

# **DRAKENSTEIN MUNICIPALITY**

## **ACCOUNTING POLICIES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2010**

### **1. BASIS OF PRESENTATION**

"The annual financial statements have been prepared in accordance with the effective Standards of Generally Recognised Accounting Practice (GRAP), including any interpretations and directives issued by the Accounting Standards Board."

These standards are summarised as follows:

<b>Reference</b>	<b>Topic</b>
GRAP Framework	Framework for the preparation and presentation of financial statements
GRAP 1	Presentation of Financial Statements
GRAP 2	Cash Flow Statements
GRAP 3	Accounting Policies, Changes in Accounting Estimates and Errors
GRAP 4	The Effects of Changes in Foreign Exchange Rates
GRAP 5	Borrowing Costs
GRAP 6	Consolidated and Separate Financial Statements
GRAP 7	Investment in Associates
GRAP 8	Investment in Joint Ventures
GRAP 9	Revenue from Exchange Transactions
GRAP 10	Financial Reporting in Hyperinflationary Economies
GRAP 11	Construction Contracts
GRAP 12	Inventories
GRAP 13	Leases
GRAP 14	Events After the Reporting Date
GRAP 16	Inventory Property
GRAP 17	Property, Plant and Equipment
GRAP 19	Provisions, Contingent Liabilities and Contingent Assets
GRAP 100	Non-current Asset Held for Sale and Discontinued Operations
GRAP 101	Agriculture
GRAP 102	Intangible Assets
IFRS 3	Business combinations
IFRS 4	Insurance contracts
IFRS 6	Exploration for and evaluation of mineral resources
IFRS 7	Financial instruments: Disclosures
IAS 12	Income taxes
IAS 19	Employee benefits
IAS 32	Financial instruments: Presentation
IAS 36	Impairment of assets
IAS 39	Financial instruments: Recognition and measurement
IPSAS 20	Related part disclosure
IPSAS 21	Impairment of non cash generating assets
GAMAP 9.29 - .35 & .39 - .54*	Revenue
IGRAP 1**	Applying the probable test on initial recognition of exchange revenue
IFRIC 2	Members shares in co-operative entities and similar instruments

IFRIC 4	Determining whether an arrangement contains a lease
IFRIC 9	Reassessment of embedded derivatives
IFRIC 12	Service concession arrangements
IFRIC 13	Customer loyalty programmes
IFRIC 14	IAS 19 – The limit on a defined benefit asset minimum funding requirements and their interaction
SIC 21	Income taxes – Recovery of re-valued non depreciable assets
SIC 25	Income taxes – Changes in the status of an enterprise or its shareholders
SIC 27	Disclosure service concession
Directive 1	Repeal of existing transitional provisions in, and consequential amendments to, standards of GRAP
Directive 2	Transitional provisions for the adoption of GRAP by public entities, municipal entities and constitutional institutions
Directive 3	Transitional provisions for the adoption of GRAP by high capacity municipalities
Directive 4	Transitional provisions for the adoption of GRAP by medium and low capacity municipalities
Directive 5	Determine the GRAP reporting framework
ASB Guide 1	Guideline on accounting for public private partnerships

Accounting policies for material transactions, events or conditions not covered by the above GRAP standards have been developed in accordance with Paragraphs 7, 11 and 12 of GRAP 3. Where a standard of GRAP that has been issued by the Accounting Standards Board, but for which an effective date has not yet been determined by the Minister of Finance, accounting policies were developed based on the relevant GRAP standard.

The following are the critical judgements, apart from those involving estimations that the management have made in the process of applying the municipality's Accounting Policies and that have the most significant effect on the amounts recognised in Annual Financial Statements:

- Operating lease commitments – Municipality as lessor**

Municipality has entered into commercial property leases on its investment property portfolio. The Municipality has determined that it retains all the significant risks and rewards of ownership of these properties, and so accounts for them as operating leases.
- Pension and other post-employment benefits**

The cost of defined benefit pension plans and other employment medical benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty.
- Impairment of trade receivables**

The calculation in respect of the impairment of debtors is based on an assessment of the extent to which debtors have defaulted on payments already due, and an assessment of their ability to make payments based on their creditworthiness. This was performed per service-identifiable categories across all classes of debtors.
- Property, plant and equipment**

The useful lives of assets are based on management's estimation. Management considers the impact of technology, availability of capital funding, service requirements and required return on assets to determine the optimum useful life expectation where appropriate. The estimation of residual values of assets is also based on management's judgement whether the assets will be sold or used to the end of their useful lives, and what their condition will be at that time.
- Provisions and contingent liabilities**

Management judgement is required when recognising and measuring provisions, and when measuring contingent liabilities, as set out in Note 49. Provisions are discounted where the effect of discounting is material using actuarial valuations.

- **Held-to-maturity financial assets**

Management has reviewed the held-to-maturity financial assets in the light of its capital management and liquidity requirements, and has confirmed the positive intention and ability to hold those assets to maturity.

## **2. PRESENTATION CURRENCY**

These annual financial statements are presented in South African Rand and are rounded off to the nearest Rand.

## **3. GOING CONCERN ASSUMPTION**

These annual financial statements have been prepared on a going concern basis.

