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Department:
Treasury
PROVINCE OF KWAZULU-NATAL

PROVINCIAL FINANCIAL MANAGEMENT & mSCOA FORUM
FAQ: asset related accounting standards and requirements

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GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Capitalisation Threshold

- Municipalities may expense items of property, plant and equipment with a cost price below a capitalisation threshold
- GRAP 17 requires assets to be capitalised if the asset meets the definition irrespective of the cost price of the asset
- Applying a capitalisation threshold is an internal policy of the municipality – should not appear in the accounting policies to the AFS (GRAP non compliance)
- GRAP takes precedence over any internal policy of a municipality
- Municipality must maintain record of all assets expensed – effect on cost and depreciation could become material over time
- Consider materiality for individual items as well as in aggregate (current year expenses as well as cumulative)
- Example: One laptop below R 5000 that has been expensed is not material, but 100 laptops below R 5000 that has been expensed may become material
- If material – could impact on audit opinion.

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Separation of assets into significant parts

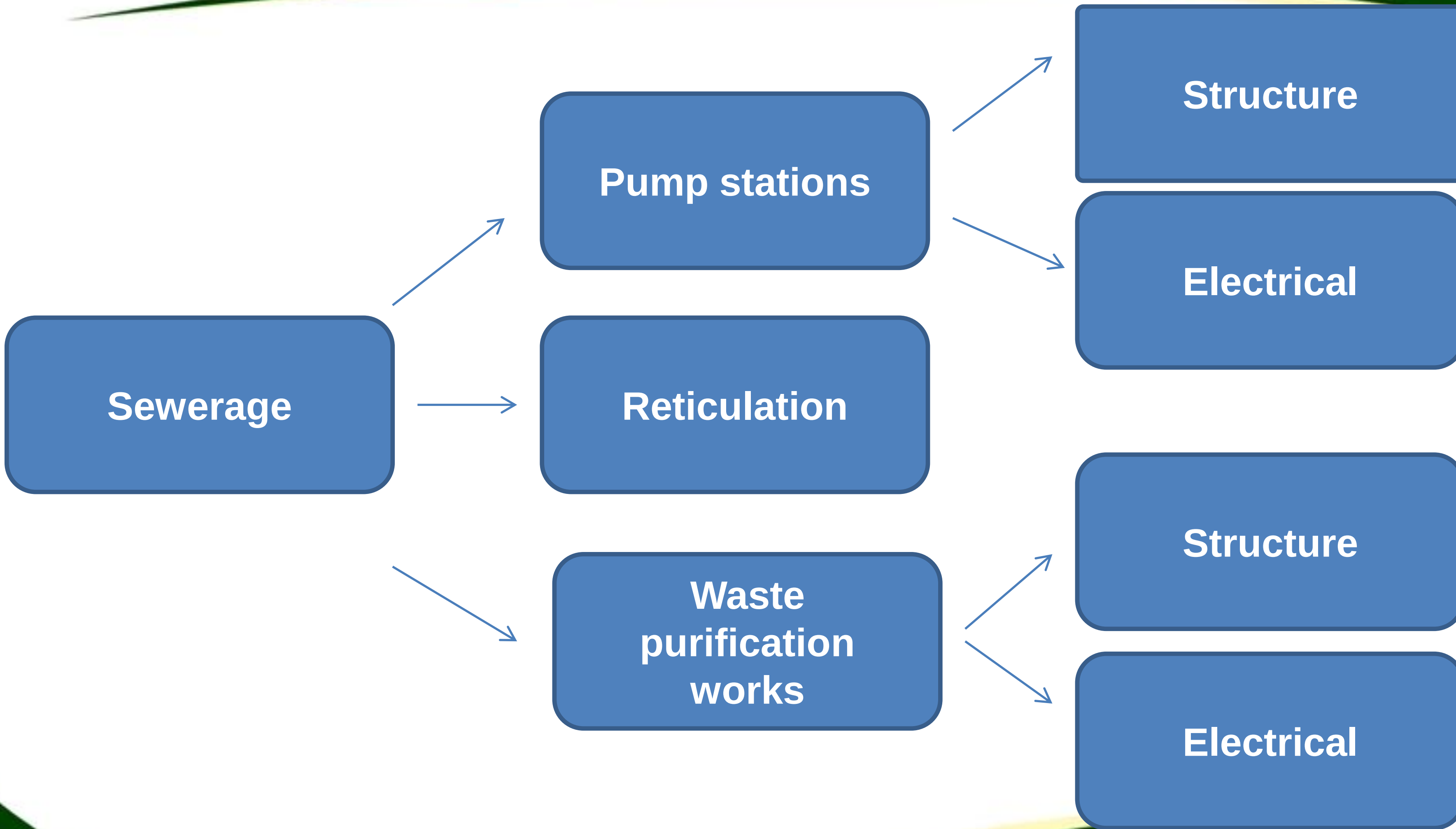
- Parts of an asset must be separately identified and depreciated if:
  - The part identifiable has a cost that is **significant** in relation to the total cost of the item; and
  - The part has a different useful life than that of the item, or other parts.

