



## **ACCOUNTING STANDARDS BOARD**

# **GUIDELINE ON ACCOUNTING FOR ARRANGEMENTS UNDERTAKEN IN TERMS OF THE NATIONAL HOUSING PROGRAMME**



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## **Authority of this Guideline**

In accordance with section 89 of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), the Accounting Standards Board's (ASB) functions include the preparation and publication of directives and guidelines on the Standards of GRAP. While Standards of GRAP set out the recognition, measurement, presentation and disclosure requirements for financial reporting in the public sector, guidelines clarify existing principles in the Standards of GRAP. Guidelines do not replace or amend any of these principles.

## **Objective of this Guideline**

Entities in the public sector are frequently involved in the construction of houses as part of government's housing policy, implemented through the national housing programme, which is aimed at developing sustainable human settlements. The Housing Act, Act No. 107 of 1997 (Housing Act) provides information about the housing programmes that fall within the scope of the national housing programme.

Concerns were raised by preparers about the inconsistent accounting applied to housing arrangements undertaken by entities under the national housing programme. Different accounting may be appropriate where there are differences between the terms and conditions of arrangements concluded by entities. However, under housing arrangements that are undertaken in terms of the national housing programme, there are common features and issues that need to be considered. As a result, the Board agreed to develop high-level guidance for arrangements undertaken in terms of the national housing programme.

## **Scope of this Guideline**

This Guideline outlines accounting for transactions and events that arise out of the national housing programme, that are undertaken by accredited and non-accredited municipalities that apply an accrual basis of accounting, in terms of the Housing Act.

The Guideline discusses key features of arrangements undertaken in terms of the national housing programme based on current legislation, as well as the principles from the relevant Standards of GRAP. It also illustrates the accounting of the revenue, expenses, assets and liabilities by municipalities that have been granted level one and level two accreditation in terms of the National Housing Code.

Accounting considerations for level three accredited municipalities are not addressed in this Guideline. Such accreditation has not been granted to any entity as yet, and an Accreditation framework for level three accredited municipalities is not yet in place to outline the roles and responsibilities of these municipalities.

The nature of functions assigned to non-accredited municipalities is, in many instances, similar to that of level one and level two accredited municipalities. As such, the Guideline can be applied by both accredited and non-accredited municipalities.

The guidance provided in this Guideline can, by analogy, be considered by other entities, e.g. public entities, that also participate in the national housing programme.





When the Housing Act came into effect in 1997, the National Treasury agreed that provincial housing funds will no longer be used to transfer funding to municipalities that participate in the national housing programme. The Housing Act has however not yet been amended in relation to the provincial housing funds. As the provincial housing funds are not currently used to direct the funding from the national Department of Human Settlements to municipalities, this Guideline does not deal with the provincial housing funds, or houses resulting from these other housing schemes.

This Guideline also does not deal with the accounting of those houses that are rented by municipalities to third parties as part of their housing stock, and those houses that are refurbished prior to their rental or sale to third parties or transfer to beneficiaries. These arrangements are often referred to as social housing schemes or social housing arrangements.



## **1. BACKGROUND TO ARRANGEMENTS UNDERTAKEN IN TERMS OF THE NATIONAL HOUSING PROGRAMME**

### **Objective of this section**

- 1.1 In terms of section 26 of the Constitution of the Republic of South Africa, 1996 and its Regulations (the Constitution), every citizen in South Africa has the right to have access to adequate housing. The Constitution requires that the state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right.
- 1.2 To achieve its objective of providing access to adequate housing, the Housing Act was promulgated. The Housing Act provides for the facilitation of a sustainable housing development process. It requires the Minister of Human Settlements to publish the National Housing Code (the Code) which contains the national housing policy which is binding on national, provincial and local spheres of government. The Code contains, amongst other things, details pertaining to the sources of funding for housing development, the eligibility criteria for beneficiaries, the technical specifications required for the construction of houses, as well as the monitoring requirements of the national housing programmes by national and provincial departments.
- 1.3 This section provides background information on some of the principles applicable to the housing development process. It highlights, amongst other things, the characteristics relating to housing development, such as the applicable legislation or similar means, the parties involved, and the sources of funding for national housing programmes. "Legislation or similar means" includes, but is not limited to, laws, regulation, policies, decisions concluded by authorities such as cabinet, executive committees, boards, municipal councils and ministerial orders.

### **Defining housing development**

- 1.4 The facilitation of housing development is conducted through national housing programmes, in accordance with the Code.

### **Roles and responsibilities in the housing development process**

- 1.5 The Housing Act outlines general principles that are applicable to housing development in all spheres of government, prescribes the roles and responsibilities of national government, provincial government and local government in meeting the objectives of the national housing programme, and how these programmes are funded. These roles and responsibilities of national, provincial and local government are outlined below.

#### *National government*



1.6 The functions of the national Department of Human Settlements, through the Minister of Human Settlements, include the establishment and facilitation of a sustainable national housing development process. This process includes:

- determining a national housing policy which is contained in the Code;
- instituting the financing of national housing programmes;
- determining the norms and standards for the subsidy financed houses which are the standards setting out the minimum technical norms and standards for the creation of serviced residential stands and houses that are to be constructed through the national housing programme; and
- establishing and maintaining a National Housing Subsidy Database (NHSD) and associated therewith, a national Housing Subsidy System (HSS).

*Provincial government*

1.7 Provincial departments of Human Settlements, through a member of the Executive Council of a province (MEC), are required in terms of the Housing Act, to promote and facilitate the provision of adequate housing in their province within the framework of the national housing policy. The provision of adequate housing includes, amongst other things:

- determining provincial policy in respect of housing development;
- promoting the adoption of provincial legislation to ensure effective housing delivery;
- co-ordinating housing development in the province;
- taking reasonable and necessary steps to support municipalities to effectively exercise their powers and perform their duties in respect of housing development;
- supporting and strengthening the capacity of municipalities to exercise their powers and perform their required duties in respect of housing development; and
- preparing and maintaining a multi-year plan in respect of the execution in the province of every national housing programme.

1.8 The MEC is required to execute every national housing programme which is undertaken in accordance with the Code.

1.9 Provincial departments of Human Settlements execute and promote national housing programmes either through the use of external contractors or local government. The execution, including the monitoring of municipalities by provincial departments in relation to housing development, is discussed in subsequent sections.

*Local government*



- 1.10 Section 9 of the Housing Act requires all municipalities, as part of their process of Integrated Development Planning, to take all reasonable and necessary steps within the framework of national and provincial housing legislation to set housing delivery goals, identify and designate land for housing development and initiate, plan, co-ordinate, facilitate, promote and enable appropriate housing development in its jurisdiction.
- 1.11 In delegating or assigning the functions of the national housing programme to a municipality, the Housing Act permits a municipality to participate in such a programme by:
- promoting a housing development by a developer;
  - acting as a developer in respect of the planning and execution of a housing development project on the basis of full pricing for cost risk;
  - entering into a joint venture contract with a developer in respect of a housing development project;
  - establishing a separate business entity to execute a housing development project;
  - executing any national housing programme in respect of its area of jurisdiction subject to the relevant accreditation requirements; and
  - facilitating and supporting the participation of other role players in the housing development process.
- 1.12 The Code requires municipalities that want to participate in one or more of the national housing programmes, to apply, in writing, to the MEC for accreditation. Approval is granted once the MEC is satisfied that the municipality complies with the relevant accreditation criteria that have been set by the national Department of Human Settlements, and that are prescribed in the Code. Even though the Code only applies to accredited municipalities, non-accredited municipalities can also participate in a national housing programme.
- 1.13 There are three levels of accreditation that a municipality can apply for – level one, level two or level three. The roles and responsibilities of a municipality that participates in a national housing programme depend on the level of accreditation granted to the municipality.

## **Accreditation of municipalities**

### **Purpose of the accreditation**

- 1.14 The Code establishes the Accreditation and Assignment Framework for municipalities to Administer National Human Settlements Programmes (Accreditation framework), which includes the formal accreditation process to be followed for the accreditation of municipalities to participate in the national housing programme. The Accreditation framework is currently applicable to level one and level two accredited municipalities.



- 1.15 In terms of the Housing Act, municipalities may apply for accreditation, and the provincial MEC responsible for Human Settlements will determine, in terms of the criteria agreed by the Minister of Human Settlements, whether the applicant municipality will receive accreditation, and if so, at what level.
- 1.16 The objective of accreditation is to enable municipalities to coordinate decisions relating to housing programmes with other decisions that relate to the broader sustainability of human settlements and to promote greater efficiency in service delivery. Municipalities are well placed to undertake certain responsibilities as part of the national housing programme because of their involvement with communities.
- 1.17 The accreditation of municipalities involves the delegation by the relevant provincial Department of Human Settlements, or assignment by the national Department of Human Settlements, of certain clearly defined functions specified in legislation. This enables municipalities to plan the implementation of their developmental functions on a coordinated basis. In order for accreditation to be effected, municipalities must have the capacity required to take on the ensuing functions.
- 1.18 The Accreditation framework clarifies that, in terms of the accreditation granted to municipalities, the participation of municipalities in the national housing programme can either be seen as the **delegation** or **assignment** of functions to the accredited municipality. These concepts are explained in the Accreditation framework.
- 1.19 In terms for the Accreditation framework, level one and level two accredited municipalities are **delegated** the responsibility to execute certain functions, whereas the objective of level three accreditation is to **assign** certain functions to the accredited municipality. If a municipality is accredited as level two, it also has the responsibility of a level one accredited municipality, and a level three accredited municipality has the responsibility of both a level one and a level two accredited municipality.
- 1.20 **Delegation** entails the exercise of a function, as outlined in legislation, on behalf of the delegating authority. The ultimate authority vests with the delegating authority, which can revoke the delegation when it decides to exercise the function itself. Delegation is not a transfer of functions. It does not include the shifting of planning, financial and legal accountability.
- 1.21 **Assignment** involves a formal transfer of the functions, as outlined in legislation, related to the execution of a national housing programme from the provincial MEC responsible for Human Settlements to a municipality through the existing Constitutional and legal framework for assignment. Unlike a delegation, it does include the shifting of planning, financial and legal accountability from the assigning to the receiving authority. Assuming financial accountability for a function includes the right to directly receive the funds and the assets from the national Department of Human Settlements that are necessary to perform the function.

### **The levels of accreditation**



- 1.22 There are different roles and responsibilities that are attributable to each level of accreditation. Although roles and responsibilities are attributable to specific levels of accreditation, a municipality should assess the roles and responsibilities it undertakes for each project undertaken in terms of the national housing programme. A municipality does this by assessing the terms and conditions agreed with the relevant Provincial Department of Human Settlements. Such terms and conditions may be established in the Implementation Protocol Agreement, Service Level Agreement, Memorandum of Understanding, or other similar agreements.
- 1.23 The different roles and responsibilities broadly relate to the following:
- planning for housing development;
  - contract management;
  - beneficiary management; and
  - funding arrangements.

The types of transactions that can be undertaken by a municipality in these roles and responsibilities are discussed below based on the level of accreditation of the municipality.

- 1.24 As an Accreditation framework is not yet in place to outline the roles and responsibilities of level three accredited municipalities, this Guideline does not address the accounting considerations for level three accredited municipalities.

#### ***Level one accreditation***

##### *Planning for housing development*

- 1.25 Level one accredited municipalities are required to identify and plan local housing programmes and projects. This is done through the Municipal Human Settlements Plan (MHSP), which is integrated into the municipality's Integrated Development Plan (IDP). The IDP is approved through a Council decision where after it is submitted to the MEC for local government for review and comment.
- 1.26 The MHSP is required to demonstrate the municipality's plans, budget and organisational capacity to deliver on its mandate, as prescribed in legislation or similar means. Some of the responsibilities that a municipality is required to fulfil, as noted in its MHSP, include:
- describing and quantifying the housing demand in its area of jurisdiction; taking into account housing backlogs and population growth projections;
  - quantify the extent of informal settlements and the plans to eradicate informal housing;
  - describing the community consultation process followed in the development of the MHSP;



- setting objectives and formulating strategies in terms of achieving its vision for human settlements development; and
- providing comprehensive and detailed project plans for all programmes and projects.

