



# **CAPITAL ASSET MANAGEMENT POLICY 2018/2019**

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## 1. ACRONYMS

AMT	Asset Management Team
EUL	Expected Useful Life
MM	Municipal Manager
CFO	CFO
MCLM	Merafong City Local Municipality
FAR	Fixed Asset Register
GPS	Global Positioning System
GRAP	Generally Recognised Accounting Practice
MFMA	Municipal Finance Management Act, No. 56 of 2003
MSA	Municipal Systems Act, No. 32 Of 2000
NT	National Treasury
OHSA	Occupational Health and Safety Act
PPE	Property, Plant & Equipment

## 2. DEFINITIONS

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

An **asset** is a resource:

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

**Asset Custodian** is a person in any position or level in the organisation entrusted with the safeguarding and use as well as the condition monitoring of a specific asset.

**Asset Life-Cycle** is the cycle of activities that an asset goes through – including planning, design, initial acquisition and/or construction, cycles of operation and maintenance and capital renewal, and finally disposal.

**Asset Management** is a broad function and includes a structured process of decision-making, planning and control over the acquisition, use, safeguarding and disposal of assets to maximise their service delivery potential and benefits, and to minimise their related risks and costs over their entire life.

**Asset Manager** is any official who has been delegated responsibility and accountability for the control, usage, physical and financial management of the entity's assets in accordance with the entity's standards, policies, procedures and relevant guidelines.

**Asset Register** is a record of information on each asset that supports the effective financial and technical management of the assets, and meets statutory requirements. The asset register should also facilitate proper financial reporting and is ultimately the responsibility of the Chief Financial Officer (CFO).

**Capital Assets** are all assets with a life cycle of greater than one year. For example, this would include property, plant and equipment (infrastructure network, furniture, motor vehicles, computer equipment, etc.), intangible assets, and investment property.

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

**Cash-generating assets** are assets managed with the objective of generating a commercial return.

A **cash-generating unit** is the smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

**MM** is the person defined as the Accounting Officer of a municipal entity.

**Class of property, plant and equipment** means a grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.

**Component** is a part of an asset with a significantly different useful life and significant cost in relation to the rest of the main asset. Component accounting requires that each such part should be separately accounted for and is treated separately for depreciation, recognition and derecognition purposes. It is also referred to as separately depreciable parts.

**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

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amount attributed to that asset when initially recognised in accordance with the specific requirements of other Standards of GRAP.

**Costs of disposal** are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

**Current Replacement Cost** is the cost of replacing an existing asset with a modern asset of equivalent capacity.

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

**Depreciated Replacement Cost** is a measure of the current value of an asset based on its current replacement cost less an allowance for deterioration of condition to date (based on the fraction of remaining useful life/expected useful life).

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

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

**Economic Life** is either:

- the period over which an asset is expected to yield economic benefits or service potential to one or more users, or
- the number of production or similar units expected to be obtained from the asset by one or more users.

**Enhancement/Rehabilitation** is an improvement or augmentation of an existing asset (including separately depreciable parts) beyond its originally recognised service potential for example, remaining useful life, capacity, quality, and functionality.

**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.

**Fair value less costs to sell** is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

**Financially Sustainable**, in relation to the provision of a service, means the provision of a service in a manner aimed at ensuring that the financing of that service from internal and external sources, including budgeted income, grants and subsidies for the service, is sufficient to cover the costs of—

- the initial capital expenditure required for the service;
- operating the service; and
- maintaining, repairing and replacing the physical assets used in the provision of the service.

An **impairment** is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

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

An **impairment loss of a non-cash-generating asset** is the amount by which the carrying amount of an asset exceeds its recoverable service amount.

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**Infrastructure** means assets that usually display some or all of the following characteristics

- they are part of a system or network;
- they are specialised in nature and do not have alternative uses;
- they are immovable; and
- they may be subject to constraints on disposal.

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

**Maintenance/Refurbishment** to an asset will restore or maintain the originally assessed future economic benefits or service potential that an entity can expect from an asset and is necessary for the planned life to be achieved.

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

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

**Modern Equivalent Asset** is an asset that replicates the existing asset with the most cost-effective asset performing the same level of service. This includes improvements in technology that may change the nature, life and value of an asset.

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

**Non-cash-generating assets** are assets other than cash-generating assets.

**Non-monetary assets are assets** other than monetary assets.

**Property, plant and equipment** are tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and
- are expected to be used during more than one reporting period.

**Recognition** is the process of incorporating in the statement of financial position or statement of financial performance an item that meets the definition of an element (of financial statements) and satisfies the criteria for recognition, namely:

- It is probable that any future economic benefit or service potential associated with the item will flow to or from the entity and
- The item has a cost or value that can be measured reliably.

**Recoverable amount** is the higher of a cash-generating asset or a cash-generating unit's fair value less costs to sell and its value in use.

**Recoverable service amount** is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use.

**Remaining Useful Life** is the time remaining (of the total estimated useful life) until an asset ceases to provide the required service level or economic usefulness.

**Renewal** is the work required to replace/enhance/rehabilitate an asset. Expenses on renewal works are considered capital expenditure.

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

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.

**Service Potential** is a tangible capital asset's output or service capacity, normally determined by reference to attributes such as physical output capacity, quality of output, associated operating costs and useful life.

**Useful life is:**

- the period over which an asset is expected to be available for use by an entity, or
- the number of production or similar units expected to be obtained from the asset by an entity.

The useful life of an asset is entity specific.

**Value in use of a cash-generating asset** is the present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life.

**Value in use of a non-cash-generating asset** is the present value of the asset's remaining service potential.

### 3. AUTHORITY, PURPOSE AND SCOPE

This document prescribes the policy and procedures of Merafong City Local Municipality (MCLM) for the management of its Capital Assets. The policy requires the entity to establish and maintain an asset register that complies with relevant accounting standards, and managing the assets to ensure that the entity's objectives and recognised good practices are met.

This policy covers all Capital Assets (Property, plant and equipment and intangible assets) controlled by MCLM.

### 4. BACKGROUND

#### 4.1 Statutory framework

The South African Constitution requires municipalities (and thus also municipal entities) to strive, within their financial and administrative capacity, to achieve the following objects:

- providing democratic and accountable government for local communities;
- ensuring the provision of services to communities in a sustainable manner;
- promoting social and economic development;
- promoting a safe and healthy environment; and
- encouraging the involvement of communities and community organisations in matters of local government.

The manner in which the entity manages its capital assets is central to meeting the above requirements. Accordingly, the Municipal Systems Act (MSA) specifically highlights the duty of municipalities (and thus also municipal entities) to provide services in a manner that is sustainable, and the Municipal Finance Management Act (MFMA) requires municipalities and municipal entities to utilise and maintain their assets in an effective, efficient, economical and transparent manner. The MFMA specifically places responsibility for the management of capital assets with the Accounting Officer.

The OHS Act requires entities to provide and maintain a safe and healthy working environment, and in particular, to keep its immovable capital assets safe.

#### 4.2 Accounting standards

The municipal entity is required to comply with the Standards of Generally Recognised Accounting Practice (GRAP). MCLM converted to GRAP on 1 July 2009.

#### 4.3 Management of capital assets

Effective management of capital assets is central to the entity providing an acceptable standard of services. Capital assets impacts on the quality of the living environment and opportunities to prosper. Not only is there a requirement to be effective, but the manner in which the entity discharges its responsibilities as a municipal entity is also important. The entity must demonstrate good governance and customer care, and the processes adopted must be efficient and sustainable. Officials are custodians of the capital assets.

Key themes of the latest generation of national legislation introduced relating to municipal (and thus municipal entity) capital asset management include:

- long-term sustainability and risk management;

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- service delivery efficiency and improvement;
- performance monitoring and accountability;
- community interaction and transparent processes;
- priority development of minimum basic services for all; and
- the provision financial support from central government in addressing the needs of the poor.

There is a need to direct limited resources to address the most critical needs, to achieve a balance between maintaining and renewing existing infrastructure whilst also addressing backlogs in basic services and facing ongoing changes in demand. Making effective decisions on service delivery priorities requires a team effort, with inputs provided by officials from a number of departments of the entity, including infrastructure, community services, financial planning, and corporate services.

Accordingly, the asset register adopted by MCLM must meet not only financial compliance requirements, but also set a foundation for improved infrastructure asset management practice.

### **5. OBJECTIVES**

The objective of this document is for the entity to:

- ✓ implement prevailing accounting standards; and
- ✓ apply asset management practice in a consistent manner and in accordance with legal requirements and recognised good practice.

### **6. APPROVAL AND EFFECTIVE DATE**

The CFO is responsible for the submission of this document to the Board to consider its adoption after consultation with the MM. The board shall indicate the effective date for implementation of the policy.

### **7. POLICY AMENDMENTS**

Changes to this document shall only be applicable if approved by the board. Any proposals in this regard shall be motivated by the CFO in consultation with the MM and respective Senior Managers. The recommendations of the CFO shall be considered for adoption by the board.

### **8. REFERENCES**

The following references were observed and used in compiling this document:

- Accounting Guideline - GRAP 17 Property, plant and equipment, National Treasury, as revised
- Generally Recognised Accounting Practice (GRAP 1, 3, 5, 17, 21, 26, 31)
- Municipal transfer and disposal regulations, Government Gazette no.31346
- Municipal Finance Management Act, 2003
- Local Government Capital Asset Management Guidelines, National Treasury, 2008
- **MCLM Asset management Policy, Revision June 2016**
- **MCLM Financial Policy: Policy for the disposal of assets and equipment, Revision June 2010**

## 9. ASSET MANAGEMENT

The goal of asset management is to achieve the required level of service in the most cost effective manner, which is achieved through management of the asset's life cycle.

### 9.1 Effective asset management

To be effective, asset management in MCLM should include the following:

- Service level needs drive asset management practices and decision-making;
- Asset management plans that are an integral part of the entity planning process;
- Asset acquisition decisions that are based upon the evaluation of alternatives, including demand management and non-asset solutions;
- Asset acquisition proposals that include a full business case, including costs, benefits and risks across each phase of an asset's life cycle;
- Defined responsibility and accountability for performance, safe custody and use.
- Disposal decisions based upon an analysis of disposal options, designed to achieve the best possible return for the entity and made in accordance with the provisions of the MFMA;
- Sound risk-based internal controls supporting all asset management practices.

Effective asset management will:

- maximise the service potential of existing assets by ensuring that they are appropriately used; maintained, safeguarded and that risks are mitigated;
- optimise the life cycle costs of owning and using these assets by seeking cost-effective options throughout an asset's life cycle;
- reduce the demand for new assets through optimal use of existing assets and management of demand through the use of non-asset service delivery options; and
- establish clear lines of accountability and responsibility for performance.

### 9.2 Asset strategy

The entity should adopt an integrated approach to asset management:

- taking the entity's strategy, converting that into an asset management strategy and producing plans based upon an analysis of service delivery options;
- formulating an asset management strategy consisting of detailed plans for acquisitions and replacements, operation and maintenance as well as disposals in terms of the entity's policies;
- informing the annual budget, using the detailed plans;
- funding each approved asset management plan appropriately through the budget;
- including in the Service Delivery and Budget Implementation Plan the measurable objectives and targets of each asset management plan;
- reporting on the performance of assets as measured in terms of service delivery.

#### 9.2.1 Asset management plans

The development of asset management plans is an interactive process that starts with the identification of service delivery needs and ends with an approved "multiyear" budget based upon the most cost-effective method of delivering that service. During that process the asset manager should:

- consider the service-level requirements;
- review the current levels of service provided from the relevant assets;
- conduct a "gap analysis" of the required vs. current service levels;
- identify a range of options to resolve that service-level gap;
- conduct a preliminary assessment of the feasibility of various options;

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- develop a business case for the most feasible option or options. This business case should include:
  - the proposed service delivery option,
  - identified benefits and identified needs,
  - a full life-cycle-costs forecast,
  - credible revenue forecasts including other funding sources;
  - a risk assessment across the whole life cycle of each option, and
  - performance measures that can be used to assess the success of the options and implementation progress.

The asset manager will consult with other divisions in the development of the entity's asset management plans. For example they should:

- review any legislative issues with the entity's legal department;
- review any human resource issues with the human resource manager; and
- review other issues with any other relevant managers, e.g. Information Technology, CFO and Human Resources.

Asset management plans should also include asset maintenance plans to ensure provision in the budget for appropriate funding to guarantee that existing assets continue to perform at the required levels and standards of service. MCLM is in the process of developing an asset maintenance plan.

### 9.3 Asset life cycle

The asset life-cycle is a key concept underpinning asset management. An asset life-cycle covers all phases of an asset's life starting with planning, through its acquisition, operation, maintenance and eventual disposal. Management of these phases should be aligned to the entity's planning, budgeting, monitoring and reporting processes. In summary the phases are as follows:

- a) The **planning phase** deals with the planning for service delivery that drives the need for assets. This phase will include input into the budget and asset management plans. Various acquisition options should be considered during this phase.
- b) The **acquisition phase** deals with the purchase, construction or manufacture of new assets.
- c) The **operation and maintenance phase** deals with the operation of the assets, maintenance/refurbishment, enhancement/rehabilitation, depreciation and impairment. This phase includes activities of a capital and current nature.
- d) The **disposal phase** deals with the timing of and disposal of the assets including the disposal costs and specific requirements for the assets, e.g. dismantling costs, etc.

An asset's life-cycle is determined by its useful life to the entity. This useful life might be shorter than its economic life.

