national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Generally Recognised Accounting Practice For National and Provincial Departments

Modified Cash Standard

Chapters

PREFACE TO THE MODIFIED CASH STANDARD

Chapter Content

Introduction to and authority of the Modified Cash Standard

.01 The Public Finance Management Act (PFMA), No 1 of 1999, requires departments to "*prepare financial statements for each financial year in accordance with generally recognised accounting practice*". The Treasury Regulations further defines "generally recognised accounting practice" for departments as being the reporting framework prescribed by the National Treasury, Office of the Accountant General (OAG).

.02 The OAG has developed and issued the Modified Cash Standard (hereafter 'the Standard') which sets out the principles for the recognition, recording, measurement, presentation and disclosure of information required in terms of the prescribed formats.

.03 Departments and any other entity that claims compliance with the modified cash basis of accounting must adhere fully with the principles, presentation and disclosure requirements contained in this Standard in order to achieve fair presentation, and compliance with the PFMA and its regulations.

.04 The Standard comprises of separate chapters for assets, liabilities, revenue and expenditure. More than one chapter may exist for each item depending on the nature and complexity of the topic. Each chapter sets out the recognition, recording, measurement, presentation and disclosure requirements on these items.

Structure of the Modified Cash Standard

.05 Under the modified cash basis of accounting, only certain elements are recognised in the Statement of Financial Position and Statement of Financial Performance, while others are recorded for presentation as disclosure notes. Elements are primarily recognised when they arise from cash inflows or outflows. This differs from accrual accounting which requires the recognition of the effects of transactions and other events when they occur, rather than when cash or its equivalent is received or paid.

.06 To ensure a complete view of the financial position and performance of a department for the purposes of fair presentation, and without changing the basis of accounting, this Standard also prescribes disclosure requirements for accrual-basis financial information despite these items not qualifying for recognition. To aid preparers in understanding this requirement, the Standard distinguishes between *primary* (recognised, presented and disclosed) and *secondary* (recorded and disclosed) financial information, but does not place a greater degree of importance on either type of information.

.07 Primary and secondary information are of equal importance and are therefore considered to be equally necessary for fair presentation. As such, secondary information is considered an integral part of the financial statements.

.08 Primary financial information relates to the presentation and disclosure of *recognised* assets, liabilities, revenue and expenditure in the financial statements and their supporting notes. Secondary financial information relates to the disclosure of additional information about assets and liabilities that are also required to be recorded, but are at present *not recognised* in the financial statements due to the application of the modified cash basis of accounting. Secondary information therefore generally provides information about elements that would have qualified for recognition had an accrual basis of accounting been applied. Where applicable, chapters are divided into two distinct parts dealing separately with primary and secondary financial information.

.09 Appendices are added to explain and expand upon the principles in the chapters through illustrative examples or questions and answers.

.10 Each chapter must be read in the context of the objective stated therein. Any exclusion from the scope of that chapter is set out in the chapter itself. All paragraphs in the chapters have equal authority. The authority of the appendices is dealt with in the introduction to each appendix.

Developing the Modified Cash Standard

.11 In developing the Standard the OAG considers and makes use of pronouncements issued by:

- the Accounting Standards Board (ASB);
- the International Public Sector Accounting Standards Board (IPSASB);
- the International Accounting Standards Board (IASB); and
- other organisations that develop financial reporting, accounting and auditing requirements for the public sector.

.12 In developing the Standard the OAG also considers:

- best practices, both locally and internationally;
- the capacity of departments to comply with the reporting requirements; and
- the systems used by departments in preparing and collating the information required to comply with the reporting requirements.

Due process

.13 The Standard was developed through a due process that involves accountants, auditors, preparers and the users of the departmental financial statements.

.14 In developing the Standard, research was carried out to identify and review issues associated with the topic and to consider the application of the concepts and principles to the issues. The principles in the existing accounting standards, such as Generally Recognised Accounting Practice (GRAP), International Public Sector Accounting Standards (IPSAS) or International Financial Reporting Standards (IFRS), were also studied. Where required, the national and provincial legislation was consulted to develop principles and or required disclosures.

.15 The draft Standard was exposed for comment by interested parties including auditors, preparers, standard setters, public sector consultants and individuals. The draft was published on the OAG's website for a period of time to allow interested parties to consider and comment on the Standard. The OAG considered all comments received and made modifications where appropriate.

.16 The Standard will be reviewed by the OAG periodically. The process for the amendment of the Standard will be as described in the preceding paragraphs. The appendices are updated periodically to provide clarification on issues arising from time to time for example during the preparation of the departmental financial statements and or the audit thereof.

Timing and application of the Modified Cash Standard

.17 The Standard is effective for all financial periods beginning on 1 April 2013.

.18 In the extremely rare circumstances when management, in consultation with the Office of the Accountant General, concludes that compliance with a requirement of this Standard would be so misleading that it would conflict with the overall objectives of the Standard with regard to fair presentation, the department shall depart from that requirement in the manner set out in par .19 and .20:

.19 The department must disclose the following in the notes and accounting policies to the financial statements:

a) that management has concluded that the financial statements present fairly the department's primary and secondary information;

b) that the department complied with the Standard except that it has departed from a particular requirement to achieve fair presentation; and

c) the requirement from which the department has departed, the nature of the departure and the reason for departure.

.20 Departments are also required, where practicable, to disclose information explaining the financial impact of the departure by providing a summary of the disclosures that would have been required, had the departure not been applied.

CONCEPTS AND PRINCIPLES

Chapter Content

Introduction

.01 This Chapter sets out the principles on which the chapters dealing with specific topics will be based. The primary purpose of articulating these principles is to provide a coherent frame of reference to be used in the development of generally recognised accounting practice for departments.

.02 Accordingly, this Chapter sets out the concepts that underlie the preparation and presentation of financial statements for users. The purpose of this Chapter is to:

a) provide users of the departmental financial statements with information on the bases on which such financial statements are prepared and to assist them to assess whether proper stewardship was exercised;

b) assist preparers of the departmental financial statements in applying the Standard and in dealing with topics that have yet to be dealt with in the ensuing chapters;

c) assist auditors in forming an opinion as to whether financial statements comply with the Standard;

d) assist the users of departmental financial statements in interpreting the information contained in the financial statements prepared in conformity with the Standard; and

e) provide the OAG with a conceptual basis for the formulation of the Standard.

.03 This chapter is concerned with general-purpose financial statements including consolidated financial statements. Such financial statements are prepared annually and are directed towards the common information needs of a wide range of users. Many users rely on the financial statements as the primary source of financial information for departments and such financial statements should therefore, be prepared and presented taking these needs into consideration.

The Objective of the Departmental Annual Financial Statements

.04 The purpose of the financial statements is to present a true and fair view of a department's financial performance, financial position, changes in net assets and cash flows and other disclosures that is useful to a wide range of users, and to provide additional information that would be useful in decision-making. Financial statements also reflect the results of the stewardship of management, and the accountability of management for the resources entrusted to it. As such, they are an important means of demonstrating how the public sector meets its financial management responsibilities.

.05 Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make decisions since they largely portray the financial effects of past events and do not necessarily provide prospective information or non-financial information.

Assessing stewardship

.06 Stewardship is an important factor in the user's assessment of the departmental financial statements. Accountability for the use of public funds and the safekeeping of the department's resources is of paramount importance. Financial reporting plays a major role in fulfilling the duty to be publicly accountable for the collection of revenue and the use of resources in the rendering of public services.

.07 Management is also interested in the information contained in the financial statements even though it has access to additional management and financial information required for it to carry out its planning, decision-making and control responsibilities. Management has the ability to determine the form and content of such additional information to meet its own needs. The reporting of such information, however, is beyond the scope of the Standard. Nevertheless, published financial statements are based on the information used by management about the financial performance, financial position, changes in net assets and cash flows of the department.

Accountability

.08 Accountability is the cornerstone of financial reporting in government. Accountability is based on the belief that the citizens have a "right to know", a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives. Financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society.

.09 Public sector entities impose taxes and provide services. The taxes imposed and services provided by public sector entities possess characteristics that need to be considered when developing financial reporting objectives, bearing in mind those taxpayers cannot choose whether or not to pay taxes. Neither is there a proportional relationship between the amount of taxes paid, and the cost or value of the services received by the individual. These characteristics highlight the need for public accountability.

.10 At a minimum, accountability through financial reporting includes providing information to assist in evaluating whether the government has operated within the legal constraints imposed by the citizens. The structure of government, the nature of the resource providers, and the political process are characteristics of the environment that underscore the need for accountability.

Decision Usefulness

.11 Financial statements are an important source of information upon which users base their decisions about government policy, future resource requirements, and, ultimately, service delivery. For departmental financial statements to be useful to the users thereof, they should meet the qualitative characteristics and fair presentation set out in this Standard.

Users of the Departmental Financial Statements

.12 The users of the departmental financial statements include:

- Parliament / Provincial Legislatures;
- Elected officials;
- National / Provincial Treasuries;
- The public (including taxpayers and employees of the department);
- Donors;
- Statisticians & economists;
- Suppliers and creditors;
- Present and potential institutional and individual lenders, including purchasers of government bonds;
- Other Governments; and
- The media.

.13 Financial statements in general are aimed at meeting the information requirements of a wide range of users. Accounting requirements are therefore set with this principle in mind. The financial statements of a department provide information for the above users as far as possible to facilitate oversight and decision making. For example information is provided on:

- the utilisation of appropriated funds;
- the collection of departmental (own) revenue;
- the management of resources as well the resources available to deliver goods and services (such as the capital assets held by a department);
- future commitments and or savings (incl. roll-overs);
- how the funds have been used and to what extent funds have been made available to deliver goods and services;
- the utilisation of donor funding;

.14 While financial statements cannot meet all the information needs of the users, there are needs that are common to all users. Since government, national and provincial treasuries, parliament and the legislatures have a direct interest; the provision of financial statements that meet their needs will also meet most of the needs of other users.

The Modified Cash Basis of Accounting

.15 The most appropriate basis of accounting depends on the qualitative characteristics set out in this Chapter, which in turn are interpreted in the context of users' needs. At present the users of the departmental financial statements are primarily concerned with the utilisation of allocated resources.

.16 The South African departmental financial statements are prepared on a modified cash basis of accounting. Under a "pure" cash basis, the effects of transactions and other events are recognised in the financial statements when the resulting cash or its equivalent are received or paid. In other words, a transaction is only recognised when it is initiated by the receipt or payment of cash. However, other chapters of this Standard may also incorporate other recognition practices that are not based solely on the aforementioned cash accounting principles, giving rise to the Modified Cash Basis,

.17 As explained in the Preface to the Standard, supplementary accrual information is provided in the notes to the departmental financial statements to assist users in holding a department accountable for the management of its assets and liabilities. For the purposes of this Standard, the recognised assets, liabilities, revenue and expenditure are presented as primary financial information, whereas the supplementary information is presented as secondary information in the notes. Secondary information includes certain important information that provides additional information to the users of the financial statements on which other assets and liabilities would have been recognised had an accrual basis of accounting been applied, and is consequently deemed to be of equal importance and an integral part of the financial statements.

.18 Transactions, events, assets and liabilities are measured in accordance with the specific Chapter that addresses those transactions, events, assets and liabilities.

Qualitative Characteristics and Fair Presentation

.19 To achieve its stated objective, information in the financial statements must have certain qualitative characteristics. These qualitative characteristics are discussed below.

Understandability

.20 The information contained in the financial statements must be understandable to the average user who has a reasonable knowledge of government, the department's activities and environment, accounting and a willingness to study the information with reasonable diligence.

.21 This does not imply that information should be excluded from the financial statements simply because it may be too complex for certain readers to understand.

Relevance

.22 Relevant information is information that is decision useful and can therefore influence stewardship by helping users to evaluate past, present or future events, or confirming or correcting their past evaluations.

.23 The relevance of information is established by reference to the nature and the materiality of the information concerned.

.24 Information is material if its omission, misstatement, or non-disclosure could influence the decisions of users made on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission, misstatement, or non-disclosure in the financial statements. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have to be useful.

Reliability

.25 Information is reliable when it does not contain material errors and is free from bias. The users of the financial statements should be able to rely on the information as a faithful representation of the transactions, balances and events that it purports to represent. The term “reliability” does not mean “absolute accuracy” but rather refers to information that the users can trust.

.26 Reliable information will:

- reflect the substance rather than the legal form of the transactions or events;
- be neutral in that it should not present information in a manner to achieve a predetermined result; and
- be complete, within the bounds of materiality and cost.

Comparability

.27 Information should be comparable to enable users to identify trends and to assess performance over time and between similar entities. One of the main reasons for the disclosure of accounting policies in the financial statements is to assist users in comparing the financial statements of different entities.

The Elements of Financial Statements

.28 The financial statements portray the financial effects of specific transactions and events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements.

Financial position

.29 The elements directly related to the measurement of financial position are as follows:

a) an **asset** is a resource controlled by the department as a result of past events and from which future economic benefits or service potential is expected to flow to the department.

b) a **liability** is a present obligation of the department arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits or service potential.

c) **net assets** are the residual that remains after deducting all of a department’s recognised liabilities from its recognised assets.

.30 The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised or recorded for disclosure in the financial statements. Thus, the definitions are broader than only those elements recognised as assets and liabilities in the statement of financial position or recorded for disclosure purposes. Generally, the expectation that future economic benefits or service potential will flow to or from a department must be sufficiently certain before an asset or liability is recognised or recorded.

.31 In assessing whether an item meets the definition of an asset, liability or net assets, attention needs to be given to its underlying substance and economic reality and not merely its legal form.

Assets

.32 Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with a department’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential”. Assets that are used to generate net cash inflows are often described as embodying “future economic benefits”.

.33 The future economic benefit or service potential embodied in an asset is the potential to contribute directly or indirectly, to the flow of cash and cash equivalents to the department or the rendering of services by the department. The potential may be a productive one that is part of the operating activities of the department. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative method of service delivery reduces the cost of delivery.

.34 A department usually employs its assets to provide goods or services capable of satisfying the wants or needs of beneficiaries. Furthermore, in many cases, assets are used to provide goods or services to beneficiaries or customers that are free or subsidised. An item can meet the definition of an asset if it is used either directly or indirectly to provide goods and/or services that are used in furtherance of a department's objectives.

.35 The future economic benefits or service potential embodied in an asset may flow to the department in a number of ways. For example, an asset may be:

a) used singly or in combination with other assets in the production of goods or services to the benefit of the department's beneficiaries;

b) exchanged for other assets;

c) used to settle a liability; or

d) distributed or reallocated within government.

.36 Many assets, for example, capital assets have a physical form. However, physical form is not essential to the existence of an asset; hence, mineral rights, patents and copyrights, for example, are assets if future economic benefits or service potential is expected to flow from them to the department and if they are controlled by the department.

.37 Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the department controls the benefits, which are expected to flow from the property. Although the capacity of a department to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know - how obtained from a development activity may meet the definition of an asset when a department controls the benefits that are expected to flow from it.

.38 Entities that have custody of an asset may not have all the legal powers of ownership, such as the ability to sell the item. There may also be restrictions on the department's use of the asset. However, this does not necessarily mean that the department does not control access to future economic benefits or service potential. To satisfy the requirement for control, the department does not need unlimited power over the physical item. Instead, it is the rights or access to future economic benefits or service potential that need to be controlled.

.39 The requirement that the rights or other access should be controlled by the department treating them as its assets means that a particular right or other access to future economic benefits or service potential will appear in only one set of department financial statements, because such rights or access can be directly controlled by only one department.

.40 The assets of a department result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by a department from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future in themselves do not give rise to assets; hence, for example, an intention to purchase inventory of itself, does not meet the definition of an asset.

.41 There is a close association between incurring expenses and generating assets but the two do not necessarily coincide. Hence, when a department incurs expenses, this may provide evidence that future economic benefits or service potential were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly, the absence of a related expense does not preclude an item from satisfying the definition of an asset for example, items that have been donated to the department or natural increases in biological assets may satisfy the definition of an asset.

Liabilities

.42 An essential characteristic of a liability is that the department has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a contractual or statutory arrangement, i.e. the department has no realistic alternative to avoid the outflow of economic resources or service potential. This is normally the case, for example, with amounts payable for services rendered and goods received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good relations or act in an equitable manner.

.43 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of a department to acquire assets in the future does not of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the department enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of an order of court, leave the department with no realistic alternative to avoid the outflow of resources to another party.

.44 Governments make, and amend, general promises and policies as part of the ongoing political processes. Consideration should be given to such promises to determine if, and when, such promises have given rise to a present obligation and/or a future commitment.

.45 The settlement of a present obligation usually involves the department giving up resources embodying economic benefits or service potential in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

a) payment of cash;

b) transfer of other assets;

c) provision of services;

d) replacement of that obligation with another obligation; or

e) conversion of the obligation to net assets.

.46 An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

.47 Liabilities result from past transactions or other past events.

.48 Sometimes a series of events will have to take place before the department will have an obligation to transfer economic benefits or service potential. In such circumstances, whether the obligation exists depends on whether any events that have still to take place are under the department's control. If they are, the department has a realistic alternative to avoid the transfer, so no obligation exists. For example, as long as it has a realistic alternative to avoid a penalty clause in a contract by performing, a liability in respect of the penalty will not arise.

.49 Some liabilities can be measured only by using a substantial degree of estimation, sometimes described as provisions. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated.

Net assets

.50 Residual interest is the amount calculated by deducting all of the department's liabilities from all of the department's assets.

.51 "Net assets" is the term used to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets may be positive or negative. Other terms may be used in place of net assets, provided their meaning is clear.

.52 Although net assets are defined as a residual, it may be sub-classified in the statement of financial position. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the department to distribute or otherwise apply its net assets.

.53 The distinction between liabilities and residual interest is highly significant. Creditors have the ability to insist that a transfer of economic benefit or service potential is made to them regardless of the circumstances. Most entities in the public sector are owned by other government entities or by the public as a constituency or the community as a whole. These owners frequently do not have the right to participate in a distribution of the net assets. Government departments are owned by their respective national or provincial governments, depending on which sphere of government they operate in. Any net surplus remaining after discharging liabilities to other creditors is generally payable back to the relevant treasury.

Financial performance

.54 The elements directly related to the measurement of the surplus or deficit are as follows:

a) **revenue** is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to capital contributions to net assets.

b) **expenses** are decreases in economic benefits or service potential during the reporting period in the form of outflows or incurrences of liabilities that result in decreases in net assets, other than those relating to capital distributions from net assets.

.55 The definitions of revenue and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognised in the statement of financial performance. Revenue and expenses are discussed below.

Revenue

.56 Revenue arise in the course of the operating activities of a department, and is referred to by a variety of different names including tax receipts, transfers, interest, dividends and rent on land.

.57 Various kinds of assets may be received or enhanced by revenue; for example cash, may be received for services rendered and goods supplied or taxes due and payable. Revenue may also result from the settlement of liabilities. For example, a lending department may receive goods or services in settlement of a present obligation to repay an outstanding loan. Revenue also results from the sharing of revenue collected by one sphere of government and transferred to another sphere of government, also known as ‘voted funds’, or ‘equitable share’.

Expenses

.58 The definition of expenses encompasses losses as well as those expenses that arise in the course of the operating activities of the department. Expenses that arise in the course of the operating activities of the department include, for example, cost of services rendered and salaries and wages. They usually take the form of an outflow of assets such as cash and cash equivalents.

.59 Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the operating activities of the department. Losses represent decreases in economic benefits or service potential and as such, they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this Standard.

.60 Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of capital assets. Losses are often reported net of related revenue to reflect the substance of the transaction or event.

Recognition and Recording of the Elements of the Departmental Financial Statements

.61 *Recognition* is the process of incorporating in the statement of financial position or statement of financial performance an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 66. It involves the depiction of the item in words, and in monetary amounts, and the inclusion of those amounts in the statement of financial position or statement of financial performance totals.

.62 *Recording* is the process of capturing the financial information relating to a particular transaction, event, asset or liability in the electronic or manual accounting records of the department for the purposes of disclosure as secondary financial information.