- Facilitates accurate depreciation and derecognition of components when replaced.
- The level of identification of parts or components should be documented in municipal asset management policy and applied consistently for all assets.

- Example: A municipality has acquired a building for R 6 million which includes 5 air conditioners and an elevator.

- Break down in separate parts: Airconditioners, elevator, building itself, parking, fencing etc.
- Need to determine the value of each of the components/parts by reviewing actual cost documentation or fair value (which is then applied as deemed cost)
- Determine useful life for each part, as well as residual value.

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Separation of assets into significant parts



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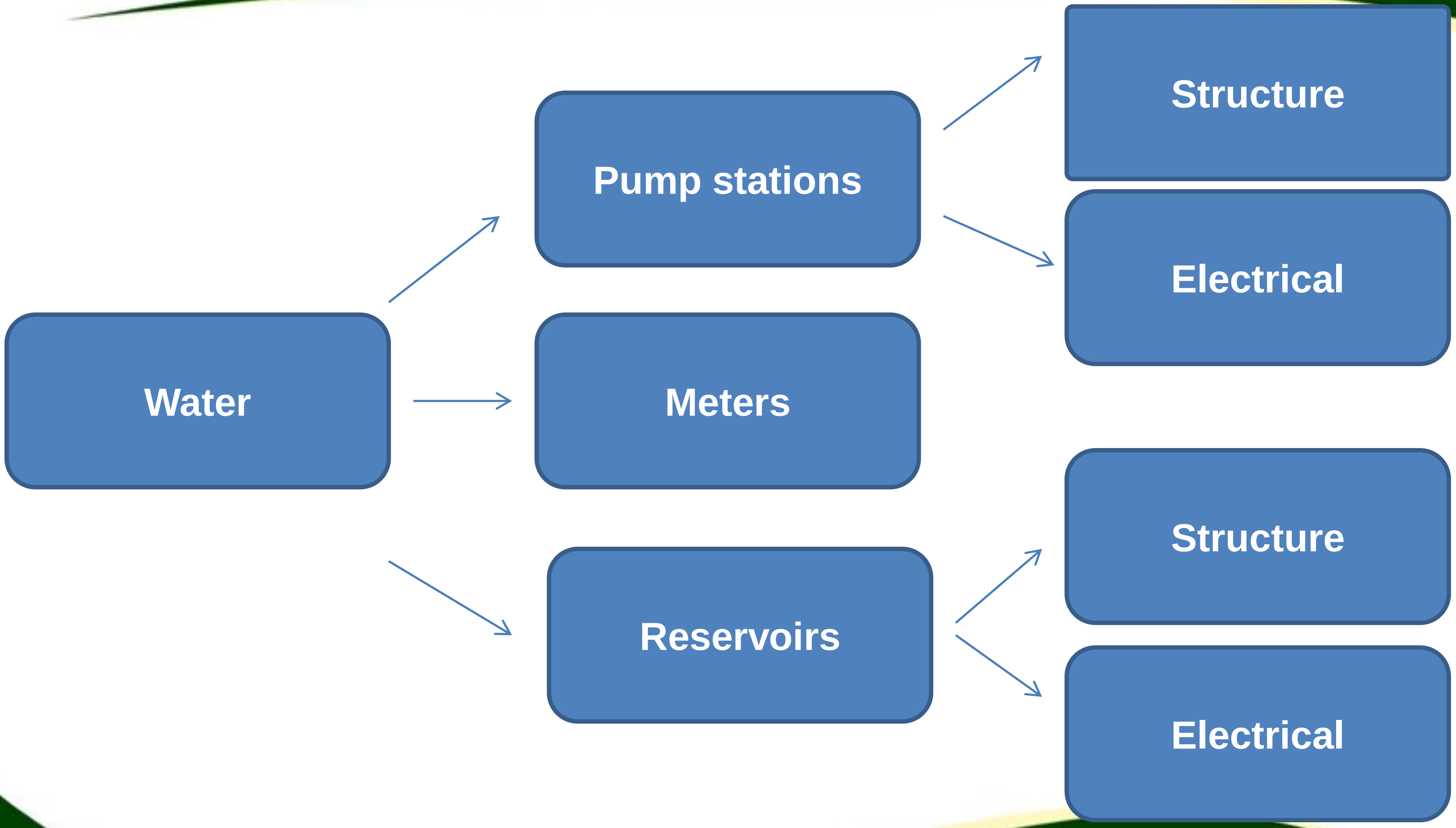