#### *Contract management*

- 1.27 The municipality undertakes transactions as a project manager in relation to the housing development and is not responsible for the construction of houses. The responsibility for appointing contractors and/or other service providers to construct the houses vests with the provincial Department of Human Settlements.
- 1.28 The transactions that a municipality undertakes with contractors and/or service providers include, amongst others:
- identifying potential contractors and/or other service providers that can be used for the housing development;
  - preparing contracts and project agreements with contractors and/or other service providers in accordance with the prescripts in the Code;
  - using the municipal inspectorate to monitor, certify and control the project construction to ensure that it meets acceptable and prescribed standards; and
  - making payments to contractors and/or other service providers for work completed on instruction from the relevant provincial Department of Human Settlements based on milestones achieved.
- 1.29 In many instances, the municipality may facilitate the appointment of contractors and/or other service providers. However, in terms of the rights and obligations agreed between the municipality appointed as project manager and the relevant provincial Department of Human Settlements, the municipality appoints contractors and/or other service providers on behalf of the relevant Department of Human Settlements. The relevant Department of Human Settlements remains responsible to fulfil the rights and obligations in terms of the arrangement entered into on its behalf by the municipality.

#### *Beneficiary management*

- 1.30 The transactions that a municipality undertakes in relation to beneficiary management involve, amongst others:
- marketing of the stands by, for example, providing leaflets to the community and other forms of advertising;
  - receiving beneficiary application forms and submitting them to the relevant provincial Department of Human Settlements for approval;
  - facilitating an arrangement between the provincial Department of Human Settlements and eligible beneficiaries that provides information to the beneficiaries on, amongst others, a description of the house, confirmation on when risks pass



to the beneficiary and the transfer process to be followed once construction of the house is completed; and

- handing over of the completed house to the beneficiary.

#### *Funding of programmes*

- 1.31 Funding for the execution of national housing programmes is provided by the provincial Department of Human Settlements. The funding received is used by the municipality to pay contractors and/or other service providers for the construction and other services received by the Department. In some instances, however, the relevant provincial Department of Human Settlements can make payments to the appointed contractors and/or other service providers directly. Municipalities may also be reimbursed for other project-related expenses incurred on behalf of the provincial Department of Human Settlements. Funding is discussed in more detail in later sections of this chapter.

#### **Level two accreditation**

- 1.32 Level two accredited municipalities undertake transactions that include the following:

##### *Planning for housing development*

- 1.33 These responsibilities are similar to a level one accredited municipality.

##### *Contract management*

- 1.34 In addition to the responsibility of a level one accredited municipality, level two accredited municipalities are allowed to undertake transactions as project developer in relation to housing development and are responsible for the construction of the houses. In performing this role, the transactions that a municipality undertakes with contractors and/or service providers includes, amongst others:

- appointing contractors and/or other service providers by entering into contracts with them; and
- making payments to contractors and/or other service providers for work completed on meeting milestones agreed between itself and the service provider.

##### *Beneficiary management*

- 1.35 In addition to the responsibility of a level one accredited municipality, level two accredited municipalities are responsible for the housing subsidy registration function. This includes the capturing of application forms submitted by beneficiaries to the municipality. The processing of applications is done electronically on the HSS to provide information to the provincial Department of Human Settlements for approval.

##### *Funding of programmes*

- 1.36 The funding of programmes for level two accredited municipalities is similar to that of level one accredited municipalities.





1.37 The following table summarises the key roles and responsibilities of a level one and level two accredited municipality, although a municipality should assess its own situation in relation to each project:

Level One	Level Two
<b>Planning</b>	
<ul style="list-style-type: none"> <li>Identify and plan for local housing</li> </ul>	<ul style="list-style-type: none"> <li>Similar to level one's roles and responsibilities.</li> </ul>
<b>Contract management</b>	
<p>Project manager role</p> <ul style="list-style-type: none"> <li>Identifying potential contractors</li> <li>Preparing contracts and project agreements</li> <li>Using municipal inspectorate to monitor projects</li> <li>Payment of contractors on instruction from province</li> </ul>	<ul style="list-style-type: none"> <li>Municipality can act as project developer</li> </ul> <p>Role as project developer</p> <ul style="list-style-type: none"> <li>Construction of houses</li> <li>Appointing contractors for housing development</li> <li>Payment of contractors based on contract entered into with them</li> </ul>
<b>Beneficiary management</b>	
<ul style="list-style-type: none"> <li>Receiving application forms from beneficiaries</li> <li>Submit application forms received to the province</li> <li>Marketing of stands</li> <li>Facilitating arrangements with beneficiaries</li> <li>Handing over of house</li> </ul>	<p>In addition to level one's roles and responsibilities:</p> <ul style="list-style-type: none"> <li>Implementation of a Housing Subsidy System (HSS)</li> <li>Capturing and processing of application forms received on the HSS</li> </ul>
<b>Funding</b>	
<ul style="list-style-type: none"> <li>Funding received from province</li> </ul>	<ul style="list-style-type: none"> <li>Similar to level one</li> </ul>

***Non-accredited municipalities***

1.38 Where non-accredited municipalities participate in the national housing programme, their responsibilities may be similar to a level one or level two accredited municipality.

1.39 In determining the specific responsibilities of non-accredited municipalities, a non-accredited municipality should assess its roles and responsibilities in relation to the national housing programme in which it participates by considering paragraphs 1.22 to



1.37. The non-accredited municipality assesses its responsibilities using the binding arrangement entered into with the relevant Department of Human Settlements.

- 1.40 Non-accredited municipalities may therefore have roles and responsibilities similar to a level one accredited municipality for some national housing programmes, and roles and responsibilities similar to a level two accredited municipality for other national housing programmes. Non-accredited municipalities may also be appointed as account administrators with similar roles and responsibilities to that of project managers.

### **Formalising the responsibilities as part of the accreditation process**

- 1.41 The accreditation process is formalised through an implementation protocol. An implementation protocol is entered into between the MEC and the municipality in terms of section 35 of the Inter-Governmental Relations Framework Act, Act No. 13 of 2005 (IGRFA). The objective of the implementation protocol is to prescribe, at a high level, the roles and responsibilities of the municipality based on the accreditation granted.
- 1.42 In terms of section 35(4), (5) and (6) of the IGRFA, the Implementation Protocol must be consistent with the provisions of the Constitution and national housing legislation, and must be in writing and signed by the parties after consultation with other spheres of government.
- 1.43 The Implementation Protocol should address, amongst others, the challenges to be faced on implementation of the statutory function, describe the roles and responsibilities of each party, outline the priorities, set the indicators to measure implementation, provide oversight mechanisms, determine the required and available resources, set out the dispute-settlement procedures and set the timeframe for the duration of the protocol.
- 1.44 To regulate the specific responsibilities, the municipality enters into a Memorandum of Understanding or Service Level Agreement with the relevant provincial Department of Human Settlements. In the absence of a Memorandum of Understanding or a Service Level Agreement, the business plan is drawn up to formalise the arrangement between the parties. For purposes of this Guideline, reference will be made to an “arrangement” that sets out the detailed roles, responsibilities of the municipality and provincial Department of Human Settlements once the level of accreditation has been approved.

### **Sources of funding for municipalities**

- 1.45 The municipality receives funding in the form of the Human Settlements Development Grant (HSDG) and the Urban Settlements Development Grant (USDG).

#### *Human Settlements Development Grant (HSDG)*

- 1.46 Allocations from the national budget are made to a municipality through the HSDG. A conditional grant is allocated in the Division of Revenue Act (DORA) as a transfer from the national Department of Human Settlements. The grant is administered by the



relevant provincial Department of Human Settlements and transferred to the accredited municipality.

- 1.47 The distribution of funds to accredited municipalities is managed through reporting by municipalities and monitoring of performance by provincial and national departments of Human Settlements.

*Urban Settlement Development Grant (USDG)*

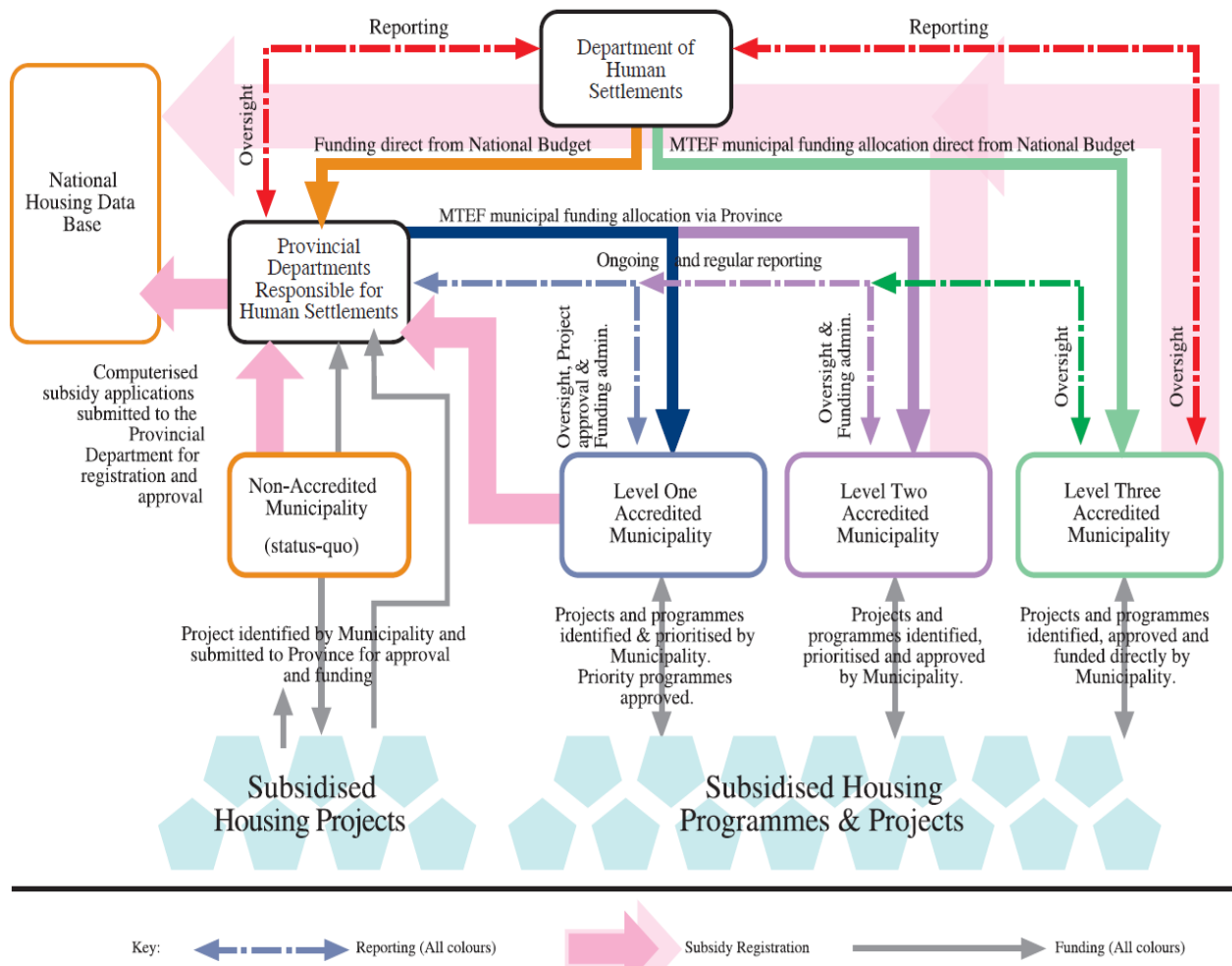
- 1.48 The cost of acquiring land for housing development is not part of the funding provided through the housing subsidy scheme as part of the equitable share allocation in the DORA. Land for housing is identified in accordance with the municipality's IDP. Land acquired from third parties is usually funded in terms of the USDG.
- 1.49 The USDG funding is provided to facilitate sustainable human settlements, and therefore, a portion of the USDG grant may be used to develop the necessary infrastructure that is needed as part of the township development.
- 1.50 The USDG is allocated as a conditional grant in the DORA and is paid from the national Department of Human Settlements to metropolitan municipalities.

*Multi-purpose funding*

- 1.51 Where a non-metropolitan municipality receives funding in the form of the HSDG, a portion of that funding may, in certain instances, relate to the development of infrastructure.
- 1.52 The municipality will have to determine the portion of the grant that relates to the construction of the houses, and the portion granted for the development of infrastructure. This determination may be made using the municipality's IDP or the budget as approved by Council.

**Summary of housing development process**

- 1.53 The following diagram reflects the interaction of the various spheres of government in terms of sources of funding, lines of reporting, oversight and accountability.



