

## **Nketoana Local Municipality**

Annual Financial Statements for the year ended 30 June 2013

### **Accounting Policies**

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#### **1. Presentation of Annual Financial Statements**

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

These annual financial statements have been prepared on an accrual basis of accounting and are in accordance with historical cost convention unless specified otherwise. They are presented in South African Rand.

A summary of the significant accounting policies, which have been consistently applied, are disclosed below.

These accounting policies are consistent with the previous period, except for the changes set out in note 2 Changes in accounting policy

##### **1.1 Significant judgements and sources of estimation uncertainty**

In preparing the annual financial statements, management is required to make estimates and assumptions that affect the amounts represented in the annual financial statements and related disclosures. Use of available information and the application of judgement is inherent in the formation of estimates. Actual results in the future could differ from these estimates which may be material to the annual financial statements. Significant judgements include:

##### **Trade receivables / Held to maturity investments and/or loans and receivables**

The municipality assesses its trade receivables, held to maturity investments and loans and receivables for impairment at the end of each reporting period. In determining whether an impairment loss should be recorded in surplus or deficit, the surplus makes judgements as to whether there is observable data indicating a measurable decrease in the estimated future cash flows from a financial asset.

The impairment for trade receivables, held to maturity investments and loans and receivables is calculated on a portfolio basis, based on historical loss ratios, adjusted for national and industry-specific economic conditions and other indicators present at the reporting date that correlate with defaults on the portfolio. These annual loss ratios are applied to loan balances in the portfolio and scaled to the estimated loss emergence period.

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#### **1.1 Transfer of functions between entities under common control (continued)**

##### **Fair value estimation**

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the end of the reporting period. The quoted market price used for financial assets held by the municipality is the current bid price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The municipality uses a variety of methods and makes assumptions that are based on market conditions existing at the end of each reporting period. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the municipality for similar financial instruments.

##### **Impairment testing**

The recoverable amounts of cash-generating units and individual assets have been determined based on the higher of value-in-use calculations and fair values less costs to sell. These calculations require the use of estimates and assumptions. It is reasonably possible that the assumption may change which may then impact our estimations and may then require a material adjustment to the carrying value assets.

The municipality reviews and tests the carrying value of assets when events or changes in circumstances suggest that the carrying amount may not be recoverable. In addition, goodwill is tested on an annual basis for impairment. Assets are grouped at the lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. If there are indications that impairment may have occurred, estimates are prepared of expected future cash flows for each group of assets.

##### **Provisions**

Provisions were raised and management determined an estimate based on the information available. Additional disclosure of these estimates of provisions are included in note 20 - Provisions.

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#### **1.1 Transfer of functions between entities under common control (continued)**

##### **Useful lives**

The municipality's management determines the estimated useful lives and related depreciation charges for these assets. This estimate is based on industry norm, other impact management consider are technology, service requirement of the assets. The estimated residual values of assets is also based on management's judgement on whether the assets will be sold or used to the end of their useful lives, and what their condition will be at that time.

Management will increase the depreciation charge where useful lives are less than previously estimated useful lives.

##### **Post retirement benefits**

The present value of the post retirement obligation depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) include the discount rate. Any changes in these assumptions will impact on the carrying amount of post retirement obligations.

The municipality determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the municipality considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Other key assumptions for pension obligations are based on current market conditions. Additional information is disclosed in Note 21.

##### **Effective interest rate**

The municipality used the prime interest rate to discount future cash flows.

##### **Allowance for doubtful debts**

On debtors an impairment loss is recognised in surplus and deficit when there is objective evidence that it is impaired. The impairment is measured as the difference between the debtors carrying amount and the present value of estimated future cash flows discounted at the effective interest rate, computed at initial recognition.

##### **VAT**

The Municipality accounts for value-added tax on the payment basis.



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#### **1.1 Transfer of functions between entities under common control (continued)**

##### **Budget Information**

The annual budget figures have been prepared in accordance with the GRAP standards, and are consistent with the accounting policies adopted by Council for the preparation of these financial statements. The amounts are scheduled as a separate additional financial statement, called the statement of comparison of budget and actual amounts. Explanatory comments are provided in the notes to the financial statements, firstly stating reasons for overall growth or decline in the budget, and, secondly, motivating overspending or underspending on line items.

