

OPERATING AND REPORTING MANUAL

USER GUIDE

January 2004



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I: Introduction

1. Background

The Ministry of Mines & Energy, Namibia, issued a White Paper on the Energy Policy in May 1998. The goals used as a framework for energy policies for purposes of the White Paper are set out below:

- Effective governance;
- Security of supply;
- Social upliftment;
- Investment and growth;
- Economic competitiveness and efficiency; and
- Sustainability.

Government established the Electricity Control Board (ECB) in terms of the Electricity Act, No.2, 2000, as amended. The objectives of the ECB are to exercise control over and regulate the provision, use and consumption of electricity in Namibia and to oversee the functioning and development of the electricity industry, in accordance with prevailing Government policy so as to ensure order in the sufficient supply of electricity.

In terms of the Distribution License Conditions issued by the ECB the licensee shall ring fence the electricity distribution operations and maintain separate accounts of the electricity distribution undertakings as if it were carried on by a separate commercial entity. The licensee shall prepare financial statements in a constantly uniform manner from the accounting records for each financial year, comprising:

- A balance sheet;
- An income statement; and
- A cash flow statement.

2. Purpose of the user guide

The user guide is developed to provide the user of the Operating and Reporting Manual (ORM) with the necessary guidance in order to complete the reporting schedules required by the ECB, and to supply further information that may be required by the future Red's.

I: Introduction

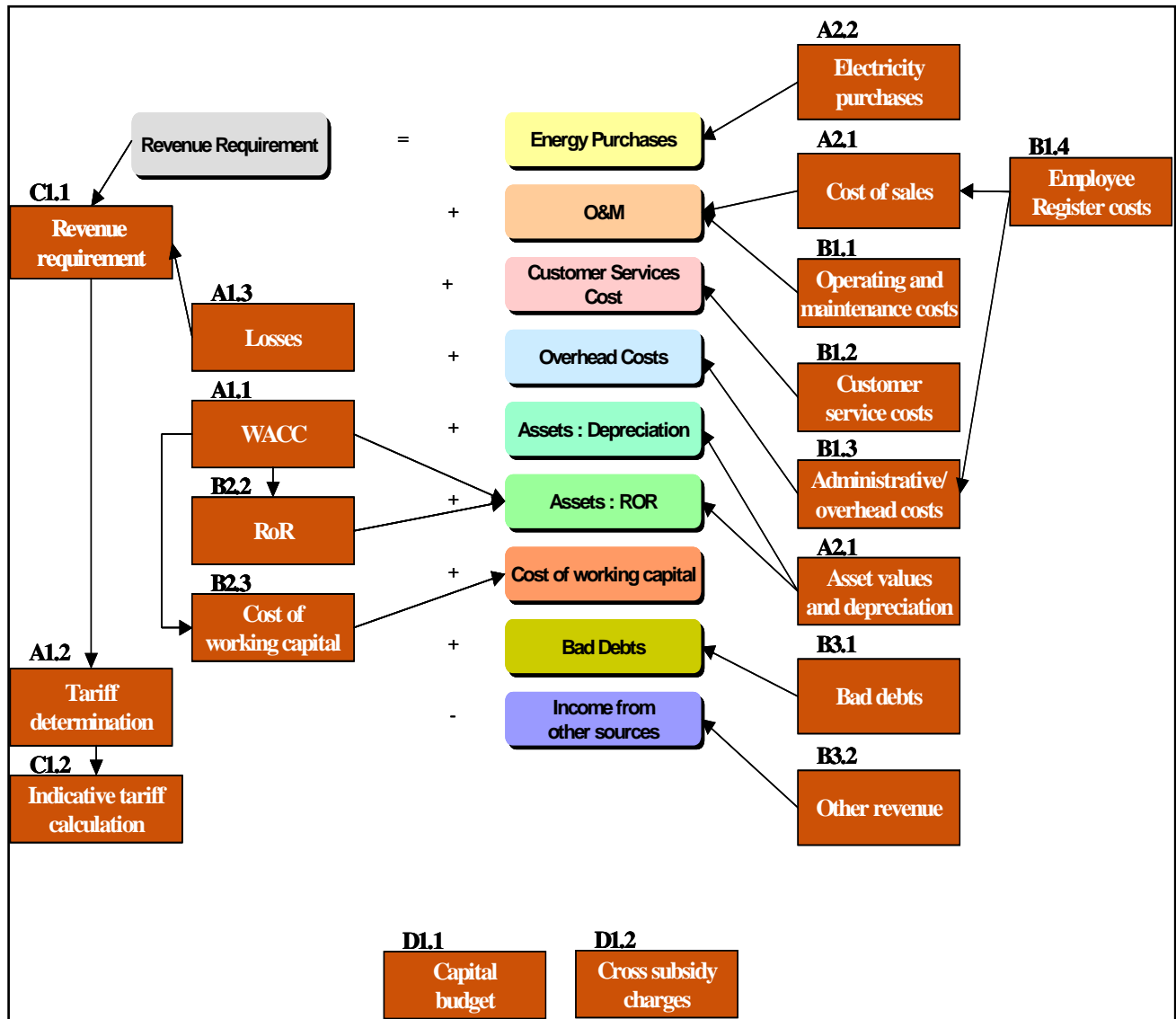
3. Why the requested information is needed

The tariff study recommends that an electricity distributor in Namibia be regulated based on its revenue requirement, including a return on assets used for electricity distribution and supply. The cost structure of the distributor must be determined in order to determine the revenue requirement, and should include:

- Power supply costs;
- Distribution costs, including network assets and capital related costs;
- Operation and maintenance costs associated with electricity distribution;
- Distribution losses; and
- Customer services costs, including marketing and billing and overhead costs attributed to retail.

To this end, the Operating and Reporting manual (ORM) and user guideline have been developed to ensure a unified approach to the collection and reporting of information to the ECB. The reporting schedules have been developed to include the necessary information to calculate the revenue requirement, and can be illustrated as follows:

Part A : Tariff determination

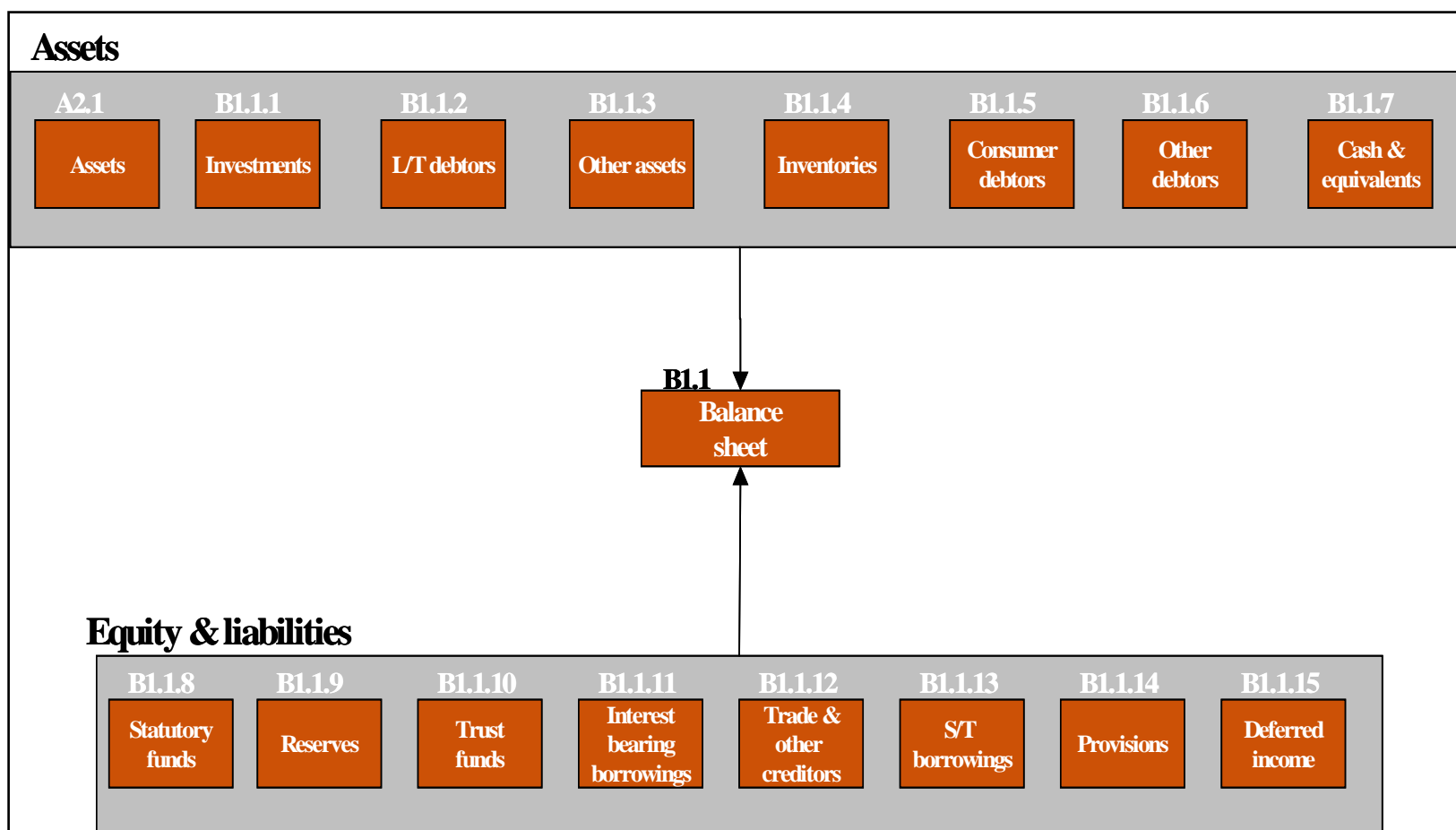


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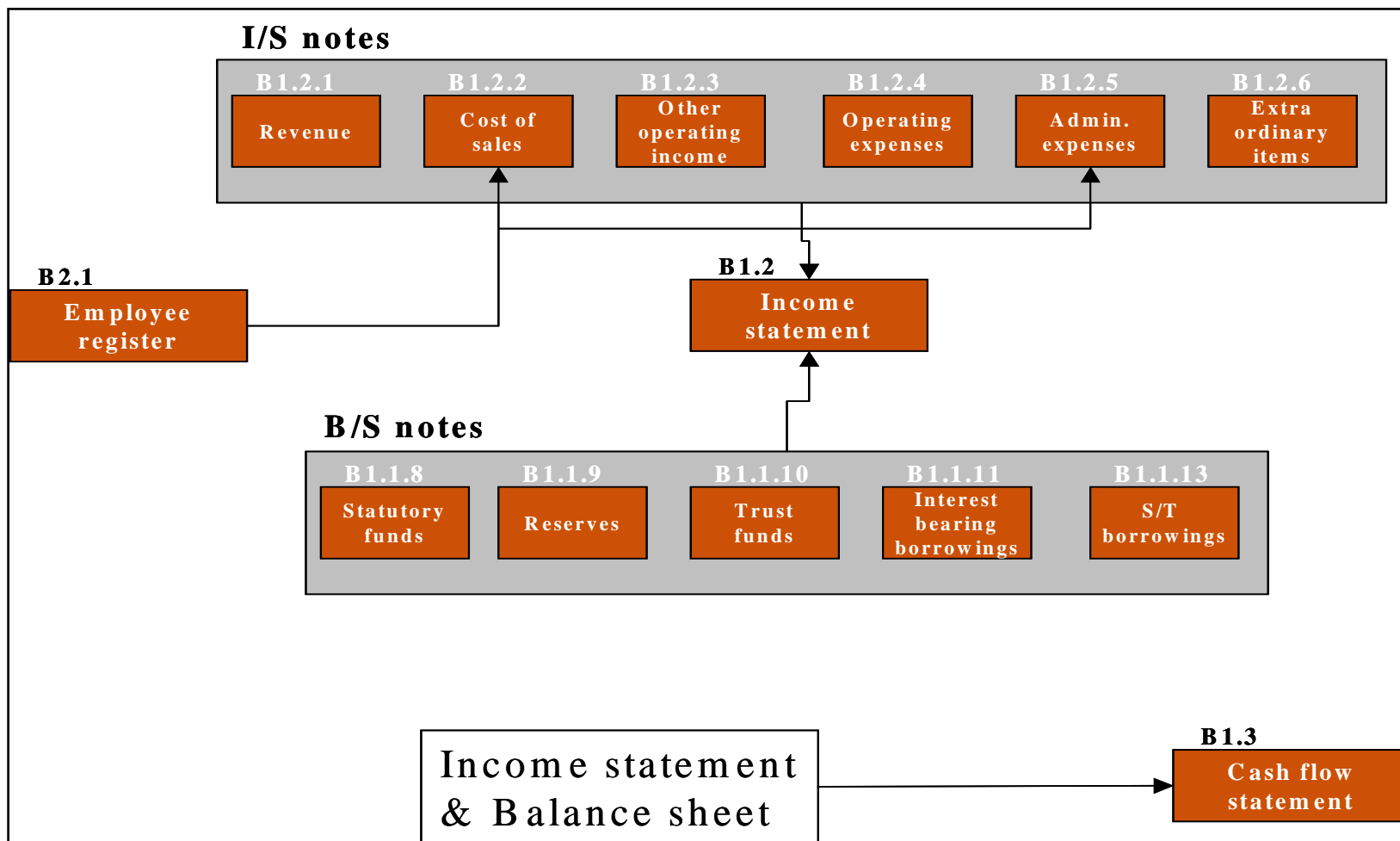
Part B : Financial information

Balance sheet:



Part B : Financial information

Income statement:



I: Introduction

3. Why the requested information is needed (continued)

The information collected will further be useful for the distribution utility management and decision-making.

Some of the most challenging issues when it comes to reporting will be the following:

1. valuation and pricing of assets;
2. the classification of an item as a maintenance cost or an investment;
3. overhead and allocation keys for overheads and specifically to devise simple reliable allocations bases taking cognisance of the actual cost drivers;
4. working capital and relevant principles for this;
5. verification arrangements for the documentation received from auditor's etc.

I: Introduction

4. Terminology

MWh: mega watt hour

KVA: kilo volt amps

kWh: kilowatt hour

GAAP: Generally accepted accounting practice

Asset: a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

Liability: a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Equity: is the residual interest in the assets of the enterprise after deducting all its liabilities.

Accounting policies: the specific principles, bases, conventions, rules and practices adopted by the enterprise in preparing and presenting financial statements.

Historic cost: the carrying value of an asset is based on its purchase price.

Replacement cost: the value of an asset is based on the current cost of replacement with a similar asset.

Deferred income: significant items of unearned finance income of a long-term nature.

Extraordinary item: those items of income and expenditure that are material, and result from events or transactions that are clearly distinct from the ordinary activities of the enterprise and are therefore not expected to recur frequently.

Impairment: permanent decrease in the carrying amount of assets.

I: Introduction

4. Terminology (continued)

Maintenance: - expenditure on repairs or maintenance of the condition of property, plant and equipment made to restore or maintain the future economic benefits.

Investment: - expenditure that improves the capacity of the asset beyond its originally assessed standard of performance.

Administration cost/Overhead: - represent those costs that can not be directly associated with units of electricity i.e. all the costs incurred to distribute electricity to customers excluding direct material and labour costs. It usually includes indirect labour, materials and running costs of the department/unit.

Customer Service Cost: - represent those cost related to providing and supporting customer care or the retail business.

Common costs: - those costs related to mainly support and corporate services that cannot be allocated directly to an individual product/service.

II: Notes on the use of the operating and reporting manual

1. Schedule and supporting note classification

The ORM is structured in two parts, namely:

- Part A: Tariff determination; and
- Part B: Financial information.

Part B of the ORM also includes annexures relating to possible RED requirements that are not compulsory information at this time.

Each part contains sub sections. Each sub-section has schedules in which data must be captured. In instances where schedules require significant data, notes (working papers) have been prepared where data can be captured and collated into the schedule.

The classification of the schedules and supporting notes set out below are included in the ORM and should be read with the applicable ORM schedule:

Part A. Tariff Determination:

Sub-section	Schedule
A1. Customer Information	A1.1. Weighted average cost of capital
	A1.2. Customer & Tariff Information
	A1.3. Losses
A2. Direct Costs	A2.1. Cost of Sales
	A2.2. Electricity Purchases
B1. Expenditure	B1.1. Operating & Maintenance Costs
	B1.2. Customer Service Costs
	B1.3. Overhead Costs
	B1.4. Human Resources Register
B2. Asset Information	B2.1. Fixed Assets
	B2.2. Rate of Return
	B2.3. Cost of Working Capital

II: Notes on the use of the operating and reporting manual

1. Schedule and supporting note classification (continued)

Part A. Tariff determination (continued):

B3. Debt and Revenue	B3.1. Bad Debts
	B3.2. Other Revenue
C1. Tariff Determination	C1.1 Revenue Requirement
	C1.2 Tariff Determination
D1. Other Charges	D1.1 Capital Budget
	D1.2 Cross Subsidy Charge

II: Notes on the use of the operating and reporting manual

1. Schedule and supporting note classification (continued)

Part B. Financial information:

Sub-section	Schedule	Supporting note
B1. Financial statements	B1.1. Balance sheet	B1.1.A Assets
		B1.1.AA Depreciation
		B1.1.1 Investments
		B1.1.2 Long term debtors
		B1.1.3 Other assets
		B1.1.4 Inventories
		B1.1.5 Consumer debtors
		B1.1.6 Other debtors
		B1.1.7 Cash and cash equivalents
		B1.1.8 Statutory funds
		B1.1.9 Reserves
		B1.1.10 Trust funds
		B1.1.11 Interest bearing borrowings
		B1.1.12 Trade and other payables
		B1.1.13 Short term borrowings
		B1.1.14 Provisions
		B1.1.15 Deferred income
	B1.2 Income statement	B1.2.1 Revenue
		B1.2.2 Cost of sales
		B1.2.3 Other operating income
		B1.2.4 Operating expenses
		B1.2.5 Administrative expenses
		B1.2.6 Extraordinary item
	B1.3 Cash flow statement	

II: Notes on the use of the operating and reporting manual

1. Schedule and supporting note classification (continued)

Part B. Financial information (continued):

Sub-section	Schedule	Supporting note
B2. Human resource information	B2.1 Employee register and cost	

C. Annexures : Non-compulsory possible RED requirements:

Annexure	Description
C1.1	Employee contracts
C1.2	Contracts
C1.3	Litigation issues
C1.4	Existing/contingent liabilities
C1.5	Customer information
C1.6	IT infrastructure
C1.7	Billing information
C1.8	Debt management
C1.9	Customer care

Please note that all schedules and notes (working papers) should be submitted to the ECB. In instances where the supporting documentation is too large, (i.e. asset register, employee register, stock register and consumer debtor lists) information may be summarised in the schedules and notes. The full supporting documentation nevertheless needs to be compiled and regularly updated. The ECB may from time to time request the submission of full supporting documentation.