## **4. OFFSETTING**

Financial assets and liabilities are offset and the net amount reported on the balance sheet when there is a legally enforceable right to set off the recognised amount, and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

## **5. HOUSING DEVELOPMENT FUND**

The Housing Development Fund was established in terms of the Housing Act (Act No. 107 of 1997).

### **5.1 Housing Development Fund**

Sections 15(5) and 16 of the Housing Act, (Act 107 of 1997), which came into operation on 1 April 1998, required that the Municipality maintain a separate housing operating account. This legislated separate operating account is known as the Housing Development Fund.

The Housing Act also requires in terms of Section 14(4)(d)(ii)(aa), read with, inter alia, Section 16(2), that the net proceeds of any letting, sale or alienation of property, previously financed from government housing funds, be paid into a separate operating account, and be utilised by the Municipality for housing development in accordance with the National Housing Policy.

The following provisions are set for the creation and utilisation of the Housing Development Fund:

- The proceeds in this fund are utilised for housing development in accordance with the National Housing Policy, and also for housing development projects approved by the MEC for Housing.
- Any contributions to or from the fund are shown as transfers in the Statement of Changes in Net Assets.
- Interest earned on the investments of the fund is disclosed as interest earned in the Statement of Financial Performance.

### **5.2 Un-realized Housing Proceeds**

In order to comply with Section 14(4) (d) (i) and (ii) of the Housing Act, (Act 107 of 1997) where all net proceeds need to be paid into the Housing Development Fund, it was necessary to create a holding account which represents the un-realized funds due by long-term housing selling schemes and sponsored loan debtors. This account is reduced when debtors are billed for their payment.

## **6. Accumulated Surplus**

The municipality creates and maintains reserves in terms of specific requirements.

### 6.1 *Capital Replacement Reserve (CRR)*

In order to finance the provision of infrastructure and other items of property, plant and equipment from internal sources, amounts are transferred from the accumulated surplus/(deficit) to the CRR. A corresponding amount is transferred to a designated CRR bank or investment account. The cash in the designated CRR bank account can only be utilised to finance items of property, plant and equipment. The CRR is reduced and the accumulated surplus/(deficit) is credited by a corresponding amount when the amounts in the CRR are utilised.

The amount transferred to the CRR is based on the municipality's need to finance future capital projects included in the Integrated Development Plan.

### 6.2 *Capitalisation Reserve*

On the implementation of GRAP, the balance on certain funds, created in terms of the various Provincial Ordinances applicable at the time, that had historically been utilised for the acquisition of items of property, plant and equipment have been transferred to a Capitalisation Reserve instead of the accumulated surplus/(deficit) in terms of a directive (budget circular) issued by National Treasury. The purpose of this Reserve is to promote consumer equity by ensuring that the future depreciation expenses that will be incurred over the useful lives of these items of property, plant and equipment are offset by transfers from this reserve to the accumulated surplus/(deficit).

The balance on the Capitalisation Reserve equals the carrying value of the items of property, plant and equipment financed from the former legislated funds. When items of property, plant and equipment are depreciated, a transfer is made from the Capitalisation Reserve to the accumulated surplus/(deficit).

When an item of property, plant and equipment is disposed, the balance in the Capitalisation Reserve relating to such item is transferred to the accumulated surplus/(deficit).

### 6.3 *Donations and Public Contributions Reserve*

When items of property, plant and equipment are financed from public contributions and donations, a transfer is made from the accumulated surplus/(deficit) to the Donations and Public Contributions Reserve equal to the donations and public contributions recorded as revenue in the Statement of Financial Performance in accordance with a directive (budget circular) issued by National Treasury. When such items of property, plant and equipment are depreciated, a transfer is made from the Donations and Public Contributions Reserve to the accumulated surplus/(deficit). The purpose of this policy is to promote community equity and facilitate budgetary control by ensuring that sufficient funds are set aside to offset the future depreciation charges that will be incurred over the estimated useful life of the item of property, plant and equipment financed from donations and public contributions.

When an item of property, plant and equipment financed from donations and public contributions is disposed, the balance in the Donations and Public Contributions Reserve relating to such item is transferred to the accumulated surplus/(deficit).

### 6.4 *Insurance Reserve*

A general Insurance Reserve has been established and, subject to re-insurance where deemed necessary, it covers claims that may occur. Premiums are charged to the respective services taking into account claims history and replacement value of the insured assets.

Reinsurance premiums paid to external re-insurers are regarded as an expense and are shown as such in the Statement of Financial Performance. The net surplus or deficit on the insurance operating account is transferred to or from the insurance reserve via the Statement of Changes in Net Assets.

The balance of the self-insurance reserve is invested in short term cash investments. Interest earned on the insurance reserve is recorded as interest earned in the Statement of Financial Performance and is transferred to the Insurance reserve via the Statement of Changes in Net Assets as a contribution.

### 6.5 Government Grant Reserve

The municipality has applied GRAP 23 as a result capital grants and receipts relating to the creation of fixed assets are included in non-current liabilities as Government Grants and Subsidies. The accounting policy on conditional grants and receipts is set out in accounting policy note 23.

