PHUMELELA LOCAL MUNICIPALITY

Detailed Accounting Policies

for the year ended 30 June 2017

Table of Contents

CHAPTER 1: PURPOSE, SCOPE AND RESPONSIBILITY 3
CHAPTER 2: APPLICABLE ACCOUNTING FRAMEWORK, BASIS OF ACCOUNTING AND OTHER CONSIDERATIONS 6
CHAPTER 3: ASSETS 14
SECTION A: CASH AND CASH EQUIVALENTS 15
SECTION B: TRADE AND OTHER RECEIVABLES FROM EXCHANGE TRANSACTIONS 17
SECTION C: TRADE, OTHER AND LONG-TERM RECEIVABLES FROM NON-EXCHANGE TRANSACTIONS 18
SECTION D: FINANCIAL ASSETS 19
SECTION E: PREPAID EXPENSES 28
SECTION F: INVENTORIES 29
SECTION G: NON CURRENT ASSETS HELD FOR SALE 31
SECTION H: INVESTMENT PROPERTY 32
SECTION I: BIOLOGICAL ASSETS 33
SECTION J: INTANGIBLE ASSETS 34
SECTION K: PROPERTY, PLANT AND EQUIPMENT 37
CHAPTER 4: LIABILITIES 44
SECTION L: TRADE AND OTHER PAYABLES FROM EXCHANGE TRANSACTIONS 45
SECTION M: TAXES AND TRANSFERS PAYABLE 46
SECTION N: FINANCIAL LIABILITIES 47
SECTION O: EMPLOYEE BENEFITS AND KEY MANAGEMENT 50
SECTION P: SOCIAL BENEFIT OBLIGATIONS 53
SECTION Q: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS 54
CHAPTER 6: REVENUE 56
SECTION R: NON-EXCHANGE REVENUE 57
SECTION S: EXCHANGE REVENUE 59
CHAPTER 7: EXPENSES 61
SECTION T: BORROWING COSTS 62
CHAPTER 8: NET ASSETS AND RESERVES 63
SECTION U: OWNERS CONTRIBUTION AND NET ASSETS 64
CHAPTER 9: OTHER 65
SECTION V: UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE 66
SECTION W: LEASES 67
SECTION X: RELATED PARTIES 69
SECTION Y: DISCONTINUED OPERATIONS 70
APPENDIX: DEFINITIONS 71

CHAPTER 1: PURPOSE, SCOPE AND RESPONSIBILITY

Purpose of this document

Accounting policies are defined in GRAP 1, Presentation of Financial Statements, as the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. GRAP 1 also requires that an entity shall disclose in the summary of significant accounting policies the measurement basis (or bases) used in preparing the financial statements and the other accounting policies that are relevant to an understanding of the financial statements.

The purpose of this document is to describe the detailed internal accounting policies adopted by Phumelela Local Municipality that would ensure proper accounting treatment in accordance with the applicable accounting framework prescribed by National Treasury. The accounting policies disclosed in the annual financial statements are derived from these policies.

The purpose of the detailed accounting policies is to provide detailed description of the accounting treatment adopted in respect of every type of transaction or event and includes the classification, recognition and measurement thereof.

These accounting policies form a sub-set of the financial management policies and should be read in conjunction with the approved GRAP for municipalities.[1]

Framework of statutory and regulatory standards

These policies have been written to ensure compliance with the relevant statutory and regulatory standards as far as they may impact the accounting policies that should be contained in the annual financial statements.

Scope

The accounting policies as set out below would apply to Phumelela Local Municipality as the reporting entity and to any municipal entity controlled by the Municipality.

Responsibility and approval

It would be the responsibility of the accounting officer of Phumelela Local Municipality to maintain and adopt these accounting policies to ensure that they are updated with the changes in the relevant accounting standards on an annual basis by 30 April.

These accounting policies were approved by the Council and are applicable for the financial year commencing on 1 July 2009.

Where Phumelela Local Municipality needs to depart from the accounting policies as set out below, the Accounting Officer *of the Phumelela Local Municipality would need to request permission from the Council and motivate the reasons why the selected policy would provide better disclosure. In doing so, the accounting officer would need to consider whether this departure is a departure from GRAP and would need to consider the requirements of GRAP1, paragraphs 21 - 23.*

[1] ASB defines GRAP for municipalities and it is approved by the Minister of Finance for application.

Appendix

The appendix provided does not form part of the accounting policies and may not contain all the definitions included in the applicable accounting frameworks.

CHAPTER 2: APPLICABLE ACCOUNTING FRAMEWORK, BASIS OF ACCOUNTING AND OTHER CONSIDERATIONS

Legislative requirement and accounting framework

Section 122 of the MFMA requires the following in respect of the preparation of financial statements:

Section 122(1)(a): Separate financial statements
"Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year."

Section 122(2): Consolidated financial statements
"A municipality which has sole control of a municipal entity, or which has effective control within the meaning of the Municipal Systems Act of a municipal entity which is a private company, must in addition to complying with section 122(1), prepare consolidated annual financial statements incorporating the annual financial statements of the municipality and of such entity."

Section 122(3): Application of GRAP
"Both annual financial statements and consolidated annual financial statements must be prepared in accordance with generally recognised accounting practice" as set by the Accounting Standards Board (ASB) and prescribed by the Minister of Finance.

Compliance with section 122 of the MFMA is based on a phased implementation strategy in accordance with the different capacity levels of municipalities. The initial implementation dates for compliance with section 122 of the MFMA were legislated in *General Notice 772*, issued in *Government Gazette no. 26510* of 25 June 2004 and *General Notice 773*, issued in *Government Gazette no. 26511* of 1 July 2004.

However, *General Notice 552* of 2007, issued in *Government Gazette* no. 30013 of 29 June 2007, delayed the phased implementation strategy for compliance with section 122, as summarised in table 1 below.

Table 1: Phased implementation strategy for compliance with section 122 of the MFMA

Type of entity	Separate financial statements: MFMA sections 122(1) & 122(3) are applicable in the following financial years:	Consolidated financial statements: MFMA sections 122(2) & 122(3) are applicable in the following financial years:
High capacity municipalities	2008/09	2008/09
Medium capacity municipalities	2008/09	2008/09

Type of entity	Separate financial statements: MFMA sections 122(1) & 122(3) are applicable in the following financial years:	Consolidated financial statements: MFMA sections 122(2) & 122(3) are applicable in the following financial years:
Low capacity municipal entities	2009/10	2009/10
Municipal entities	No exemption	2009/10

Basis of preparation

The annual financial statements and consolidated annual financial statements are prepared in accordance with the Standards of Generally Recognised Accounting Practices (GRAP) as prescribed by the Accounting Standards Board in terms of section 91(1)(b) and approved by the Minister of Finance in terms of General Notice 522 issued in GG 30013 (dated 29 June 2007).

The Reporting Standards applicable to low capacity municipalities with financial years ending 30 June 2010 are summarised in Appendix B of Directive 5 as follows:

Reference	Topic
GRAP 1	Presentation of Financial Statements
GRAP 2	Cash Flow Statements
GRAP 3	Accounting Policies, Changes in Accounting Estimates and Errors
GRAP 4	The Effect of Changes in Foreign Exchange Rates
GRAP 5	Borrowing Costs
GRAP 6	Consolidated and Separate Financial Statements
GRAP 7	Investments in Associates
GRAP 8	Interests in Joint Ventures
GRAP 9	Revenue from Exchange Transactions
GRAP 10	Financial Reporting in Hyperinflationary Economies
GRAP 11	Construction Contracts
GRAP 12	Inventories
GRAP 13	Leases
GRAP 14	Events After the Reporting Date
GRAP 16	Investment Property
GRAP 17	Property, Plant and Equipment
GRAP 19	Provisions, Contingent Liabilities and Contingent Assets
GRAP 21	Impairment of Non-Cash Generating Units
GRAP 23	Revenue from non-exchange transactions (taxes and transfers
GRAP 24	Presentation of Budgeted Information in the Financial Statements
GRAP 26	Impairment of Cash Generating Units

GRAP 100	Non-Current Assets held for Sale and Discontinued Operations
GRAP 101	Agriculture
GRAP 102	Intangible Assets
GRAP 103	Heritage Assets
GRAP 104	Financial Instruments

Directives issued and effective:

Reference	**Topic**
Directive 5	Determining the GRAP Reporting Framework
Directive 7	The Application of Deemed Cost on the Adoption of Standards of GRAP

Reference	**Topic**
IGRAP 1	Applying the Probability Test on Initial Recognition of Exchange Revenue

Reference	**Topic**
GRAP 18	Segment Reporting
GRAP 20	Related Party Disclosures
GRAP 25	Employee Benefits
GRAP 105	Transfer of functions between entities under common control
GRAP 106	Transfer of functions between entities under common control
GRAP 107	Mergers
IFRS 3 (AC 140)	Business Combinations
IFRS 4 (AC 141)	Insurance Contracts
IFRS 6 (AC 143)	Exploration for and Evaluation of Mineral Resources
IFRS 7 (AC 144)	Financial Instruments: Disclosures
IAS 12 (AC 102)	Income Taxes
IAS 19 (AC 116)	Employee Benefits
IAS 32 (AC 125)	Financial Instruments: Presentation
IAS 39 (AC 133)	Financial Instruments: Recognition and Measurement
SIC – 21 (AC 421) Income Taxes – Recovery of Revalued Non-Depreciable Assets	
SIC – 25 (AC 425) Income Taxes – Changes in the Tax Status of an Entity or its	
Shareholders	
SIC – 29 (AC 429) Service Concession Arrangements – Disclosures	
IFRIC 2 (AC 435) Members' Shares in Co-operative Entities and Similar Instruments	
IFRIC 4 (AC 437) Determining whether an Arrangement contains a Lease	
IFRIC 9 (AC 442) Reassessment of Embedded Derivatives	
IFRIC 12 (AC 445) Service Concession Arrangements	
IFRIC 13 (AC 446) Customer Loyalty Programmes	
IFRIC 14 (AC 447) IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding	
Requirements and their Interaction	
IFRIC 15 (AC 448) Agreements for the Construction of Real Estate	
IFRIC 16 (AC 449) Hedges in a Net Investment in a Foreign Operation	

Accounting policies for material transactions, events or conditions not covered by the above GRAP Standards are developed in accordance with paragraphs 7, 11 and 12 of GRAP 3 (See paragraph on *selection of accounting policies* below).

Basis of accounting

The Phumelela Local Municipality prepares its financial statements, except for cash flow information, using the accrual basis of accounting.

The annual financial statements are prepared on the historical cost basis, except where the standards specifically requires fair value measurement or amortised costs as indicated in the individual accounting policies as indicated below.

Significant judgments and estimates

In preparing the 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 judgment are 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.

The Phumelela Local Municipality shall disclose any significant judgements made in applying their accounting policies in the summary of significant accounting policies disclosed in the annual financial statements.

Examples of significant judgement made in applying the accounting policies, disclosed in the accounting policies section, may include:

- *Impairment of trade receivables and/or loans and receivables*

  The Phumelela Local Municipality assesses its trade and/or loans and receivables for impairment at each balance sheet date. In determining whether an impairment loss should be recorded in the statement of financial performance, the Municipality 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 and/or 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.

Any key assumptions made concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amount of assets and/or liabilities within the next financial year shall be disclosed in the respective notes to the financial statements. In respect of these estimations, the notes shall include detail of the nature and the carrying amount of the asset/liability at reporting date.