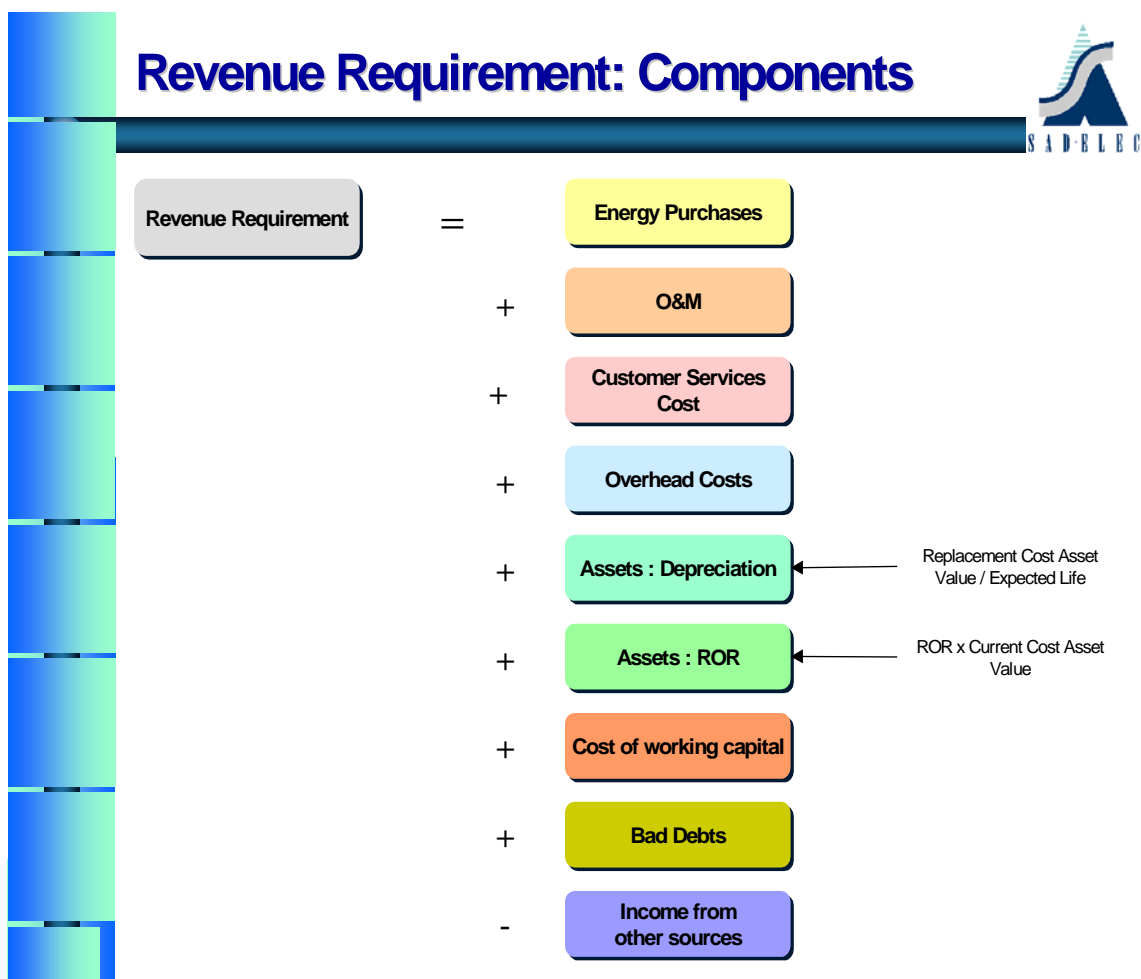
Part A. Tariff determination

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules.

Part A : Tariff determination - Technical schedules:

The tariff determination schedules are based on the National Tariff Study Report – November 2001 requirement that tariffs be regulated in terms of revenue requirement. The components for the revenue requirement are depicted below:



II: Notes on the use of the operating and reporting manual

Part A : Tariff determination - Technical schedules:

2. Clarification of the primary reporting schedules (continued)

Schedule A1.1 Weighted average cost of capital:

The note contains the real and nominal weighted average cost of capital (WACC) as calculated by the ECB. The WACC will be calculated and published on an annual basis, and will be used for the calculation of the return on assets (Note B2.2) and the cost of working capital (Note B2.3) to be used in the revenue requirement calculation (Schedule C1.1).

Schedule A1.2 Customer & Tariff Information:

The schedule should be completed to capture all information relevant to customers, current approved tariffs and proposed tariffs. From this information it is possible to calculate the revenue for the current and budget year. The annual sales in MWh per customer category are incorporated and the total thereof feed into schedule A1.3 to determine electricity losses.

The annual load factor and monthly average maximum demand information needed for tariff calculation is recorded on this schedule. The number of new connections per customer category should be recorded on the sheet provided.

Schedule A1.3 Losses:

The total losses should be calculated in order to comply with the license conditions to strive towards maintaining the overall distribution megawatt hour losses below 10%.

The schedule incorporates the total MWh loss calculation that will feed into schedule C1.1 – revenue requirement, and further attempts to unpack the losses into technical and non-technical losses, where information is available.

The distribution line losses occur as part of the inherent process of electricity distribution. The amount of losses is measured as the difference between metered energy purchased and metered energy sold.

II: Notes on the use of the operating and reporting manual

Part A : Tariff determination - Technical schedules:

2. Clarification of the primary reporting schedules (continued)

Schedule A1.3 Losses (continued):

Distribution line losses are caused by the physical characteristics of the network design including cable length and type as well as the power flows in the lines. These losses are referred to as technical line losses. Non-technical line losses occur when un-metered consumption occurs somewhere in the distribution network. Non-technical losses can occur because of theft, incorrect energy meters or even faulty metering processes and systems.

Regardless of the nature of the line losses the distributor remains liable to pay for all the energy it has purchased, including the lost energy. The cost of losses therefore represents a cost to the distributor that is ultimately passed on to consumer via an increase in the tariffs.

Schedule A2.1 Cost of sales:

Cost of sales includes only those costs directly related to the electricity distribution activities, including electricity purchases (mainly the cost of purchasing electricity from NamPower). The cost of electricity purchases directly links from schedule A2.2 – Electricity purchases. Other items should be fully explained and supported by the necessary documentation in the area provided on the schedule provided. The items listed in the note will be carried forward to the revenue requirement calculation (Schedule C1.1).

Schedule A2.2 Electricity Purchases:

The schedule on electricity purchases captures all information on purchases from NamPower or in some cases Premier Electric. The total of this schedule should be the same as the total purchases from NamPower. This total links to schedule A2.1 – Cost of Sales.

II: Notes on the use of the operating and reporting manual

Part A : Tariff determination - Technical schedules:

2. Clarification of the primary reporting schedules (continued)

Schedule B1.1 Operating and Maintenance Cost

This schedule relates to all costs to maintain and operate the assets. The schedule provides a list of typical O&M costs in utilities to provide a guideline of the costs allowed for the revenue requirement. If utilities have other costs full details of these costs should be provided in order for the ECB to evaluate the validity of the cost in the area provided.

This schedule links to schedule C1.1 – Revenue Requirement in order to calculate the total direct costs of the electricity business.

Shedule B1.2 Customer Service Costs

The schedule refers to those costs incurred in order to provide a service to the customer and should included such costs such as cashiers and telephone costs. The schedule has the same format as the schedule B1.1 and the same guidelines should be followed. The schedule also links to schedule C1.1 – Revenue Requirement.

Schedule B1.3: Administrative/Overhead Costs

The schedule refers the administrative costs incurred by the utility. These costs are mainly the indirect costs and pure administrative costs. The schedule should be handled in the same manner as the previous two schedules and carries forward to the revenue requirement calculation (Schedule C 1.1).

Schedule B1.4: Employee Register and Cost

The employee register is divided into dedicated (direct) and support (indirect) staff. The direct staff costs will be taken into account in schedule B1.1 – Operating and Maintenance Cost, and the indirect costs are included in schedule B1.3 - administrative costs.