#### 9.3.1 Asset life-cycle costs

A clear understanding of asset life-cycle costs is crucial for the development of cost-effective asset management plans and options. The analysis of life-cycle costs should cover the four broad phases, thus covering the entire life of the asset, including any environmental rehabilitation at the end of its life.

This analysis will be based upon estimates and include all cash flows such as operation, maintenance, administration, capital, and financing costs. The budget should have a split between capital and operational costs including depreciation.

These are typical asset life-cycle costs:

**Planning-phase costs** – concept design costs, scientific studies, environmental impact studies and feasibility studies. These costs are usually incurred when weighing up the different options, before deciding on the best option.

**Acquisition-phase costs & revenues** – special levies, purchase price / construction costs (labour, materials, and components), detailed design costs (not feasibility analysis), transportation costs, installation and commissioning cost, use of own assets in construction (limited to depreciation over duration of use), freight, legal fees, warehousing costs, initial consumables (e.g. initial set of tyres for a vehicle) and all other costs required to bring that asset to its proper working condition and location for intended use (excluding training on use of the new asset, should this be required).

**Operation and maintenance-phase costs:**

**Operation** - fuel or energy costs, operational labour, security costs, safety costs, training costs, performance monitoring costs, cleaning costs and consumables.

**Maintenance** - spare parts and repair labour.

**Administration (asset specific)** - insurance, rates and taxes, management fees, etc.

**Rehabilitation and renewal** - upgrade costs, modification costs if this improves asset life etc (capital), re-training costs (current), etc.

**Asset-related receipts** – tariffs, etc.

**Disposal-phase costs** - disposal costs (like auctioneer fees, etc.), storage costs, environmental rehabilitation costs, decommissioning costs, demolition costs, etc.

### **9.3.2 Planning and budgeting phase**

The entity need to plan for the level of services they need and how they will use the available funds to maintain and expand those services. This should include service delivery options and funding alternatives.

This phase requires clear answers to the following questions:

- What existing assets does the entity have and where are they? (Asset Registers)
- What is the existing assets worth? (Valuation)
- What are their condition and their expected remaining useful life? (Condition Assessments)
- What is the expected or required level of service?
- How can that level of service be achieved? (Asset Management and Operational Plans)
- What additional assets does the entity require? (GAP analysis)
- How much will that level of service cost and when or how can we fund it? (Multi-year Capital and Operating Budgets)
- How can we ensure that level of service is “financially sustainable”? (Fiscal Policy, Short to Long-Term Financial Plans)
- How will we manage and monitor the delivery of that level of service? (Performance Management System and Performance Agreements)

#### **9.3.2.1 Funding of the acquisition**

The funding strategies should optimise the entity’s ability to achieve its strategic objectives. Loans to acquire assets should not be longer than the life of the assets they are used to acquire.

The funding strategy should consider available sources of finance such as operating surpluses, cash-backed reserves, loans, grants, and cash donations. This should be part of a long-term cash flow forecast.

#### **Loan finance option**

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The entity should ensure that a loan satisfies the requirements of legislation on incurring debt. In particular, MCLM should ensure that long-term debt is:

- incurred only for the purposes of capital expenditure for the purpose of achieving the objectives,
- incurred in line with its capital budget,
- is incurred only after the anticipated debt repayment schedule has been submitted to the board,
- included in the liabilities register, and
- satisfies the other requirements of the MFMA, the MSA and the Constitution (where applicable).

The entity should have a long-term financial plan to repay the loan, pay the interest and manage the overall borrowings of the entity.

### **Refinancing loans**

Circumstances may arise that require MCLM to refinance a loan or loans. There is a legislative need to link loan-funding sources to assets.

A register of loans should indicate the capital assets for which the loan was raised. The asset register should reflect the asset and the corresponding loan (e.g. cross reference to the loan register) to ensure that, when the asset is disposed of, the corresponding liability is settled.

Where the entity raises a loan or a short-term bond against a capital expenditure programme (many capital assets) and then wants to refinance that loan, it may prove difficult to allocate the loan to specific assets. This situation can be dealt with as follows:

1. Match the value of the loan against the value of assets connected to the project.
2. Apply the loan against the value of specific long-life assets.
3. Where the loan is to be refinanced, the entity has specific long-life assets related to the loan against which it can be refinanced.
4. The short-life assets would then be financed/allocated through other sources, e.g. internal funds or grants.

Loans for new assets/projects should preferably be raised against specific assets related to the programme or project to avoid such difficulties.

### **9.3.2.2 Multi-year capital projects and projected rollovers**

Multi-year capital projects will require funding over the period of the project.

The MFMA allows for the appropriation of money for capital expenditure for a period not exceeding three financial years, provided a separate appropriation is made for each of those financial years.

Although the MFMA requires planning for three financial years of the project, the entity should plan for the funding needed for every financial year of the project to ensure its financial sustainability.

Situations will arise where capital appropriations are unable to be spent during the allocated financial year. MCLM can either include the projected capital roll-overs as part of an adjustment budget or provide for an adjusted capital appropriation as part of the next annual budget. This also facilitates long-term contracts with suppliers to enable a smooth flow of work over the three or more years of construction.

Life-cycle planning should also be done for each individual asset. This information will feed into the entity's acquisition, operation and maintenance, as well as disposal, plans.

### **9.3.3 Acquisition phase**

The acquisition phase covers a number of financial steps including:

- Pre-Acquisition Planning
- Approval to Acquire
- Funding of the acquisition
- Supply-chain management process
- Physical Receipting and Management.

#### **9.3.3.1 Pre-acquisition planning**

During this phase various options for acquisition or alternatives to asset ownership should be considered by the performance of cost-benefit analyses for all options, taking into account the period for which the asset is required for use by the entity.

#### **Methods of acquisition**

There are various methods of acquisition namely:

##### **Asset purchasing (Buy)**

- Land, for the purposes of this document, encompasses both improved and unimproved land. It generally also includes all improvements of a permanent nature, for example levelling a piece of land. Legislation governing the acquisition of land by entities for public purposes should be observed. Generally, an entity acquires land either by agreement or by compulsory acquisition:

- Purchase by agreement can be achieved by negotiation and entering into a common law contract of sale.
- Compulsory acquisition is where the acquiring entity may be empowered under legislation to acquire the land. If agreement on the compensation to be paid cannot be reached, the courts determine the matter.

- The acquisition by the entity of assets other than land and those that are constructed is governed by the MFMA and by relevant policies and guidelines applicable to the entities.

When buying land with improvements such as buildings, the cost of the land and the buildings should be separated in the asset register and the ledger for reporting purposes.

##### **Asset construction (Build)**

- Choosing an appropriate contractual method is fundamental to the feasibility, development and ultimate success of the procurement.

The entity is responsible for choosing the most appropriate method on a project-by-project basis and for identifying, assessing and allocating potential risks in order to optimise investment return.

The method used to acquire assets should enable:

- appropriate allocation of risks and obligations to relevant parties;
- definition of the respective roles of the various parties involved;
- definition of the required outcomes of the acquisition process;
- effective project management by the entity to ensure that contractual stipulations and the budget are met; and
- the receipt and physical checking of progress reports before their authorisation.

- The choice of method is made by considering costs, financial benefits, funding options, risks, delivery times and the period for which the asset is needed.

- Lump-sum contracts involve the design and documentation of the project. Tenders are then invited and a contractor appointed to construct the works, as documented, in return for an agreed lump-

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sum payment, paid as the work progresses. A project manager undertakes to manage the project for delivery within the specified time and to meet specified cost and quality targets. The project manager may be an architect or other building professional.

- A design-and-construct contract involves a single supplier or contractor undertaking both the design and construction processes. The contractor engages consultants to design and document the project, generally with the close involvement of the customer. This type of contract may include a warranted or guaranteed maximum price, subject to the allocation of risks.
- The build-own-operate-transfer (BOOT) process involves the private construction of a public asset at the expense of the private owner in return for the right to operate the facility and charge users a fee. At the end of the contract period, the facility reverts to the State i.e. Public Private Partnerships (PPPs). This process can be modified to suit particular needs (e.g. build-own-transfer), depending on the requirements for ownership and operation.

### ***Using Non-Asset Service-Delivery Options***

The entity should consider non-asset based service-delivery options, such as:

- Managing Demand for that service, e.g. user-charging regimes
- Redesign Service Delivery Options, e.g. use mobile phones instead of Radio Phones.
- Managing Utilisation / Waste of that Service, e.g. Community Education
- Consider External Service Provision including:
  - leasing (Finance and operating);
  - Public Private Partnerships (PPP); and
  - outsourcing.

### ***Decision to lease or buy***

- The decision to lease or buy an asset is where the market can provide generic assets to meet MCLM's service needs.
- Where an asset is leased it is necessary to record the details in an appropriate register. Additional details, which should also be recorded, include:
  - lease start and completion dates;
  - first-instalment date;
  - asset-fair value;
  - implicit interest rate; and
  - lease payments.
- Leases have a built-in interest cost which should be considered when evaluating whether to lease or buy (cash) an asset. Information in the register should be reviewed annually to confirm that the decision remains the most economical one.
- The advantages of leasing include:
  - increased flexibility to change 'asset solutions' (with an operating lease);
  - reduced need for large capital outlays; and
  - isolation from short-term fluctuations in market supply and values.
- Disadvantages can include:
  - penalty clauses for the early termination of leases;
  - higher implicit interest costs in leases compared to cost of funds available to the entity; and
  - dependence on the market to supply assets leading to long-term exposure to market risk.

Before a decision is made to acquire an asset, the acquisition plans that have been prepared should be checked to ensure that budget planning has been done.

Before a capital project is included in the budget for approval, the asset manager should demonstrate that he/she has considered:

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- the preliminary or conceptual design and specification of the asset;
- the projected cost over all the financial years until the project is operational;
- the future operational costs and revenue on the project, including tax and tariff implications;
- the financial sustainability of the project over its operational life, including revenue generation and subsidisation requirements;
- all preliminary costing-projected timeframes, cash flows and other requirements; and
- alternatives to this capital purchase.

The CFO should ensure the asset manager receives all reasonable assistance, guidance and explanations to enable him/her to achieve the planning requirements.

Closer to the actual acquisition date, the initial estimates and the preferred options should be re-assessed, and, if necessary, an updated business case prepared for the approval of the acquisition.

### **9.3.3.2 Approval to acquire capital assets**

The time frame for the acquisition process/project start date, and the timing and amount of required capital outlays should be considered and included in the annual medium term budgets at a time that takes account of acquisition lead times.

Expenditure on a capital project will be approved through the budget process and by the capital expenditure committee, and should follow the supply chain management policies and procedures.

Once the acquisition has been approved, the actual purchase will be done through the supply-chain unit.

### **9.3.4 Operation and maintenance phase**

#### **9.3.4.1 Accountability for capital assets**

Accountability for the operation and maintenance of capital assets is delegated from the MM, through the senior managers, to the asset manager. The asset manager is accountable for ensuring that entity resources assigned to him/her are utilised effectively, efficiently, economically and transparently. This would include:

- complying with systems of management and internal controls established by the entity;
- preventing inappropriate losses;
- appropriately managing, safeguarding and maintaining assigned assets; and
- providing all asset-related information as and when required.

The asset manager will delegate custodianship of assets to specific users.

The custodians will be required to perform functions assigned to the asset manager in respect of their specific assets.

#### **9.3.4.2 Reporting on emerging issues**

Each asset custodian should report to the asset manager, who will report to the appropriate executive manager; and executive managers should report to the MM on the execution of their delegated responsibilities, including any issues that will significantly impede the capability of the assets to provide the required level of service or economic benefit. One of these issues will be the adequacy of the maintenance, operation and safeguarding of assigned assets.

#### **9.3.4.3 Operation and maintenance policies and plans**

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The asset manager must have a thorough understanding of the operational policies and budgets required to maintain assigned assets to the required level of performance. The asset manager will need to participate in the development of asset-management policies and strategies and to provide budget input that optimises the useful lives of their assets.

The selection of a maintenance strategy involves consideration of the appropriate mix of procedures and the capacity to undertake minor modifications and enhancements when required. It is unlikely that any one approach will be suitable. The main approaches are:

- corrective - no maintenance is undertaken unless, or until, the asset no longer functions to the required standard or has broken down; and
- preventative - programmed maintenance is undertaken to reduce the likelihood of failure and to keep the asset operating at an acceptable level.

For some specialised assets the technical requirements for scheduled maintenance are provided by the manufacturer.

These schedules need to be taken into account when planning for the long and medium term and appropriate budget provision made to ensure adherence to schedules. Schedules are based on normal usage and specified fuel standards as well as risk assessments in relation to the assets.

Inappropriate or excessive use over extended periods may increase the risk of increased maintenance interventions, down time and reduction in the life of the asset.

An important consideration is the nature of the asset itself. Certain categories of assets require little or no regular maintenance (for example furniture and fittings). It is valid to exclude such assets from a formal maintenance programme and to rely instead on regular, periodic inspection of condition. This could be undertaken in conjunction with the physical verification programme.

Risk is also an important consideration in determining appropriate maintenance policies. Risks associated with the operation of the asset in terms of occupational health and safety standards, as well as consequence of failure, need to be considered.

A maintenance strategy is a comprehensive plan that:

- defines the asset, the performance required of it, and the level to which it is to be maintained;
- identifies the risks associated with the chosen strategy in terms of service delivery in the event of asset failure;
- describes the systems (not specifically IT) and procedures to be used to plan and manage the maintenance work;
- specifies the types of maintenance to be carried out (i.e. in-house or outsourced), and why;
- nominates the means of resourcing and implementing maintenance;
- indicates any requirements for in-house spare parts and any specialist equipment needed to maintain certain assets; and
- outlines the projected costs of routine (and corrective/preventive) maintenance and forecasts major replacements for the next 5–10 years, depending on the type of asset.