.63 *Disclosure* is the depiction of a recognised and or recorded item of information in the notes to financial statements in accordance with the requirements of this Standard, whereas *presentation* refers to the layout and positioning of the item within the primary financial statements.

.64 Items that satisfy the recognition criteria should be recognised in the statement of financial position or statement of financial performance (primary financial information). The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

.65 The inclusion of elements in the financial records and ultimately the financial statements results from the following process:

a) initial recognition / recording and measurement, which is when an item is initially captured in the electronic or manual records for the first time;

b) subsequent re-measurement, which involves changing the amount at which an already recognised / recorded asset or liability is stated in the electronic or manual records;

c) derecognition, which is when an item that was previously recognised in primary financial information ceases to be recognised; and

d) removal, which is when an item that was previously recorded and disclosed in the secondary financial information is no longer required to be disclosed in accordance with this Standard.

.66 Generally, unless specified otherwise, an item that meets the definition of an element should be recognised if:

- it results in an immediate cash in- or outflow; or
- it is readily convertible to known amounts of cash; and
- the item has a cost or value that can be measured reliably.

.67 An item that meets the definition of an element should be recorded for disclosure (secondary financial information) where it meets the specific criteria established for such items in the relevant chapters of this Standard.

.68 In assessing whether an item meets these criteria and therefore qualifies for inclusion in the financial statements, regard needs to be given to the materiality considerations discussed in paragraphs .23 and .24. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, revenue or a liability. In particular, advances received or prepayments would result in the recognition of a corresponding liability or asset being recognised, since these transactions arise from an inflow or outflow of cash. This interrelationship is however not necessarily applicable in the case of secondary financial information, since these items are merely disclosed, and not recognised.

.69 Transactions are the most common reason for recognising / recording and derecognising / removal of items. Events other than transactions may nevertheless also result in the recognition / recording and derecognition / removal of items. For example, an event such as the loss or destruction of an asset may result in the removal of that asset from the secondary financial information.

Measurement of the Elements of the Departmental Financial Statements

.70 Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the Statement of Financial Position and Statement of Financial Performance, or recorded for disclosure as secondary financial information. This involves the selection of the particular basis of measurement. The individual chapters of this Standard will specify the appropriate measurement basis to use for a specific element.

.71 The two common measurement bases are historical cost and fair value:

a) for assets, **historical cost** is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition. For liabilities, historical cost is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred, or in some circumstances the amounts of cash or cash equivalents expected to be paid to settle the liability in the normal course of business.

b) **fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

FINANCIAL STATEMENT PRESENTATION

Chapter Content

Introduction

.01 This Chapter sets out the overall considerations for the presentation of the departmental financial statements.

Definitions

.02 ***The following terms are used in this chapter with the meanings specified:***

Impracticable Applying a requirement is impracticable when the department cannot apply it after making every reasonable effort to do so.

Management comprises those persons responsible for planning, directing and controlling the activities of the department, including those charged with the governance of the department in accordance with legislation in instances where they are required to perform such functions.

Material omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The size or nature of the information item, or a combination of both, could be the determining factor.

Notes contain additional disaggregated financial information on transactions and balances that have been recognised and presented in the statement of financial position, statement of financial performance, statement of changes in net assets and cash flow statement (primary financial information). They are also used to provide other information that may be required by the Standard (secondary financial information).

Presentation currency is the currency in which the financial statements are presented (i.e. ZAR).

Recording refers to the recording of a transaction, event or balance in the financial records of the department for the purposes of disclosing secondary financial information in the financial statements.

Recognition is the process of incorporating in the statement of financial position or statement of financial performance an item that meets the definition of an element and satisfies the criteria for recognition. It involves the depiction of the item in words, and in monetary amounts, and the inclusion of those amounts in the primary statements' totals.

Reporting date means the date of the last day of the reporting period to which the financial statements relate.

Reporting entity means the department for which the financial statements are prepared.

Terms defined in other chapters are used in this chapter with the same meaning as in those other chapters.

Components of financial statements

.03 **A complete set of financial statements comprises:**

a) appropriation statement;

b) a statement of financial performance;

c) a statement of financial position;

d) a statement of changes in net assets;

e) a cash flow statement;

f) notes to the primary financial statements, comprising a summary of significant accounting policies and other explanatory notes; and

g) notes on secondary financial information.

.04 In a complete set of financial statements, a department shall present each financial statement with equal prominence. Similarly, the notes to the financial statements should be presented with equal prominence regardless of whether they relate to primary or secondary financial information.

Primary and Secondary Financial Information

.05 **Financial statements shall present primary financial information, consisting of recognised revenue, expenses, assets and liabilities presented in a statement of financial position, statement of financial performance, statement of changes in net assets and other primary financial statements such as the appropriation statement, cash flow statement, and notes thereto.**

.06 Primary financial information disclosures relate to items of revenue, expenses, assets, and liabilities that have been recognised in accordance with the recognition criteria established by this Standard.

.07 **Financial statements shall present secondary financial information that provides additional information about items of revenue, expenditure, assets and liabilities that have been recorded, but did not qualify for recognition in the primary financial statements as required by this Standard.**

.08 **Financial statements shall present any other disclosures required by this Standard for the purposes of achieving fair presentation.**

.09 The criteria for recording and disclosing secondary financial information in the notes to the financial statements are established in the relevant chapters of this Standard. The process of recording involves capturing sufficient information in supplementary schedules and registers (usually outside of the main financial accounting system) to enable the department to comply with the minimum disclosure requirements of this Standard. For example, the notes would include certain information about accruals, assets and liabilities that have not been recognised.

.10 **The principles of fair presentation, going concern, materiality and aggregation, consistency, offsetting and the presentation of comparative information, as explained in the following paragraphs, apply equally to the primary and secondary financial information presented in the financial statements.**

Fair presentation

.11 **Financial statements shall present fairly the financial position, financial performance and cash flows of a department. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in the Standard. The application of the Standard with additional disclosures when necessary is presumed to result in financial statements that achieve fair presentation.**

.12 The additional disclosures mentioned above are necessary when specifically required by this Standard, or when compliance with the specific requirements in the Standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the department’s financial position and financial performance.

.13 **A department whose financial statements comply with the Standard shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with the Standard unless they comply with all the requirements in each chapter.**

.14 **Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.**

.15 The application of the Modified Cash Basis of Accounting, combined with sufficient disclosure of secondary financial information prescribed by this Standard, is presumed to achieve fair presentation for the purposes of the users of departmental financial statements given the current level of maturity of the accounting systems and the environment as a whole. The appropriateness of this presumption will however be continuously assessed as the environment matures and progressively moves closer toward being capable of generating accrual accounting information in accordance with Generally Recognised Accounting Practice issued by the Accounting Standards Board.

Going concern

.16 **When preparing financial statements an assessment of a department's ability to continue as a going concern shall be made. This assessment shall be made by management. When management is aware, in making this assessment, of material uncertainties related to events or conditions which may cause significant doubt upon the department's ability to continue as a going concern or to meet its obligations as they fall due, those uncertainties shall be disclosed.**

.17 Financial statements are normally prepared on the assumption that the department is a going concern and will continue in operation and meet its statutory and financial obligations for the foreseeable future. In assessing whether the going concern assumption is appropriate, those responsible for the preparation of the financial statements take into account all available information about the future, which is at least, but is not limited to, twelve months from the reporting date.

Materiality and aggregation

.18 **Each material class of similar items shall be presented separately in the financial statements. Items of a dissimilar nature or function shall be presented separately unless they are immaterial.**

.19 Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data which form line items on the face of the statement of financial position, statement of financial performance, statement of changes in net assets and cash flow statement, or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of those statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of those statements may nevertheless be sufficiently material for it to be presented separately in the notes.

.20 Applying the concept of materiality means that a specific disclosure requirement in a chapter in this Standard need not be satisfied if the information is not material. For purposes of consistency and to ensure the needs of the primary users of the financial statements are met, guidance on the level of aggregation and classification may be issued by the Office of the Accountant General. This application guidance, in the form of specimen financial statements, is issued as a separate publication.

Consistency of Presentation

.21 **The presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is required in terms of the Standard.**

.22 **When the presentation or classification of items in the financial statements is changed, a department shall reclassify comparative amounts unless the reclassification is impracticable.**

.23 When comparative amounts are reclassified, a department shall disclose the following:

a) the nature of the reclassification.

b) the amount of each item or class of items that is reclassified.

c) the reason for the reclassification.

.24 If it is impracticable to reclassify comparative amounts, a department shall disclose why reclassification was not practicable.

Offsetting

.25 **Assets and liabilities, revenue and expenses, shall not be offset unless required or permitted by this Standard or Legislation.**

.26 It is important that assets and liabilities, and revenue and expenses, are reported separately. Offsetting in the statement of financial performance or the statement of financial position, except where offsetting reflects the substance of the transaction or other event, detracts from the ability of users to understand the transactions, other events and conditions that have occurred.

Comparative Information

.27 **Except when the Standard permits or requires otherwise, comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.**

.28 In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last reporting date and is yet to be resolved, are disclosed in the current period. Users benefit from information (a) that the uncertainty existed at the last reporting date, and (b) about the steps that have been taken during the period to resolve the uncertainty.

Identification of the Departmental Financial Statements

.29 **The financial statements shall be identified clearly, and distinguished from other information in the same published document.**

.30 This Standard applies only to the departmental financial statements, and not to other information presented in the annual report or other document. Therefore, it is important that the users can distinguish information that is prepared using this Standard from other information that may be useful to users but is not the subject of those requirements.

.31 **Each component of the financial statements shall be identified clearly. In addition, the following information shall be displayed prominently, and repeated when it is necessary for a proper understanding of the information presented:**

a) the name of the reporting department or other means of identification, and any change in

that information from the proceeding reporting date;

b) whether the financial statements cover the individual department or the economic entity;

c) the reporting date or the period covered by the financial statements, whichever is appropriate to the component of the financial statements;

d) the presentation currency; and

e) the level of rounding used in presenting amounts in the financial statements.

.32 The requirements in paragraph .31 are normally met by presenting page headings and abbreviated column headings on each page of the financial statements.

.33 Financial statements are often made more understandable by presenting information in thousands of the presentation currency. This is acceptable as long as the level of rounding in presentation is disclosed and material information is not omitted.

Presentation of the Departmental Financial Statements

Current/non-current distinction

.34 **A department shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its statement financial position.**

.35 Separate classification of current and non-current assets and liabilities on the face of the statement of financial position provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the department's long-term operations (where applicable). It also highlights assets that are expected to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.

Current assets

.36 **An asset shall be classified as current when it satisfies any of the following criteria:**

a) it is expected to be realised in, or is held for sale or consumption in, the department's normal operating cycle;

b) it is held primarily for the purpose of being traded;

c) it is expected to be realised within twelve months after the reporting date; or

d) it is cash or a cash equivalent asset unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

.37 The operating cycle of a department is the time taken to convert inputs or resources into outputs, i.e. the time taken to convert resources into goods and services, or outputs, to meet its service delivery objectives. When the department's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

Current liabilities

.38 **A liability shall be classified as current when it satisfies any of the following criteria:**

a) it is expected to be settled in the department's normal operating cycle;

b) it is held primarily for the purpose of being traded;

c) it is due to be settled within twelve months after the reporting date; or

All other liabilities shall be classified as non-current.

.39 Some current liabilities are part of the working capital used in the normal operating cycle of the department. Such operating items are classified as current liabilities even if they are due to be settled more than twelve months after the reporting date. The same normal operating cycle applies to the classification of a department's assets and liabilities. When the department's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

Information presented on the face of the statement of financial position and statement of financial performance

.40 **The face of the statement of financial position shall include separate line items that represent material aggregations of recognised assets and liabilities.**

.41 **The face of the statement of financial performance shall include the following broad classifications, with additional detail being provided for all material sub-classifications of revenue and expenditure that have been recognised during the period. The economic reporting format shall be used with the following categories:**

a) revenue;

b) current expenditure;

c) transfers and subsidies;

d) expenditure for capital assets;

e) payments for financial assets;

f) surplus/(deficit) for the year; and

g) a reconciliation of net surplus/(deficit) for the year.

.42 **The notes to the departmental financial statements:**

a) shall present information about the basis of preparation of the financial statements and the specific accounting policies used; and

b) may disclose, in the summary of significant accounting policies or other notes, the judgements, management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

.43 In the process of applying the department's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts of items recognised in the financial statements. For example, management makes judgements in determining

a) whether assets are investment properties;

b) when substantially all the significant risks and rewards of ownership of lease assets are transferred to or from other entities;

c) whether spending on an existing asset is of a current or capital nature.

Other disclosures for arrangements

.44 **To the extent that a department has entered into an arrangement for the transfer of functions, the departments shall disclose, as part of the secondary financial information, the following information to enable the users to determine the impact of the transfer of functions on the department:**

a) a description of the changes as a result of the transfer or receipt of functions;

b) details of the assets and liabilities given up or assumed, as a result of the transfer or receipt of functions;

c) a description of the steps taken to ensure compliance with laws and regulations for the transfer of function;

d) a reference to the proclamation or declaration giving effect to the transfer or receipt of functions; and

e) an indication as to whether there was an agreement drawn up, and if so provide a description of roles, responsibilities and accountability arrangements.

.45 **To the extent that a department is party to a public private partnership (PPP) it shall disclose, as part of the secondary financial information, the following information to enable the users to determine the impact of the public private partnership on the department:**

a) a description of the nature and amount of any contract fees received from parties to the PPP arrangement;

b) a general description of the significant terms of the agreement, along with the parties to the agreement, and the date of commencement thereof;

c) contract fees paid indicating the fixed and indexed components of the payments;

d) an analysis of the indexed component of the contract fees paid;

e) the value of any rights, tangible or intangible capital assets and loans provided for in terms of the PPP agreement; and

f) the value of prepayments and advances, pre-production obligations and / or any other obligations the department might have in terms of the PPP agreement.

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ACCOUNTING POLICIES, ESTIMATES AND ERRORS

Chapter Content

Introduction

.01 This Chapter provides guidance for selecting and applying the accounting policies used in preparing financial statements. It also covers changes in accounting estimates and correction of errors in the prior period financial statements.

.02 The requirements of this Chapter apply equally to both the primary and secondary financial information presented in the financial statements.

Definitions

.03 ***The following terms are used in this chapter with the meanings specified:***

<u>Accounting policies</u> are the specific principles, bases, conventions, rules and practices applied by the department in preparing, presenting and disclosing information in the financial statements.

A <u>change in accounting estimate</u> is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

<u>Prior period errors</u> are omissions from, and misstatements in, the department's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a) was available when financial statements for those periods were authorised for issue; and

b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

<u>Prospective application</u> of a change in an accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

b) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

<u>Retrospective application</u> is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

<u>Retrospective restatement</u> is correcting the recognition, measurement and disclosure of amounts of elements of financial statements and or disclosure notes as if a prior period error had never occurred.

Terms defined in other chapters are used in this chapter with the same meaning as in those other chapters.

Accounting policies

.04 **When a chapter specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Chapter and considering any relevant Interpretations and Directives issued by the Office of the Accountant-General for the chapter.**

.05 This Standard sets out the accounting policies that will result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from the Standard to achieve a particular presentation of a department's financial position, financial performance or cash flows.

.06 Where a chapter does not specifically apply to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

a) relevant to the economic decision-making needs of users; and

b) reliable, in that the financial statements and or disclosure notes:

   (i) represent faithfully the financial position, financial performance and cash flows of the department;

   (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

   (iii) are neutral, i.e. free from bias;

   (iv) are prudent; and

c) are complete in all material respects.

.07 In making the judgement described in paragraph .06, management is encouraged to seek guidance from the Office of the Accountant-General so as to ensure consistent treatment on consolidation, and should refer to and consider the applicability of, the definitions, recognition criteria and measurement concepts for assets, liabilities, revenue and expenses set out in the Chapter on *Concepts and Principles*.

Consistency of accounting policies

.08 **A department shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless the Standard specifically requires or permits categorisation of items for which different accounting policies may be appropriate. If the Standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.**

Changes in accounting policies

.09 **A department shall change an accounting policy only if the change is required by the Standard.**

.10 Users of financial statements need to be able to compare the financial statements of a department over time to identify trends in its financial information. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in an accounting policy is required by the Standard. Similarly, the comparability of the financial statements of a department in relation to other departments may be negatively affected where different accounting policies are applied. Where a change is required, the relevant chapter will clarify how the current and historical information should be amended to effect the change.

.11 **The following are not changes in accounting policies:**

a) the application of an accounting policy for events or transactions, other events or conditions that differ in substance from those previously occurring; and

b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or that were immaterial.

.12 **The Standard will indicate whether the change should be made prospectively or retrospectively.**

Disclosures

.13 **A department shall present information about the basis of preparation of the financial statements and the specific accounting policies used in preparing and presenting / disclosing the information.**

.14 **Where there is a change an accounting policy, a department shall disclose:**

a) the nature of the change in accounting policy;

b) the amount of the adjustment for each financial statement line item affected, including secondary financial information, for the applicable reporting periods;

Financial statements of subsequent periods need not repeat these disclosures.

Changes in accounting estimates

.15 As a result of the uncertainties inherent in delivering services, conducting trading or other activities, some items that form part of the secondary information in the financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information.

.16 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

.17 An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

.18 A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

.19 **The effect of a change in an accounting estimate shall be recognised prospectively.**

.20 Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate.

Disclosures

.21 **A department shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.**

.22 **If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.**

Errors

.23 **Errors can arise in respect of the recording, recognition, measurement, presentation or disclosure of elements in the financial statements and or notes. Financial statements do not comply with the Standard if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation. Potential current period errors discovered in that period are investigated and corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.**

.24 Subject to paragraph .25, a department shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and net assets for the earliest prior period presented or disclosed.

.25 **A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.**

.26 **When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods the department shall restate the opening balances of recognised assets, liabilities and net assets for the earliest period for which retrospective restatement is practicable (which may be the current period). Similarly, opening balances reflected in the secondary financial information that are affected by a prior period error shall be restated accordingly.**

.27 **When it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the department shall restate the comparative information to correct the error prospectively from the earliest date practicable.**

.28 When it is impracticable to determine the amount of an error (e.g. a mistake in applying an accounting policy) for all prior periods, the department, in accordance with paragraph .27, restates the comparative information prospectively from the earliest date practicable.

.29 Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known.

Disclosures

.30 **A department shall disclose the following, distinguishing clearly between primary and secondary financial information:**

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction for each line item affected;

(c) the amount of the correction at the beginning of the earliest prior period presented;

(d) the impact on unauthorised expenditure and voted funds to be surrendered (where applicable); and

(e) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

.31 **Financial statements of subsequent periods need not repeat these disclosures.**

APPROPRIATION STATEMENT

Chapter Content

Introduction

.01 This Chapter requires a comparison of budget amounts and the actual amounts arising from execution of the budget to be included in the financial statements of departments.

.02 The Chapter also requires disclosure of an explanation of the reasons for material differences between the budget and actual amounts. Compliance with the requirements of this Chapter will ensure that departments discharge their accountability obligations and enhance the transparency of their financial statements by demonstrating compliance with the approved budget(s) for which they are held publicly accountable and their financial performance in achieving the budgeted results

Scope

.03 A department that prepares and presents financial statements shall apply this Chapter in preparing the appropriation statement and the related disclosures, as part of its primary financial information.

Definitions

.04 The following terms are used in this Chapter with the meanings specified:

<u>Annual budget</u> means an approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.

<u>Appropriation</u> is an authorisation granted by Parliament and or the legislatures approving the budget to allocate funds for purposes specified by Parliament and or the legislatures.

<u>Approved budget</u> means the expenditure authority derived from laws, appropriation bills, regulations and other decisions related to the anticipated revenue or receipts for the budgetary period.