The allocation of support staff costs should be based on the % time spent on electricity distribution business, and taken into account in the revenue requirement calculation in Schedule C1.1.

II: Notes on the use of the operating and reporting manual

Part A : Tariff determination - Technical schedules:

2. Clarification of the primary reporting schedules (continued)

Schedule B2.1: Asset Values and Depreciation

The schedule is one of the most important support schedules of the ORM. The process of moving from current standard accounting to GAAP standards of accounting is necessary for the future incorporation into a RED structure. The major difference between current municipal accounting principles where fixed assets are disclosed at cost less loans redeemed and other capital receipts, is that depreciation needs to be calculated and set off against the cost or re-valued value of the asset.

The schedules contained in the Tariff Determination and Financial Sections provide for the following information to be reported. This section refers to both and should be read as such:

- The asset type;
- The asset description;
- The acquisition date of the asset;
- The original cost of the asset;
- The method/s of finance, if more than one;
- The current condition, that will impact directly on the useful life remaining of the asset;
- The accumulated depreciation to date (that needs to be recalculated);
- The carrying value;
- The designation of the asset based on the department(s) where it is used if not used in the electricity department.
- The % allocation, which is important for the calculation of asset values used partly for the distribution business.
- The % accumulated depreciation allocation, based on the % usage; and
- The % carrying value allocation based on the % usage.
- Revaluation adjustments
- Additions
- Disposals

The second part of the schedule is used for the calculation of the current year depreciation and closing carrying amount based on replacement cost.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

The following recommendations are made in order to successfully determine the asset carrying value to be disclosed:

Preparation of the fixed asset register:

- *A detailed physical inventory of all movable and immovable assets needs to be done prior to the depreciation adjustments. This can be done in-house (if the required resources are on hand) or by an external consultant who has the requisite skills.*
- *The basis of identifying immovable assets should include the use of engineering records and apportioning the cost based on a unit of measure, for example kilometres of lines.*
- *The detailed physical inventory list should then be compared on an item for item basis with the existing fixed asset register maintained by the accounting department. The data in these two registers should be merged into one accurate and complete fixed asset register to be maintained by the accounting department. A purchased or customised software package could be utilised to assist with this function.*
- *A capitalisation policy limit should be set. For example minor assets in the current asset register with a cost of less than N\$1,000 should be written off. Such assets will have an immaterial value when aggregated, and will not impact on the total assets disclosed. All future purchases should be handled in the same manner.*
- *It is important to allocate the source of funding to each asset. The municipalities with a detailed capital ledger will be able to allocate the loans outstanding, loans redeemed and other capital receipts to specific assets with ease.*

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

- *Other details which should be included in the fixed asset register include:*
 - *Asset bar code number*
 - *Asset category*
 - *Quantity on hand*
 - *Serial number (if available)*
 - *Location bar code number*
 - *Department / Supervisor*
- *Assets should be physically verified at least annually.*

Assets paid for by customers should be accounted for in the same manner as assets received from grant sources (e.g. donor funds), i.e. subsidised assets. The asset will be accounted for in the fixed asset register of the electricity department at cost. A deferred income account (liability) will be raised to the value of the asset. This deferred income account will then be amortised (written down) to operating income over the useful life of the asset (on a yearly basis). The value of the subsidised asset will not be included in the expected return on assets calculation. The depreciation charge will, however, be included in cost of sales for tariff determination purposes.

The cost of an asset should include all costs directly attributable to bringing the asset into working condition for its intended use. This would therefore include the labour cost as well. For practical purposes we recommend that this only be done for current and future purchases and not for items that are already included in the fixed asset register.

Major improvements to buildings, plant and equipment should be capitalised. Maintenance and repairs should not be capitalised, but expensed as incurred. Subsequent expenditure on assets is only recognised as an asset (i.e. capitalised) when the expenditure improves the condition of the asset beyond its originally assessed standard of performance. In other words when the asset's useful life is extended, its capacity is increased, the quality of its output is improved or the operating costs are reduced. Repairs or maintenance on assets is made to restore the asset to its originally assessed standard of performance. It is therefore recognised as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment. Refer to Appendix A of the user guide for further guideline.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

The National Electricity Tariff Study Report – November 2001 recommends that assets be valued at depreciated replacement cost.

When the replacement cost is used as the basis of valuation, we recommend that:

Replacement cost revaluation:

- *The ECB will approve the replacement cost values per asset category and update the approved values on an annual basis. This will be on an approved list applicable to all municipalities.*
- *The municipality will use the approved values to determine the asset value and re-stated accumulated depreciation figures.*
- *The revaluation reserve should be created and credited with the devalued amount of the assets.*

The process of calculating backlog depreciation could easily be undertaken if the information is available. By capturing the date of purchase, historic cost and depreciation rate, the accumulated depreciation could be calculated at a specific point in time.

Municipalities that do not have such information can only go back as far as such information is available and would need to use estimates based on realistic assumptions.

It is extremely important to calculate backlog-accumulated depreciation, as it would not be possible to eliminate loans redeemed and other capital receipts if this is not done. It further prevents excessive credits to unappropriated surpluses or non-distributable reserves or a duplication of expenses through excessive future depreciation charges.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

Calculating backlog depreciation:

- *Property, investment property, plant and equipment should be stated at cost less accumulated depreciation.*
-
- *Depreciation should be calculated at cost, using the straight-line method over the estimated useful life of the asset.*
- *The following estimated asset lives can be used as a guide:*
 - *Electricity network and related infrastructure - refer to NENA*
 - *Investment property – 50 years*
 - *Buildings – 50 years*
 - *IT hardware – 5 years*
 - *IT software – 2 years*
 - *Vehicles busses – 10 years*
 - *Vehicles trucks – 5 years*
 - *Motor vehicles – 5 years*
 - *Office equipment – 5 years*
 - *Furniture and fittings – 5 years*
 - *Bins and containers – 5 years*

Investment property:

Investment property is property (land or buildings) held to earn rentals or for capital appreciation. In other words it is not used in the production or supply of goods or services or for administrative purposes or for sale in the ordinary course of business. GAAP AC 135 (refer to extract included as Appendix C for more details) states that investment property can be accounted for at fair value (market value with no depreciation, but gains or losses on revaluation are taken to the income statement) or cost (depreciation).

Finance/operating leases:

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. . A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership. Refer to Appendix E for more details on the accounting treatment of leases.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

Should the assets be disclosed at depreciated replacement value, the backlog depreciation needs to be adjusted as follows:

	Historic	Replacement	Adjustment
Cost	N\$ 100	N\$150	N\$50 to revaluation reserve
Date of acquisition	July 1998	Same	
Current date	June 2002	Same	
Useful life	10 years	Same	
Current year depreciation	N\$10	N\$15	N\$15 to income statement and accumulated depreciation, not N\$10
Accumulated depreciation at the beginning of the year	N\$30	N\$45	N\$15 against the unappropriated surplus at the beginning of the year
Accumulated depreciation at the end of the year	N\$40	N\$60	None
Carrying value	N\$60	N\$90	Stated in asset register and balance sheet

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

Once the accumulated depreciation has been calculated, the problem of unbundling the loans redeemed and other capital receipts should be addressed.

The following matrix illustrates the adjustments required:

Source of funding	Process to be followed	Conversion to accumulated depreciation	Treatment of residual balance, if necessary
Revenue contributions	Determine backlog accumulated depreciation	Allocate corresponding balance of revenue contributions to accumulated depreciation	Balance of revenue contributions to unappropriated surplus
Public contributions/ donations	Determine backlog accumulated depreciation	Allocate corresponding balance of public contributions/ donations to accumulated depreciation	Balance of public contributions/ donations to non-distributable reserves
External loans redeemed	Determine backlog accumulated depreciation – It should agree to the balance of the external loans redeemed account if the loan period corresponds to the useful life of the asset	Allocate loans redeemed to accumulated depreciation	N/A

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

Source of funding	Process to be followed	Conversion to accumulated depreciation	Treatment of residual balance, if necessary
Internal loans redeemed	Determine backlog accumulated depreciation – It should agree to the balance of the internal loans redeemed account if the loan period corresponds to the useful life of the asset	Allocate loans redeemed to accumulated depreciation	N/A
Government grants	Determine backlog accumulated depreciation	Allocate corresponding balance of government grants to accumulated depreciation	Balance of government grants to non-distributable reserves
Other sources	Determine backlog accumulated depreciation	Allocate corresponding balance of funding to accumulated depreciation	Balance of funding to non-distributable reserves (if externally funded) Or Unappropriated surplus if internally funded

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.1 Network and other assets: (continued)

Foreign exchange transactions:

The ORM was developed to include all transactions in N\$, which means that all transactions in foreign currency, be it purchases or sales of electricity or purchases and sales of assets, will be handled in the same fashion as previously. Transactions are normally recorded in the financial records of an organisation at the spot rate at date of transaction

The following extracts from AC 112 with regard to transactions in foreign currency is quoted:

A foreign currency transaction is a transaction that is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

- (a) buys or sells goods or services whose price is denominated in a foreign currency,
- (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency,
- (c) becomes a party to an unperformed foreign exchange contract, or
- (d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

The exchange rate at the date of the transaction is often referred to as the spot rate. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable and the spot rate should then be used.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule B2.2: Rate of Return

The note calculates the expected return on assets to be included in the revenue requirement calculation (Schedule C1.1) and excludes the value of the subsidised assets or assets paid by the customers as stated in NENA (Namibia Electricity Network Assets) software.

