treasury
Department
Treasury
PROVINCE OF KWAZULU-NATAL

145 Chief Albert Luthuli Street
8th Floor, Treasury House
Private Bag X9082
Pietermaritzburg 3200
Tel: 033 897 4200 - Fax: 033 342 4662

OFFICE OF THE HEAD OF DEPARTMENT

Our Ref:	Re-Demarcation
Enquiries:	Mr F. Cassimjee
Date:	9 June 2016

TO: MUNICIPAL MANAGERS
CHIEF FINANCIAL OFFICERS

KWAZULU NATAL MUNICIPALITES AFFECTED BY THE RE-DETERMINATION OF BOUNDARIES

PROVINCIAL TREASURY CIRCULAR TC-RM 8 OF 2015/16

ACCOUNTING REQUIREMENTS AND PREPARATION OF ANNUAL FINANCIAL STATEMENTS FOR MUNICIPALITIES AFFECTED BY THE RE-DETERMINATION OF BOUNDARIES IN TERMS OF SECTION 21 OF THE LOCAL GOVERNMENT: MUNICIPAL DEMARCATION ACT, 1998 (ACT NO. 27 OF 1998)

The Member of the KwaZulu-Natal Executive Council (MEC) responsible for Local Government promulgated Government Gazette No. 1594, Notice in terms of Section 14(5) of the Local Government: Municipal Structures Act, 1998, Transitional Measures to facilitate Integrated Development Planning, Approval of Budgets, Preparation of Financial Statements, Levying of Rates and Acting Appointments in Municipalities affected by the Re-determination of Boundaries in terms of Section 21 of the Local Government: Municipal Demarcation Act, 1998 (Act No. 27 of 1998), on 24 December 2015.

In terms of this Notice, new municipalities will be established and the former municipalities will be disestablished with effect from the date of the municipal elections.

In accordance with the delegated functions of Provincial Treasury, Provincial Treasury is required to monitor and assess compliance by municipalities and municipal entities with any applicable Standards of Generally Recognised Accounting Practice (GRAP).

Provincial Treasury hereby issues Provincial Treasury Circular TC-RM 8 of 2015/16 to provide further guidance to assist municipalities affected by the re-determination of boundaries in accounting and preparation of the financial statements in accordance with the Standards of Generally Recognised Accounting Practice.

This Circular does not replace any GRAP Standard which municipalities are required to apply, and municipalities are still required to refer to these Standards directly to determine compliance requirements, together with the National Treasury Accounting Guidelines for each Standard. However, this Circular aims at providing additional guidance to the current accounting standard requirements and addresses significant matters to assist municipalities in accounting for the re-determination of boundaries.

This Circular, in summary, provides an overview of the following:

1. Application of the Standards of GRAP 105, 106 and 107
2. Establishing a Binding Agreement
3. Annual Financial Statements Process – 2015/16 Financial Year
4. Annual Financial Statements Process – 2016/17 Financial Year
5. Implementation of mSCOA for Re-Demarcated Municipalities

1. APPLICATION OF THE STANDARDS OF GRAP 105, 106 AND 107

1.1 The following relevant GRAP standards are effective from 1 April 2015 and are therefore applicable from 1 July 2015 for municipalities and municipal entities:

- GRAP 105 - Transfer of Functions between Entities under Common Control
- GRAP 106 - Transfer of Functions between Entities not under Common Control
- GRAP 107 – Mergers

1.2 In order for municipalities and their entities to identify the GRAP standard applicable to the re-determination of boundaries, it is important to understand the definition of common control.

Definition of common control (GRAP 105.10 and GRAP 106.11):

1.3 For a transaction or event to occur between entities under common control, the same transaction or event needs to be undertaken between entities within the same sphere of government or between entities that are part of the same economic entity.

1.4 Entities that are ultimately controlled by the same entity before and after the transfer of functions are within the same economic entity.

1.5 The accounting guideline issued by National Treasury on GRAP 105 and GRAP 106 specifically indicates that despite all municipalities being within the same sphere of government, each municipality is independently responsible for own election and establishment of Municipal Council. Hence, such municipalities are **not under the same control** as they are different economic entities.

1.6 In light of the above, it is therefore determined that **GRAP 106** is applicable in instances of a transfer of functions between municipalities.