<u>Final budget</u> is the approved budget adjusted for transfers, allocations, supplemental appropriations, and other changes applicable to the budget period.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Purpose of the appropriation statement

.05 The primary focus within South African government is service delivery and the fulfilment of the institutional mandates of departments. Annual appropriations, received by departments, serve as the primary funding for the fulfilment of the service delivery obligations of departments. The performance of departments is therefore informed by the extent to which their service delivery obligations are executed and the manner in which their appropriations are utilised in the fulfilment of their objectives.

.06 Appropriations to departments are made on the basis of their budgets. It is important to take into consideration that the budgets of the departments are based on the strategic plans of the departments. As such, the budget of a department is a quantification of the strategic priorities of the department. The division of the department’s budget into the different programmes of the department is therefore indicative of strategic objectives of the department. Accordingly, the appropriation statements provide the users of the financial statements with an indication of how the department utilised its budget to achieve its strategic priorities.

.07 Taking into consideration that the budget process of departments allows for adjustments to the budget, for those instances where circumstances require a change, the appropriation statement should also reflect the changes made to the budget during the year. Through the reflection of the changes in the budget, the users of the financial statements are provided with a better understanding of the manner in which the budget was utilised by the department.

.08 As such, the appropriation statement should reflect the budget, with other changes thereto that occurred during the year to arrive at the final budget of the department.

Approved and final appropriations

.09 An approved appropriation reflects the anticipated revenues or receipts expected to be raised in the annual budget period based on current plans and the anticipated economic conditions during that budget period, and expenses or expenditures approved by the legislative body, being Parliament or the provincial legislatures. An approved appropriation is not a forward estimate or a projection based on assumptions about future events and possible management actions that are not necessarily expected to take place. As such, the approved appropriation is a reflection of a department's approved budget.

.10 The critical feature of approved budgets is that the authority to withdraw funds from the relevant revenue fund for agreed and identified purposes is provided by Parliament or the provincial legislatures. The approved budget establishes the expenditure authority and is generally considered the legal limit within which a department must operate.

.11 Departments, through the budget process are appropriated funds by Parliament or the provincial legislatures, which are to be spent in accordance with certain priorities. The budget for the financial year is usually approved before the start of the financial year or, in exceptional circumstances, on a date as soon as possible after the start of that financial year. Subsequent to this initial budget being approved, it might become necessary to revise the initial estimates of revenue and expenditure due to for example, increased collection of revenue, unforeseen and unavoidable expenditure being incurred, the reallocation of funds between activities or types of expenses, the use of savings generated, or the roll-over of unspent funds from prior years. These adjustment budgets are required by legislation to be approved again by Parliament or the provincial legislatures. The most recent budget approved by Parliament or the provincial legislatures is the approved budget for purposes of this Chapter.

.12 Departments are allowed to make certain changes to the budget after it was previously approved by Parliament or the provincial legislatures. For example, departments are allowed to reallocate funds between programmes subject to limitations in legislation. These changes to the approved budget may in some instances not be formally approved again by Parliament or the provincial legislatures. The final budget, for purposes of this Chapter, is the most recently approved budget, adjusted for changes made to the budget by the department.

Presentation and disclosure of a comparison of budget and actual amounts

.13 A department shall present a comparison of the approved, final budget and actual amounts as a separate additional financial statement. The comparison shall present separately for each programme as well as for each economic classification:

(a) the adjusted appropriation, the shifting of funds within that appropriation, virements and final appropriation;

(b) the actual expenditure;

(c) variances, if any, between actual expenditure and the final appropriation as well as actual expenditure as % of final appropriation; and

(d) a reconciliation of the budget with the statement of financial performance;

.14 Presentation in the financial statements of the approved and final appropriation amounts and the actual amounts will complete the accountability cycle by enabling users of the financial statements to identify whether resources were obtained and used in accordance with the approved budget. In addition, users can assess management decisions with regard to virements.

.15 Budget documents may provide great detail about particular activities or programmes. These details are often aggregated in broad classes under common “budget classifications”, or “budget headings” for presentation to, and approval by Parliament or the provincial legislatures. For departments, the budgets are prepared and submitted per programme and economic classification. As such, when presenting the appropriation statement it is pertinent to ensure that the budget presented within the appropriation statement is also presented per programme as well as per economic classification. This will ensure that comparisons are made at the relevant level of oversight set by Parliament or the provincial legislatures and as identified in the department’s budget documents.

.16 A department shall by way of note disclosure, provide an explanation of material differences between the budget and actual amounts.

.17 An explanation of the material differences between actual amounts and the budget amounts will assist users in understanding the reasons for material departures from the approved budget for which the department is held publically accountable.

.18 The appropriation statement shall also reflect the final budget and actual expenditure for the comparative period. This comparative information shall be presented for the appropriation per programme as well as the appropriation per economic classification.

CASH FLOW STATEMENT

Chapter Content

Introduction

.01 This Chapter sets out the requirements for the presentation of information about the historical changes in cash and cash equivalents of a department by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

Scope

.02 **A department shall apply this Chapter in preparing the cash flow statement and the related disclosures, as part of its primary financial information.**

Definitions

.03 ***The following terms are used in this Chapter with the meanings specified:***

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed capital and borrowings of the department.

Investing activities are the acquisition and disposal of capital assets and other investments not included in cash equivalents.

Operating activities are the activities of the department that are not investing or financing activities.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Purpose of the cash flow statement

.04 The cash flow statement identifies the sources of cash inflows, the items on which cash was expended during the reporting period, and the cash balances as at the reporting date, classified into operating, investing and financing activities. Information about the cash flows of an entity is useful in providing users of financial statements with information for both accountability and decision making purposes.

.05 In the Modified Cash Basis of Accounting, the statement of financial performance is already based mainly on cash flow information. However, reclassifying these inflows and outflows of cash as required by this Chapter provides users with additional useful information on how the department's operations have utilised cash, and also provides information that could be useful in assessing a department's future cash resource requirements. In making and evaluating decisions about the allocation of resources, such as the sustainability of the department's activities, users require an understanding of the timing and certainty of cash flows.

Cash and cash equivalents

.06 Cash equivalents are held for the purpose of meeting short-term cash commitments. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents.

.07 Bank borrowings are generally considered to be financing activities. Bank overdrafts which are repayable on demand may form an integral part of an entity's cash management activities. In these circumstances, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

.08 Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of a department rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Presentation of a cash flow statement

.09 **The cash flow statement shall report cash flows during the period classified by operating, investing and financing activities.**

.10 A department presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its activities. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the department and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

.11 A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element is classified as a financing activity.

Operating activities

.12 The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the department are funded:

(a) by way of appropriations; or

(b) from the recipients of goods and services provided by the department (departmental revenue).

The amount of the net cash flows also assists in showing the ability of the department to maintain its operating capability and satisfy its service delivery requirements.

.13 Cash flows from operating activities are primarily derived from the appropriations received. Other examples of cash flows from operating activities are:

(a) cash receipts from taxes, levies and fines;

(b) cash receipts from charges for goods and services provided by the department;

(c) cash receipts from local and foreign donors;

(d) cash receipts from royalties, fees, commissions and other revenue;

(e) cash transfers to other entities to finance their operations (not including loans);

(f) cash payments to suppliers for goods and services;

(g) cash payments to and on behalf of employees;

(h) cash payments of rates and taxes;

(i) cash receipts or payments from transfers of functions / discontinuance of functions; and

(j) cash receipts or payments in relation to litigation settlements.

Some transactions, such as the sale of a capital asset, may give rise to revenue that is included in surplus or deficit. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to manufacture or acquire assets for rental to others and subsequently sold are cash flows from operating activities. The cash received from rents and subsequent sales of such assets are also cash flows from operating activities.

.14 The Revenue Fund may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made through the Revenue Fund are usually classified as operating activities since they relate to the main cash-generating activity of that entity.

Investing activities

.15 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which cash outflows have been made for resources which are intended to contribute to the department's future service delivery. Only payments made, or proceeds received in respect of capital assets or investments are eligible for classification as investing activities. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire tangible and / or intangible assets. These payments include those relating to capitalised development costs and self-constructed tangible and / or intangible assets;

(b) cash receipts from sales of tangible and / or intangible assets;

(c) cash payments to acquire equity or debt instruments of other entities;

(d) cash receipts from sales of equity of other entities;

(e) cash advances and loans made to other parties;

(f) cash receipts from the repayment of advances and loans made to other parties;

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

Financing activities

.16 The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the department. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short- or long-term borrowings;

(b) cash repayments of amounts borrowed; and

(c) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities

.17 **A department shall report cash flows from operating activities using the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.**

.18 The direct method provides information which may be useful in estimating future cash flows. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the department; or

(b) by adjusting operating revenues, operating expenses and other items in the statement of financial performance for:

(i) changes during the period in operating receivables and payables;

(ii) other non-cash items; and

(iii) other items for which the cash effects are investing or financing cash flows.

.19 **Departments should provide a reconciliation of the surplus/deficit with the net cash flow from operating activities. This reconciliation should be provided in the notes to the financial statements.**

Reporting cash flows from investing and financing activities

.20 A department shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs .21 and .24 are reported on a net basis.

Reporting cash flows on a net basis

.21 **Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:**

(a) cash receipts collected and payments made on behalf of customers, taxpayers or beneficiaries when the cash flows reflect the activities of the other party rather than those of the department; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

.22 Paragraph .21(a) refers only to transactions where the resulting cash balances are controlled by the department. Examples of such cash receipts and payments include:

(a) the collection of taxes by one level of government for another level of government;

(b) funds held for individuals; and

(c) rents collected on behalf of, and paid over to, the owners of properties.

.23 Examples of cash receipts and payments referred to in paragraph .21(b) are advances made for, and the repayment of:

(a) the purchase and sale of investments; and

(b) other short-term borrowings, for example, those which have a maturity period of three months or less.

.24 **Cash flows arising from each of the following activities of a department may be reported on a net basis:**

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial institutions; and

(c) cash advances and loans made to customers and the repayment of those advances and loans.

Foreign currency cash flows

.25 **Cash flows arising from transactions in a foreign currency shall be recorded in a department's functional currency by applying to the foreign currency amount the exchange rate between the**

functional currency and the foreign currency at the date of the cash flow.

.26 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

Interest and dividends or similar distributions

.27 **Cash flows from interest and dividends or similar distributions received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as either operating, investing or financing activities.**

.28 The total amount of interest paid during a period is disclosed in the cash flow statement.

.29 Interest paid and interest and dividends or similar distributions received may be classified as operating cash flows because they enter into the determination of surplus or deficit. Alternatively, interest paid and interest and dividends or similar distributions received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

.30 Dividends or similar distributions paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends or similar distributions paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of a department to make these payments out of operating cash flows.

Non cash transactions

.31 **Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a cash flow statement. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.**

.32 Many investing and financing activities do not have a direct impact on current cash flows although they do affect the asset structure of a department. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement, as these items do not involve cash flows in the current period. Examples of non-cash transactions are:

(a) the acquisition of assets through the exchange of assets; and

(b) the conversion of debt to equity.

Components of cash and cash equivalents

.33 **Departments shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the statement of financial position.**

.34 The effect of any change in the policy for determining components of cash and cash equivalents, for example, a change in the classification of financial instruments previously considered to be part of a department's investment portfolio, is reported in accordance with the Chapter on *Accounting Policies, Estimates and Errors*.

Other disclosures

.35 **A department shall disclose, together with a commentary by management, the amount of**

significant cash and cash equivalent balances held by the department that are not available for use.

.36 There are various circumstances in which cash and cash equivalent balances held by a department are not available for use by the department. Examples include cash and cash equivalent balances held by a department on behalf of an individual.

.37 Additional information may be relevant to users in understanding the cash position of a department. Disclosure of this information, together with a commentary by management, is encouraged and may include:

(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and

(b) the amount and nature of restricted cash balances.

REVENUE

Chapter Content

Introduction

.01 This Chapter prescribes the accounting treatment for revenue received from exchange as well as non-exchange transactions.

Scope

.02 **A department shall apply this Chapter in accounting for revenue for the purposes of primary financial information.**

.03 The Chapter on *General Departmental Assets and Liabilities* prescribes the accounting for any receivable and / payable in respect of departmental revenue.

Definitions

.04 ***The following terms are used in this Chapter with the meanings specified:***

Appropriated funds comprise of departmental allocations as well as direct charges against the revenue fund (i.e. statutory appropriations)

Departmental revenue (for the purpose of this Chapter) is the inflow of cash arising in the course of the ordinary activities of the department, normally from the sale of goods, the rendering of services, and the earning of interest, taxes and dividends. It includes transactions in financial assets and liabilities and also transfers received. Departmental revenue is collected by national/provincial departments, and is subsequently paid over to the National/Provincial Revenue Fund. However, departmental revenue excludes appropriated funds.

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Fines are economic benefits or service potential received or receivable by entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Taxes are economic benefits or service potential compulsorily paid or payable to entities, in accordance with laws and or regulations, established to provide revenue to government. Taxes do not include fines or other penalties imposed for breaches of the law.

Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Non-exchange vs. exchange transactions

.05 The distinction between non-exchange and exchange transactions lies in whether equal value was exchanged in return for the receipt or supply of goods and or services. Where the distinction is not immediately clear the department must examine the substance of the transaction. For example, the sale of goods is normally classified as an exchange transaction. If, however the transaction is conducted at a subsidised price, that is, a price that is not approximately equal to the fair value of the goods sold, that transaction falls within the definition of a non-exchange transaction. In determining whether the substance of a transaction is that of a non-exchange transaction or an exchange transaction, professional judgement is exercised.

.06 The receipt of trade discounts, quantity discounts or other reductions in quoted prices of assets does not necessarily mean that the transaction is a non-exchange transaction.

Revenue

.07 The Chapter on *Concepts and Principles* defines revenue as "the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners". Thus, revenue comprises only of amounts received or receivable by the department on its own account. Amounts collected by a department as an agent of another government entity or other third parties will not give rise to an increase in net assets or revenue of the agent. This is because the agent entity cannot control the use of, or otherwise benefit from, the collected assets in the pursuit of its objectives. Further guidance on agency / principal relationships is included in the Chapter on *Agent-Principal Disclosures.*

Recognition and measurement of revenue

.08 **A department recognises revenue (other than appropriated funds) in the statement of financial performance on the date that the cash is received.**

.09 When a department incurs some cost in relation to revenue arising from a transaction, the revenue is the gross inflow of future economic benefits or service potential, and any outflow of resources is recognised separately as a cost of the transaction. Revenue is not recognised net of any commission paid unless the amount actually received is the net amount.

.10 A department generates revenue from exchange transactions through the sale of goods, the rendering of services or the earning of interest and dividends. The recording of the revenue from an exchange transaction coincides with the receipt of the funds from the recipient of the good and or services.

.11 Taxes are defined in paragraph .04 as economic benefits compulsorily paid or payable to entities, in accordance with laws or regulation, established to provide revenue to government, excluding fines or other penalties imposed for breaches of laws or regulations. Similar to exchange revenue amounts received from such non-exchanged transactions are recognised in the statement of financial performance when received.

.12 Cash receipts arising from transactions in a foreign currency should be recognised in South African Rand by applying to the foreign currency amount the exchange rate between South African Rand and the foreign currency at the date of the receipts.

.13 **Appropriated funds are recognised in the financial statements on the date the appropriation becomes effective. Adjustments made in terms of the adjustments budget process are recognised in the financial statements on the date the adjustments become effective.**

.14 Transfers received can be in the form of appropriations and or donations (also referred to as donor funding or aid assistance). Appropriations (and to some extent donor funding) comprise of grants to acquire or construct capital assets, funds for the furtherance of national and provincial government policy objectives and general allocations to fund the costs incurred by departments in supplying / rendering goods and or services. Transfers (other than appropriations) are usually from local or international donors and are received under terms and conditions as agreed between the department and the donor.

.15 **Revenue is measured at the cash amount received.**

Disclosures

.16 **The accounting policies adopted for the recognition, measurement, presentation and disclosure of revenue.**

.17 **A department shall disclose in its notes:**

a) its appropriation to the extent that the amount was budgeted as a separate line item in the published budget;

b) the amount of the actual appropriation received (showing separately the actual amount of statutory appropriation received);

c) the amount of appropriation not requested/not received along with an explanation theron;

d) a breakdown of the total departmental revenue into the different categories of departmental revenue. This breakdown should also reflect the amount by which departmental revenue is reduced in light of the amount of own revenue included in the appropriation;

e) for each of the categories of departmental revenue, the department shall also disclose a separate breakdown of the revenue included in each of these categories. This breakdown should reflect the sources / nature of the revenue that make up the category of departmental revenue;

f) for aid assistance received a department shall present a separate reconciliation of the local and foreign aid assistance in total and per category;

EXPENDITURE

Chapter Content

Introduction

.01 This Chapter prescribes the accounting treatment for expenditure paid by a department.

Scope

.02 **A department shall apply this Chapter in accounting for expenditure, including expenditure for capital assets and leases, for the purposes of primary financial information in the statement of financial performance.**

.03 This chapter excludes estimated or anticipated expenditure (i.e. liabilities) recorded in the notes to the financial statements as secondary financial information. The Chapter on *Provisions and Contingents* prescribes the recording and measurement of such amounts. The impact these amounts have on the actual expenditure levels of a department are not directly presented or disclosed in the financial statements.

.04 The Chapter on *General Departmental Assets and Liabilities* prescribes the accounting for any payables recognised and / or disclosed for the purposes primary financial information.

.05 **A department shall apply the principles in the Chapter on *Capital Assets* to assess whether it has a capital asset and if so the type of capital asset purchased before applying the recognition and measurement principles in this Chapter.**

.06 This Chapter does not apply to the disclosure of information on capital assets, leases assets and inventories for the purposes of secondary financial information. A department applies the relevant chapter for guidance on the recording and disclosure of such information in the notes to the financial statements.

Definitions

.07 ***The following terms are used in this Chapter with the meanings specified:***

Date of payment is the date on which the expenditure is authorised for payment (but no later than the last day of the reporting period).

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Expenditure

.08 Departments are responsible for a wide variety of services such as providing health, safety, education, social and other services to the public. In rendering these services, departments incur a range of different expenses. The types of expenses are categorised into the following:

(a) Current payments, comprising of compensation of employees, goods and services and interest and rent on land;

(b) Transfers and subsidies;

(c) Payments for capital assets; and

(d) Payments for financial assets.

.09 The types of expenses incurred by a particular department will depend on the type of activities mainly conducted by that department. Departments providing mainly policy advice will spend a high portion of its budget on compensation of employees, whereas departments providing operational services will incur a wider range of expenses both of a current and a capital nature.

Recognition and measurement of expenditure

.10 **A department recognises expenditure in the statement of financial performance on the date of payment.**

.11 As a practical expedient, there is a rebuttable presumption that when a department authorises a payment on its system, the likelihood of this payment not occurring is remote and the department can recognise the expense. However, where there is evidence to the contrary, the department shall make appropriate adjustments to ensure that expenses are recognised on the actual date that the cash outflow occurred.

.12 **Cash payments arising from a transaction in a foreign currency should be recorded in South African Rand by applying the exchange rate between South African Rand and the foreign currency to the foreign currency amount at the date of the cash flow.**

.13 **Expenditure is measured at the cash amount paid to settle the expenditure incurred.**

Disclosures

.14 **The accounting policies adopted for the recognition, measurement, presentation and disclosure of expenditure.**

.15 **A department shall disclose the following with regards to compensation of employees:**

a) a breakdown of the salaries and wages paid

b) a breakdown of the social contributions paid in relation to its employees, for example distinguishing between pension payments and medical payments;

c) the total compensation of employees paid during the year; and

d) the average number of employees of the department for the year.

.16 **A department shall disclose the following with regards to payments for goods and services:**

a) the amount paid for goods and services, reflecting separately the significant categories of goods and services;

b) payments for assets that cost less than the threshold value prescribed by the OAG, showing significant classes separately and distinguishing between tangible and intangible assets;

c) payments made in relation to computer services, differentiating between computer services from SITA and other external computer service providers;

d) for each significant class of service, the payments made in relation to consultants, contractors and agency/outsourced services;

e) the payment for and nature of each external audit conducted during the period;

f) for each significant class of inventory / consumables, the payments made in relation to the acquisition of inventory / consumables;

g) a high level analysis of all property payments made during the year;

h) travel and subsistence paid, differentiating between local and foreign costs; and

i) an analysis, per significant category, of other operating expenditure.