The Rate of Return as calculated in this schedule represents the return expected by stakeholders for their investment in assets. In the utility this return will represent the profit that the ECB allows the utility to make over and above cost recovery of the electricity unit.

In the schedule the Total Revalued Assets excludes those asset paid either through donations/grants or by customers. The total for the Revalued assets comes from schedule B2.1.

Schedule B2.3: Cost of Working Capital

The note calculates the cost of working capital based on real WACC to be included in the revenue requirement calculation (Schedule C1.1)

Cash and cash equivalents included in current assets (Schedule B1.1.7, ORM Part B) only includes operating cash and not excess liquidity.

Schedule B 3.1: Bad Debts

The revenue from the previous year that was written off should be included in the schedule. The ECB would like to encourage utilities to improve debt collection by allowing the minimum of 5% of the Revenue Requirement or bad debt provision to be incorporated in the tariff determination as bad debts. These amounts will then be included in the revenue requirement schedule C1.1.

Schedule B3.2: Other Revenue

All the revenue related to the electricity distribution activities except electricity sales should be included in the note, such as connection and re-connection fees. All the revenue items listed in the schedule will be carried forward to the revenue requirement calculation (Schedule C1.1). Information about other items should be provided.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule C1.1: Revenue Requirement

The revenue requirement schedule is the main schedule in the ORM, and is supported by the other schedules and notes in the ORM. The schedule relies on the accurate completion of the other schedules and supporting notes.

The schedule incorporates the electricity units sold, purchased and losses in MWh, as well as cost and income components as defined in the National Electricity Tariff Study Report – November 2001.

The schedule is further supported by three notes that should be completed in order to calculate the expected return on assets and cost of working capital.

Schedule C1.2: Indicative Tariff Calculation

The schedule incorporates the different customer categories, meter type and voltage for each customer. The schedule draws on information provided in the prior schedules and uses the revenue requirement as a basis to calculate the indicative tariffs. The calculations are based on the recommendations of the National Tariff Study 2001.

The tariff calculation in the schedule only provides an indicative tariff for the main customer categories such as domestic, commercial, etc. Due to the fact that the schedule ignores coincidence peak demand the demand charges would not be correct. Therefore the utility would still need to do its own analysis of tariffs that would be indicated in schedule A1.2 – Customer Information.

Schedule D1.1: Capital Budget

Capital budget information must be provided for the current and forthcoming financial years. The budget should be divided into new and continuing projects. This would serve as an indication of future tariff increases that need to be taken into account for planning purposes.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part A : Tariff determination - Technical schedules:

Schedule D1.2: Cross Subsidy Charges

Subsidised prices to certain categories of customers need to be approved by the ECB. This schedule will incorporate the latest approved subsidised charges, for which a lost revenue component needs to be calculated, and charged to other tariff categories. The schedule will thus incorporate the ECB guidelines for subsidised tariffs, and is incorporated as information for the user.

This schedule is not compulsory at this time but may be required at a later stage as determined by the ECB.

Part B. Financial information

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part B : Financial information - Financial schedules:

Schedule B1.1 Balance sheet:

The balance sheet is stated in GAAP format with assets and equity and liabilities as the two elements. The schedule is supported by 15 separate notes that need to be completed that will feed into the balance sheet.

Schedule B1.1A Network and other assets:

This schedule should be handled in the same manner as that of Schedule B2.1 to Part A : Tariff determination, included on page 18 of this guide.

Schedule B1.2 Income statement:

The income statement is stated in GAAP format except for the appropriations of net profit, due to the fact that the municipality will still make contributions to funds and reserves for future financing requirements. The income statement requires the calculation of gross profit from revenue and cost of sales. Only revenue and costs directly related to the distribution activity should be included in the calculation of the gross profit.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part B : Financial information - Financial schedules:

Schedule B1.3 Cash flow statement:

The cash flow statement is required by the license agreement and needs to be prepared from the financial information gathered for schedules B1.1 and B1.2.

The cash generated from operations can be calculated as follows:

Net surplus for the year	xxx
Adjusted for:	
Depreciation (add back)	xx
Capital receipts realised	(xx)
Investment income	(xxx)
Interest paid (add back)	xx
Operating surplus before working capital charges	xxxx
Decrease in investors	xx
Increase in debtors	(xx)
Increase in provisions	xx
Increase in creditors	xx
Decrease in short term portion of long term debtors	xx
Cash generated from operations	

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Part B : Financial information - Financial schedules:

Schedule B2.1 Employee register and cost:

The employee register is divided into dedicated (direct) and support (indirect) staff. The direct staff costs will be taken into account in the calculation of the gross profit (see schedule B1.2) and the indirect costs included in other operating expenses in the income statement.

The allocation of support staff costs should be based on the % time spent on electricity distribution business.

Please note that:

Currently, the % support staff costs, the % support asset carrying amount (schedule B2.1) and other support costs will be included in the different departmental charges paid by the electricity distribution to other municipality departments. All such support costs need to be revised and allocated to the electricity distribution business based on actual costs. Once the actual costs are identified and service level agreements are in place, the cost charged as per service level agreement will replace the % allocated costs in schedules B 2.1, and should thus not be taken into account once the service level agreement has been established.

II: Notes on the use of the operating and reporting manual

2. Clarification of the primary reporting schedules (continued)

Support costs (overheads and common costs)

It is recommend that support costs be allocated based on the methods set out below. These might well change once the service level agreements have been put in place:

Cost	Allocation method
Accommodation	Floor space
Council expenses	Income
Administration charges	Income
Engineers charges	Income
Human resources support	Staff numbers
Treasury charges	Income
IT	Income
Customer service	Income
Security	Asset values
Insurance	Asset values
Municipal services	Income

Once all the subsidised/support costs are calculated, service level agreements can be entered into which will determine the fee for services rendered with escalation charges in future. This fee will replace the current allocated costs in the income statement.

II: Notes on the use of the operating and reporting manual

3. Clarification of the supporting notes

Part B : Financial information - Financial notes:

Notes to the balance sheet:

Note A2.1.1 Depreciation:

Depreciation should be calculated on this note as per guidelines given in Schedule B 2.1 guidance on page 18 of this guide.

Note B1.1.1 Investments:

A distinction needs to be made between non-current and current investments. Marketable securities should be disclosed at market value. Non-current investments excluding marketable securities should be shown at cost and adjustments are made for impairments.

The total investments of the municipality should be allocated based on the funds and reserves allocated to the electricity distribution unit.

Note B1.1.2 Long-term debtors:

Long-term debtors represent receivables over a longer period of time, normally more than 12 months. Such debtors include staff housing loans and car loans, and the short-term portion (receivables over the next 12 months) should be carried over to current assets.

Note B1.1.3 Other assets:

Other assets include any intangible assets that the electricity distribution unit may have. This disclosure item is rarely used in municipality accounting.

II: Notes on the use of the operating and reporting manual

3. Clarification of the supporting notes (continued)

Part B : Financial information - Financial notes:

Notes to the balance sheet:

Note B1.1.4 Inventories:

Inventories should be disclosed at the lowest of cost or net realisable value. The stock condition and future usefulness will determine the realisable value. A complete list of inventory should be kept, with a physical stock take at least once per annum.

In the event that assets have been written off and are kept for sale, the estimated recoverable value of such “inventory” should be included in the total inventory disclosure in the balance sheet.

Note B1.1.5 Consumer debtors:

Consumer debtors include the current electricity debtors that should be clearly identifiable from the rest of the municipal debtors. Municipal debtor systems are usually consolidated, and it may be necessary to revise the system in order to receive the necessary electricity debtor information. Equally important is the cash allocation methods used by the municipality. Receipts for electricity need to be clearly identifiable, and posted to the correct debtor account. All unallocated charges and income need to be cleared before debtor balances are disclosed in the financial statements.

II: Notes on the use of the operating and reporting manual

3. Clarification of the supporting notes (continued)

Part B : Financial information - Financial notes:

Notes to the balance sheet:

Note B1.1.5 Consumer debtors: (continued)

The allocation of debtor balances can be done in the following manner:

The movement on debtor accounts for the current year and preceding year can be used as the basis for allocating the electricity debtors balance included in the total debtors balance.

The movement will usually consist of charges, interest, correction journals and receipts. The debtor system should in most instances be able to provide the movement on total debtor accounts for electricity for a given year.

