



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Accounting Manual for Departments

General Departmental Assets and Liabilities

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1 Overview

The purpose of this Chapter is to provide guidance on the recognition / recording and measurement of certain (financial and non-financial) assets and liabilities of a department.

The Office of the Accountant-General compiles a Modified Cash Standard (MCS), this manual serves as an application guide to the MCS which should be used by departments in the compilation of their financial statements.

Any reference to a "Chapter" in this document refers to the relevant chapter in the MCS and / or the corresponding chapter of the Accounting Manual.

Explanation of images used in manual:

	Definition
	Take note
	Management process and decision making
	Example

2 Key Learning Objectives

- Understanding the different types of assets and liabilities (financial and non-financial) not covered elsewhere in the MCS/ covered in this Chapter / in the scope of this Chapter;
- Understanding the accounting requirements to be applied for these assets and liabilities;

3 Scope


A department applies this chapter in accounting for the following assets and liabilities for the purpose of primary and secondary information:

- bank overdraft, cash and cash equivalents, investments, loans, other financial assets, payables and receivables;
- voted funds and departmental revenue to be surrendered to the revenue fund;
- prepayments and advances; and
- unauthorised, irregular and fruitless and wasteful expenditure.

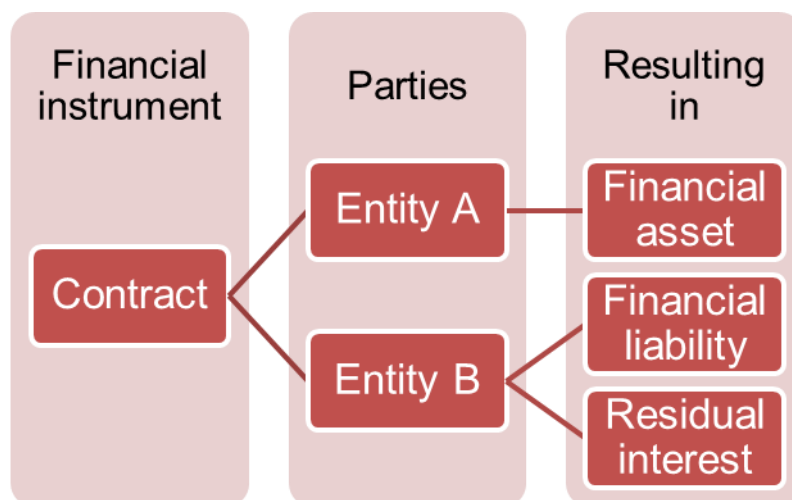
This Chapter thus deals with financial instruments, contractual non-financial assets and liabilities as well as statutory receivables and payables. These different categories are not specifically outlined in the MCS because the accounting principles in the modified cash environment are much the same. This guide does however provide some explanation on the definitions for different categories along with the discussion on the recognition / recording and measurement thereof.

4 Definitions


4.1 Financial instruments

	<p>A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or a residual interest of another entity.</p>
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Illustrating the definition of a financial instrument:



For the purpose of this Chapter, “contract” and “contractual” refer to an arrangement between two or more parties that have clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.


	<p>A financial asset is:</p> <ul style="list-style-type: none"> (a) cash; (b) a residual interest of another entity [<i>i.e. investments</i>]; or (c) a contractual right to: <ul style="list-style-type: none"> (i) receive cash or another financial asset from another entity; or (ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.
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Examples of financial assets included in the **primary financial information**, specifically the **statement in financial position**, are as follows:

- ✓ cash, or cash equivalents under the control of the department;
- ✓ receivables (such staff debt, supplier overpayments, claims recoverable);
- ✓ loans; and
- ✓ investments in public entities.

Examples of financial assets included in the **secondary financial information** are as follows:

- ✓ accrued departmental revenue.

	<p>A financial liability is any liability that is a contractual obligation to:</p> <ul style="list-style-type: none"> (a) deliver cash or another financial asset to another entity; or (b) exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity.
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Examples of financial liabilities included in the **primary financial information**, specifically the **statement in financial position**, are as follows:

- ✓ payables (such as deposits, salary deduction payments);


Examples of financial liabilities included in the **secondary financial information** are as follows:


- ✓ accruals;
- ✓ payables not recognised

4.2 Non-financial assets and liabilities

As discussed above, financial instruments represent contractual rights or obligations to receive or pay cash or other financial assets. Non-financial items have a more indirect relationship to future cash flows. Non-financial assets for example, create an opportunity to generate an inflow of cash or another financial asset, but does not give rise to a present right to receive cash or another financial assets. Typical examples include inventories and capital assets.

Non-financial assets and liabilities included in the scope of this Chapter are prepayments and advances because the future economic benefit is the receipt of goods or services rather than the right to receive cash or another financial asset.