.17 **A department shall disclose the amount of payments for interest and rent on land.**

.18 **A department shall disclose breakdown of each significant class of payments for financial assets including a description of the nature of the losses that form part of the payments for financial assets.**

.19 **A department shall disclose the following with regards to transfers and subsidies paid:**

- **a) a department shall disclose separately, per major category, the transfers and subsidies paid to various entities; and**
- **b) a department shall further also disclose the amount of unspent funds transferred to beneficiaries.**

.20 **A department shall disclose the following with regards to expenditure for capital assets:**

- **a) total expenditure for each type/class of assets;**
- **b) an analysis of voted funds and aid assistance funds utilised to acquire the capital assets; and**
- **c) an analysis of finance lease expenditure included in expenditure for capital assets.**

GENERAL DEPARTMENTAL ASSETS AND LIABILITIES

Chapter Content

Introduction

.01 This Chapter prescribes the recognition and measurement practices to be applied to the general departmental assets and liabilities as described in paragraph .03 in the financial statements of departments.

Scope

.02 **A department shall apply this Chapter for the recognition / recording and measurement of its general departmental assets and liabilities for the purposes of primary and secondary information.**

.03 **The following assets and liabilities are explicitly included in the scope of this chapter:**

(a) bank overdraft, cash and cash equivalents, investments, loans, other financial assets, payables and receivables;

(b) voted funds and departmental revenue to be surrendered to the revenue fund;

(c) prepayments and advances; and

(d) unauthorised, irregular and fruitless and wasteful expenditure.

Definitions

.04 ***The following terms are used in this Chapter with the meanings specified:***

<u>Advances</u> comprise funds received in advance of goods/services that are yet to be delivered by the department by the department in accordance with the agreement under which the advance is received.

A <u>financial asset</u> is:

(a) cash;

(b) a residual interest of another entity; or

(c) a contractual right to:

(i) receive cash or another financial asset from another entity; or

(ii) exchange financial assets or financial liabilities with another entity under conditions that are favourable to the department.

A <u>financial instrument</u> is any contract that gives rise to a financial asset of one entity and a financial liability or a residual interest of another entity.

A <u>financial liability</u> is any liability that is a contractual obligation to:

(a) deliver cash or another financial asset to another party; or

(b) exchange financial assets **or financial liabilities under conditions that are potentially unfavourable to the department.**

<u>Cost</u> (for purposes of this Chapter) is the transaction amount, less any amounts derecognised (where applicable).

<u>Loans</u> payable are financial liabilities, other than short-term payables on normal credit terms.

A <u>prepayment</u> is a payment made in advance of the goods or services being received.

A residual interest is any contract that manifests an interest in the assets of an entity after deducting all of its liabilities. A residual interest includes contributions from owners, which may be shown as:

(a) equity instruments or similar forms of unitised capital;

(b) a formal designation of a transfer of resources (or a class of such transfers) by the parties to the transaction as forming part of an entity's net assets, either before the contribution occurs or at the time of the contribution; or

(c) a formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets of an entity.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Accounting for financial assets / liabilities and prepayments / advances

Recognition and measurement of financial assets / liabilities and prepayments / advances for the purpose primary financial information

.05 **A department shall recognise a financial asset or a financial liability, a prepayment or an advance in its statement of financial position when, and only when, the department becomes a party to the provisions of the arrangement, and one of the following additional recognition criteria are met:**

(i) the instrument is cash, or a cash equivalent under the control of the department;

(ii) the financial asset or liability, prepayment or advance initially arose from a cash transaction (for example loans to employees or other parties, that will be settled in cash); or

(iii) the financial asset is a capital investment.

A department may recognise a prepayment in the statement of financial performance in accordance with the Chapter on Expenditure if the prepayment was budgeted for as an expense in the year in which the actual prepayment was made.

.06 An arrangement for the purposes of this chapter encompasses both contractual and non-contractual arrangements. A contractual arrangement refers to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Non-contractual arrangements arise out of legislation, supporting regulations or similar means (i.e. documents issued in terms of legislation such as ministerial orders and cabinet decisions).

.07 A financial liability may arise out of legislation for example the requirement for departments surrender all unspent appropriations and collected departmental revenue to the relevant revenue fund. Financial receivables recognised in the statement of financial position arise when employees owe money to the department or where an overpayment has been made to a supplier.

.08 **When a financial asset or financial liability is recognised initially, a department shall measure it at its cost plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.**

.09 **At the reporting date, a department shall measure its financial assets and financial liabilities at cost, less amounts already settled or written-off, except for recognised loans and receivables, which are measured at cost plus accrued interest, where interest is charged, less amounts**

already settled or written-off.

.10 **A prepayment or advance is initially and subsequently measured at cost.**

.11 The impact of the time value of money on the value of a financial liability (and financial asset) is ignored, where for practical reasons, the actual flow of funds occurs at a later date for example after the finalisation of the audit.

Recording and measurement of financial assets / liabilities for the purpose secondary financial information

.12 **A financial asset / liability not recognised in accordance with paragraph .05 shall be recorded as a financial asset or financial liability for disclosure purposes when, and only when, the department becomes a party to the contractual provisions of the arrangement and when the criteria in paragraphs .13 and .19 are met.**

Accrued revenue receivable

.13 **A department records and discloses accruals in respect of departmental revenue (excluding tax revenue), when:**

(a) it is probable that the economic benefits or service potential associated with the transaction will flow to the department; and

(b) the amount of revenue can be measured reliably.

Furthermore, to the extent that revenue is related to the sale of goods or the rendering of services the following additional criteria must be satisfied:

Sale of goods

(a) the department has transferred to the purchaser the significant risks and rewards of ownership of the goods;

(b) the department retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; and

(c) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Rendering of services

(a) the stage of completion of the transaction at the reporting date can be measured reliably; and

(b) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

.14 A department needs to assess the degree of certainty attached to the flow of future economic benefits or service potential on the basis of the available evidence. Revenue should only be recorded once evidence of the probability of the flow becomes available, for example the signing of an agreement.

Taxation revenue

.15 **A department is exempt from the recording of an accrual for taxation revenue. By implication, a department need not accrue for any receivables or payables such as interest or other charges that are directly related to the levying and or collection of the tax receipt.**

.16 **Notwithstanding the exemption in paragraph .15, a department shall record an accrual for any amounts collected by third parties and which are due to the department at the reporting date.**

.17 **Accrued revenue shall be measured at the fair value of the consideration receivable.**

.18 The fair value of the accrual is the transaction price, which is the value agreed in the contract between the two parties.

Accrued expenditure payable

.19 **Accrued expenditure payable is recorded when goods are received or, in the case of services, when they are delivered to the department.**

.20 For the purposes of recording accruals, a department should maintain an accruals register that will enable it to comply with the disclosure requirements of this Chapter.

.21 **A department shall record its accrued expenditure payables, at cost, as at the reporting date**

Impairment

.22 **For all financial assets (primary and secondary information), where there is an indication of impairment, appropriate disclosures should be included in the secondary financial information to show the estimated reduction in the recorded carrying value to reflect the best estimate of the amount of the future economic benefits expected to be received from that asset.**

.23 Impairment estimates are determined by estimating the present value of the expected future inflow of cash that is expected in settlement of the recorded financial asset. The present value is determined by using an appropriate interest rate to discount the future expected cash flow. As a practical expedient, departments are encouraged to consider the prevailing prime rate of interest. Further adjustments to the rate that may better reflect the credit risk associated with the instrument may be made.

Derecognition and removal

.24 **A department shall derecognise and / or remove a financial asset only when:**

(a) the contractual rights to the cash flows from the financial asset expire, are settled, or waived (written-off); or

(b) the department transfers to another party substantially all of the risks and rewards of ownership of the financial asset;

.25 **A department shall derecognise and / or remove a financial liability (or a part of a financial liability) when, and only when, it is extinguished — i.e. when the obligation specified in the contract is discharged, cancelled, expires or is waived.**

.26 **Prepayments and advances recognised in the statement of financial position are de-recognised when the related goods / services are received or the funds are utilised in accordance with the contractual arrangement.**

Offsetting financial assets and liabilities

.27 **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, the department:**

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

.28 This chapter requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects a department's expected future cash flows from settling two or more separate financial instruments. When a department has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.

.29 Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss.

.30 A right of set-off is a debtor‘s legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor‘s right of set-off. Because the right of set-off is a legal right the laws applicable to the relationships between the parties need to be considered.

.31 A department‘s intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When a department has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the department should not offset the financial asset and financial liability.

Disclosures

Primary financial information

.32 **A department shall disclose the following in its notes with regard to cash and cash equivalents:**

a) the balance of significant classes of cash and cash equivalents separately at the end of the reporting period.

.33 **A department shall disclose the following in its notes with regard to other financial assets:**

a) the major categories of current and non-current financial assets.

b) individually material financial assets shall be disclosed separately.

c) in disclosing the major categories of other financial assets the department shall differentiate between local and foreign financial assets.

.34 **A department shall disclose the following in its notes with regard to prepayments and advances:**

a) per significant category, the prepayments and advances at the end of the reporting period; and

b) total value of prepayments included in the current year’s expenditure, along with an explanation for expensing the payment prior to the receipt of the goods / services;

.35 **A department shall disclose the following in its notes with regard to receivables:**

a) an age analysis for receivables per category of receivable. The age analysis presented should reflect the following aging classifications:

(i) Less than one year;

(ii) One to three years; and

(iii) Older than three years.

b) for each category of receivable a department shall also disclose separately the classes of receivables per category, with a description of the class and value thereof.

.36 **A department shall disclose the following, in its notes to the financial statements, with regard to investments:**

a) its non-current investment in:

(i) shares and other equity; and

(ii) securities other than shares.

b) a reconciliation of the opening balance and the balance at the reporting date of the non-current investments reflecting the following:

(i) additions in cash;

(ii) disposals in cash; and

(iii) non cash movements.

.37 **A department shall disclose the following, in its notes to the financial statements, with regard to loans:**

a) the value of each class of loans; and

b) an analysis of the total balance of loans reflecting the following:

(i) New loans issued;

(ii) Repayments of loans; and

(iii) Loans written off.

.38 **A department shall disclose the following, in its notes to the financial statements, with regard to bank overdrafts:**

a) details of the bank overdraft balance at year end.

.39 **A department shall disclose the following, in its notes to the financial statements, with regard to current payables:**

a) the total of each separate significant category of current payables.

b) for each category disclosed, the department shall disclose a description of the payable and value thereof.

.40 **A department shall disclose the following, in its notes to the financial statements, with regard to non-current payables:**

a) A department shall disclose, in the notes to the financial statements, an age-analysis for non-current payables per category. The age analysis presented should reflect the following aging classifications:

(i) Less than one year;

(ii) One to three years; and

(iii) Older than three years.

b) For each category of non-current payables a department shall disclose separately the significant classes of non-current payables, with a description of the class and value thereof, included in the category.

.41 **A department shall disclose the following in its notes with regard to aid assistance:**

a) an analysis of the total aid assistance balance to indicate the following:

(i) Aid assistance receivable;

(ii) Aid assistance prepayments;

(iii) Aid assistance unutilised; and

(iv) Aid assistance repayable.

.42 **A department shall disclose the following in its notes with regard to voted funds to be surrendered to the Revenue Fund:**

a) A reconciliation of the opening balance and the closing balance at the end of the reporting period reflecting the following:

(i) Transfer from statement of financial performance;

(ii) Unauthorised expenditure for current year;

(iii) Voted funds not requested/not received;

(iv) Transferred to retained revenue to defray excess expenditure (but only to the extent that the department is either Parliament or a provincial legislature); and

(v) Amounts paid during the year.

b) To the extent that the department is either Parliament or a provincial legislature, the department shall also present a breakdown of the amounts transferred to retained revenue to defray excess expenditure.

.43 **As part of the primary financial information, a department shall disclose the following in its notes with regards to departmental revenue and NRF receipts to be surrendered to the Revenue Fund:**

a) **A reconciliation of the opening balance and the closing balance at the end of the reporting period showing the following:**

(i) Transfer from Statement of Financial Performance;

(ii) Own revenue included in appropriation;

(iii) Transfer from aid assistance; and

(iv) Transferred to retained revenue to defray excess expenditure (but only to the extent that the department is either Parliament or a provincial legislature).

Secondary financial information

.44 **As part of the secondary financial information, a department shall disclose the following in its notes with regard to recorded receivables for departmental revenue:**

a) The major categories of receivables for departmental revenue;

b) An analysis of the opening balance and the closing balance of departmental revenue receivables at the reporting date; and

c) A description of the nature and value of any receivables for departmental revenue written off.

.45 **A department shall also disclose the following in its notes with regard to impairments of recorded receivables:**

a) the impairment losses for the period for each class of financial asset.

.46 **A department shall disclose a summary of its accruals (other than those relating to employee benefits) per economic classification. In presenting this summary the department shall also provide an aging of those accruals differentiating between 30 day accruals and those accruals that are more than 30 days old**.

.47 **A department shall disclose the value of each major class of accruals for employee benefits as at the reporting date.**

Unauthorised, irregular and fruitless and wasteful expenditure

Recognition/recording and measurement

Unauthorised expenditure

.48 **Unauthorised expenditure is recognised as an asset in the statement of financial position until such time as the expenditure is either approved by the relevant authority or transferred to receivables for recovery.**

.49 **Unauthorised expenditure is measured at the amount of the confirmed unauthorised expenditure.**

.50 **Unauthorised expenditure approved with funding is derecognised in the statement of financial position when the unauthorised expenditure is approved and the related funds are received. Where the amount is approved without funding it is recognised as expenditure in the statement of financial performance on the date stipulated in the Act.**

Fruitless and wasteful expenditure

.51 **Fruitless and wasteful expenditure is recorded in the notes to the financial statements when confirmed. The amount recorded is equal to the total value of the fruitless and or wasteful expenditure incurred. Fruitless and wasteful expenditure is removed from the notes to the financial statements when it is resolved or transferred to receivables for recovery. Any recoverable amounts shall be recognised as a receivable in accordance with par .05.**

.52 **Fruitless and wasteful expenditure receivables are measured at the amount that is expected to be recoverable and are de-recognised when settled or subsequently written-off as irrecoverable.**

Irregular expenditure

.53 **Irregular expenditure is recorded in the notes to the financial statements when confirmed. The amount recorded is equal to the total value of the irregularity unless it is impracticable to determine, in which case reasons therefor are provided in the note. Any recoverable amounts shall be recognised as a receivable in accordance with par .05.**

.54 **Irregular expenditure receivables are measured at the amount that is expected to be recoverable and are de-recognised when settled or subsequently written-off as irrecoverable.**

Disclosures

.55 **A department shall disclose the following in its notes with regard to unauthorised expenditure:**

a) a reconciliation of the opening balance and the balance at the reporting date reflecting the following:

(i) unauthorised expenditure discovered in the current financial year;

(ii) amounts approved by Parliament/Legislature with funding;

(iii) amounts approved by Parliament/Legislature without funding and written of in the statement of financial performance per economic classification; and

(iv) amounts transferred to receivables for recovery.

b) An analysis of amounts awaiting authorisation per economic classification;

c) An analysis of amounts awaiting authorisation per major category; and

d) A general description of the current year's unauthorised expenditure with an indication of any disciplinary steps taken or criminal proceedings initiated/underway.

.56 **A department shall disclose the following in its notes with regard to irregular expenditure:**

a) A reconciliation of the opening balance and the balance at the reporting date reflecting the following:

(i) irregular expenditure identified in the current financial year (relating to the current and prior year);

(ii) amounts condoned;

(iii) amounts not condoned and transferred to receivables for recovery; and

(iv) amounts not condoned and written-off.

b) An analysis of amounts awaiting condonation per age classification;

c) An general discussion irregular expenditure identified in the current year along with a discussion on disciplinary steps taken/criminal proceedings initiated/underway

d) A general discussion on irregular expenditure condoned;

e) A general discussion on irregular expenditure recoverable (not condoned);

f) A general discussion on irregular expenditure not recoverable (not condoned); and

g) Details of irregular expenditure under investigation.

.57 **A department shall disclose the following in its notes with regard to fruitless and wasteful expenditure:**

a) A reconciliation of the opening balance and the balance at the reporting date reflecting the following:

(i) fruitless and wasteful expenditure identified in the current financial year (relating to the current and prior year);

(ii) amounts resolved; and

(iii) amounts transferred to receivables for recovery

b) An analysis of amounts awaiting resolution along with a discussion on disciplinary steps taken/criminal proceedings initiated/underway;

c) An analysis of fruitless and wasteful expenditure transferred to receivables for recovery per economic classification;

TREASURY FINANCIAL INSTRUMENTS

Chapter Content

Introduction

.01 This Chapter prescribes the recognition and measurement practices to be applied to treasury financial instruments in the consolidated financial statements of national / provincial government.

Scope

.02 **A department shall apply this chapter for the recognition and measurement of its treasury financial instruments for the purpose of primary financial information.**

.03 This chapter applies to departments that are involved in investing or issuing certain types of financial instruments for the purposes of making a return or raising finance. Typically, these types of instruments would be limited to the National or a Provincial Treasury.

.04 **This Chapter does not apply to the following instruments, except where indicated otherwise:**

(i) Rights and obligations under leases to which the Chapter on Leases applies;

(ii) Insurance contracts as defined in the International Financial Reporting Standard on Insurance Contracts;

(iii) Financial guarantee contracts that are issued by a department and recognised, measured and/or disclosed in accordance with the Chapter on Provisions, Contingent Liabilities and Contingent Assets;

(iv) Loan commitments that are issued by a department and recognised, measured and/or disclosed in accordance with the Chapter on Provisions, Contingent Liabilities and Contingent Assets;

(v) Contractual rights and obligations arising from non-exchange revenue transactions to which the Chapter on Revenue applies; and

(vi) Financial instruments that are within the scope of the Chapter on General Departmental Assets and Liabilities.

Definitions

.05 ***The following terms are used in this chapter with the meanings specified:***

The <u>amortised cost</u> of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the coupon rate.

The <u>cost method</u> (for purposes of this Chapter) is the method used to account for financial instruments that requires such instruments to be measured at their transaction amount, plus any accrued interest and other charges (where applicable), less any amounts derecognised.

A <u>concessionary loan</u> is a loan granted or received on terms that are not market related.

The <u>coupon rate</u> of an instrument is the agreed interest rate quoted in the agreement for the instrument at which interest is levied on the instrument. E.g. the coupon rate of a 5% R100 bond would be 5%.

<u>Derecognition</u> is the removal of a previously recognised financial asset or financial liability from the statement of financial position.

A <u>derivative</u> is a financial instrument or other contract within the scope of this Chapter with all three of the following characteristics:

(a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').

(b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

(c) It is settled at a future date.

The <u>face value</u> of an instrument is the coupon price of the instrument, e.g. the face value of a R100 bond, would be R100.

The <u>transaction amount</u> for financial instruments means the cash amount received at the date of issue.

The <u>settlement value</u> of an instrument is the amount that would be required to extinguish any right to cash or obligation to deliver cash related to the instrument at a specific point in time. E.g. the settlement value of a loan at the reporting date would be the amount required to extinguish the obligation at the reporting date.

<u>Special drawing rights (SDRs)</u> are supplementary foreign exchange reserve assets defined and maintained by the IMF.

.06 ***The following types (classes) of financial assets typically exist in the South African public sector and are defined as follows:***

<u>Capital subscriptions</u> represent South Africa's membership / shareholding in international financial institutions. These institutions have been established by more than one country and are subject to international law. Their owners or shareholders are generally national governments.

.07 ***The following types (classes) of financial liabilities typically exist in the South African public sector and are defined as follows:***

<u>Callable capital</u> is the portion of subscribed capital stock in international financial institutions that is subject to call only as and when required by the institution to meet its obligations:

a) for funds borrowed or loans guaranteed by it; or

b) on foreign investment guarantees to investors that are planning investments in developing member countries.