The apportionment of receipts for electricity should also be provided by the system. By adding the charges, interest, journals and receipts in respect of electricity, the movement for electricity debtors for a given year can be calculated. The movement for the electricity debtors over the last two years as percentage of movement for total debtors over the same period can be calculated and used as percentage to allocate the electricity portion of the total debtor balance.

$$\begin{array}{r} \text{Electricity debtors} \\ \text{balance} \end{array} = \frac{\begin{array}{l} \text{Electricity charges + interest +} \\ \text{journals - receipts for the last 2} \\ \text{years} \end{array}}{\begin{array}{l} \text{Movement on total debtors for the} \\ \text{last two years} \end{array}} \times \begin{array}{l} \text{Total debtors} \\ \text{balance at} \\ \text{year end} \end{array}$$

The allocation of debtor deposits and bad debts should be done in the same manner as the allocation method used for the debtor balances.

Note B1.1.6 Other debtors:

Other debtors include all payments received in advance and short term loans.

II: Notes on the use of the operating and reporting manual

3. Clarification of the supporting notes (continued)

Part B : Financial information - Financial notes:

Notes to the balance sheet:

Note B1.1.7 Cash and cash equivalents:

Cash and cash equivalents include petty cash on hand, cash in bank and short term deposits. The cash should be allocated to the electricity unit based on the % revenue to total revenue of the municipality.

Note B1.1.8, B1.1.9 and B1.1.10 Statutory funds, reserves and trust funds:

Funds and reserves should be allocated to the electricity unit based on the reason for establishment or source of funding. The reason for establishment will be the dominating factor for allocation. If funded from retained surpluses allocation should be based on % revenue to total revenue of the municipality.

Note B1.1.11 Interest bearing borrowings:

Interest bearing borrowings should be allocated to the electricity unit based on the funding of assets thereof. The loan should “follow the asset”, and in instances where pooled loans were used for asset financing, the portion of the pooled loans equal to the cost of the asset should be allocated to the unit.

Note 1.1.12 Trade and other payables:

Trade and other payables include trade (electricity purchase) and other creditors.

Note B1.1.13 Short term borrowings:

Short-term borrowings include bank overdrafts and borrowings for less than a 12-month period.

II: Notes on the use of the operating and reporting manual

3. Clarification of the supporting notes (continued)

Part B : Financial information - Financial notes:

Notes to the balance sheet:

Note B1.1.14 Provisions:

Provisions are recognised when the enterprise has a present obligation as a result of past events, only if the amount of the provision can be estimated and it is probable that the obligation will be settled.

The municipality's current provisions should be allocated to the electricity unit only if it pertains directly to the electricity unit, such as provision for bad electricity debt or a contingent liability.

Note B1.1.15 Deferred income:

Deferred income will only be disclosed in case where grants were received from government and other sources for capital expenditure, for which the expense has not been incurred. The deferred income will be amortised over the period of construction of the asset.

Notes to the income statement:

Note B1.2.1 Revenue:

Revenue directly related to the electricity distribution activities should be included in the note, such as electricity sales, connection and re-connection fees.

The definition of revenue as included in AC 111 states that: "Revenue is the gross inflows of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants." This definition applies to both notes B1.2.1 and B 1.2.3. Revenue includes only the gross inflow of economic benefits received and receivable by the enterprise on its own account. Amounts collected on behalf of third parties such as value added taxes are not economic benefits that flow to the enterprise and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal that do not result in increases in equity for the enterprise. The amounts collected on behalf of the principal are not revenue of the enterprise. Instead, revenue is the amount of commission.

II: Notes on the use of the operating and reporting manual

3. Clarification of the supporting notes (continued)

Part B : Financial information - Financial notes:

Notes to the income statement:

Note B1.2.2 Cost of sales:

Cost of sales includes only those costs directly related to the electricity distribution activities, including electricity purchases, tools and equipment and direct salaries cost.

Note B1.2.3 Other operating income:

Other operating income includes all other income not included in revenue (Note B1.2.1) and also includes sundry income and interest received.

Note B1.2.4 Operating and maintenance expenses:

Operating and maintenance expenses include all other expenses not included in the cost of sales (Note B1.2.2) except for administrative expenses, which is a separate line item on the income statement. Operating expenses include rental expenses, insurance and indirect salaries cost.

Note B1.2.5 Administrative expenses:

In the event that the unit accounts for administrative expenses separately in its financial records, those costs need to be included under this note. Administrative expenses are usually classified as those costs incurred by support departments to the electricity unit such as finance and HR.

Note B1.2.6 Extraordinary item:

Extraordinary items are those items of income and expenditure that are material, and result from events or transactions clearly distinct from the ordinary activities of the enterprise and are therefore not expected to recur frequently. Such income or expense is therefore not included in the revenue requirement calculation, but should be separately disclosed in the income statement. Extraordinary items should not normally occur and prior approval will be required from the ECB on a case by case basis. Please refer to Appendix B to the guide for further guidance.

II: Notes on the use of the operating and reporting manual

4. Clarification of the annexures to the ORM:

The annexures (C 1.1 to C 1.9) contain non-compulsory information that may be required by the future RED management. The information may be provided if available, and the annexures will be adjusted from time to time with new RED requirements.

III: Maintenance and reporting timeframe of information

1. Maintenance

The information gathered in the various schedules and notes should be constantly updated to ensure completeness of information at all times for the electricity distribution management. It is recommended that all the information be updated at least quarterly or more frequently if so wished by management.

2. Audit/verification

The financial statements of the municipalities should be audited on an annual basis. The information submitted in Part A: Tariff determination and Part B: Financial information of the Operating and Reporting Manual should also be audited on an annual basis. The audit could be conducted as part of the annual audit of the municipality's financial statements, or separately as agreed with the Auditor General. This can be done by means of a full audit or agreed upon procedures. Please refer to Appendix C to the guide for agreed upon audit procedure guideline.

Verification of opening balances:

Opening balances means those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of:

- transactions of prior periods, and
- accounting policies applied in the prior period.

II: Notes on the use of the operating and reporting manual

2. Audit/verification (continued)

A comprehensive audit should be conducted on the opening balances of the financial statements to obtain sufficient appropriate audit evidence that:

- the opening balances do not contain misstatements that materially affect the current period's financial statements,
- the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated, and
- appropriate accounting policies are consistently applied, or changes in accounting policies have been properly accounted for and adequately disclosed.

Please refer to Appendix D to the guide for the verification of opening balances.

3. Reporting timeframe requirements

The ORM should be submitted to the ECB in the following manner:

Part A : Tariff determination information – by a date of each year that will be determined by the ECB, at this stage the reporting date is set at 30 April of each year. This will enable the review and approval of tariffs in time for the preparation of the unit's budget for the coming year.

Part B : Financial information – by a date of each year that will be determined through discussions with the Auditor General. This will enable the review of information and financial position of the unit and profits/losses incurred relating to the tariffs approved previously.

The format of the submission may be different from that of the financial statements and related information of the municipality as a whole. It is recommended that the manager/head of the electricity distribution unit reconcile the submitted information to that contained in the municipality's financial statements before the ORM is submitted. This will further assist the auditor during the verification of information contained in the ORM.

Appendix A

Extract from AC 123 Property, plant and equipment:

Subsequent expenditure

.27 Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised should be added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the enterprise. All other subsequent expenditure should be recognised as an expense in the period in which it is incurred.

.28 Subsequent expenditure on property, plant and equipment is only recognised as an asset when the expenditure improves the condition of the asset beyond its originally assessed standard of performance. Examples of improvements that result in increased future economic benefits include:

- (a) modification of an item of plant to extend its useful life, including an increase in its capacity,
- (b) upgrading machine parts to achieve a substantial improvement in the quality of output, and
- (c) adoption of new production processes enabling a substantial reduction in previously assessed operating costs.

.29 Expenditure on repairs or maintenance of property, plant and equipment is made to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the asset. As such, it is usually recognised as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.

Appendix A (continued)

Extract from AC 123 Property, plant and equipment:

Subsequent expenditure

.30 The appropriate accounting treatment for expenditure incurred subsequent to the acquisition of an item of property, plant and equipment depends on the circumstances that were taken into account on the initial measurement and recognition of the related item of property, plant and equipment and whether or not the subsequent expenditure is recoverable. For instance, when the carrying amount of the item of property, plant and equipment already takes into account a loss in economic benefits, the subsequent expenditure to restore the future economic benefits expected from the asset is capitalised provided that the carrying amount does not exceed the recoverable amount of the asset. This is also the case when the purchase price of an asset already reflects the enterprise's obligation to incur expenditure in the future that is necessary to bring the asset to its working condition. An example of this might be the acquisition of a building requiring renovation. In such circumstances, the subsequent expenditure is added to the carrying amount of the asset to the extent that it can be recovered from future use of the asset.

.31 Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph .11 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the replaced asset is written off.

Appendix B

Extraordinary item

Extract from AC 103 Net profit or loss for the period, fundamental errors and changes in accounting policies:

Definitions

.05 The following terms are used in this statement with the meanings specified:

Extraordinary items:

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

Ordinary activities:

Ordinary activities are any activities that are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from these activities.