	<p>An advance paid comprises of funds paid in advance of goods/services that are yet to be delivered to the department, and in the case of transfers and subsidies cash is yet to be earned by the recipient, in accordance with the agreement under which the advance is paid. An allocation to advances paid is only made when the agreement involves one or more government entities and/or when advances are paid to staff.</p> <p>A prepayment is a payment made in advance of the goods or services that are yet to be received and in the case of transfers and subsidies cash is yet to be earned by the recipient, in accordance with the agreement under which the payment is made. An allocation to prepayments is made when the agreement involves the department with non-governmental entity.</p>
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	<p>Separate accounting principles have not been established in the MCS for the recognition and measurement of financial and non-financial assets and liabilities. This is because in the modified cash environment the timing of recognition is the same.</p>
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4.3 Statutory receivables and payables

Certain departmental receivables and payables arise out of legislation and are sometimes not “contractual” for the following reasons:

- a) they are compulsory in nature (i.e. willing parties do not necessarily enter into the arrangement);
- b) rights and or obligations may only arise for one party to the arrangement.

Examples of such are:


- ✓ collected departmental revenue due to the revenue fund;
- ✓ unspent annual appropriations due to the revenue fund; and
- ✓ appropriated funds not received from the revenue fund;

5 Accounting for financial assets / liabilities and prepayments / advances for the purpose of primary financial information


5.1 Recognition


A department recognises a financial asset, or a financial liability, a prepayment or an advance when and only when, the department becomes a party to the provisions of the arrangements, and one of the following additional recognition criteria are met:

- a) the instrument is cash, or a cash equivalent under the control of the department;

	<p>Cash in a bank account (under the control of a department) represents a contractual right of the department to obtain cash for the payment of creditors from the institution holding the funds. A department therefore accounts for such cash balances (positive and negative) in its statement of financial position.</p>
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- b) the financial asset or liability, prepayment or advance initially arose from a cash transaction; or

	<p>The purpose of this additional criterion is to exclude the recognition, in the statement of financial position, of receivables and payables for the delivery of goods / services for which payment is deferred to a later date.</p> <p>Staff receivables are included here due to the fact that they arise out of a past cash transaction, i.e. a department utilised cash on an employee or otherwise which is now due back to the department.</p>
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	<p>Example: Staff receivables</p> <p>An official owes the department R145 for private calls made from the department's land line. The department recognises a receivable because:</p> <ul style="list-style-type: none"> ✓ it has a right (in terms of its internal policies and employment contract) to recover such funds from the official; and ✓ the department is recovering an expense already incurred (i.e. it is a consequence of a cash transaction).
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Refer also to the Chapter on **Expenditure** for guidance on the accounting for loans advanced.


- c) the financial asset is a capital investment.

	<p>Departments mainly hold investments in public entities which are either in the form of shares or owner's contributions.</p>
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5.2 Initial measurement

5.2.1 Financial assets and financial liabilities

When a financial asset or financial liability is initially recognised, a department measures it at its cost plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.


	<p>Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the instrument.</p>
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Transaction costs include fees and commissions paid to agents, advisors, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. It does not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Refer also to the *Guide on managing departmental debt* for further guidance on the accounting for staff debt.

5.2.2 Prepayments and advances

Prepayments arise where for example the department paid for goods and or services in advance of receipt of such due to a contractual obligation. Accordingly, prepayments and advances are initially measured at cost.

	<p>Prepayments and advances include advances made to and due from officials who are required to perform his/her duties from his/her headquarters. The types of advances are:</p> <p><i>Normal advance:</i> a normal advance is paid to officials before expenses are incurred. An advance is usually granted to an official to cover travel and subsistence costs while away from the office.</p> <p><i>Standing advances:</i> a standing advance is paid to officials who have travel and subsistence on a regular basis and where use of a normal advance would cause unnecessary administration.</p>
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Prepayments are made if required by the contractual arrangements with the supplier or recipient.

The distinction between prepayments and advances is that prepayments relate to payments made in advance to non-governmental entities, whereas advances relates to payments made in advance to other government entities. Therefore payments to other departments, public entities, municipalities and any other government institution should be classified as advances. If these payments were previously classified as prepayments, the department should reclassify them as advances. This is a change in classification and not a change in accounting policy. Therefore the recognition and measurement criteria remain the same.

As a general rule prepayments are recognised in the statement of financial position when the payment to the supplier is made. The department should consider materiality of the amount prepaid before the department elect to immediately expense the payment in accordance with the Chapter on *Expenditure*. This is usually the case when the recognition in the statement of financial position will have a negative impact on the Appropriation Statement and actual cash flows of the department. Departments are encouraged to take the necessary steps to match the timing of the spending to the budget through contract management which will lessen possibilities of negative cash flows.