### 6.6 Revaluation Reserve

The surplus arising from the revaluation of land and buildings is credited to a non-distributable reserve. The revaluation surplus is realised as re-valued buildings are depreciated, through a transfer from the revaluation reserve to the accumulated surplus/ (deficit). On disposal, the net revaluation surplus is transferred to the accumulated surplus/ (deficit) while gains of losses on disposal, based on re-valued amounts are credited or charged to the Statement of Financial Performance.

## 7. PROVISIONS

Provisions are recognized when the municipality has a present or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the provision can be made.

Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

## PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and impairment, or at fair value. Land and Buildings is stated at fair value.

Heritage assets, which are culturally significant resources and are shown at cost, are not depreciated, owing to the uncertainty regarding their estimated useful lives. Land is also not depreciated, as it is deemed to have an indefinite life.

Where items of property, plant and equipment have been impaired, the carrying value is adjusted by the impairment loss, which is recognised as an expense in the Statement of Financial Performance in the period that the impairment is identified.

Subsequent expenditure relating to property, plant and equipment is capitalised if it is probable that future economic benefits or potential service delivery of the assets are enhanced in excess of the originally assessed standard of performance. If expenditure only restores the originally assessed standard of performance, it is regarded as repairs and maintenance, and is expensed.

The gain or loss arising from the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying value, and is recognised in the Statement of Financial Performance.

### 8.1 Depreciation

Depreciation is calculated on cost, using the straight-line method, over the estimated useful lives of the assets. The depreciation rates at initial recognition are based on the following estimated useful lives: -

Asset class	Useful lives as applied in the FAR (years)
<b>Infrastructure</b>	
Roads and paving	7-100
Pedestrian Malls	7-100

Electricity	4-75
Water	0-100
Sewerage	5-100
Housing	30
<b>Community</b>	
Improvements	30
Recreational facilities	20-36
Security	5
Land	0
<b>Other</b>	
Buildings	30
Specialist vehicles	10-20
Other vehicles	3-10
Office equipment	3-10
Furniture & fittings	5-10

Assets under construction are carried at cost. Depreciation of an asset commences when the asset is ready for its intended use. Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets, or, where shorter, the term of the relevant lease.

## **8.2 Impairment of property, plant and equipment**

Property, plant and equipment are reviewed at each reporting date for any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The impairment charged to the Statement of Financial Performance is the excess of the carrying value over the recoverable amount.

An impairment is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined had no impairment been recognised. A reversal of an impairment is recognised in the Statement of Financial Performance.

## **9. INVESTMENT PROPERTIES**

Investment Property is initially stated at cost. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the reporting date. Investment properties are written down for impairment where considered necessary. Investment property excludes owner-occupied property that is used in the production or supply of goods or services, or for administrative purposes, or property held to provide a social service.

Gains or Losses arising from changes in the fair value of investment property are included in the Statement of Financial Performance in the year in which they arise.

Where the classification of an investment property is based on management's judgement, the following criteria have been applied to distinguish investment properties from owner-occupied property or property held for resale:

- All properties held to earn market-related rentals or for capital appreciation or both and that are not used for administrative purposes and that will not be sold within the next 12 months are classified as Investment Properties.
- land held for a currently undetermined future use.
- a building owned (or held by under a finance lease) and leased out under one or more operating leases.
- leased properties that are held to provide a social (community) service or that are necessary for employees to perform their job functions, but which also generates rental revenue are not seen as investment properties. The rental revenue generated is incidental to the purposes for which the property is held.
- a building that is vacant but is held to be leased out under one or more operating leases.

The gain or loss arising on the disposal of an investment property is determined as the difference between the sales proceeds and the carrying value and is recognised in the Statement of Financial Performance.

## **10. BIOLOGICAL ASSETS**

Biological assets are measured at each balance sheet date at their cost or fair value less estimated point-of-sale costs. The fair value of livestock is determined by using the present value of expected net cash flows from the asset discounted at the municipality's required rate of return.

Gains or losses arising on initial recognition of a biological asset at cost or fair value less estimated point-of-sale costs and from a change in fair value less estimated point-of-sale costs of a biological asset shall be included in profit or loss for the period in which it arises.

## **11. INVENTORIES**

Inventories consist of raw materials, work in progress, consumables and finished goods, which are valued at the lower of cost, determined on the first in first out basis, and net realisable value, except for plants and compost, which are valued at the tariffs charged. Where it is held for distribution or consumption at no charge or for a nominal amount, inventories are valued at the lower of cost and current replacement value.

Cost of inventories comprises all costs of purchase, cost of conversion, and other costs incurred in bringing the inventories to their present location and condition.

Redundant and slow moving inventories are identified and written down to their estimated net realisable values. Consumables are written down according to their age, condition and utility.

## **12. NON CURRENT ASSETS HELD-FOR-SALE**

Non-current assets and disposal groups are classified as held-for-sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition applies only when the sale is highly probable, and the asset (or disposal group) is available for immediate sale in its present condition. Assets classified as held-for-sale are measured at the lower of the asset's carrying amount or fair value less cost to sell.

## **13. INTANGIBLE ASSETS**

Intangible assets are identifiable non-monetary assets without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes are classified and recognised as intangible assets.