**Source: Housing Code, 2009**

## Beneficiaries and conditions of occupation

- 1.54 In assessing whether potential beneficiaries are eligible to receive a house<sup>1</sup>, an application needs to be submitted by them to the municipality or to the relevant provincial Department of Human Settlements.
- 1.55 The Code prescribes the eligibility criteria of beneficiaries who can benefit from housing subsidies. The eligibility criteria require that, amongst other things, the beneficiary is a South African resident and that the individual must be competent to contract (i.e. over 18 years of age). The contributions that beneficiaries are required to make in order to occupy a house in terms of a housing subsidy is set out in the respective national housing programme. The contributions are determined by reference to income, nature of programme concerned and criteria for indigent persons.

<sup>1</sup> The Code makes reference to property as the land and the constructed house, but for purposes of this Guideline, reference will only be made to "house" where appropriate.



- 1.56 A municipality may seek approval from the relevant provincial Department of Human Settlements for beneficiaries who do not meet the qualifying criteria. The approval of beneficiaries is the responsibility of the relevant provincial Department of Human Settlements.

### **Registration and approval of beneficiaries**

- 1.57 In instances where applications are submitted to the municipality, the municipality, upon receipt of the application, verifies the completeness of the information provided. The application is then sent to the relevant provincial Department of Human Settlements for approval. Approval is granted after the necessary eligibility checks have been performed through the NHSD. Once approval has been granted by the relevant provincial Department of Human Settlements, a stand or plot number is created and allocated to the approved beneficiary. This information is then submitted to the municipality who in turn communicates it to the beneficiary.
- 1.58 The NHSD serves as the data base for all housing subsidy beneficiaries, and is used in the evaluation and approval of housing subsidy applications by providing a search facility against databases such as:
- (a) the population register to verify citizenship;
  - (b) the deeds register to verify ownership status and history; and
  - (c) the NHSD, to search against existing records to verify state housing assistance access status.

### **Conditions of occupation**

- 1.59 Beneficiaries may take occupation of a house on receipt of a quality assurance certificate relating to the construction of the house.

### **Restrictions on voluntary sale**

- 1.60 The Housing Act imposes conditions on beneficiaries that have been allocated houses. Beneficiaries are not allowed to sell or otherwise alienate their house within a period of eight years from the date on which the house was acquired, unless the house is first offered to the relevant provincial Department of Human Settlements.
- 1.61 The relevant provincial Department of Human Settlements to which the house has been offered will endorse in its records that the person wishes to vacate their house. When the house is vacated, the relevant provincial Department of Human Settlements is deemed to have been vested with ownership and an application must be made to the Registrar of Deeds by the relevant provincial Department of Human Settlements for the title deed of the house to be endorsed to reflect the department's ownership of that house.



## **2. TRANSACTIONS THAT AFFECT THE ACCOUNTING OF HOUSING ARRANGEMENTS**

### **Introduction**

- 2.1 The previous section explained the background, the role and responsibilities of municipalities, and the transactions that municipalities undertake when they participate in the national housing programme. This section of the Guideline considers what the accounting consequences may be for the municipality.

### **Transactions undertaken by municipalities and the accounting consequences thereof**

- 2.2 Paragraphs 1.18 to 1.21 noted the difference between the delegation and assignment of functions in the national housing programme. Based on the existing arrangements in place between municipalities and the relevant provincial Departments of Human Settlements, no functions have been assigned yet to any municipality.
- 2.3 Municipalities have, however, been delegated certain functions. The nature and extent of the delegation of functions to the municipality depends on the municipality's level of accreditation as determined in the Accreditation framework.
- 2.4 In understanding the transactions that a municipality may be required to undertake in terms of the national housing programme, the municipality needs to consider the implementation protocol that prescribes its roles and responsibilities. These roles and responsibilities are based on the accreditation granted to the municipality. In addition, the municipality needs to consider any other arrangement entered into with the relevant provincial Department of Human Settlements.
- 2.5 A number of arrangements concluded between municipalities and the relevant provincial Department of Human Settlements were considered to understand the specific responsibilities that municipalities can be delegated. These transactions are summarised in paragraphs 1.22 to 1.37.
- 2.6 From that summary, it is evident that the main differences between the responsibilities delegated to a level one and level two accredited municipality relate to beneficiary management and contract management.

#### *Beneficiary management*

- 2.7 Transactions with beneficiaries include the marketing of the housing arrangement to potential beneficiaries, the collection of application forms from beneficiaries, informing eligible beneficiaries of the outcome of their application by the relevant provincial Department of Human Settlements and assisting with the handover of the completed house.
- 2.8 In addition to these responsibilities, level two accredited municipalities are required to process the application forms received from the beneficiaries directly on the HSS for



consideration by the relevant provincial Department of Human Settlements.

- 2.9 In relation to beneficiary management, the municipality undertakes certain responsibilities on behalf of the relevant provincial Department of Human Settlements.

#### *Contract management*

- 2.10 Contract management involves transactions with contractors and/or other service providers responsible for the construction of the houses, and other related functions. The nature of the transactions that a municipality undertakes with contractors and/or other service providers depends on whether the municipality is appointed as project manager, or project developer. A municipality's appointment as project manager or project developer depends on the level of accreditation granted to the municipality in terms of the Accreditation framework.
- 2.11 Appointment of the municipality as the project manager or project developer impacts on the accounting of the resources and related expenses incurred.

### **Accounting consequences based on the transactions undertaken by municipalities**

- 2.12 The transactions and events undertaken with the beneficiaries of the national housing programme and contractors and/or other service providers result in the receipt of resources from the relevant Department of Human Settlements, as well as incurring certain expenses to allow the municipality to perform the required transactions.
- 2.13 Based on these transactions, the following accounting consequences have been identified and will be considered in the sections to follow:
- As municipalities undertake certain transactions with third parties, i.e. the beneficiaries of the national housing programme and contractors and/or other service providers, it should be considered whether a principal-agent arrangement exists as defined in the Standard of GRAP on *Accounting by Principals and Agents* (GRAP 109). Based on this assessment, it should be considered how the resources received from the relevant provincial department of Human Settlements, and the expenses incurred, should be accounted for by the municipality.
  - Accounting considerations where the municipality is the project manager.
  - Accounting considerations where the municipality is the project developer.
  - Accounting for the accreditation fee, commission, administration or transaction fee received for undertaking certain roles and responsibilities in terms of the national housing programme.



### **3. CONSIDER WHETHER THE MUNICIPALITY UNDERTAKES TRANSACTIONS WITH THIRD PARTIES ON BEHALF OF ANOTHER PARTY**

#### **Introduction**

- 3.1 Paragraphs 2.7 to 2.11 noted that when a municipality participates in the national housing programme, it undertakes certain transactions with third parties, namely the beneficiaries of the national housing programme, and contractors and/or other service providers responsible for the construction and other related functions.
- 3.2 This section of the Guideline considers whether a principal-agent arrangement exists, and therefore, whether arrangements undertaken in terms of the national housing programme, are within the scope of GRAP 109. A municipality should assess the application of GRAP 109 for each individual arrangement it undertakes in terms of the national housing programme.
- 3.3 Based on this assessment, the sections that follow consider the accounting consequences for the resources received from the relevant provincial Department of Human Settlements and the related expenses incurred by the municipality.

#### **Do transactions undertaken by a municipality in terms of the national housing programme result in a principal-agent arrangement?**

##### **Introduction**

- 3.4 In accordance with GRAP 109, a principal-agent arrangement results from a binding arrangement in which one entity (an agent), undertakes transactions with third parties on behalf of, and for the benefit of, another entity (principal).
- 3.5 Therefore, in considering whether an arrangement that a municipality undertakes in terms of the national housing programme is within the scope of GRAP 109, three aspects should be considered, i.e.:
- (a) are the transactions undertaken in accordance with a binding arrangement;
  - (b) are there third parties with whom these transactions are undertaken; and
  - (c) are the transactions undertaken on behalf of another entity.

##### **Existence of a binding arrangement**

- 3.6 The first consideration involves an assessment of whether the transactions are governed by, and performed in terms of, a binding arrangement.
- 3.7 In accordance with GRAP 109, a binding arrangement needs to exist, as the rights and obligations that are established for the various parties in the arrangement inform an entity's assessment of whether it undertakes transactions for its own benefit, or for the benefit of another entity.





- 3.8 GRAP 109 indicates that a binding arrangement is any arrangement that confers enforceable rights and obligations on the various parties in the principal-agent arrangement and may arise from the following means:
- (a) a contract concluded between the parties;
  - (b) legislation, supporting regulations or similar means including, but not limited to, laws, regulation, policies, decisions concluded by authorities such as cabinet, executive committees, boards, municipal councils and ministerial orders; or
  - (c) through the operation of law, including common law.
- 3.9 As noted in previous sections of the Guideline, an implementation protocol is concluded outlining the roles and responsibilities of each organ of state that participates in the national housing programme. In addition, a municipality may also conclude an arrangement with the relevant provincial Department of Human Settlements following the accreditation process.
- 3.10 From paragraphs 3.8 and 3.9 it is evident that a binding arrangement does exist that establishes, and sets out the roles, responsibilities and authority of the parties involved in the national housing programme.
- 3.11 It is unlikely that municipalities will undertake activities in terms of the national housing programme in the absence of an arrangement between itself and the relevant provincial Department of Human Settlements. In the absence of any specific arrangement, legislation or similar means forms the basis for the binding arrangement between the parties.
- 3.12 When changes are made to the original arrangement concluded between the municipality and the relevant provincial Department of Human Settlements, the municipality should re-assess the underlying substance of the amended agreement using the principles in GRAP 109, to determine whether it continues to perform functions as a project manager, or a project developer.

#### **Existence of third parties with whom transactions are undertaken**

- 3.13 In accordance with GRAP 109, “transactions with third parties” include the execution of a specific transaction with a third party, as well as interactions with third parties, e.g. when an agent is able to negotiate with third parties on behalf of the principal. The nature of the transactions with third parties is linked to the type of activities carried out by the agent in accordance with the binding arrangement. In the absence of any transactions with third parties, entities that perform certain activities in accordance with a binding arrangement are seen to provide a service to that entity and is a service provider rather than an agent.
- 3.14 From paragraphs 1.22 to 1.37 it is noted that the third parties with whom a municipality undertakes transactions in terms of the national housing programme, include the beneficiaries of the national housing programme, and contractors and/or other service



providers. The types of transactions that a municipality undertakes with these third parties are also highlighted in paragraphs 1.22 to 1.37.

### **Undertaking transactions on behalf of another entity**

- 3.15 The final aspect to consider before concluding that a principal-agent arrangement exists is to determine whether the transactions that are undertaken with third parties are undertaken on behalf of another entity. This assessment should be done based on the roles, responsibilities and authority in relation to the activities undertaken in terms of the housing arrangement.
- 3.16 Even though the binding arrangement may use the term “project manager” or “project developer” for specific parties to the arrangement, the municipality should still assess its roles and responsibilities to determine whether it is undertaking the transaction in the housing arrangement as a project developer or project manager based on the principles in this Guideline.

#### *Transactions with beneficiaries of the national housing programme*

- 3.17 Based on the discussion in paragraph 1.27, a municipality undertakes transactions on behalf of the relevant provincial Department of Human Settlements in relation to beneficiaries, as the municipality:
- markets the stands to potential beneficiaries;
  - receives application forms from potential beneficiaries and submits them to the relevant provincial Department of Human Settlements, or process the application forms on the HSS, whichever is applicable;
  - communicate the approved list of beneficiaries to the applicants after approval has been received from the relevant provincial Department of Human Settlements; and
  - may handover the completed house to the beneficiary based on the approved list from the relevant provincial Department of Human Settlements.

- 3.18 It can be concluded that a municipality is undertaking transactions with the beneficiaries of the national housing programme on behalf of the national and/or provincial departments of Human Settlements.

#### *Transactions with contractors and/or other service providers*

- 3.19 In terms of the accreditation granted to municipalities in the Accreditation framework, the municipality can either be appointed as the project manager or the project developer. The nature of the transactions that the municipality undertakes with the beneficiaries of the national housing programme is the same irrespective of whether the municipality is appointed as the project manager or the project developer.
- 3.20 Where a municipality is appointed as the project manager, the relevant provincial Department of Human Settlements is responsible for the appointment of the contractors and/or service providers that will construct the houses. It may be that the



municipality is required to apply its approved legislative prescripts, such as its supply chain management policy to identify potential contractors and/or service providers, However, in terms of the rights and obligations agreed between the municipality appointed as project manager and the relevant provincial Department of Human Settlements, the municipality appoints these contractors and/or other service providers on behalf of the relevant Department of Human Settlements. The relevant Department of Human Settlements therefore remains responsible to fulfil the rights and obligations in terms of the arrangement entered into on its behalf by the municipality.