The treatment of prepayments relating to the purchase of goods / services is discussed below:

	Scenario 1	Scenario 2	Scenario 3
Budget	Expenditure budgeted for in the current financial period	Expenditure budgeted for in the current financial period	Expenditure budgeted for in future financial period
Receipt of goods / services	Goods / services received in future financial period shortly after payment is made.	Goods / services received in future financial period for a period longer than a month and is material.	Goods / services received in future financial period.
Example	Rent paid for a building in March for April where the contractual agreement requires one month advance payment	Rent paid for a building in March for April, May and June where the contractual agreement requires quarterly payments in advance payment	Rent paid for a building in March for April where the contractual agreement requires one month advance payment

	Expense Immediately as current year expenditure in the PER. (Department may opt to raise a prepayment.)	Recognise as a prepayment in the POS	Recognise as a prepayment in the POS
Entries in the current financial period	Dr Relevant expenditure account Cr Bank	Dr Prepayments and advances Cr Bank	Dr Prepayments and advances Cr Bank
Entries in the future financial period	None	Dr Relevant expense account Cr Prepayments and advances	Dr Relevant expense account Cr Prepayments and advances

Example: Prepayment made for the purchase of capital goods received in the subsequent financial year

The department has a capital budget of R10 million for the 2013/14 financial year. On 20 February 2014 the department places an order with a supplier for the purchase of a capital asset with a cost of R500 000. The supplier requires a 50% deposit and will deliver the asset within 3 months of the order date. The payment is made on 25 February 2014.


The department records the prepayment as follows:

Dr	Prepayments and advances	250 000
Cr	Bank	250 000

Assume that the department spent (and expensed) R9.5 million of the capital budget during the financial year. It subsequently makes an application to the relevant treasury to “roll-over” the saving, and specifically R250 000, into the new financial year. If approved, the department will have the funds available in the vote against which the prepayment will be expensed.

Upon receipt of the asset in May 2014, the department:

Dr	Payments for capital assets	500 000
Cr	Prepayments and advances	250 000
Cr	Bank	250 000

	<p>Example: Prepayment made for the purchase of capital goods/services received over multiple periods</p> <p>A department plans to host a conference in June 2014 and booked the venue in January 2014. The conference facility requires an upfront deposit of R250 000 to secure the venue. The payment is made by the end of January 2014.</p> <p>The department elects to expense the R250 000 on date of payment as follows:</p> <table><tr><td>Dr</td><td>Venues and facilities</td></tr><tr><td>Cr</td><td>Bank</td></tr></table> <p>The department however discloses the fact that actual expenditure includes fees for</p>	Dr	Venues and facilities	Cr	Bank
Dr	Venues and facilities				
Cr	Bank				

	the securing of a conference venue paid in advance of the actual event.
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5.2.3 Exchequer grant account

The difference between the voted amount and the amount actually expended during a financial year (surplus)/underspending per the appropriation statement) is repayable to the revenue fund and is included in the statement of financial position item with the heading Voted funds to be surrendered. The actual amount paid over to the relevant fund excludes any voted funds not requested or received during the financial year. The amount due to the relevant revenue fund is calculated in the “exchequer grant account” as shown below:

Exchequer grant account

Opening journal entry (appropriated amount available to a department)	Requisition of funds made during the year credited to this account (the balance on this account during the year will indicate the drawings still available to the department)
Total expenditure incurred during the year (all expenditure accounts are closed-off to this account)	Closing journal entry of the general account of the vote (representing total final appropriation)
XXX	XXX
DEBIT balance in this account means that the department’s expenditure was more than the Appropriation Act (refer to note 11 – unauthorised expenditure). This amount must be journalised to the unauthorised expenditure asset account.	CREDIT balance in this account means that the department’s expenditure was less than the Appropriation Act (refer to note 20 – voted funds to be surrendered to the revenue fund). This amount must be paid to the relevant revenue fund.

The credit balance in the exchequer grant account is presented as “voted funds to be surrendered to the revenue fund” in the statement of financial position.

6 Accounting for financial assets / liabilities for the purpose of secondary financial information

6.1 Recording

A department records a financial asset or financial liability for the purpose of secondary financial information, when and only when, the department becomes a party to the contractual provisions of the arrangement (prior to the actual receipt or payment of the cash).

Information provided in the secondary financial information arises from accrued revenue and or expenditure.

6.1.1 Accrued revenue – receivables for departmental revenue


A department records and discloses accruals in respect of departmental revenue (excluding taxation revenue), when:

- It is probable that the economic benefits or service potential associated with the transaction will flow to the department; and
- The amount of revenue can be measured reliably.

Furthermore, to the extent that revenue is related to the sale of goods or the rendering of services the following additional criteria must be met:

Sale of goods


- The department has transferred to the purchaser the significant risks and rewards of ownership of the goods;
- The department retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

	<p>Example: Sale of goods</p> <p>A department sells a pair of crutches to a patient for R800 and allows the patient to pay for the crutches within 30 days. The department recognises the accrual when the crutches are issued to the patient.</p>
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Application of criteria for the recording of accrued revenue for the purpose of secondary information:

	Seller (department) has transferred risks & rewards	Seller (department) has relinquished managerial involvement	Point at which revenue should be recorded
Title transferred with delivery of goods in an unconditional sale arrangement	Y	Y	On transfer of goods
Goods are transferred, but seller retains title for credit protection purposes (protection against non-payment)	Y	Y	On transfer of goods. Credit risk is not a significant risk of ownership
Goods transferred, sale is unconditional; however, sale price is not fixed until buyer takes delivery of goods	Y	Y	On transfer of goods
Buyer and seller enter in a layaway sales arrangement	N	N	When buyer takes delivery of goods
Buyer takes delivery of goods, payment to be made subject to satisfactory installation	N	N	When installation and inspection is complete
Buyer takes delivery of goods, seller guarantees product performance within normal warranty provisions	Y	Y	When buyer takes delivery of goods