Examples of estimates includes in the notes to the financial statements:

- Trade and other receivables

Trade and other receivables	100 000.00
Less: Impairment provision	(20 000,00)
Carrying amount	80 000.00

The impairment for trade and other receivables has been calculated based on the following key assumptions:

Risk free rate: 10% p.a. based on the government bond rate
Trade debt portfolios are based on the ageing of debtors.

Current vs. non-current

The Phumelela Local Municipality classifies items on the statement of financial position between current and non-current.

An asset or liability is classified as current when it is within the normal operating cycle, when it is expected that the asset or liability will be realised within 12 months, is held for trade or held specifically as cash or cash equivalents.

All other assets and liabilities are classified as non-current.

Offsetting

The Phumelela Local Municipality shall not offset revenue and expenses or assets and liabilities unless specifically allowed by a specific standard within the applicable accounting framework.

Trade date accounting

The Phumelela Local Municipality uses trade date accounting for recognising assets and liabilities. The trade date is the date that an entity commits itself to purchase or sell an asset.

Structure of accounting policies

The structure of the accounting policies is based on the structure as included in the accounting framework. The accounting policies deal with classification criteria, the initial recognition and measurement, subsequent recognition and measurement and de-recognition as well as significant judgements that has to be made.

Selection of accounting policies

The following shall be considered when selecting accounting policies that is applied to a transaction:

1. Standard(s) of Generally Recognised Accounting Practice (GRAP) that is specifically applied to that transaction.
2. In the absence of a particular Standard of GRAP, the following hierarchy is used in order to select the appropriate accounting policy:

- The requirements and guidance in GRAP dealing with similar and related issues;
- The definitions, recognition criteria and measurement concepts in the Framework for the Preparation and Presentation of Financial Statements (GRAP 1)
- International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants – Public Sector Committee
- Standards and pronouncements by the International Accounting Standards Board, the Accounting practices Board and the South African Institute of Chartered Accountants Practices Committee (IFRS/IAS/SAGAAP).

In accordance with the requirements set out in the standard on accounting policies, changes in account estimates and errors (GRAP 3), accounting policies are consistently applied from year to year and supported by reasonable and prudent judgments and estimates, unless GRAP specifically requires or permits categorisation of items for which different policies is appropriate.

Changes in accounting policies[2]

Phumelela Local Municipality shall only amend its accounting policies when it is required by a specific standard or the change would result in more reliable and relevant information about the effects of transaction and events.

When a change in accounting policy is made, Phumelela Local Municipality shall disclose such change in a "Changes in accounting policy" note in the annual financial statements.

This note shall disclose:

- The title of the applicable standard;
- When applicable, that the change in accounting policy is made in accordance with its transitional provisions;
- The nature of the change in the accounting policy;
- When applicable, a description of the transitional provisions;
- When applicable, the transitional provisions that may have an effect on future periods;
- For the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial line item affected; and
- The amount of the adjustment relating to the period before those presented, to the extent practicable.
- If the retrospective application of the change in accounting policy proved to be impracticable and the impact of the impracticability to apply the change retrospectively cannot be quantified, this fact is disclosed.

Presentation currency

The financial statements are presented in South African Rand.

[2] Refer to the Standard on Accounting Policies, Changes in Estimates and Errors (GRAP3) for specific requirements

Materiality and aggregation

Material omissions or misstatements of items are material if they could, individually or collectively; influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.[3]

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 the cash flow statement, or in the notes.

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.

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. This also means that an item that requires specific disclosure in terms of GRAP need not be disclosed as such if the item is not material.

The materiality levels defined on an annual basis for Phumelela Local Municipality are as follows:

	Materiality level above which disclosure is compulsory	***Materiality level that cannot be exceeded for aggregated "other or sundry items"***
Assets	R500 000	R2 500 000
Liabilities	R500 000	R2 500 000
Revenue	R500 000	R2 500 000
Expenses	R500 000	R2 500 000

Other or sundry items that are aggregated cannot exceed R2 500 000. Notwithstanding the above, all *aggregated* amounts for similar items less than R500 000 is not considered material for disclosure purposes. (Prior year figures are also taken into account when considering whether or not an item is material.) Items that are material due to their nature will also be disclosed separately.

Items will be rounded off to the nearest hundred for disclosure purposes.

In defining materiality for financial statement disclosure purposes on an annual basis, the accounting officer shall consider the following:

- The nature of the item
- The amount of the item
- The nature of similar items

[3] GRAP 1 definitions

- Any legislative requirements
- Previous year materiality levels and the adequacy of disclosures in the previous years
- Consistency

CHAPTER 3: ASSETS

Definition

Assets are resources controlled by Phumelela Local Municipality as a result of past events from which future economic benefits or service potential is expected to flow to the Municipality.[4]

Classification

Assets are classified into the following categories for disclosure purposes on the face of the statement of financial position:

- Cash and cash equivalents
- Trade receivables from exchange transactions
- Other receivables from exchange transactions
- Other receivables from non-exchange transactions
- Long term receivables from non-exchange transactions
- Financial assets (*excluding cash and cash equivalents and trade and other receivables*)
- Prepaid expenses
- Inventories
- Non-current assets held for sale
- Finance lease investments (*see section W below*)
- Intangible assets
- Investment property
- Property, plant and equipment
- Investments

Measurement

Where assets are classified as current, the initial carrying value is assumed to approximate fair value for subsequent measurement and disclosure purposes, unless other factors indicate differently. Other factors include initial discounting of receivables for measurement purposes and indicators of impairment, as discussed under financial assets below.

[4] Source: *GRAP 1*, Definitions

SECTION A: CASH AND CASH EQUIVALENTS

Identification and classification

Cash and cash equivalents comprise cash on hand, demand deposits and other short-term investments with a maturity of less than three months that are readily convertible to a known amount of cash, and are subject to an insignificant risk of changes in value.

Where cash equivalents are not convertible to cash within a three-month period, it shall be classified according to the sub-classes identified for other financial assets (see section D below).

Cash and cash equivalents are sub-classified into:

- Cash at banks
- Cash on hand
- Investments in financial instruments

Where bank balances are in overdraft, the Municipality shall disclose the bank overdraft as a separate line item.

Recognition and measurement

Phumelela Local Municipality recognises cash and cash equivalents when it meets the definition of an asset.

All cash receipts shall be recorded and classified as cash and cash equivalents. Where amounts are received, and the recognition criteria of revenue are not met, the amounts received shall be deferred to the statement of financial position as deferred revenue.

Cash and cash equivalents are measured at fair value.

Risk and Impairment

The risk associated with cash and cash equivalents are managed through compliance with the MFMA (Chapter 3), the approved financial policies and the investment policy.

Phumelela Local Municipality only banks with registered financial institutions in terms of the Banks Act, 1990 (Act No. 94 of 1990) operating in South Africa.

Where any of the registered financial institutions experience financial difficulty that may result in Phumelela Local Municipality not being able to receive the expected amount of cash, an impairment loss shall be considered.

Phumelela Local Municipality will identify indicators for impairment by inter alia:

- Announcements by the national press or the specific financial institution
- Difficulty of financial institutions to pay cash on demand, other than through the *normal* waiting period (per agreement or otherwise)
- Differences in confirmation of amounts due or no responses to such confirmations

- Difficulty in locating the institution

SECTION B: TRADE AND OTHER RECEIVABLES FROM EXCHANGE TRANSACTIONS

Identification and classification

Trade and other receivables from exchange transaction are a separately disclosable line item on the face of the statement of financial position in terms of GRAP1.

Trade and other receivables from exchange transactions include financial assets with fixed or determinable payments that are not held for trading purposes (and as a result, are not quoted in an active market) and are a sub-class of loans and receivables (see section D below) and receivables that may not meet the definition of financial assets but result from exchange transactions between the Municipality and third parties.

Exchange transactions are transactions in which the one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value to another entity in exchange.[5]

Trade and other receivables from exchange transactions are sub-classified for disclosure purposes into:

- Consumer receivables - sub-classified as:
  - RSC Levies
- Other receivables (material balances are shown separately)
- Sundry receivables
- Interest on investments

Recognition, de-recognition and measurement

Trade and other receivables that are financial assets are recognised and measured in accordance with the policy on loans and receivables (see section D below).

Other receivables are recognised in accordance with the general recognition criteria of assets and are initially measured at fair value and subsequently at amortised cost using the effective interest rate method.

The Municipality derecognises trade and other receivables from exchange transactions when and only when:

- the rights to the cash flows expire; or
- it transfers a financial asset and the transfer qualifies for de-recognition.

Impairment

Trade and other receivables from exchange transactions are tested for impairment similar to other financial assets (see section D below).

[5] Source: IPSAS 23 Revenue from non-exchange transactions , Definitions

SECTION C: TRADE, OTHER AND LONG-TERM RECEIVABLES FROM NON-EXCHANGE TRANSACTIONS

Identification and classification

Trade and other receivables from non-exchange transaction is a separately disclosable line item on the face of the statement of financial position in terms of GRAP1.

Trade and other receivables from non-exchange transactions include receivables that may not meet the definition of financial assets but are receivables resulting from *non-exchange* transactions between the Municipality and other entities.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, the Municipality 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.[6]

Trade and other receivables from non-exchange transactions are sub-classified for disclosure purposes into:

- Long-term receivables – sub-classified as:
  - Receivables from related parties
  - Car loans
  - Study loans
  - Municipal Loans
- VAT receivable
- Other receivables (material balances are shown separately)

Recognition, de-recognition and measurement

Trade and other receivables from non-exchange transactions are recognised when the Municipality receives the right to the future cash flows of the non-exchange transaction, either by legislation or otherwise.

Trade and other receivables from non-exchange transactions are initially measured at fair value and subsequently at amortised cost, similar to loans and receivables (see section D below).

The Municipality derecognises trade and other receivables from non-exchange transactions when and only when the rights to the cash flows expire.

Impairment

Trade and other receivables from non-exchange transactions are tested for impairment similar to other financial assets (see section D below).

[6] Source: IPSAS 23 Revenue from non-exchange transactions , Definitions

SECTION D: FINANCIAL ASSETS

Identification and classification

Where the Phumelela Local Municipality has any asset that is:

- cash;
- an equity instrument of another entity;
- a contractual right:
  - to receive cash or another financial asset from another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- a contract that will or may be settled in the municipal entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments,

the asset is classified as a financial asset.

The following shall not be classified as financial assets:

- Contracts where the delivery is not cash or another financial instrument e.g. prepayment where it is expected that services will be delivered and government grants once the payment has been received/made.
- Statutory rights – see non-exchange revenue (see section L).
- Assets as a result of finance leases (see section F).
- Employers' rights under employee benefit plans.
- Rights arising under (i) an insurance contract other than an issuer's rights arising under an insurance contract that meets the definition of a financial guarantee, or (ii) a contract that contains a discretionary participation feature. If an issuer of financial guarantee contracts has previously asserted explicitly that it regards such the contract as insurance contract and has used accounting applicable to insurance contracts, the issuer may elect to apply the accounting of financial instruments or the accounting policies relating to insurance contracts to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.
- Contracts for contingent consideration in a business combination - this exemption applies only to the acquirer.
- Contracts between an acquirer and a vendor in a business combination to buy an acquiree at a future date
- Rights to payments to reimburse the Municipality for expenditure it is required to make to settle a liability that it recognises as a provision.