GRAP 106 – Transfer of functions between entities not under common control

1.7 GRAP 106 is applicable to municipalities that are to be disestablished and the existing municipalities incorporating the following areas of jurisdiction:

- Ntambanana Municipality, which will be split between uMfolozi, uMhlatuze and Mthonjaneni Municipalities; and
- Vulamehlo Municipality, which will be split between eThekwini and Umdoni Municipalities.

1.8 For each transfer of functions between entities not under common control, **an acquirer and acquiree shall be identified.**

1.9 An acquirer is an entity that obtains control of the acquiree or transferor.

1.10 In the case of Vulamehlo Municipality's transfer of functions, Ethekwini and Umdoni are the acquirers and Vulamehlo is the acquiree or transferor.

1.11 With regard to Ntambanana Municipality's transfer of functions, uMfolozi, uMhlatuze and Mthonjaneni are the acquirers and Ntambanana is the acquiree or transferor.

1.12 The terms and conditions for a transfer of functions are determined in a **binding arrangement** e.g. written agreement, legislation, notice, Council resolution etc.

1.13 This therefore implies that the Municipalities affected by the Transfer of Functions must enter into a written agreement to clarify the terms and conditions for the transfer of functions.

1.14 The acquirer shall identify the effective date, which is the date on which the acquirer obtains control over the acquiree.

1.15 The binding arrangement, as indicated in 1.12 above, shall specify the effective date.

1.16 The effective date in the binding agreement can be subsequent to the legislated date. In other words, the municipal elections can take place on 3 August 2016, but the effective date for the transfer of functions may be later than 3 August 2016.

1.17 The assets and liabilities that qualify for recognition by the acquirer and derecognition by the transferor are normally governed by the terms and conditions of the binding arrangement.

1.18 **Pre-existing relationships** between the entities must be identified and accounted for separately in terms of the relevant Standard of GRAP and <u>not</u> in accordance with the transfer of functions.

What is a pre-existing relationship?

Municipality A is to be disestablished on 3 August 2016 and its functions are to be transferred to Municipality B. As at 30 June 2016, Municipality A owes Municipality B an amount of R 50,000 for catering arrangements made during the prior year's budget roadshows for the District.

As the debt between the municipalities arises prior to the transfer of functions, it is considered to be a pre-existing relationship.

1.19 Should the debt related to the pre-existing relationship still be outstanding on the effective date that the transfer of functions takes place, the transfer of functions will result in the settlement of the debt.

1.20 Where transfer of functions results in a settlement of debt from a pre-existing relationship, the acquirer would need to account for the following:

a) Identify if the pre-existing relationship is contractual or non-contractual;

What is a pre-existing *contractual* relationship?

A pre-existing contractual relationship is where the debt arises where a vendor and customer or vendor and supplier relationship exists (debt arises in terms of a contract in place) e.g. the provision of electricity services from Municipality A to Municipality B.

What is a pre-existing *non-contractual* relationship?

A pre-existing non-contractual relationship occurs where there is no binding agreement e.g. Municipality A has a legal dispute with Municipality B which is under consideration by the court.

b) Recognise a gain or loss measured as follows for a pre-existing relationship should a ***contractual relationship*** exist at the **lesser** of:

- amount by which the binding arrangement is favourable/unfavourable from the perspective of the acquirer when compared with current market transactions for the same or similar items, **and**
- amount of any stated settlement provisions in the binding arrangement available to the counterparty to whom the contract is unfavourable.

If the latter is less than the former, the difference should be included as part of the transfer of functions accounting.

c) For a pre-existing ***non-contractual relationship*** the gain or loss should be measured at **fair value**.

Example: Measuring the settlement of pre-existing contractual relationship

Entity A, the acquirer, leases an office building from Entity B, the acquiree (municipality that is to be disestablished).

If the contract terms are unfavourable by R2 million when compared to current market transactions, then a R2 million loss should be recognised on transfer date by the acquirer.

However, if the contract includes a provision for the acquirer to settle the contract by making a payment of R1,2 million, then the loss will be recognised at this lesser amount.

The difference between R2 million and R1,2 million is included as part of the transfer of functions accounting.

Example: Measuring the settlement of pre-existing non-contractual relationship

Municipality A (acquirer) is a defendant in a lawsuit brought about by the acquiree/transferor. At the date of transfer, the fair value of the settlement of the lawsuit is R2 million.