	Seller (department) has transferred risks & rewards	Seller (department) has relinquished managerial involvement	Point at which revenue should be recorded
Buyer takes delivery of goods; seller continues to share in certain benefits.	Will depend on facts and circumstances	Will depend on facts and circumstances	When seller has relinquished right to significant benefits
Seller transfers goods to the buyer, seller has an obligation to repurchase goods	N	N	No sale is recorded, as substantially all the risks and rewards are retained by the seller
Seller transfers goods to the buyer, seller has an option to repurchase goods at an amount below their fair value	N	N	When seller relinquishes purchase option

	The retention of credit risk should not prevent the recognition of revenue. Credit risk is not a risk of ownership of goods but a risk of the collection of an amount due.
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Rendering of services

- The stage of completion of the transaction at the reporting date can be measured reliably; and
- The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

A department should assess the degree of certainty attached to the flow of future economic benefits or service potential on the basis of the available evidence. Revenue should only be recorded once evidence of the probability of the flow becomes available, for example the signing of an agreement.

	<p>One of the important things to remember for receivables for departmental revenue is that, regardless of the fact that these are not recognised, there should be proper controls in place to recover the amounts owed to the department.</p> <p>Furthermore, proper approval for any write-off of irrecoverable amounts must be obtained from the Accounting Officer or delegated official.</p>
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Taxation revenue


Departments are exempt from recording an accrual for taxation revenue. By implication, a department need not accrue for any receivables or payables such as interest or other charges that are directly related to the levying and or collection of the tax receipt. However any amounts collected by third parties (i.e. public entities) and which are due to the department at the reporting date are not exempted and should be recorded as an accrual.

The different categories of taxation revenue, as catered for in the Standard Chart of Accounts are:

- ✓ Casino taxes;


- ✓ Horse racing taxes;
- ✓ Liquor license taxes; and
- ✓ Motor vehicle license taxes;

According to the MCS departments are not required to estimate the amount of taxation revenue due to government, but must include amounts already collected from agencies which are due to the department / relevant revenue fund.

	<p>Example: Motor vehicle license taxes</p> <p>A municipality collects money from the issuance of motor vehicle licenses on behalf of a provincial department.</p> <p>By year-end the municipality had collected R17 million, of which R3 million is yet to be paid over to the department. According to the e-natis system the total value of expired motor vehicle licenses is R5,5 million.</p> <p>The amount to be disclosed as an accrual in the notes to the financial statements is R3 million.</p>
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Similar to taxation revenue fines, penalties and forfeits are a form of non-exchange revenue but arise due to a breach in law or contract. There is inherently more certainty with regard to the identification and thus the recognition and measurement of fines, penalties and forfeits than for taxation revenue. The exemption from recording an accrual was consequently not extended to fines, penalties and forfeits.

The recognition criteria of fines, penalties and forfeits specified in the Chapter on **Revenue** should be met before these are recognised as revenue. Revenue expected to be collected pertaining to fines, penalties and forfeits is accrued for and recorded as receivables for departmental revenue in the notes to the financial statements. Such receivables should be assessed for impairment at every reporting date.

	<p>The entity responsible for reporting traffic fines should initially raise a receivable. Depending on the prevailing legislative requirements and also the terms and conditions of the Service Level Agreement (SLA) entered between different levels of government, the department may need to use estimates to determine the amount receivable in respect of the traffic fines at the reporting date that it is likely collect if the department is the appropriate entity to raise the receivable. For example, the department may offer early settlement discounts, or may offer reductions in the amount payable by the debtor in certain circumstances. Where these exist, the department should consider past history in assessing the likelihood of these discounts or reductions being taken up by debtors. Such receivables should be assessed for impairment every reporting date. A receivable is only written off when identified as irrecoverable and approved by the Accounting Office. If the amount is irrecoverable, the Accounting Officer may write the debt off after following the necessary requirements and processes.</p>
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6.1.2 Accruals and payables not recognised

As mentioned previously, accruals represent goods or services that have been delivered prior to year-end, but no invoice has been received from the supplier at year-end, and has not been approved for payment at year-end. The ageing of accruals therefore starts when the accruals are recorded.

It is required that ALL invoices that have not been approved for payment (but relate to the current financial year) at year-end must be disclosed, even if payment was made subsequent to year-end.

Where goods or services have been delivered and no invoice has been received at year-end, an estimate of the invoice amount should be made based on the order, quote, progress certificate, copy of invoice or goods received note.

A department must record its accruals, at cost, as at the reporting date.



Example: Accruals

Department X ordered stationery to the value of R100 000 on 29 March 20x2. The stationery was delivered on 30 March 20x2. The invoice was received on 3 April 20x2 and approved payment of R100 000 was made on 5 April 20x2.