The following categories of financial assets are identified for disclosure purposes:

- Held for trading
- Designated at fair value
- Available-for-sale
- Held-to-maturity
- Loans and receivables

Financial assets held for trading is sub-classified as:

- Cash and cash equivalents (disclosed separately, see above)
- Derivatives
- Other financial assets held for trading (material balances are shown separately)

Derivatives embedded in other financial instruments or other non-financial host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with unrealised surpluses or deficits reported in surplus or deficit.
Loans and receivables are further classified as:

- Trade and other receivables from exchange transactions (*disclosed separately, see above*)[7]
- Trade and other receivables from non-exchange transactions (*disclosed separately, see above*) [8]
- Loans to group companies
- Loans to related parties
- Other loans (*material loans are disclosed separately*).

Cash and cash equivalents (section A above) and trade and other receivables from exchange transaction or – non-exchange transactions (section B and C above) are excluded from the above classifications as they are separately disclosed on the face of the statement of financial position. Where it is required that the carrying values of financial assets will be disclosed per category, Phumelela Local Municipality shall include these. For this purpose, cash and cash equivalents is classified as held for trading and financial assets included in trade and other receivables from exchange transactions are classified as loans and receivables.

The Municipality does not classify any financial asset as held to maturity if the Municipality has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

- are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- occur after the Municipality has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or
- are attributable to an isolated event that is beyond the Municipality's control, is non-recurring and could not have been reasonably anticipated.

[7] In as far as Trade and other receivables from exchange transactions include financial assets
[8] In as far as Trade and other receivables from non-exchange transactions include financial assets

The Municipality does not offset a financial asset and a financial liability unless a legally enforceable right to set off the recognised amounts currently exist; and the Municipality intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously

Initial recognition and measurement

Phumelela Local Municipality recognises financial assets when the Municipality becomes party to the contractual provisions of the instrument.

Financial assets are initially measured at fair value *plus* transaction costs that are directly attributable to the acquisition or issue of the financial asset, except for financial assets designated at fair value, *less* any trade or settlement discounts. In case financial assets designated at fair value, the transaction costs is immediately expensed.

The fair value of a financial instrument is normally the transaction price, unless there are other indicators indicating that the transaction was not at fair value, for example a loan given at less than market related interest or interest free loan.

In case of the latter, the fair value shall be determined using the following methods in descending order:

1. Comparing the transaction price to the approved pricing structure of the Municipality for similar goods and services taken into account any discounts allowed or similar transactions
2. Reference to the current fair value of another instrument that is substantially the same if available
3. Discounting cash flow analysis (see below).

Subsequent recognition and measurement

1. Loans and receivables

Subsequently these loans are measured at amortised cost using the effective interest rate method, less any impairment losses recognised to reflect irrecoverable amounts.

2. Held for trade and designated at fair value financial assets

Financial assets held for trade or financial assets designated at fair value are subsequent to initial recognition, measured at fair value.

The following criteria need to be satisfied before the Municipality designates the financial asset at fair value:

- if a contract contains one or more embedded derivatives; or
- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about

the group is provided internally on that basis to the Municipality's key management personnel

Changes in the fair values are recognised in surplus or deficit as they arise.

3. Held-to-maturity investments

Held-to-maturity investments are measured at amortised cost using the effective interest rate method, less any impairment loss recognised to reflect irrecoverable amounts.

4. Available-for-sale

Available-for-sale financial assets are subsequently measured at fair value.

Changes in the fair value of available-for-sale financial assets are recognised in the statement of changes in net assets through a mark-to-market reserve.

Effective interest rate

The Municipality calculates the effective interest rate as the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset.

The Municipality includes incurred credit losses, transactions costs, premiums and discounts in the estimated cash flows when computing the effective interest rate. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates, it is amortised over the expected life of the instrument.

The Municipality re-estimates the effective interest rate for floating rate financial assets and floating rate financial liabilities. These changes do not affect the capital amounts of the asset.

If the Municipality revises its estimates of payments or receipts, the carrying amount of the financial asset or financial liability (or group of financial instruments) is adjusted, to reflect actual and revised estimated cash flows. The Municipality recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognised as revenue or expenses in surplus or deficit.

Impairment

At reporting date (the end of each financial year), the Municipality determines whether there is any objective evidence that a financial asset or group of financial assets is impaired. This is done as follows:

Financial assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in surplus or deficit.

If, in a subsequent period, the amount of the impairment loss is decreased and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the borrower's credit rating), the previously recognised impairment loss is reversed either directly or by adjusting an allowance account. The reversal may not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in surplus or deficit.

Financial assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and is settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

Available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in net assets and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in net assets shall be removed and recognised in surplus or deficit even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from net assets and recognised in surplus or deficit is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that financial asset previously recognised in surplus or deficit.

Impairment losses recognised in surplus or deficit for an investment in an equity instrument classified as available-for-sale are not reversed through surplus or deficit.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss is recognised in surplus or deficit, the impairment loss must be reversed, with the amount of the reversal recognised in surplus or deficit.

Financial assets, an impairment loss is recognised in surplus and deficit

When there is objective evidence that it is impaired. The impairment is measured as the cash flows discounted at the effective interest rate computed at initial recognition.

Impairment losses are reversed in subsequent periods when an increase in the loans recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to the restriction that the carrying amount of the loan at the date the impairment is reversed shall not exceed what the amortised cost would have been had the impairment not been recognised.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
- adverse changes in the arrangements for payment of arrears of borrowers in the group (e.g. an increased number of delayed payments or where arrangements have been negotiated); or
- national or local economic conditions that correlate with defaults on the assets in the group (e.g. an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

Discounting cash flow analysis

Discounting future cash flows shall not be considered appropriate for the initial recognition of financial assets where other methods are available indicating that the transaction has been recorded initially at fair value (see above).

Where the period between the expected settlement date and the transaction date is 30 calendar days or less, and no interest is charged, the time value of money is not considered to have a material effect on such a short period that would influence the users understanding of the financial statements unless the Municipality is subject to hyperinflation.

When using discounting cash flow analysis, the Municipality shall use a market rate of interest for a similar instrument with a similar credit rating for a similar period. It is considered to be prime+1%.

Where no such rate exists, the Municipality shall use an estimated discount rate using the risk free interest rate of government bonds (RE 518) as the best indicator of

the effect of the time value of money and adjust it for the type of financial asset and the credit risk associated with the instrument:

Class	*Type*	*Adjusted percentile (added to risk free rate)*
Consumer receivables from exchange transaction	1. Debtors with agreements 2. Debtors with late payments 3. Current debtors 4. Government debtors	1. 5% 2. 7% 3. 0% 4. 2%
Other receivables	1. Sundry 2. Interest on investments 3. Accrued	

The period over which the initial transaction is discounted shall be used as a basis for adjusting for the credit risk associated with the initial debtors. For this purpose, the following portfolios of financial instruments have been identified:

Type	*Portfolios*	*Discounting period at initial recognition*
All debtor types	Expected settlement exceeding 1080 days	1080 days
	Expected settlement exceeding 1050 days but not exceeding 1080 days	1050 days
	Expected settlement exceeding 1020 days but not exceeding 1050 days	1020 days
	Expected settlement exceeding 990 days but not exceeding 1020 days	990 days
	Expected settlement exceeding 960 days but not exceeding 990 days	960 days
	Expected settlement exceeding 930 days but not exceeding 960 days	930 days
	Expected settlement exceeding 900 days but not exceeding 930 days	900 days
	Expected settlement exceeding 870 days but not exceeding 900 days	870 days
	Expected settlement exceeding 840 days but not exceeding 870 days	840 days
	Expected settlement exceeding 810 days but not exceeding 840 days	810 days
	Expected settlement exceeding 780 days but not	780 days

	exceeding 810 days	
	Expected settlement exceeding 750 days but not exceeding 780 days	750 days
	Expected settlement exceeding 720 days but not exceeding 750 days	720 days
	Expected settlement exceeding 690 days but not exceeding 720 days	690 days
	Expected settlement exceeding 660 days but not exceeding 690 days	660 days
	Expected settlement exceeding 630 days but not exceeding 660 days	630 days
	Expected settlement exceeding 600 days but not exceeding 630 days	600 days
	Expected settlement exceeding 570 days but not exceeding 600 days	570 days
	Expected settlement exceeding 540 days but not exceeding 570 days	540 days
	Expected settlement exceeding 510 days but not exceeding 540 days	510 days
	Expected settlement exceeding 480 days but not exceeding 510 days	480 days
	Expected settlement exceeding 450 days but not exceeding 480 days	450 days
	Expected settlement exceeding 420 days but not exceeding 450 days	420 days
	Expected settlement exceeding 390 days but not exceeding 420 days	390 days
	Expected settlement exceeding 360 days but not exceeding 390 days	360 days
	Expected settlement exceeding 330 days but not exceeding 360 days	330 days
	Expected settlement exceeding 300 days but not exceeding 330 days	300 days
	Expected settlement exceeding 270 days but not exceeding 300 days	270 days
	Expected settlement	240 days

	exceeding 240 days but not exceeding 270 days	
	Expected settlement exceeding 210 days but not exceeding 240 days	210 days
	Expected settlement exceeding 180 days but not exceeding 210 days	180 days
	Expected settlement exceeding 150 days but not exceeding 180 days	150 days
	Expected settlement exceeding 120 days but not exceeding 150 days	120 days
	Expected settlement exceeding 90 days but not exceeding 120 days	90 days
	Expected settlement exceeding 60 days but not exceeding 90 days	60 days
	Expected settlement exceeding 30 days but not exceeding 60 days	30 days

For impairment purposes, the actual expected settlement period is used for discounting purposes.

Where there is no interest and no repayment terms, the Municipality accounts for the loan given at initial transaction price as it would be impracticable to calculate the present value. Discounting is not considered an appropriate method to determine the present value of such assets. Rather, the Municipality would assess the ability of the entity to pay the loan back at reporting date and impair the loan on that basis.

Hedge accounting[9]

The Municipality shall not apply hedge accounting.

De-recognition

The Municipality derecognises a financial asset when and only when:

- the rights to the cash flows from the financial asset expire; or
- it transfers the financial asset and the transfer qualifies for de-recognition. The Municipality firstly needs to evaluate the extent to which it retains the risks and rewards of ownership of the financial asset.

The Municipality transfers a financial asset if, and only if, it either:

- transfers the contractual rights to receive the cash flows of the financial asset; or
- retains the contractual rights to receive the cash flows of the financial asset.

9 See paragraph 85-102 of IAS39 Recognition and Measurement of Financial Instruments

SECTION E: PREPAID EXPENSES

Identification and classification

Prepayments are payments made in advance with expected future delivery of goods and services to the Municipality rather than expected future cash flow expectations and subsequently, are not financial instruments or part of lease transactions.

Phumelela Local Municipality shall ensure that deposits paid for the rental of equipment or other operating assets is included in the assessment of the minimum lease payments and are not disclosed separately.

Prepayments are disclosed separately on the face of the financial statements, unless the aggregated amount for both the reporting period and the comparative year is not material. In such a case, prepayments will be disclosed separately in trade and other receivables from exchange transactions.

Recognition, de-recognition and measurement

Prepayments are recognised when the payment is made to the third party requesting the payment and are measured initially at the transaction price. The prepayment is derecognised as the services are delivered.

