Financial reporting by municipalities in South Africa in terms of GAMAP/GRAP versus the IMFO standard

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ABSTRACT

The implementation of the Generally Accepted Municipal Accounting Practices combined with the Generally Recognised Accounting Practices (referred to as GAMAP/GRAP) in municipalities in South Africa is resulting in changes to some financial policies and applications. Practitioners are of the general opinion that these changes will have a substantial effect on reporting on the financial performance and financial position of municipalities, especially directly after full implementation, which is scheduled for 2009.

This article assesses the effect of the implementation of GAMAP/GRAP by comparing the financial statements of a metropolitan municipality in South Africa, based on the Institute of Municipal Finance Officers (IMFO) standard and GAMAP/GRAP. The implementation of GAMAP/GRAP not only affects the principles, but also the format of the presentation of the financial statements, resulting in some content having to be restated and regrouped, with substantial effects on some comparative figures.

To enable an objective assessment of the effect of the changes, the major financial statements (namely, the Balance Sheet, Income Statements and Appropriations Statements as per the IMFO standard) are compared with the corresponding Statement of Financial Position, Statement of Financial Performance and Statement of Changes in Net Assets in terms of GAMAP/GRAP.

Some relevant comparisons are made, and a few ratios are calculated to clearly indicate the effect of the implementation of

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GAMAP/GRAP on the financial performance and financial position of a municipality.

Key words: municipal accounting, financial reporting, GAMAP, GRAP, IMFO accounting standards

INTRODUCTION

The Generally Accepted Municipal Accounting Practice (GAMAP) and Generally Recognised Accounting Practice (GRAP) accounting standards (referred to as GAMAP/GRAP) originated from section 216(1)(a) of the Constitution of South Africa (Act No. 108 of 1996). This section requires national legislation to prescribe measures to ensure both transparency and expenditure control in each sphere of government by introducing generally recognised accounting practice, uniform expenditure classifications and uniform Treasury norms and standards.

GAMAP was originally introduced to overcome shortcomings experienced with municipal accounting practices of the Institute of Municipal Finance Officers (IMFO), which were based on the 'double accounting system' (IMFO 1996, 1998: 57), as inherited from the British rule. These IMFO practices were complex and were based on the different provincial ordinances. They did not promote transparency and encouraged taxation in advance of need, which adversely affected the accurate costing of services. The financial statements of municipalities based on the IMFO practices suffered from shortcomings and did not disclose the financial position of municipalities correctly (Fourie, Opperman & Scott 2007: 416).

GRAP was subsequently introduced, and GRAP standards are systematically being developed to replace the GAMAP standards. Eventually, GRAP will be the only standard applicable in municipalities. The target date for this is 2009 (ASB 2007a).

In terms of section 87(1) of the Public Finance Management Act (PFMA) (No. 1 of 1999), the Minister of Finance established the public sector Accounting Standards Board (ASB), which came into operation in 2002. A primary objective of the ASB is to set standards of generally recognised accounting practice (GRAP) for, *inter alia*, municipalities and other entities under the ownership control of a municipality (ASB 2007b).

The ASB is reviewing GAMAP with a view of amending or withdrawing individual statements in accordance with International Public Sector Accounting Standards (IPSASs). Where a new statement of GRAP is issued, the relevant GAMAP is withdrawn. The list of statements currently applicable to municipalities therefore includes Generally Recognised Accounting Practice (GRAP) and Generally Accepted Municipal Accounting Practice (GAMAP). For items that were not covered in the scope of GAMAP or GRAP, the ASB listed a number of International Public Sector Accounting Standards (IPSAS) as guidance for practitioners (Fourie et al. 2007: 417).

New standards are implemented in a structured manner, offering sufficient time for municipalities to comply, and are communicated by the National Treasury. To enable a smooth transition from the 'old' IMFO standards to GAMAP/GRAP, the National Treasury also classified municipalities into groups relating to their capacity to implement the new standards. National Treasury issued Circular No. 4 of 2004 in terms of the Municipal Finance Management Act (MFMA) (No. 56 of 2003) (National Treasury 2004), which provides guidance on a framework to be used in the preparation of financial statements of municipalities. The circular specifies that municipalities and municipal entities will comply with the Standards of GRAP issued by the ASB and regulated by the Minister of Finance as at the end of the financial year applicable to them, as follows:

- High capacity municipalities: 30 June 2006
- Medium capacity municipalities: 30 June 2007
- Low capacity municipalities: 30 June 2008.