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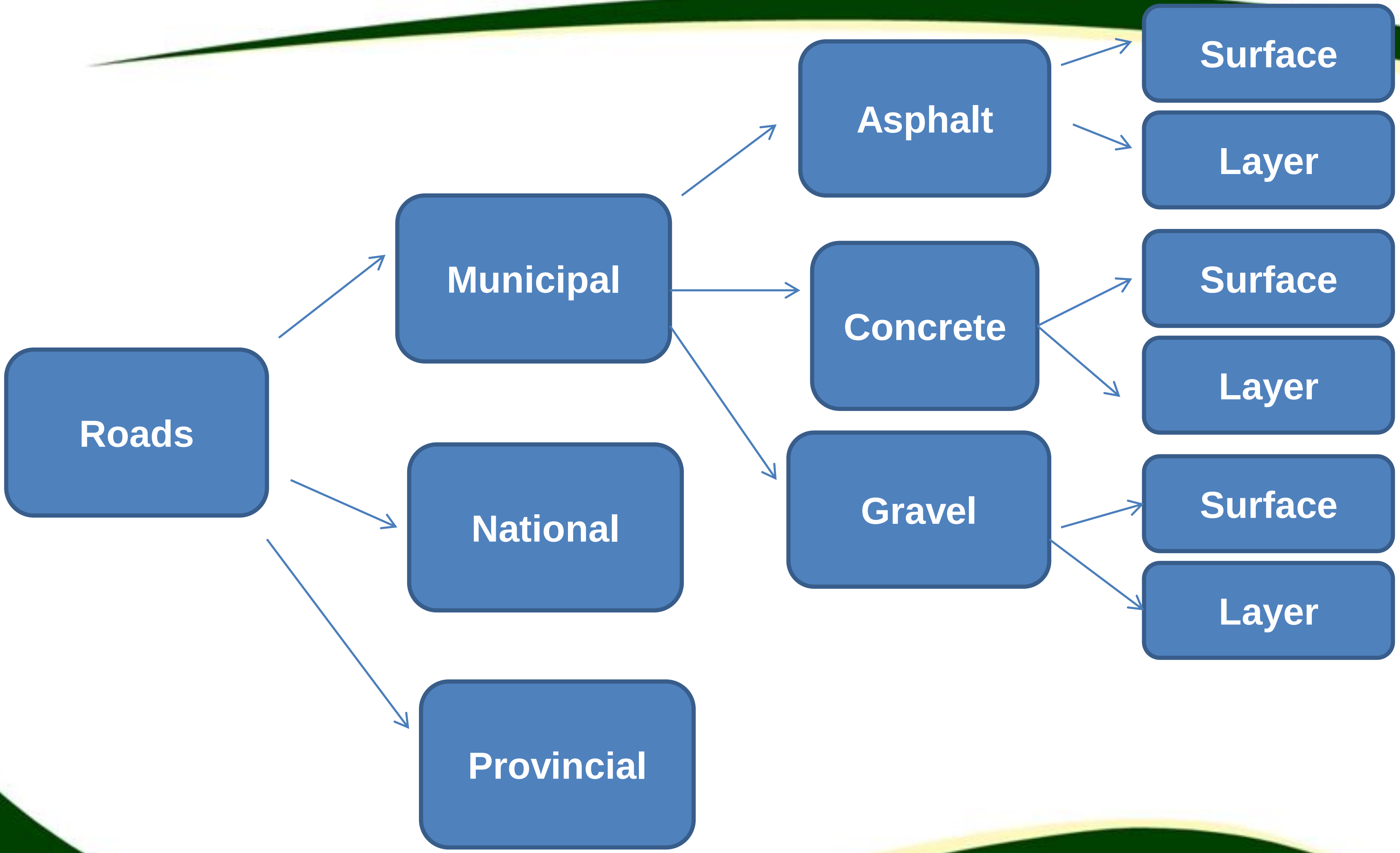

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Determining fair value (deemed cost)

- Municipalities may identify assets that are not recorded on the fixed asset register or may receive assets via donation or transfer to the municipality.