Net profit or loss for the period

.06 All items of income and expense recognised in a period should be included in the determination of net profit or loss for the period unless a Statement of Generally Accepted Accounting Practice requires or permits otherwise.

.07 Normally, all items of income and expense recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, circumstances may exist when certain items may be excluded from net profit or loss for the current period. This statement deals with two such circumstances: the correction of fundamental errors and the effect of changes in accounting policies.

.08 Other Statements of Generally Accepted Accounting Practice deal with items which may meet the Framework definitions of income or expense but which are usually excluded from the determination of the net profit or loss. Examples include revaluation surpluses and gains and losses arising on the translation of the financial statements of a foreign entity.

Appendix B (continued)

Extraordinary item

.09 The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the income statement:

- (a) Profit or loss from ordinary activities.
- (b) Extraordinary items.

Extraordinary items

.10 The nature and the amount of each extraordinary item should be separately disclosed detailing, in the notes to the financial statements, the taxation effect and any amount attributable to outside shareholders.

.11 Virtually all items of income and expense included in the determination of net profit or loss for the period arise in the course of the ordinary activities of the enterprise. Therefore, only on rare occasions does an event or transaction give rise to an extraordinary item.

.12 Whether or not an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not extraordinary for another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.

.13 Examples of events or transactions that generally give rise to extraordinary items for most enterprises are:

- (a) the expropriation of assets, or
- (b) an earthquake or other natural disaster.

.14 The disclosure of the nature and amount of each extraordinary item, net of the taxation effect and any amount attributable to outside shareholders may be made on the face of the income statement, or when this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items net of the taxation effect and any amount attributable to outside shareholders is disclosed on the face of the income statement.

Appendix B (continued)

Extraordinary item

Profit or loss from ordinary activities

.15 When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately, detailing, in the notes to the financial statements, the taxation effect, and any amount attributable to outside shareholders.

.16 Although the items of income and expense described in paragraph .15 are not extraordinary items, the nature and amount of such items may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Disclosure of such information is usually made in the notes to the financial statements.

.17 Circumstances that may give rise to the separate disclosure of items of income and expense in accordance with paragraph .15 include:

- (a) the write-down of inventories to net realisable value or property, plant and equipment to recoverable amount, as well as the reversal of such write-downs,
- (b) a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring,
- (c) disposals of items of property, plant and equipment,
- (d) disposals of long term investments,
- (e) discontinued operations,
- (f) litigation settlements, and
- (g) other reversals of provisions.

Appendix C

Agreed upon procedures audit guideline

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1. Introduction

The purpose of this document is to provide guidance on the auditor's professional responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken. The document is based on the Namibian Audit Standard SAAS 920 – Engagements to perform agreed-upon procedures regarding financial information.

The international and Namibian audit statements on agreed upon procedures engagements are directed toward engagements regarding financial information. However, it may also provide useful guidance for engagements regarding non-financial information, which should be undertaken provided the auditor has adequate knowledge of the subject matter in question, and reasonable criteria exist on which to base findings.

An engagement to perform agreed-upon procedures may involve the auditor in performing certain procedures concerning individual items of financial data (for example, accounts payable, accounts receivable, purchases from related parties, and sales and profits of a segment of an entity), a financial statement (for example, a balance sheet) or even a complete set of financial statements.

This document attempts to provide guidance on the performance of agreed upon procedures by the auditor with regard to the audit of the information reported by the electricity distribution businesses to the Electricity Control Board (ECB).

2. Objectives of the audit

The objective of an agreed upon procedures engagement as defined by SAAS 920 is:

- ❑ for the auditor to carry out procedures of an audit nature, to which the auditor and the entity and any appropriate third parties have agreed, and to report on factual findings

3. General principles of the engagement

The auditor should comply with the codes of professional conduct issued by the Institute of Chartered Accountants of Namibia. Ethical principles governing the auditor's professional responsibilities are:

- integrity,
- objectivity,
- professional competence and due care,
- confidentiality,
- professional behaviour, and
- technical standards.

Independence is not a requirement for agreed-upon procedures engagements, however, the terms or objectives of an engagement may require the auditor to comply with the independence requirements of codes of professional conduct. Where the auditor is not independent, a statement to that effect would be made in the report of factual findings.

4. Steps performed during the engagement

a) Defining the terms of the engagement

The auditor should ensure that there is a clear understanding regarding the agreed procedures and the conditions of the engagement, by the agreement thereof with representatives of the electricity distribution business and, ordinarily, other specified parties that will receive copies of the report of factual findings.

Matters to be agreed include the:

- nature of the engagement, including the fact that the procedures performed will not constitute an audit or a review, and that accordingly no assurance will be expressed;
- stated purpose of the engagement being to perform the procedures agreed with the electricity distribution business management on the financial statements/accounts and supporting documentation reported to the ECB;
- identification of the financial information to which the agreed-upon procedures will be applied, including the financial statements, support schedules, general ledger and other supporting information;
- nature, timing and extent of the specific procedures to be applied;
- anticipated form of the report of factual findings; and
- limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

It is in the interests of both the client and the auditor that the auditor sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the auditor's acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objectives and scope of the engagement, the extent of the auditor's responsibilities and the form of reports to be issued.

Matters that would be included in the engagement letter include:

- ❑ a listing of the procedures to be performed as agreed upon between the parties, and
- ❑ a statement that the distribution of the report of factual findings would be restricted to the specified parties that have agreed to the procedures to be performed.

In addition, the auditor may consider attaching to the engagement letter a draft of the type of report of factual findings that will be issued.

b) Planning

The auditor should plan the work so that the engagement will be performed in an effective manner.

c) Documentation

The auditor should document matters that are important in providing evidence to support the report of factual findings, and evidence that the engagement was carried out in accordance with the auditing statement(s) applicable to agreed-upon procedures engagements and the terms of the engagement.

d) Procedures and evidence

The auditor should carry out the procedures agreed upon, and use the evidence obtained as the basis for the report of factual findings.

The procedures applied in an engagement to perform agreed-upon procedures may include:

- inspection,
- observation,
- enquiry and confirmation,
- computation,
- analytical procedures, and
- reperformance.

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The procedures and evidence that should be carried out with regard to the electricity distribution business information reported to the ECB include, but are not limited to:

Aspect	ORM reference	Procedure	Evidence
Technical – tariff determination	C 1.2	The correct transfer of amounts to the lead schedules Schedule calculations and cross-balancing are correct The relevant formulas are correctly applied	Technical data used to complete schedules Financial statements Support accounting records
Technical – network assets and information	B2.1 NENA NENA B2.1 B2.1 B2.1 A2.2 A1.2	Existence of an asset register Physical verification of assets to the asset register for completeness Verification of assets on the asset register to physical existence (accuracy of the register) Depreciation calculation verification Depreciation policies are complied with Approval of asset acquisitions and disposals Verification of electricity purchases to supplier invoices Verification of electricity sold for re-distribution to invoices issued Schedule calculations and cross-balancing are correct and the relevant formulas are correctly applied	Asset register Internal audit reports Electricity supplier statements Meter readings

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Aspect	ORM reference	Procedure	Evidence
Technical – retail information	A1.2 to A1.3 A1.3 A1.2	Schedule calculations and cross-balancing are correct and the relevant formulas are correctly applied Verification of losses to supporting meter readings, purchase and selling statistics Verification of customer profile and numbers to the debtor system information	Meter readings Supplier invoices Electricity debtor system
Financial information	B1.1.1 to B1.1.7, B1.1.11 to B1.1.13 B1.1.1 B1.1.7 B1.1.4 B1.1.2, B1.1.5, B1.1.6 B1.1.11, B1.1.13 B1.1.12	Verification of performance of monthly debtor, creditor, bank and other reconciliations and the review and approval thereof Verification of investment balance and interest to bank/external certificates Verification of bank balance to bank statements Physical verification of inventories on a sample basis Verification of electricity and other debtor balances to debtor lists Verification of loans balance to loans register Verification of creditor balance to invoices received	Bank statements Debtor lists External certificates Inventory lists Loans register Creditor invoices

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Aspect	ORM reference	Procedure	Evidence
	B1.1.8 to B1.1.10	Verification of allocation of funds and reserves based on either reason for establishment or as balancing figure to the B/S	Funds register
	B1.1.8 to B1.1.10	Verification of minimum contribution rate calculation and contributions made	
	B1.1.8, B1.1.10	Verification of advance repayments, interest and comparisons of life of assets financed to terms of the advance	
	B1.1.8 to B1.1.10	Verification of available cash invested with approved institutions.	
	B1.2.1 to B1.2.6	Verification of income and expenses to relevant supporting documents and approvals	Council resolutions Cheque vouchers
	B2.1	Verification of employees	Payroll
	B2.1	Comparison of stated employee information to the payroll and relevant personnel files	Personnel files
	B1.1.8 to B1.1.10	Review of journal entries for transfers to and from funds	
	B1.1 to B2.1	Schedule calculations and cross-balancing are correct and the relevant formulas are correctly applied	

e) Reporting

The report on an agreed-upon procedures engagement needs to describe the purpose and the agreed-upon procedures of the engagement in sufficient detail to enable the reader to understand the nature and the extent of the work performed.