The capacity classification is based on an assessment of the level and capability to implement the standards of GRAP. In total, 48 of the 283 municipalities in South Africa are rated as 'high capacity' municipalities (SA *Government Gazette* 2004). These 'high capacity' municipalities are metropolitan municipalities and district municipalities, which are all relatively large institutions.

OBJECTIVE OF THE ARTICLE

The implementation of GAMAP/GRAP results in changes to some financial policy issues and subsequent reporting, for example, the dealing and disclosure of funds, cash backing and the capital model. Some IMFO practices therefore need to be restructured and unbundled to enable reporting in terms of GAMAP/GRAP.

The objective of this article is to indicate whether substantial changes to the reporting on financial performance and financial position of municipalities are evident as a result of the implementation of GAMAP/GRAP.

METHODOLOGY

To ensure a smooth transformation from the IMFO standard to GAMAP/GRAP, National Treasury identified a number of pilot municipalities of various sizes to pilot GAMAP/GRAP. During these pilot processes, a large number of practical difficulties and issues were identified and resolved. During this pilot phase, the municipalities involved were compelled to submit their financial statements for publication, still in the IMFO standard format.

For this study, the financial statements of a metropolitan municipality were restated to enable a comparison between the IMFO standard and GAMAP/GRAP.

The major differences and changes to the financial policies affected by the implementation of GAMAP/GRAP are briefly described, and the effect on the financial information is analysed.

OBJECTIVES OF GAMAP/GRAP

The major objectives of GAMAP/GRAP are (Fourie et al. 2007: 421):

- To ensure consistency in the accounting treatment of transactions and classification of account balances in municipalities
- To enhance comparability between similar-sized municipal bodies on a national basis
- To enable users of financial statements to make more accurate assessments of risks and returns.

The introduction of GAMAP/GRAP also has other positive implications for municipalities, including the disclosure of more relevant and detailed information in financial statements, the improvement of accountability and transparency, and increased focus specifically on cash flow activities to ensure that sufficient cash is generated to finance operating and capital expenditure. Attention must also be paid to the management of working capital, as detailed disclosure is required in the financial statements.

MAJOR DIFFERENCES AND CHANGES WITH THE IMPLEMENTATION OF GAMAP/GRAP

The implementation of GAMAP/GRAP necessitates a number of changes to the policy, interpretation and presentation of the annual financial statements of municipalities. The IMFO standard ‘Balance Sheet’ was renamed in terms of

GAMAP/GRAP as the 'Statement of Financial Position'. The major changes to this statement can be summarised as follows (National Treasury 2005: 6–9):

Changes to the Balance Sheet (IMFO standard)

Statutory funds

The various Statutory Funds are amalgamated, and a Capital Replacement Reserve (CRR) is created. The only Statutory Fund that has been retained is the Housing Development Fund (National Treasury 2005: 6).

Reserves

In terms of the IMFO standard, reserves were not properly defined and reserves were established for numerous purposes. Some municipalities established reserves for such purposes, for example, as 'the purchasing of library books' and 'the stabilisation of interest' (National Treasury 2005: 6).

With GAMAP/GRAP, reserves are limited to the following:

- A Capital Replacement Reserve (CRR), which is established from existing Statutory Funds, excluding the Housing Development Fund, as already mentioned.
- In terms of the requirements dealing with property, plant and equipment, a Capitalisation Reserve, or a Government Grant Reserve, or a Public Contributions and Donations Reserve must be created.
- The only other reserve that may be retained is the Self-insurance Reserve.