If the acquirer recognised a provision of R1,5 million, then the loss recognised would be R2 million – R 1,5 million = R 500 000 (in the books of the acquirer).

This would be recorded as a separate transaction from the transfer of functions.

1.21 Due to the complexities in accounting for pre-existing relationships on the effective date, municipalities are encouraged to settle such pre-existing relationships prior to date for the transfer of functions.

1.22 **On the date of the transfer of functions**, as determined in terms of binding agreement (effective date), the **acquirer** shall **recognise the purchase consideration given, if any, to the transferor and all the assets acquired and liabilities assumed.**

1.23 The purchase consideration given by the acquirer includes cash, cash equivalents and/or other assets.

1.24 The assets acquired and liabilities assumed by the acquirer must be measured at fair value at transaction date. Further, contingent liabilities must be recognized only where a present obligation exists at fair value.

1.25 Exceptions to this principle are reacquired rights, indemnification assets and employee benefits, which must be recognized in accordance with the relevant respective GRAP standards.

1.26 As at the transfer date, the acquiree shall derecognise all assets transferred and liabilities relinquished in a transfer of functions at carrying amounts.

1.27 The difference between the fair values of the assets acquired, liabilities assumed and the consideration paid (if applicable) and any adjustments required to the basis of accounting shall be recognised in surplus or deficit by the acquirer.

1.28 Expenses such as relocation costs are accounted for separately from the transfer of functions, after such functions have been transferred, by the acquirer. These costs must not be accounted for in the transfer of functions journals.

1.29 Acquirees are required to note that all applicable GRAP standards shall be applied in preparation of the annual financial statements until the transfer date.

1.30 Acquirees shall further recognise the difference between the carrying amounts of the assets acquired, liabilities assumed and the consideration paid, if applicable, in surplus or deficit.

Example: Accounting journals to record assets acquired and liabilities assumed on the transfer date (effective date)

Municipality A's functions is being transferred to Municipality B and Municipality C. The binding agreement indicates the assets and liabilities at the carrying values shall be transferred to Municipality B for NIL consideration:

The **carrying values** as per Municipality A records on transfer date are as follows:

Account	Debit (R)	Credit (R)
Property, plant and Equipment	200 000	
Trade receivables	75 000	
Cash and cash equivalents	45 000	
Trade Payables		250 000
Accumulated Surplus		70 000

The **fair values** of Municipality A assets and liabilities on transfer date are as follows:

Account	Debit (R)	Credit (R)
Property, plant and Equipment	300 000	
Trade receivables	125 000	
Cash and cash equivalents	45 000	
Trade Payables		250 000

The journal to be recognised in the **Acquirer's books** (Municipality B) at **FAIR VALUE**:

Account	Debit (R)	Credit (R)
DR: Property, plant and Equipment	300 000	
DR: Trade receivables	125 000	
DR: Cash and cash equivalents	45 000	
CR: Trade Payables		250 000
CR: Gain from transfer of functions (P/L)		220 000

The journal to be recognised in the **Acquiree's books** (Municipality A) at **CARRYING VALUE:**

Account	Debit (R)	Credit (R)
Dr Trade payables	250 000	
Dr Loss from transfer of functions (P/L)	70 000	
Cr Property, plant and Equipment		200 000
Cr Trade receivables		75 000
Cr Cash and cash equivalents		45 000

Operating leases:

1.31 There may be instances where the acquiree/transferor has entered into an operating lease agreement, for which the acquirer must then take over for the remaining lease period.

1.32 In such cases, an acquirer shall recognise no assets or liabilities relating to an operating lease except for the following:

- An acquirer must determine whether the terms of each operating lease entered into by the acquiree is favourable or unfavourable;
- An operating lease will be considered favourable if the lease value is lesser than market terms, and hence the acquirer must recognize an intangible asset;
- An operating lease is considered to be unfavourable where the lease value is greater than market terms, and the acquirer shall then recognize a liability.

Example: Operating lease value is equal to market terms

An acquiree enters into a lease agreement for a building at a monthly lease payment of R 10 000. The market-related monthly lease payment for a similar property is also R 10 000 per month.

The terms are neither favourable or un favourable and as a result, no intangible asset or liability is recognised.

Example: Operating lease value is favourable

An acquiree (transferor) has entered into a lease agreement, with remaining term of 4 years on transfer date and lease rentals of R 120 000 per annum. A market related lease rental for a similar lease is R 140 000 per annum. The current market-related interest rate is 8% per annum.