The annual budget figures included in the financial statements are for the Municipality. These figures are those approved by Council both at beginning and during the year following a period of consultation with the public as part of the IDP.

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#### **1.2 Biological assets that form part of an agricultural activity**

An entity shall recognise a biological assets that form part of an agricultural activity or agricultural produce when, and only when:

- the entity controls the asset as a result of past events;
- it is probable that future economic benefits or service potential associated with the asset will flow to the municipality; and
- the fair value or cost of the asset can be measured reliably.

Biological assets that form part of an agricultural activity are measured at their fair value less point-of-sale costs.

The fair value of livestock is determined based on market prices of livestock of similar age, breed, and genetic merit.

A gain or loss arising on initial recognition of biological assets that form part of an agricultural activity or agricultural produce at fair value less estimated point-of-sale costs and from a change in fair value less estimated point-of-sale costs of a biological assets that form part of an agricultural activity is included in surplus or deficit for the period in which it arises.

Where market determined prices or values are not available, the present value of the expected net cash inflows from the asset, discounted at a current market-determined pre-tax rate where applicable is used to determine fair value.

An unconditional government grant related to a biological assets that form part of an agricultural activity measured at its fair value less costs to sell is recognised as income when the government grant becomes receivable.

Where fair value cannot be measured reliably, biological assets are measured at cost less any accumulated depreciation and any accumulated impairment losses.

#### **Derecognition**

Biological assets is derecognised on disposal or when biological assets is loss through natural course and included in profit and loss in period losses are accounted.

#### **1.3 Investment property**

##### **Initial Recognition**

Investment property is property (land or a building - or part of a building - or both) held to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for
- administrative purposes, or
- sale in the ordinary course of operations.

Owner-occupied property is property held for use in the production or supply of goods or services or for administrative purposes.

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#### 1.3 Investment property (continued)

Investment property is recognised as an asset when, it is probable that the future economic benefits or service potential that are associated with the investment property will flow to the municipality, and the cost or fair value of the investment property can be measured reliably.

Investment property is initially recognised at cost. Transaction costs are included in the initial measurement.

Where investment property is acquired through a non-exchange transaction, its cost is its fair value as at the date of acquisition.

Costs include costs incurred initially and costs incurred subsequently to add to, or to replace a part of, or service a property. If a replacement part is recognised in the carrying amount of the investment property, the carrying amount of the replaced part is derecognised.

#### Cost model

Investment property is carried at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is provided to write down the cost, less estimated residual value over the useful life of the property, which is as follows:

Item	Useful life
Land	indefinite
Buildings	30 years

Investment property is derecognised on disposal or when the investment property is permanently withdrawn from use and no future economic benefits or service potential are expected from its disposal.

Compensation from third parties for investment property that was impaired, lost or given up is recognised in surplus or deficit when the compensation becomes receivable.

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#### **1.4 Property, plant and equipment**

Property, plant and equipment are tangible non-current assets (including infrastructure assets) that are held for use in the production or supply of goods or services, rental to others, or for administrative purposes, and are expected to be used during more than one period.

The cost of an item of property, plant and equipment is recognised as an asset when:

- it is probable that future economic benefits or service potential associated with the item will flow to the municipality; and
- the cost of the item can be measured reliably.

Property, plant and equipment is initially measured at cost.

The cost of an item of property, plant and equipment is the purchase price and other costs attributable to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Trade discounts and rebates are deducted in arriving at the cost.

Where an asset is acquired through a non-exchange transaction, its cost is its fair value as at date of acquisition.

Where an item of property, plant and equipment is acquired in exchange for a non-monetary asset or monetary assets, or a combination of monetary and non-monetary assets, the asset acquired is initially measured at fair value (the cost). If the acquired item's fair value was not determinable, it's deemed cost is the carrying amount of the asset(s) given up.

When significant components of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. If a replacement cost is recognised in the carrying amount of an item of property, plant and equipment, the carrying amount of the replaced part is derecognised.