Intangible assets acquired separately or internally generated are reported at cost less accumulated amortisation and accumulated impairment losses.

Amortization is calculated on cost, using the straight-line method, over the useful lives of the assets, which is estimated to be between 3 to 10 years upon initial recognition. Where intangible assets are deemed to have

an indefinite useful life, such intangible assets are not amortised.

Intangible assets are annually tested for impairment.

Where items of intangible assets have been impaired, the carrying value is adjusted by the impairment loss, which is recognised as an expense in the period that the impairment is identified except where the impairment reverses a previous revaluation.

The estimated useful life and amortisation method are reviewed annually at the end of the financial year. Any adjustments arising from the annual review are applied prospectively.

## **14. EMPLOYEE BENEFITS**

Defined benefit plan accounting as required by IAS 19. These defined benefit plans had been accounted for as defined contribution plans and the defined benefit obligations had been disclosed by narrative information for the previous financial year. The accounting policy was in accordance with the exemptions stated in the above-mentioned General notice.

The municipality provides short term benefits, long term benefits and retirement benefits for its employees and councillors.

### *14.1 Short-term Employee Benefits*

Remuneration to employees is recognised in the Statement of Financial Performance as the services are rendered, except for non-accumulating benefits which are only recognised when the specific event occurs.

The costs of all short-term employee benefits such as leave pay, are recognised during the period in which the employee renders the related service. The municipality recognises the expected cost of performance bonuses only when the municipality has a present legal or constructive obligation to make such payment and a reliable estimate can be made.

### *14.2 Post employment benefits: Defined Contribution Plans*

A **defined contribution plan** is a plan under which the municipality pays fixed contributions into a separate entity. The municipality has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to service in the current or prior periods.

The municipality's contributions to the defined contribution funds are established in terms of the rules governing those plans. Contributions are recognised in the Statement of Financial Performance in the period in which the service is rendered by the relevant employees.

### *14.3 Post employment benefits: Defined Benefit Plans*

A **defined benefit plan** is a plan that defines an amount of benefit that an employee will receive on retirement.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation and unrecognised actuarial gains and losses, reduced by unrecognised past service costs. The plan is unfunded. The defined benefit obligation is calculated using the projected unit credit method, incorporating actuarial assumptions and a discount rate based on the government bond rate. Valuations of these obligations are carried out by independent qualified actuaries regularly, as may be required for fair presentation.

Actuarial gains or losses are accounted for using the "*corridor method*". Actuarial gains and losses are eligible for recognition in the Statement of Financial Performance to the extent that they exceed 10 per cent of the present value of the gross defined benefit obligations in the scheme. Actuarial gains and losses exceeding 10 per cent are spread over the expected average remaining working lives of the employees participating in the scheme.

#### **14.3.1 Post-retirement Health Care Benefits:**

The municipality has an obligation to provide Post-retirement Health Care Benefits to certain of its retirees. According to the rules of the Medical Aid Funds, with which the municipality is associated, a member (who is on the current Conditions of Service), on retirement, is entitled to remain a continued member of the Medical Aid Fund, in which case the municipality is liable for a certain portion of the medical aid membership fee. The other Medical Aid Funds, with which the Municipality is associated, do not provide for continued membership.

#### 14.3.2 Ex-gratia Pension Benefits:

The Municipality provides pension benefits to all employees that are not members of the Pension - or Provident Funds, that have completed at least 10 years of service at the Council and have reached the age of 60.

#### 14.4 Other long-term employee benefits: Long-service Allowance

The municipality has an obligation to provide Long-service Allowance Benefits to all of its employees. According to the rules of the Long-service Allowance Scheme, which the municipality instituted and operates, an employee (who is on the current Conditions of Service), is entitled to a cash allowance, calculated in terms of the rules of the scheme, after 10, 15, 20, 25 and 30 years of continued service. The municipality's liability is based on an actuarial valuation. The projected unit credit method has been used to value the liabilities. Actuarial gains and losses on the long-term incentives are accounted for through the statement of financial performance.

#### 14.5 Provincially-administered Defined Benefit Plans

The municipality contributes to various National- and Provincial-administered Defined Benefit Plans on behalf of its qualifying employees. These funds are multi-employer funds (refer to Note 6 of the Annual Financial Statements for details). The contributions to fund obligations for the payment of retirement benefits are charged against revenue in the year they become payable. These defined benefit funds are actuarially valued triennially on the Projected Unit Credit Method basis. Deficits are recovered through lump sum payments or increased future contributions on a proportional basis from all participating municipalities.

The municipality does not apply defined benefit accounting to the defined benefit funds to which it is a member where these funds are classified in terms of GRAP as multi-employer plans, as sufficient information is not available to apply the principles involved. As a result, paragraph 30 of IAS 19 is applied and such funds are accounted for as defined contribution funds.

Salaried personnel are members of the Cape Joint Pension fund established in terms of the Local Authorities Pension Fund Ordinance, 1969 (Ordinance 23 of 1969), and the provisions of the Pension Fund Act, 1956 (Act 24 of 1956) or the SAMWU National Provident Fund.

#### 14.6 Leave Pay

Liabilities for annual leave are recognised as they accrue to employees. The liability is based on the total accrued leave days at year end and is shown as a provision in the Statement of Financial Position.