Trust funds

Traditionally, the terminology 'Monies held in Trust', with specific reference to government grants, was disclosed as a Trust Fund in terms of the IMFO standard. Trust Funds were established for unspent provincial grants or in cases where municipalities had an obligation to undertake an activity at a future date. In terms of GAMAP/GRAP, this accounting treatment is not correct, as municipalities are not trustees, nor has a formal trust fund been established. Unspent government grants are liabilities and should be disclosed as such. Only where the municipality is a trustee of a Trust in terms of a Trust Deed should the terminology 'Trust Funds' should be used. Trust Funds are separate legal entities with the municipality as the trustee. As separate legal entities, separate financial statements should be prepared for each Trust Fund (National Treasury 2005: 42).

Some examples of situations in which municipalities may need to reclassify certain transactions that have previously been classified as trusts are as follows:

- Amounts received as capital grants from the provincial government should be disclosed as *liabilities* in terms of GAMAP 9.
- Funds collected for the Mayor's Charity, Christmas Fund or Flood Relief and deposited in the municipal bank accounts are an obligation by the municipality and should be disclosed as a *liability*.
- Operational grants, such as National Treasury Financial Management and Restructuring Grants, should be *credited to revenue* once the conditions have been met. Until the conditions of the specific grants are met, there is an obligation to National Treasury.

External loans

In terms of the IMFO standard, external loans were all regarded as of a long-term nature and disclosed under a separate heading as 'long-term liabilities'.

GAMAP/GRAP introduced the concept of an 'External Financing Fund' (EFF) as a memorandum account ring-fencing external loan. The components of the EFF are shown on the face of the Statement of Financial Position under appropriate headings (National Treasury 2005: 12, 32).

Current liabilities

There are no fundamental changes in the disclosure of current liabilities. Consumer deposits are no longer disclosed as long-term liabilities (non-current), but as current liabilities. In terms of the new capital accounting model (GAMAP/GRAP), unspent conditional government grants are recognised as a liability until the conditions of the grant have been met. Thereafter, such grants are recognised as revenue, and when used to acquire an item of property, plant and equipment, a Future Depreciation Reserve is created. The same principles apply to unspent public contributions. Staff leave is an accrual, and the full staff leave obligation at year-end must be raised as a current liability, regardless of how the obligation will be settled at a future date. Staff leave will be disclosed under current liabilities (National Treasury 2005: 8).

Property, plant and equipment

GAMAP 17 provides information to gain an understanding of the accounting treatment and disclosure information relating to property, plant and equipment. GAMAP/GRAP requires that a comprehensive Fixed Assets Register be prepared.

Once the Fixed Assets Register has been prepared, Loans Redeemed and Other Capital Receipts (in terms of the IMFO standard) must be reversed. Loans Redeemed and Other Capital Receipts must initially be used to finance backlog depreciation and establish the Capitalisation Reserve, the Government Grants Reserve, and the Public Contributions and Donations Reserve, and the residual balance must be transferred to either the CRR or accumulated surplus/deficit.

GAMAP 17 also requires that from a disclosure perspective, all items of property, plant and equipment must be categorised into infrastructure, community, heritage and other assets (National Treasury 2005: 20).

Non-current assets

There is no change in the classifications of non-current assets, except where a municipality has previously used a Township Development Suspense Account. The cost of unsold developments must be determined and classified as inventory. Infrastructure costs previously included in the Suspense Account must be transferred to Property, Plant and Equipment (PPE) (National Treasury 2005: 9).

Current assets

There are no changes affecting current assets emanating from the implementation of GAMAP. There is, however, an expectation that appropriate provisions will be made for irrecoverable consumer debtors' balances and inventory obsolescence.

Major changes to the statement of financial performance

In respect of the Statement of Financial Performance, the major changes arising from the implementation of the GAMAP/GRAP accounting standards are as follows (National Treasury 2005: 5):

- All external interest earned will be *included as revenue* in the Statement of Financial Performance. No external interest earned will be credited to a statutory fund, reserve or provision.
- Government grants, public contributions and donations will be *recognised as revenue* to the extent that there has been compliance with the conditions associated with such government grant, public contribution or donation.
- Internal interest and internal redemption charges are *no longer recognised* in the annual financial statements.
- External loan redemptions are *no longer recognised* as an expense.