The department should thus update the accrual register with an amount of R100 000 and disclose an amount of R100 000 in the financial statements under the accruals note to the financial statements for the 20x2 financial year.




One of the important things to remember for accruals is that, regardless of the fact that these are not recognised, there should be proper controls in place to ensure that all accruals are disclosed in the financial statements.

Payables not recognised are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier or recipient (and include payments in respect of social benefits where formal agreements for specified amounts exist).

In the MCS environment, the key difference between accruals and payables not recognised is receipt of invoice.

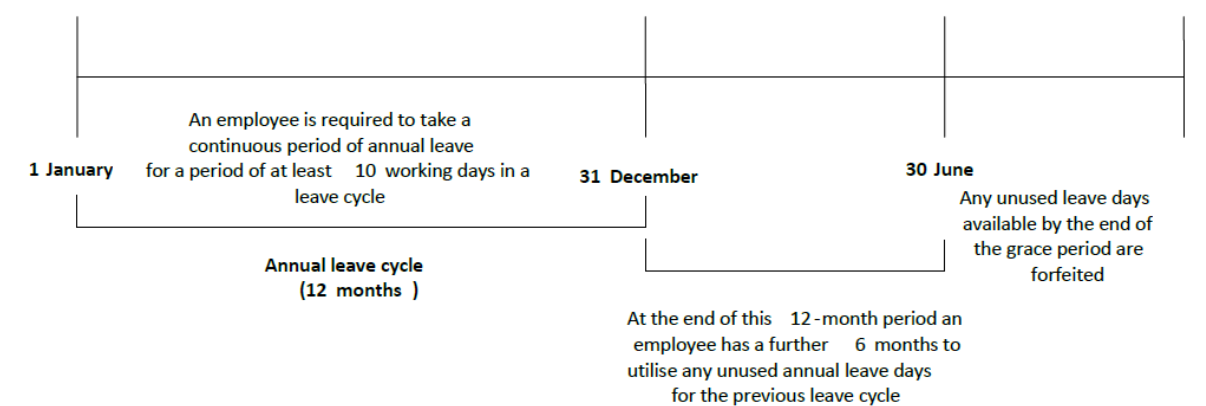
	<p>Example: Payables not recognised</p> <p>Department X ordered stationery to the value of R100 000 on 29 March 20x2. The stationery was delivered on 30 March 20x2. The invoice was received on 31 March 20x2 and approved payment of R100 000 was made on 5 April 20x2.</p> <p>The department should thus update disclose an amount of R100 000 in the financial statements under the payables not recognised note to the financial statements for the 20x2 financial year.</p>
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6.2 Specific types of accruals

	<p>Leave and bonus accruals</p> <p>The following guidance relates to leave and bonus is based on the requirements specified by DPSA and Persal as at time of publication of this Accounting Manual. Departments should visit the DPSA website and the PERSAL website for any new developments on compensation of employees.</p> <p>www.dpsa.gov.za</p> <p>http://persal.pwv.gov.za/</p>
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6.2.1 Annual Leave Entitlements

The annual leave dispensation is illustrated below:



Unused annual leave is paid out only in the following circumstances:

- an employee terminates his or her services; or

- if the application for annual leave was declined due to operational requirements, and could not be rescheduled in the course of the leave cycle.

For this purpose, at the end of the 18-month period a written request, supported by written proof of refusal of the annual leave, and that it could not be rescheduled, by the Head of Department or delegated authority must be submitted.



Example: Calculating annual leave entitlements

An employee resigns with effect from 1 June 20x0. The employee's total remuneration on the last day of duty is R102 750. The employee is entitled to 22 working days leave per year and has taken at least 10 working days leave in the prior year's leave cycle.

In accordance with the Department of Public Service and Administration (DPSA) guide Determination on Leave of Absence in the Public Service, 2008, the cash value in respect of the unused leave credits should be computed in the following manner:

$$[(A - B) + (C - D)] \times E3 / 260.714$$

Where:

A = represents the full annual or pro rata leave entitlement in the previous leave cycle (Pro rata leave entitlement calculated as (number of completed months in leave cycle) x (annual leave entitlement) / 12)

B = represents the leave taken in the previous leave cycle

C = represents the pro rata leave entitlement in the current leave cycle (Calculated according to the formula in A above)

D = Leave taken in the current leave cycle

E = Represents the employee's remuneration (i.e. annual basic salary plus 37% in respect of employees at level 1 – 11, or the all-inclusive remuneration package in respect of middle management).

Step 1

Use the given information on the employee's leave category to determine A. In the event of a full annual leave entitlement, use Annexure A of the DPSA guide Determination on Leave of Absence in the Public Service and in the event of a pro rata leave entitlement (in the previous leave cycle), use the formula in STEP 3 below.

Step 2

Use the given information to determine B (Leave taken in the previous leave cycle) and D (Leave taken in the current leave cycle).

Step 3

Use the formula in STEP 1 above to determine C (Pro rata leave entitlement calculated as (number of completed months in leave cycle) x (annual leave entitlement) / 12).