<u>Fixed-rate bonds</u> are debt instruments which carry a fixed interest rate (coupon rate) over the life of the instrument payable on the face value of the security. Interest is payable every 6 months. At issue the debt instrument has an outstanding term-to-maturity in excess of one year. The bonds are repayable on maturity at face value.

<u>Fixed-rate retail savings bonds</u> are debt instruments which carry a fixed interest rate (coupon rate) over the life of the instrument on the face value of the security. The instruments have a term-to-maturity of 2, 3 and 5 years with interest payable monthly, every 6 months or capitalised. Investors have the option to redeem their investment prior to maturity at a penalty.

<u>Foreign concessionary loans</u> are debt instruments issued in a foreign currency on terms substantially more generous than market loans. The concessionality is achieved either through interest rates below those available in the market or by grace periods, or a

combination of these. The interest and capital is repayable at maturity in that foreign currency.

Foreign currency bonds / loans are debt instruments issued in a foreign currency with interest payable at a fixed rate (coupon rate) and capital repayable at maturity in that foreign currency.

Inflation-linked bonds are debt instruments where the principle amount is indexed to the headline inflation (consumer price inflation) thus the outstanding value of the bonds vary over time according to the consumer price index. Interest is payable at a fixed rate (coupon rate) on the inflation adjusted outstanding amount. At maturity the adjusted capital value of the bonds are paid.

Inflation-linked retail savings bonds are debt instruments issued at a face value with a term to maturity of 2, 3 and 5 years. The principal value fluctuates according to the consumer price index. Interest is payable at a fixed rate (coupon rate) on the adjusted principal value outstanding.

International Monetary Fund (IMF) securities are securities in the IMF's general recourses account held with the South African Reserve Bank.

Loans are amounts borrowed from the Corporation for Public Deposits for bridging finance purposes.

Perpetual bonds are debt instruments with no predetermined maturity. Interest is payable six monthly at a fixed-rate.

A repurchase agreement (REPO) / Scrip lending is a form of short-term borrowing where government sells a security and agrees to repurchase it in the future.

Separately traded interest and principal bonds (STRIPS) are securities that have been transformed from a principle amount with periodic interest coupons into a series of zero-coupon bonds, whose range of maturities matches the coupon payment dates and the redemption date of the principle amount.

Treasury bills are short-term debt instruments issued at a discount to par with a term-to-maturity between 1-day to 364-days.

Variable rate bonds are debt instruments with the interest rate indexed to the 91 day Treasury bill yield. Interest is payable on a quarterly basis and the bonds are repayable at its face value on maturity.

Zero coupon bonds are debt instruments issued at a deep discount and are repayable at its face value on maturity. The discount at issue is amortised six monthly over the life of the bond using the effective interest rate at time of issue.

Distinguishing liabilities and residual interests

.08 **The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or residual interest in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and a residual interest.**

.09 When an issuer applies the definitions in paragraph .05 to determine whether a financial instrument is a residual interest rather than a financial liability, the instrument is a residual interest if, and only if, the instrument includes no contractual obligation to:

a) deliver cash or another financial asset to another entity; or

b) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

No contractual obligation to deliver cash or another financial asset

.10 A critical feature in differentiating a financial liability from a residual interest is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder), or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Although the holder of a residual interest may be entitled to receive a pro rata share of any dividends or similar distributions, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

.11 The substance of a financial instrument, rather than its legal form, governs its classification on the department's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of a residual interest but are liabilities in substance. Others may combine features associated with residual interests and features associated with financial liabilities.

.12 If a department does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability. For example:

a) a restriction on the ability of a department to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the department's contractual obligation or the holder's contractual right under the instrument; or

b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the department does not have the unconditional right to avoid delivering cash or another financial asset.

.13 A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example, a financial instrument may contain a nonfinancial obligation that must be settled if, and only if, the department fails to make distributions or to redeem the instrument. If the department can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.

Primary financial information

Initial recognition

.14 **A department shall recognise a financial asset or a financial liability in its consolidated statement of financial position when, and only when, the department becomes a party to the contractual provisions of the instrument.**

Measurement at initial recognition

.15 **When a financial asset or financial liability is recognised initially, a department shall measure it at its face value.**

.16 **At initial recognition a department may also designate a financial instrument to be measured at its transaction amount at initial recognition. As such, the department may measure the financial instrument, at initial recognition, at the amount that was received in cash on the date of issue.**

.17 **All transaction costs that are directly attributable to the acquisition or issue of a financial asset or liability are recongised as an expense in accordance with the Chapter on Expenditure.**

.18 Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers, and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs, or internal administrative or holding costs

.19 **Costs that are not directly attributable to the acquisition or issue of a financial asset or financial liability are recognised as an expense in accordance with the Chapter on Expenditure.**

.20 **Costs that are directly attributable to the acquisition or issue of financial assets or financial liabilities, but which cannot be linked to specific financial assets or financial liabilities are recognised as an expense in accordance with the Chapter on Expenditure.**

.21 Credit rating agency fees are incurred in the process of obtaining credit ratings from international credit rating agencies such as Moody's, Standards & Poor, etc. The credit ratings thus obtained provide potential investors (in the government debt instruments issued by National Treasury) with an indication of the risk of payment default associated with the issuer of the instrument. As such, these costs are integral to the issuing of debt instruments. However, taking into consideration that the credit rating is done at an entity level (i.e. the issuer of the instrument is evaluated and not the individual instrument) the credit rating fee cannot be linked to a specific instrument. Therefore the credit rating agency fees will not be recognised in the cost of an instrument.

Subsequent measurement

Cost method

.22 **Under the cost method, the transaction amount of the financial asset and or liability is changed subsequent to initial recognition to reflect any:**

a) change in the foreign exchange rate (where applicable);

b) interest capitalized (where applicable); or

c) amounts derecognized.

Foreign currency gains and losses

.23 At reporting date the foreign currency of amount of a loan or bond is converted to South African Rand using the spot rate with any revaluation gain or loss is recognized in surplus or deficit.

.24 **All interest paid or received is recongised as revenue or an expense in accordance with the relevant chapter on Revenue and Expenditure.**

Alternative measurement models

.25 **A department may designate the subsequent measurement of a specific class of non-derivative financial instruments with fixed or determinable payments to be at:**

a) amortised cost; or

b) settlement value.

Amortised cost

.26 For financial instruments at amortised cost, the interest expense (for financial liabilities) or revenue (for financial assets) is calculated by using the coupon rate of the instrument.

.27 The coupon rate is the rate that is quoted and agreed upon within the contract for the instrument. For example, where a department issues a bond with a face value of R 100 and agrees an interest rate of 8% in the bond (which will be stated as such in the bond agreement) the coupon rate will be 8%. Where interest is recognized with reference to the coupon rate it will therefore be determined as the face value multiplied by the coupon rate. For the aforementioned example the interest expense determined with reference to the coupon rate would be R100 x 8% = R8.

.28 The coupon rate ignores all premiums and discounts. Furthermore, this rate also excludes any fees related to the issuing of the instrument. This rate is determined with pure reference to the agreement that underpins the financial instrument.

.29 **For financial assets and financial liabilities measured at amortised cost, a gain or loss is recognised in surplus or deficit when the financial asset or financial liability is derecognised or through the amortisation process.**

Settlement value

.30 For financial assets and financial liabilities measured at settlement value the amount determined is the "exit price". For assets this is the amount the department would have received if it had sold the asset and for liabilities the amount reflects the amount the department would have paid if it had been relieved of the liability.

.31 **For financial assets and financial liabilities measured at settlement value, a gain or loss is recognised in surplus or deficit when the financial asset or financial liability is derecognised or revalued.**

Derecognition of financial assets

.32 **A department shall derecognise a financial asset only when:**

a) the contractual rights to the cash flows from the financial asset expire, are settled or waived; or

b) the department transfers to another party substantially all of the risks and rewards of ownership of the financial asset;

Assessing the transfer of risks and rewards, and control

.33 The transfer of risks and rewards is evaluated by comparing the department's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. A department has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g. because the department has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). A department has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g. because the department has sold a financial asset subject only to an option to buy it back at its fair value at the time of repurchase).

.34 Often it will be obvious whether the department has transferred or retained substantially all of the risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the department's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison is made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

.35 Whether the department has transferred control of the asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the department has not retained control.

.36 **On derecognition of a financial asset in its entirety, the difference between:**

a) the carrying amount; and

b) the sum of the consideration received (including any new asset obtained less any new liability assumed) shall be recognised in surplus or deficit.

Derecognition of financial liabilities

.37 **A department shall remove a recognised financial liability (or a part of a financial liability) from its consolidated statement of financial position when, and only when, it is extinguished — i.e. when the obligation specified in the contract is discharged, cancelled, expires or waived.**

.38 **An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as having extinguished the original financial liability, and a new financial liability recognised. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as having extinguished the original financial liability and having recognised a new financial liability.**

.39 **The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in surplus or deficit.**

Offsetting financial assets and financial liabilities

.40 **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, the department:**

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Disclosures

.41 **The department shall disclose the measurement model applied to its financial instruments in the notes to the financial statements.**

.42 **A department shall disclose the following items of revenue, expense, gains or losses either in the statement of financial performance or in the notes:**

a) total interest revenue and total interest expense for financial instruments; and

b) total foreign exchange gains and or losses on the revaluation of financial instruments;

.43 **For each type of risk arising from financial instruments, a department shall disclose:**

a) the exposures to risk and how they arise; and

b) its objectives, policies and processes for managing the risk.

.44 **A department shall disclose:**

a) a maturity analysis or redemption analysis for financial liabilities that shows the remaining contractual maturities; and

b) a description of how it manages the liquidity risk inherent in (a).

Appendix - Measurement of financial assets and liabilities

The appendix is an integral part of the Chapter. The purpose of the appendix is to illustrate the application of the Chapter to the classes of financial instruments in South Africa.

Class of financial instrument	Initial measurement	Subsequent measurement
Financial assets		
Capital subscriptions (e.g. in the International Finance Corporation, International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the IMF and the African Development Bank)	The investment is initially recognised at the issue price	Revalued using the closing exchange (spot) rate at 31 March each year. Forex gain / loss recognised in the consolidated statement of financial performance.
Financial liabilities		
Callable capital (relating to the subscription in the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the IMF and the African Development Bank)	The liability is initially recognised at the issue price (of the capital subscription).	Revalued using the closing exchange (spot) rate at 31 March each year. Forex gain / loss recognised in the consolidated statement of financial performance.
Concessionary loans	Initially recognised at the face value of the loan	The cost model is applied. The loan is stated at the face value less subsequent repayments of the capital amount. As such, unpaid interest is not capitalised as part of the bond amount.
Fixed rate bonds These bonds can be issued at par, a discount or premium.	Initially recognised at the face value of the bond	After initial recognition the bond is measured at its face value. As such, unpaid interest is not capitalised as part of the bond amount.
Fixed rate retail savings bonds	Initially recognised at the face value of the bond	After initial recognition the bond is measured at its face value. However, with certain of these bonds the agreement allows for capitalisation of the interest. Where the agreement allows for this capitalisation interest is capitalised to the face value using the coupon rate.
Foreign concessionary loans	Initially recognised at the face value loan. The face value of the loan at initial recognition is determine as	The cost model is applied. The loan is stated at the face value less subsequent repayments of the capital

Class of financial instrument	Initial measurement	Subsequent measurement
	the actual Rand amount received for the loan denominated in a foreign currency.	amount and adjusted for translation of the foreign currency amount to Rand. At reporting date the foreign currency amount of the bond(loan) is converted to Rand using the sport rate (mid-rate). This results in either a foreign currency revaluation profit or loss. As such, unpaid interest is not capitalised as part of the bond amount.
Foreign currency bonds / loans	Initially recognised at the face value loan / bond. The face value of the loan / bond at initial recognition is determine as the actual Rand amount received for the loan / bond denominated in a foreign currency.	The cost model is applied. The loan is stated at the face value less subsequent repayments of the capital amount and adjusted for translation of the foreign currency amount to Rand. At reporting date the foreign currency amount of the bond(loan) is converted to Rand using the sport rate (mid-rate). This results in either a foreign currency revaluation profit or loss. As such, unpaid interest is not capitalised as part of the bond amount.
Inflation linked bonds	Initially recognised at the transaction amount of the bond	After initial recognition the bonds are measured at their settlement value. The bond's face value is adjusted for changes in CPI to arrive at the amount that will be required to settle the outstanding obligation.
Inflation linked retail savings bonds	Initially recognised at the face value of the bond	After initial recognition the bonds are measured at their settlement value. The bond's face value is adjusted for changes in CPI to arrive at the amount that will be required to settle the outstanding obligation.
Loans (CPD borrowings)	Initially recognised at the face value of the loans.	The cost model is applied. The loan is stated at the face value less subsequent repayments of the capital amount.

Class of financial instrument	Initial measurement	Subsequent measurement
		As such, unpaid interest is not capitalised as part of the bond amount.
Perpetual bonds	Initially recognised at the face value of the bond	After initial recognition the bond is measured at its face value. As such, unpaid interest is not capitalised as part of the bond amount.
Repos / Scrip lending	Initially recognised at face value	After initial recognition the repos are measured at their settlement value.
STRIPS	At initial recognition the STRIPS are measured at their face value. Currently, the principal STRIPS are included as part of debt with the coupon STRIPS as part of debt-service cost	After initial recognition the STRIPS are measured at their face value.
Treasury bills	Initially recognised at the face value of the bills	After initial recognition the bill is measured at its face value.
Variable rate bonds	Initially recognised at the face value of the bond	After initial recognition the bond is measured at its face value. As such, unpaid interest is not capitalised as part of the bond amount.
Zero coupon bonds	Initially recognised at the transaction amount of the bond. As such, the bond is initially recognised at the cash amount received.	After initial recognition the bonds are measured at their settlement value. The bonds are issued initially at a discount with no coupon rate. The difference between the face value of the bond and the transaction amount is unwound over the term of the bond. As such, at the reporting date the bond is measured at the face value increased with a portion of the discount that was unwound to date to arrive at the settlement value of the bond at the reporting date.

CAPITAL ASSETS

Chapter Content

Introduction

.01 This Chapter provides guidance on the identification of and the types of capital assets in the public sector. It further prescribes the accounting treatment for capital assets in the secondary financial information to the annual financial statements.

Scope

.02 **A department shall apply this Chapter in accounting for capital assets for the purposes of secondary financial information. The accounting requirements in respect of the primary financial information (i.e. the expenditure relating to the acquisition / maintenance etc.) are dealt with in the Chapter on *Expenditure.***

.03 This Chapter applies to capital assets including:

(a) investment properties;

(b) biological assets;

(c) specialised military equipment;

(d) heritage assets;

(e) infrastructure assets

(f) intangible assets; and

(g) other immovable and movable items of capital assets

.04 **A department shall apply the principles in this Chapter to assess whether it has a capital asset and if so the type of capital asset purchased before applying the recognition and measurement principles in the Chapter on *Expenditure.***

.05 **This Chapter does not apply to the recording of a capital asset subject to a finance lease. A department shall however apply the provisions of this Chapter on expiry of the lease if the department takes control over the asset.**

.06 **In addition, this Chapter does not apply to:**

(a) intangible assets arising from powers and rights conferred to a department by legislation, a constitution, or by equivalent means;

(b) agricultural produce after the point of harvest; and

(c) inventories.

.07 Departments may execute a regulatory right over certain activities, for example fishing, mining or industries such as telecommunications and energy. These regulatory rights and the power to transfer, license, rent or execute such rights are excluded from the scope of this Chapter and are not accounted for by departments. These rights once issued, are usually an intangible asset of those individuals or entities that acquired each right, provided that the acquirer can demonstrate that the definition and criteria for recording an intangible asset are met.

.08 Similarly, a department's right to levy taxes is granted in terms of statute. Rights arising from statute are excluded from the scope of this Chapter as departments are not required to account for such rights.

Definitions

.09 ***The following terms are used in this Chapter with the meanings specified:***

A biological asset is a living animal or plant.

Capital assets are non-current tangible or intangible assets of a department that are expected to be used or held by that department for longer than one year.

Class of assets means a grouping of assets of a similar nature or function in a department's operations that is shown as a single item for the purpose of disclosure in the financial statements.

Cost (for the purpose of this chapter) is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction, or the deemed cost where this has been determined in accordance with this Chapter.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of production or use.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Heritage assets are capital assets that have a cultural, environmental, historical, natural, scientific, technological or artistic significance and are held indefinitely for the benefit of present and future generations.

An immovable asset is a capital asset consisting of land, infrastructure, buildings or a combination of thereof.

An intangible asset is an identifiable non-monetary asset without physical substance.

Investment property is a property (land or a building or part of a building or both) held with the primary purpose of earning rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or,

(b) sale in the ordinary course of operations.

A major capital asset is a tangible or intangible capital asset that costs more than a threshold value specified by treasury from time-to-time.

A minor capital asset is a tangible or intangible capital asset that costs less than a threshold value specified by treasury from time-to-time.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Tangible assets are non-monetary assets having physical substance that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes or for the development, construction, maintenance or repair of other capital assets; and

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

A movable asset is a capital asset that is not an immovable asset as defined.

Terms defined in other chapters are used in this Chapter with the same meaning as in those

other chapters.

Control over a capital asset

.10 The definition of an asset, as discussed in the Chapter on *Concepts and Principles*, has three components which must all be satisfied in order for an item to be classified as 'an asset' for accounting purposes. These components are:

a) the department has the power and capacity to control the service potential or future economic benefits of the asset;

b) the service potential or future economic benefits arose from past transactions or events; and

c) the asset has future service potential or economic benefit for the department.

Control

.11 Legal title and physical possession are good indicators of control but the right of ownership is not essential. The key principle is that of control of the economic benefits or service potential of the asset rather than 'physical' control. The capacity of a department to control benefits may be the result of legal rights, but benefits may satisfy the definition of an asset even when there is no legal control. If a department comes into possession of an asset due to an expropriation or seizure the asset will be included in its asset register when control of the asset passes to the department.

.12 With regard to immovable assets, consideration should also be given to the guidance issued by the OAG.

Past transactions or events

.13 Capital assets are accounted for at the point when some event or transaction transfers control over the asset to the department. This usually occurs when the department either pays for the asset, takes possession of the asset or when it completes a project to develop/construct the asset. It is essential that the past event giving rise to control be identified as transactions or events expected to occur in future do not give rise to assets.

Future economic benefit or service potential

.14 Assets that are used to generate net cash inflows are usually described as embodying 'future economic benefits'. Assets that are used to deliver goods and services in accordance with a department's mandate but do not directly generate net cash inflows are often described as embodying 'service potential'. In applying the asset definition to the public sector environment, the focus is mostly on service potential rather than future economic benefits. The concept of 'commercial return' for assessing whether an asset should be recognised / recorded is not always applicable to public sector entities, as they provide public services and redistribute wealth for a variety of social and economic purposes.

.15 Departments may consider the following in assessing service potential:

a) Will the asset provide any benefit to the department that controls it?

b) Does the asset have potential to support programme delivery?

c) Does the asset have a resale value?

d) Can the asset be exchanged for something else that is useful to the department?

e) Will the asset save the department money in the future?

Tangible and Intangible Assets

.16 Tangible assets are assets that have a physical form. Tangible assets include assets such as machinery, buildings and land. In contrast, intangible assets are non-physical capital assets, such as patents, trademarks, copyrights etc.

.17 Not all intangible items meet the definition of an intangible asset for the purposes of financial reporting as they are not, for example, identifiable. If an item within the scope of this Chapter does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is not recognised or recorded in the department's asset register.

Identifiability of an intangible asset

.18 **An asset meets the identifiability criterion in the definition of an intangible asset when it:**

(a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licenced, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) arises from binding arrangements (including rights from contracts) regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

.19 For the purpose of this Chapter, a binding arrangement describes an arrangement that confers similar rights and obligations on the parties to it as if it were in the form of a contract.