## 15. LEASES

### 15.1 The Municipality as Lessee

Leases are classified as finance leases where substantially all the risks and rewards associated with ownership of an asset are transferred to the municipality. Property, plant and equipment subject to finance lease agreements are capitalised at their cash cost equivalent. Corresponding liabilities are included in the Statement of Financial Position as Finance Lease Obligations. The cost of the item of property, plant and equipment is depreciated at appropriate rates on the straight-line basis over its estimated useful life. Lease payments are allocated between the lease finance cost and the capital repayment using the effective interest rate method. Lease finance costs are expensed when incurred.

Operating leases are those leases that do not fall within the scope of the above definition. Operating lease rentals are recognised on the straight-line basis over the term of the relevant lease.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

#### *15.2 The Municipality as Lessor*

Amounts due from lessees under finance leases or instalment sale agreements are recorded as receivables at the amount of the Municipality's net investment in the leases. Finance lease or instalment sale income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Municipality's net investment outstanding in respect of the leases or instalment sale agreements.

Operating lease rental income is recognised on a straight-line basis over the term of the relevant lease.

### **16. BORROWINGS**

Interest-bearing external loans and bank overdrafts are recorded net of direct issue costs. Finance charges, including premiums payable, are accounted for on an accrual basis. Borrowings are initially recognised at fair value, net of transaction costs. Subsequently, they are measured at amortised cost using the effective interest rate method.

Borrowing costs are recognised as an expense in the Statement of Financial Performance.

### **17. FINANCIAL INSTRUMENTS AND INVESTMENTS**

The municipality has various types of financial instruments and these can be broadly categorised as either *Financial Assets* or *Financial Liabilities*.

A financial instrument is recognised if the municipality becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the municipality's contractual rights to the cash flows from the financial assets expire or if the municipality transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the municipality commits itself to purchase or sell the asset. Financial liabilities are derecognised if the municipality's obligations specified in the contract expire or are discharged or cancelled (IAS 32.61, 66(a)).

#### *17.1 Financial Assets*

A financial asset is any asset that is a cash or contractual right to receive cash. The municipality has the following types of financial assets as reflected on the face of the Statement of Financial Position or in the notes thereto:

- Listed Investments (RSA Government Stock)
- Long-term Receivables
- Current portion of Long-term Receivables
- Consumer Debtors
- Other Debtors
- VAT receivables
- Short-term Investment Deposits (Call)
- Bank Balances and Cash

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the municipality's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows. (IAS 7.46)

In accordance with IAS 39.09 the *Financial Assets* of the municipality are classified as follows into the four categories allowed by this standard:

<b>Type of Financial Asset</b>	<b>Classification in terms of IAS 39.09</b>
Listed Investments – RSA Government Stock	Held to maturity
Finance Lease Receivables	Loans and receivables
Long-term Receivables	Loans and receivables
Current portion of Long-term Receivables	Loans and receivables
Consumer Debtors	Loans and receivables
Other Debtors	Loans and receivables
VAT receivables	Loans and receivables
Short-term Investment Deposits – Call	Available for sale
Bank Balances and Cash	Available for sale

*Financial assets at fair value through profit or loss* are financial assets that meet either of the following conditions:

- they are classified as held for trading; or
- upon initial recognition they are designated as at fair value through the Statement of Financial Performance.

*Available for sale investments* are financial assets that are designated as available for sale or are not classified as:

- Loans and Receivables;
- Held-to-Maturity Investments; or
- Financial Assets at fair value through the Statement of Financial Performance.

*Loans and Receivables* are financial assets that are created by providing money, goods or services directly to a debtor.

*Held-to-Maturity Investments* are financial assets with fixed or determinable payments and fixed maturity where the municipality has the positive intent and ability to hold the investment to maturity.

### 17.2 Financial Liabilities

A financial liability is a contractual obligation to deliver cash or another financial asset to another entity. The municipality has the following types of financial liabilities as reflected on the face of the Statement of Financial Position or in the notes thereto:

- ◆ Long-term Liabilities
- ◆ Current portion of long term liabilities
- ◆ Provisions (in terms of contractual agreements)
- ◆ Creditors
- ◆ Unspent Conditional Grants and Receipts
- ◆ Bank Overdraft
- ◆ Short-term loans
- ◆ Finance Lease Liability
- ◆ Consumer Deposits
- ◆ VAT payables

There are two main categories of *Financial Liabilities*, the classification based on how they are measured. Financial liabilities may be measured at:

- (i) Fair value through profit or loss; or
- (ii) Not at fair value through profit or loss ('other financial liabilities', measured at amortised cost

Financial liabilities that are measured at fair value through profit or loss are financial liabilities that are essentially held for trading (i.e. purchased with the intention to sell or repurchase in the short term; derivatives other than hedging instruments or are part of a portfolio of financial instruments where there is recent actual evidence of short-term profiteering or are derivatives). Financial liabilities that are measured at fair value through profit or loss are stated at fair value, with any resulted gain or loss recognised in the Statement of Financial Performance.