- 3.21 In contrast, where a municipality is appointed as the project developer, the municipality is responsible for the construction of the houses, and any other service related thereto as noted in paragraph 1.34. The municipality can decide to undertake the construction of the houses itself, or can enter into an arrangement with another contractor and/or service provider to construct the houses. Where the construction is sub-contracted, the municipality enters into an arrangement with the contractor and/or other service provider to construct the houses or provide other services.
- 3.22 When the municipality is appointed as the project developer, it needs to ensure that the houses are constructed in accordance with the prescribed norms and standards and is responsible if such construction does not meet the specified norms and standards in the Code. The municipality remains responsible irrespective of whether it has entered into an arrangement with another contractor and/or service provider for the construction of the houses.
- 3.23 Thus, where a municipality is appointed as project developer, it does not undertake transactions with contractors and/or service providers on behalf of the national or provincial departments of Human Settlements, because the municipality is responsible for the construction of the houses.

## **Conclusion**

- 3.24 GRAP 109 requires an entity to assess specific transactions with third parties within a particular arrangement, and the focus should therefore not be on the housing arrangement itself, but rather on the transactions that the municipality undertakes with the beneficiaries, and contractors and/or other service providers. The application of GRAP 109 should be assessed against each individual arrangement that the municipality undertakes in terms of the national housing programme.

### *Transactions with beneficiaries of the national housing programme*

- 3.25 The nature of the transactions that the municipality undertakes with the beneficiaries of the national housing programme is similar, irrespective of whether the municipality is appointed as project manager or project developer. Where the municipality undertakes transactions with the beneficiaries of the national housing programme a principal-agent arrangement exists.

### *Municipality appointed as project manager*



- 3.26 From the discussion in paragraphs 3.4 to 3.23 it can be concluded that the arrangement between the municipality and relevant Department of Human Settlements where the municipality is appointed as project manager, meets the definition of a principal-agent arrangement, and is within the scope of GRAP 109.

*Municipality appointed as project developer*

- 3.27 Where the municipality is appointed as project developer, the municipality assumes the responsibility for the construction of the houses. As the municipality assumes responsibility for the construction of the houses, transactions and arrangements with contractors and/or other service providers are entered into in its own name. From the discussion in paragraphs 3.4 to 3.23 it can be concluded that where the municipality is appointed as project developer, the definition of a principal-agent arrangement is not met, and therefore, is not within the scope of GRAP 109.



## 4. ACCOUNTING BY MUNICIPALITIES APPOINTED AS PROJECT MANAGER

### Introduction

- 4.1 The previous section concluded that where a municipality is appointed as the project manager in specific arrangements, it undertakes transactions with contractors and/or other service providers on behalf of the relevant provincial Department of Human Settlements. This section of the Guideline assesses whether the municipality is the agent or the principal in the arrangement and how the resources received from the relevant provincial Department of Human Settlements, and the expenses incurred by the municipality in relation thereto, should be accounted for.

### Assessing whether a municipality is an agent or principal

#### Introduction

- 4.2 GRAP 109 defines an agent as the entity that has been directed by a principal, through a binding arrangement, to undertake transactions with third parties on behalf of the principal and for the benefit of the principal. The principal is defined as the entity that directs an agent, through a binding arrangement, to undertake transactions with third parties on its behalf and for its own benefit.
- 4.3 In accordance with GRAP 109, an entity should assess whether it is an agent or a principal in accounting for revenues, expenses, assets and/or liabilities by assessing the rights and obligations of the various parties established in the binding arrangement. The assessment of whether an entity is an agent or a principal requires the entity to assess whether the transactions it undertakes with third parties are for the benefit of another entity or for its own benefit. GRAP 109 indicates that when an entity in a principal-agent arrangement concludes that it undertakes transactions with third parties for the benefit of another entity, then it is the agent. If an entity concludes that it is not the agent, then it is the principal in the transactions.

#### Criteria to be considered in assessing whether a municipality is an agent or principal

- 4.4 In applying the criteria in GRAP 109 to assess whether the municipality is the agent or the principal in an arrangement, all three of the following criteria need to be present for the municipality to conclude that it is the agent, except in the circumstances indicated in paragraph 4.5:
- (a) it does not have the power to determine the significant terms and conditions of the transaction;
  - (b) it does not have the ability to use all, or substantially all, of the resources that result from the transaction for its own benefit; and
  - (c) it is not exposed to variability in the results of the transaction.



In accordance with GRAP 109 all three of the above requirements need to be met for the municipality to be the agent.

- 4.5 GRAP 109 does however indicate that there may be instances when criterion (a) need not be met. Criterion (a) need not be met if legislation or similar means, grant powers to an entity to determine the terms and conditions of particular transactions, particularly where an entity acts in a regulatory capacity or as an enforcement agency. Even though these entities may be able to demonstrate that they have the power to determine the significant terms and conditions, they are often not able to use all or substantially all of the resources that result from the transaction, nor are they exposed to variability in the results of the transactions.
- 4.6 GRAP 109 indicates that if the entity assesses that it is not the agent in an arrangement, then it is by default the principal.

**Applying the criteria in GRAP 109 to assess whether a municipality is an agent or principal**

- 4.7 In determining whether a municipality is the agent or the principal in the housing arrangement, the criteria in paragraph 4.4 need to be assessed against the rights and obligations in terms of the arrangement concluded between the municipality and the relevant provincial Department of Human Settlements.

***Power to determine the significant terms and conditions of the transactions***

- 4.8 In assessing the transactions that the municipality undertakes with the beneficiaries of the national housing programme and with contractors and/or other service providers on behalf of the national and relevant provincial departments of Human Settlements, it should be considered (a) who determines the specifications of the houses to be constructed; (b) who selects and identifies eligible beneficiaries; and (c) who appoints the contractors and/or other service providers.

***Specifications for the construction of the houses***

- 4.9 Paragraph 1.6 noted that one of the responsibilities of the Minister of Human Settlements is the publication of the national technical norms and standards as part of the Code. These norms and standards set out the minimum national technical requirements to be applied during the construction and creation of serviced residential stands and houses.
- 4.10 The Code specifies that the norms and standards need to be applied by all municipalities that undertake roles and responsibilities through the national housing programme. Any deviation from the norms and standards needs to be approved by the MEC through an application to the relevant provincial Department of Human Settlements.
- 4.11 The technical norms and standards are prescriptive with regards to conditions, standards and specifications in respect of the stand-alone permanent residential



structures and houses. In addition to prescribing the sizes and minimum design and layout of the houses to be constructed, the norms and standards also prescribe aspects such as the material that should be used during the construction and specifications with regards to the foundations, fillings, wall and floor slabs, roof, lightning, etc.

- 4.12 As any amendments and deviations from these specifications can only be approved by the MEC through an application to the relevant provincial Department of Human Settlements, it is evident that the municipality does not have the power to determine any significant terms and conditions related to the houses to be constructed.

*Selection and identification of eligible beneficiaries*

- 4.13 Paragraph 1.55 noted that the Code prescribes the eligibility criteria of beneficiaries of the national housing programme. Where an application form is received by a municipality, it is only responsible to verify the completeness of the information provided by the beneficiary. The information on the application form may either be submitted to the relevant provincial department of Human Settlements, or it can be entered into the HSS by the municipality. The selection and approval of eligible beneficiaries remains the responsibility of the relevant provincial Department of Human Settlements.
- 4.14 The municipality is not responsible for the selection of the beneficiaries nor can it amend the list of beneficiaries once approved. Once an eligible beneficiary has been identified by the provincial Department of Human Settlements, a stand or plot number is created and allocated to the eligible beneficiary. This information is then submitted to the municipality who in turn communicates it to the beneficiary.
- 4.15 If an amount needs to be paid by the eligible beneficiary before he or she can occupy the house after construction, this will also be determined by the relevant provincial Department of Human Settlements based on the grant allocated to the beneficiary by the relevant department.

*Transfer of completed house to beneficiary*

- 4.16 After the completion of the constructed house, the municipality may play a role in the handing over of the house to the beneficiary, but the allocation of a house to a beneficiary rests with the relevant provincial Department of Human Settlements and not with the municipality.
- 4.17 Therefore, from the discussion above it is evident that the municipality does not have the power to determine the significant terms and conditions of the transactions with the beneficiaries.

*Appointment of contractors and/or other service providers*

- 4.18 Paragraph 1.29 noted that, even though the municipality may facilitate the appointment of contractors and/or other service providers on behalf of the relevant provincial



Department of Human Settlements, the relevant Department of Human Settlements is responsible for fulfilling the rights and obligations in terms of the arrangement entered with the contractors and/or other service providers. As such, the municipality does not have the power to determine the significant terms and conditions of the transactions with the contractors and/or other service providers, but engages with them on behalf of the relevant provincial Department of Human Settlements.

***Ability to use all or substantially all of the resources that result from the transactions for its own benefit***

- 4.19 In accordance with GRAP 109, an entity does not have the ability to use the resources that result from the transactions with third parties when it does not have unrestricted access to those resources and cannot use those resources for its own benefit.
- 4.20 In the housing arrangement, municipalities receive a grant from the relevant provincial Department of Human Settlements that is to be used for the construction of houses for the eligible beneficiaries as selected and identified by the relevant provincial Department of Human Settlements.
- 4.21 The municipality needs to assess whether it is able to use the constructed houses and the grant received for its own benefit.

***A municipality's ability to use the constructed house to be received by eligible beneficiaries for its own benefit***

- 4.22 A municipality is not responsible for the selection of the beneficiaries nor can it amend the list once approved by the relevant provincial Department of Human Settlements.
- 4.23 The municipality may play a role in the handing over of the house to the beneficiary after completion of the house, but at no point can the municipality decide to change the beneficiary.
- 4.24 It is thus evident that a municipality does not have the ability to use the constructed houses allocated to eligible beneficiaries in the national housing programme for its own benefit or purposes.

***The municipality's ability to use subsidy grants for its own benefit***

- 4.25 As the grant received from the relevant provincial Department of Human Settlements is to be used only for the construction of the houses as agreed between the relevant provincial Department of Human Settlements and the municipality, the municipality is unable to demonstrate that it has the ability to use all, or substantially all, of the grant for its own benefit.
- 4.26 Even though municipalities are often permitted to retain a portion of the revenue received from the relevant provincial Department of Human Settlements as a fee for the services undertaken on behalf of the relevant provincial Department (which may be referred to as the accreditation fee), the fee is usually nominal in relation to the total grant allocated.





### ***Exposure to variability in the results of transactions***

- 4.27 The last criterion that a municipality needs to assess to determine whether it is an agent in relation to the transactions undertaken with the beneficiaries and contractors and/or other service providers, is its exposure to variability in the results of transactions with the beneficiaries.
- 4.28 In accordance with GRAP 109, an entity's exposure to the results of a transaction does not only refer to the receipt or sacrifice of economic benefits or service potential. It also refers to the end result achieved by undertaking a particular transaction. Although results include the specific outputs of a transaction, they may also include exposure to broader consequences arising from a transaction.
- 4.29 GRAP 109 indicates that an entity is exposed to variability in the results of the transaction when it has exposure to both the positive and negative results associated with that transaction, and these exposures are not limited or fixed. There may be a number of factors that need to be considered in determining whether it is exposed to the variability in the results of transactions. An entity's exposure to the variability in the results of a transaction is usually limited if:
- (a) Another party is responsible for fulfilling the rights and obligations established in the binding arrangement. For example, if the provision of a certain good or service is the responsibility of a specific type of entity in legislation or similar means, then it is likely that recipients of that good or service will look to that entity for delivery of those goods or services.
  - (b) The entity has limited inventory risk, i.e. the risk of theft, obsolescence or other losses, as well as changes in value.
  - (c) The entity receives a fixed fee or a fixed margin, e.g. commission, or administration or transaction fee, for carrying out the transactions.
  - (d) The entity is not exposed to significant default risk, i.e. the risk of fees, taxes, levies or other charges not being paid by third parties.

The list is, however, not exhaustive and other factors may be relevant in assessing exposure to variability in the results of transactions with third parties.

- 4.30 As municipalities that are appointed as project managers do not determine the specifications of the houses, and are not responsible for the identification and selection of beneficiaries, it can be concluded that municipalities are not exposed to the variability in the results of transactions with beneficiaries.
- 4.31 Likewise, municipalities that are project managers are not responsible for fulfilling the rights and obligations under the contractual arrangement entered into with contractors and/or other service providers as the municipality has entered into such arrangements on behalf of the relevant provincial Department of Human Settlements. As a result, the municipality is not exposed to variability in the results of transactions with contractors



and/or other service providers as they undertake transactions on behalf of the relevant provincial Department of Human Settlements.