Identification and types of capital assets

.20 **An item shall be regarded as a capital asset if, and only if:**

(a) it is probable that future economic benefits or service potential associated with the item will flow to the department; and

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

.21 Under this principle, a department evaluates all costs on the date of acquisition and subsequent costs to add to, replace part of, or service it. The principles in paragraphs .63 to .76 should be applied in determining the cost or fair value of a capital asset.

Loose tool, spare parts and servicing equipment

.22 Spare parts and servicing equipment are usually accounted for as inventory. However, certain spare parts and stand-by equipment qualify as capital assets when a department expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with a capital asset, they are accounted for as capital assets.

.23 For example, loose tools, such as saws, spades, knives, axes, hammers, screwdrivers and spanners or wrenches, are normally not considered as capital assets, even though they are often used repeatedly, or continuously, in production over many years. This is because such tools are small and relatively inexpensive. Expenditure on such tools takes place at a fairly steady rate and, because of their value, is normally treated as a minor capital asset or as a consumable.

.24 Some degree of flexibility is however needed, depending on the importance of such tools. For example, a department may have a very extensive maintenance unit where the total value of the tools is high. These tools may be treated as capital assets and their acquisition and disposal recorded as such. Another example is where medical toolkits which include scalpels, forceps, tongs etc. are used. The medical toolkit can be treated as one unit and as a major capital asset if the value of all the items in the toolkit exceeds the capitalisation threshold.

Safety equipment

.25 Safety equipment acquired to meet environmental regulations qualifies as a capital asset if they enable related assets to generate future economic benefits or service potential in excess of what these benefits would have been if this safety equipment was not acquired.

Library material

.26 Departments purchase library material for use in schools or community libraries or for their own purposes such as for research. Library material may comprise of books, journals, manuscripts, audio CDs, posters, magazines etc. Such material would be accounted for in accordance with this Standard when it meets the definition of a capital asset (intangible or tangible).

Investment properties

.27 An investment property is a capital tangible asset (land, buildings, or a property consisting of both) that generates its own cash flows (in the form of rental revenue) or is held for capital appreciation, or both. The following are examples of investment property:

(c) A building owned by the department that is leased out under one or more operating leases (regardless of whether or not the rental is market-related).

(d) Property that is being redeveloped for continued use as an investment property.

(e) Property that is being constructed or developed for future use as investment property.

(f) Land held for an undetermined use.

Rent earned does not have to be at a commercial basis or market related for the property to be classified as investment property.

.28 In determining whether a capital asset should be classified as investment property, a department considers the main purpose and most significant use of the property is to earn rental or for capital appreciation. For example, when a department owns a building, mainly used for the delivery of social housing, but rents out a floor of the building to shops, banks and other external parties, the building should not be classified as investment property as its main purpose and most significant use is the provision of social services. This should be the case irrespective of whether the rental earned from the one floor of the building is significant in relation to the rental earned from the remainder of the building.

Biological assets

.29 Biological assets are living animals and plants. Examples of animals to be included in this category are dairy cattle, wool-producing animals, breeding stocks, game, and police dogs. Examples of plants are standing trees, vines and shrubs cultivated for production of fruits, nuts, sap, resin, wood, bark and leaf products. Biological assets also include animals held for recreational purposes, such as game.

.30 Slaughtered animals and harvested crops do not fall within this category because once a biological asset is slaughtered or harvested it no longer meets the definition of a biological capital asset and should then be regarded as inventory until it is sold or distributed.

.31 Biological assets exclude any cultures, cells, bacteria and viruses used in laboratory purposes or as inputs into vaccines etc. Items used for research purposes are classified as “current expenses”.

Heritage assets

.32 A capital asset is classified as a “heritage asset” because of its cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves and works of art.

.33 Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):

(a) their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;

(b) legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;

(c) they are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and

(d) it may be difficult to estimate their useful lives, which in some cases could be several hundred years.

Infrastructure assets

.34 Some assets are commonly described as "infrastructure assets". While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics:

(a) they are part of a system or network;

(b) they are specialised in nature and do not have alternative uses;

(c) they are immovable; and

(d) they may be subject to constraints on disposal.

Although ownership of infrastructure assets is not confined to entities in the public sector, significant infrastructure assets are frequently found in the public sector. Infrastructure assets meet the definition for capital assets. Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communication networks.

Specialised military equipment

.35 Specialised military equipment such as military aircraft, guided missile systems and marine equipment will normally meet the definition for capital assets and should be accounted for as such in accordance with this Standard.

Internally generated intangible assets

.36 It is sometimes difficult to assess whether an internally generated intangible asset qualifies as an intangible asset because of problems in:

(a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and

(b) determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the department's day-to-day operations.

.37 Therefore, in addition to complying with the general requirements for the recognition an intangible asset, a department applies the requirements and guidance in paragraphs .40 to .47 to all internally generated intangible assets.

.38 To assess whether an internally generated intangible asset should be accounted for as such, a department classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Chapter.

.39 If a department cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the department treats the expenditure on that project as if it was incurred in the research phase only.

Research phase

.40 **No intangible asset arising from research (or from the research phase of an internal project) shall be recorded as an asset. Research expenditure is included as part of current expenditure in the financial statements as per the Chapter on *Expenditure*.**

.41 In the research phase of an internal project, a department cannot demonstrate that an intangible asset exists that will generate probable future economic benefits or service potential.

.42 Examples of research activities are:

(a) activities aimed at obtaining new knowledge;

(b) the search for, evaluation and final selection of, applications or research findings or other knowledge;

(c) the search for alternatives for materials, devices, products, processes, systems or services; and

(d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development phase

.43 **Capitalisation of costs to the carrying value of an asset commences with the development phase, subject to paragraph .44.**

.44 **An intangible asset arising from development (or from the development phase of an internal project) shall be accounted for as such, and only if, the department can demonstrate all of the following:**

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits or service potential. Among other things, the department can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

.45 In the development phase of an internal project, a department can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits or service potential. This is because the development phase of a project is further advanced than the research phase.

.46 Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

.47 Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a strategic plan showing the technical, financial and other resources needed and the department's ability to secure those resources.

Initial measurement for the recording of capital assets

.48 For the purposes of recording assets, a department should maintain an asset register that will enable it to comply with the disclosure requirements of this Chapter.

.49 **Upon initially recording a capital asset, a department shall determine whether the capital asset is a minor or major capital asset and record the asset as such.**

.50 The threshold value for distinguishing between minor and major capital assets is determined by the Office of the Accountant-General.

Movable capital assets

.51 **A movable asset that qualifies for recording as a capital asset shall be measured at its cost.**

.52 The cost is the cash price equivalent, which for the purpose of this Chapter, is the actual amount paid for the asset. Payment can be made as either a single payment or a series of payment over a period of time.

.53 A movable asset acquired before 1 April 2002 (or another date as approved by the OAG) will accordingly be measured at R1 if the cost cannot be determined accurately.

.54 **Where a movable asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**

.55 A movable asset may be acquired through a non-exchange transaction. For example, vehicles may be contributed to a department by a manufacturer at nil or nominal consideration, to enable the department to perform policing services. An asset may also be acquired through a non-exchange transaction by the exercise of powers of expropriation. Under these circumstances the cost of the item is its fair value as at the date it is acquired. In determining the fair value of a movable asset acquired through a non-exchange transaction, the department applies the principles in paragraphs .71 to .76.

.56 **Where the cost cannot be determined accurately, the movable asset is measured at its fair value and where fair value cannot be determined, the movable asset is measured at R1. The use of fair value or R1 as initial measurement for initial recording of a movable capital asset is deemed cost.**

.57 **The fair value measurement requirement in paragraph .56 and .61 does not apply in instances where the asset was acquired before 1 April 2002 (or another date as approved by the OAG).**

.58 A department applies the principles in paragraphs .71 to .76 in determining the fair value of an asset.

Immovable capital assets

.59 **An immovable asset that qualifies for recording as a capital asset shall be measured at its cost.**

.60 **Where an immovable capital asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**

.61 **Where the cost of an immovable asset cannot be determined accurately, the immovable asset is measured at R1 unless the fair value of the asset has been reliably estimated, in which case fair value shall be used. The use of fair value or R1 as initial measurement for initial recording of an immovable capital asset is deemed cost.**

.62 A department applies the principles in paragraphs .71 to .76 in determining the fair value of an immovable capital asset.

Elements of cost

.63 The cost of a capital asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

.64 Examples of directly attributable costs are:

(a) compensation of employees directly involved in the construction or acquisition asset to the extent that the department can reliably estimate the amounts to be capitalised;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

.65 Recording of costs as part of capital asset ceases when the capital asset is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included. For example, the following costs are not included:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) initial operating losses, such as those incurred while demand for the item’s outputs build up; and

(c) costs of relocating or reorganising part or all of the entity‘s operations.

.66 Some operations occur in connection with the construction or development of a capital asset, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, revenue may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognised in the statement of financial performance in arriving at the net surplus or deficit and included in their respective classifications of revenue and expense.

.67 The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

Warranty costs

.68 When a department acquires an asset, such as a motor vehicle, the invoice price sometimes includes an element relating to the manufacturer’s warranty. These costs are deemed to form part of the initial cost of the asset as they are directly attributable to bringing the asset to its location and condition necessary for it to be capable of operating in the manner intended by management. The warranty enables the department to derive service potential from related assets in excess of what could be derived had the warranty not been there. The cost of the warranty is therefore accounted as part of the asset acquisition cost.

Assets transferred between departments

.69 **All capital assets shall be transferred at cost where cost information is available. Where the asset is recorded at R1 or at its fair value in the asset register of the transferor then the asset should be transferred at that value.**

.70 All the documentation supporting the value should accompany the transferred assets transferred. If the transferor cannot sufficiently substantiate the cost or fair value of the transferred asset, the transferee may take on the asset at R1 as an interim measure until such time as a reliable fair value has been determined.

Fair value

.71 The fair value of an immovable capital asset is usually its market value determined by appraisal. An appraisal of the value of the asset is normally, but not necessarily undertaken by a member of the valuation profession, who holds a recognised and relevant professional qualification.

.72 For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land, non-specialised buildings, motor vehicles and many types of machinery and equipment.

.73 For some assets, it may be difficult to establish their market value because of the absence of market transactions for these assets. Some departments may have significant holdings of such assets. In certain circumstances, it may also be costly to undertake a detailed professional valuation of each individual property, particularly for those departments that act as default custodians of the state's immovable assets. To facilitate cost-effective compliance with this Standard and to avoid unnecessary duplication of costs across different spheres of government, departments are encouraged to as far as possible make use of existing available information (for example municipal valuation rolls) as an alternative to undertaking their own professional valuations on each individual immovable asset. Where such information is used, departments should ensure that the information is sufficiently reliable for the purposes of financial reporting.

.74 If no evidence is available to determine the market value in an active and liquid market of a capital asset, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land with similar features and topography in a similar location for which market evidence is available.

.75 In the case of specialised buildings and other man-made structures, an entity may need to estimate fair value using a depreciated replacement cost approach. In many cases, the depreciated replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset's reproduction cost will be the best indicator of its replacement cost. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation because of its significance to the community.

.76 In cases where the depreciated replacement cost of a capital asset is required in lieu of fair value, this may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. When the indexed price method is used, judgement is required to determine whether production technology has changed significantly over the period, and whether the capacity of the reference asset is the same as that of the asset being valued.

Subsequent measurement

.77 **After initial recording, a capital asset shall be carried at its cost.**

.78 Currently all capital assets remain in the asset register at their original cost (or deemed cost). Capital assets are not depreciated nor subject to impairment testing or valuation adjustments.

.79 **Departments may elect to revalue all or a class of biological assets at its fair value at the reporting date.**

Subsequent costs

.80 **Any subsequent expenditure incurred on an existing capital asset (owned or to be owned by the department) that is of a capital nature is added to the cost of that asset. Where the subsequent expenditure relates to a project that spans over more than one financial year, the total project costs are added to the cost of the capital asset at the end of the project (i.e. when the capital asset is ready for use).**

.81 If a building on which improvements is carried out is owned or accounted for by another department, all associated costs must be included in the asset register of that other department on completion of the project. The department that expenses the costs must keep record of the capital work-in-progress and on completion of the project take the asset on to its asset register prior to transferring the total cost to the other department.

.82 A department that has a project with elements of repairs and maintenance, upgrading and additions to it will have to assess upfront whether the project is significantly a current or a capital project. The project costs will be recorded as capital assets in the asset register where the project is predominantly capital in nature.

.83 **A department does not include in the carrying amount of a capital asset the costs of the day-to-day servicing of the item. Rather, these costs are recognised in surplus or deficit as incurred and in accordance with the Chapter on *Expenditure*. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the capital asset.**

Derecognition

.84 **A capital asset shall be removed from the financial statements:**

(a) on disposal; or

(b) when no future economic benefits or service potential are expected from its use or disposal.

.85 **All proceeds shall be recognised in accordance with the Chapter on *Revenue*.**

Disclosures

Secondary financial information

.86 **A department shall disclose the following in its notes with regards to major movable tangible capital assets for each class:**

a) the cost at the beginning and end of the period; and

b) a reconciliation of the cost at the beginning and end of the period (for both the current and the prior year) showing:

(i) adjustments to the opening balance;

(ii) additions; and

(iii) disposals.

c) additions to movable assets for the reporting period, showing separately:

(i) cash additions;

(ii) non-cash additions;

(iii) capital work-in-progress current costs and finance lease payments; and

(iv) received current, not paid (Paid current year, received prior year).

d) disposals of movable assets for the reporting period , showing separately:

(i) assets sold for cash;

(ii) assets transferred out or destroyed or scrapped; and

(iii) total actual cash received from disposals.

.87 **A department shall disclose the following in its notes with regards to minor capital assets for each class (for the current and prior year):**

a) the reconciliation of the opening balance of each class of minor capital assets to the closing balance per category indicating the following:

(i) adjustments to the opening balance;

(ii) additions; and

(iii) disposals.

b) the total value and quantities of minor capital assets in the asset register at the end of the reporting period.

.88 **A department shall disclose the total amount for each class of movable assets the total cost of assets written off.**

.89 **A department shall disclose the following in its notes with regards to intangible assets for each class of intangible assets:**

a) the movement in intangible assets during the reporting period (for both the current and the prior year) reflecting the following:

(i) the cost at the beginning and end of the period;

(ii) adjustments to the opening balance;

(iii) additions; and

(iv) disposals.

b) additions to intangible assets for the reporting period showing separately:

(i) cash additions;

(ii) non-cash additions;

(iii) development work-in-progress – current costs; and

(iv) received current, not paid (Paid current year, received prior year).

c) disposals of movable intangible assets for the reporting period , separately reflecting the following:

(i) assets sold for cash;

(ii) assets transferred out or destroyed or scrapped; and

(iii) total actual cash received from disposals.

.90 **As part of the secondary financial information, a department shall disclose the following in its notes with regards to immovable assets:**

a) the movement in assets at the end of the period (for both the current and the prior year)showing the following:

- **(i) the cost at the beginning and end of the period;**
- **(ii) adjustments to the opening balance;**
- **(iii) additions; and**
- **(iv) disposals.**

b) additions to immovable asset for the reporting period separately reflecting the following:

- **(i) cash additions;**
- **(ii) non-cash additions;**
- **(iii) capital work-in-progress current costs and finance lease payments; and**
- **(iv) received current, not paid (Paid current year, received prior year).**

c) disposals of immovable assets for the reporting period, separately reflecting the following:

- **(i) assets sold for cash;**
- **(ii) assets transferred out or destroyed or scrapped; and**
- **(iii) total actual cash received from disposals;**

d) total immovable assets valued at R1 for each class of assets.

.91 **A department shall disclose the total amount of immovable assets written off during the reporting period separately for each class of immovable assets.**

.92 **For each class of immovable assets the number of assets to be transferred to another department in terms of section 42 of the Public Finance Management Act, 1 of 1999.**

INVENTORIES

Chapter Content

Introduction

.01 This Chapter prescribes the accounting treatment for inventory in the secondary financial information to the annual financial statements. The accounting requirements in respect of the primary financial information on acquisition of inventory are dealt with in the Chapter on *Expenditure*.

Scope

.02 **A department shall apply this Chapter in accounting for inventories for the purposes of secondary financial information. The accounting requirements in respect of the primary financial information (i.e. the expenditure relating to the acquisition of inventory etc.) is dealt with in the Chapter on *Expenditure.***

.03 This Chapter applies to inventory including:

(h) ammunition;

(i) maintenance materials;

(j) spare parts for plant and equipment other than those that qualify as capital assets;

(k) strategic stockpiles; and

(l) work-in-progress related to inventories.

.04 **This Chapter does not apply to:**

(a) financial instruments;

(b) biological assets related to agricultural activity and agricultural produce at the point of harvest;

(c) work-in-progress of services to be provided through a non-exchange transaction directly in return from the recipients; and

(d) heritage assets

.05 This Chapter only applies to those goods that are essential for satisfying the service delivery obligation of a department. Accordingly the following items are excluded from the scope of this Chapter:

(a) stationery and printing; and

(b) items that are considered to be consumables.

Definitions

.06 ***The following terms are used in this Chapter with the meanings specified:***

<u>Inventories</u> are assets:

(a) in the form of materials or supplies to be consumed in the production process;

(b) in the form of materials or supplies to be consumed or distributed in the rendering of services;

(c) held for sale or distribution in the ordinary course of operations; or

(d) in the process of production for sale or distribution

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Inventory

.07 Inventory encompasses those goods purchased / produced and held specifically for executing the service delivery mandate of the department.

.08 Inventories also encompass finished goods produced, or work-in-progress being produced, by the entity. Inventories also include materials and supplies awaiting use in the production process and goods purchased or produced by an entity, which are for distribution to other parties through a non-exchange transaction; for example, educational books produced by an education authority for donation to schools

Recording and measurement of inventory

.09 For the purposes of recording inventory, a department should maintain an inventory register that will enable it to comply with the disclosure note requirements of this Chapter.

.10 **Inventories shall be recorded if, and only if:**

(a) it is probable that future economic benefits or service potential associated with the item will flow to the department, and

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

Initial measurement

.11 **Inventories that qualify for recording shall initially be measured at cost.**

.12 **Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition.**

Subsequent measurement

.13 **Inventories shall be measured at the lower of cost and net realisable value, except where paragraph .14 applies.**

.14 **Inventories shall be measured at the lower of cost and current replacement cost where they are held for:**

(a) distribution through a non-exchange transaction; or

(b) consumption in the production process of goods to be distributed at no charge or for a nominal charge.

Cost of inventories

.15 **The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.**

Costs of purchase

.16 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and supplies. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

Costs of conversion

.17 The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

.18 For example, the allocation of costs, both fixed and variable, incurred in the development of undeveloped land held for sale into residential or commercial landholdings, could include costs relating to landscaping, drainage, pipe laying for utility connection etc.

Other costs

.19 Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

Cost of inventories of a service provider

.20 To the extent that service providers have inventories except those referred to in paragraph .04(d), they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. The costs of labour not engaged in providing the service are not included. Labour and other costs relating to general administrative personnel are not included in the cost of inventory.

Inventory acquired through a non-exchange transaction

.21 Inventories may be transferred to the department by means of a non-exchange transaction. For example, an international aid agency may donate medical supplies to a public hospital in the aftermath of a natural disaster. Under such circumstances, the cost of the inventory is its fair value as at the date it is acquired.

Cost formulas

.22 **The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.**

.23 Specific identification of costs means that specific costs are attributed to identified items of inventory. This is the appropriate treatment for items that are segregated for a specific project. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on the surplus or deficit for the period.

.24 **The cost of inventories, other than those dealt with in paragraph .22, shall be assigned by weighted average cost formula.**

Disclosure

.25 **A department shall disclose the following in its notes with regards to inventories:**

a) the accounting policies adopted in measuring inventories, including the cost formula used;

b) the total carrying amount of inventories and the carrying amount in classifications

appropriate to the entity; and

Effective date

.26 **This Chapter becomes effective for annual financial statements covering periods beginning on 1 April 2016.**

LEASES

Chapter Content

Introduction

.01 This Chapter prescribes the criteria for distinguishing between operating and finance leases, and prescribes the disclosure requirements for leases from both the lessor's and the lessee's perspectives. In particular, this Chapter sets out the accounting requirements in respect of secondary financial information disclosures.