In developing a maintenance strategy, two considerations are particularly important: the level of maintenance required for the asset and maintenance priorities.

### *Level of maintenance*

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The level of maintenance required for an asset, and the performance expected of it, should be clearly established. The level set should:

- be consistent with the role that the asset will play in the delivery of services, relative to other like assets in the portfolio of the entity;
- reflect obligations for compliance with statutory requirements in terms of occupational health and safety, fire, environmental management and the like;
- be realistically attainable, given the age, condition and expected life of the asset;
- be capable of being achieved within planned resource availability; and
- be agreed upon with the users of the asset.

The level of maintenance should specify the extent to which the performance of the asset is operationally critical and to which visual appearance is important. It should also stipulate the necessary response times in the event of failure.

### *Maintenance priorities*

Higher-priority maintenance tasks are identified in the maintenance strategy. This will enable maintenance efforts to be focused on these areas if resources fall below the planned levels.

Some operational policies will require input in specialist areas, such as from engineers for infrastructure, technology managers for computer equipment, etc. Some of the budgetary requirements will be determined by asset management policies. For example, if the policy is for computer equipment to be replaced every three years, then this should be provided for in the budget in the third year of operation.

The usefulness of an asset depends on how effectively it meets its purpose.

The chosen operation and maintenance policies of the entity have a direct bearing on the useful life of an asset. The correct application and implementation of the policies will also impact on the maintenance of the useful life of the assets. The useful life of assets will be reduced if they are poorly operated and maintained.

Deferring maintenance on an asset is not a healthy practice as it means that the asset will not reach the estimated useful life envisaged on acquisition. In the long run, the cost to the entity in terms of lost economic benefits or backlog in service delivery will exceed the perceived 'saving' in maintenance costs. The cumulative effect of deferred maintenance should be assessed, and the impact on the budget considered, as this will have a significant bearing on the formulation of the asset plans and budgets.

Operation and maintenance plans define the approaches to be used, and what needs to be done, to optimise performance and asset life. The objective of operation and maintenance plans is to ensure that assets remain appropriate to programme requirements; are efficiently utilised; and are maintained in the condition necessary to support programme delivery at the lowest possible long-term cost.

The following is a checklist of what should at least be covered in the operation and maintenance plans:

### *Operation plan:*

- resources required to operate and maintain assets;
- responsibility for, control of, access to, and security of the asset (Logistics Management);
- operating policies (i.e. working hours, security, cleaning, energy management and the like);

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- the level and standard of performance required of the asset;
- arrangements for collecting, monitoring and reporting performance data;
- training staff in use of the asset; and
- estimates of operating costs.

### *Maintenance plan:*

- definition of maintenance standards;
- allowance for the rectification of existing defects;
- description of the work to be carried out; and
- forecast of the necessary maintenance, major repairs and preventative maintenance expenditure for the planning period.

### **9.3.4.4 Maintenance decisions**

A planned approach to maintenance will ensure that the delivery of maintenance services, such as routine inspections, and servicing are undertaken in a manner which minimises disruption to the users of the asset and ensures that maintenance resources are used in the most cost-effective manner.

Planning for asset maintenance enables targeted action to be taken in a timely and cost-effective manner. For many types of assets, this may depend on the regularity and appropriateness of its maintenance. Regular maintenance may also help to preserve an asset's value.

As a first step to planning, the entity must determine which of its assets need to be maintained (i.e. prioritisation in terms of service delivery within a programme). By recognising the decline in asset values through use and obsolescence, management is encouraged to consider the costs of holding and using assets. Under-utilisation will increase the unit cost of programme delivery and may prompt the purchase of new assets when they are not required. Over-utilisation can have adverse effects in terms of deterioration in asset performance and condition, shortening productive life and increasing recurring operating and maintenance costs. Through the above process, management is able to manage those costs, and to make informed decisions, such as outsourcing a service.

### **9.3.5 Disposal phase**

The MFMA (section 14 & 90) and the Municipal Supply Chain Management Regulation no. 27636 have specific requirements regarding the disposal of capital assets.

Specifically:

- An entity may not... “dispose of a capital asset needed to provide the minimum level of basic municipal services”.
- Where an entity has decided that a specific asset is not needed to provide the minimum level of basic services, a transfer of ownership of an asset must be fair, equitable, transparent, competitive and consistent with the entity's supply chain management policy.

Where assets have been identified as under-performing, or no longer functionally suited for basic service-delivery needs, consideration should be given to the possible alternatives to disposal.

A factor to consider is whether utilisation can be increased (for example by adapting the asset to another function or using it in another programme). For assets such as property or large IT installations, consideration could be given to the letting of surplus capacity to other entities.

Enhancement/rehabilitation/upgrade of the asset may also be viable. The cost benefit of such alternatives should be included in the disposal strategy.

Reasonable grounds for determining that a capital asset is not required for the provision of the minimum level of basic entity services may include:

- The asset was acquired specifically for resale or distribution, e.g. investment property or stands held for distribution
- The asset is impaired (in respect of which the asset custodian can provide evidence).
- The entity no longer performs the function for which the asset was purchased.
- It is an immovable asset no longer located close to where the service is required.
- The asset has been replaced.
- The asset no longer performs the required level of service.

Processes should be in place to ensure that:

- under-utilised and under-performing assets are identified as part of a regular, systematic review process;
- the reasons for under-utilisation or poor performance are critically examined, and corrective action taken to remedy the situation or a decision to dispose of the asset is made;
- the analysis of disposal methods takes into consideration the potential market or other intrinsic values; the location and volume of assets to be disposed of; the ability to support other government programmes; and environmental implications;
- regular evaluation of disposal performance is undertaken.

To ensure that a disposal is fair, equitable, transparent and competitive, the following should happen:

- The supply chain management policy should state the mechanism for determining the market value for different types of assets.
- The process should be open to the public and public scrutiny.
- Consideration should be given to the fair market value of the asset and to the economic and community value to be received in exchange for the asset.
- Reasonable efforts should be made to ensure that an appropriately competitive process for disposal is adopted.

The entity will need to know what the expected market price is in order to demonstrate that it has considered the market value of that asset.

### ***Methods of disposal***

There are various methods of disposal. Different disposal methods will be needed for different types of assets. Before deciding on a particular disposal method, the following should be considered:

- the nature of the asset (i.e. a specialised asset or a common item);
- its potential market value;
- other intrinsic value of the asset (i.e. cultural/heritage aspects, etc.);
- its location (with respect to its transportation or access);
- its volume;
- its trade-in price;
- its ability to support wider Government programmes;
- environmental considerations;
- market conditions; and
- the asset's life.

Appropriate means of disposal may include:

- public auction;

- public tender (competitive bidding);
- transfer to another institution;
- sale to another institution;
- letting to another institution;
- trade-in; and
- controlled dumping (for items that have a low value or are unhygienic).

### **9.3.5.1 Assessment of performance/post-disposal review**

The whole-of-life approach to asset management and effective strategic asset planning requires that the outcomes and outputs of each phase of the asset life cycle become inputs to the next planning cycle.

The actual timing and proceeds of the disposal should be compared with the standard established for that specific class in the entity's accounting policies. This makes it possible to confirm that the useful life, estimated proceeds, and therefore the depreciation rates used, are valid. It also provides the opportunity to identify reasons why assets are routinely not meeting the service life expectations or their estimated proceeds on disposal.

A higher-level review also needs to be undertaken at regular intervals to ensure that the Government's disposal goals and aims are being met.

Better practice suggests that, in addition to undertaking the cost-benefit analysis of disposal methods, asset managers be required to compare the actual life on disposal with the expected useful life and to explain significant variations.

The entity must ensure that it implements a proper system of internal controls over disposals to avoid the risk of theft or misappropriation of these assets while waiting for disposal processes to be initiated.

## **10. GOVERNANCE AND INTERNAL CONTROLS**

The control structure within MCLM in relation to asset management is an essential element of good corporate governance and is a necessary precursor to effective implementation of asset management principles.

Internal controls are the systems, processes and procedures established within the entity to ensure that management's plans and intentions are implemented.

The MFMA views proper internal controls from its wider perspective of "sound and sustainable" financial management. In other words, resources are seen to be "utilised effectively, efficiently, economically and transparently" or "maintained to the extent necessary". Therefore the control environment should extend across the whole asset management process.

There are four basic principles for governance over the management of assets:

- Systems of Delegations and Accountability
- Safeguarding and Maintaining
- Planning and Budgeting
- Monitoring and Reporting.

### **10.1 System of delegation and accountability**

#### **10.1.1 Systems of delegation required**

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The entity needs clear and up-to-date systems of delegations and accountability within the administration, and between the administration and the board.

There needs to be clear monitoring and reporting lines between asset managers, senior managers, MM and the board.

### **10.1.2 Principles of delegation**

The MM should delegate the responsibilities (such as asset management) to other officials as envisaged.

#### **10.1.2.1 Typical delegated responsibilities and accountabilities**

Typically, a delegation policy concerning assets will allocate the following types of responsibilities:

**The MM** is responsible for the management of the assets of the entity, including the safeguarding and the maintenance of those assets.

The MM should ensure that:

- the entity has and maintains a management, accounting and information system that accounts for the assets of the entity;
- the entity's assets are valued in accordance with standards of generally recognised accounting practice;
- the entity has and maintains a system of internal control of assets, including an asset register; and
- senior managers and their teams comply with this policy.

**The Chief Finance Officer** is responsible to the MM for ensuring that the financial investment in the entity's assets is safeguarded and maintained.

The CFO, as one of the senior managers of the entity, should also ensure, in exercising his/her financial management responsibilities, that:

- appropriate systems of financial management and internal control are established and carried out diligently;
- the financial and other resources of the entity are utilised effectively, efficiently, economically and transparently;
- any unauthorised, irregular, fruitless or wasteful expenditure and losses resulting from criminal or negligent conduct are prevented;
- all revenue due to the entity is collected, for example rental income relating to assets.
- the systems, processes and registers required to substantiate the financial values of the entity's assets are maintained to standards sufficient to satisfy the requirements of the auditor-general.
- financial processes are established and maintained to ensure that the entity's financial resources are optimally utilised through appropriate asset plans, budgeting, purchasing, maintenance and disposal decisions.
- the MM is appropriately advised on the exercise of powers and duties pertaining to the financial administration of assets;
- the senior managers and senior management teams are appropriately advised on the exercise of their powers and duties pertaining to the financial administration of assets;
- this policy and any supporting procedures or guidelines are established, maintained and effectively communicated.

The CFO may delegate or otherwise assign responsibility for performing these functions but he/she will remain accountable for ensuring these activities are performed.

**Asset managers** should ensure that:

- appropriate systems of physical management and control are established and carried out for all assets;
- the entity's resources assigned to them are utilised effectively, efficiently, economically and transparently;
- proper accounting processes and procedures are implemented in conformity with the entity's financial policies and the MFMA to produce reliable data for inclusion in the entity's asset register;
- any unauthorised, irregular, fruitless or wasteful utilisation and losses resulting from criminal or negligent conduct are prevented;
- the asset management systems, processes and controls can provide an accurate, reliable and up-to-date account of assets under their control;
- they are able to manage the asset plans, budgets, purchasing, maintenance and disposal decisions and justify that they optimally achieve the entity's strategic objectives;
- manage the asset life-cycle transactions to ensure that they comply with the plans and legislative and entity's requirements.

The asset managers may delegate or otherwise assign responsibility for performing these functions, but they will remain accountable for ensuring that these activities are performed.

### **10.1.3 Asset management policies**

A suite of policies covering asset management should be developed, as far as practical and possible, to facilitate internal control of the entire asset management function.

This suite of policies is dependent upon organisational circumstances. These policies would cover the following:

- Delegations Policy
- Supply Chain Management Policy
- Risk Management Policy
- Strategic Planning
- Budget Policy
- Inventory Management Policy
- Expenditure Management Policy
- Revenue and Tariff Policy
- Treasury and Cash Management Policy
- Financial Management Policy
- Internal Audit Policy
- Asset Management Policy (all assets).

### **10.2 Safeguarding and maintaining**

The entity need to ensure that there are proper controls and safeguards to ensure capital assets are protected against improper use, loss, theft, malicious damage or accidental damage. It is also necessary to ensure that capital assets are maintained to the extent necessary for optimal levels of effective, efficient and economical service delivery.

#### **10.2.1 Responsibilities of each asset manager**

The asset manager should have specific responsibilities vis-à-vis entity's assets. These responsibilities should be part of the written systems of delegation.

These responsibilities should include:

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- ensuring that, when acquiring assets, decisions on how to account for the transactions, e.g. whether they should be capitalised or expensed, are made in full compliance with the MFMA and accounting standards.
- ensuring that the purchase of capital assets complies with all the entity's policies and procedures, including the acquisition plans;
- ensuring that the correct date on which an asset is put into service or commissioned is properly recorded in the asset register and that the appropriate financial data are recorded;
- ensuring that all capital assets are duly processed, identified and recorded before issued for use;
- ensuring that all capital assets under the asset manager's control are appropriately safeguarded from inappropriate use or loss, including appropriate control over the physical access to these assets and regular asset verification to ensure losses have not occurred, and ensuring that any known losses are immediately reported to the CFO and loss control officer;
- ensuring that proper procedures for the movement of assets from one user to another, for maintenance, or disposals outside the entity are in place and enforced;
- ensuring capital assets are utilised for the purpose for which they were acquired by the entity.