- The fair value can be determined by applying any one of three methods:
  - Reference to quoted prices in an active and liquid market;
  - Where market values are not available, estimates can be made with reference to market value if assets with similar characteristics, in similar circumstances and location, or with reference to recent arms length transactions concluded for similar assets; OR
  - For specialised assets and market value is not available, the replacement cost or reproduction cost of the asset may be determined.

- Depreciated replacement cost = current replacement/reproduction cost of the asset, less accumulated depreciation

- Replacement cost – cost of replacing the service potential of the asset
- Reproduction cost – cost of creating an exact replica of the asset

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Fully depreciated assets still in use

- If an entity made an appropriate estimate of useful lives, residual values and depreciation method of an asset based on information available at previous reporting dates, an entity may continue to measure the assets **at nil value**. Assets **must not be significant** to the operation and service delivery objectives of the entity.

- Disclose the fact that such assets have been fully depreciated and still in use.

- The above mentioned guidance is applicable to assets that are scheduled to be replaced in accordance with the municipal policy but due to budget constraints, the entity was unable to replace the assets.

- Where the entity did not appropriately review the useful life, residual value and depreciation method, and the asset is fully depreciated, but still being used, this constitutes a **prior period error**.

- Correct the error **retrospectively** (restatement to the AFS as if the error has never occurred)

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Repairs and Maintenance vs Improvements

- The cost of day to day servicing i.e. Repairs and maintenance is expensed
- Improvements can be capitalised if they meet the recognition criteria

- If there is uncertainty as to whether the costs incurred relating to an asset should be expensed or capitalised, consider the following:
- Does the cost incurred satisfy the recognition criteria?
- Will the cost enhance the service provision of the asset beyond its original expectation?
- Will the cost increase the performance of the asset beyond its original performance?
- Will the cost increase the useful life beyond its original life?
- Is the cost incurred **not** primarily for labour, consumables or small parts?
- Is the cost incurred to increase the size of the asset or change its shape?
- Is the cost incurred to replace a significant part of the asset?

- If the answer is yes to one or more, the cost should be capitalised.

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Accounting for library books

- Consider whether the municipality controls the library books of whether it is under the control of another party.

- To assess control, consider:
  - Whether the economic benefit or service potential will flow to the municipality;
  - Whether the municipality is responsible for replacing the books;
  - Whether the municipality can restrict access and use of libraries by third parties;
  - Whether the municipality has the right to dispose of the library books;
  - Legislation;
  - Binding arrangements, e.g. Library books may be donated to the municipality for a specified period.

- If under the control of the municipality, the municipality must consider the nature and use of the library books to formulate the appropriate accounting treatment regarding library books.

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Accounting for library books

- Could account for library books as property, plant and equipment, expenses or heritage assets
- Library books held to provide a service to the community and may be used for more than one reporting period – classify as Property, plant and equipment
- Appropriate to aggregate the value of library books and capitalise the aggregate value.
- Municipality does not expect that the use of library books will exceed current reporting period – recognise as expense
- If the library books meet the definition of heritage assets (scarce books) – account as heritage assets.
- Municipality can have all three classes of library books.

GRAP 17 – PROPERTY, PLANT AND EQUIPMENT
Directive 11 – Change in Measurement basis

- Directive 11 – changes in measurement basis allows an entity, that has initially adopted the fair value model for investment property or revaluation model for property, plant and equipment, intangible assets or heritage assets to change its accounting policy **once-off** to the cost model in terms of the accounting policy of the municipality

- Accounted for as a change in accounting policy – GRAP 3

- Effective from 1 April 2015, but a municipality can early adopt/apply this directive

- Directive 11 can only be applied with a period of three years following the expiry of transitional provisions applied on initial adoption of Standards of GRAP or the effective date of Directive 11, whichever is later.