In other words: = 5 x 22 / 12 = 9.17 days

Step 4


Use the given information to determine E

Step 5

Compute the cash value of leave credits available in the following manner:

$$[(A - B) + (C - D)] \times E / 260.714$$

	<p> $\text{Cash value} = \{[(22 - 10) + (9.17 - 0)] \times R102,750\} / 260.714$ $= \{(12 + 9.17) \times R102,750\} / 260.714$ $= 21.17 \times R102,750 / 260.714$ $= R8,343.31$ </p> <p>Note:</p> <p>The pro rata leave credits in this example derive from the leave credits in the current leave cycle beginning from 1 January 20x0 to 31 May 20x0.</p> <p>Unused leave credits brought forward from a previous cycle are forfeited if not used within 6 months from the expiry of the relevant leave cycle. After 6 months, the value of A-B should therefore theoretically be zero.</p>
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	<p>For further examples of leave calculations in different scenarios, please refer to the DPSA guide on Determination on Leave of Absence in the Public Service.</p>
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6.2.2 Service bonuses (13th cheque)

The service bonus represents the amount payable to an employee in his/her birthday month and is equal to a month's salary. It is the "13th cheque" which is the amount payable to an employee over and above the employee salary payable in a month. The amount of service bonus owed to the person as at the end of March is calculated from the last date since a service bonus was paid. In cases where no previous service bonus was paid, the date will be used from when the person became entitled to service bonus. Service bonus payable to employees is determined using the formula included in the DPSA Financial Manual. Departments must ensure that amounts accrued up to end of March of the financial year are taken into account in calculating leave entitlement.

6.3 Initial measurement


All accrued revenue must be measured at the fair value of the consideration receivable.

	<p>The fair value of the accrual is the transaction price, which is the value agreed in the contract between the two parties (discounting does not apply)</p>
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	<p>Example: Measurement of accrued revenue</p> <p>A department charges R40 000 to a group of hikers for the issuance of hiking trail license at one of its nature reserves. The hikers pay R40 000 to the department on 10 April 20x3 for the hike that took place on 12 March 20x3.</p> <p>At year-end on 31 March 20x3 the department will record R40 000 as accrued revenue without discounting it.</p>
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A department records its accruals, at cost, as at the reporting date.

For the purposes of recording accruals, a department should maintain an accruals register that will enable it to implement proper internal control and to ensure that the disclosure requirements of the MCS are adhered to.

	<p>Example: Measurement of accrued expenditure</p> <p>A department receives an invoice of R8 000 for minor repair work done at the premises. The invoice is received on 30 March. Facilities management confirms that work was done satisfactorily and payment can be made. Payment to the service provider is made on 22 April 20x3.</p> <p>At year-end on 31 March 20x3 the department will record R8 000 as accrued expenditure at the cost of R8 000.</p>
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6.4 Impairment

	<p>Impairment is a loss in the future economic benefits or service potential of an asset.</p>
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At the end of **each** reporting period, a department should assess whether there is any objective evidence that a financial asset recognised or recorded, in the primary or secondary financial information respectively, is impaired.

If there is **objective evidence that impairment** on a financial asset has occurred, the loss must be recorded in the notes to the financial statements.

Objective evidence that a financial asset is impaired can be as a result of the occurrence of one or more of the following events:

- Significant financial difficulty experienced by the borrower / debtor;
- Delays in payments (including interest payments) or failure to pay / defaults; or
- It is probable that the borrower / debtor will enter sequestration (bankruptcy) or other financial reorganisation.

The amount for impairment should be included in the secondary financial information to show the estimated reduction in the recognised or recorded carrying value, to reflect the best estimate of the amount of the future economic benefits expected to be received from that asset.

Impairment estimates could be determined by estimating the present value of the expected future inflow of cash that is expected in settlement of the recorded financial asset. The present value is determined by using an appropriate interest rate to discount the future expected cash flow. For practical purposes, departments are encouraged to consider the prevailing prime rate of interest. Further adjustments to the rate that may better reflect the credit risk associated with the instrument may be made.

The impairment loss on financial assets (as discussed above), is therefore determined as follows:



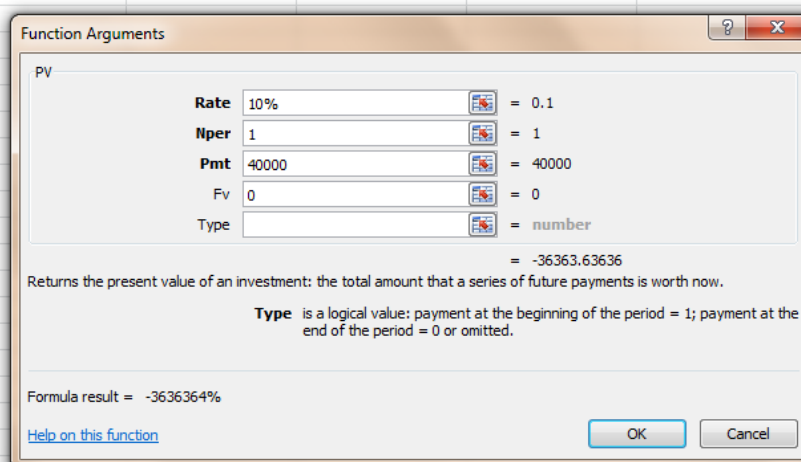
Example: Impairment of a financial asset

Department X rendered services to Entity Y to the value of R100 000 on 15 December 20x2.