- Depreciation is *recognised as an expense*.
- Contributions to statutory funds and reserves, including the self-insurance reserve, are *no longer included as expenses*. Instead, transfers are made from the accumulated surplus/deficit to such statutory funds and reserves.
- Gains and losses on the disposal of property, plant and equipment are *recognised as revenue or as expenses*.

To summarise, the most dramatic changes were those to the capital model. The most difficult single financial administrative activity to be addressed is the Assets Register. The IMFO standard did not provide for depreciation, while GAMAP/GRAP does. This requires a comprehensive analysis of all municipal assets with an evaluation of their fair value and expected life span.

CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements are presented separately based on the IMFO standard and GAMAP/GRAP, as the format differences do not allow for presentation in a single statement.

IMFO standard financial statements

The Balance Sheet, Income Statement, and Income and Expenditure analysis for an example municipality, based on the IMFO standard, are shown in Tables 1–3.

GAMAP/GRAP-based financial statements

The Statement of Financial Position, Statement of Financial Performance and Statement of Changes in Net Assets based on GAMAP/GRAP for an example municipality are shown in Tables 4–6.

EFFECT ON THE STATEMENT OF FINANCIAL PERFORMANCE

In comparing the Income Statement (according to IMFO standard) in Table 2 and the Income and Expenditure analysis in Table 3 with the Statement of Financial Performance (according to GAMAP/GRAP) in Table 5, it is evident that, although the format and presentation are different, the net effect is exactly the same. The surplus for the year, before any appropriations, is in both cases R24 074.

Table 1: Balance Sheet at 30 June 2006 based on IMFO standard

EXAMPLE MUNICIPALITY

BALANCE SHEET AT 30 JUNE 2006

	Note	2006
		R'000
CAPITAL EMPLOYED		
FUNDS AND RESERVES		2 606 734
Statutory Funds		2 605 602
Reserves		1 132
ACCUMULATED SURPLUS		29 646
		2 636 380
LONG-TERM LIABILITIES		1 496 230
CONSUMER DEPOSITS: SERVICES		216 220
		4 348 830
EMPLOYMENT OF CAPITAL		
FIXED ASSETS		2 703 700
INVESTMENTS		398 440
LONG-TERM DEBTORS		328 395
		3 430 534
NET CURRENT ASSETS		918 295
CURRENT ASSETS		2 659 773
Inventory		152 590
Debtors		1 772 329
Cash		222
Short-term investments		645 484
Short-term portion of long-term debtors		89 148
CURRENT LIABILITIES		1 741 478
Provisions		137 375
Creditors		1 375 198
Short-term portion of long-term liabilities		140 397
Bank overdraft		88 508
		4 348 830

Table 2: Income statement for the year ended 30 June 2006 based on IMFO standard

EXAMPLE MUNICIPALITY

INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

SERVICE	Actual Income	Actual Expenditure	Actual Surplus/ (Deficit)	Original Budget Surplus/ (Deficit)
	R'000	R'000	R'000	R'000
RATES AND GENERAL SERVICES	2 781 592	2 851 520	(69 929)	(232 281)
Community services	2 339 874	2 015 886	323 988	12 252
Subsidised services	47 762	499 785	(452 024)	(436 620)
Economic services	393 956	335 849	58 107	192 087
HOUSING SERVICES	13 367	81 203	(67 835)	(75 345)
TRADING SERVICES	3 095 467	2 933 629	161 838	300 598
TOTAL	5 890 426	5 866 352	24 074	(7 028)
Appropriations for the year			(44 884)	
Net surplus/(deficit) for the year			(20 810)	
Accumulated surplus/(deficit) at the beginning of the year			50 456	
ACCUMULATED SURPLUS AT THE END OF THE YEAR			**29 646**	

Table 3: Income and Expenditure for the year ended 30 June 2006 based on the IMFO standard