These responsibilities remain until the asset is disposed of, or transferred to another entity.

### **10.2.1.1 Separation of duties**

Separation of duties is one of the key controls. The entity should separate the ordering, payment and receipting functions. This means that the official responsible for the purchase request, the person paying for the request and the person receipting the goods cannot be the same person.

There should be independent authorisation at every stage of the process.

Capturing and authorisation functions should also be separated.

Proper processes and procedures should be in place to ensure this segregation of duties. For example, assets are ordered by the supply chain function on instruction from the user via the asset manager. These assets may be received at central point into the care of the store man (reporting to the supply chain unit) where the numbers and quality of assets delivered by supplier are checked against the order, signed for and recorded in a goods received register (alternatively the assets could be delivered directly to the user who then notifies the supply chain unit). The asset manager should be notified immediately of the delivery to enable his/her unit to tag, update the asset register with the relevant information, issue the asset to the user and notify finance that the payment function can be initiated. The payment for the asset should not be made by the asset manager or the store man. This should be the function of a separate individual/unit in the CFO's office.

### **10.2.2 Internal controls over asset registers**

Controls around asset registers should be sufficient to provide an accurate, reliable and up-to-date account of assets under the control of the entity.

These controls will also cover access to the asset register to ensure that only authorised recording of all transactions relating to assets takes place.

The asset manager should ensure that the asset register is accurate and complete at all times. This should be tested by performing physical verification tests. Cyclical coverage of assets can vary between types of assets depending on their risk profiles and degree of physical security. Full

physical verification should be performed, as a minimum, at each reporting date. If it is not possible to conduct all verifications at the time of reporting, it would be prudent to confirm the acceptability of a phased programme of verification with the external auditor.

### **10.2.2.1 Validation of the asset register**

Validation of the asset register involves verification to show that the information contained in the register is complete and accurate as at a certain date. Lists of additions, enhancements and disposals should be generated and centrally reviewed for reasonableness. Validation is required on an ongoing basis.

In some cases, there will be some asset movements (additions, enhancements and disposals) between the original valuation and loading of information into the asset register and the reporting date. This information should be maintained and reconciled, and appropriately recorded in the asset register.

### **10.2.2.2 Controls over physical verification of assets**

Planning is the most important procedure in conducting successful asset verification and involves establishing priorities, assigning responsibilities, setting up a problem-resolving mechanism, determining the physical verification method and coordinating all activities. The physical verification date and time is also determined and communicated to all involved.

The asset manager should appoint an asset count supervisor to assist in the planning of the physical asset verification.

The asset count supervisor will be responsible for co-ordination and completion of the physical verification. All issues should be directed to the asset manager for resolution.

Good physical verification procedures:

- Prior identification of all locations at which assets are located.
- Areas to be counted are allocated to teams of counters.
- A systematic approach is taken to ensure a full physical verification (assets should not be omitted or double counted).
- All assets are verified at the same time to ensure no movement takes place to cover irregularities and avoid any double counting or omissions. In the event that verification cannot be performed at the same time, processes are put into place to ensure as little movement of the assets as possible and very strict written authorisation where movements are required.
- Before physical verification commences counters should be given written instructions on the verification procedures. Verbal instructions are given to reinforce the written instructions and to ensure that the counters understand the procedures, know what is required and are familiar with follow-up procedures for resolving variances.
- The instructions clearly delineate the roles and responsibilities of all involved in the physical verification process. A practice asset verification session to illustrate the procedures may be helpful for those who have not previously participated in a physical count.
- Responsibility for the control of the physical verification rests with the asset count supervisor. The supervisor oversees the process to ensure that counting is carried out and that counters are following the procedures laid down.
- The asset count supervisor, together with the asset manager, secures (in advance to ensure availability) staff (other than members of the Asset Management Team (AMT)) to participate in the physical verification procedure as well as independent observers (individuals not ordinarily involved in asset management, for example the internal auditors).

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- The master listing of assets should be available for verification and includes the following information:
  - Asset number;
  - Description;
  - Serial number/Identification number;
  - Last known location;
  - Custodian;
  - Space for condition assessment.
- On the day prior to the physical verification procedure, the responsible AMT member verifies that:
  - all assets received on the day are entered into the system and, where applicable, a barcode label affixed;
  - all movements in the assets under their control throughout the period of review are updated and fully accounted for on the system, and that barcode labels are affixed.
- On the day of the count:
  - staff conducting the physical verification:-
    - are assigned areas to count;
    - are provided with the master listing of the assets;
    - verify the assets within the assigned areas, taking care to identify the assets correctly;
    - mark assets/attractive items once they have been counted to ensure they are only counted once;
    - investigate discrepancies as directed by the supervisor and recount assets as requested;
    - ensure that all items within their assigned area are included in the verification and assess the condition of the asset as per the basic condition parameters, and should mark the verification sheet where the asset manager needs to assess and determine whether the asset should be maintained or replaced.
  - the asset count supervisor ensures that:-
    - variances are investigated;
    - any proposed adjustments are approved by him/herself and the asset manager;
    - all the steps in the physical verification process, including counts, investigations of variances, are adequately documented; and,
    - prior to the commencement of the count, that:-
      - ❖ the master listing has been received and signed for by a team leader;
      - ❖ stationery is available for counters (clipboards, pens, etc.);
      - ❖ all the necessary preparations for the production of variance reports have been finalised.
  - the accuracy of all master-listing details is confirmed by the counters during verification, e.g. asset number, location, area, serial number, etc. by the counter/count teams. A tick is used to indicate that an asset has been verified.
  - during the physical verification, those supervising the count check that all assets have been marked as verified and follow up with the count team if assets are not marked.
  - where scanners are used:
    - all teams are issued with scanners;
    - once all items in a selected area have been scanned, the scanner is taken to the designated person for downloading and recording on the plan;
    - a report of items recorded by the scanner is printed;
    - any barcodes not recognised by the scanner are printed in an exception report and followed up.

- the team leader responsible for the verification procedure is required to make a manual note of all assets not recorded by the barcode scanner.
- variances are investigated by re-counting the assets and verifying the records of receipts and deliveries to ensure that no counting or cut-off errors have occurred.
- the supervisor evaluates the progress of the physical verification and any adjustments made in the prearranged procedures are documented.
- in the event of assets not found after double checking, the loss control policy and procedures of the entity are followed. For example, this includes a written statement from the custodian responsible for the asset.
- the loss control should provide for the asset manager to be notified of a possible claim so that further action may be taken as is deemed necessary.
- the responsible team leader should sign the count sheet, together with the count supervisor, to indicate that he/she is satisfied that the asset count was properly conducted and that the results are true and accurate.
- Subsequent to the verification:
  - authorisation for write-off or disposals should be obtained from the CFO.
  - the necessary approved adjustments should be recorded by the asset manager in the asset register.
  - barcode labels should be affixed to assets that were not previously on the master list, and steps are taken to ensure the asset register is updated with this information.
  - detailed reports on the planned physical verification as well as performance reports relating to random physical verification should be submitted to the CFO.
  - the asset manager should evaluate the physical verification procedures applied and determine how these procedures may be modified to improve the next count.

All documentation relating to the verification should be filed securely and be available for audit purposes.

Potential risk of non-compliance with procedures or lack of procedures:

- Inaccurate physical verification procedures could render the verification results unreliable.
- Missing assets could be left undetected.
- Without physical verification procedures when the custody of assets changes, misappropriation of assets could be left undetected. Such a situation could also result in the entity significantly postponing or losing its right to collect damages.
- The audit trail of transferred assets could be lost.
- Obsolete or redundant assets could continue to be recorded in the asset register.

During the course of the year, for quality control purposes, the AMT should undertake sample physical asset verification based on clear criteria. The sample should focus on areas of high risk, e.g. where there has in the past been a high incidence of accidental or deliberate loss owing to the portability, attractiveness and high value of items.

### **10.3 Insurance of Assets**

The MM must ensure that all movable assets are insured at least against fire and theft, and entity's buildings and infrastructure are insured at least against fire and allied perils.

The MM shall recommend, after consultation with the CFO, the basis of insurance cover to be applied: either the carrying value or the replacement value of the assets. Such a recommendation shall take due cognizance of the budgetary resources of the municipality.

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Any theft, loss or damage to an asset should immediately be reported to entity's insurance brokers by the relevant head of department under whose responsibility the asset falls. A copy of the insurance claim submitted should be forwarded to the CFO. All insurance claims must be recorded in an insurance register and all outstanding insurance claims reported on a monthly basis to the CFO. It is the responsibility of the relevant head of department to ensure that all documents/information for the completion of the claim is forwarded to entity's insurance brokers and that copies thereof is forwarded to the CFO. The head of department should in writing request the replacement of the asset which can only be authorized, if sufficient provision for the replacement of the asset is on the capital budget, by the MM after consultation with the CFO. If sufficient provision is not on the capital budget, the asset can only be replaced if provision for the replacement is made on an adjustments budget. In the case where an asset must be replaced as an emergency measure, the MM may authorise such expenditure, subject to compliance with relevant legislation and regulations.

Third-party (insurance) pay-outs must be treated as revenue when the amount is certain, and may not be offset against the cost of replacing the item. The carrying value of items lost, stolen or damaged beyond repair must be treated as impairment against the relevant department or vote. The full cost of the replacement item must then be capitalised.

If the entity operates a self-insurance reserve, the CFO shall annually determine the premiums payable by the departments or votes after having received a list of the assets and insurable values of all relevant assets from the heads of departments concerned.

The MM shall recommend to the board of directors of the entity, after consulting with the CFO, the basis of the insurance to be applied to each type of asset: either the carrying value or the replacement value of the assets concerned. Such recommendation shall take due cognisance of the budgetary resources of the entity.

The CFO shall annually submit a report to the board of directors of the entity on any reinsurance cover which it is deemed necessary to procure for the entity's self-insurance reserve.

### **10.4 Planning and budgeting**

The entity should plan for the level of service they have chosen to deliver and how they need to apply the available funding to maintain and expand those services where necessary. This should include service delivery options and funding alternatives.

The decisions taken should be followed through by the drawing up of asset management plans. The asset management plans, for example, will inform the maintenance budget (planned maintenance as well as a possible percentage built in for unforeseen circumstances based on experiences in prior years).

### **10.5 Monitoring and reporting**

The entity needs to monitor the implementation, as expected, of the service delivery plans and budgets. The entity also needs to report on implementation progress to stakeholders. The MFMA and associated regulations prescribe specific reporting requirements. MFMA circulars and other guidelines provide more explanation on how these requirements should be met and implemented.

The asset manager is responsible for preparing monthly, quarterly, and other reports measuring the implementation progress and deadlines against that of the plan. These reports should be given to the CFO for his authorisation and for inclusion in the formal reports. It is suggested that service performance of capital assets, as well as financial aspects extracted from the asset register, be reported on in the same cycle and also be given to the CFO for his authorisation and for inclusion in

the formal reports. The annual report of the entity should contain information on the performance of capital assets and status of asset management during the year under review.

### 11. ASSET REGISTER

An asset register is a complete and accurate database of the assets that is under the control of the entity and that is regularly updated and validated. An adequate asset register is integral to effective asset management. It is the basis of an asset management information system and should contain relevant data beyond that required for financial reporting.

The asset register provides important information required for effective management of the assets as well as the detail of the figures disclosed in the annual financial statements. This register enables the entity to maintain sufficient, appropriate audit evidence. It stores information on each asset, which includes amongst others the cost price, date acquired, location, asset condition and expected life. It can also include information on current replacement costs. All assets owned and controlled by MCLM must be recorded in an asset register, regardless of the funding source or value thereof. All disposed assets must be excluded.

In its simplest form, an asset register may be a manual document or a spreadsheet. Alternatively, it can be a computerised system that interfaces directly with the general ledger (modern computerised accounting systems have this facility). An asset register does not have to be a single computerised system or document. It can also be a series of subsystems with linkages and a common directory. The design of an asset register will, to a large extent, be influenced by the content of existing asset management systems and databases, but should contain sufficient information for effective management. Where this is not the case, processes should be put in place to ensure that the missing information is collected and documented to enable reporting.

#### 11.1 Creation of the asset register

##### ***Information to be Included in the Asset Register***

The type of information required in an asset register should include information on the following aspects, as far as practical and possible:

- Identification & Location – What and where is this asset, and who does it serve?
- Accountability – Who is accountable and how it is being safeguarded?
- Performance – What is its intended and actual level of service?
- Accounting – How is it accounted for? This should include:
  - historical cost;
  - depreciation;
  - carrying value;
  - valuation basis;
  - depreciation parameters;
  - Impairments.
- Management & Risk – How is it managed? How critical is it? This should include some maintenance, engineering and operational data and may be summarised from sub-systems.
- Acquisition and disposal – Transactional source (Audit Trail). This should include:
  - date;
  - amount;
  - proceeds received; and
  - reason for disposal

##### **Acquisition**

- Transaction Date

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- Amount
- Supplier / Contractor
- Reference (invoice/contract/payment/order number).

### Identification

- Asset class: should facilitate GRAP financial reporting requirements, e.g. PPE, investment property, intangible asset, etc.
  - Asset sub-class: should facilitate management and reporting, e.g. motor vehicle, furniture, road infrastructure, etc.
  - Asset functional group (if relevant): e.g. warehouse, hall.
- Parent asset or standalone asset: if parent then must have links to separately depreciable parts.
  - For separately depreciable parts: link to parent asset.
- Asset number: a unique system-generated identifier, bar code or other unique number so that the individual asset can be distinguished from others.
- Asset specific identifiers (where applicable): e.g. serial numbers, registration number, erf number.
- Asset description: e.g. 2005 Toyota Corolla 140i, brown wooden six-seater boardroom table, etc.
  - Asset dimensions/capacity (if relevant): e.g. 200 litre (tank), 4000 sq metre (building/land)
  - Asset construction (if relevant): e.g. brick, wood, cast iron
- Location: e.g. Office 123, Store Abc, Erf. Xyz
  - Zoning: residential, agricultural, industrial, etc.
  - GPS: recommended for easy location (where relevant).