Where there is an expectation that cash will be received in the future, the initial transaction is discounted using the risk free rate over the expected period of settlement. The initial discounted amount is recognised as part of trade and other receivables from exchange transactions and the difference is included in prepayments when the recognition criteria for assets are satisfied and amortised to the financial asset over the expected period of settlement.

Where the expected period cannot be estimated reliably, the prepayment is measured at cost.

Impairment

The impairment criteria applicable to financial assets shall be considered for prepayments.

SECTION F: INVENTORIES

Identification and classification

Inventories are assets:

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Phumelela Local Municipality classifies inventories as follows:

- Consumables stores
- Fuel
- Work in progress

Initial recognition and measurement

The Municipality recognise identified inventories at cost when the item meets the recognition criteria of an asset.

The cost of inventories would include any cash discounts, discounts on deferred settlements and incremental interest.

The cost of inventories comprises of all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects are assigned using specific identification of the individual costs.

Fuel is deemed a strategic item and is therefore considered material due to the nature. It will therefore be disclosed separately in the financial statements regardless of it's value.

Subsequent recognition and measurement

Inventories are measured at the lower of cost and net realisable value, except where the paragraph mentioned below applies.

Inventories are measured at the lower of cost and current replacement cost where they are held for:

- distribution at no charge or for a nominal charge, or
- consumption in the production process of goods to be distributed at no charge or for a nominal charge.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

The following cost formulas are applied for every inventory class:

The first-in-first-out measurement basis will be used for all classes of inventory.

When inventories are sold or consumables are used, the carrying amount of those items is recognised as an expense in the period in which the related revenue is recognised.

The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

SECTION G: NON CURRENT ASSETS HELD FOR SALE

Identification and classification

Phumelela Local Municipality classifies non-current assets and disposal groups as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use.

Recognition and measurement

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

This condition is regarded as met only when the sale is highly probable and the assets (or disposable group) are available for immediate sale in its present condition.

The following steps are to be followed before a sale is highly probable:

1. Management shall be committed to a plan to sell the asset (or disposal group) in line with the MFMA requirements.
2. An active programme to locate a buyer and complete the plan should have been initiated.
3. The asset (or disposal group) shall be actively marketed for sale at a price that is reasonable in relation to its current fair value.
4. The sale shall be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets (and disposal groups), which are classified as held for sale, are disclosed as current assets and are not depreciated.

An asset, which is to be abandoned, is not classified as held for sale because its carrying amount will be recovered principally through continuing use. An asset, which has temporarily been taken out of use, is not abandoned.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

The Municipality does not classify a non-current asset as available-for-sale if it is not through a sales transaction and does not derecognise items or groups of property, plant and equipment if the asset(s) are only temporarily not in use.

The carrying value of an item of property, plant and equipment is derecognised when the items is disposed off or when no future economic benefits are expected from it, in other words, when the Municipality does no longer use the asset and have no intention to use the asset any further.

Any gain/loss on the measurement of non-current assets classified as held for sale that does not meet the definition of a discontinued operation, is recognised in the surplus or deficit.

SECTION H: INVESTMENT PROPERTY

Identification and classification

Investment property represents property held to earn long-term rental yields and/or capital appreciation. Investment property comprises freehold land and building and leasehold land with buildings, but excludes owner-occupied property.

Owner occupied property includes property used for administrative purposes or in the production of goods and services and including property rented to employees notwithstanding the rental amounts. Owner occupied property is classified with property, plant and equipment.

Initial recognition and measurement

Investment property is recognised as an asset when, and only when, it is probable that the future economic benefits that are associated with the investment property will flow to the enterprise, and the cost of the investment property can be measured reliably.

Investment property is initially recognised at cost.

Subsequent recognition and measurement

The Municipality measures investment property using the fair value model.

The Municipality determines the fair value on an annual basis.

Fair value is defined as the estimated amount for which a property can be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction.

The Municipality recognises the gain/loss arising from changes in the fair value of investment properties as a surplus or deficit in the statement of financial performance.

Impairment

An impairment test is carried out annually to ensure that the investment property is fairly valued.

Changes in use and de-recognition

The Municipality reclassifies an investment property where there is a change in use, in other words, where the property could be classified as owner-occupied or where it meet the definition of inventories.

The investment property is derecognised on disposal or when no future economic benefits are expected from it. The gain or loss arising from the disposal is recognised as surplus or deficit in the statement of financial performance.

SECTION I: BIOLOGICAL ASSETS

Identification and classification

The Phumelela Local Municipality classifies living animals or plants as biological assets.

Initial recognition and measurement

The Municipality recognises biological assets at cost when the asset is acquired, including permanent donations. See section A above for the discussion on cost and donated assets or assets acquired at less than cost.

Changes in biological assets through growth, procreation or obtained on a temporary basis through an exchange programme or otherwise are not accounted for, unless the asset is intended for sale. In case of the latter the asset would be accounted for as assets held for sale and the revenue would be recognised in accordance with the revenue recognition criteria. The municipality must disclose the nature of all biological assets that are not measured in the notes to the financial statements.

Subsequent recognition and measurement

Biological assets are measured at fair values at each reporting date less estimated point-of-sale costs where the assets constitute agricultural activities. Where the assets do not constitute agricultural activities, the assets are measured on historical costs.

The fair value is determined based on market prices of animals of similar age, breed, and genetic merit, sold in June of each year. Changes in the fair values from year to year are recognised in surplus or deficit.

Impairment

An impairment test is carried out annually to ensure that the biological assets are fairly valued.

Changes in use and de-recognition

The biological asset is derecognised on disposal or when no future economic benefits are expected from it. The gain or loss arising from the disposal is recognised as surplus or deficit in the statement of financial performance.

Once a non-current biological asset meets the criteria to be classified as held for sale, it should be classified as such (see section E below).

SECTION J: INTANGIBLE ASSETS

Identification and classification

Phumelela Local Municipality classifies assets that are non-monetary without physical substance as intangible assets.

Intangible assets are classified as:

- Computer software (*excluding operational programmes that would be classified as property, plant and equipment*)
- Licences
- Mortgage servicing rights
- Patents and copyrights
- Other (*material balances are shown separately*)

Initial recognition and measurement

Phumelela Local Municipality only recognises an intangible asset if it meets the definition of an asset and it is separately identifiable and the Municipality have control over it. If the Municipality does not have sufficient control over the expected future benefits then the item cannot be classified as an intangible asset.

An intangible asset is recognised when:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the Municipality; and
- the cost of the asset can be measured reliably.

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,
- there are available technical, financial and other resources to complete the development and to use or sell the asset, and
- the expenditure attributable to the asset during its development can be measured reliably.

The Municipality recognises intangible assets initially at cost.

The Municipality does not recognise internally generated goodwill or research cost as intangible assets. These costs are recognised as expenses.

When software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Subsequent recognition and measurement

The Municipality uses the cost model for subsequent measurement of intangible assets.

Intangible assets are carried at cost less any accumulated amortisation and any impairment losses.

The Municipality accounts for an intangible asset at cost where the intangible asset has an indefinite useful life. This is where there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows. Amortisation is not provided for these intangible assets. For all other intangible assets amortisation is provided on a straight-line basis over their useful lives, taking into account the residual value of the intangible assets.

Profit or losses on the disposal of property, plant and equipment or intangible assets and profit or losses as a result of fair value adjustments are not classified as revenue or expenses, but are classified as separate line items on the statement of financial performance and are included in the surplus/deficit for the period.

Amortisation

The amortisation period and method for intangible assets are reviewed at every reporting date. This is done similar to that of property, plant and equipment (see above).

The amortisation cost is recognised in surplus or deficit in the statement of financial performance unless it forms part of the carrying amount of another asset.

The residual value of an intangible asset is zero unless there is a commitment by a third party to buy the asset or it is probable that an active market will exist at the end of the useful life.

Impairment

At each reporting date, the Municipality reviews the carrying amounts of its intangible assets to determine whether there is any indication that those assets have been impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is identified that the related asset does not generate cash flows that are independent from the other assets, the entities estimates the recoverable amount of the cash generating unit to which the asset belongs.

An intangible asset with an indefinite useful life (e.g. mining rights, and mining licenses) is tested for impairment annually and whenever there is an indication that the asset may be impaired, an impairment loss is recognised in the statement of financial performance. 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.

An impairment loss is calculated and recognised on a similar basis as for property, plant and equipment (see section A above).

De-recognition and reclassification

The Municipality derecognises an intangible asset on disposal or when no future economic benefits are expected from it. The gain or loss arising from the disposal is

recognised as surplus or deficit in the statement of financial performance. Intangible assets that meet the definition of non-current assets held for sale should be classified as such (see section D below).

SECTION K: PROPERTY, PLANT AND EQUIPMENT

Identification and classification

Property, plant and equipment are assets held for use in the production or supply of goods or services or for administrative purposes.

The following classes of property, plant and equipment are identified for disclosure purposes:

Other Assets
- Heritage assets
- Leased assets
- Office equipment
- Other land and buildings
- Security measures
- Motor vehicles
- Plant and equipment

Heritage assets

Heritage assets are assets with cultural, historical or environmental significance e.g. conservation areas and artwork.

Heritage assets with service potential, is recognised and measured on the same basis as other items of property, plant and equipment.

Heritage assets with an indefinite useful life would be carried at cost, where the cost can reliably be measured. Where it is impracticable to determine cost, the Municipality discloses that fact.

Initial recognition and measurement

An item of property, plant and equipment is recognised as an asset when:
- it is probable that future economic benefits associated with the item will flow to the Municipality; and
- the cost of the item can be measured reliably.

Intitial costs

The cost of an item of property, plant and equipment comprises:
- the purchase price
- import duties
- non-refundable purchase taxes
- trade discounts and rebates.
- 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.
- initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located,

- the obligation incurred either when the item is acquired or as a consequence of having used the item

Directly attributable costs include:

- costs of employee benefits arising directly from the construction or acquisition of the item
- costs of site preparation;
- initial delivery and handling costs;
- installation and assembly costs;
- 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
- professional fees.

Cost is the cash price equivalents at recognition date. Cost excludes interest beyond normal credit terms. Cost includes any direct taxes or other duties that are not recoverable, rebates, discounts and any cost that are directly attributable to bringing the asset to the location and condition for it to be capable of operating in the manner intended by the Municipality.

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 are also included in the cost of property, plant and equipment. Abnormal amounts of wasted material, labour and other resources are recognised immediately as an expense in the statement of financial performance.

Donated assets

Donated assets and assets obtained at less than fair value are accounted for at fair value. The difference between the fair value and the cash consideration is accounted for using the accounting policy relating to the accounting of non-exchange revenue.

Subsequent cost

Subsequent cost will be evaluated against the definition of assets to determine whether it shall be capitalised.

Day-to-day servicing costs are not capitalised.

Repairs and maintenance expenses are charged to the statement of financial performance during the financial year in which they are incurred.

The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits will flow to the Municipality and the cost can be measured reliably.

Capital commitments

Capital commitments are not recognised but are disclosed separately by the Municipality.

Subsequent recognition and measurement

Cost Model

Phumelela Local Municipality measures property, plant and equipment at cost less accumulated depreciation except for the following classes, which are measured using the revaluation model:

- Land
- Buildings

Revaluation model

Land held for use in the production or supply of goods and services or for administrative purposes are stated in the statement of financial position at their revalued amounts, being the fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Land is revalued at least once every four years. Interim valuations are performed when erven are for example subdivided or consolidated.