Initial measurement: Receivables for departmental revenue R100 000 for the year ending 31 March 20x3


If the receivable becomes impaired at the end of 20x3, the impairment loss is calculated as the difference between the carrying amount (R100,000) and the present value of estimated future cash flows (R40,000) discounted at the prevailing prime rate of interest (10%).

Carrying amount	R100,000
Estimated future cash flows	R40,000
Prevailing prime interest rate	10%



The department assessed R63 636 as being irrecoverable. Department X therefore determines that only R36 364 is recoverable in future (see calculations above). Approval for write off has however not been provided by the accounting officer at year end.

Impairment recorded at year-end on 31 March 20x3 is R100 000 less R36 364 which amounts to R63 636

	<p>In the MCS environment, impairment loss is calculated on all financial assets reported in the primary and secondary financial information, and not on capital assets. The amount is recorded in the relevant note to the financial statements. Some notes, for example receivables, investments, loans have sub-notes where impairment can be recorded, whereas there is also a note for other financial assets' impairment.</p> <p>Since all impairment is recorded and not recognised, it does not reduce the carrying value of the recognised financial asset.</p>
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6.5 Derecognition and removal

A department must derecognise and/or remove a **financial asset** only when:

- the contractual rights to the cash flows from the financial asset expire, are settled, or waived (written-off); or
- the department transfers to another party substantially all of the risks and rewards of ownership of the financial asset.

When is it an impairment and when is it a write off?

	Impairment	Write-off
Recognition or recording	Never recognised only recorded. The asset is therefore not "derecognised".	Can be recognised (for a recognised asset written off) or recorded (for a recorded asset written off). The asset is derecognised in the case of a primary financial information asset.
Recoverability	There is a possibility that the full amount owed (or partially owed) will not be recoverable; or Know for certain that the amount owed will not be recoverable, however approval for write-off has not been obtained at year end	Know for certain that the full amount owed (or partially owed) will not be recoverable; and approval for write-off has been obtained

	<p>Example: Impairment vs. write-off of financial asset</p> <p>Scenario 1:</p> <p>Department X accidentally overpaid one of its suppliers. The department consequently raised a receivable for the overpayment and started the process of recovering the debt.</p> <p>Date that the receivable was raised: 31 July for R172 000.</p> <p>During March the supplier notified the department that they are experiencing financial difficulties and they will not be able to pay back the debt.</p> <p>After assessing the situation and taking every reasonable step in trying to recover the debt, the department concluded that it would not be in the interest of the state to continue trying to recover the debt and therefore decided to write it off. Approval for the write off was however no obtained by the accounting officer at year end.</p> <p>Initial measurement by Department X: Receivables: Recoverable expenditure R172 000</p> <p>Impairment recorded at year-end by Department X: Impairment R172 000</p>
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Assume the same information as above however approval for the write off was obtained at year end.

The following journal entry will be processed to write-off the receivable.

A department must derecognise and / or remove a **financial liability** (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished. A financial liability (or part of it) is extinguished when the debtor either:

- Below are examples of the treatment of a write off which occurred in different period and where the amount due was only partially recovered.



The accounting entries will be as follows:

	Debit	Credit
	R	R
Debt Account	10 000	

	Expenditure (bursaries to employees)		10 000
	Amount to be recovered from employee		
		Debit	Credit
		R	R
	PMG Bank Account	9 000	
	Debt Account		9 000
	Recovery of funds from employee		
		Debit	Credit
		R	R
	Thefts and losses	1 000	
	Debt Account		1 000
	Write-off of debts not recovered		


Example: Debt write-off in the subsequent financial year (with partial recovery)

Department B provides bursaries to certain of its employees which it then recovers from the employees. During year 1 it gave R10 000 to employee X. Employee X only paid back R9 000 during year 1. After department B exhausted all options of trying to recover the outstanding R1 000 it decided to write it off (in year 2) as it would be uneconomical to recover it from the employee.

The accounting entries will be as follows:

Year 1	Debit	Credit
	R	R
Expenditure (bursaries to employees)	10 000	
PMG Bank Account		10 000
Recording of bursary paid to an employee		

Year 1	Debit	Credit
	R	R
Debt Account	10 000	
Expenditure (bursaries to employees)		10 000
Amount to be recovered from employee		

Year 1	Debit	Credit
	R	R
PMG Bank Account	9 000	
Debt Account		9 000
Recovery of funds from employee		
Year 2	Debit	Credit
	R	R
Thefts and losses	1 000	
Debt Account		1 000
Write-off of debts not recovered		



Example: Debt only recoverable in the subsequent financial year and write off in that year (with partial recovery)

Department B provides bursaries to certain of its employees which it then recovers from the employees. During year 1 it gave R10 000 to employee X, which only became recoverable in year 2. Employee X only paid back R9 000 during year 2. After department B exhausted all options of trying to recover the outstanding R1 000 it decided to write it off (in year 2) as it would be uneconomical to recover it from the employee.

