significantly longer complete and halted projects/projects put on hold. • No impairment assessment on projects taking longer to complete and no impairment testing and documented results of thereof on halted projects. • Inadequate security and safety measures applied by management to prevent vandalism and/or theft of municipal infrastructure including WIP projects. • Non-compliance with MFMA s14, MFMA SCM regulation 40 and MFMA Asset Transfer Regulations e.g. Constitutional Court's Tafelberg judgment. • Lack of funding to update the infrastructure masterplans, asset management, operations, repairs and maintenance and funding plans including budget constraints that adversely impact on timeous completion of projects. • Inadequate assets management key controls including ineffective or non-existent Asset Management Steering Committees

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

8. Other asset valuation issues

To correctly address other assets valuation issues, the following should be done by the municipality:

- Assess non-functional or performing assets first for change in useful life, if the impact is significant, also test the assets for impairment to ensure fair presentation.
- Where, water and electricity technical distribution losses are higher than the accepted norm i.e. 5 or 7% for electricity and 15% for water:

✓ test the network assets for impairment and allocate impairment loss to components with worst condition first.

- CIDMs expected useful life relates to design life of the asset rather than the estimated useful life of an asset as per GRAP i.e.

✓ CIDMs EUL is the economic life whereas GRAP expected useful is based on the projected useful life of an asset considering specific operating conditions at the municipality.

- In practice, CIDMs and National Treasury Local Government Asset Management Guide EULs are used as a starting point, however, where there is verifiable data that suggests a different useful life, the municipality should replace the CIDMs or National Treasury Local Government Asset Management Guideline EULs.

- CIDMs design life EUL are not expected to change hence the inclusion of an adjusted EUL and RUL in the FAR to reflect the operating conditions of the asset component.

KEY AUDIT FINDINGS, ROOT CAUSES AND RECOMMENDATIONS

RECOMMENDATIONS

8. Other asset valuation issues …continued…

- Weekly meetings to monitor implementation of the asset verification and FAR update plan.
- Detailed review of the impairment assessment, testing and recognition results for compliance with GRAP 21 or 26.
- Implementation of procurement and contract management controls to avoid long standing times, excessive prices, penalties not recovered from contractors or consultant and other deficiencies.
- Implementation of infrastructure delivery and management key controls to address all infrastructure related risks.
- Security assessments and implementing fit for purpose solutions to safeguard assets, also consider social compact/community-based asset management to involve the community in the safeguarding of assets.
- Ensuring compliance with the National Treasury MFMA Asset Transfer Regulations Guide when disposing assets or transferring assets to third parties or other organs of the state.
- Developing or updating Infrastructure masterplans, operations and maintenance plans and strategic asset management plans to inform the budget.
- Establishing Asset Management Steering Committee to direct, manage and report on asset management issues in the municipality.

CLOSING REMARKS

"Applying accounting standards is not just about compliance and balancing the numbers

but about ensuring accountability and enhancing service delivery through informed planning and decision-making.

The citizens are not a bunch of mushrooms to be kept in the dark – transparency is key."


Thank you
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