Any accumulated depreciation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

Any revaluation increase arising on the revaluation of the Municipality' land and buildings are credited to the property revaluation reserve (net assets), except to the extent that it reverses a revaluation decrease for the same asset previously recognised in surplus and deficit, in which case the increase is credited to surplus and deficit to the extent of the decrease previously charged.

A decrease in carrying amount arising on the revaluation of such land and buildings are charged to surplus and deficit to the extent that it exceeds the balance, if any, held in the property revaluation reserve relating to a previous revaluation of the asset.

On the subsequent sale or retirement of a revalued item, the attributing surplus remaining in the revaluation reserve is transferred directly to the Municipality's accumulated surpluses (not through surplus/deficit).

Depreciation

Depreciation is charged so as to write off the cost of assets, other than land and properties under construction, over their estimated useful lives to residual value, using the straight-line method unless another method provides better estimation of the use of the asset e.g. voltage used. Depreciation commences when the assets are ready for their intended use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the Municipality. Depreciation ceases at the earlier of the date the asset is classified as held for sale or the date that the asset is derecognised.

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

As described above, general repairs and maintenance incurred from time to time is expensed. If the intention is to replace the item of property, plant and equipment in its entirety, rather than by replacing the respective significant parts, the item should be considered as a whole.

It should be noted that as a result of the reassessment policy, it is possible that the items of property, plant and equipment within the same category are depreciated over different useful lives.

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

Land is not depreciated, except for landfill sites.

Depreciation commences when the assets are ready for their intended use.

Property, plant and equipment, excluding land that is not depreciated and assets under construction, are measured in the statement of financial position at cost less accumulated depreciation and any accumulated impairment losses.

The residual value and useful life of an asset as well as the depreciation method are reviewed at least at each financial year-end. If expectations or the pattern of consumption differ or change, it is accounted for as a change in accounting estimate in accordance with GRAP 3 as described below.

Useful life

The useful life of an item of property, plant and equipment is the period over which the Municipality expects the asset to be available for use, or the number of production or similar units expected to be obtained from its use.

The useful life of all items of property, plant and equipment or a component of property, plant and equipment is reassessed on an annual basis to ensure that the estimated useful lives are still appropriate.

The estimated useful life is assessed based on the following:

- The replacement policy of the specific assets
- Technological obsolescence
- The economic life of an asset

Where an asset is reaching its replacement period and management are of the opinion that the asset should not be replaced, the replacement policy for the specific asset would be amended based on the reassessment, and the useful life would be adjusted accordingly.

Leasehold assets

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

Componentisation

Phumelela Local Municipality does not componentise items of property, plant and equipment where the individual component is not significant in relation to the total cost.

Both quantitative and qualitative significance is considered.

Quantitative significance is 25% of the value of the total asset. However, if this significant part of the asset is less than the minimum materiality level set out above, it is not componentised.

Qualitative significance is based on the following questions:

- Can the asset be sold separately and use as a separate asset?
- Does the asset have a useful life that is significantly different from that of the whole asset?

If any of these answers are yes, the Municipality accounts for the component as a separate asset.

Residual values

Residual value is calculated based on an estimated amount that the Municipality would currently obtain from the disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.

The residual values are reviewed each year and where estimates differ from those previously determined, the difference is accounted for as a change in accounting estimate on a prospective basis.

Where the residual values are unknown, it is assumed to be 1% of the cost of the asset. The residual values of assets to which section 14(1) of the MFMA is applicable, is assumed to be zero.

Impairment

At each reporting date, the Municipality reviews the carrying amounts of items and groups of property plant and equipment to determine whether there is any indication that those assets have been impaired.

An asset is impaired when its carrying amount exceeds its recoverable amount.

If any such indication exists, the recoverable amount of the asset or group of assets is estimated in order to determine the extent of the impairment loss (if any).

Where it is identified that the related asset does not generate cash flows that are independent from the other assets, the Municipality estimates the recoverable amount of the cash-generating unit to which the asset or group of assets belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of the asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

At each reporting date the Municipality assesses whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, and the increased carrying amount may not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years.

A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

An impairment test is performed at the end of each financial period by comparing an asset's carrying amount to the recoverable amount. The recoverable amount is calculated as described above.

Changes in estimates and errors

Where the Municipality identifies a change in estimated useful lives, the change is accounted for as a change in accounting estimate and the financial statements are prospectively adjusted, unless it has been identified that the previous estimate were inherently incorrect. In case of the latter, the change would be a correction of the estimate and would need to be corrected retrospectively as an error.

Reclassification and de-recognition

Where the Municipality is intending to sell any item or group of property, plant and equipment within the next 12 months and the sale is highly probable, the Municipality reclassifies the item or group of property, plant and equipment as assets held for sale under current assets in the statement of financial position (see section above for a discussion of assets held for sale).

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised as a surplus or deficit in the statement of financial performance.

CHAPTER 4: LIABILITIES

Definition

Liabilities are present obligations of the Municipality arising from past events, the settlement of which is expected to result in an outflow from the Municipality of resources embodying economic benefits or service potential.[10]

Classification

Liabilities are classified into the following categories for disclosure purposes on the face of the statement of financial position:

- Trade and other payables from exchange transactions
- Unspent conditional grants and receipts
- Taxes payable
- Financial liabilities (*excluding trade and other payables*)
- Post employment benefits
- Social benefit obligations
- Provisions
- Finance lease obligations (*see section W below*)

Measurement

Where payables are classified as current, the initial carrying value is assumed to approximate fair value for subsequent measurement and disclosure purposes, unless other factors indicate differently. Other factors include initial discounting of payables for measurement purposes.

[10] Source: *GRAP 1*, Definitions

SECTION L: TRADE AND OTHER PAYABLES FROM EXCHANGE TRANSACTIONS

Identification and classification

Trade and other payables from exchange transaction are a separately disclosable line item on the face of the statement of financial position in terms of GRAP1.

Trade and other payables include financial assets with fixed or determinable payments that are not held for trading purposes (and as a result, are not quoted in an active market) and are a sub-class of loans and payables (see section M below) and receivables that may not meet the definition of financial assets but result from exchange transactions between the Municipality and third parties.

Exchange transactions are transactions in which the one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value to another entity in exchange.[11]

Trade and other payables from exchange transactions are classified into:

- Trade payables
- Payments received in advance
- Retentions
- Staff bonuses
- Staff leave
- Other payables (*material balances are shown separately*)
- Deferred revenue (*see chapter 6*)

Deferred revenue shall be classified further in the notes to ensure the nature of the revenue deferred is shown e.g. unallocated receipts, conditional grants, etc.

Recognition, de-recognition and measurement

Trade and other payables that are financial liabilities are recognised and measured in accordance with the policy on loans and payables (see section M below).

Other payables are recognised in accordance with the general recognition criteria of liabilities and are initially measured at fair value and subsequently at amortised cost using the effective interest rate method.

The Municipality derecognises trade and other payables from exchange transactions when liability is extinguished or transferred and the Municipality does not assume any further liability.

[11] Source: IPSAS 23 Revenue from non-exchange transactions , Definitions

SECTION M: TAXES AND TRANSFERS PAYABLE

Identification and classification

Phumelela Local Municipality classifies all taxes and transfers payable into the following categories:

- VAT
- Other taxes (e.g. Levies payable, material balances are showed separately)
- Transfers (material balances are shown separately)

Phumelela Local Municipality is exempted from South African Income Tax.

Recognition and measurement

Phumelela Local Municipality recognise tax expenses and the related liability when the Municipality has the obligation to pay these taxes. The Municipality recognises transfers in a similar way.

The Municipality recognises VAT expenses net of revenue.

SECTION N: FINANCIAL LIABILITIES

Identification and classification

Where Phumelela Local Municipality has any liability that is:

- a contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments

the liability is classified as a financial liability.

Where the Municipality issues rights to their own net assets/equity, these are not classified as financial instruments by the Municipality, but rather as part of the net assets of the Municipality (see chapter 8 below).

Further exemptions are:

- Contracts where the delivery is not cash or another financial instrument government grants once the payment has been received.
- Statutory obligations (see section L above)
- Liabilities as a result of finance leases (see section W).
- Obligations under employee benefit plans (see section N)
- Obligations arising under (i) an insurance contract other than an issuer's obligations arising under an insurance contract that meets the definition of a financial guarantee, or (ii) a contract that contains a discretionary participation feature. The issuer may elect to apply the accounting of financial instruments or the accounting policies relating to insurance contracts to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.
- Contracts for contingent consideration in a business combination - this exemption applies only to the acquirer.
- Contracts between an acquirer and a vendor in a business combination to buy an acquiree at a future date
- Rights to payments to reimburse the Municipality for expenditure it is required to make to settle a liability that it recognises as a provision
- Loan commitments classified as provisions.

The following categories of financial liabilities shall be used for disclosure purposes:

- Held for trading
- Designated at fair value
- Loans and payables

Held for trading financial instruments are further classified as:

- Derivatives
- Other held for trading financial liabilities (material amounts are showed separately)

Financial liabilities will only be designated at fair value if the criteria for designation (see section D above) are met.

Loans and payables are classified as:
- Trade and other payables from exchange transactions[12]
- Loans from group companies
- Loans from related parties
- Other loans (material loans are disclosed separately)

Initial recognition and measurement

The Municipality recognises financial liabilities when the Municipality becomes party to the contractual provisions of the instrument.

Financial liabilities are initially measured at fair value plus transaction costs (except for financial liabilities designated at fair value) that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The fair value of a financial liability is normally the transaction price; unless other indicators exist which indicate that it is not.

The Municipality accounts for long-term loans with no interest at the present value of all future cash flows, using a market rate of interest for a similar instrument with a similar credit rating. However, where no interest and no repayment terms exist, the Municipality accounts for the loan at the transaction price as it would be impracticable to calculate the present value.

Subsequent recognition and measurement

1. Held-for-trade and Designated at fair value

These liabilities are measured at fair value.

Changes in the fair values are recognised in surplus or deficit as they arise.

2. Loans and payables

Subsequently these loans are measured at amortised cost using the effective interest rate method, less any impairment loss recognised to reflect irrecoverable amounts.

Effective interest rate

The Municipality calculates the effective interest rate as the rate that exactly discounts estimated future cash payments 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.

The Municipality includes transactions costs, premiums and discounts in the estimated cash flows when computing the effective interest rate. However, a shorter period is used if this is the period to which the fees, points paid or received,

[12] Disclosed separately (see above), in as far as this include financial liabilities

transaction costs, premiums or discounts relate. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates, it is amortised over the expected life of the instrument.

The Municipality re-estimates the effective interest rate for floating rate financial liabilities. These changes do not affect the capital amounts of the liability.

If the Municipality revises its estimates of payments, the carrying amount of the financial liability (or group of financial instruments) is adjusted, to reflect actual and revised estimated cash flows. The Municipality recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognised as revenue or expenses in surplus or deficit.

Hedge accounting

The Municipality does not apply hedge accounting.[13]

De-recognition

The Municipality removes a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—i.e. when the obligation specified in the contract is discharged or cancelled or expires.

An exchange between an existing borrower and lender of debt instruments with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. 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) are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The Municipality recognises the difference between the carrying amount of the 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, in surplus or deficit.

