

Accounting for demarcations

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Introduction

The Constitution of the Republic of South Africa (Act No 108 of 1996) sets out a vision for local government to provide equitable and efficient services, build local democracy, promote social and economic development, collect revenue, ensure safe and healthy environments; and create a generally viable and sustainable system for local government affairs.

Demarcation is one method in a local government transformation process that aims to give substance to the Constitution's vision. Following the recent elections in August 2016, various demarcation processes will be effected at a number of local municipalities and municipal entities to determine new municipal boundaries.

To ensure that an appropriate level of accountability is maintained, it is imperative that entities account for demarcations appropriately. The Accounting Standards Board (ASB) has developed three Standards of GRAP (Generally Recognised Accounting Practices) that prescribe accounting principles to account for demarcations. The Minister of Finance determined an effective date of 1 April 2015 for the Standards of GRAP on *Transfers of Functions Between Entities Under Common Control* (GRAP 105), *Transfers of Functions Between Entities Not Under Common Control* (GRAP 106) and *Mergers* (GRAP 107). These Standards are available on the ASB's website on www.asb.co.za.

Transfer of functions or merger

When the definition of a transfer of functions or merger is met, municipalities and municipal entities affected by the demarcation process need to account for the demarcation accordingly.

The demarcation will be accounted for as a merger if:

- No acquirer can be identified;
- None of the parties involved in the demarcation are seen to be dominant, and no party gains control. As a result, the parties each maintain their decision making powers in the new entity;
- All the parties to the demarcation, as represented by management, participate in the establishment of the new management structure, and in selecting the management personnel. Such decisions are made on the basis of consensus between the parties involved in the demarcation; and
- The relative sizes of the combining municipalities or municipal entities are not so disparate that one entity dominates the new entity by virtue of its relative size.

If, based on the criteria above, the demarcation is not a merger, the principles in GRAP 106 need to be applied if the demarcation is undertaken between different municipalities. GRAP 105 is applied when the demarcation is undertaken between entities within the same economic entity (for example, between a municipality and one or more of its municipal entities).

Two year measurement period in which to recognise and measure identifiable assets and liabilities

GRAP 105 to GRAP 107 allows an entity a two year measurement period in which to complete the accounting for the transfer of functions or merger from the transfer or merger date. This time period was given to ensure that the municipality or municipal entity affected by the demarcation, has a reasonable time to obtain the information necessary to identify and measure the assets and liabilities acquired. Therefore, if the initial accounting for the demarcation is incomplete by the end of the reporting period in which the transfer of merger occurs, the entity is required to report provisional amounts for the items for which the accounting is incomplete. Adjustments should be recognised during the measurement period to these provisional amounts as if the accounting for the transfer or merger had been completed at the transfer or merger date.

Other relevant guidance

The guideline issued by the National Treasury on the *Annual Financial Statements and Annual Performance Reporting Processes for Municipalities Affected by the Demarcations* may also be useful in understanding the timeliness for preparing annual financial statements and performance reports covering the period after 1 July 2016 to the date of disestablishment.