The lease is considered to be favourable, as the lease rental is less than the market rate, and the municipality is required to record an intangible asset and amortise over remaining lease term.

The municipality would need to calculate the present value (PV) of the favourable amount on date of transfer of functions. The calculation on a financial calculator would be:
PMT = 140 000 – 120 000 = 20 000; i = 8% (market-related interest rate); n = 4 remaining years
COMP PV = R 66,243

The accounting journals to recognise the favourable operating lease through transfer of functions are as follows on the effective date:

Account	Debit (R)	Credit (R)
Dr Intangible asset – operating lease (SFP)	66 243.00	
Cr Gain from transfer of functions (Profit/Loss)		66 243.00

Subsequent to the recognition of an intangible asset on transfer date, the municipality must then amortise the intangible asset over the remaining lease term (R66243/4 years):

Dr Amortisation of operating lease (Profit/Loss)	16,560.75	
Cr Intangible asset – operating lease (SFP)		16,560.75

Example: Operating lease value is unfavourable

The acquiree (transferor) enters into a lease agreement for a building at a monthly lease payment of R 10 000. The remaining lease term is 5 years on the effective date for the transfer of functions. The market related lease rental for a similar property is R 8 000 per month. The current market-related interest rate is 5% per annum.

Due to the monthly lease amount being more than the current market rate, the operating lease is considered to be unfavourable, and the municipality must record a financial liability.

The municipality is required to calculate a present value (PV) of the unfavorable amount on the effective date as follows:
PMT (monthly unfavourable amount) = (10 000 – 8000 = 2 000); i = 5%/12 = 0,417% (market discount rate); n = 5 x 12 = 60; COMP PV = R 105,981.

The accounting journals to recognise the unfavourable operating lease liability through transfer of functions on the effective date:

Account	Debit (R)	Credit (R)
Dr Loss on transfer of functions (P/L)	105 981	
Cr Operating lease liability (SFP)		105 981

Subsequent to the recognition of an operating lease liability on transfer date, the municipality must then recognize the monthly operating lease payments:

Dr Operating lease expense (P/L)	10 000	
Cr Bank		10 000
Dr Operating lease liability (105 981/60)	1 766	
Cr Operating lease expense (P/L)		1 766

Provisional amounts and subsequent measurement:

1.33 Should the initial accounting be incomplete by the end of the reporting period in which the transfer occurs, the acquirer shall report in the financial statements provisional amounts for the items for which the accounting is incomplete.

1.34 The measurement period ends as soon as the acquirer receives the information that it was seeking about facts and circumstances that existed as of the acquisition date. However, the measurement period shall not exceed two years from the acquisition date.

1.35 Municipalities shall retrospectively adjust, i.e. restatement of comparative amounts, the provisional amounts recognised at transfer date to reflect new information obtained about facts and circumstances that existed on acquisition date which affects the measurement.

1.36 Once the measurement period has lapsed, the acquirer shall revise the accounting for a transfer of functions only to correct an error in accordance with the Standard of GRAP – Accounting Policies, Changes in Accounting Estimates and Errors.

1.37 Acquisition related costs incurred by the acquirer to effect the transfer of functions such as advisory, legal, accounting and other related costs must be expensed.

1.38 Any subsequent measurement of assets acquired and liabilities assumed shall be accounted for in terms of the relevant Standard of GRAP.

Disclosure in the Annual Financial Statements – **Acquirer and Acquiree:**

1.39 Disclosure should be made of information relevant to evaluate the nature and financial effect of the transfer of functions that occurs either:

- during the reporting period, or
- after the end of the reporting period but prior to the financial statements are authorised for issue.

1.40 As elections are taking place subsequent to 30 June 2016, only the disclosure requirements must be included in 2015/16 Financial Statements and the accounting for the transfer of functions is undertaken in the 2016/17 Financial Statements.

1.41 The disclosure requirements for the above mentioned scenarios are indicated in paragraphs .90 to .96 of Standard of GRAP 106.

GRAP 107 – Mergers

1.42 A merger is the establishment of a new combined entity in which none of the former entities obtains control over any other municipality and no acquirer can be identified.