### Accountability

- Department / division:
  - Section / unit
  - Sub-section
  - Cost centre
- Custodian: e.g. user of the asset or person responsible for safeguarding the asset in his/her possession: for laptop, custodian is Mr Jones (Financial Manager).
- Restrictions (if any) in use or changing of an asset
- Ownership (if legal title is not with the entity)
- Licence or permits
- Transfers: (to record date and transferor)
- Carrying amounts.

### Performance

- Capacity (where relevant), e.g. 2 tonne, 2000 sq metres, 200 ml/day
- Performance measures (where relevant)
- Condition Assessment (date, rating, person doing assessment, file no – for details)
- Warranties, guaranties or certification
- Useful life: e.g. years/hours/units/mileage, etc. of expected use
- Residual value: to be evaluated annually.

### Disposal

- Date
- Amount: proceeds received

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- Capacity: at date of disposal
- Condition: e.g. good, fair, bad, etc.
- Remaining useful: if sold earlier than originally planned
- Residual value: to compare with proceeds
- Reason for disposal
- Gain/loss on disposal.

### Accounting

- Historical cost (or fair value where cost not available for initial recognition)
- Funding source
- Useful life: (original)
- Remaining useful life: (assessed, date of assessment)
- Residual value: (original, assessed and date of assessment)
- Depreciation method: (straight line, sum of units, diminishing balance, etc.)
- Revaluation: (amount, date, method, by whom): if revaluation model adopted by entity, should continue revaluing for subsequent measurement.
- Impairment. (amount, date assessed)
- Depreciation: value and rate: current year
- Accumulated depreciation: life to date
- Carrying amount
- Disposal (where relevant): (date, realised amount, details on disposal, resolution).

### Management and risk information

- Criticality rating: prioritisation in terms of service delivery within a programme
  - Service type: e.g. Administration, Water, Electricity
- Maintenance history: (summarised from maintenance systems)
- Operational history: (summarised from maintenance systems)
- Risk assessment: (may reference other documentation)
- The GL accounts relating to the asset

### 11.2 Condition assessment

The regular assessment of the condition and performance of all the tangible capital assets allows the entity to determine the ability of tangible capital assets to continue to perform and provide services into the future.

While condition assessments for specialised assets like infrastructure would generally be an engineering function, the entity can also establish basic performance and benchmarking indicators that will assist in the process. For example:

- Keeping historical information on sewer failure could be used to predict when replacements might be needed. This can also be done for motor vehicles and other capital assets.
- Analysing the quality of water treated compared to the quality of water needed can provide a useful indicator of the condition of the treatment plant to provide sufficient treated water, as can:
  - reviewing estimated life-cycle costs and comparing them to the actual amounts spent on infrastructure maintenance and replacement.

Condition assessments can become very sophisticated and expensive, and should be part of risk management and performance management. More sophisticated techniques can be developed over time as the experience and skills within the entity increase.

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Condition data can be used to predict the timing of remedial action or asset replacement. As time goes by, predictions will become more accurate as more information becomes available.

A condition assessment can be conducted using a top down approach based upon staff knowledge, maintenance records, customer complaints and performance records. A physical check can also be conducted whenever routine maintenance is done. This will facilitate updated condition information and save time as it will eliminate a second visit. Information collected on the condition should be recorded in the asset register and updated in the strategic plans where necessary.

The condition assessment will vary depending upon the class of capital asset being assessed and the asset management policy pertaining to that class. For example, furniture (chairs) will be considered operational until returned to the store because they are broken. Complex tangible capital assets like buildings and other infrastructure will require a more appropriate asset management policy to ensure a more robust assessment process and criteria. This again will vary between assets.

The following rating scales must be used to assess the condition of assets:

### Condition rating table for Infrastructure assets, as well as Plant and Machinery

Grade Estimated	Description	Detailed Description	Remaining Life
1	Excellent	New or as good as new with no deterioration. Continue with planned maintenance.	96%-100% (Average of 98%) of Estimated/Expected Useful Life
2	Very Good	Sound structure or appearance, well maintained. Only normal planned maintenance required.	71%-95% (Average of 83%) of Estimated/Expected Useful Life
3	Good	Performance acceptable/serves needs but with minor deterioration (less than 5% deterioration). Normal planned maintenance, as well as minor additional maintenance, required.	51%-70% (Average of 61%) of Estimated/Expected Useful Life
4	Fairly	Marginal, clearly evident deterioration (greater than 5% up to 20% deterioration). Significant maintenance required.	36%-50% (Average of 43%) of Estimated/Expected Useful Life
5	Fairly Poor	Clearly evident deterioration (greater than 20% up to 35% deterioration). Significant maintenance required.	23%-35% (Average of 29%) of Estimated/Expected Useful Life
6	Poor	Significant deterioration in structure and/or appearance (greater than 35% up to 50% deterioration). Significant deterioration of performance/functionality. Significant renewal/upgrade required.	11%-22% (Average of 17%) of Estimated/Expected Useful Life
7	Very Poor	Unsound, does not perform. Strongly consider reconstruction or replacement (greater than 50% up to 70% needs replacement).	6%-10% (Average of 8%) of Estimated/Expected Useful Life

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Grade Estimated	Description	Detailed Description	Remaining Life
8	Condemned	Failed needs. Should be condemned (greater than 70% needs replacement). Reconstruction or replacement required.	0%-5% (Average of 3%) of Estimated/Expected Useful Life

## Condition rating table for other assets

Grade Estimated	Description	Detailed Description	Remaining Life
1	Excellent	New or as good as new with <b>Minor to No</b> deterioration. Sound structure or appearance.	71%-100% (Average of 86%) of Estimated/Expected Useful Life
2	Fair	Performance acceptable/serves needs but with deterioration varying between <b>Minor deterioration</b> and <b>Marginal deterioration</b> .	46%-70% (Average of 58%) of Estimated/Expected Useful Life
3	Poor	Deterioration varying between <b>Marginal deterioration</b> and <b>Significant deterioration in structure and/or appearance</b> .	21%-45% (Average of 33%) of Estimated/Expected Useful Life
4	Very poor	Condition varying between <b>Unsound, does not perform</b> (strongly consider reconstruction or replacement) and <b>Failed needs</b> (should be condemned). Scrapping expected within next 18 months.	0%-20% (Average of 10%) of Estimated/Expected Useful Life

The entity must have clearly defined risk-based parameters and asset management processes must have been developed and be in operation. The basic asset management processes that should be operational include:

- complete asset registers with appropriately defined capital asset classes;
- performance measurement processes implemented;
- maintenance expenditure and events recorded for the capital assets;
- strategic plans drafted for the medium term;
- asset criticality analysis conducted;
- risk management plans for the capital assets developed; and
- acquisition, operation and maintenance, and disposal plans developed based upon the information in the asset register.

It is important to bear in mind that the benefits of conducting the condition assessment should outweigh the costs of conducting this assessment. For unreasonably expensive condition assessments, alternative approaches should be considered so that the entity is able to justify the costs while still having fairly reliable information to act upon.

### 11.3 System linkages and interfaces

Key issues in the design and development of an asset register are:

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- Should it be integrated with the general ledger/other systems?
- What information does it need to contain?

The asset register should not operate in isolation of other financial or management systems. It is an integral component of the financial management system and should be closely coupled to the general ledger to facilitate reporting.

The particular architecture of the entity's information systems will depend upon the organisational structure, information system development and asset management demands.

Where the asset register is not integrated with the general ledger and other systems, information from the asset register needs to be periodically transferred (using a manual or computerised interface) into the general ledger for the preparation of the financial statements and other system for management purposes.

If the asset register is integrated with the general ledger, the opening and closing balance information will automatically flow through into the general ledger, also creating automatic journal entries for depreciation.

Integration of the asset register with other systems has clear advantages. For example, integration of the asset register with the purchasing, capital planning, preventative maintenance, accounts payable (to capture acquisitions) and general ledger systems will:

- minimise manual intervention;
- reduce the possibility of corruption of data or error;
- reduce the number of reconciliations required;
- prevent duplicate data entries and processing; and
- allow journals for depreciation and asset revaluations to be automatically generated.

When designing a new system, it is preferable to integrate/interface the asset management system with the general ledger and other systems. If the entity is considering a completely new IT network management system (i.e. general ledger, asset management and other systems such as project management, HR, etc.), it should consider a central database. This will facilitate access by all relevant people to the same information and reduce the risk of errors.

During the initial stages of implementation of an asset register, the entity may be constrained by the nature of existing systems and the time and cost to redesign or replace those systems. Manual or computer interfaces between existing systems and the general ledger will be required. Such interfaces are potential sources of errors, not least of these being the possibility that not all data on assets may be transferred. Careful design, training and testing are required to avoid such interface problems.

The asset management system should contain operational and financial management and reporting information. The asset management system should cover the fields as discussed earlier in this document. This will enable the entity to develop a comprehensive asset register that will facilitate the financial and operational management of assets.

Additional systems may be required in the management of specific asset classes, e.g. fleet management, lease management, property management, etc. The existence of these systems does not exclude these assets from the asset register, but will provide additional information. All capital assets must be recorded in an asset register. Ideally, in an integrated environment, the asset register should be linked to and accessible from a range of information systems, such as a geographic information system, document management systems and image databases.

Technical data from asset operation, maintenance and management systems should be passed to the asset register using a prescribed set of accounting rules and data definitions, making this information accessible to the asset manager from the asset register for the efficient and effective management of assets. Any system that provides information upon which management decisions are made must be subjected to a high level of internal controls to ensure data integrity.

## **12.RELEVANT DOCUMENTS RELATING TO MCLM CAPITAL ASSET MANAGEMENT**

### **12.1 Transfer of capital assets**

Assets transferred from one location to another must be accompanied by a transfer document (Annexure A). Such transfer document must be completed and signed by both the sender and the recipient, before being passed on to the Financial Department to update the register.

### **12.2 Procurement and Maintenance of capital assets**

Any proposed expenditure to procure or maintain Fixed Assets must be put forward on an Asset Expenditure Requisition (Annexure B) and is subject to the approval of the Capital Expenditure Committee. The Finance Manager will consider the financial aspects of the requisition before approval, and may reclassify proposed capital expenditure as maintenance expenditure, or vice versa. The procurement procedure should be followed as per the Supply Chain Management Policy

#### *Preparation of Capital Expenditure Requisitions*

An Asset Expenditure Requisition, as detailed in Annexure B, must be completed in full and contain sufficient information and financial justification for consideration by the Financial Manager. The following additional information could be presented, if required:

- Cash flows.
- Overhead costs.
- Cost savings.
- Potential sales.
- Potential service improvements.
- Legal requirements in terms of the Safety and Water Acts

### **12.3 Asset Expenditure Document Flow**

The document flow for proposed Asset Expenditure Requisitions is flowcharted in Annexure C.

### **12.4 Retirement and Disposal of Fixed Assets**

**Note:** This should be read together with MCLM Financial Policy: Policy for the disposal of assets and equipment.

The proposed retirement or disposal of an asset must be put forward on a Scrap Note. (Annexure D and Flow Chart on Annexure E). The scrapping of an asset is subject to the approval of the relevant District Manager, or Executive Manager or the Computer Committee (Refer to the Scrapping of assets and equipment policy). The disposal procedure as per MCLM's Supply Chain Management Policy should be followed. Section 90 of the Municipal Finance Management Act 56 of 2003 state the following:

#### ***Disposal of capital assets***

(1) A municipal entity may not transfer ownership as a result of a sale or other transaction or otherwise dispose of a capital asset needed to provide the minimum level of basic municipal services.

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- (2) A municipal entity may transfer ownership or otherwise dispose of a capital asset other than an asset contemplated in subsection (1), but only after the council of its parent municipality, in a meeting open to the public—
- (a) has decided on reasonable grounds that the asset is not needed to provide the minimum level of basic municipal services; and
  - (b) has considered the fair market value of the asset and the economic and community value to be received in exchange for the asset.
- (3) A decision by a municipal council that a specific capital asset is not needed to provide the minimum level of basic municipal services may not be reversed by the municipality or municipal entity after that asset has been sold, transferred or otherwise disposed of.
- (4) A municipal council may delegate to the accounting officer of a municipal entity its power to make the determinations referred to in subsection (2) (a) and (b) in respect of movable capital assets of the entity below a value determined by the council.
- (5) Any transfer of ownership of a capital asset in terms of subsection (2) or (4) must be fair, equitable, transparent and competitive and consistent with the supply chain management policy which the municipal entity must have and maintain in terms of section 111.
- (6) This section does not apply to the transfer of a capital asset to a municipality or another municipal entity or to a national or provincial organ of state in circumstances and in respect of categories of assets approved by the National Treasury provided that such transfers are in accordance with a prescribed framework.

### **Accident / Stolen Assets**

The Scrap Note should have Police case No., together with the insurance claim forms and claims number. All these documents should be signed

### **12.5 Infrastructure Asset Hierarchy and EUL , as well as Other Capital Assets EUL**

The Infrastructure Asset Hierarchy and EUL, as well as Other Capital Assets EUL, are contained in Annexure F. This is the hierarchy and EULs used to establish the appropriate level and section where a specific asset, component and sub-component should be added and managed in the FAR.