## **Conclusion**

- 4.32 A municipality that is appointed as a project manager is not able to demonstrate that it has the power to determine the significant terms and conditions of the transactions with the beneficiaries, or contractors and/or service providers in relation to the construction of the houses. The municipality is also not able to use all, or substantially all of the resources, i.e. the grant and constructed houses, that result from the transactions undertaken on behalf of the relevant provincial Department of Human Settlements, nor is the municipality exposed to the variability in the results of these transactions.
- 4.33 Based on the assessment of the three criteria in paragraph 4.4 against the transactions undertaken by a municipality appointed as a project manager, it can be concluded that the municipality is an agent in the arrangement.

## **Accounting by the municipality for resources received as an agent**

- 4.34 In accordance with GRAP 109, an agent should only recognise revenue and expenses that it receives or incurs in return for executing the transactions on behalf of the principal. This includes expenses incurred by the municipality which will not be reimbursed by the relevant provincial Department of Human Settlements. The principal should account for revenues and expenses arising from transactions with third parties in its statement of financial performance because the transactions with the third parties are concluded for the benefit of the principal.
- 4.35 The resources that result from the transactions with the beneficiaries in the housing arrangement include the grant that is received from the provincial Department of Human Settlements. The grant is utilised by the municipality to pay the appointed contractor and/or other service provider, on behalf of the provincial Department of Human Settlements, based on the achievement of agreed performance targets (as agreed between the contractor and/or service provider and the relevant provincial department of Human Settlements).
- 4.36 As the municipality undertakes transactions on behalf of the relevant provincial Department of Human Settlements, it is the agent in relation to the constructed houses, both during construction and when the construction is complete. As the municipality is not the principal for the constructed houses, it should not recognise the grants received that are to be used to construct the houses.
- 4.37 As a municipality that is appointed as project manager is the agent in the arrangement, it is not required to account for the grant that is received from the relevant provincial Department of Human Settlements as its own revenue. Likewise, expenses and payments to contractors and/or other service providers should also not be reflected as an expense in the municipality's statement of financial performance.



- 4.38 As noted in paragraph 1.31, the relevant provincial Department of Human Settlements may in some instances make payments directly to the appointed contractors and/or other service providers. As the municipality undertakes transactions on behalf of the relevant provincial Department of Human Settlements as an agent, these payments will not have an impact on the accounting by the municipality.
- 4.39 The following example illustrates how a municipality that is appointed as project manager should account for the grant received and payments made to the developer for cost incurred for the construction of the houses:

**Example**

Municipality XYZ enters into an arrangement with the provincial Department of Human Settlements in terms of which the municipality must oversee the development and construction of 450 houses by Developer EF.

Developer EF was appointed by the provincial Department of Human Settlements and a contract was entered into between the two parties.

In order to pay the developer for costs incurred for the construction of the houses, the provincial Department of Human Settlements pays a grant amount of R1 000 000 into the bank account of the municipality. The municipality is required to pay the contractor once the agreed performance targets have been met.

The municipality is appointed as the project manager, and is an agent in the arrangement.

As Developer EF has not yet met its target in terms of the construction of the houses, the municipality needs to recognise the grant received as an advance until the developer has met the specified targets:

Dr	Bank account	1 000 000
Cr	Advance: Provincial department of Human Settlements	1 000 000

When the developer is paid, the municipality should reduce the advance:

Dr	Advance: Provincial department of Human Settlements	1 000 000
Cr	Bank account	1 000 000

**Disclosure requirements**

- 4.40 The disclosure requirements in GRAP 109 and other relevant Standards of GRAP should be applied when the municipality is the project manager.



## 5. ACCOUNTING BY MUNICIPALITIES APPOINTED AS PROJECT DEVELOPER

### Introduction

- 5.1 Paragraph 3.25 concluded that the nature of the transactions that the municipality undertakes with the beneficiaries of the national housing programme when appointed as project developer in a specific housing arrangement, is within the scope of GRAP 109. However, because the municipality undertakes the responsibility to construct the houses to be transferred to the eligible beneficiaries, the municipality is not undertaking transactions on behalf of another entity.
- 5.2 This section of the Guideline considers how the municipality should account for the resources received from the relevant provincial Department of Human Settlements, and the expenses incurred by the municipality, where it is appointed as the project developer.

### Accounting for resources received and expenditure incurred by a municipality appointed as project developer

#### Introduction

- 5.3 Where municipalities are appointed as project developer, they undertake the construction of the houses themselves, or appoint a sub-contractor to undertake the construction on their behalf. The municipality needs to assess whether it should apply the principles in the Standard of GRAP on *Construction Contracts* (GRAP 11) to account for the construction activities.

#### Is the municipality a contractor when appointed as project developer?

- 5.4 GRAP 11 applies to a contractor that engages in construction activities. GRAP 11 defines a construction contract as a contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
- 5.5 GRAP 11 defines a contractor as an entity that performs construction work pursuant to a construction contract. In accordance with GRAP 11, a contractor is an entity that enters into a contract to build structures, construct facilities, produce goods, or render services to the specifications of another entity either itself or through the use of sub-contractors. The term “contractor” thus includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.
- 5.6 In assessing the roles and responsibilities of a municipality that is appointed as project developer against the definition of a construction contract and a contractor, it can be concluded that the arrangement entered into between the municipality and the relevant provincial Department of Human Settlements, is within the scope of GRAP 11 as the arrangement requires the construction of houses.



- 5.7 The municipality is the contractor, whether it undertakes the construction itself, appoints a sub-contractor to construct the houses, or enters into any other arrangement with a service provider for the construction of the houses.

**Accounting for the grants received and expenses incurred in relation to the construction of houses**

- 5.8 In accordance with GRAP 11, a construction activity may be funded indirectly by way of a general appropriation or other allocation of general government funds to the contractor, or from general purpose grants from third party funding agencies or other governments. These are classified as fixed price contracts.
- 5.9 In a housing arrangement, the relevant provincial Department of Human Settlements transfers grants to the municipality, which the municipality is, in terms of its arrangement with the relevant provincial Department of Human Settlements, required to use for the construction of the houses.

*Recognition of the grant received as contract revenue*

- 5.10 In accordance with GRAP 11 the grants received should be recognised as contract revenue.
- 5.11 GRAP 11 explains that contract revenue comprises:
- (a) the initial amount of revenue agreed in the contract; and
  - (b) variations in contract work, claims and incentive payments to the extent that:
    - (i) it is probable that they will result in revenue; and
    - (ii) they are capable of being reliably measured.

Contract revenue is measured at the fair value of the consideration received or receivable.

- 5.12 The contract revenue receivable by the municipality is allocated in the DORA.
- 5.13 GRAP 11 requires that when the outcome of a construction contract can be estimated reliably, contract revenue should be recognised as revenue by reference to the stage of completion of the contract activity at the reporting date. The outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
- (a) total contract revenue, if any, can be measured reliably;
  - (b) it is probable that the economic benefits or service potential associated with the contract will flow to the entity;
  - (c) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

- (d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.
- 5.14 As noted in paragraph 1.31, the relevant provincial Department of Human Settlements may in some instances make payments directly to the appointed contractors and/or other service providers. As the municipality is the project developer and responsible for the construction of the houses, the payments made by the relevant provincial Department of Human Settlements to contractors and/or other service providers should be accounted in accordance with GRAP 11.
- 5.15 GRAP 11 requires that contractors should review all amounts relating to the construction contract paid. Amounts reimbursed by third party funding agencies, in this case the relevant provincial Department of Human Settlements, which meet the definition of, and recognition criteria for, revenue, should be accounted for by the contractor in the same way as other contract revenue.
- Recognition of expenses incurred as contract costs*
- 5.16 GRAP 11 requires that contract cost comprise:
- (a) costs that relate directly to the specific contract;
  - (b) costs that are attributable to contract activity in general and can be allocated to the contract on a systematic and rational basis; and
  - (c) such other costs as are specifically chargeable to the customer under the terms of the contract.
- 5.17 GRAP 11 further clarifies that contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:
- (a) general administration costs for which reimbursement is not specified in the contract;
  - (b) selling costs;
  - (c) research and development costs for which reimbursement is not specified in the contract; and
  - (d) depreciation of idle plant and equipment that is not used on a particular contract.
- 5.18 As with contract revenue, GRAP 11 determines that contract costs should be recognised as expenses when the outcome of a construction contract can be estimated reliably, by reference to the stage of completion of the contract activity at the reporting date.
- 5.19 As with amounts reimbursed by third party funding agencies, GRAP 11 requires that the contractor should review all amounts relating to the construction contract paid



directly by subcontractors, and which are reimbursed by third party funding agencies, to determine whether they qualify as contract costs. Amounts meeting the definition of, and recognition criteria for, contract expenses should be accounted for by the contractor in the same way as other contract expenses.

- 5.20 A municipality needs to assess whether expenses incurred which will not be reimbursed by the relevant Department of Human Settlements comprise contract costs as outlined in paragraph 5.16. Based on this assessment, the costs incurred should be recognised in accordance with the applicable Standard of GRAP.
- 5.21 The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and surplus/deficit which can be attributed to the proportion of work completed.
- 5.22 Under the percentage of completion method, contract revenue is recognised as revenue in surplus or deficit in the reporting periods in which the work is performed. Contract costs are usually recognised as an expense in surplus or deficit in the reporting periods in which the work to which they relate is performed.

*Amounts due from and to customers in relation to construction of the houses*

- 5.23 In accordance with GRAP 11, the contractor should recognise the gross amount due from customers for contract work as an asset. This amount is calculated as the net amount of:
- (a) costs incurred plus recognised surpluses; less
  - (b) the sum of recognised deficits and progress billings for all contracts in progress for which costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits) exceeds progress billings.
- 5.24 The contractor is also required to recognise the gross amount due to customers for contract work as a liability. The gross amount due to customers for contract work is calculated as the net amount of costs incurred plus recognised surpluses less the sum of recognised deficits and progress billings for all contracts in progress for which progress billings exceed costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits).
- 5.25 Municipalities should therefore recognise any payments due from the relevant provincial Department of Human Settlements as amounts due from customers for work performed, and any advance payments from the relevant provincial Department of Human Settlement as amounts due to customers.

*Other amounts due to the relevant provincial Department of Human Settlements*



- 5.26 In some instances, the relevant Department of Human Settlements may determine that an amount needs to be paid by the eligible beneficiary before he or she can occupy the house after construction. As the relevant provincial Department of Human Settlements is responsible for approving the eligible beneficiaries and the amount to be paid, if any, these payments are not revenue for the municipality but the relevant provincial Department of Human Settlements. If the eligible beneficiary pays any amount to the municipality, it should also be reflected as amounts due to the provincial Department of Human Settlements until paid.

*Disclosure requirements*

- 5.27 The disclosure requirements in GRAP 11 should be applied when the municipality is the project developer.





## **6. ACCOUNTING FOR THE ACCREDITATION FEE, COMMISSION, ADMINISTRATION OR TRANSACTION FEE RECEIVED**

### **Introduction**

- 6.1 The Accreditation framework and the Code note that municipalities are compensated for undertaking certain transactions following their accreditation. This compensation is referred to in the Code as an accreditation fee.
- 6.2 In addition, the municipality may also receive commission, or an administration or transaction fee for undertaking certain transactions in the national housing programme, for example, marketing the stands and receiving application forms from beneficiaries and processing these on the HSS. This section of the Guideline considers the accounting of the accreditation fee and any other commission, administration or transaction fee that the municipality may receive.

### **Accounting for the accreditation fee, commission, administration or transaction fee received**

#### **Accreditation fee**

- 6.3 For performing the delegated functions in terms of the national housing programme, municipalities are permitted to retain a portion of the HSDG grant as a fee, referred to as the accreditation fee. This fee is received to cover operational costs and is paid in relation to the accreditation-linked functions. The Code clarifies that municipalities are entitled to the accreditation fee on meeting certain performance objectives.
- 6.4 The accreditation fee is normally transferred by the relevant provincial department of Human Settlements to municipalities at the same time as the HSDG grant. Municipalities should therefore identify the accreditation fee as a separate component from the grant received for the construction of the houses and account for it separately.
- 6.5 A specified formula, as set out in the Code, is used to calculate the accreditation fee to be received by the municipality. The accreditation fee is calculated as a percentage of the municipal housing budget based on the projected operational cost set down in the business plan, expressed as a percentage of the housing budget allocated to the municipality (accreditation fee % = projected annual operation cost / municipal housing budget).