[13] See paragraph 85-102 of IAS39 Recognition and Measurement of Financial Instruments

SECTION O: EMPLOYEE BENEFITS AND KEY MANAGEMENT

Identification and classification

Phumelela Local Municipality discloses and classifies employee benefits as follows for statement of financial position purposes:

- Short and long term employee benefit obligations (as part of trade and other receivables from exchange transactions)
- Post-employment benefit obligations (relating to defined benefit plans: pensions, gratuities and medical aid)

For statement of financial performance purposes, the Municipality discloses and classify employee benefits separately as follows:

- Current service costs
- Past service cost
- Social contributions
- Housing benefits and allowances
- Motor vehicle allowances
- Other allowances and benefits
- Overtime payments
- Leave benefits
- Performance bonuses

The Municipality includes remuneration to key management in the above amounts, but discloses separately the remuneration to key management.

Key management are persons who have the responsibility and and authority for planning, directing and controlling the activities of the entity directly or indirectly.

For the Municipality, this will include the City Manager, the Chief Financial Officer, the Chief Operating Officer and the Executive Directors.

For Centlec, this will include the Chief Executive Officer, the Chief Financial Officer/Chief Operating Officer and Executive Managers.

The amount classified as social contributions or any other allowances only include the portion paid by the Municipality, e.g. contributions to medical aid.

Reimbursement expenses are classified separately from employee benefits.

Recognition and measurement

1. Short term employee benefits

The Municipality recognises the cost of short-term employee benefits, (those payable within 12 months after the service is rendered, such as paid vacation leave and sick leave, bonuses, and non-monetary benefits such as medical care) in the period in which the service is rendered and are not discounted.

The expected cost of compensated absences is recognised as an expense as the employees render services that increase their entitlement or, in the case of non-accumulating absences, when the absence occurs.

The expected cost of profit sharing and bonus payments is recognised as an expense when there is a legal or constructive obligation to make such payments as a result of past performance.

The Municipality recognises the difference between the amount due and the amount paid is as short-term employee benefit obligations.

2. Defined contribution plans

Payments to defined contribution retirement benefit plans are charged as an expense as they fall due.

Payments made to industry-managed (or state plan) retirement benefit schemes are dealt with as defined contribution plans where the company's obligation under the schemes is equivalent to those arising in a defined contribution retirement benefit plan.

The Municipality recognises the difference between the amount due and the amount paid is as short-term employee benefit obligations.

3. Defined benefit plans

For defined benefit plans the cost of providing the benefits is determined by using the projected credit method. Actuarial valuations are conducted on an annual basis for each plan separately by independent actuaries, unless it is impracticable.

Multi-employer plans is recognised as as a contribution plan when it is impracticable to determine the separate liability of the Municipality relating to the plan. Where it is impracticable, the reasons shall be disclosed.

Consideration is given to any event that could impact the funds up to the reporting date where the interim valuation is performed at an earlier date.

Past service costs are recognised immediately to the extent that the benefits are already vested, and are otherwise amortised on a straight-line basis over the average period until the amended benefits become vested.

To the extent that, at the beginning of the financial year, any cumulative unrecognised actuarial gain or loss exceeds ten percent (10%) of the greater of the present value of the projected benefit obligation and the fair value of the plan assets (the corridor), that portion is recognised in the statement of financial performance over the expected average remaining service lives of participating employees. Actuarial gains or losses within the 10% corridor are not recognised.

Surpluses or deficits on the curtailment or settlement of a defined benefit plan are recognised when the Municipality is demonstrably committed to curtailment or settlement.

When it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the right to reimbursement is recognised as a separate asset. The asset is measured at fair value. In all other respects, the asset is treated in the same way as plan assets. In the statement of financial performance, the expense relating to a defined benefit plan is presented as the net of the amount recognised for a reimbursement.

The amount recognised in the statement of financial position represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service costs, and reduces by the fair value of plan assets.

Any asset is limited to unrecognised actuarial losses, plus the present value of available refunds and reduction in future contributions to the plan.

4. Defined benefit plans: gratuities and medical aid

The Municipality could provide defined benefit plans in respect of retirement benefits, gratuities, and subsidisation of medical aid contributions after retirement to qualifying employees.

The amount recognised in the statement of financial position represents the present value of the defined benefit obligations, calculated by using the projected unit credit method, and reduced by the fair value of plan assets, where relevant. The amount of any surplus recognised is limited to the present value of any available refunds and reduction in future contributions for the employees in the Municipality. To the extent that there is uncertainty as to the entitlement to the surplus, no asset is recognised.

Actuarial gains and losses are recognised immediately in the statement of financial performance in the period in which they arise. Past service costs are recognised immediately once the benefits are vested, otherwise they are recognised when it is probable that the expenses will be incurred.

5. Termination benefits and other long term employee benefits

Long-term employee benefits are recognised as a provision when the recognition criteria of a provision are met.

The Municipality only recognises termination benefits if there is a demonstrated commitment that:

- Employment will be terminated before normal retirement date or
- The Municipality provides termination benefits as a result of an offer made in order to encourage voluntary redundancy.

The provision is made in accordance with the accounting policy on provisions.

SECTION P: SOCIAL BENEFIT OBLIGATIONS

Identification and classification

Social benefits are cash transfers to individuals or households and collective and individual goods and services provided by an entity to recipients in a non-exchange transaction to protect the entire population, or a particular segment of the population, in any jurisdiction against certain social risks[14].

Social benefits are categorised into three categories:

- Cash transfers;
- Individual goods and services; and
- Collective goods and services.

Cash transfers are classified as transfers and categorised with Grants and Taxes payable (see section L above). The Municipality shall disclose the nature of the transfer and a description of the transfer.

Individual goods and services include services rendered by the Municipality e.g. sewerage services and are classified with expenses according to the class of expenditure (see Chapter 5 below). The liabilities associated with individual goods and services are classified either as accrued expenses or provisions, depending on the nature of the liability.

The following classes of collective goods and services are rendered by the Municipality:

The expenses relating to the services provided are classified with expenses. The associated liabilities are disclosed as social benefit obligations.

Recognition, de-recognition and measurement

The Municipality determines the best estimate of the present obligation of social benefits and recognise such benefits as liabilities and expenses when all the eligible criteria has been met for such benefits. Future expenses shall not be recognised.

The disclosure requirements of social obligations are similar to that of provisions.

The Municipality determines the best estimate of the present value of amounts expected to be transferred under cash transfer programs to eligible individuals or households in the future and disclose these amounts as commitments in the financial statements.

[14] Source: IPSASB, ED34, March 2007

SECTION Q: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Identification and classification

Phumelela Local Municipality identifies provisions as present obligations arising from past events of uncertain timing or amount. Contingent liabilities are similar to provisions, however, are dependant on a future event for it to be probable. Contingent assets are possible assets that arise from past events but for which the occurrence is dependant on future uncertain events.

Initial recognition and measurement

The Municipality recognises provisions when:

- the Municipality has a *present* obligation as a result of a past event;
- it is *probable* that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a *reliable estimate* can be made of the obligation.

The amount of a provision is the present value of the expenditure expected to be required to settle the obligation. The Municipality uses a pre-tax rate that reflects current market assessments of the time value of money and the risks for which future cash flow estimates have been adjusted. The Municipality does not discount the liability where the time value of money is not material.

Where some or all of the expenditure required settling a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the Municipality settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision.

Provisions are not recognised for future operating deficits.

The present obligation under onerous contracts shall be recognised and measured as a provision. A contract is onerous if it is a contract in which the unavoidable cost of meeting the obligation under the contract exceed the economic benefits expected to be received under it.

A constructive obligation to restructure arises only when the Municipality

- has a detailed formal plan for the restructuring, identifying at least:
  - the business or part of a business concerned;
  - the principal locations affected;
  - the location, function, and approximate number of employees who will be compensated for terminating their services;
  - the expenditures that will be undertaken; and
  - when the plan will be implemented;
- has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Contingent assets and contingent liabilities are not recognised. Contingencies are disclosed in the notes to the annual financial statements.

In accordance with applicable legal requirements, a provision for site restoration in respect of contaminated land is recognised when the liability is established through environmental assessment.

Subsequent recognition and measurement

After their initial recognition, contingent liabilities recognised in business combinations that were recognised separately are subsequently be measured at the higher of:

- the amount that would be recognised as a provision; and
- the amount initially recognised less cumulative amortisation.

CHAPTER 6: REVENUE

Definition

Revenue is the gross inflow of 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.[15]

Classification

Revenue is disclosed as a line item and categorised between exchange revenue and non-exchange revenue on the face of the statement of financial performance.

Revenue is aggregated into classes in accordance with the nature thereof. Material classes of revenue are disclosed separately in the notes to the financial statements.

Recognition and measurement

Revenue is recognised when it is:

- probable and
- measurable

Revenue received that does not meet the recognition criteria are deferred to the statement of financial position and included in deferred revenue.

Revenue is measured at fair value.

[15] Source: *GRAP 1*, Definitions

SECTION R: NON-EXCHANGE REVENUE

Identification and classification

Phumelela Local Municipality classifies revenue received from taxes and transfers (whether cash or non-cash, including grants, debt forgiveness, fines, bequests, gifts, donations and goods and services in-kind) as non-exchange revenue.

The following minimum classes of non-exchange revenue are identified:

- RSC Levy
- Government grants and subsidies
- Public contribution and donations

The Municipality classifies the assets relating to non-exchange transactions depending on the nature of the asset. The asset can take any form e.g. cash, items of property, plant and equipment or receivables. The Municipality classifies receivables relating to non-exchange transactions separately from other receivables.

The Municipality should first determine whether the rise in the asset as a result of non-exchange revenue satisfies the definition of contributions from owners (see chapter 8 below). Where the transaction does not satisfy the definition of contributions from owners, then the transaction should be classified as either revenue or liabilities.

Initial recognition and measurement

The Municipality recognises an inflow of resources from non-exchange transactions as an asset depending on the nature of the asset received. Revenue from non-exchange transactions is measured at fair value.

The Municipality recognises an asset relating to non-exchange revenue when the recognition criteria of and asset is met and the Municipality controls the asset.

The Municipality recognises an asset relating to taxes when the recognition criteria of and asset is met and the taxable event occurs.

Where the transaction satisfied the definition of owners' contribution, the credit is recognised in net assets.

Revenue from non-exchange transactions that is not owner's contribution and satisfy the definition of a present obligation (liability) in other words revenue that are subject to conditions are recognised as deferred revenue and are not recognised as revenue, but recognised as deferred revenue until there is reasonable assurance that:

- the Municipality will comply with the conditions attaching to them; and
- the grants will be received

Revenue from non-exchange transactions where restrictions comply are recognised as revenue.

Subsequent recognition and measurement

Assets and liabilities relating to non-exchange revenue are measured based on their nature as it relates to other accounting policies. The Municipality recognises receivables from non-exchange transactions subsequently at amortised cost taken into account the effect of the effective interest rate from the legislative settlement date.

Deferred revenue is recognised when the conditions to the revenue is satisfied.

Revenue from RSC Levies is recognised when the legal entitlement to this revenue arises. Collection charges are recognised when such amounts are legally enforceable. Penalty interest on unpaid levies is recognised on a time proportion basis, which should only be recognised when leviable in terms of the law.