1.43 GRAP 107 is therefore applicable to current municipalities (combining municipalities) that are to be disestablished and the new (combined) municipality being formed:

- Ezinqoleni and Hibiscus Coast Municipalities
- KwaSani and Ingwe Municipalities
- Imbabazane and Umtshezi Municipalities
- Indaka and Emnambithi Municipalities
- Big Five and Hlabisa Municipalities

1.44 For each merger, the combining entities and combined entity, being the new entity formed, shall be identified.

1.45 The terms and conditions of a merger shall be determined in terms of a binding agreement, such as a memorandum of agreement, legislation, etc.

1.46 The combined entity and the combining entities shall identify the effective date for the merger, which is the date that the combined entity obtains control of assets and liabilities and combining entities loses control of their assets and liabilities as per the binding agreement.

1.47 The date in the binding agreement may be later than the legislated date.

1.48 The assets and liabilities that qualify for recognition by the combined municipality and derecognition by the former/combining municipalities are normally governed by the terms and conditions of the binding arrangement.

1.49 As at effective date, the combined municipality shall recognise all the assets acquired and liabilities assumed, measured at carrying amounts.

1.50 The above mentioned indicates that municipalities are not required to fair value any assets or liabilities on the effective date.

1.51 The Standard acknowledges instances where the initial accounting in the former/combining municipalities may not be in accordance with the relevant Standards of GRAP.

1.52 In those instances, combined municipalities shall adjust, before the merger, the basis of accounting for the carrying amounts of assets or liabilities to comply with the Standards of GRAP.

1.53 The combined municipality shall record the difference between carrying amounts of assets acquired, liabilities assumed and any adjustments required to the basis of accounting, which shall be recognised to accumulated surplus or deficit.

Example: Accounting for the merger of municipalities – Combined Municipality

Municipality A and B are being combined into Municipality C. The carrying amounts of Municipality A and B assets and liabilities on the date of the merge (effective date) are as follows:

Account	Municipality A	Municipality B
Property, plant and Equipment	200 000	450 000
Inventory	15 000	10 000
Debtors	35 000	33 000
Creditors	(40 000)	0

The journal to account for the combined transaction in Municipality's C accounting records:

Account	Debit (R)	Credit (R)
Dr Property, plant and Equipment (200 000+450 000)	650 000	
Dr Inventory (15 000+10 000)	25 000	
Dr Debtors (35 000+33 000)	68 000	
Cr Creditors (40 000+0)		40 000
Accumulated Surplus (Gain from merger)		703 000

1.54 As at the transfer date, the combining/former municipalities shall transfer and derecognise all assets and liabilities at carrying amounts.

1.55 The former municipalities must apply the applicable standards of GRAP until the merger date.

1.56 The former municipalities shall recognise the difference between the carrying amounts of the assets transferred, and liabilities derecognised in Accumulated Surplus or Deficit.

Example: Accounting for the merger of municipalities – Combining/former municipalities

Municipality A and B are being combined into Municipality C. The carrying amounts of Municipality A and B assets and liabilities on the date of the merge (effective date) are as follows:

Account	Municipality A	Municipality B
Property, plant and Equipment	200 000	450 000
Inventory	15 000	10 000
Debtors	35 000	33 000
Creditors	(40 000)	0

The journal to account for the combined transaction in Municipality's A accounting records:

Account	Debit (R)	Credit (R)
Dr Creditors	40 000	
Dr Accumulated Surplus (loss on merger)	210 000	
Cr Property Plant and Equipment		200 000
Cr Inventory		15 000
Cr Debtors		35 000

Provisional amounts:

1.57 Should the initial accounting be incomplete by the end of the reporting period in which the merger occurs, the acquirer shall report in the financial statements provisional amounts for the items for which the accounting is incomplete.

1.58 Measurement period ends as soon as the combined entity receives the information that it was seeking about facts and circumstances that existed as of the merger date or learns that more information is not obtainable. However, the measurement period shall not exceed two years from the merger date.

1.59 Municipalities shall retrospectively adjust the provisional amounts recognised at merger date to reflect new information obtained about facts and circumstances that existed at the merger date which affects the measurement.

1.60 Once the measurement period has lapsed, the combined municipality shall revise the accounting for a merger only to correct an error in accordance with the Standard of GRAP – Accounting Policies, Changes in Accounting Estimates and Errors.

1.61 Acquisition related costs incurred by the combined entity to effect the transfer of functions such as advisory, legal, accounting and other related costs must be expensed.