GRAP 31 – INTANGIBLE ASSETS
Classification: Computer Software

- Computer Software may be classified as tangible asset (Property, Plant and Equipment) or intangible asset

- Hardware cannot operate without the software (integral part of the related hardware) – Software will be treated as PPE and capitalised to hardware costs (computer equipment) e.g. Laptop cannot operate without Microsoft Windows

- Hardware can operate without the hardware – determine whether it meet the definition and recognition principle of intangible asset – and if so, capitalise e.g. Microsoft Office, Accounting Software Packages, Pastel, e-Venus etc

- Licence fees may be expensed when the following conditions are met:
  - The licence fee is for a period of one year of less; AND
  - The one year or less period falls exactly within the financial year period of the entity i.e. Does not overlap into the next financial year

GRAP 31 – INTANGIBLE ASSETS
Classification: Website Costs

- Website must demonstrate probable future economic benefit/service potential to capitalise the website as intangible asset – income must be directly connected to the website, e.g. Consumers can pay accounts using the website facilities

- If unable to demonstrate future economic benefit, expense all costs.

- If website is solely intended to promote products/services – difficult to prove future economic benefit, hence expense.

- Website meets the recognition criteria of intangible asset - only recognise cost from actual commencement of development such as registration cost for the domain etc.

- Costs related to planning (feasibility study establishing user specifications etc) – must expense.

GRAP 31 – INTANGIBLE ASSETS
Classification: Software upgrades

- Determine if upgrade is likely to **maintain** the expected future economic benefit/service potential OR meets the definition of an intangible asset by **increasing** the capacity, efficiency or extending the useful life

- If the nature of the upgrade is such that the existing software is replaced, the replaced asset should be derecognised and the cost of the replacement software (upgrade) should be recognised.

- Updates and minor upgrades included in maintenance subscription should be expensed.

- Example: Entity purchases accounting software version 5, which includes monthly maintenance fee and minor upgrades at no additional cost - recognise software cost for version 5 as intangible asset, expense maintenance cost.

GRAP 31 – INTANGIBLE ASSETS
Classification: Valuation Roll

- Entity has legal right by statute to levy rates – thus legislation and not the valuation roll provides the municipality with the right to levy rates.

- Hence, valuation roll does not generate economic benefit/service potential

- Valuation roll costs should be expensed.

GRAP 31 – INTANGIBLE ASSETS
Classification: Servitudes

- Servitudes – legal right granted by a property owner to another party to use land for certain purposes. May be acquired through an agreement between parties, court order or statute.

- If servitude created by legislation:
- Example: A municipality may declare servitudes to be registered over certain parts of land that falls within a proclaimed township so that the municipality can install infrastructure to provide basic services.
- No compensation is required to the landowner, however costs with registration in Deeds office may be incurred.
- Such servitudes do not meet identifiable criteria as it cannot be sold, transferred, rented, or exchanged freely and not separable from the municipality, and they arise directly from rights granted in legislation.
- Cost incurred to register servitudes should be expensed.

GRAP 31 – INTANGIBLE ASSETS
Classification: Servitudes

- If servitude created by way of acquisition (via agreement):
- Example: A municipality may need an identified piece of land to install infrastructure eg. Power cable
- When the landowner is compensated for the rights received associated with the land, the registered servitude shall be accounted for as intangible asset
- Identifiable criteria is met – arise from contractual rights in terms of binding agreement
- Cost acquired to obtain servitude (compensation paid to owner) and any additional costs to bring asset in usable condition must be capitalised.

- If servitude arising from binding agreement that do not meet the definition of “identifiable” intangible asset should be recognised as intangible asset OR part of related tangible asset(PPE). For it to be part of related tangible asset, it must be essential to the operation of the asset.

GRAP 13 – LEASES
Cellphones and 3G Modems

- Cell phone and 3G modems general indicators of the transfer of risks and rewards are as follows:
  - The lease transfers ownership of the asset to the lessee by the end of the lease term;
  - The lease term is for the major part of economic life of the asset;
  - At the inception of the lease, the present value of minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
  - If the lessee can cancel the lease, the lessor’s losses associated with the cancellation are borne by the lessee.

- Classification will therefore be a finance lease.

GRAP 11 – CONSTRUCTION CONTRACTS
RDP houses

- Municipalities are frequently involved in construction of houses as part of the reconstruction and development programme.

- In determining the accounting treatment, the municipality should examine the contract to determine the following:
  - Whether the municipality acts as a contractor (must have been appointed to provide services related to the RDP houses) and the contract meets the definition of a construction contract in terms of GRAP 11;

  - Whether the municipality is selling or distributing inventory, either directly to beneficiaries in a housing programme or to another public sector entity;

  - Whether the municipality acts as an agent in the construction of the RDP houses