Any other financial liabilities should be classified as financial liabilities that are not measured at fair value through profit or loss. These liabilities are initially measured at fair value, net of transaction costs, and subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

In accordance with IAS 39.09 the *Financial Liabilities* of the municipality are all classified as financial liabilities that are not measured at fair value through profit or loss.

#### *Creditors*

Creditors and Other Payables are stated at their nominal value.

#### *17.3 Measurement*

Financial Instruments in prior years were recognised and measured at cost. The requirement of IAS 39.43, AG 64, AG 65, AG 79 and SAICA Circular 9 that financial instruments should initially be measured at fair value has been exempted in terms of General Notice 522 of 2007. The prior year accounting policy was in accordance with the exemption.

#### **Financial Assets:**

*Held-to-maturity Investments* and *Loans and Receivables* are initially measured at fair value and subsequently measured at amortised cost using the Effective Interest Method less any impairment, with revenue recognised on an effective yield basis.

Financial Assets at *Fair Value* and *Available-for-Sale* are initially and subsequently, at the end of each financial year, measured at fair value with the profit or loss being recognised in the Statement of Financial Performance.

#### **Financial Liabilities:**

Financial liabilities that are not held-for-trading are measured at amortised cost using the effective interest rate method.

#### *17.4 Impairment of Financial Assets*

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence of impairment of Financial Assets. If there is such evidence the recoverable amount is estimated and an impairment loss is recognised in accordance with IAS 39.

Initially Accounts Receivable are valued at fair value and subsequently carried at amortised cost using the effective interest rate method. An estimate is made for doubtful debt based on past default experience of all outstanding amounts at year-end. Bad debts are written off the year in which they are identified as irrecoverable. Amounts receivable within 12 months from the date of reporting are classified as current.

A provision for impairment of trade receivables is established when there is objective evidence that the municipality will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the Statement of Financial Performance.

With the exception of Available-for-Sale equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the Statement of Financial Performance to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of Available-for-Sale equity securities, impairment losses previously recognised through profit or loss are not reversed through the Statement of Financial performance. Any increase in fair value subsequent to an impairment loss is recognised directly in equity.

**Loans and Receivables** are non-derivative Financial Assets with fixed or determinable payments. They are included in current assets, except for maturities greater than 12 months, which are classified as non-current assets. Loans and receivables are recognised initially at cost which represents fair value. After initial recognition Financial Assets are measured at amortised cost, using the effective interest rate method less a provision for impairment.

**Consumer debtors, long term debtors and other debtors** are stated at its anticipated realisable value, thus its cost less an estimated provision for bad debts. The provision is made in accordance with IAS 39.64 whereby the recoverability of Consumer Debtors is assessed on an individual basis or collectively after grouping the assets in financial assets with similar credit risks characteristics, i.e. Government, Business and Households. Government accounts are not provided for as such accounts are regarded as payable.

Separate classes of loans and receivables are assessed for impairment using the following methodologies:

#### **Consumer debtors**

According to IAS 39.64, the assessment for impairment needs to be made for each individual financial asset separately or for groups of financial assets with similar credit risks. The following methodology was followed to make a provision for bad debts for the year under review:

- *Consumer debtors are assessed individually, considering factors such as payment histories and ratios, qualitative factors e.g. correspondence from attorneys, disputes about certain accounts, etc.*

#### **Other Debtors**

- *Other Debtors are reviewed individually considering payment histories and disputes about certain amounts. Provision for impairment is made accordingly.*

#### **Long term debtors**

##### Housing Loans

*The loans in this group are assessed by reviewing their payment histories and ratios. Provision for impairment is made accordingly.*

##### Other Long Term Debtors

*No provision for impairment is made for Other Debtors, because it is envisaged that these debts will be fully recovered.*

### *17.5 Derecognition of Financial Assets*

The municipality derecognises Financial Assets only when the contractual rights to the cash flows from the asset expires or it transfers the financial asset and substantially all the risks and rewards of ownership of the

asset to another entity, except when Council approves the write-off of Financial Assets due to non recoverability.

If the municipality neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the municipality recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the municipality retains substantially all the risks and rewards of ownership of a transferred financial asset, the municipality continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

#### *17.6 Derecognition of Financial Liabilities*

The municipality derecognises Financial Liabilities when, and only when, the municipality's obligations are discharged, cancelled or they expire.

The entire IFRS 7 / IAS 144 has been exempted in terms of General notice 522 of 2007. However, according to the afore-mentioned General notice, this standard is to be replaced by IAS 32 issued August 2006 and effective for financial statements covering periods beginning on or after 1 January 1998. The requirements of the latter standard have been applied for the previous financial year. The prior year accounting policy was in accordance with the exemptions stated in the above-mentioned General notice.

### **18. CASH AND CASH EQUIVALENTS**

Cash includes cash on hand and cash with banks. Cash equivalents are short-term highly liquid investments that are held with registered banking institutions with maturities of three months or less and are subject to an insignificant risk of change in value.

For the purpose of the cash flow statements, cash and cash equivalents comprise cash on hand, deposits held on call with banks and investments in financial instruments, as well as net of bank overdrafts.

### **19. REVENUE RECOGNITION**

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, stock rotation, price protection, rebates and other similar allowances.

Revenue, excluding value-added taxation where applicable, is derived from a variety of sources which include rates levied, grants from other tiers of government and revenue from trading activities and other services provided.