#### **Commission, administration or transaction fee**

- 6.6 Non-accredited municipalities may also undertake certain transactions in a housing arrangement for which they are compensated either in the form of commission, or an administration or transaction fee.
- 6.7 Municipalities should identify and separately account for any commission, administration or transaction fee received from the relevant provincial Department of Human Settlements.



## **Recognition of the accreditation fee, commission, administration or transaction fee**

- 6.8 The accreditation fee, commission, administration or transaction fee received or receivable should be accounted for in terms of the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9). GRAP 9 requires that such revenue should be measured at the fair value of the consideration received or receivable.
- 6.9 To the extent that the accreditation fee, commission, administration or transaction fee received or receivable relates to the rendering of services which are directly related to the construction of the houses, the principles in GRAP 11 could also be applied to account for the revenue. However, when the accreditation fee, commission, administration or transaction fee is received for undertaking responsibilities not directly related to the construction of the houses, the principles in GRAP 9 should be applied.
- 6.10 The principles for the recognition of revenue in terms of GRAP 11 are discussed in section 5.
- 6.11 As the accreditation fee is calculated as a percentage of the municipal housing budget based on the projected operational cost of the project, the fair value will be the amount receivable, calculated per the prescribed formula. The commission, administration or transaction fee will be determined and agreed between the municipality and the relevant provincial Department of Human Settlements in the binding arrangement, and fair value will be the amount of the receivable as per the binding arrangement.
- 6.12 When the principles in GRAP 9 are applied, the revenue should be recognised in the reporting period that relates to the rendering of services.
- 6.13 GRAP 9 requires that revenue from rendering of services should be recognised when:
- (a) the amount of revenue can be measured reliably;
  - (b) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity;
  - (c) the stage of completion of the transaction at the reporting date can be measured reliably; and
  - (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.
- 6.14 The following example illustrates how a municipality should recognise the accreditation fee received:

### **Example**

Municipality ABC, who is accredited as a level one municipality in terms of the Housing Act, signs an arrangement with the provincial Department of Human Settlements, in terms of which it will receive an accreditation fee of R1 500 000 for undertaking certain functions in relation

to the construction of 500 houses. The municipality's entitlement to the accreditation fee is based on meeting agreed performance targets.

In terms of the arrangement, the municipality will receive R850 000 when 70% of the construction is completed, a further R300 000 when 90% of the construction is completed, and the remainder of the accreditation fee when the letter is received from the beneficiary indicating that they are satisfied with the house handed to them.

Construction of the housing development is completed as follows:

20X1 – 60%

20X2 – 80%

20X3 – 100%

In addition to the accreditation fee, the municipality also receives a transaction fee of R50 000 for its role in the marketing of the stands to potential beneficiaries. The municipality undertakes the marketing during 20X1.

Exchange revenue should be recognised by Municipality ABC in its statement of financial performance as follows:

20X1 –	<p>Recognition of the transaction fee:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding-left: 20px;">Dr Bank (Receivable)</td> <td style="text-align: right;">50 000</td> </tr> <tr> <td style="padding-left: 20px;">Cr Exchange revenue: Transaction fee</td> <td style="text-align: right;">50 000</td> </tr> </table> <p>Recognition of accreditation fee</p> <p>No revenue in relation to the accreditation fee received is recognised as 70% of the construction has not been completed.</p>	Dr Bank (Receivable)	50 000	Cr Exchange revenue: Transaction fee	50 000
Dr Bank (Receivable)	50 000				
Cr Exchange revenue: Transaction fee	50 000				
20X2 –	<p>Revenue of R850 000 should be recognised as 70% of the construction is completed. To the extent that the revenue is not received from the provincial Department of Human Settlements when the 70% performance target is met, a receivable should be recognised.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding-left: 20px;">Dr Bank (Receivable)</td> <td style="text-align: right;">850 000</td> </tr> <tr> <td style="padding-left: 20px;">Cr Exchange revenue: Accreditation fee</td> <td style="text-align: right;">850 000</td> </tr> </table>	Dr Bank (Receivable)	850 000	Cr Exchange revenue: Accreditation fee	850 000
Dr Bank (Receivable)	850 000				
Cr Exchange revenue: Accreditation fee	850 000				
20X3 –	<p>Revenue of R300 000 should be recognised when 90% of the construction is completed. To the extent that the revenue is not received from the provincial Department of Human Settlements when the 90% performance target is met, a receivable should be recognised.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding-left: 20px;">Dr Bank (Receivable)</td> <td style="text-align: right;">300 000</td> </tr> <tr> <td style="padding-left: 20px;">Cr Exchange revenue: Accreditation fee</td> <td style="text-align: right;">300 000</td> </tr> </table>	Dr Bank (Receivable)	300 000	Cr Exchange revenue: Accreditation fee	300 000
Dr Bank (Receivable)	300 000				
Cr Exchange revenue: Accreditation fee	300 000				



	<p>A further R350 000 (R1 500 000 – R850 000 – R300 000) should be recognised when the construction is completed and the letter from the beneficiary is received. To the extent that the revenue is not received from the provincial department of Human Settlements when this target is met, a receivable should be recognised.</p>
	<p>Dr Bank (Receivable) 350 000</p> <p>Cr Exchange revenue: Accreditation fee 350 000</p>

### Disclosure requirements

- 6.15 For disclosure requirements that should be considered by a municipality who has been appointed as project developer, reference should be made to GRAP 9.
- 6.16 If the principles in GRAP 11 are applied to recognise the accreditation fee, commission, administration or transaction fee received or receivable, reference should be made to GRAP 11 for the disclosure requirements.



## 7. LAND AND INFRASTRUCTURE

### Introduction

- 7.1 Section 9 of the Housing Act requires every municipality, as part of its IDP to identify and designate land for a housing development.
- 7.2 Sections 1 to 6 of this Guideline describe the accounting treatment for the construction of houses. This section focuses on the different ways in which land can be acquired for housing development purposes and the related accounting implications. It also considers how to account for infrastructure, vacant land and other assets that may be acquired or constructed as part of a township development.
- 7.3 The principles in this section relating to the accounting for land and infrastructure may be applied by a municipality that acts as a project manager or project developer as described in Section 1.

### Acquisition of land for a housing development

- 7.4 Section 1 indicates that a municipality identifies the need for a housing development within its jurisdiction and incorporates plans to address those needs in its Municipal Human Settlements Plan (MHSP).
- 7.5 The MHSP is developed by considering input from the provincial Department of Human Settlements as well as other stakeholders. The part of the MHSP that addresses the execution of national housing programmes is approved by the relevant MEC for Human Settlements.
- 7.6 The plans contained within the MHSP include the manner in which land is expected to be acquired for a housing development, for example:
- (a) the use of existing land that is owned by a municipality,
  - (b) land acquired through:
    - (i) allocations received from the national Department of Human Settlements in the form of the Urban Settlement Development Grant (USDG); and
    - (ii) donations or transfers from third parties.
- 7.7 The MHSP is integrated into the municipality's IDP. The IDP is approved by Council.
- 7.8 The following paragraphs discuss the accounting implications of land used for a housing development, in particular, whether or not the land used for housing development purposes should be recognised as an asset by a municipality.

### Assessment of control over land

- 7.9 The definition of an asset is met if the resource is controlled by the entity as a result of past events and from which future economic benefits or service potential is expected to flow to the entity. An asset is recognised in the statement of financial position when



it is probable that the future economic benefits or service potential will flow to the entity and the asset has a cost or value that can be measured reliably.

- 7.10 The Interpretation of the Standards of GRAP on *Recognition and Derecognition of Land* (IGRAP 18) provides guidance on when an entity recognises and derecognises land as an asset in its financial statements.
- 7.11 The IGRAP notes that an entity must have control of the resource for it to be recognised. Control of the resource requires the ability of the entity to use the resource, or direct other parties to use it, so as to benefit from its service potential or future economic benefits.
- 7.12 In order for information to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not their legal form.
- 7.13 Legal ownership is one method to assess control over land, but a right to service potential or the ability to generate future economic benefits, may exist without legal ownership of the land. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal ownership.
- 7.14 As a result, control may be evidenced by certain criteria. These criteria, as described in IGRAP 18 assist an entity to conclude that it controls the land. These control criteria are as follows:
- legal ownership; and/or
  - the right to direct access to land, and to restrict or deny the access of others to the land.
- 7.15 These criteria need to be assessed to determine the accounting treatment of land used for a housing development.

#### **Assessment of control criteria**

- 7.16 A municipality enters into an arrangement with the relevant provincial Department of Human Settlements as described in paragraph 1.44. This arrangement may be in the form of a Memorandum of Understanding, Service Level Agreement or other similar agreements.
- 7.17 The arrangement confirms, amongst other things, the detailed roles and responsibilities of the municipality and provincial Department of Human Settlements. This includes confirmation of the participation of the municipality in the specified national housing project and the resources to be acquired and/or used for a housing development. The MHSP, IDP or similar documents may provide more detailed information about the resources to be used in executing the arrangement.
- 7.18 Once an arrangement is entered into with the provincial Department of Human Settlements, land that has been identified for a housing development, can only be used



by the municipality for the purposes of housing development.

- 7.19 Such land, whether or not it is legally owned by the municipality, is subjected to an assessment of control by the municipality.
- 7.20 The right to direct access to the land, and to restrict or deny the access of others to the land is an essential element of control that distinguishes an entity's assets from those resources that all entities have access to and benefit from. The right means that the entity has the ability to decide how, and by whom the land can be used.
- 7.21 IGRAP 18 indicates that in assessing whether an entity has the right to direct access to the land, and to restrict or deny the access of others to the land, an entity considers whether it can:
- direct the use of the land's future economic benefits or service potential to provide services to beneficiaries; or
  - exchange, dispose of, or transfer the land; and/or
  - use the land in any other way to generate future economic benefits or service potential.
- 7.22 When a municipality enters into an arrangement with the provincial Department of Human Settlements, the municipality:
- cannot direct the use of the future economic benefits or service potential of the land acquired or expected to be acquired to provide services to beneficiaries as it transfers the land to the provincial Department of Human Settlements;
  - cannot exchange, dispose of or transfer the land;
  - cannot use the land in any other way to generate future economic benefits or service potential, other than for use in a housing development; and
  - undertakes a housing development on behalf of the provincial Department of Human Settlements (see discussion in paragraphs 3.24 to 3.27).
- 7.23 Although a municipality may indicate that it intends using the land for a housing development, e.g. through the approval of its MHSP, IDP or similar documents, until such time that an arrangement is entered into with the provincial Department of Human Settlements, a municipality has the ability to change its intended use of the land. This is because it can decide to exchange, dispose or transfer that land instead of using it for a housing development. As a result, it controls the land until an arrangement is entered into with the provincial Department of Human Settlements.
- 7.24 When assessing control of land, a municipality must consider the terms and conditions of each arrangement entered into with the provincial Department of Human Settlements, the requirements of legislation or similar means, and any other factors, in relation to the control criteria.



## Impact of the control assessment

### Existing land owned by the municipality

- 7.25 Land owned by municipalities is classified in their financial statements based on the municipalities' use of that land.
- 7.26 When the intention of a municipality is to use existing land owned for the purposes of a housing development, the classification of that land may change as a result of the change in its expected use following a decision by the municipal Council to use the land for a housing development. A change in intention may also be evidenced through the approval of a municipality's MHSP, IDP or similar documents.

### Classification of land as inventory

- 7.27 Land held for the purposes of a housing development is transferred to the provincial Department of Human Settlements for use in meeting its objectives, i.e. housing development.
- 7.28 The Standard of GRAP on *Inventories* (GRAP 12) defines inventories as those assets that are:
- in the form of materials or supplies to be consumed in the production process;
  - in the form of materials or supplies to be consumed or distributed in the rendering of services;
  - held for sale or distribution in the ordinary course of operations; or
  - in the process of production for sale or distribution.
- 7.29 In determining whether the land transferred by a municipality to the provincial Department of Human Settlements is a distribution that is made in the ordinary course of a municipality's operations, its mandate, as determined in legislation or similar means, needs to be evaluated. The identification and designation of the land in relation to the housing development is within the mandate of municipalities, as indicated in paragraph 7.1.
- 7.30 Therefore, the land that has been designated for the purposes of a housing development meets the definition of inventory in accordance with GRAP 12 and requires reclassification to inventory.
- 7.31 The principles in the applicable Standard of GRAP are applied to account for the land until the date of reclassification to inventory.
- 7.32 GRAP 12 requires that inventories that qualify for recognition as assets are initially measured at cost. The carrying amount of the land up until the date of reclassification, as determined in accordance with the applicable Standards of GRAP, is the cost amount on the date of reclassification.
- 7.33 The subsequent measurement principles in GRAP 12 should then be applied.