EXAMPLE MUNICIPALITY
INCOME AND EXPENDITURE FOR THE YEAR ENDED 30 JUNE 2006

	2006 Actual
	R'000
INCOME	
Grants and Subsidies:	235 047
Central Government	17 621
Provincial Government	217 426
Operating Income:	5 655 379
Assessment Rates	1 363 697
Sale of electricity	2 166 844
Sale of water	718 075
Regional Services Council Levies	494 170
Other	912 593
TOTAL INCOME	**5 890 426**
EXPENDITURE	
Remuneration and allowances	1 836 928
General expenses:	3 102 054
Purchase of electricity	1 028 556
Purchase of water	479 379
Other general expenses	1 594 119
Repairs and maintenance	861 307
Capital charges	619 715
Contributions to fixed assets	132 093
Contributions	264 257
GROSS EXPENDITURE	**6 816 354**
Less: Amounts charged out	950 002
NET EXPENDITURE	**5 866 352**
Net surplus for the year	**24 074**
Appropriations for the year	**(44 884)**
	(20 810)
Accumulated surplus/(deficit) at beginning of year	**50 456**
Accumulated surplus at end of year	**29 646**

Table 4: Statement of Financial Position at 30 June 2006 based on GAMAP/GRAP

EXAMPLE MUNICIPALITY

STATEMENT OF FINANCIAL POSITION AT 30 JUNE 2006

	Note	**June 2006**
		R'000
NET ASSETS AND LIABILITIES		
Net Assets		5 547 203
Housing Development Fund		110 520
Capital Replacement reserve		892 490
Capitalisation reserve		1 363 434
Government Grant reserve		2 910 823
Donations and public contribution reserves		0
Self-insurance reserve		240 290
Revaluation reserve		0
Accumulated Surplus/(Accumulated deficit)		29 646
Non-current liabilities		1 496 230
Long-term liabilities		1 496 230
Non-current provisions		0
Current liabilities		1 957 698
Consumer deposits		216 220
Provisions		0
Creditors		1 308 565
Unspent Conditional Grants and Receipts		201 469
VAT		2 539
Short-term loans		0
Bank overdraft		88 508
Current portion of long-term liabilities		140 397
Total Net Assets and Liabilities		9 001 131
ASSETS		
Non-current assets		
Property, plant and equipment		5 614 524
Investment property		0
Investments		398 440
Long-term receivables		328 394
Current assets		2 659 773
Inventory		152 590
Consumer debtors		1 481 891
Other debtors		290 438
Current portion of long-term debtors		89 148
Call investment deposits		645 484
Bank balance and cash		222
Total Assets		9 001 131

Table 5: Statement of Financial Performance for the year ended 30 June 2006 based on GAMAP/GRAP

EXAMPLE MUNICIPALITY
STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2006

	Note	Actual
		R'000
REVENUE		
Property rates		1 363 697
Property rates – penalties imposed and collection charges		0
Service charges		3 247 552
Regional Services levies – turnover		340 977
Regional Services levies – remuneration		153 193
Rental of facilities and equipment		48 755
Interest earned – external investments		12 350
Interest earned – outstanding debtors		112 395
Dividends received		0
Fines (traffic fines)		41 287
Licences and permits		19 189
Income for agency services		0
Government grants and subsidies		235 047
Other income		315 984
Public contributions, donated and contributed property, plant and equipment		0
Gains on disposal of property, plant and equipment		0
TOTAL REVENUE		**5 890 426**
EXPENDITURE		
Employee-related costs		1 836 928
Remuneration of Councillors		31 838
Bad debt		128 212
Collection costs		33 104
Depreciation		410 120
Interest paid		209 595
Bulk purchases		1 507 935
Repairs and maintenance		341 403
Contracted services		0
Grants and subsidies paid		4 616
General expenses (less rest of charged out)		1 362 601
Loss on disposal of property, plant and equipment		0
TOTAL EXPENDITURE		**5 866 352**
NET SURPLUS/(DEFICIT) FOR THE YEAR		**24 074**

Table 6: Statement of Changes in Net Assets for the year ended 30 June 2006 based on GAMAP/GRAP