Revenue is recognised when it is probable that future economic benefits or service potential will flow to the municipality and these benefits can be measured reliably, except when specifically stated otherwise.

#### *19.1 Revenue from Exchange Transactions*

##### **19.1.1 Service Charges**

Service charges relating to electricity and water are based on consumption. Meters are read on a monthly basis and are recognised as revenue when invoiced. Provisional estimates of consumption, based on the consumption history, are made monthly when meter readings have not been performed. The provisional estimates of consumption are recognised as revenue when invoiced, except at year-end when estimates of consumption up to year-end are recorded as revenue without it being invoiced. Adjustments to provisional estimates of consumption are made in the invoicing period in which meters have been read. These adjustments are recognised as revenue in the invoicing period. In respect of estimates of consumption between the last reading date and the reporting date, an accrual is made based on the average monthly consumption of consumers.

Service charges relating to refuse removal are recognised on a monthly basis in arrears by applying the approved tariff to each property that has improvements. Tariffs are determined per category of property usage, and are levied monthly based on the number of refuse containers on each property, regardless of whether or not all containers are emptied during the month.

Service charges from sewerage and sanitation are based on the type of service and the number of sewer connections on all developed property, using the tariffs approved by Council and are levied monthly.

In circumstances where services cannot readily be measured and quantified, a flat rate service charge is levied monthly on such properties.

### **Pre-paid Electricity**

Revenue from the sale of electricity pre-paid meter cards are recognised at the point of sale. Revenue from the sale of electricity prepaid meter cards are recognised based on an estimate of the prepaid electricity consumed as at the reporting date.

### **19.1.2 Interest earned and Rentals received**

Interest and rentals are recognised on a time proportion basis that takes into account the effective yield on the investment. Interest may be transferred from the Accumulated Surplus to the Housing Development Fund or the Insurance Reserve.

Interest earned on the following investments is not recognized in the Statement of Financial Performance:-

- ◆ Interest earned on Trust Funds is allocated directly to the fund and is not recognized in the Statement of Financial Performance.
- ◆ Interest earned on unutilized conditional grants is allocated directly to the creditor: unutilized conditional grants, if the grant conditions indicate that interest is payable to the funder.

### **19.1.3 Dividends**

Dividends are recognised on the date that the municipality becomes entitled to receive the dividend in accordance with the substance of the relevant agreement, where applicable.

### **19.1.4 Royalties**

Royalties are recognised on an accrual basis in accordance with the substance of the relevant agreement. Royalties determined on a time basis are recognised on a straight-line basis over the period of the agreement. Royalty arrangements that are based on production, sales and other measures are recognised by reference to the underlying arrangement.

### **19.1.5 Tariff Charges**

Revenue arising from the application of the approved tariff of charges is recognised when the relevant service is rendered by applying the relevant authorised tariff. This includes the issuing of licences and permits.

### **19.1.6 Income from Agency Services**

Income for agency services is recognised on a monthly basis once the income collected on behalf of agents has been quantified. The income recognised is in terms of the agency agreement.

### **19.1.7 Housing Rental and Instalments**

Finance income from the sale of housing by way of instalment sales agreements or finance leases is recognised on a time proportion basis.

### **19.1.8 Sale of Goods**

Revenue from the sale of goods is recognised when all the following conditions have been satisfied:

- ◆ The municipality has transferred to the buyer the significant risks and rewards of ownership of the goods.
- ◆ The municipality retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

- ◆ The amount of revenue can be measured reliably.
- ◆ It is probable that the economic benefits or service potential associated with the transaction will flow to the municipality.
- ◆ The costs incurred or to be incurred in respect of the transaction can be measured reliably.

## 19.2 Revenue from Non-exchange Transactions

### 19.2.1 Rates and Taxes

Revenue from property rates is recognised when the legal entitlement to this revenue arises. Collection charges are recognised when such amounts are legally enforceable. Penalty interest on unpaid rates is recognised on a time proportion basis with reference to the principal amount receivable and effective interest rate applicable. A composite rating system charging different rate tariffs is employed. Rebates are granted to certain categories of ratepayers and are deducted from revenue.

### 19.2.2 Fines

Fines constitute both spot fines and summonses. When an estimate can be made for the revenue amount that is expected to be collected from spot fines based on past experience of amounts collected, this is recognized as revenue. Where a reliable estimate cannot be made, revenue from spot fines is recognized when paid by the offender. Revenue from the issuing of summonses is only recognized when notified by the public prosecutor of the amount actually collected.

### 19.2.3 Donations and Contributions

Donations are recognised on a cash receipt basis or where the donation is in the form of property, plant and equipment, when the risks or rewards of ownership have transferred to the municipality.

### 19.2.4 Revenue from Recovery of Unauthorised, Irregular, Fruitless and Wasteful Expenditure

Revenue from the recovery of unauthorised, irregular, fruitless and wasteful expenditure is based on legislated procedures, including those set out in the Municipal Finance Management Act (Act No.56 of 2003) and is recognised when the recovery thereof from the responsible councillors or officials is virtually certain. Such revenue is based on legislated procedures.