### **Land acquired through the Urban Settlement Development Grant (USDG)**

- 7.34 Section 1 of the Guideline notes that the DORA describes the Urban Settlement Development Grant (USDG) as a conditional grant that is transferred from the national department of Human Settlements directly to metropolitan municipalities for the purpose of supporting national housing arrangements. This includes increasing the supply of land for a housing development.
- 7.35 The USDG is a method of funding that a municipality plans to use for acquiring land for a housing development (see discussion in paragraph 7.6). For the purposes of this Guideline, acquisition of land is made from parties other than the provincial Department of Human Settlements.
- 7.36 The USDG may also be used by the municipality to fund bulk infrastructure capacity to provide basic services such as water, sanitation, electricity, refuse removal and access to transport and is discussed in paragraphs 7.70 to 7.83.
- 7.37 When the USDG is used to fund both land and infrastructure, the municipality needs to distinguish the portion of the USDG that is expected to be used for the acquisition of the land, and the portion that relates to the acquisition or development of infrastructure. Such apportionment may be based on the MHSP or similar plans.

### **Accounting for transactions relating to the USDG**

- 7.38 The Standard of GRAP on *Revenue from Non-Exchange Transactions (Taxes and Transfers)* (GRAP 23) requires that revenue received by an entity, where the recipient receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange, constitutes revenue from non-exchange transactions.
- 7.39 Municipalities receive the grant from the national Department of Human Settlements without directly giving approximate equal value in exchange to the national Department of Human Settlements. Instead, the provincial Department of Human Settlements receives the value or benefit from the use of the grant, i.e. the land. Therefore, the allocation of the USDG to a municipality is within the scope of GRAP 23.
- 7.40 GRAP 23 requires an entity to establish enforceability of its control over resources before it can recognise it as an asset.
- 7.41 The allocation of the USDG in the DORA specifies the name of the receiving municipality, the amount allocated and the financial period to which the allocation relates. As a result, the municipality has an enforceable claim to the resources and has the capacity to exclude or regulate access to the future economic benefits or service potential of that resource.
- 7.42 The asset is measured on initial recognition at the amount stipulated in the DORA allocation for the applicable financial period to which the allocation relates.



- 7.43 GRAP 23 further indicates that an inflow of resources from a non-exchange transaction recognised as an asset should be recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow. In addition, it states that if conditions are attached to a transferred asset, it gives rise to a present obligation on initial recognition.
- 7.44 The USDG allocated in terms of the DORA is conditional, and if not used as stipulated, the grant needs to be returned to the national Department of Human Settlements.
- 7.45 Municipalities should recognise the grant as a liability until the conditions attached to the grant are met. These conditions will be met when the municipality acquires the land for the purposes of a housing development.
- 7.46 The amount of the liability that should be recognised is equivalent to the asset recognised on initial recognition.
- 7.47 When the land is acquired, the condition is met resulting in the carrying amount of the liability being reduced and non-exchange revenue being recognised in the statement of financial performance. The amount of non-exchange revenue recognised is equal to the reduction of the amount of the liability.
- 7.48 An evaluation of the control criteria indicates that a municipality controls the land until an arrangement is entered into with the provincial Department of Human Settlements (see discussion in paragraphs 7.16 to 7.24).
- 7.49 In determining whether the land acquired using the USDG is recognised as an asset, a municipality considers whether it, at the time of acquiring the land, has entered into such an arrangement.
- 7.50 If an arrangement has not been entered into when the land is acquired, the land acquired by the municipality is recognised as an asset in the statement of financial position.
- 7.51 Such land is classified as inventory when the municipality intends to use it for a housing development, and is initially measured at cost (see discussion in paragraphs 7.25 to 7.33).
- 7.52 If however, such an arrangement has been entered into prior to the acquisition of the land, the municipality does not control the land when it is acquired, and it is expensed in the statement of financial performance. When the land is acquired, it is immediately transferred to the provincial Department of Human Settlements as it controls the land from that point on.

### **Land acquired through transfers/donations from third parties**



- 7.53 Land may be transferred or donated to a municipality for the purposes of a housing development. For purposes of this Guideline, the expectation of the transferor or donor is that this land will only be used for a housing development. Such arrangements may be evidenced by an agreement entered into between the municipality and the transferor or donor.
- 7.54 For the purposes of this Guideline, transfers or donations includes transfers or donations made by parties other than the provincial Department of Human Settlements. Transfers or donations from the provincial Department of Human Settlements are not accounted for as assets by the municipality, as the land is controlled by the provincial Department of Human Settlements to fulfil its own objectives, i.e. housing development.
- 7.55 The transfer or donation of land to a municipality results in the municipality receiving value from the transferor or donor, without the municipality directly giving approximately equal value in exchange, or giving value to another entity without directly receiving approximately equal value in exchange.
- 7.56 GRAP 23 indicates that an entity recognises an asset arising from non-exchange transaction when it gains control of resources that meet the definition of an asset and satisfy the recognition criteria.
- 7.57 A municipality is required to have legal ownership of the land transferred or donated to it in order for that land to be used for a housing development purposes. Although legal ownership is transferred to the municipality, substance over form of the transaction needs to be considered. This requires an assessment of the control criteria.
- 7.58 In determining whether the land acquired through the donation or transfer is recognised as an asset, the municipality considers whether if, at the time of acquiring the land, it has entered into an arrangement with the provincial Department of Human Settlements.
- 7.59 An evaluation of the control criteria indicates that a municipality controls the land until an arrangement has been entered into with the provincial Department of Human Settlements (see discussion in paragraphs 7.16 to 7.24).
- 7.60 If an arrangement has not been entered into when the land is acquired, the land acquired is recognised as an asset in the statement of financial position of the municipality.
- 7.61 In accordance with the requirements of GRAP 23, the municipality is required to initially measure an asset acquired through a non-exchange transaction at its fair value as at the date of acquisition.
- 7.62 As the intention of the municipality is to acquire the land for housing development purposes, that land should be classified as inventory in accordance with GRAP 12 (see discussion in paragraphs 7.25 to 7.33).



- 7.63 GRAP 23 requires an inflow of resources from a non-exchange transaction recognised as an asset to be recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow.
- 7.64 In determining if a liability is also recognised, the municipality considers the terms and conditions of the agreement entered into with the party that has donated or transferred the land.
- 7.65 GRAP 23 provides guidance on when such liabilities may arise. It requires entities to determine if stipulations imposed on the transfer of assets are restrictions or conditions. A liability is recognised when conditions are present, which if present, result in the asset being transferred to the transferor, if the recipient does not meet its obligations in terms of the agreement entered into.
- 7.66 The requirements would be different if a municipality enters into an arrangement with the provincial Department of Human Settlements prior to the acquisition of land.
- 7.67 GRAP 23 prescribes the accounting treatment of goods received in-kind. Goods in-kind are recognised as assets when the entity gains control of the goods and the recognition criteria are satisfied. The goods are measured at fair value on the date of acquisition.
- 7.68 The acquisition of land in these arrangements is similar to the receipt of goods in-kind. However, because the land acquired is immediately transferred to the provincial Department of Human Settlements, the municipality recognises an expense for the consumption of the goods received, i.e. the land. Revenue equal to the value of the goods received is recognised, and this will be equivalent to the fair value of the land on the date of acquisition.

### **Examples to illustrate the accounting for land**

#### ***Reclassification of existing land owned by a municipality to inventory***

##### **Example 1**

Municipality A currently owns land and accounts for it in terms of the Standard of GRAP on *Investment Property* (GRAP 16). The land is measured in terms of the cost model at an amount of R1 000 000. On 1 August 20X1, the Council approves the IDP of the municipality which designates the land to be used for a housing development in accordance with a national housing programme. Assume no impairment has been previously recognised on the land.

##### **Reclassification of land to inventory due to a change in manner of use**

*01 August 20X1*



Dr Inventory	1 000 000
Cr Investment property	1 000 000

**Land acquired through the USDG**

**Example 2**

In terms of its approved IDP by Council, Municipality A plans to acquire land for a housing development through the use of its USDG for the 20X2 financial period.

A USDG allocation to the value of R1 200 000 is made in the DORA to Municipality A on 1 July 20X1. Municipality A has determined that the grant will be used for the acquisition of land, and not for the development of infrastructure.

On 1 August 20X1, an arrangement is entered into with the provincial Department of Human Settlements for the municipality to establish a housing development.

On 1 September 20X1, the municipality enters into a sale agreement with a third party for the purchase of land for R1 200 000. The municipality's financial year-end is 30 June 20X2.

The following journal entries should be reflected in the financial statements of the municipality:

Recognition of the grant asset and equivalent liability

01 July 20X1

Dr Receivable/Bank	1 200 000
Cr Liability	1 200 000

Arrangement with provincial Department of Human Settlements

01 August 20X1

*An arrangement is entered into with the provincial Department of Human Settlements. As a result, land that is acquired subsequent to this date, is not controlled by the municipality.*

Acquisition of land and settlement of liability

01 September 20X1

Dr Expense	1 200 000
Cr Bank/Payable	1 200 000

Acquisition of land by the municipality and immediate transfer thereof

Dr Liability	1 200 000
Cr Non-exchange revenue	1 200 000

Reduction of liability and recognition of revenue

### **Land donated or transferred**

#### **Example 3**

On 1 September 20X1, party X transfers legal ownership of land to Municipality A for the purposes of housing development.

The intention of the municipality is to use this land for a housing development. An arrangement with the provincial Department of Human Settlements has not as yet been entered into.

The land is transferred at Rnil.

The fair value of the land on the date of transfer is R1 500 000. The municipality is not required to return the land to the transferor under any circumstances.

1 September 20X1

Dr Inventory	1 500 000	
Cr Non-exchange revenue		1 500 000

### **Derecognition of land**

- 7.69 When a municipality intends to use the land that it controls for a housing development, that land is classified as inventory (see discussion in paragraphs 7.25 to 7.33). It is derecognised when an arrangement is entered into with the provincial Department of Human Settlements (see discussion in paragraphs 7.16 to 7.24).

### **Infrastructure, vacant land and other assets**

#### **Infrastructure assets acquired or constructed**

- 7.70 The end result of a housing development is the provision of houses to beneficiaries resulting in the establishment of a township development. Access to services such as water, sanitation and transport to the residents within the township development are essential. As a result, appropriate infrastructure assets, for example, sewer systems for sanitation purposes, are necessary to provide these services.
- 7.71 The Standard of GRAP on *Property, Plant and Equipment* (GRAP 17) indicates that infrastructure assets 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 subjected to constraints on disposal.
- 7.72 GRAP 17 provides examples of infrastructure assets. These include road networks, sewer systems, water and power supply systems and communication networks.
- 7.73 A municipality uses infrastructure, which are tangible items, to deliver services to the township establishment, which are expected to be used during more than one reporting period. As such, it satisfies the definition of property, plant and equipment as defined in GRAP 17. A municipality is required to assess the recognition criteria to determine if the infrastructure assets should be accounted for as its assets.
- 7.74 The acquisition or development of infrastructure assets may be funded from the USDG or from other sources of funding available to a municipality.
- 7.75 The same principles outlined in paragraphs 7.38 to 7.52 can be applied to the recognition and measurement of the USDG as it relates to infrastructure development.
- 7.76 Those paragraphs discuss the initial recognition of the grant as an asset and equivalent liability. In relation to infrastructure assets, the liability is reduced when the condition attached to the grant is met. This occurs when the municipality acquires or develops the necessary infrastructure assets.
- 7.77 The determination of whether infrastructure assets acquired or developed meet the definition of an asset for a municipality requires assessment.
- 7.78 The definition of an asset is met if the resource is controlled by the entity as a result of past events and from which future economic benefits or service potential is expected to flow to the entity. An asset is recognised in the statement of financial position when it is probable that the future economic benefits or service potential will flow to the entity and the asset has a cost or value that can be measured reliably.
- 7.79 Control of a resource requires the ability of an entity to use the resource, or direct other parties to use it, so as to benefit from the service potential or future economic benefits.
- 7.80 The municipality is responsible for managing the infrastructure assets throughout its life cycle, which includes amongst other things:
- making decisions about the type of infrastructure to be constructed;
  - assessing the nature, type and volume of goods and/or services to be provided, and to whom and at what price; and
  - maintaining the infrastructure and ensuring that it meets the required service delivery objectives.
- 7.81 As a result, the municipality is able to demonstrate that it controls the infrastructure assets and recognised in its statement of financial position.
- 7.82 During the construction of the infrastructure asset that is controlled by a municipality, it is classified as an asset under construction.