EXAMPLE MUNICIPALITY

STATEMENT OF CHANGES IN NET ASSETS FOR THE YEAR ENDED 30 JUNE 2006

	Pre-GAMAP Reserves and Funds	Housing Develop-ment Fund	Capital Replace-ment Reserve	Capitali-sation Reserve	Government Grant Reserve	Self-insurance Reserve	Accumul-ated Surplus/ (Deficit)	Total
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**
2006								
Balance at 30 June 2006	**2 255 924**	**110 520**				**240 290**	**29 646**	**2 636 380**
Implementation of GAMAP	(2 255 924)		892 490	1 363 434	2 910 823			2 910 823
Change in accounting policy								0
Restated balance 30 June 2006	**0**	**110 520**	**892 490**	**1 363 434**	**2 910 823**	**240 290**	**29 646**	**5 547 203**

The level of detail included in the Statement of Financial Performance is much greater than required by the IMFO standard. The IMFO standard Income Statement differentiates for both income and expenditure the functional service categories, namely:

- Rates and general services, with sub-categories:
  - community services
  - subsidised services
  - economic services
- Housing services
- Trading services.

On the same level, the GAMAP/GRAP-based Statement of Financial Performance provides a comprehensive number of relevant revenue and expenditure items.

The GAMAP/GRAP Statement of Financial Performance also discloses amounts charged out within the relevant items to ensure that the user of the statement is not uncertain regarding the allocation of these charge outs.

GAMAP/GRAP also introduces proper accounting for property, plant and equipment. This results in all assets having to be disclosed at real value and thus depreciation having to be charged as an expense in the Statement of Financial Performance. While the IMFO standard does not provide for depreciation, the debit 'redemption' as part of capital charges is used to provide for the depreciation expense in the operating account.

On the expenditure side of the Statement of Financial Performance, the prescribed categories of expenditure are also relatively user friendly. Items such as the remuneration of councillors, collection costs, bad debts and others, which are of importance to the lay user, are now presented on the face of the Statement of Financial Performance.

EFFECT ON THE STATEMENT OF CHANGES IN NET ASSETS

GAMAP/GRAP provides for a separate statement of changes in net assets. This statement indicates clearly all the movements in the net assets before disclosure in the Statement of Financial Position. The comparative disclosure with the IMFO standard is a note to the Income Statement dealing with appropriations. The net result of this note is then shown as an entry on the Income Statement (see Table 2).

The IMFO standard does not require the net assets of a municipality to be disclosed as a unit. Users have to analyse the financial statements of a municipality to determine the net assets. Table 6 shows clearly the various funds and reserves representing the net assets of the municipality in terms of GAMAP/GRAP.

EFFECT ON THE STATEMENT OF FINANCIAL POSITION

The statement of financial position is mostly affected by the implementation of GAMAP/GRAP. The GAMAP/GRAP structure of the Statement of Financial Position represents the format of the accounting equation. The basic accounting equation is: ASSETS = NET ASSETS + LIABILITIES (Faul, Pistorius, Van Vuuren, Vorster & Swanevelder 1997: 33).

Table 7 compares the format, structure and headings of the IMFO standard Balance Sheet and GAMAP/GRAP Statement of Financial Position based on the financial statements of the example municipality. This comparison shows changes in structure and restatement of some relevant items (National Treasury 2006: 8).

Effect on figures disclosed

- Funds and reserves are restructured, and the accumulated surplus or deficit is included under the same heading of 'Net assets'. This restructuring and restatement results in the following comparative figures (refer to Table 7):

IMFO standard		GAMAP/GRAP	
	R'000		**R'000**
Funds and reserves Accumulated surplus	2 606 733 29 646	Net assets	5 547 204
Total funds, reserves and accumulated surplus	**2 636 379**	Net assets	**5 547 204**

- 'Current liabilities' – with the exclusion of 'Consumer deposits', which were disclosed under 'Employment of Capital' – are now disclosed as an element of 'Net assets and liabilities', with the inclusion of 'Consumer deposits'. This restructuring and restatement results in the following comparative figures:

IMFO STANDARD		GAMAP/GRAP	
	R'000		**R'000**
Current liabilities	1 741 478	Current liabilities	1 957 698

Table 7: Comparison of IMFO standard Balance Sheet and GAMAP/GRAP Statement of Financial Position in terms of format, structure and headings

