ASSET MANAGEMENT
@CIGFARO LOCAL GOVERNMENT YEAR-END - WITH YOU EVERY STEP OF THE WAY.....

CIGFARO PRACTITIONERS TOOLS
ASSET MANAGEMENT YEAR-END READINESS
PART 1

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Non-Profit Company
Part 1: Asset Management Overview

Being just over two months away from closing the 2019/2020 financial year; CIGFARO will be listing important asset management functions to be performed to ensure adherence to all asset management regulatory & legislative requirements.

Remember before any Act or Accounting Standard, when it comes to asset management everything centres around the definition of an asset “A resource controlled by the entity where future economic benefits are expected to flow into the entity”

Any form of compliance passes this test, anything you do to comply passes this test; when you are not sure of what to do – go back into the definition and find your way out within the prescript of legislation, applicable regulations or relevant accounting standards.

As an example the relevant asset management accounting standard lists the Recognition Criteria as follows:
The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:
(a) it is probable that future economic benefits or service potential associated with the item will flow to the entity, and
(b) the cost or fair value of the item can be measured reliably.

To briefly unpack:-

A resource = An Asset (in any form – tangible or intangible; movable or immovable)
Controlled by the entity = Municipality must own, have full rights into the usage of the assets (particularly to the issue of servitudes)
Future economic benefits = Must be providing a form of service directly or indirectly to the communities (can be office furniture or water treatment works). Decrease in these ‘benefits’ than normally would have been the case, gives rise to impairments

When a Resource is not in Control of the Municipality – must be De-recognised;
When a Resource is not providing economic benefits in the manner intended, such gives rise to a possible impairment.

Impairment being in simple terms, a way to lower the carrying value of the asset due to the particular factor/s that caused the asset not to provide the economic benefits.
Thus as a starting point, asset practitioners:-

- Must **know exactly** where the existing assets are ('Location') and who is using the asset (Person/Department);

- Must know the **Condition** of the assets (for understanding level of service asset is still providing & for impairment testing purposes)

- Must **record new** assets accordingly on the books of the municipality (Asset Register & General Ledger) *For other costs can be incorrectly recognised as expenses, such must be reallocated to capital expenditure for General Ledger and capitalisation purposes* Ensuring that the Original Cost and Useful Life assigned are accurate.

- Must know exactly what **construction projects** (i.e. Work in Progress/Asset under Construction) are taking place and their corresponding values. Including project management fees associated with each project; locations must be known, and whether each project is progressing well or there could be delays caused by various factors.

- **Dispose assets** no longer in use, thus not providing any benefits to the municipality; assets that’s are lost or stolen; leases returned to the lessor

- **Impair assets**, among other indicators - that are damaged; or broken; or severely deteriorated than what was originally anticipated; or development of an asset has been halted necessitating value to be decreased.

- Must ensure **Depreciation is calculated correctly**, per class of asset, per correct useful life. Asset additions & disposal in between the year must be apportioned accordingly.

- **Reconcile** cost opening & closing balances per class of assets; ensuring in-year movements are correct i.e. new assets, transfers from work in progress; transfers to completed assets, any take-ons of assets, disposals that could have taken place during the year.
  Reconcile accumulated depreciation and impairments opening & closing balances per class of assets; also ensuring in-year calculation movement are corrects i.e. new assets including transfers of completed projects; disposals that could have taken place during the year (depreciation calculated to a date point of disposal)

- Importantly, **report & disclose** the asset values appropriately. Per category & class of each assets.
The above overview is performed in accordance to the following key compliance regulatory frameworks:-

  Local government is the only sphere of South African government for which the country's constitution stipulates a specific mandate. It gives local authorities a basic framework of objectives.