The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located is also included in the cost of property, plant and equipment, where the entity is obligated to incur such expenditure, and where the obligation arises as a result of acquiring the asset or using it for purposes other than the production of inventories.

Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.



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#### 1.4 Property, plant and equipment (continued)

Major spare parts and stand by equipment which are expected to be used for more than one period are included in property, plant and equipment. In addition, spare parts and stand by equipment which can only be used in connection with an item of property, plant and equipment are accounted for as property, plant and equipment.

Major inspection costs which are a condition of continuing use of an item of property, plant and equipment and which meet the recognition criteria above are included as a replacement in the cost of the item of property, plant and equipment. Any remaining inspection costs from the previous inspection are derecognised.

Property, plant and equipment is carried at cost less accumulated depreciation and any impairment losses.

#### Depreciation and Impairment

Property, plant and equipment are depreciated on the straight line basis over their expected useful lives to their estimated residual value.

Property, plant and equipment is carried at cost less accumulated depreciation and any impairment losses.

The useful lives of items of property, plant and equipment have been assessed as follows:

Item	Average useful life
Land	Indefinite
Buildings	30 years
Furniture and fixtures	7-10 years
Motor vehicles	5-7 years
Office equipment	3-5 years
Computer equipment	5 years
Computer software	5 years
Infrastructure	
• Roads and Paving	20 years
• Pedestrian malls	20 years
• Electricity	20-30 years
• Water	15-20 years
• Sewerage	15-20 years



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#### 1.4 Property, plant and equipment (continued)

##### Community

• Building	30 years
• Recreational facilities	30 years
• Security	30 years
• Halls	30 years
• Libraries	30 years
• Parks and gardens	30 years
• Other assets	20-30 years

Specialised property, plant and equipment 5-15 years

##### Other equipment

• Landfill sites	30 years
• Quarries	30 years
• Emergency	5-15 years

Bins and containers 5 years

Specialised vehicles 5-7 years

##### Water network

• Watercraft	15 years
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##### Heritage

• Buildings	nil
• Paintings and artifacts	nil

Other property, plant and equipment 5-15 years

The residual value, and the useful life and depreciation method of each asset are reviewed at the end of each reporting date. If the expectations differ from previous estimates, the change is accounted for as a change in accounting estimate.

Reviewing the useful life of an asset on an annual basis does not require the entity to amend the previous estimate unless expectations differ from the previous estimate.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

The depreciation charge for each period is recognised in surplus or deficit unless it is included in the carrying amount of another asset.

Items of municipality are derecognised when the asset is disposed of or when there are no further economic benefits or service potential expected from the use of the asset.

#### Derecognition

The gain or loss arising from the derecognition of an item of property, plant and equipment is included in surplus or deficit when the item is derecognised. The gain or loss arising from the derecognition of an item of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

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#### **1.4 Property, plant and equipment (continued)**

Assets which the municipality holds for rentals to others and subsequently routinely sell as part of the ordinary course of activities, are transferred to inventories when the rentals end and the assets are available-for-sale. These assets are not accounted for as non-current assets held for sale. Proceeds from sales of these assets are recognised as revenue. All cash flows on these assets are included in cash flows from operating activities in the municipality.

#### **Work in progress**

Property, plant and equipment (fixed assets) shall be capitalised, that is, recorded in the fixed assets register, as soon as it is acquired. If the assets is constructed over a period of time, it shall be recorded as work in progress until it is available for use, where after it shall be appropriately capitalised as a fixed assets.

#### **1.5 Intangible assets**

An asset is identified as an intangible asset when it:

- is capable of being separated or divided from an entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, assets or liability; or
- arises from contractual rights or other legal rights, regardless whether those rights are transferable or separate from the municipality or from other rights and obligations.

An intangible asset is recognised when:

- it is probable that the expected future economic benefits or service potential that are attributable to the asset will flow to the municipality; and
- the cost or fair value of the asset can be measured reliably.

Intangible assets are initially recognised at cost.

An intangible asset acquired through a non-exchange transaction, the cost shall be its fair value as at the date of acquisition.