IMFO STANDARD BALANCE SHEET	GAMAP/GRAP STATEMENT OF FINANICAL POSITION
CAPITAL EMPLOYED	**NET ASSETS AND LIABILITIES**
Funds and Reserves	**Net Assets**
Statutory Funds	Housing Development Fund
Reserves	Capital Replacement reserve
	Capitalisation reserve
	Government Grant reserve
	Donations and public contribution reserves
	Self-insurance reserve
	Revaluation reserve
Accumulated Surplus/(Deficit)	Accumulated Surplus/(Deficit)
	Non-current liabilities
Long-term liabilities	Long-term liabilities
	Non-current provisions
	Current liabilities
Consumer deposits: Services	Consumer deposits
	Provisions
	Creditors
	Unspent Conditional Grants and Receipts
	VAT
	Short-term loans
	Bank overdraft
	Current portion of long-term liabilities
TOTAL CAPITAL EMPLOYED	TOTAL NET ASSETS AND LIABILITIES
EMPLOYMENT OF CAPITAL	**ASSETS**
	Non-current assets
Fixed assets	Property, plant and equipment
	Investment property
Investments	Investments
Long-term debtors	Long-term receivables
Net current assets	
Current assets	Current assets
Inventory	Inventory
Debtors	Consumer debtors
	Other debtors
Short-term investments	Current portion of long-term debtors
Short-term portion of long-term debtors	Call investment deposits
Cash	Bank balance and cash
Current liabilities	
Provisions	
Creditors	
Short-term portion of long-term liabilities	
Bank overdraft	
TOTAL EMPLOYMENT OF CAPITAL	TOTAL ASSETS

The difference between the two standards is represented by 'Consumer deposits' of R216 220.

- 'Fixed assets' has been redefined as 'Property, Plant and Equipment' with very specific accounting standards as indicated by GAMAP 17. The principal issues are the timing of the recognition of an asset, the determination of its carrying amount and the depreciation charges to be recognised in relation to it, as well as the determination and accounting treatment of impairments to the carrying amount. These changes result in the following difference in total amounts disclosed:

IMFO STANDARD		**GAMAP/GRAP**	
	R		R
Fixed assets	2 703 700	Property, plant and equipment	5 614 524

The restatement of 'Property, Plant and Equipment' results in a total amount disclosed of more than twice the total amount shown with the IMFO standard.

Effect on financial ratios

From the preceding section, it is clear that analysis involving any of the figures restated differently will have an effect on the interpretation thereof. The effect on the Statement of Financial Position is indicated by calculating a series of applicable ratios.

Current ratio

The *current ratio*, also referred to as the operating capital ratio in municipalities, is a *financial ratio* that measures whether or not the institution has enough resources to pay its debts within the next 12 months. The current ratio is thus an indication of an institution's ability to meet short-term obligations. Acceptable current ratios vary from industry to industry. Swanevelder (1991: 193) determined the current ratios of municipalities to be 1.98 : 1. If a municipality's current assets are in this range, then it is generally considered to have good short-term financial strength. If current liabilities exceed current assets (and the current ratio is below 1), then the institution may have problems meeting its short-term obligations. If the current ratio is too high, the institution may not be efficiently utilising its current assets (Swanevelder 2005: 73).

The *current ratio* compares an institution's *current assets* to its *current liabilities* and is expressed as follows:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Table 8 shows the calculation of the current ratio (operating capital ratio) for the example municipality.

Table 8: Net current assets at 30 June 2006

2005/06	IMFO standard R'000	GAMAP/GRAP R'000
CURRENT ASSETS	2 659 773	2 659 773
Inventory	152 590	152 590
Debtors	1 772 329	1 772 329
Cash	222	222
Short-term investments	645 484	645 484
Short-term portion of long-term debtors	89 148	89 148
CURRENT LIABILITIES	1 741 478	1 957 698
Consumer deposits	0	216 220
Provisions	137 375	0
Creditors	1 375 198	1 308 565
Unspent conditional grants and receipts	0	201 469
VAT	0	2 539
Current portion of long-term liabilities	140 397	140 397
Bank overdraft	88 508	88 508
NET CURRENT ASSETS	918 295	702 075

	IMFO standard R'000	GAMAP/GRAP R'000
Current ratio = Current assets	2 659 773	2 659 773
Current liabilities	1 741 478	1 957 698
Current ratio =	1.53	1.36

Conclusion

The IMFO standard overstated the current ratio by approximately 12.5% compared with GAMAP/GRAP. This difference in current ratio may have a substantial effect on, for example, the credit rating of municipalities (Scott 2001: 144).