## **13. ACCOUNTING POLICY**

### **13.1 Property, plant and equipment**

#### **INITIAL RECOGNITION**

Property, plant and equipment are tangible non-current assets (including infrastructure assets) that are held for use in the production or supply of goods or services, rental to others, or for administrative purposes, and are expected to be used during more than one year. Items of property, plant and equipment are initially recognised as assets on acquisition date and are initially recorded at cost. The cost of an item of property, plant and equipment is the purchase price and other costs attributable to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by the municipality. Trade discounts and rebates are deducted in arriving at the cost. The cost also includes the necessary costs of dismantling and removing the asset and restoring the site on which it is located.

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

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

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When significant components of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. Items such as spare parts, standby equipment and servicing equipment are recognised when they meet the definition of property, plant and equipment.

Where an asset is acquired by the municipality for no or nominal consideration (i.e. a non-exchange transaction), the cost is deemed to be equal to the fair value of that asset on the date acquired.

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

### **SUBSEQUENT MEASUREMENT - COST MODEL**

Subsequent to initial recognition, items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. Land is not depreciated as it is deemed to have an indefinite useful life. Where the municipality replaces parts of an asset, it derecognises the part of the asset being replaced and capitalises the new component. Subsequent expenditure incurred on an asset is capitalised when it increases the capacity or future economic benefits associated with the asset and the cost or fair value of the item can be measured reliably.

### **DEPRECIATION AND IMPAIRMENT**

Depreciation is calculated on the depreciable amount, using the straight-line method over the estimated useful lives of the assets. Components of assets that are significant in relation to the whole asset and that have different useful lives are depreciated separately. The annual depreciation rates are based on the following estimated average asset lives:

#### **Infrastructure Other**

Roads and Paving 30 Years

Buildings 30 Years

Pedestrian Malls 30 Years

Specialist vehicles 6 - 10 Years

Electricity 20 - 45 Years

Other vehicles 5 Years

Water 15 - 25 Years

Office equipment 3 - 7 Years

Sewerage 15 - 20 Years

Furniture and fittings 7 Years

#### **Community**

Bins and containers 10 Years

Plant and equipment 2 - 15 Years

Buildings 30 Years

Landfill sites 15 Years

Recreational Facilities 20 - 30 Years

Security 5 Years

Emergency equipment 5 Years

Halls 30 Years

Computer equipment 5 Years

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Libraries 30 Years  
Library Material 8 Years  
Parks and gardens 30 Years  
Land Indefinite  
Other assets 5 Years

### **Finance lease assets**

Office equipment 3 - 6 Years  
Other assets 5 Years

The residual value, the useful life of an asset and the depreciation method is reviewed annually and any changes are recognised as a change in accounting estimate in the Statement of Financial Performance. The municipality tests for impairment where there is an indication that an asset may be impaired. An assessment of whether there is an indication of possible impairment is done at each reporting date. Where the carrying amount of an item of property, plant and equipment is greater than the estimated recoverable amount (or recoverable service amount), it is written down immediately to its recoverable amount (or recoverable service amount) and an impairment loss is charged to the Statement of Financial Performance.

### **DERECOGNITION**

Items of Property, plant and equipment are derecognised when the asset is disposed of or when there are no further economic benefits or service potential expected from the use of the asset. 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 value and is recognised in the Statement of Financial Performance.

### **13.2 Intangible assets**

An asset is identified as an intangible asset when it:

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

An intangible asset is recognised when:

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

Intangible assets are initially recognised at cost. An intangible asset acquired through a non-exchange transaction, the cost shall be its fair value as at the date of acquisition. Expenditure on research (or on the research phase of an internal project) is recognised as an expense when it is incurred.

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

- it is technically feasible to complete the asset so that it will be available for use or sale.

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

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

The amortisation period and the amortisation method for intangible assets are reviewed at each reporting date. Reassessing the useful life of an intangible asset with a finite useful life after it was classified as indefinite is an indicator that the asset may be impaired. As a result the asset is tested for impairment and the remaining carrying amount is amortised over its useful life.

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

### **INITIAL RECOGNITION**

Internally generated intangible assets are subject to strict recognition criteria before they are capitalised. Research expenditure is never capitalised, while development expenditure is only capitalised to the extent that:

- the municipality intends to complete the intangible asset for use or sale;
- it is technically feasible to complete the intangible asset;
- the municipality has the resources to complete the project; and
- it is probable that the municipality will receive future economic benefits or service potential.

Intangible assets are initially recognised at cost. Where an intangible asset is acquired by the municipality for no or nominal consideration (i.e. a non-exchange transaction), the cost is deemed to be equal to the fair value of that asset on the date acquired.

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

### **SUBSEQUENT MEASUREMENT - COST MODEL**

Intangible assets are subsequently carried at cost less accumulated amortisation and impairments. The cost of an intangible asset is amortised over the useful life where that useful life is finite. Where the useful life is indefinite, the asset is not amortised but is subject to an annual impairment test.

### **AMORTISATION AND IMPAIRMENT**

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Amortisation is charged so as to write off the cost or valuation of intangible assets over their estimated useful lives using the straight line method. The annual amortisation rates are based on the following estimated average asset lives:

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

Computer software 3 - 10 years

The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at each reporting date and any changes are recognised as a change in accounting estimate in the Statement of Financial Performance. The municipality tests intangible assets with finite useful lives for impairment where there is an indication that an asset may be impaired. An assessment of whether there is an indication of possible impairment is done at each reporting date. Where the carrying amount of an item of an intangible asset is greater than the estimated recoverable amount (or recoverable service amount), it is written down immediately to its recoverable amount (or recoverable service amount) and an impairment loss is charged to the Statement of Financial Performance.

### **DERECOGNITION**

Intangible assets are derecognised when the asset is disposed of or when there are no further economic benefits or service potential expected from the use of the asset. The gain or loss arising from the derecognition of an intangible asset is included in surplus or deficit when the asset is derecognised.

### **Heritage assets**

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

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

Class of heritage assets means a grouping of heritage assets of a similar nature or function in an municipality's operations that is shown as a single item for the purpose of disclosure in the annual financial statements. Heritage assets at the municipality are primarily art work.

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 Standards of GRAP.

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

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

Heritage assets are assets that have a cultural, environmental, historical, natural, scientific, technological or artistic significance and are held indefinitely for the benefit of present and future generations. An impairment loss of a cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable amount.

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An impairment loss of a non-cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable service amount.

An inalienable item is an asset that an municipality is required by law or otherwise to retain indefinitely and cannot be disposed of without consent.

Recoverable amount is the higher of a cash-generating asset's net selling price and its value in use.

Recoverable service amount is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use.

Value in use of a cash-generating asset is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

Value in use of a non-cash-generating asset is the present value of the asset's remaining service potential.

### **Recognition**

The municipality recognises a heritage asset as an asset if it is probable that future economic benefits or service potential associated with the asset will flow to the municipality, and the cost or fair value of the asset can be measured reliably.

### **Initial measurement**

Heritage assets are measured at cost. Where a heritage asset is acquired through a non-exchange transaction, its cost is measured at its fair value as at the date of acquisition.

### **Subsequent measurement**

After recognition as an asset, a class of heritage assets is carried at its cost less any accumulated impairment losses. After recognition as an asset, a class of heritage assets, whose fair value can be measured reliably, is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent impairment losses.

If a heritage asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to a revaluation surplus. However, the increase is recognised in surplus or deficit to the extent that it reverses a revaluation decrease of the same heritage asset previously recognised in surplus or deficit.

If a heritage asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised in surplus or deficit. However, the decrease is debited directly to a revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that heritage asset.

### **Impairment**

The municipality assess at each reporting date whether there is an indication that it may be impaired. If any such indication exists, the municipality estimates the recoverable amount or the recoverable service amount of the heritage asset.

### **Transfers**

Transfers from heritage assets are only made when the particular asset no longer meets the definition of a heritage asset. Transfers to heritage assets are only made when the asset meets the definition of a heritage asset.

### **Derecognition**

The municipality derecognises heritage asset on disposal, or when no future economic benefits or service potential are expected from its use or disposal.

The gain or loss arising from the derecognition of an intangible asset is included in surplus or deficit when the asset is derecognised.

### **13.3 Impairment**

Cash-generating assets are assets managed with the objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Non-cash-generating assets are assets other than cash-generating assets.

Impairment is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation (amortisation).

The entity classifies all assets held with the primary objective of generating a commercial return as cash-generating assets. All other assets are classified as non-cash-generating assets.

When the carrying amount of a cash-generating asset exceeds its recoverable amount or when the carrying amount of a non-cash-generating asset exceeds its recoverable service amount, it is impaired.

The entity assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists the entity estimates the recoverable amount or the recoverable service amount of the asset.

Irrespective of whether there is any indication of impairment, the entity also assesses an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable or recoverable service amount. This impairment test is performed at the same time every year. If an intangible asset was initially recognised during the current reporting period, that intangible asset was tested for impairment before the end of the current reporting period.

Value in use of a cash-generating asset is the present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life. Value in use of non-cash-generating assets is the present value of the non-cash-generating assets remaining service potential.

When estimating the value in use of a cash-generating asset, the entity estimates the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal and the entity applies the appropriate discount rate to those future cash flows. The present value of the remaining service potential of a non-cash-generating asset is determined using the most appropriate of the following approaches:

# Merafong City Local Municipality

## Capital Asset Management Policy

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- Depreciated replacement cost approach;
- Restoration cost approach;
- Service units approach

If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount or recoverable service amount. This reduction is an impairment loss.

An impairment loss is recognised immediately in surplus or deficit.

When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, the entity recognises a liability only to the extent that is a requirement in the Standard of GRAP.

After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

The entity assesses at each reporting date whether there is any indication that an impairment loss recognised in prior periods for an asset may no longer exist or may have decreased. If any such indication exists, the entity estimates the recoverable amount or recoverable service amount of that asset.

An impairment loss recognised in prior periods for an asset is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. The carrying amount of the asset is increased to its recoverable amount. The increase is a reversal of an impairment loss. The increased carrying amount of an asset attributable to a reversal of an impairment loss does not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised for the asset in prior periods.

A reversal of an impairment loss for a cash-generating asset is recognised immediately in surplus or deficit.

After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

The redesignation of assets from a cash-generating asset to a non-cash-generating asset or from a non-cash-generating asset to a cash-generating asset only occurs when there is clear evidence that such a redesignation is appropriate.

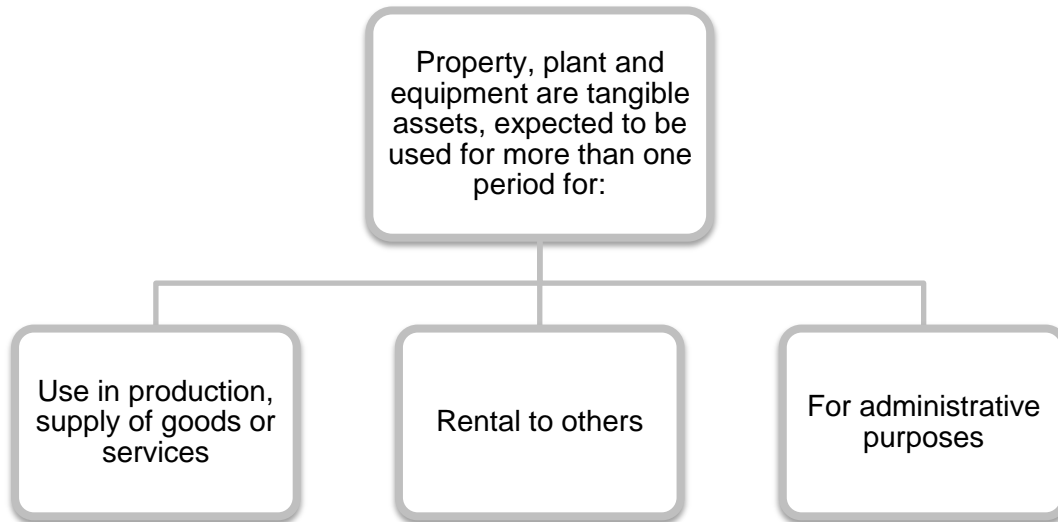
### **13.4 Fully depreciated assets still in use**

If the entity made an appropriate estimate of the useful lives, residual values and depreciation method of an asset based on the information available at the previous reporting dates, it continues to measure the assets at R0.

Where the entity did not appropriately review the useful life, residual values and depreciation and amortisation method in accordance with GRAP 17 and GRAP 31, and the asset is fully depreciated or amortised, but still being used, this constitutes a prior period error. The error is corrected and disclosed in accordance with the requirements of GRAP 3.