Expenditure on research (or on the research phase of an internal project) is recognised as an expense when it is incurred.

An intangible asset arising from development (or from the development phase of an internal project) is recognised when:

- it is technically feasible to complete the asset so that it will be available for use or sale.
- there is an intention to complete and use or sell it.
- there is an ability to use or sell it.
- it will generate probable future economic benefits or service potential.
- there are available technical, financial and other resources to complete the development and to use or sell the asset.
- the expenditure attributable to the asset during its development can be measured reliably.

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#### 1.5 Intangible assets (continued)

An intangible asset is regarded as having an indefinite useful life when, based on all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows or service potential. Amortisation is not provided for these intangible assets, but they are tested for impairment annually and whenever there is an indication that the asset may be impaired. For all other intangible assets amortisation is provided on a straight line basis over their useful life.

The amortisation period and the amortisation method for intangible assets are reviewed at each reporting date.

Reassessing the useful life of an intangible asset with a finite useful life after it was classified as indefinite is an indicator that the asset may be impaired. As a result the asset is tested for impairment and the remaining carrying amount is amortised over its useful life.

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance are not recognised as intangible assets.

Amortisation is provided to write down the intangible assets, on a straight line basis, to their residual values as follows:

Item	Useful life
Computer software, other	3 years

#### Intangible assets are derecognised:

- on disposal; or
- when no future economic benefits or service potential are expected from its use or disposal.

The gain or loss is the difference between the net disposal proceeds, if any, and the carrying amount. It is recognised in surplus or deficit when the asset is derecognised.

#### 1.6 Financial instruments

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

The amortised cost 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 effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

A concessionary loan is a loan granted to or received by an entity on terms that are not market related.

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.



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#### 1.6 Financial instruments (continued)

Derecognition is the removal of a previously recognised financial asset or financial liability from an entity's statement of financial position.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

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.

A financial asset is:

- cash;
- a residual interest of another entity; or
- a contractual right to:
  - receive cash or another financial asset from another entity; or
  - exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.

A financial liability is any liability that is a contractual obligation to:

- deliver cash or another financial asset to another entity; or
- exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity.

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk encountered by an entity in the event of difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Loan commitment is a firm commitment to provide credit under pre-specified terms and conditions.

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

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#### 1.6 Financial instruments (continued)

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

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:

- equity instruments or similar forms of unitised capital;
- 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
- 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.

Financial instruments at amortised cost are non-derivative financial assets or non-derivative financial liabilities that have fixed or determinable payments, excluding those instruments that:

- the entity designates at fair value at initial recognition; or
- are held for trading.

Financial instruments at cost are investments in residual interests that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured.

Financial instruments at fair value comprise financial assets or financial liabilities that are:

- derivatives;
- combined instruments that are designated at fair value;
- instruments held for trading. A financial instrument is held for trading if:
  - it is acquired or incurred principally for the purpose of selling or repurchasing it in the near-term; or
  - on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short term profit-taking;
  - non-derivative financial assets or financial liabilities with fixed or determinable payments that are designated at fair value at initial recognition; and
  - financial instruments that do not meet the definition of financial instruments at amortised cost or financial instruments at cost.

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#### **1.6 Financial instruments (continued)**

##### **Initial recognition**

The entity recognises a financial asset or a financial liability in its statement of financial position when the entity becomes a party to the contractual provisions of the instrument.

The entity recognises financial assets using trade date accounting.

##### **Initial measurement of financial assets and financial liabilities**

The entity measures a financial asset and financial liability initially at its fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The entity measures a financial asset and financial liability initially at its fair value.

The entity first assesses whether the substance of a concessionary loan is in fact a loan. On initial recognition, the entity analyses a concessionary loan into its component parts and accounts for each component separately. The entity accounts for that part of a concessionary loan that is:

- a social benefit in accordance with the Framework for the Preparation and Presentation of Financial Statements, where it is the issuer of the loan; or
- non-exchange revenue, in accordance with the Standard of GRAP on Revenue from Non-exchange Transactions (Taxes and Transfers), where it is the recipient of the loan.