Donations are recognised on a cash receipt basis or when the donation is in the form of property, plant and equipment, when such items of property, plant and equipment are brought into use. Contributed property, plant and equipment are recognised when such items of property, plant and equipment are brought into use.

Revenue from the recovery of unauthorised, irregular, fruitless and wasteful expenditure is based on legislated procedures, including those set out in the Municipal Finance Management Act (Act No. 56 of 2003) and is recognised when the recovery thereof from the responsible councillors or officials is virtually certain.

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs is recognised as income of the period in which it becomes receivable.

SECTION S: EXCHANGE REVENUE

Identification and classification

Phumelela Local Municipality classifies revenue from exchange transactions as follows for financial statement purposes:

- Rental of facilities and equipment
- Investment income
- Rental income from operating leases
- Dividends received
- Income for agency services
- Other income (*material balances are shown separately*)

Investment income further sub-classified as:

- Dividend income - investments
- Interest earned - external investments
- Interest earned - outstanding debtors
- Interest earned – finance leases

Recognition and measurement

Revenue is measured at the fair value of the consideration received or receivable and represents the amounts receivable for goods and services provided in the normal course of business, net of trade discounts and volume rebates, and value added tax.

When accounting for discounts, an asset or liability account is utilised to account for such transaction. The discount is estimated at transaction date and the transaction is accounted for net of discount at transaction date. The discount is not subsequently accounted for when the transaction is settled, but on initial recognition.

The Municipality applies the following recognition criteria:

1. Rental income from operating leases

The recognition and measurement of rental income is dealt with under the accounting policy of leases (see section W).

2. Interest income

Interest revenue is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

3. Dividend income

Dividends shall be recognised when the Municipality’s right to receive payment is established.

4. Other revenue

The Municipality recognises and measures other revenue in accordance with the substance of the agreement.

Exchange revenue classes

Interest, dividends and finance income:

Interest is recognised on a time proportion basis.

Dividends are recognised on the date that the Municipality becomes entitled to receive the dividend.

Finance income from the sale of housing by way of instalment sale agreements or finance leases is recognised on a time proportion basis.

Sale of goods

Revenue from the sale of goods is recognised when the risk is passed to the consumer.

CHAPTER 7: EXPENSES

Definition

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence's of liabilities that result in decreases in net assets, other than those relating to distributions to owners.[16]

Classification

Expenses are classified by nature into the following classes on the face of the statement of financial performance:

- Bulk purchases (Electricity and water)
- Borrowing costs
- Bad debts
- Contractors fees
- Consultancy fees
- Councillors remuneration
- Repairs and maintenance
- Depreciation and amortisation
- Employee benefits (see discussion above)
- Grants and subsidies paid
- Impairment of financial assets
- Impairment of other assets
- Other expenses (material balances are shown separately)

Recognition

Expenses are recognised when the transaction occurred.

[16] Source: *GRAP 1*, Definitions

SECTION T: BORROWING COSTS

Identification and classification

Phumelela Local Municipality classifies interest and other cost incurred in connection with the borrowing of funds as borrowing costs.

Recognition and measurement

The Municipality recognises borrowing costs as an expense in the period in which they are incurred.

CHAPTER 8: NET ASSETS AND RESERVES

Definition

Contributions from owners means future economic benefits or service potential that have been contributed to the entity by parties external to the entity that establish a financial interest in the net assets of the entity, provided that the contributions:

(a) do not result in liabilities of the entity, and

(b) meet the following test, that they:

   (i) convey entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or

   (ii) can be sold, exchanged, transferred or redeemed.[17]

Classification

Net assets are classified between:

- Owners' contributions (only applicable to the subsidiary)
- Accumulated surplus or deficit
- Revaluation reserve
- Mark-to-market reserve
- Housing development fund
- Capital replacement reserve
- Capitalisation reserve
- Government grant reserve
- Donations and public contribution reserve
- Self insurance reserve
- COID reserve

[17] Source: *GRAP 1*, Definitions

SECTION U: OWNERS CONTRIBUTION AND NET ASSETS

Identification and classification

Equity instruments issued by the Municipality are classified according to the substance of the contractual arrangements entered into.

The Municipality may not sub-divide their net assets further unless it is required by a specific accounting standard.

Recognition and measurement

Contributions to the Municipality by its owners, are made directly though net assets where it explicitly give rise to residual rights in the net assets of the Municipality.

Distributions allocated to the Municipality, in its capacity as owner, are directly credited to the owners' contribution.

Other reserves are dealt with in accordance with the related policies.

CHAPTER 9: OTHER

The Municipality shall recognise and disclose any other matters in accordance with the relevant accounting framework.

The sections contained hereafter may relate to both assets or liabilities or income and/or expenses and has been grouped here for ease of reference.

SECTION V: UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE

Identification and classification

Unauthorised expenditure is expenditure that has not been budgeted, expenditure that is not in terms of the conditions of an allocation received from another sphere of government, Municipality or organ of state and expenditure in the form of a grant that is not permitted in terms of the Municipal Finance Management Act.

Irregular expenditure is expenditure that is contrary to the Municipal Finance Management Act, the Municipal Systems Act, the Public Office Bearers Act, and the Companies Act or is in contravention of the Municipality supply chain management policy. Irregular expenditure excludes unauthorised expenditure.

Fruitless and wasteful expenditure is expenditure that was made in vain and would have been avoided had reasonable care been exercised.

Recognition and measurement

The Municipality recognises the expenditure relating to unauthorised, irregular or fruitless and wasteful expenditure as expenses in the statement of financial performance in the year that the expenditure was incurred and classify the expenditure in accordance with the nature of the expense, and where recovered, it is subsequently accounted for as revenue in the statement of financial performance.

The Municipality discloses unauthorised, irregular and fruitless and wasteful expenditure separately for the current and the prior period and any previous years if the expenditure has not been recovered or condoned.

The Municipality discloses the steps taken to recover these expenditures and steps taken to prevent future losses as a result of the above.

SECTION W: LEASES

Identification and classification

Phumelela Local Municipality classifies leases as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The following are indicators of situations that individually or in combination would normally lead to a lease being classified as a finance lease:

- The lessor transfers ownership of the asset to the lessee at the end of the lease term;
- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable. At the inception of the lease, it should be reasonably certain that the option will be exercised;
- The lease term should be for the major part of the economic life of the asset even if title/legal ownership is not transferred;
- At the inception of the lease the present value of the minimum lease payments should amount to at least substantially all of the fair value of the leased asset.
- The leased assets are of such a specialised nature that only the lessee can use them without major modifications.
- If the lessee can cancel the lease, the lessors' losses associated with the cancellation are borne by the lessee;
- Gains or losses from the fluctuation in the fair value of the residual should 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
- The lessee should have the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

The Municipality considers land and buildings separately when classifying the lease when the land and building portions can be proportioned. The Municipality classifies the land as an operating lease unless title is expected to pass to the lessee by the end of the lease term. If the land portion cannot be identified, then both land and buildings are classified as finance leases, unless both classifies as operating leases.

Recognition and measurement

1. Phumelela Local Municipality as lessor

Amounts due from lessees under finance leases are recognised as receivables at the net investment amount of the leases. Finance lease income is allocated over accounting periods so as to reflect a constant periodic rate of return on the outstanding net investment amounts in respect to those leases.

For finance leases other than those involving manufacturers or dealer lessors, initial direct costs are included in the initial measurement of the finance lease receivable and should reduce the amount of income recognised over the lease term.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. The straight-line rentals are determined as the average rental charge over the contract period, including renewal periods if it is virtually

certain that the lease will be extended for that period. It therefore includes the effect of future escalation clauses.

Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

2. Phumelela Local Municipality as lessee

Assets held under finance leases (e.g. busses) are recognised as assets of the Municipality at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The discount rate used in the determination of the present value of the minimum lease payments are the interest rate implicit in the lease. Any initial direct costs of the lease are added to amount recognised as an asset. The corresponding liability is included in the statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance charges are charged to surplus or deficit and included as a sub-class under borrowing costs.

Rentals payable under operating leases are charged to surplus or deficit on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also being spread on a straight-line basis over the lease term.

The straight-line rentals are determined as the average rental charge over the contract period, including renewal periods if it is virtually certain that the lease will be extended for that period. It also includes the effect of the future escalation clauses.

SECTION X: RELATED PARTIES

Identification and classification

Related party transactions and outstanding balances with other entities (parent, subsidiaries, associates and joint ventures) in the Municipality are disclosed in the financial statements. Inter-group related party transactions and outstanding balances (e.g. inter-company loans) are eliminated in the preparation of consolidated financial statements of the Municipality, if applicable.

A party is related to the Municipality if:

1. Directly, or indirectly through one or more intermediaries, the party:
    a. controls, is controlled by, or is under common control with, Municipality (this includes parents, subsidiaries and fellow subsidiaries);
    b. has an interest in the Municipality that gives it significant influence over the Municipality; or
    c. has joint control over the Municipality;
2. The party is an associate of the Municipality;
3. The party is a joint venture in which the Municipality is a venture
4. The party is a member of the key management personnel of the Municipality;
5. The party is a close member of the family of any individual referred to in (1) or (4);
6. The party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such Municipality resides with, directly or indirectly, any individual referred to in (4) or (5); or
7. The party is a post-employment benefit plan for the benefit of employees of the Municipality.

A related party transaction is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged at fair value or not. Therefore, related party transactions between parties in the Municipality are disclosed, even when the transaction is at no consideration.

Where there have been related party transactions during a period, the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the potential effect of the relationship on the financial statements are disclosed.

SECTION Y: DISCONTINUED OPERATIONS

Identification and classification

A discontinued operation is a component of the Municipality that either has been disposed of, or is classified as held for sale, and

- represents a separate major line of business or geographical area of operations,
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or
- is a subsidiary acquired exclusively with a view to resale.

Recognition and measurement

The Municipality recognises and disclose separately the post tax surplus or deficit of discontinued operations and the post tax gain or loss recognised in the measurement to fair value less cost to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

The Municipality discloses the revenue and expenses and related income tax expense(s) in a note to the financial statements, together with the net cash flows attributable to operating, investing and financing activities of the discontinued operation.

APPENDIX: DEFINITIONS

GRAP 1

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Accrual basis means a basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets, revenue and expenses.

Assets are resources controlled by an entity as a result have past events and from which future economic benefits or service potential are expected to flow to the entity.

Associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a controlled entity nor a joint venture.

Biological assets are a living animal or plant.

Borrowing costs are interest and other expenses incurred by an entity in connection with the borrowing of funds.

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.

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.

Contributions from owners means future economic benefits or service potential that have been contributed to the entity by parties external to the entity that establish a financial interest in the net assets of the entity, provided that the contributions:

(a) do not result in liabilities of the entity, and

(b) meet the following test, that they:

  (i) convey entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or

  (ii) can be sold, exchanged, transferred or redeemed.

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity, including an unincorporated entity such as a partnership that is under the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

Distributions to owners means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The surplus or deficit of the investor includes the investor's share of the results of operations of the investee.

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence's of liabilities that result in decreases in net assets, other than those relating to distributions to owners.

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 any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
  - (i) to receive cash or another financial asset from another entity; or
  - (ii) to exchange financial assets or liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

Foreign operation is an entity that is a controlled entity, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

Government business enterprise means an entity that, in accordance with the Public Finance Management Act, Act No. 1 of 1999 as amended:

(a) is a juristic person under the ownership control of the national/provincial executive;

(b) has been assigned the financial and operational authority to carry on a business activity;

(c) as its principal business, provides goods or services in accordance with ordinary business principles; and

(d) is financed fully or substantially from sources other than: (i) the National or Provincial Revenue Fund;
(ii) by way of a tax, levy or other statutory money.