The accounting entries will be as follows:

Year 1	Debit	Credit
	R	R
Expenditure (bursaries to employees)	10 000	
PMG Bank Account		10 000
Recording of bursary paid to an employee		
Year 2	Debit	Credit
	R	R
Debt Account	10 000	
Recoverable Revenue		10 000
Amount to be recovered from employee (credited against statement of financial position account as current year's expenditure cannot be affected)		

Year 2	Debit	Credit
	R	R
PMG Bank Account	9 000	
Debt Account		9 000
Recovery of funds from employee		

Year 2	Debit	Credit
	R	R
Thefts and losses	1 000	
Debt Account		1 000
Write-off of debts not recovered		


Year 2	Debit	Credit
	R	R
Recoverable Revenue	10 000	
Departmental Revenue		10 000
Write-off of recoverable revenue		

6.6 Offsetting Financial Assets and Financial Liabilities

A financial asset and a financial liability should be offset and the net amount presented in the statement of financial position when, and only when, the department satisfies **both the following conditions**:


- Currently has a legally enforceable right to set off the recognised amounts; and
- Intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Financial assets and financial liabilities are presented on a net basis when, in doing so, it reflects a department's expected future cash flows from settling two or more separate financial instruments. When a department has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In all other circumstances, financial assets and financial liabilities are presented separately from each other, consistently with their characteristics as resources (assets) or obligations (liabilities) of the department.

	<p>Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount in the statement of financial position is not the same as derecognition of a financial asset or a financial liability.</p> <p>With derecognition, a financial instrument previously recognised is removed from the statement of financial position and may also result in a gain or loss.</p>
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A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Since the right of set-off is a legal right, the laws applicable to the relationships between the parties need to be considered.

A department's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When a department has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the department should not offset the financial asset and financial liability.

	<p>Offsetting cash and cash equivalents</p> <p>A department should not offset bank accounts in overdraft against other bank balances, unless it has a legally enforceable right to do so.</p> <p>Therefore, bank accounts in overdraft should be disclosed separately under current liabilities and not offset against other cash and equivalents (which are disclosed under current assets).</p>
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7 Summary of Key Principles

This chapter provides guidance on how to identify and account for different types of departmental financial instruments.

7.1 Identification

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

Financial asset	Financial liability
<p>A financial asset is:</p> <ul style="list-style-type: none"> • cash; • a residual interest of another entity; or • a contractual right to: <ul style="list-style-type: none"> ○ receive cash or another financial asset from another entity; or ○ exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity. 	<p>A financial liability is any liability that is a contractual obligation to:</p> <ul style="list-style-type: none"> • deliver cash or another financial asset to another entity; or • exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity.

7.2 Recognition / recording

A financial instrument is initially recognised when the entity becomes a party to the contractual provisions.

Accrued revenue and accrued expenditure fall under secondary financial information which is only disclosed which may undermine the importance thereof. In order to prevent this, a department should exercise proper control over such information, such as steps to recover amounts owed to the department, ensuring the completeness and accuracy of accruals, etc.

7.3 Measurement

A financial instrument is measured at its cost plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

At the end of each reporting period, a department assesses whether there is any objective evidence that a financial asset recognised or recorded, in the primary or secondary financial information respectively, is impaired.

The impairment is the difference between the carrying amount and the present value of estimated future cash flows discounted at an appropriate interest rate, normally prime rate.

An impairment is only recorded never recognised.

A write off can be recognised or recorded depending on whether the related asset was recognised or only recorded.

If an amount is irrecoverable, but approval for the write off thereof has not been obtained at year end, the department should rather record an impairment than recognise or record a write off.

7.4 Derecognition

Financial assets	Financial liabilities
A department should derecognise a financial asset only when:	A department should remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is

<ul style="list-style-type: none"> • The contractual rights to the cash flows from the financial asset expire, are settled or waived (written-off); • The department transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or • The department, despite having retained some significant risks and rewards of ownership of the financial asset, has transferred control of the asset to another party and the that party has the practical ability to sell the asset in its entirety to an unrelated third party, and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer. <p>If the department has not transferred substantially all of the risks and rewards of ownership of the financial asset, it should continue to recognise the asset.</p>	<p>extinguished.</p> <p>A financial liability (or part of it) is extinguished when the debtor discharges the liability, is legally released from primary responsibility for the liability, or waives the debt.</p>
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7.5 Presentation

<p>A financial asset and a financial liability should be offset and the net amount presented in the statement of financial position when, and only when, a department:</p> <ul style="list-style-type: none"> • currently has a legally enforceable right to set off the recognised amounts; and • intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.