- 7.83 GRAP 17 requires that buildings and other structures constructed on the land should be accounted for separately. The municipality should therefore assess whether the land on which the infrastructure is constructed should be accounted for as its asset after considering the principles in paragraphs 7.84 to 7.96.

***Vacant land***

- 7.84 Portions of land that are vacant may also exist within a township establishment.
- 7.85 A municipality should assess the control criteria in terms of IGRAP 18 to determine if it controls the future economic benefits or service potential associated with the vacant portions of land. This assessment is made when an arrangement is entered into with the provincial Department of Human Settlements, as well as during the township development.
- 7.86 If a municipality, at the time of entering into an arrangement with the provincial Department of Human Settlements, concludes that it controls portions of vacant land, it should account for that land as its assets in terms of the applicable Standard of GRAP based on the intended use of the land when the arrangement is entered into. If the land is already recognised as an asset by the municipality, the municipality should only derecognise the portion that it does not control after entering into an arrangement with the provincial Department of Human Settlements. Once the township development is completed, revisions may need to be made to the values of the land initially recognised in accordance with the applicable Standard of GRAP. This revision should be treated as a change in accounting estimate in accordance with the Standard of GRAP on *Changes in Accounting Policies, Estimates and Errors* (GRAP 3).
- 7.87 In determining the portions of vacant land it controls, a municipality may use township planning guidelines and frameworks, policies or similar documents in making an estimation of those portions. For example, using the township planning guidelines, a municipality estimates that twenty per cent of the total land area will be used for the construction of roads, and by applying the control criteria in IGRAP 18, the municipality concludes that it controls those portions of vacant land that will be used as roads.
- 7.88 When vacant land is recognised as an asset, its classification is dependent on how it is expected to be used, and this determines the relevant Standard of GRAP that should be applied to account for it.
- 7.89 When vacant land is held for “strategic purposes” (as described in GRAP 16), a municipality should apply the requirements of GRAP 17.
- 7.90 Land held for strategic purposes is property that, although not currently used as property, plant and equipment, is likely to be used in the production or supply of goods and services or for administrative purposes in future because of legislation, policies, decisions or plans adopted by an entity.





- 7.91 The following example illustrates how the municipality should recognise the portion of vacant land that it controls after it has entered into the arrangement with the relevant provincial Department of Human Settlements:

***Accounting for existing land used for housing development controlled by the municipality***

**Example 1**

A municipal Council decides on 15 July 20X1 to use existing land for a housing development, to be undertaken in terms of the national housing programme. Based on the approved township development, the municipality will build a clinic to provide health facilities to the community. The municipality estimates that the 15% of the total land area will be used to build the clinic. A municipality enters into an arrangement on 1 August 20X1 with the provincial Department of Human Settlements in terms of which the municipality agrees to use its existing land for housing development under the national housing programme. The vacant land is currently recognised by the municipality at R1 100 000 as property, plant and equipment. The municipality's year-end is 30 June 20X2.

Reclassification of existing land owned by the municipality

15 July 20X1

Dr Inventory	935 000
Cr Property, Plant and Equipment	935 000

*(Reclassification of portion of land that will be derecognised based on Council decision – R1 100 000 x 85%)*

Derecognition of the portion of land not controlled by the entity when the arrangement is entered into with the provincial Department of Human Settlements

01 August 20X1

Dr Expense	935 000
Cr Inventory	935 000

*(Derecognition of portion of land not controlled by entity)*

*At year end, i.e. 30 June 20X2, the vacant portion of the land that is controlled by the entity in the housing arrangement is R165 000.*

Adjust the value of land retained after completion of the township development

At completion of the township development on 31 May 20X3, the municipality verifies that the clinic is built on 12% of the total land area.

31 May 20X3

Dr Expense	33 000
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Cr Land 33 000

*(R165 000 less (R1 100 000 x 12%))*

*Adjust for the change in the accounting estimate in relation to the portion of land that is retained by the municipality after the township development is completed. Initial estimation was 15% while actual portion retained is 12% after completion of the township development.*

**Accounting for land used for housing development controlled by the provincial Department of Human Settlements**

**Example 2**

A municipality enters into an arrangement on 15 September 20X1 with the provincial Department of Human Settlements in terms of which the municipality agrees to participate in a housing development project. The land on which the housing development will take place on existing land of the provincial Department of Human Settlements, and is reflected as an asset in the Department's financial statements as R1 500 000.

Based on the approved township development, the municipality will build a recreation facility for the community. The municipality estimates that 17% of the total land area will be used to build the facility. The municipality's year-end is 30 June 20X2.

Recognition of the land portion on which facility will be constructed

*15 September 20X1*

Dr Land 225 000

Cr Non-exchange revenue 225 000

*(R1 500 000 x 17%)*

*At year end, i.e. 30 June 20X2, the vacant (the vacant portion of the land that is controlled by the entity in the housing arrangement is R225 000).*

**Other assets**

- 7.92 In addition, buildings such as municipal halls, clinics and fire stations may be constructed within a township development for the benefit of the community.
- 7.93 Similar criteria as explained in paragraph 7.80 to determine control over infrastructure assets are used to determine control of other assets.
- 7.94 In determining control of other assets, control of the land on which these assets are constructed on needs to be assessed separately.
- 7.95 As these types of assets are tangible items that are held for use in the production or supply of goods or services, for rental to others or administrative purposes and are



expected to be used during more than one reporting period, they are accounted for in accordance with GRAP 17.

- 7.96 During the construction of other assets that are controlled by a municipality, they are classified as an asset under construction.

### **Conclusion**

- 7.97 Based on this section, the following principles should be applied when accounting for land, infrastructure assets, and other assets used in the national housing programme:
- Land is classified as inventory when there is a clear intention of the municipality to use existing land for a housing development.
  - The municipality loses control of land when an arrangement is entered into with the relevant provincial Department of Human Settlements.
  - Infrastructure assets are accounted for as property, plant and equipment.
  - Control of vacant portions of land needs to be determined when an arrangement is entered into with the relevant provincial Department of Human Settlements, using the control criteria.
  - Control over other assets, and the land on which they are built, needs to be assessed separately, using the control criteria in IGRAP 18.



## **8. APPLICATION OF THIS GUIDELINE TO EXISTING ARRANGEMENTS**

### **Aligning existing accounting policies with the principles in the Guideline**

- 8.1 If a municipality, who is appointed as a project manager and/or a project developer in relation to arrangements undertaken in terms of the national housing programme, is not accounting for its housing arrangements as outlined in chapters 4 to 6 of the Guideline, it applies the principles in GRAP 3 to align its accounting policies with those outlined in this Guideline.
- 8.2 GRAP 3 prescribes the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and errors.
- 8.3 Likewise, if the municipality has not accounted for land, infrastructure, vacant land and other assets as outlined in chapter 7, the municipality applies the principles in GRAP 3 to align its accounting policies in relation to land, infrastructure, vacant land and other assets with the principles outlined in Chapter 7 of this Guideline.



## **Annexure A – Acronyms and abbreviations used in the Guideline**

The following acronyms and abbreviations are used in the Guideline:

APP	Annual Performance Plan
Code	The National Housing Code
DORA	Division of Revenue Act
GEAR	Growth, Employment and Redistribution
Housing Act	The Housing Act, Act No. 107 of 1997
HSS	Housing Subsidy System
HSDG	Human Settlements Development Grant
IDP	Integrated Development Plan
IGRFA	Inter-Governmental Relations Framework Act, Act No. 13 of 2005
MEC	Member of the Executive Council of a Province
MFMA	Municipal Finance Management Act, Act No. 56 of 2003
MHSP	Municipal Human Settlements Plan
MTEF	Medium-Term Expenditure Framework
NHBRC	National Home Builders Registration Council
NHSD	National Housing Subsidy Database
PMYHSP	Provincial Multi-Year Human Settlements Plan
RDP	Reconstruction and Development Programme
USDG	Urban Settlements Development Grant



## Annexure B – The roles and responsibilities of the three spheres of government in the national housing programme

The Accreditation and Assignment Framework for municipalities to Administer National Human Settlements Programmes (Accreditation framework), applicable to level 1 and level 2 accredited municipalities, summarises the role and responsibilities of the various spheres of government in the national housing programme as follows:

National Department responsible for Human Settlements	<ul style="list-style-type: none"> <li>• Setting national human settlements policy</li> <li>• Setting national human settlements goals and outcomes</li> <li>• Monitoring the performance of the human settlements sector against human settlements delivery goals and key indicators</li> <li>• Assist the provincial department of Human Settlements to develop their administrative capacity and to support and strengthen the capacity of municipalities</li> <li>• Promoting effective communication within the human settlements sector</li> </ul>
MEC responsible for Human Settlements	<ul style="list-style-type: none"> <li>• Taking decisions on accreditation</li> <li>• Issuing accreditation compliance certificates</li> <li>• Approving the part of the Municipal Human Settlements Plan (MHSP) that addresses the accredited programmes and projects in compliance with Section 9(2)(b) of the Housing Act</li> <li>• Approving the Provincial Multi-Year Human Settlements Plan (PMYHSP) and Annual Performance Plan (APP) and ensuring alignment with the MHSP</li> <li>• Issuing policy directives to municipalities consistent with national housing policy</li> <li>• Facilitating inter-governmental planning and budget alignment with the MHSP</li> <li>• Entering into Implementation Protocols with municipalities</li> <li>• Regularly reviewing the performance of the municipalities</li> <li>• Intervening and taking the steps necessary to ensure adequate municipal performance</li> <li>• Allocating funds to the accredited municipality in terms of the formula</li> </ul>



<p>Provincial Department responsible for Human settlements</p>	<ul style="list-style-type: none"> <li>• Co-ordinating human settlements development within the province</li> <li>• Transferring funds to municipalities in terms of approved payment schedules</li> <li>• Supporting municipalities in the development of MHSPs</li> <li>• Facilitating inter-governmental alignment of planning and budgeting with the MHSP</li> <li>• Ensuring reporting compliance in terms of relevant legislation</li> <li>• Reviewing the performance of municipalities and advising the MEC accordingly</li> <li>• On-going liaison with the municipalities through its Accreditation Unit</li> <li>• Undertaking a technical assessment of affected resources and assets and overseeing a transfer of staff and assets</li> <li>• Providing the necessary support and capacity to municipalities</li> <li>• Performing duties of the Accounting Officer for monies transferred to municipalities</li> </ul>
<p>Municipalities</p>	<ul style="list-style-type: none"> <li>• Undertaking responsibilities as required in terms of the relevant level of accreditation</li> <li>• Adoption of a MHSP as part of the IDP and budget</li> <li>• Capacitation of the Human Settlements Unit and putting in place effective programme and project management systems</li> <li>• Proactively engage stakeholders regarding land availability and acquisition</li> <li>• Resource mobilisation</li> <li>• Reporting to province</li> <li>• Demonstrating commitment towards accelerated service delivery</li> <li>• Carrying out the policy directives of the MEC</li> <li>• Reporting allegations of fraud or corruption or other risks associated with accredited functions</li> <li>• Informing province of support and capacity requirements</li> </ul>



**Source: Accreditation and Assignment Framework for municipalities to Administer National Human Settlements Programmes**

## **References**

The Housing Act, Act No. 107 of 1995

The National Housing Code, 2009

Accreditation and Assignment Framework for Municipalities to Administer National Human Settlements Programmes (August 2012)

*Framework for the Preparation and Presentation of Financial Statements*<sup>2</sup>

Standard of Generally Recognised Accounting Practice on *Revenue from Exchange Transactions* (GRAP 9)

Standard of Generally Recognised Accounting Practice on *Construction Contracts* (GRAP 11)

Standard of Generally Recognised Accounting Practice on *Inventories* (GRAP 12)

Standard of Generally Recognised Accounting Practice on *Investment Properties* (GRAP 16)

Standard of Generally Recognised Accounting Practice on *Property, Plant and Equipment* (GRAP 17)

Standard of Generally Recognised Accounting Practice on *Revenue From Non-exchange Transactions (Taxes and Transfers)* (GRAP 23)

Standard of GRAP on *Accounting by Principals and Agents* (GRAP 109)

Interpretation of the Standards of GRAP on *Recognition and Derecognition of Land* (IGRAP 18)

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<sup>2</sup> In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.