### 13.5 Summary of key principles

#### Identification (Property, plant and equipment)



#### Identification (Intangible assets)

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

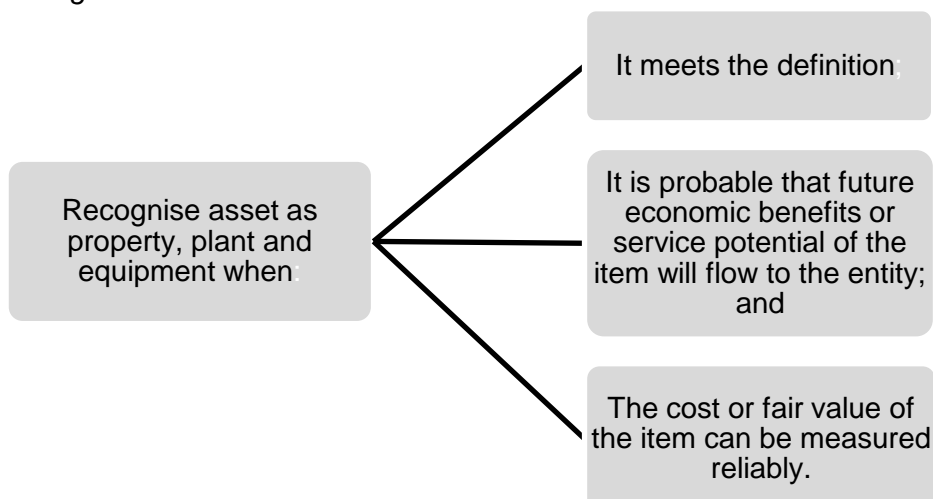
An asset meets the identifiable criterion when it is separable, i.e. capable of being sold, transferred, etc. or arises from contractual rights (including binding arrangements) or other legal rights (excluding rights granted by statute), regardless of whether those rights are transferable or separable.

Only software that is not an integral part of the related hardware can be classified as intangible assets.

#### Recognition (Property, plant and equipment)

Property, plant and equipment are recognised when they meet the definition and recognition criteria in GRAP 17.

##### *Initial recognition criteria*



### *Subsequent costs*

All costs incurred subsequently to add to, replace part of, or service any asset are recognised to the carrying amount of the related asset if the recognition criteria are met.

### **Recognition (Intangible assets)**

Intangible assets are recognised when the assets meet the definition and recognition criteria of an intangible asset. Otherwise the expenditure incurred is recognised as an expense in surplus or deficit.

Only costs incurred under the development stage can be capitalised if it meet the specific recognition criteria, over and above the general recognition criteria.

Without ignoring the general recognition criteria, costs incurred to develop a website, can only be capitalised if an entity can demonstrate that future probable economic benefits or service potential will arise as a result from the website.

### **Measurement (Property, plant and equipment)**

Assets are initially measured at cost or fair value (if acquired for no cost or for nominal consideration).

Other costs incurred which typically can be included in the cost of the asset are, restoration and rehabilitation costs, borrowing costs, other costs to bringing the asset to its present condition and location as intended by management, etc.

Assets are subsequently measured in accordance with the cost model.

#### *Cost model:*

- *Cost or fair value less accumulated depreciation and impairment*

Costs of day-to-day servicing, i.e. repairs and maintenance are expensed, only costs incurred to improve an asset are capitalised.

Subsequent cost incurred to replace a part of an asset or for major inspections, are capitalised in the carrying amount of the related asset by derecognising the carrying amount of the replaced part or inspection cost and recognising the new cost.

### **Measurement (Intangible assets)**

Intangible assets are initially recognised at cost (or at fair value if acquired for no cost or nominal consideration).

Only cost incurred to bringing the asset to its location and condition as intended by management can be capitalised.

Intangible assets are subsequently measured in accordance with the cost model.

#### *Cost model:*

- *Cost less accumulated amortisation and impairment*

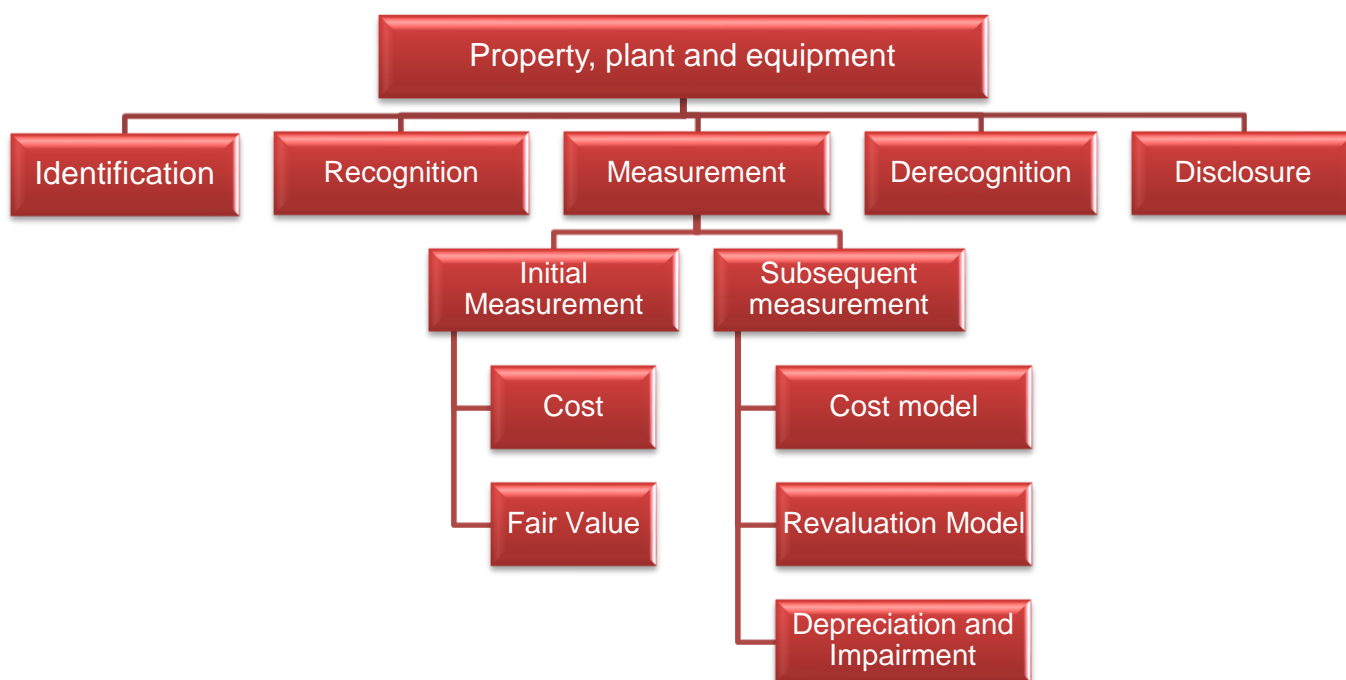
Subsequent costs incurred after the developed phase are expensed.

Costs previously expensed cannot be capitalised subsequently.

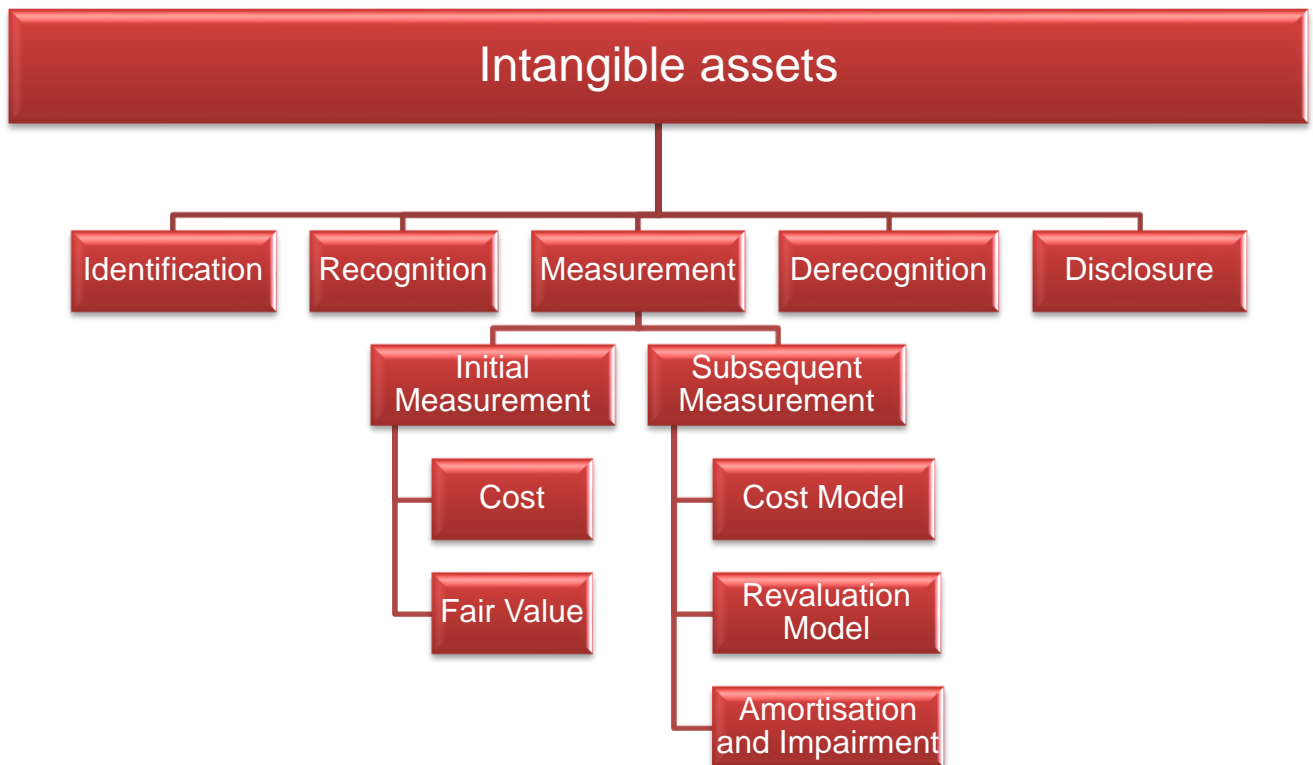
**Derecognition (Property, plant and equipment and Intangible assets)**

An asset is derecognised when it is disposed of or when no future economic benefits or service potential is expected. Any gain or loss is recognised in surplus or deficit.

**BIG PICTURE (PROPERTY, PLANT AND EQUIPMENT)**



**BIG PICTURE (INTANGIBLE ASSETS)**



## 14. REVIEW

Management shall review, at intervals that it determines appropriate, the entity's asset management system to ensure its continuing suitability, adequacy and effectiveness. Reviews shall include assessing the need for changes to the asset management system, including the asset management policy, the asset management strategy, and asset management objectives.

***Input to management reviews shall include:***

- Results of internal audits and evaluations of compliance with applicable legal requirements and with other requirements to which the local municipality subscribes;
- The results of communication, participation and consultation with employees and other stakeholders
- Relevant communication from external stakeholders, including complaints;
- Records or reports on the asset management performance of the entity;
- The extent to which objectives have been met;
- Performance in addressing incident investigations and corrective actions;
- Follow-up actions from previous management reviews; and
- Changing circumstances, including developments in legal and other requirements related asset management and changes in technology.

The management review shall also cover aspects of the asset management system, if any, that are outsourced to a contracted service provider.

The outputs from management reviews, consistent with the entity's commitment to continual improvement, shall include decisions and actions for possible changes to:

- asset management policy, the strategy and objectives
- asset management performance requirements
- resources; and
- other elements of the asset management system.

Outputs from management reviews, which are relevant to the entity's strategy plan, shall be made available to top management for consideration in reviews of the entity's strategic plan. Records of management reviews shall be retained.



**TRANSFER OF ASSETS**

Department: \_\_\_\_\_

Date: \_\_\_\_\_

Transfer from \_\_\_\_\_ to \_\_\_\_\_

\_\_\_\_\_ on \_\_\_\_\_

DESCRIPTION	ASSET NUMBER

Sender \_\_\_\_\_

Date: \_\_\_\_\_

Receiver \_\_\_\_\_

Date: \_\_\_\_\_

**Approved:** .....  
**Executive Manager**

Date: \_\_\_\_\_

Financial Department

**Executed by** .....

**Date** .....



## ASSET EXPENDITURE REQUISITION

Requisition No

Department:	Location:	Financial Year: 200__ / 200 __
-------------	-----------	--------------------------------

Year to Date	Budget	Actual
	Rand	Rand
Capex: This item		
Cost Centre		

To be:	Show Quarters							
	Current Year				Next Year			
Committed in	1	2	3	4	1	2	3	4
Delivered in	1	2	3	4	1	2	3	4

Was this item Yes No Additional item of a capital nature Replacement of an existing Item Where Supply Chain Management procedures followed 

## \* ITEM TO BE DISPOSED

Description			
Details of Purchaser			
Scrap Note No.	Selling Price	Book Value	Profit/(Loss)

## \*\* ITEM(S) TO BE PURCHASED

Description						Number of Items	
Recommended Supplier							
Date	Order No	Price	Discount	Sub-Total	VAT	Total	
<b>Total Cost for all items</b>							

## CLASS OF PROPOSED ASSET EXPENDITURE

Land / Buildings	<input type="checkbox"/>	Leased Plants	<input type="checkbox"/>	Implement & Machinery	<input type="checkbox"/>	Office Equipment	<input type="checkbox"/>
Plant	<input type="checkbox"/>	Motor Vehicles	<input type="checkbox"/>	Computer Equipment	<input type="checkbox"/>	Furniture & Fittings	<input type="checkbox"/>

## \*\*\* FINANCIAL JUSTIFICATION OF PROPOSED EXPENDITURE

List the purpose or reason for the expenditure




## ASSET EXPENDITURE REQUISITION

Requisition No

**\*\*\* FINANCIAL JUSTIFICATION OF PROPOSED EXPENDITURE (continued)**

Please list the alternative solutions that have been considered to achieve the purpose for which the proposed expenditure is to be incurred. Where necessary, please attach the calculations used to determine the cost impact of the alternatives.