Impracticable
Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

(a) the effects of the retrospective application or retrospective restatement are not determinable;

(b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

(c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
   (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
   (ii) Would have been available when the financial statements for that prior period were authorised for issue from other information.

Joint venture is a binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Management is those persons charged with the responsibility for the governance of an entity in accordance with the relevant applicable legislation including accounting officers, accounting authorities and municipal managers.

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.

Minority interest is that portion of the surplus or deficit and of net assets of a controlled entity attributable to interests that are not owned, directly or indirectly through controlled entities, by the controlling entity.

Net assets are the residual interest in the assets of the entity after deducting all its liabilities.

Notes contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements.

Presentation currency is the currency in which the financial statements are presented.

Prior period errors are omissions from, and misstatements in, the entity'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.

Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

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

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 contributions from owners.

Separate financial statements are those presented by a controlling entity, an investor in an associate or a venture in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

GRAP 2

Cost method is a method of accounting whereby the investment is recorded at cost. The statement of financial performance reflects revenue from the investment only to the extent that the investor receives distributions from

accumulated net surpluses of the investee arising subsequent to the date of acquisition.

Exchange rate is the ratio for exchange of two currencies.

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

Foreign currency is a currency other than the functional currency of the entity.

Functional currency is the currency of the primary economic environment in which the entity operates.

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

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

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

Proportionate consolidation is a method of accounting and reporting whereby a venture's share of each of the assets, liabilities, revenue and expenses of a jointly controlled entity is combined on a line-by-line basis with similar items in the venture's financial statements or reported as separate line items in the venture's financial statements.

Provisions are liabilities of uncertain timing and amount.

Revaluations are restatements of assets and liabilities.

GRAP 3

Cost method is a method of accounting whereby the investment is recorded at cost. The statement of financial performance reflects revenue from the investment only to the extent that the investor receives distributions from accumulated net surpluses of the investee arising subsequent to the date of acquisition.

A change in accounting estimate 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.

Prospective application of a change in an accounting policy and have 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.

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

Retrospective restatement is correcting the recognition, measurement and disclosure Of amounts of elements of financial statements as if a prior period error had never occurred.

IAS 16: par 6

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

Cost 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, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 Share-based Payment.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction.

An *impairment loss* is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:
(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
(b) are expected to be used during more than one period.

Recoverable amount is the higher of an asset’s net selling price and its value in use.

The *residual value* of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:
(a) the period over which an asset is expected to be available for use by an entity; or
(b) the number of production or similar units expected to be obtained from the asset by an entity.

IAS 40: par 5

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn 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 business.

Owner-occupied property is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

IAS 38: par 8

An *active market* is a market in which all the following conditions exist:

(a) the items traded in the market are homogeneous;
(b) willing buyers and sellers can normally be found at any time; and
(c) prices are available to the public.

The *agreement date* for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

An *asset* is a resource:

(a) controlled by an entity as a result of past events; and
(b) from which future economic benefits are expected to flow to the entity.

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 commercial production or use.

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

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

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

IAS 17: par 4

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.

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.

An *operating lease* is a lease other than a finance lease.

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 such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.

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) a lease is classified as either an operating or a finance lease; and
(b) in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined.

The *commencement of the lease term* is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e. the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate).

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 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.

Economic life is either:

(a) the period over which an asset is expected to be economically usable by 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.

Useful life is the estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the entity.

Guaranteed residual value is:

(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.

Un-guaranteed 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.

Initial direct costs are incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or dealer lessors.

Gross investment in the lease is the aggregate of:
(a) the minimum lease payments receivable by the lessor under a finance lease, and
(b) any un-guaranteed residual value accruing to the lessor.

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.

Unearned finance income is the difference between:
(a) the gross investment in the lease, and
(b) the net investment in the lease.

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 un-guaranteed 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.

The *lessee's incremental borrowing rate of interest* is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

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 (eg percentage of future sales, amount of future use, future price indices, future market rates of interest).

IAS 37: par 10

A *provision* is a liability of uncertain timing or amount.

A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

A *legal obligation* is an obligation that derives from:
(a) a contract (through its explicit or implicit terms);
(b) legislation; or
(c) other operation of law.

A *constructive obligation* is an obligation that derives from an entity's actions where:
(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A *contingent liability* 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 entity; or 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 will be required to settle the obligation; or
(ii) the amount of the obligation cannot be measured with sufficient reliability.

A *contingent asset* 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 entity.

An *onerous contract* is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

A *restructuring* is a programme that is planned and controlled by management, and materially changes either:
(a) the scope of a business undertaken by an entity; or
(b) the manner in which that business is conducted.

IAS 19: par 7

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.

Short-term employee benefits are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.

Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.
Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Defined benefit plans are post-employment benefit plans other than defined contribution plans.

Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) pool the assets contributed by various entities that are not under common control; and

(b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.

Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

Termination benefits are employee benefits payable as a result of either:

(a) an entity's decision to terminate an employee's employment before the normal retirement date; or

(b) an employee's decision to accept voluntary redundancy in exchange for those benefits.

Vested employee benefits are employee benefits that are not conditional on future employment.

The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.

Plan assets comprise:

(a)assets held by a long-term employee benefit fund; and

(b)qualifying insurance policies.

Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

(i)the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or
(ii)the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

A *qualifying insurance policy* is an insurance policy* issued by an insurer that is not a related party (as defined in IAS 24 Related Party Disclosures) of the reporting entity, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and
(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:
(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or
(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

The return on plan assets is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.

Actuarial gains and losses comprise:

(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
(b) the effects of changes in actuarial assumptions.

Past service cost is the increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

IAS 18: par 7

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

IAS 23: par 5

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

A *qualifying asset* is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

IAS 20: par 3

Government refers to government, government agencies and similar bodies whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

Forgivable loans are loans which the lender undertakes to waive repayment of under certain prescribed conditions.

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

IAS 28: par 2

An *associate* is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

Consolidated financial statements are the financial statements of a group presented as those of a single economic entity.

Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The *equity method* is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

Joint control is the contractually agreed sharing of control over an economic activity, 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).

Separate financial statements are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are

accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

A *subsidiary* is an entity, including an unincorporated entity such as a partnership that is controlled by another entity (known as the parent).

IAS 24: par 9

Related party A party is related to an entity if:

(a) directly, or indirectly through one or more intermediaries, the party:
- (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
- (ii) has an interest in the entity that gives it significant influence over the entity; or
- (iii) has joint control over the entity;

(b) the party is an associate (as defined in IAS 28 Investments in Associates) of the entity;
(c) the party is a joint venture in which the entity is a venturer (see IAS 31 Interests in Joint Ventures);
(d) the party is a member of the key management personnel of the entity or its parent;
(e) the party is a close member of the family of any individual referred to in (a) or (d);
(f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
(g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

A *related party transaction* is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

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 (Phumelela Local Municipality). They may include:
(a) the individual's partner and children;
(b) children of the individual's partner; and
(c) dependants of the individual or the individual's partner.

Compensation includes all employee benefits (as defined in IAS 19 Employee Benefits) including employee benefits to which IFRS 2 Share-based Payment applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. Compensation includes:
(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;
(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation;
(d) termination benefits; and
(e) share-based payment.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

IAS 12: par 5

Accounting profit is profit or loss for a period before deducting tax expense.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:
(a) Deductible temporary differences;
(b) the carry forward of unused tax losses; and
(c) the carry forward of unused tax credits.

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:
(a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
(b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

The *tax base* of an asset or liability is the amount attributed to that asset or liability for tax purposes.

IFRS 5:

Cash-generating unit

The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Component of an entity
Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

Costs to sell
The incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs and income tax expense.

Current asset
An asset that satisfies any of the following criteria:

(a) it is expected to be realised in, or is intended for sale or consumption in, the entity'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 balance sheet 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 balance sheet date

Discontinued operation
A component of an entity that either has been disposed of or is classified as held for sale and:

(a) represents a separate major line of business or geographical area of operations,
(b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or
(c) is a subsidiary acquired exclusively with a view to resale

Disposal group
A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80–87 of IAS 36 Impairment of Assets (as revised in 2004) or if it is an operation within such a cash-generating unit.

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

Firm purchase commitment
An agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-performance that is sufficiently large to make performance highly probable.

Highly probable
Significantly more likely than probable.

Non-current asset
An asset that does not meet the definition of a current asset.

Probable
More likely than not.

Recoverable amount
The higher of an asset's fair value less cost to sell and its value in use.

Value in use
The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

IPSAS 23

Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.

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.

Expenses paid through the tax system are amounts that are available to beneficiaries' regardless of whether or not they pay taxes.

Fines are economical benefits or services potential received or receivable by public sector 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 the 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.

Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or services potential is required to be returned to the transferor if not deployed as specified.

Stipulations on transferred assets are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

Tax expenditure are preferential provisions of the tax law that provide certain taxpayers with concessions that are nor available to others.

The *taxable event* is the event that the government, legislature or other authority has determined that will be subject to taxation.

IAS 20

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets (e.g. grants for new busses, refurbishment of buildings or workshops) are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

IAS 39

Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) de-recognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.

Effective interest rate is the rate that exactly discount estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

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

A financial asset is any asset that is:

- cash;
- an equity instrument of another entity;
- a contractual right:
  - (i) to receive cash or another financial asset from another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves

contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

- a contractual obligation:
  - (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity.

A derivative is a financial instrument or other contract within the scope of this Standard (see paragraphs 2–7) 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 (Phumelela Local Municipality 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; and

(c) it is settled at a future date.

A financial instrument is any contract that gives rise to a financial asset of one ME and a financial liability or equity instrument of another ME.

An equity instrument is any contract that evidences a residual interest in the assets of an ME after deducting all of its liabilities.

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.

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 (see IAS 18), 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 estimate reliably 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).

De-recognition is the removal of a previously recognised financial asset or financial liability from an entity's balance sheet.

A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see Appendix A paragraph AG13). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Definitions of four categories of financial instruments:

1) A financial asset or financial liability at fair value through profit or loss is a financial asset or financial liability that meets either of the following conditions.

(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:

(i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

(ii) 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; or

(iii) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

(b) Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either

(i) it eliminates or significantly reduces a measurement or recognition inconsistency (Phumelela Local Municipality referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or

(ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24

Related Party Disclosures (as revised in 2003)), for example the entity's board of directors and chief executive officer.

In IFRS 7, paragraphs 9–11 and B4 require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions. For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81), shall not be designated as at fair value through profit or loss.

It should be noted that paragraphs 48, 48A, 49 and Appendix A paragraphs AG69–AG82, which set out requirements for determining a reliable measure of the fair value of a financial asset or financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.

2) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see Appendix A paragraphs AG16–AG25) other than:

(a) those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that the entity designates as available for sale; and

(c) those that meet the definition of loans and receivables.

An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

(i) are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;

(ii) occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or

(iii) are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.

3) Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that the entity upon initial recognition designates as available for sale; or

(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

An interest acquired in a pool of assets that are not loans or receivables (for example, an interest in a mutual fund or a similar fund) is not a loan or receivable.

4) Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.