Scope

.02 **A department shall apply this Chapter in distinguishing between operating and finance leases for purposes of classifying recognised lease expenditure in the primary financial information, and for providing additional disclosures about leases in the secondary financial information.**

Definitions

.03 ***The following terms are used in this Chapter with the meanings specified:***

The commencement of the lease term is the date from which the lessee is entitled to exercise its right to use the leased asset.

Economic life is either:

(a) the period over which an asset is expected to yield economic benefits or service potential to one or more users; or

(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of future use, future price indices, and future market rates of interest).

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

Gross investment in the lease is the aggregate of:

(a) the minimum lease payments receivable by a lessor under a finance lease; and

(b) any unguaranteed residual value accruing to the lessor.

Guaranteed residual value is the aggregate of:

(a) for a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and

(b) for a lessor, that part of the residual value that is guaranteed by the lessee or by a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

The inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date a lease is classified as either an operating or a finance lease.

Initial direct costs incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments; and

(b) the unguaranteed residual value

to be equal to the sum of (i) the fair value of the leased asset; and (ii) any initial direct costs of the lessor.

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Minimum lease payments are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with:

(a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or

(b) for a lessor, any residual value guaranteed to the lessor by:

i. the lessee;

ii. a party related to the lessee; or

iii. a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

A non-cancellable lease is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency;

(b) with the permission of the lessor;

(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) upon payment by the lessee of an additional amount that, at inception, continuation of the lease is reasonably certain.

An operating lease is a lease other than a finance lease.

Unguaranteed residual value is that portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.

Useful life (of a leased asset) is the estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Classification of leases

.04 **A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.**

.05 Risks include the possibilities of losses from idle capacity, technological obsolescence or changes in value due to changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

.06 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Although the following are examples of situations which would normally lead to a lease being classified as a finance lease, a lease does not need to meet all these criteria in order to be classified as a finance lease:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;

(e) the leased assets are of a such a specialised nature that only the lessee can use them without major modifications; and

(f) the leased assets cannot easily be replaced by another asset.

.07 Other indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the fair value of the residual value accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

.08 The examples and indicators in paragraphs .06 and .07 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all such risks and rewards.

.09 Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs .05 to .07 if the changed terms had been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or the residual value of the leased property), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

.10 When a lease includes both land and buildings elements, an entity assesses the classification of each element separately. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.

Leases and other contracts

.11 A contract may consist solely of an agreement to lease an asset. However, a lease may also be one element in a broader set of agreements with private sector entities to construct, own, operate and/or transfer assets. Departments often enter into such agreements, particularly in relation to long-lived physical assets and infrastructure assets. For example, a department may construct an office building. It may then lease the office building to a private sector entity as part of an arrangement whereby the private sector entity agrees to:

(a) lease the office building for an extended period of time (with or without an option to purchase the facility);

(b) manage the office building and its facilities within; and

(c) fulfil extensive maintenance requirements.

.12 Where an arrangement contains an identifiable operating lease or finance lease as defined in this Chapter, the provisions of this Chapter should be applied in accounting for the lease component of the arrangement.

.13 Departments may also enter into a variety of agreements for the provision of goods and/or services, which necessarily involve the use of dedicated assets (such as computer equipment). In some of these agreements, it may not be clear whether or not a lease, as defined by this Chapter, has arisen. In these cases, professional judgment is exercised, and if a lease has arisen, this Chapter is applied; and if a lease has not arisen, entities account for those agreements by applying the provisions of other relevant chapters.

.14 For the purposes of recording leases, a department should maintain a lease register that will enable it to comply with the disclosure note requirements of this Chapter.

Leases in the financial statements of lessees

Primary Financial Information

Initial recognition and measurement – all leases

.15 **Lease payments made by a department during the reporting period shall be recognised and measured in accordance with the Chapter on *Expenditure*.**

.16 Operating lease payments shall be treated as current expenditure, whereas finance lease payments shall be treated as capital expenditure. Departments shall disclose primary financial information on lease payments in accordance with the Chapter on *Expenditure*, read with the disclosure requirements of this Chapter.

Disclosures

.17 **A lessee department shall disclose the amount of finance lease and operating lease expenditure as current and capital expenditure respectively in the notes to the statement of financial performance**

Secondary Financial Information

Recording and measurement – assets acquired under a finance lease

.18 **At the end of the lease term, a department that is a lessee shall measure all finance lease assets acquired at:**

(a) cost, being the fair value of the leased asset or, if lower,

(b) the sum of the minimum lease payments made, including any payments made to acquire ownership at the end of the lease term, excluding interest.

The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, a reasonable proxy rate such as the prime lending rate at inception of the lease can be used.

.19 In a finance lease, the ownership of the leased asset often transfers to the lessee depending on the terms of the arrangement. Where this is the case, the department records the transfer of ownership as a non-cash acquisition of a capital asset measured in accordance with paragraph .18, unless a final payment equal to the then fair value of the asset is required to be made for ownership to transfer.

.20 The interest rate implicit in the lease is the lessor's internal rate of return from the lease taking into account the normal cash price of the leased asset, rentals and the amount the lessor expects to recover from the residual value. Where interest rate implicit in the lease is not stipulated in the agreement, and the lessor does not volunteer the information to the lessee, the lessee will need to calculate an estimate of the rate from the information available in the lease agreement, failing which a reasonable proxy rate should be used.

.21 A lessee can normally derive a reasonable estimate of the interest rate implicit in the lease when it is possible to estimate the fair value of the leased asset(s) and its anticipate residual valu e at the end of the lease term.

.22 The value of the assets calculated in accordance with paragraph .18 above will be used for disclosure purposes as required in paragraph .24 below.

.23 Once recorded in the asset register, the Chapter on *Capital Assets* is applied in accounting for the assets.

Disclosures

.24 **A lessee department shall make the following disclosures for lease commitments, distinguishing clearly between finance and operating lease commitments:**

(a) the total of future minimum lease payments at the reporting date,

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years;

(b) the total minimum lease payments at the reporting date specified in (a) above should also be disclosed for the comparative period;

(c) a general description of the lessee's material leasing arrangements, information on any assets that are subleased, indicating the nature of the assets and the name of the lessee (occupant);

(d) a general description of renewal or purchase options as well as escalation clauses (if any) per lease agreement; and

(e) an explanation of any restrictions imposed by on the department through any lease agreement (such as restrictions relating to enhancements, repairs & maintenance, sub-leasing and disposal).

Leases in the financial statements of lessors

Primary financial information

Initial recognition and measurement – all leases

.25 **Lease payments received during the reporting period shall be recognised as revenue in accordance with the Chapter *on Revenue.***

Disclosures

.26 **A lessor department shall disclose the amount of the lease payments received during the reporting period as part of departmental revenue in the notes to the statement of financial performance.**

Secondary financial information

Recording and measurement – all leases

.27 **Where a department leases out an asset, the underlying asset shall continue to be accounted for in accordance with the Chapter on *Capital Assets.* If ownership of the leased asset transfers to the lessee at the end of the lease term, the asset shall be removed from the asset register on expiry of the lease.**

Disclosures

.28 **A lessor department shall make the following disclosures for all leases, distinguishing between operating and finance leases (where applicable):**

(a) the amount of lease revenue that is expected to be received in the following periods:

- **(i) not later than one year;**
- **(ii) later than one year and not later than five years; and**
- **(iii) later than five years;**

(b) the amount of lease revenue that is expected on dates specified in (a) above should also be disclosed for the comparative period;

(c) a general description of the lessor's material leasing arrangement, including a description of any renewal options and escalation clauses; and

(d) the amount of rental earned on sub-leased assets.

Sale and leaseback transactions

.29 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package.

Lessees

.30 **For the lessee department, all sales proceeds arising out of sale and leaseback transactions shall be recognised in accordance with the Chapter *on Revenue*.**

.31 **Capital assets of a lessee department that become the subject of a sale and leaseback transaction shall be removed from the asset register on the date of sale. The lessee department will thereafter account for the asset in accordance with paragraph .18 above.**

.32 **Where a lessee department is given a reduction in the lease payments instead of actual cash from the sale of the asset(s), it should disclose this fact in the notes to the financial statements.**

Lessors

.33 **Where a department acquires an asset and leases that same asset back to another party in a sale and leaseback arrangement, the lessor department records and disclosures the acquisition of the capital asset in accordance with the Chapter on *Capital Assets*, and treats the subsequent lease arrangement in accordance with paragraphs .26 - .29 of this Chapter. The lessor department removes the asset from its asset register if ownership of the leased asset transfers to the lessee at the end of the lease term.**

.34 Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the material leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

PROVISIONS AND CONTINGENTS

Chapter Content

Introduction

.01 This Chapter prescribes the disclosures that should be made in respect of provisions, contingent liabilities and contingent assets, and specifies how they should be measured in the secondary financial information to the financial statements to enable users to understand their nature, timing and amount.

Scope

.02 **A department shall apply this Chapter in accounting for provisions, contingent liabilities and contingent assets in its secondary financial information, including:**

(a) those resulting from executory contracts;

(b) certain employee benefits; and

(c) guarantees issued by government to employees and other departments or entities.

.03 This Chapter defines provisions as liabilities of uncertain timing or amount. The term "provision" may also be used in the context of items such as doubtful debts, which are adjustments to the carrying amounts of assets (debtors) and are not addressed in this Chapter.

Definitions

.04 ***The following terms are used in this Chapter with the meanings specified:***

A <u>constructive obligation</u> is an obligation that derives from a department's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the department has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the department has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A <u>commitment</u> is a contractual arrangement that binds the department to incur future expenditure based on items that are still to be received.

A <u>contingent asset</u> is a possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the department.

A <u>contingent liability</u> is:

(a) a possible obligation that arises from past events~~,~~ and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the department; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

<u>Executory contracts</u> are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

A <u>legal obligation</u> is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

<u>Liabilities</u> are present obligations of the department arising from past events, the settlement of which is expected to result in an outflow from the department of resources embodying economic benefits or service potential.

<u>Management</u> comprises those persons responsible for planning, directing and controlling the activities of the department, including those charged with the governance of the department in accordance with legislation, in instances where they are required to perform such functions.

An <u>obligating event</u> is an event that creates a legal or constructive obligation that results in a department having no realistic alternative to settling that obligation.

A <u>provision</u> is a liability of uncertain timing or amount.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Provisions

Provisions and other liabilities

.05 Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

(a) payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to leave entitlements). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Relationship between provisions and contingent liabilities

.06 In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Chapter the term “contingent” is used for liabilities and assets that are separately disclosed because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the department.

.07 This Chapter distinguishes between disclosures of:

(a) provisions — which are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and

(b) contingent liabilities — which are either:

(i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential; or

(ii) present obligations that do not meet the recognition criteria in this Chapter (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

.08 Departments might issue guarantees on behalf of employees to secure motor vehicle finance or even housing finance. Where a department has issued a guarantee on behalf of an employee (for securing finance), the department shall, for the purpose of this Standard, classify all such guarantees as contingent liabilities.

Criteria for recording provisions

.09 **For the purposes of disclosure only, a provision shall be recorded when:**

(a) a department has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recorded or disclosed.

.10 **If a department has a contract that is onerous, the present obligation (net of recoveries) under the contract shall be recorded and measured as a provision for disclosure purposes.**

Present obligation

.11 In rare cases, it may not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date.

.12 In almost all cases, it will be clear whether a past event has given rise to a present obligation. In other cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such cases, a department determines whether a present obligation exists at the reporting date by taking account of all available evidence including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting date.

.13 On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the reporting date, the entity discloses a provision (if the disclosure criteria are met); and

(b) where it is more likely that no present obligation exists at the reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph .50).

Past event

.14 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the department has <u>no realistic alternative</u> to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the department will discharge the obligation.

.15 Financial statements deal with balances and transactions as at the end of its reporting period and not possible future balances and transactions. Therefore, no provision is recorded for costs that need to be incurred to continue a department's ongoing activities in the future. The only liabilities disclosed are those that exist at the reporting date.

.16 It is only those obligations arising from past events existing independently of a department's future actions (that is, the future conduct of its activities) that are recorded as provisions. An example of such obligations is penalties for clean-up costs for unlawful environmental damage imposed by legislation on a department. These obligations would lead to an outflow of resources embodying economic benefits or service in settlement regardless of the future actions of the department.

.17 In contrast, because of legal requirements, pressure from constituents or a desire to demonstrate community leadership, a department may intend or need to carry out expenditure to operate in a particular way in the future. An example would be where a department decides to fit emission controls on certain of its vehicles. Because the department can avoid future expenditure by its future actions, for example, by changing its method of operation, it has no present obligation for that future expenditure and no provision is disclosed.

.18 An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed — indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a decision by a department's management does not give rise to a constructive obligation at the reporting date unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the department will discharge its responsibilities.

.19 An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the department gives rise to a constructive obligation. For example, when environmental damage is caused by a department there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the department publicly accepts responsibility for rectification in a way that creates a constructive obligation.

.20 Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Chapter, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment often make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of the law until it is enacted.

Probable outflow of resources embodying economic benefits or service potential

.21 For a liability to qualify for disclosure there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Chapter, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, a department discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph .50).

.22 Where there are a number of similar obligations (for example, government's obligation to compensate individuals who have received contaminated blood from a government-owned hospital) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is disclosed (if the other criteria are met).

Reliable estimate of the obligation

.23 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other assets or liabilities. Except in extremely rare cases, a department will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in disclosing a provision.

.24 In the extremely rare case where no reliable estimate can be made, a liability exists that is disclosed as a contingent liability (see paragraph .50).

Measurement of provisions

Best estimate

.25 **The amount disclosed as a provision shall be the best estimate of the funds required to settle the present obligation at the reporting date. The time value of money is ignored where the obligation will be settled some time after the reporting date.**

.26 The best estimate of the funds required to settle the present obligation is the amount that a department would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the reporting date. However, the estimate of the amount that a department would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the reporting date.

.27 The estimates of outcome and financial effect are determined by the judgement of the management of the department, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

.28 Uncertainties surrounding the amount to be disclosed as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is “expected value”. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60% or 90%. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

.29 Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the department considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example, if government has to pay for repairs in respect of an accident involving a government helicopter and a private property, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of R100 000, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary to return the property to its original condition.

Risks and uncertainties

.30 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

.31 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that the amounts disclosed are not understated. However, uncertainty does not justify the creation of excessive provisions. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

.32 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph .47(b).

Future events

.33 **Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.**

.34 Expected future events may be particularly important in measuring provisions. For example, where government believes that the cost of cleaning up the tar, ash and other pollutants associated with a gasworks' site at the end of its life will be reduced by future changes in technology. In this case, the amount disclosed reflects the cost that technically qualified, objective observers reasonably expect to be incurred, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus, it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, a department does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

.35 The effect of possible new legislation that may affect the amount of an existing obligation of an entity is taken into consideration in measuring that obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases, sufficient objective evidence will not exist until the new legislation is enacted.

Reimbursements

.36 **Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be disclosed when, and only when, it is virtually certain that reimbursement will be received if the department settles the obligation. The reimbursement shall be included in the estimate of the provision. The reimbursement shall not exceed the amount of the provision.**

.37 **In the statement of financial performance, the expense relating to a settlement of the provision may be presented net of the reimbursement received.**

.38 Sometimes, a department is able to look to another party to pay part or all of the expenditure required to settle a provision, for example, through insurance contracts. The other party may either reimburse amounts paid by the department or pay the amounts directly.

.39 In most cases, the department will remain liable for the whole of the amount in question, so that the department would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is disclosed for the full amount of the liability, and a reimbursement is disclosed when it is virtually certain that reimbursement will be received if the entity settles the liability.

.40 In some cases, the department will not be liable for the costs in question if the third party fails to pay. In such a case, the entity has no liability for those costs and they are not included in the provision.

.41 As noted in paragraph .51, an obligation for which a department is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in provisions

.42 **Provisions shall be reviewed at each reporting date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, the provision shall be reversed.**

Use of provisions

.43 **A provision shall be used only for expenditures for which the provision was originally disclosed.**

.44 A reduction of the provision disclosed is only made for expenditures that relate to the original provision and only when the expenditures are recognised in accordance with the Chapter on *Expenditure*.

Disclosure requirements

.45 **For each class of provision (other than those relating to employee benefits), a department shall disclose:**

- **(a) the carrying amount at the beginning and end of the period;**
- **(b) additional provisions made in the period, including increases to existing provisions;**
- **(c) reductions in the carrying amounts of provisions that result from payments made during the reporting period;**
- **(d) reductions in the carrying amounts of provisions resulting from remeasurement of the estimated future outflow of economic benefits or service potential, or from settlement of the provisions without cost to the entity;**
- **(e) unused amounts reversed during the period; and**
- **(f) reimbursements expected from another party.**

Comparative information is not required.

.46 **A department shall disclose the following for each class of provision referred to in paragraph .45:**

- **(a) A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential; and**
- **(b) An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph .32.**

.47 In determining which provisions may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs .47(a) and (b).

.48 **A department shall disclose the value of each major class of provisions for employee benefits as at the reporting date.**

Contingent liabilities

.49 For the purposes of recording contingent liabilities, a department should maintain a register of contingent liabilities that will enable it to comply with the disclosure requirements of this Chapter.

Disclosure criteria

.50 **A department shall disclose a contingent liability unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.**

.51 Where a department is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint venture debt, that part of the obligation that is to be met by other joint venture participants is treated as a contingent liability. The department discloses a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.

.52 Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is disclosed in the financial statements of the period in which the change in probability occurs, except in the extremely rare circumstances where no reliable estimate can be made. For example, a department may have breached an environmental law but it remains unclear whether any damage was caused to the environment. Where, subsequently, it becomes clear that damage was caused and remediation will be required, the department would disclose a provision because an outflow of economic benefits is now probable.

Disclosure requirements

.53 **Unless the possibility of any outflow in settlement is remote, a department shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:**

(a) an estimate of its financial effect, measured under paragraphs .26 to .42;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

.54 In determining which contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs .47(a) and (b).

.55 **Where any of the information required by paragraph .53 is not disclosed because it is not practicable to do so, that fact shall be stated**

Contingent assets

.56 For the purposes of recording contingent assets, a department should maintain a register of contingent assets that will enable it to comply with the disclosure requirements of this Chapter.

Disclosure criteria

.57 **A department shall disclose a contingent asset where an inflow of economic benefits or service potential is probable.**

.58 Contingent assets usually arise from unplanned or other unexpected events that are not wholly within the control of the department and give rise to the possibility of an inflow of economic benefits or service potential to the department.

.59 Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. Where the inflow is virtually certain (and measureable) but not yet received, then the department discloses the amount as a receivable for departmental revenue. If an inflow has become probable, a department discloses the contingent asset.

Disclosure requirements

.60 **Where an inflow of economic benefits or service potential is probable, a department shall disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs .26 to .36.**

.61 The disclosure requirements in paragraph .60 are only intended to apply to those contingent assets where there is a reasonable expectation that benefits will flow to the department.

.62 It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising. For example, a contingent asset would arise from a contract where an entity allows a private sector company to mine one of its properties in exchange for a royalty based on a set price per ton extracted and the company has commenced mining. In addition to disclosing the nature of the arrangement, the contingent asset should be quantified where a reasonable estimate can be made of the quantity of mineral to be extracted and the timing of the expected cash inflows. If there were no proven reserves or some other circumstances prevailed that indicated that it would be unlikely that any minerals would be extracted, the entity would not disclose information required by paragraph .60 as there is no probable flow of benefits.

.63 **Where any of the information required by paragraphs .60 is not disclosed because it is not practicable to do so, that fact shall be stated**

Commitments

.64 Items are classified as commitments when an entity has committed itself to future transactions that will normally result in the outflow of cash. For example, a department awarded a tender and signed a contract with a company for the construction of a dam and at the reporting date has yet to receive an invoice for work already done. The department accordingly discloses the unrecognised expenditure as a commitment in the notes.