Alternative Solution	Cost Impact of Solution

**COMMENTS (THE SPACE PROVIDED BELOW IS FOR ANY SIGNATORY TO MAKE COMMENTS AS THEY DEEM FIT)**


**\*\*\*\* REQUIRED APPROVALS**

Proposer          Date	Technical Manager          Date	XX          Date
CFO          Date	Executive Manager          Date	Municipal Manager          Date

Head Office Use Only	Budget Committed	Actual Committed
Division - Year to Date		
Head Office Comments		
Budget No:	Vote No:	

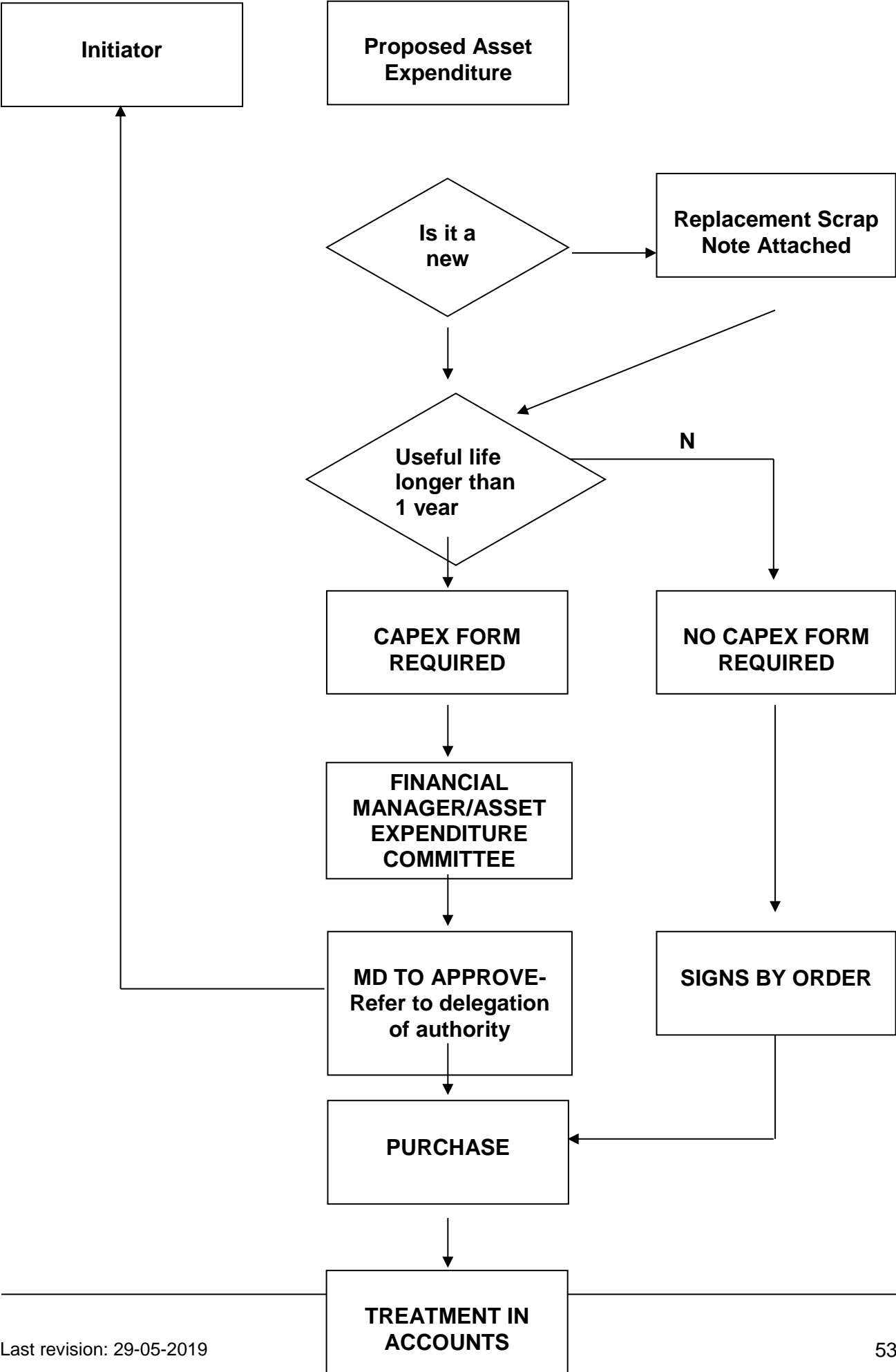
\* Attach SCRAP NOTE (refer to MCLM scrapping policy)

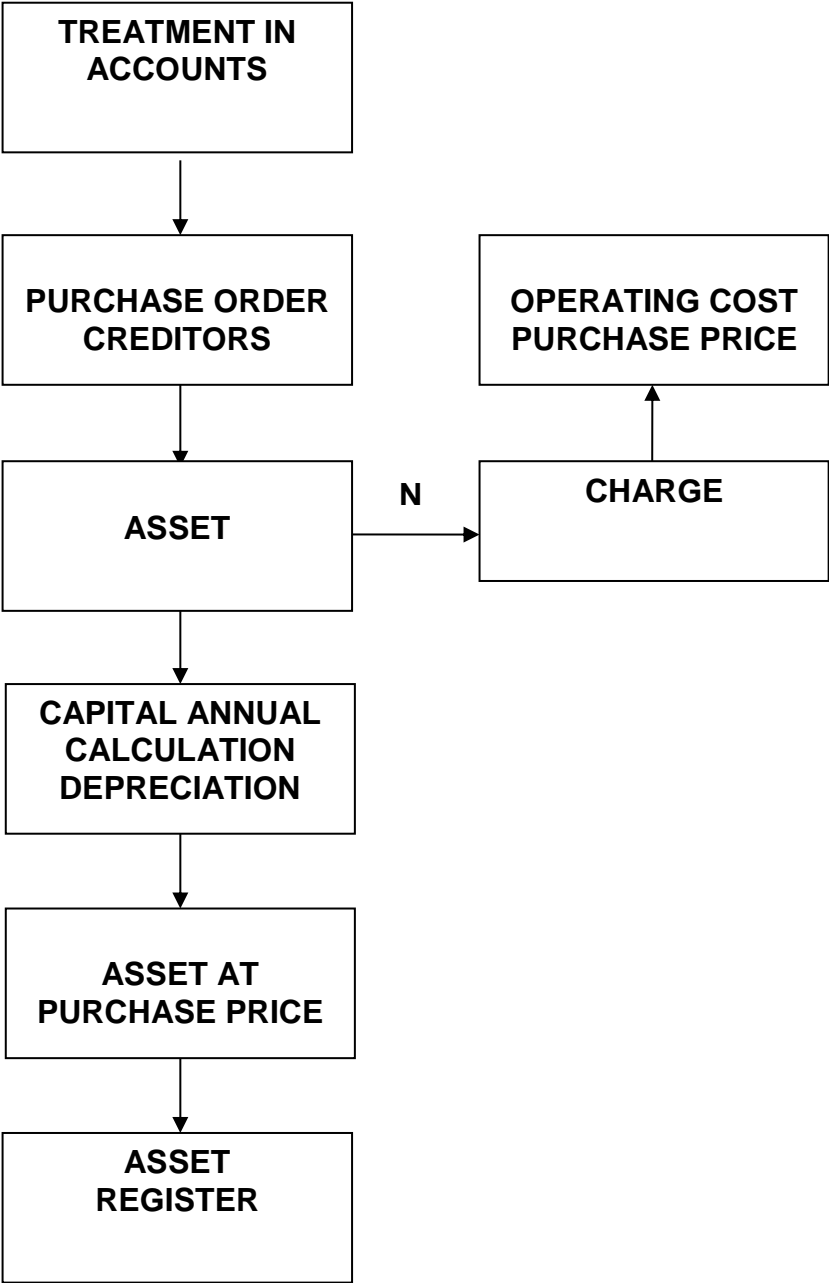
\*\* Attach PURCHASE REQUISITION and quotations/advertisement on website/approved tender as per Supply Chain Management procedure

\*\*\* Attach calculations supporting the financial and economic justification on a separate sheet if necessary

\*\*\*\* PLEASE NOTE NO PROCESSING WILL TAKE PLACE UNLESS ALL APPROVALS HAVE BEEN COMPLETED IN TERMS OF THE SCHEDULE OF AUTHORITIES

Asset Expenditure Flowchart







## SCRAP NOTE / SKRAP NOTA

Number

Town:	Location / Werke:
-------	-------------------

Description / Beskrywing	* Sub-Assembly / Sub-Onderdeel		Asset No / Bate No	Barcode No/	Serial No / Reeks No
	Yes	No			
	Ja	Nee			
	Yes	No			
	Ja	Nee			
	Yes	No			
	Ja	Nee			
	Yes	No			
	Ja	Nee			
	Yes	No			

\* Indicate with an 'x' / Dui aan met 'n 'x'

## REASON FOR SCRAPPING / REDE VIR SKRAP


## SCRAPPED BY / GESKRAP DEUR:

## MOVE INSTRUCTION ISSUED / UITREIK VAN INSTRUKSIE

Name / Naam	Date / Datum	Name / Naam	Date / Datum

## ITEM STORAGE LOCATION

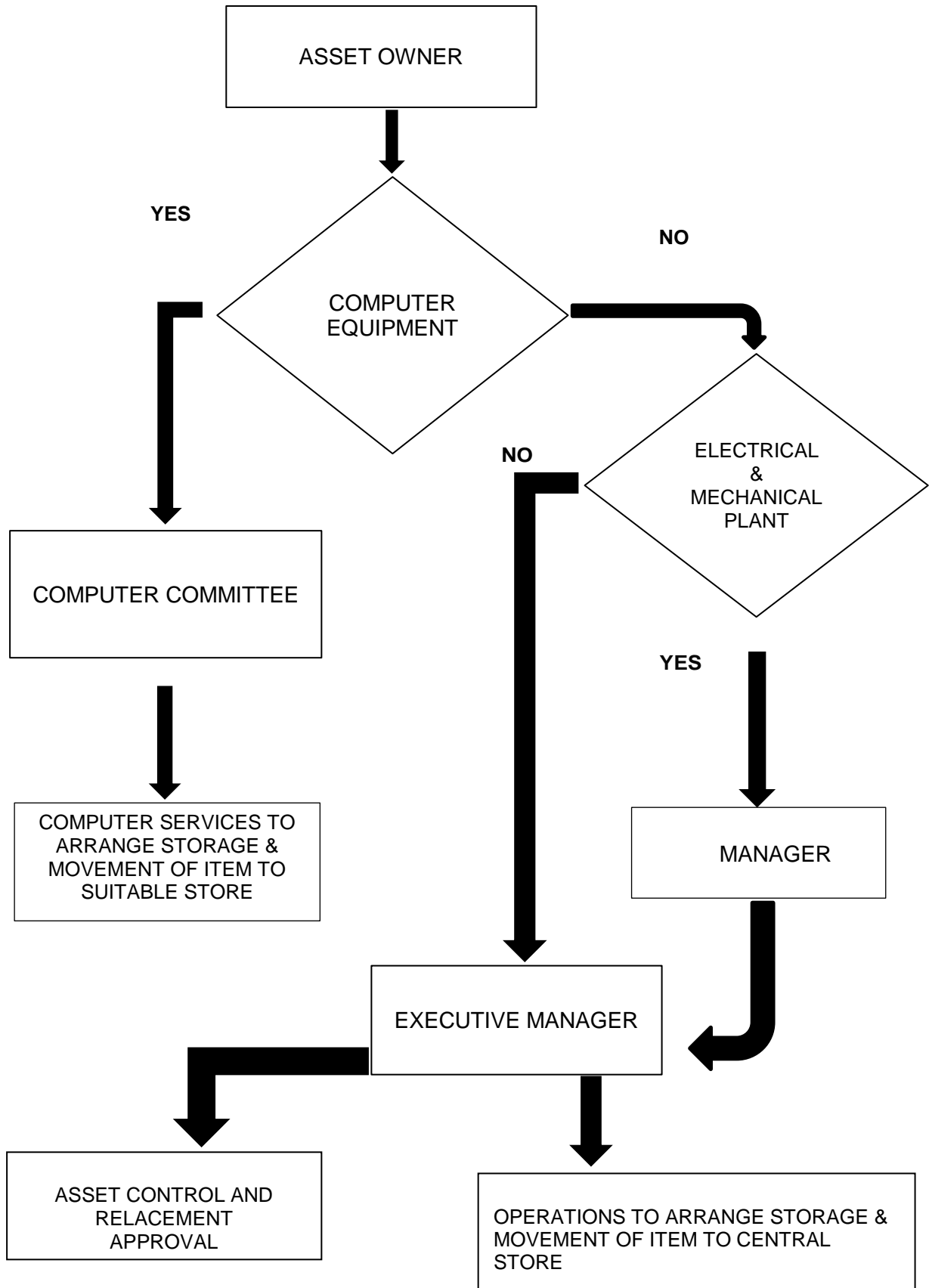
## PLEK VAN GESTOORDE ITEMS

## FOR OFFICE USE / VIR KANTOOR GEBRUIK

RECEIVED BY / ONTVANG DEUR	DATE / DATUM	NAME / NAAM	DATE / DATUM
		<b>LOT NUMBER:</b>	
		<b>LOTINGS NOMMER:</b>	

CERTIFIED AS SCRAP GESERTIFISEER AS SKRAP ITEMS	SIGNED GETEKEN	DATE DATUM
MANAGER / DISTRIKSBEST.		
TECHNICAL MANAGER / TEGNIESE BEST.		
EXECUTIVE MANAGER		

# SCRAP PROCEDURE FLOW CHART



# INFRASTRUCTURE ASSET HIERARCHY AND EUL





## OTHER CAPITAL ASSETS EUL