  Section 152 stipulates that local government must:
  - Provide democratic and accountable government for local communities;
  - Ensure the provision of services to communities in a sustainable manner;
  - Promote social and economic development;
  - Promote a safe and healthy environment; and
  - Encourage the involvement of communities and community organisations in the matters of local government

- MFMA, No. 56 of 2003 (Sections 63, 14 & 90)

- Effective GRAP Standards
  - GRAP 3 – Accounting Policies, Changes in Accounting Estimates and Errors
  - GRAP 5 – Borrowing costs
  - GRAP 11 – Construction Contracts
  - GRAP 12 – Inventories
  - GRAP 13 – Leases
  - GRAP 16 – Investment Property
  - GRAP 17 – Property, Plant and Equipment
  - GRAP 21 – Impairment of Non-cash Generating Assets
  - GRAP 26 – Impairment of Cash Generating Assets
  - GRAP 27 – Agriculture
  - GRAP 31 – Intangible assets
  - GRAP 100 – Discontinued operations
  - GRAP 103 – Heritage assets
  - GRAP 109 - Accounting by Principals and Agents

- An Approved Council Asset Management Policy

Various asset functions are thereby required to perform these duties, which include:-

- Yearly (or when deemed appropriate) review of the asset management policy and procedures
- Verification of assets - whether quarterly, bi-annually, or annually (depending on organisational controls in place & specified in the approved Policy)
- Performing Conditional Assessments on all assets, movables & immovable
- Scrutinising general ledger costs (expenses vs. capital expenditure)
- Componentisation & Capitalisation of Completed Projects
- Testing for Impairments & subsequent relevant calculations
- Compilation & submission of Disposal report to applicable committees, and Council where appropriate
- Periodic Reconciliations and Reporting
Audit Finding Example

The municipality did not record and depreciate property, plant and equipment, as required by GRAP 17, Property, plant and equipment. Depreciation was incorrectly calculated and was also calculated on leased assets that were returned to the supplier during the year. In addition, recorded amounts for work in progress did not agree to the supporting invoices and projects under construction were not recorded on the schedule of work in progress. Furthermore, the supporting documents were not provided for changes in accounting estimates recorded on the fixed asset register. The impact of this misstatement was undeterminable as it was impracticable to do so for work in progress stated at 18.73 million (2017: 7.14 million) and depreciation stated at 16.98 million (12.86 million) in note 4 to the financial statements. There was a resultant impact on the deficit for the period on accumulated surplus.

Mitigation

- All infrastructure assets must be recorded appropriately. Capital expenditure incurred must be recorded as either Work in Progress (WIP) or as an Asset to be depreciated. If the capital expenditure relate to an item not yet available for use, such must be transferred to WIP; where the item is available for use i.e. at the state and manner as intended by the municipality, such must be recorded into the asset register and be depreciated accordingly.
- Depreciation must be calculated per correct useful lives, which must be in line with the Council approved policy. Depreciation ceases when the leased item is returned as the item is no more in use by the municipality, therefore date of return is deemed as ‘date of disposal’ whereby depreciation ends.
- Any expenditure must be backed by supporting document for correct classification. Thus Work in Progress (Projects under construction) must be supported by appropriate documentation.
- A detailed methodology of reassessment of remaining useful life should form part of the working paper file. Increase or decrease in depreciation should be part of the AFS change in estimate note.
- Ensuring correct recording of assets; correct depreciation of assets; documenting and filing all information & data used in all steps undertaken to make changes to accounting estimates. All these actions will result in elimination of a similar audit finding.

Audit Finding Example

The municipality did not recognise all items of infrastructure assets in accordance with SA Standards of GRAP 17, property, plant and equipment. Assets completed were reported as one asset in the fixed asset register and not componentised to allow each asset to separately identifiable for physical verification. The impact of this misstatement on infrastructure assets stated as 952.6 million (2017: 919.02 million) in note 7 to the financial statements was undeterminable, as it was impractical to do so.
Mitigation

- Ensure complete & accurate recording of all assets in a financial year; scrutinising costs of major operations and maintenance expenditure. As these could be asset replacements which must be recorded as assets.
- Infrastructure assets must be componentised for correct useful life to be assigned and subsequent correct depreciation. Non-componentisation not only causes incorrect depreciation/misstatement, but could further leads to the accounting officer not exercising his safeguard of assets duties, delegated to the asset management section. Componentisation also allows for ease of verification and thereby safeguarding of the assets. When one component is damaged and replaced you can easily identify such component of the FAR and perform required accounting entries to that specific component only.

Part 2 To deal with How to Perform above Asset Management Duties, especially leading towards compilation of annual financial statements and dealing with Covid-19 impact;
Part 3 To deal with Year-End Asset Management Procedures

Gives us your views, and your asset management readiness for 2019/2020 financial year

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