1.62 Any subsequent measurement of assets acquired and liabilities assumed shall be accounted for in terms of the relevant Standard of GRAP. The combined municipality may need to subsequently adjust the measurement to conform with combined municipality's accounting policies.

Disclosure in the Annual Financial Statements – **Combined municipalities and Combined Municipality (new):**

1.63 The municipalities affected by the merger shall disclose information relevant to evaluate the nature and financial effect of the merger that occurs either:

- during the reporting period, or
- after the end of the reporting period but before financial statements are authorised for issue.

1.64 As elections are taking place subsequent to 30 June 2016, only disclosure requirements must be included in 2015/16 Financial Statements and accounting for the merger is undertaken in the 2016/17 Financial Statements.

1.65 Combined municipalities are further required to note that no comparative information in the first reporting period is reflected, as a new municipality is being formed.

1.66 The disclosure requirements for the above mentioned are indicated in paragraphs .40 to .47 of Standard of GRAP 107.

2. ESTABLISHING A BINDING AGREEMENT

2.1 In order to effectively manage the accounting for the re-determination of boundaries, municipalities affected by the re-determination are advised to enter into a signed binding agreement in the form of a Memorandum of Understanding (MOU) between each transfer of functions/merger of municipalities.

2.2 The MOU shall include the following minimum information:

2.2.1 In instances where a transfer of functions occurs, the MOU shall clearly identify the acquirer and the transferor;

2.2.2 For municipalities that are being merged, the names of municipalities that are being combined;

2.2.3 The effective date for the assets being acquired and liabilities assumed, which should be the date when risks and rewards are being passed to the acquirer or combined entity;

2.2.4 Detail and carrying amounts for all assets acquired and liabilities assumed for merging/combining municipalities;

2.2.5 Detail, carrying amounts and fair values for all assets acquired and liabilities assumed, and the allocation of assets and liabilities to each acquirer, in the case of a transfer of functions;

2.2.6 Details of settlement arrangements for pre-existing relationships;

2.2.7 Listing of employees with salary levels and costing, and for municipalities affected by the transfer of functions, the allocation of such employees to the respective municipalities;

2.2.8 Details of any contingent liabilities, clearly identifying between present obligations and possible obligations;

2.2.9 Details of assets or liabilities where values may not be in compliance with the Standards of GRAP; and

2.2.10 The process for preparation of the 2015/16 and 2016/17 financial statements and audit process, including the team responsible for preparation of the annual financial statements and the Accounting Officer responsibility in terms of such preparation and signoff.

3. ACCOUNTING PROCESSES: 2015/16 FINANCIAL YEAR

Municipalities affected by Transfer of Functions:

3.1 In preparation for the transfer of functions, municipalities affected by the transfer are encouraged to perform the following:

3.1.1 Determine the split of assets, liabilities, employees and Housing Operating Account between the acquirers;

3.1.2 Determine a methodology for the assessment of fair values of all assets and liabilities being transferred as this will impact on the valuation of such assets and liabilities;

3.1.3 Commence the process of determining fair values for the assets and liabilities being transferred in the 2015/16 financial year; and

3.1.4 Compare accounting policies of acquirees and determine the corrections that need to be made to ensure consistency with the acquirer's policies.

Municipalities to be Merged:

3.2 Municipalities to be merged are encouraged to perform the following in readiness for the 2016/17 merger:

3.2.1 Determine carrying amounts in compliance with the Standards of GRAP, for all assets and liabilities;

3.2.2 Compare accounting policies of the individual municipalities and determine "new" accounting policies for the combined municipality; and

3.2.3 Determine and account for any corrections that need to be made to balances based on "new" accounting policies.

All municipalities:

3.3 The following procedures are applicable to all municipalities affected by the re-determination of boundaries:

3.3.1 Conduct a 100% physical verification of all assets with supporting documentation to ensure completeness and existence of assets;

3.3.2 Validate liabilities to supporting documentation to ensure that all liabilities are accounted for and the existence of such debt;

3.3.3 Address pre-existing relationships and settle such debt prior to the transfer of functions/merge in order to reduce the complexity of accounting;

3.3.4 Reconcile and allocate financial data such as old outstanding balances, suspense accounts, amounts with no supporting documentation and incomplete balances;

3.3.5 Investigate and address outstanding irregular, unauthorised and fruitless and wasteful expenditure;

3.3.6 Prepare the required disclosure in terms of the Standards of GRAP for the transfer/merger;
3.3.7 Settle or recover any outstanding amounts with SARS;
3.3.8 Implement stringent measures to recover all Staff and Councillor debt before disestablishment; and
3.3.9 Implement measures to address audit matters and provide working papers during the audit process.