Acid-test or quick ratio

$$\text{Quick (acid test) ratio} = \frac{\text{Current assets – Inventory}}{\text{Current liabilities}}$$

Based on the information in Table 7, the quick ratio is calculated as follows:

	IMFO standard R'000	GAMAP/GRAP R'000
Quick ratio = Current assets – Inventory	2 659 773 – 152 590	2 659 773 – 152 590
Current liabilities	1 741 478	1 957 698
Quick ratio =	1.44	1.28

Swanevelder (1991: 193) determined an acid test ratio of between 105.6% (or 1.06 : 1) and 282.4% (or 2.82 : 1) for a sample group of municipalities in 1991. The fact that the keeping of inventory is not part of a municipality's major activities is noticeable in this relatively high ratio.

Conclusion

The IMFO standard overstated the quick ratio, as was the case with the current ratio, by 12.5% compared with GAMAP/GRAP. The quick ratio is substantially less than the figure calculated by Swanevelder (1991: 190) of 173%.

Solvency

The solvency of a municipality is best expressed by the debt ratio (Scott 2001: 148). This ratio compares the total assets with total liabilities, and it shows the ability of an authority to meet its obligations in the long term. A ratio of less than one is an indication of insolvency:

Description	IMFO standard R'000	GAMAP/GRAP R'000
TOTAL ASSETS:		
Current assets	3 058 213	3 058 213
Long-term receivables	328 394	328 394
Property, plant and equipment	2 703 700	5 614 524
Total assets	6 090 307	9 001 131
TOTAL LIABILITIES:		
Current liabilities	1 741 478	1 957 698
Plus: Outstanding loans	1 496 230	1 496 230
Non-current provisions	–	–
Accumulated funds	2 606 733	5 517 557
Total liabilities	5 844 441	8 971 485
Solvability (debt) ratio	**1.042:1**	**1.003:1**

Conclusion

The implementation of GAMAP/GRAP resulted in the solvency ratio of the consolidated municipalities declining slightly by 3.8%. The solvability (debt) ratio is still in excess of 1:1 and should not influence decision-makers substantially.

Other ratios

A number of additional ratios can be calculated to analyse and interpret the financial position of municipalities, but it would not contribute to the purpose of this article, as the ratio would be the same irrespective of the accounting practice applied. These ratios include the following (Swanevelder 2005: 73–77; Scott 2001: 146–152):

- Total long-term debt to total income ratio
- Inventory turnover ratio
- Cash to interest coverage ratio
- Debt to cash ratio.

SUMMARY

The implementation of GAMAP/GRAP in municipalities in South Africa resulted in changes in some financial policies and applications. Many municipal financial officials believed that the implementation of GAMAP/GRAP would have a negative effect on the financial position, as disclosed in the financial statements of municipalities.

This article tests some of the most relevant elements used to determine the financial health of a municipality by calculating comparative financial ratios based on the same source data, but disclosed in terms of the IMFO standard compared with GAMAP/GRAP.

The analysis of the financial information, as indicated in this article, substantiates the belief that the implementation of GAMAP/GRAP, compared to the IMFO standard, would have a negative effect on the financial position disclosed in the financial statements of municipalities. The ratios calculated in this article indicate a slight decrease in value when the financial statements compiled in terms of the IMFO standard are compared with GAMAP/GRAP-based financial statements.

Analysts of municipal financial statements are of the opinion, however, that although the objective ratios may look somewhat more negative by disclosing the financial information in terms of GAMAP/GRAP, they are more correct and comply with international accounting standards. The level of transparency and detail in the GAMAP/GRAP financial statements, together with the well-defined and described GAMAP/GRAP practices, results in world-class municipal financial reporting.

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