.65 For the purposes of recording commitments, a department should maintain a register of commitments that will enable it to comply with the disclosure requirements of this Chapter.

Disclosure criteria

.66 **A department shall record its commitments, at cost (as evidenced by the contract value), as at the reporting date.**

Disclosure requirements

.67 **A department shall separately disclose its commitments for current expenditure and capital expenditure at the reporting date. In disclosing the commitments, the department shall differentiate between the following:**

a) Approved and contracted; and

b) Approved but not yet contracted.

.68 Commitments should be disclosed if both the following criteria are met:

a) contracts should be non-cancellable or only cancellable at significant cost (for example, contracts for computer or building maintenance services); and

b) contracts should relate to something other than the routine, steady, state business of the entity – therefore salary commitments relating to employment contracts or social security benefits are excluded from this disclosure requirement.

.69 **A department shall disclose which of its commitments are for projects / programmes / contracts that exceed one year.**

General

.70 **In extremely rare cases, disclosure of some or all of the information required this Chapter can be expected to prejudice seriously the position of the department in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, a department need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**

RELATED PARTY DISCLOSURES

Chapter Content

Introduction

.01 This Chapter prescribes how a department should identify and disclose related party relationships and certain transactions with related parties.

Scope

.02 **A department shall apply this Chapter in identifying and disclosing related party relationships and transactions, as part of its secondary financial information.**

Definitions

.03 ***The following terms are used in this Chapter with the meanings specified:***

<u>Close members of the family of a person</u> are those family members who may be expected to influence, or be influenced by that person in their dealings with the entity. As a minimum, a person is considered to be a close member of the family of another person if they:

(a) are married or live together in a relationship similar to a marriage; or

(b) are separated by no more than two degrees of natural or legal consanguinity or affinity.

<u>Joint control</u> is the agreed sharing of control over an activity by a binding arrangement, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

<u>Control</u> is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

<u>A related party</u> is a person or an entity with the ability to control or jointly control the other party, or exercise significant influence over the other party, or vice versa, or an entity that is subject to common control, or joint control. As a minimum, the following are regarded as related parties of the reporting department:

(a) a person or a close member of that person's family is related to the department if that person:

- **(i) has control over the department; or**
- **(ii) is a member of the management of the department or its executive authority.**

(b) an entity is related to the department if any of the following conditions apply:

- **(i) the entity is a member of the same economic entity (which means that each controlling entity, controlled entity and fellow controlled entity is related to the others) or group entity;**
- **(ii) the entity is controlled or jointly controlled by a person identified in (a); and**
- **(iii) a person identified in (a)(i) has significant influence over that entity or is a member of the management of that entity (or its controlling entity).**

<u>Related party transaction</u> is a transfer of resources, services or obligations between the reporting entity and a related party, regardless of whether a price is charged.

<u>Significant influence</u> is the power to participate in the financial and operating policy decision of an entity, but not control those policies.

Terms defined in other Chapters are used in this Chapter with the same meaning as in those other chapters.

Purpose of related party disclosures

.04 Related party relationships exist throughout the public sector, because:

(a) departments are subject to the overall direction of an executive government, and ultimately, parliament, and operate together to achieve the policies of the government;

(b) departments frequently conduct activities necessary for the achievement of different parts of their responsibilities and objectives through separate controlled entities, and through entities over which they have significant influence;

(c) public entities enter into transactions with other government entities on a regular basis; and

(d) ministers or other elected or appointed members of the government and other members of management can exert significant influence over the operations of a department or other entity.

.05 Government and entities are expected to use resources efficiently, effectively and in the manner intended, and to deal with public monies with the highest levels of integrity. The existence of related party relationships means that one party can control, jointly control or significantly influence the activities of another party. This provides the opportunity for transactions to occur on a basis that may give one party an advantage at the expense of another. Disclosure of related party transactions, outstanding balances, and the relationship underlying those transactions is necessary for accountability purposes. It enables users to better understand the financial statements of the reporting entity because:

(a) related party relationships can influence the way in which an entity operates with other entities in achieving its objectives, and the way in which it co-operates with other entities in achieving common or collective objectives;

(b) related party relationships might expose an entity to risks or provide opportunities that would not have existed in the absence of such a relationship; and

(c) related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties. This occurs frequently where goods and/or services are transferred between entities at less than full cost recovery as a part of normal operating parameters consistent with the achievement of the objectives of the entity and the government.

.06 Management holds positions of responsibility within a department. Members of management are responsible for the strategic direction and operational management of a department and are entrusted with significant authority. Their remuneration may be established by statute or by another body independent of the reporting department. However, their responsibilities may enable them to influence the benefits of office that flow to them, or their related parties or parties that they represent on the governing body.

.07 Disclosure of related party transactions and balances may affect users' assessments of the financial statements of the reporting department and its ability to deliver agreed services, including assessments of the risks and opportunities facing the entity. This disclosure also ensures that the reporting department is transparent about its dealings with related parties.

Close member of the family of a person

.08 Judgement will be necessary in determining whether a person should be identified as a close member of the family or another person for purposes of application of this Chapter. In the absence of information to the contrary, such as where a spouse or other relative is estranged from the person, immediate family members and close relatives are presumed to have, or be subject to, such influence as to satisfy the definition of close members of the family of that person. At a minimum, the following should be considered to be close members of the family:

(a) that person's children and spouse or domestic partner;

(b) children of that person's spouse or domestic partner;

(c) dependants of that person or that person's spouse or domestic partner;

(d) a grandparent, grandchild, parent, brother or sister; and

(e) a parent-in-law, brother-in-law or sister-in-law.

Identifying related parties

.09 The definition of related party includes circumstances in which one party has the ability to exercise significant influence over the other party. In the public sector, an individual or department may be given oversight responsibility for a reporting entity, which gives them significant influence, but not control, over the financial and operating decisions of the reporting entity.

.10 Departments are related parties because they are subject to common control (they operate together to achieve common objectives determined by Cabinet/Provincial Legislature). However, a department in one province is not "related" to another department in a different province. In addition a municipality is not necessarily a related party to a department.

.11 Related parties include:

(a) entities that directly, or indirectly through one or more intermediaries, control or are controlled by the reporting entity;

(b) associates and joint ventures;

(c) individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;

(d) key management personnel, and close members of the family of key management personnel; and

(e) entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

Control

.12 An entity (or a person or body of persons) has control over another entity when it has certain decision-making capabilities over another and it benefits from the activities of that entity.

.13 In addition to the indicators provided in the above definition, one or more of the circumstances listed below either individually or collectively can be indicative of the existence of control:

(a) the entity has the ability to veto operating and capital budgets of the other entity;

(b) the entity has the ability to veto, overrule, or modify the board of directors or equivalent governing body decisions of the other entity;

(c) the entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity;

(d) the mandate of the other entity is established and limited by legislation;

(e) the entity holds a "golden share" (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that entity;

(f) the entity holds direct or indirect title to the net assets of the other entity;

(g) the entity has a right to a significant level of the net assets of the other entity in the event of a liquidation or in a distribution other than a liquidation;

(h) the entity is able to direct the other entity to co-operate with it in achieving its objectives; and

(i) the entity is exposed to the residual liabilities of the other entity.

.14 The national departments do not control provinces or municipalities for accounting purpose, although funding may be received from the national government.

Key management personnel

.15 Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the activities of the department.

.16 Remuneration to close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity (where these individuals are paid by the department)

.17 Remuneration includes:

(a) Short-term employee benefits such as salaries, unemployment insurance and workmen's compensation funds (where applicable), paid annual leave and paid sick leave, profit sharing and bonuses and non-monetary benefits such as medical benefits, housing, cars and free or subsidised goods and services;

(b) post-employment benefits (social benefits) such as pensions, other retirement benefits, post-employment life insurance and medical care;

(c) other long term employee benefits, including long-service leave or sabbatical leave, long term disability benefits; and

(d) termination benefits.

Disclosures

Disclosures of related party transactions

.18 **Subject to the exemption in paragraph .22 and .23, a department shall disclose transactions and balances with its related parties falling under its Minister/MEC's portfolio. In making this disclosure the department shall provide:**

(a) a breakdown of related party revenue into the major categories of revenue.

(b) a breakdown of related party expenditure into the major categories of expenditure.

(c) the total balances of receivables and payables that arose from related party transactions;

(d) the balance of loans made to / from related parties; and

(e) a breakdown of any guarantees issued to related parties;

(f) a breakdown of any other contingent liabilities between the department and the related parties; and

(g) disclose information about any in-kind goods or services received from or provided to a related party

.19 The disclosure required in terms of paragraph .18(b) above excludes transfers and subsidies paid to public entities where these have been included in the annexures to the financial statements.

.20 **A department shall further disclose a list of all its related party relationships irrespective of whether there were any transactions between the related parties.**

Disclosures of key management personnel

.21 **A department shall disclose the following with regards to key management personnel:**

(a) full compensation paid to key management personnel per category.

(b) a department shall also disclose the total payments made to close family members of key management personnel.

(c) for each category of key management personnel the department shall also disclose the number of individuals in that category.

Disclosure exemption

.22 **A department is exempt from all the disclosure requirements in paragraph .18 in relation to related party transactions if that transaction occurs within:**

(a) a normal supplier and/or client/recipient relationships on terms and conditions no more or less favourable than those which it is reasonable to expect the entity to have adopted if dealing with that individual entity or person in the same circumstances; and

(b) terms and conditions within the normal operating parameters established by that reporting department's legal mandate.

.23 **A department is exempt from all the disclosure requirements in paragraph .18 in relation to related party transactions with close family members of key management personnel.**

AGENT-PRINCIPAL DISCLOSURES

Chapter Content

Introduction

.01 This Chapter prescribes the disclosure requirements in respect of agency / principal relationships that a department may be a party to.

Scope

.02 **A department shall apply this chapter in accounting for agency / principal relationships that it is a party to.**

Definitions

.03 ***The following terms are used in this Chapter with the meanings specified:***

An <u>activity</u> is the carrying out of a separately identifiable task or process, or group of similar tasks or processes

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Identifying Agency / Principal Relationships

.04 **A department is acting as a principal when it has the power to exercise beneficial control over an activity. A department has beneficial control when it has both the power to direct the activity, and the ability to benefit from that power. In the public sector, "benefits" can consist of economic benefits, service potential or both.**

.05 Activities, in this context, would consist of events, tasks or processes that give rise to a flow of economic benefits or service potential between the department and other parties.

.06 In determining whether a department has beneficial control it should first consider any governing legislation. In the absence of any legal provision, a department should consider the indicators listed in paragraphs .07 and .08 below.

.07 Features of beneficial control (must be present for beneficial control to exist):

a) the entity is directly responsible and accountable to the legislature, the general public and/or ultimate beneficiaries in respect of the activity, regardless of indirect rights of recourse between the entity and any other parties that may exist;

b) it has the power to use the majority of activity related resources (inputs, processes or outputs) in pursuit of the entity's own service delivery objectives (for the entity's own benefit); and

c) it is exposed to variability in the outcomes (positive or negative) of the activity. "Outcomes" in this context refers to the receipt or sacrifice of economic benefits or service potential, but also to the end result achieved by undertaking a particular activity.

.08 Possible indicators of beneficial control which may assist a department in applying its judgement as to whether it has beneficial control over an activity include, but are not limited to the following:

a) there is no identifiable binding arrangement that governs the specific activity of the entity, which means that the entity chooses to undertake that activity for its own purposes rather than on behalf of another party.

b) the entity regulates the specific activity.

c) the entity has the ability to direct or restrict access to the activity related resources, notwithstanding commitments to transfer the resources at the completion of the activities.

d) significant risks and rewards inherent in the activity lie with the entity.

.09 Evidence of the existence of the above features and or indicators will be found in the binding arrangement between the two parties.

.10 Binding arrangements include, but are not limited to formal contracts. In the public sector, other forms of binding arrangements may exist between different entities such as requirements established by legislation, government policy, or common law. Determining whether an arrangement is binding (enforceable) is a matter of judgement depending on the specific facts and circumstances.

Disclosures

.11 **Where a department acts as a principal it shall disclose as part of the primary financial information, the following in the notes to the financial statements:**

(a) the total payments made to its agents (where applicable) during the period; and

(b) an explanation about the nature, circumstances and terms relating to the arrangements.

.12 **Where a department is acting as an agent for another department or public sector entity it shall disclose as part of the primary financial information, the following in the notes to the financial statements:**

(a) a reconciliation between total agency funds received and disbursements made in executing the agency services;

(b) an explanation of differences between amounts spent on behalf of the other party, and any reimbursements received in the reporting period;

(c) any revenue earned from rendering the agency service, and the amount of revenue recognised based on cash receipts during the reporting period;

(d) a narrative description and explanation of assets belonging to other entities that are held in the custody of the department; and

(e) an explanation about the nature, circumstances and terms relating to the arrangements.

EVENTS AFTER THE REPORTING DATE

Chapter Content

Introduction

.01 This Chapter prescribes when a department should adjust its financial statements for events after the reporting date; and the disclosures that a department should make concerning events that took place after the reporting date and before the financial statements were authorised for issue.

Scope

.02 **A department shall apply this Chapter in identifying adjusting and non-adjusting events that occur after the reporting date, and the treatment thereof in the financial statements.**

.03 Departments recognise expenditure on the date of payment and revenue when the cash is received. Thus for the purpose of this chapter, adjusting events will be limited to information included in the secondary information in the financial statements.

Definitions

.04 ***The following terms are used in this Chapter with the meanings specified:***

<u>Events after the reporting date</u> are those events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and

(b) those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).

<u>Reporting date</u> means the date of the last day of the reporting period to which the financial statements relate.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Authorising the financial statements for issue

.05 In order to determine which events satisfy the definition of events after the reporting date, it is necessary to identify both the reporting date and the date on which the financial statements are authorised for issue.

.06 The reporting date is the last day of the reporting period to which the financial statements relate. The date of authorisation for issue is the date on which the financial statements have received approval from management to be issued to the executive authority. The audit opinion is provided on these finalised financial statements.

.07 Events after the reporting date are all events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue.

.08 The process involved in preparing and authorising financial statements for issue may vary depending upon the management structure, the statutory requirements relating to the department and the procedures followed in preparing and finalising the financial statements. Responsibility for authorisation of financial statements of a department rests with management (e.g. the accounting officer).

Recording and measurement

.09 The recording and measurement principles established in other Chapters apply equally to adjusting events arising after the reporting date.

Adjusting events after the reporting date

.10 **A department shall adjust the amounts recognised and recorded in its financial statements to reflect adjusting events after the reporting date.**

Non-adjusting events after the reporting date

.11 **A department shall not adjust the amounts recognised or recorded in its financial statements to reflect non-adjusting events after the reporting date.**

.12 Where a restructuring announced after the reporting date meets the definition of a non-adjusting event, the appropriate disclosures are made in accordance with this Chapter, read with the Chapter on *Provisions and Contingents.*

Disclosures

Disclosure of date of authorisation for issue

.13 **A department shall disclose the date when the financial statements were authorised for issue and who gave that authorisation.**

.14 It is important for users to know when the financial statements were authorised for issue, as the financial statements do not reflect events after this date. As explained in paragraph .06, the date of authorisation for issue is the date on which the financial statements have received approval from management to be issued to the executive authority. For example, the accounting officer is required to issue its annual report, including the financial statements and the audit report on those financial statements to the executive authority for tabling in the National Assembly. The executive authority has the responsibility to approve the annual report before submission to the National Assembly. In such cases, the financial statements are authorised for issue when the accounting officer authorises the financial statements for issue to the executive authority. The audit opinion is provided on these finalised financial statements.

Updating disclosures about conditions at the reporting date

.15 **If a department receives information after the reporting date, but before the financial statements are authorised for issue, about conditions that existed at the reporting date, it shall update disclosures that relate to these conditions, in the light of the new information.**

.16 In some cases, a department needs to update the disclosures in its financial statements to reflect information received after the reporting date but before the financial statements are authorised for issue. One example of the need to update disclosures is when evidence becomes available after the reporting date about a contingent liability that existed at the reporting date. In addition to considering whether it should now disclose a provision a department updates its disclosures about the contingent liability in the light of that evidence.

Disclosures of non-adjusting events at the reporting date

.17 **If non-adjusting events after the reporting date are material, non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, a department shall disclose the following for each material category of non-adjusting event after the reporting date:**

(a) the nature of the event.

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

.18 The following are examples of non-adjusting events after the reporting date that would generally result in disclosure:

(a) the department decides after reporting date, to provide/distribute substantial additional benefits in the future directly or indirectly to participants in community service programmes that it operates, and those additional benefits have a major impact on the department;

(b) an acquisition or disposal of a major controlled entity or the outsourcing of all or substantially all of the activities currently undertaken by a department after the reporting date;

(c) announcing a plan to discontinue an operation or major programme;

(d) major purchases of assets, or decision to dispose of a large number of assets;

(e) the destruction of a major building by a fire after the reporting date;

(f) entering into significant commitments or contingent liabilities; and

(g) commencing major litigation arising solely out of events that occurred after the reporting date.

CONSOLIDATED FINANCIAL STATEMENTS

Chapter Content

Introduction

.01 The objective of this Chapter is to prescribe how the consolidation for the national and each provincial sphere of government should be prepared.

.02 This chapter further:

(a) identifies the entities that are appropriate to be incorporated into the consolidation;

(b) establishes procedures for preparing the consolidation; and

(c) specifies minimum disclosures to be made in the consolidation.

Scope

.03 **This chapter only applies to the National and provincial treasuries that are required to prepare consolidated financial statements in accordance with legislation. The scope of entities to be consolidated will be determined in accordance with the principles of this chapter.**

.04 The National Treasury is required by the Public Finance Management Act to prepare consolidated financial statements for the national government sector in accordance with generally recognised accounting practice. Similarly, provincial treasuries are required to prepare consolidated financial statements on behalf of the province. At present, a consolidation comprising of all departments and their controlled entities is not practicable due to a number of factors, including the different accounting bases currently applied in government. The Standard thus provides guidance on the entities to be included in the departmental consolidation in order to address these difficulties.

Definitions

.05 ***The following terms are used in this Chapter with the meanings specified:***

<u>Consolidated financial statements</u> are the financial statements of an economic entity presented as that of a single entity.

<u>Consolidating entity</u> is the entity that undertakes the consolidation of other entities based on its legislative mandate to do so (for example, the National Treasury and provincial treasuries).

<u>Economic entity</u> (for the purpose of this Standard) means a designated group of entities comprising a consolidating entity and one or more reporting entities.

Terms defined in other chapters are used in this Chapter with the same meaning as in those other chapters.

Economic entity

.06 The term “economic entity” is used in this chapter to define, for financial reporting purposes, a group of entities comprising the consolidating entity and any consolidated entities.

Presentation and scope of the consolidated financial statements

.07 **The consolidating entity shall present consolidated financial statements for the economic entity, which for the purpose of this Standard comprises of:**

(a) all departments (including the consolidating entity) within the respective sphere of government;

(b) the revenue fund;

(c) Parliament / the provincial legislature; and

(d) any government component, trading entity and or activity for which financial statements are prepared in accordance with this Standard.

Consolidation procedures

.08 **In preparing consolidated financial statements, the consolidating entity combines the financial statements of each entity line-by-line by adding like items of assets, liabilities, net assets, revenue and expenditure.**

.09 **Cash balances and cash transactions between entities should be eliminated in full, to the extent that those transactions and balance have been fully recognised and or recorded in the financial records of all entities concerned.**

.10 **The consolidated financial statements shall be prepared using uniform accounting policies for like transaction and other events in similar circumstances.**

.11 If an entity within the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Consolidation disclosures

The following disclosures shall be made in the consolidated financial statements:

a) a list of all entities that have been designated to be within the economic entity; and

b) a list of entities that have been excluded from the consolidation together with the reasons why the entities have not been consolidated.