4. ACCOUNTING PROCESSES: 2016/17 FINANCIAL YEAR

Municipalities affected by Transfer of Functions:

4.1 Municipalities affected by the transfer of functions are recommended to:

4.1.1 Reconcile asset and liability accounts on a monthly/bi-weekly basis;
4.1.2 Complete the process of determining fair values for the assets and liabilities being transferred;
4.1.3 Validate the corrections that need to be made to ensure consistency with the acquirer's policies; and
4.1.4 On the date of transfer, acquirers shall account for the transfer of assets and liabilities at fair value and derecognise the assets and liabilities in the books of the acquirees at carrying values.

Municipalities to be Merged:

4.2 Municipalities whom shall be merging into a combined municipality are recommended to:

4.2.1 Reconcile asset and liability accounts on a monthly/bi-weekly basis;
4.2.2 Finalise carrying values, in compliance with GRAP, for all assets and liabilities;
4.2.3 Finalise the corrections that need to be made to balances based on "new" accounting policies; and
4.2.4 On effective date, account for the assets and liabilities of new entity at carrying value and derecognise assets and liabilities in the books of disestablished entities.

All municipalities:

4.3 The following accounting processes are applicable to all municipalities affected by the re-determination of boundaries:

4.3.1 Municipalities shall incur expenditure and collect revenue on existing budgets until the budget of the new Council is adopted, as per MFMA Circular No.79, after which all expenditure and income realised must be accounted for in terms of the newly adopted budget;
4.3.2 Council budget adoption should occur as close to the election date as possible;
4.3.3 Disestablished Municipalities should prepare Financial Statements in compliance with GRAP 106 and GRAP 107 until the date that Council adopts the new budget and the assets and liabilities are transferred or merged;
4.3.4 On transfer or merger date, document the physical handover process for movable, immovable and intangible assets, which should include the detail of assets handed;
4.3.5 Settle or recover any outstanding amounts with SARS prior to election date;

4.3.6 Implement stringent measures to recover all Staff and Councillor debt before disestablishment;

4.3.7 Consider the need to enter into cession agreements with creditors for payments of debt; and

4.3.8 Disestablished municipalities to consider the communication strategy to be implemented for all creditors and debtors to be notified of the disestablishment, and provision of new contact details, banking details etc.

5. IMPLEMENTATION OF MUNICIPAL STANDARD CHART OF ACCOUNTS (mSCOA) for RE-DEMARCATED MUNICIPALITIES

5.1 Municipalities that shall be disestablished are advised to plan for mSCOA as required by National and Provincial Treasuries.

5.2 Such municipalities are advised to compare the chart to mSCOA and break down balances according to mSCOA requirements before the transfer of functions or merging of municipalities. Supporting documentation and workings shall be prepared, maintained and handed over to the acquirer or combined municipalities.

5.3 Municipalities that are intended to be disestablished are required to engage with the acquirer and merging municipalities in assessing their current systems and identifying a mSCOA financial system as per the MFMA Circular No.80, issued by National Treasury. This assessment must form part of the decision to change or remain with the current financial system.

5.4 Acquirers and combined municipalities shall incorporate the intended disestablished municipalities into their current mSCOA steering committee meetings and operational team.

5.5 It is further recommended that existing account balances only be converted into mSCOA requirements subsequent to the take on of existing balances during the merger or transfer of functions.

Municipalities affected by the re-determination of boundaries in terms of section 21 of the Local Government: Municipal Demarcation Act, 1998 (Act no. 27 of 1998), are further requested to table this Provincial Circular to Council for noting and implementation.

Yours sincerely

MR L.S. MAGAGULA
HEAD OF DEPARTMENT

CC **MEC FOR FINANCE –KZN**
MAYORS OF MUNICIPALITIES
JAN HATTINGH, NATIONAL TREASURY
TV PILLAY, NATIONAL TREASURY
VANUJA MAHARAJ, BUSINESS EXECUTIVE – KZN AUDITOR GENERAL
THANDO TUBANE, ACTING HEAD OF DEPARTMENT, KZN COGTA