## 20. VALUE ADDED TAX

The municipality accounts for Value Added Tax on the payment (cash) basis.

## 21. SEGMENTAL INFORMATION

The principle segments have been identified on a primary basis by service operation and on a secondary basis by the classification of income and expenditure. The primary basis is representative of the internal structure for both budgeting and management purposes. The secondary basis classifies all operations based on the classifications of income and expenditure.

## 22. GRANTS-IN-AID

The municipality transfers money to individuals, organizations and other sectors of government from time to time. When making these transfers, the municipality does not:-

- Receive any goods or services directly in return, as would be expected in a purchase or sale transaction;
- Expect to be repaid in future; or
- Expect a financial return, as would be expected from an investment.

These transfers are recognized in the financial statements as expenses in the period that the events giving rise to the transfer occurred.

## **23. CONDITIONAL GRANTS AND RECEIPTS**

Income received from conditional grants, donations and funding are recognised as revenue to the extent that the municipality has complied with any of the criteria, conditions or obligations embodied in the agreement. To the extent that the criteria, conditions or obligations have not been met a liability is recognised.

Interest earned on investments is treated in accordance with grant conditions. If it is payable to the funder it is recorded as part of the creditor and if it is the municipality's interest it is recognised as interest earned in the Statement of Financial Performance.

### *23.1 Grants and Receipts of a Revenue Nature*

Income is transferred to the Statement of Financial Performance as revenue to the extent that the criteria, conditions or obligations have been met. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the municipality with no future related costs are recognised in the Statement of Financial Performance in the period in which they become receivable.

### *23.2 Grants and Receipts of a Capital Nature*

Income from Government Grants whose primary condition is that the municipality should purchase, construct or otherwise acquire non-current assets are recognised as Government Grants and Subsidies under non-current liabilities in the Statement of Financial Position to the extent that the criteria, conditions or obligations have been met and is credited to the Statement of Financial Performance on a straight-line basis over the expected useful lives of the related asset.

## **24. UNAUTHORISED EXPENDITURE**

Unauthorised expenditure is expenditure that has not been budgeted for, expenditure that is not in terms of the conditions of an allocation received from another sphere of government, municipality or organ of state and expenditure in the form of a grant that is not permitted in terms of the Municipal Finance Management Act (Act No. 56 of 2003). Unauthorised expenditure is accounted for as an expense in the Statement of Financial Performance and where recovered, it is subsequently accounted for as revenue in the Statement of Financial Performance.

## **25. IRREGULAR EXPENDITURE**

Irregular expenditure is expenditure that is contrary to the Municipal Finance Management Act (Act No. 56 of 2003), the Municipal Systems Act (Act No. 32 of 2000), the Public Office Bearers Act (Act No. 20 of 1998) or is in contravention of the Municipality's Supply Chain Management Policy. Irregular expenditure excludes unauthorised expenditure. Irregular expenditure is accounted for as expenditure in the Statement of Financial Performance and where recovered, it is subsequently accounted for as revenue in the Statement of Financial Performance.

## **26. FRUITLESS AND WASTEFUL EXPENDITURE**

Fruitless and wasteful expenditure is expenditure that was made in vain and would have been avoided had reasonable care been exercised. Fruitless and wasteful expenditure is accounted for as expenditure in the Statement of Financial Performance and where recovered, it is subsequently accounted for as revenue in the Statement of Financial Performance.

## **27. FOREIGN CURRENCIES**

Transactions in foreign currencies are initially recorded at the prevailing exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in such foreign currencies are retranslated at the rates prevailing at the reporting date. Exchange differences are included in the statement of Financial Performance.

## **28. CHANGES IN ACCOUNTING POLICIES, ESTIMATES AND ERRORS**

Changes in Accounting Policies that are effected by management are applied retrospectively unless it is impracticable as set out in GRAP 3.

Changes in Accounting Estimates are applied prospectively in accordance with GRAP 3 requirements. Details of changes in estimates are disclosed in the Notes to the Annual Financial Statements where applicable.

Correction of Errors is applied retrospectively in the period in which the error has occurred in accordance with GRAP 3 requirements, except to the extent that it is impracticable to determine the period-specific effects or the cumulative effect of the error. In such cases the municipality shall restate the opening balances of assets, liabilities and net assets for the earliest period for which retrospective restatement is practicable.

## **29. RELATED PARTIES**

Individuals as well as their close family members, and/or entities are related parties if one party has the ability, directly or indirectly, to control or jointly control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Key management personnel is defined as the Municipal Manager, Chief Financial Officer and all other managers reporting directly to the Municipal Manager or as designated by the Municipal Manager.

## **30. EVENTS AFTER THE REPORTING DATE**

Events after the reporting date that are classified as adjusting events have been accounted for in the Annual Financial Statements. The events after the reporting date that are classified as non-adjusting events after the reporting date have been disclosed in the notes to the Annual Financial Statements.

## **31. COMPARATIVE INFORMATION**

### *31.1 Current year comparatives*

Budgeted amounts have been included in the Annual Financial Statements for the current financial year only.

### *31.2 Prior year comparatives*

When the presentation or classification of items in the Annual Financial Statements is amended, prior period comparative amounts are reclassified. The nature and reasons for the reclassification are disclosed.