The report of factual findings should contain:

- a title;
- an addressee, ordinarily the client who engaged the auditor to perform the agreed-upon procedures;
- identification of specific financial or non-financial information to which the agreed-upon procedures have been applied;
- a statement that the procedures performed were those agreed upon with the recipient;
- a statement that the engagement was performed in accordance with the auditing statement applicable to agreed-upon procedures engagements;
- a statement (when applicable) that the auditor is not independent of the entity;
- identification of the purpose for which the agreed-upon procedures were performed;
- a statement that the responsibility for determining the adequacy or otherwise of the procedures agreed to be performed by the auditor is that of the recipient;
- a listing of the specific procedures performed;
- a description of the auditor's factual findings, including sufficient details of errors and exceptions found;
- a statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed;
- a statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported;
- a statement that the report is restricted to those parties that have agreed to the procedures to be performed;
- a statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified, and that it does not extend to the entity's financial statements taken as a whole;
- the date of the report;
- the auditor's address; and
- the auditor's signature.

Appendix D

Audit of opening balances

Extract from SAAS 510: Initial engagements – opening balances

Introduction

.01 The purpose of this statement of South African Auditing Standards (SAASs) is to establish standards and provide guidance regarding opening balances when financial statements are audited for the first time or when the financial statements for the prior period were audited by another auditor. This statement of SAASs should also be considered by the auditor so as to become aware of contingencies and commitments existing at the beginning of the period. This statement of SAASs does not address the audit and reporting requirements regarding comparatives.

.02 For first year audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

- the opening balances do not contain misstatements that materially affect the current period's financial statements,
- the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated, and
- appropriate accounting policies are consistently applied, or changes in accounting policies have been properly accounted for and adequately disclosed.

.03 "Opening balances" means those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of:

- transactions of prior periods, and
- accounting policies applied in the prior period.

In an initial audit engagement, the auditor will not have previously obtained audit evidence supporting such opening balances.

Appendix D (continued)

Audit of opening balances

Audit procedures

.04 The sufficiency and appropriateness of the audit evidence the auditor will need to obtain regarding the opening balances depends on such matters as the following:

- The accounting policies followed by the entity.
- Whether or not the prior period's financial statements were audited, and if so whether or not the audit report was modified.
- The nature of the accounts and the risk of misstatement in the current period's financial statements.
- The materiality of the opening balances relative to the current period's financial statements.

.05 The auditor will need to consider whether or not the opening balances reflect the application of appropriate accounting policies, and that those policies are consistently applied in the current period's financial statements. When there are any changes in the accounting policies or application thereof, the auditor would consider whether or not they are appropriate, properly accounted for and adequately disclosed.

Prior period audited by another auditor

.06 When the prior period's financial statements were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by reviewing the predecessor auditor's working papers. In these circumstances, the current auditor would also consider the professional competence and independence of the predecessor auditor. If the prior period's audit report were modified, the auditor would pay particular attention in the current year to the matter that resulted in the modification.

.07 Prior to communicating with the predecessor auditor, the current auditor will need to consider the ethical principles governing the auditor's professional conduct contained in the Code of Professional Conduct (ET).

.08 When the prior period's financial statements were not audited or when the auditor is not able to be satisfied by using the procedures described in paragraph .06, the auditor will need to perform other procedures, such as those discussed in paragraphs .09 and .10.

Appendix D (continued)

Audit of opening balances

.09 For current assets and liabilities, some audit evidence can ordinarily be obtained as part of the current period's audit procedures. For example, the collection/(payment) of opening accounts receivable/ (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. In the case of inventories, however, it is more difficult for the auditor to be satisfied as to inventory on hand at the beginning of the period. Therefore, additional procedures are ordinarily necessary, such as observing a current physical inventory taking and reconciling it back to the opening inventory quantities, testing the valuation of the opening inventory items, and testing gross profit and cut-off. A combination of these procedures may provide sufficient appropriate audit evidence.

.10 For non-current assets and liabilities, such as fixed assets, investments and long term debt, the auditor will ordinarily examine the records underlying the opening balances. In certain cases, the auditor may be able to obtain confirmation of opening balances with third parties, for example, for long term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

Reporting considerations

.11 If, after performing procedures including those set out above, the auditor is unable to obtain sufficient appropriate audit evidence concerning opening balances, the audit report should include:

- a qualified opinion,
- a disclaimer of opinion, or
- where it is considered appropriate, an opinion that is qualified, adverse or disclaimed regarding the results of operations and unqualified regarding financial position.

.12 If the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor would inform management and, after having obtained management's authorisation, the predecessor auditor, if any. If the effect of the misstatement is not properly accounted for and adequately disclosed, the auditor should express a qualified opinion or adverse opinion, as appropriate.

.13 If the current period's accounting policies have not been consistently applied in relation to opening balances, and if the change has not been properly accounted for and adequately disclosed, the auditor should express a qualified opinion or adverse opinion, as appropriate.

Appendix D (continued)

Audit of opening balances

.14 If the entity's prior period audit report was modified, the auditor would consider the effect thereof on the current period's financial statements. For example, if there was a scope limitation, such as one due to the inability to determine opening inventory in the prior period, the auditor may not need to qualify or disclaim the current period's audit opinion. However, if a modification regarding the prior period's financial statements remains relevant and material to the current period's financial statements, the auditor should modify the current audit report accordingly.

Effective date

.15 The requirements set out in this statement of SAASs should be applied as soon as possible and regarded as standard for audit engagements, the planning of which commences on or after January 1996.

Public sector perspective

.16 The basic principles and essential procedures in this statement of SAASs apply to the audit of financial statements in the public sector.

Appendix E

Leases

Extract from AC 105: Leases

Definitions

The following terms are used in this statement with the meanings specified:

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

An operating lease is a lease other than a finance lease.

A non-cancellable lease is a lease that is cancellable only:

- (a) upon the occurrence of some remote contingency,
- (b) with the permission of the lessor,
- (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor, or
- (d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

The inception of the lease is the earlier of the date of the lease agreement or of a commitment by the parties to the principal provisions of the lease.

The definition of a lease includes contracts for the hire of an asset, which contain a provision giving the hirer an option to acquire title to the asset upon the fulfilment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

Classification of leases

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

Appendix E (continued)

Leases

The classification of leases adopted in this statement is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by lessor and lessee.

Examples of situations, which would normally lead to a lease being classified as a finance lease, are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term,
- (b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised,
- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred,
- (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset, and
- (e) the leased assets are of a specialised nature such that only the lessee can use them without major modifications being made.

Indicators of situations, which individually or in combination could also lead to a lease being classified as a finance lease, are:

- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee,
- (b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease), and
- (c) the lessee has the ability to continue the lease for a secondary period at a rent, which is substantially lower than market rent.

Appendix E (continued)

Leases

Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria mentioned above had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

Leases of land and buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee does not receive substantially all of the risks and rewards incident to ownership. A premium paid for such a leasehold represents pre-paid lease payments, which are amortised over the lease term in accordance with the pattern of benefits provided.

Leases in the financial statements of lessees

Finance leases

Lessees should recognise finance leases as assets and liabilities in their balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

Appendix E (continued)

Leases

If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated, thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.

It is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets. If for the presentation of liabilities on the face of the balance sheet a distinction is made between current and non-current liabilities, the same distinction is made for lease liabilities.

Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease, are included as part of the amount recognised as an asset under the lease.

Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

In practice, in allocating the finance charge to periods during the lease term, some form of approximation may be used to simplify the calculation.

A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for leased assets should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in the statement on depreciation accounting and in the statement on property, plant and equipment. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the shorter of the lease term or its useful life.

The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term or its useful life.

Appendix E (continued)

Leases

The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense in the income statement. Accordingly, the asset and the related liability are unlikely to be equal in amount after the inception of the lease.

To determine whether a leased asset has become impaired, that is when the expected future economic benefits from that asset are lower than its carrying amount, an enterprise applies the statement dealing with impairment of assets, that sets out the requirements for how an enterprise should perform the review of the carrying amount of its assets, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

Lessees should, in addition to the requirements of the statement on financial instruments: disclosure and presentation make the following disclosures for finance leases:

- (a) For each class of asset, the net carrying amount at the balance sheet date.
- (b) A reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:
 - (i) Not later than one year.
 - (ii) Later than one year and not later than five years.
 - (iii) Later than five years.
- (c) Contingent rents recognised in income for the period.
- (d) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.
- (e) A general description of the lessee's significant leasing arrangements including, but not limited to, the following:
 - (i) The basis on which contingent rent payments are determined.
 - (ii) The existence and terms of renewal or purchase options and escalation clauses.
 - (iii) Restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Appendix E (continued)

Leases

In addition, the requirements on disclosure, in accordance with the statement on property, plant and equipment apply to the amounts of leased assets under finance leases that are accounted for by the lessee as acquisitions of assets.

Operating leases

Lease payments under an operating lease should be recognised as an expense in the income statement on a straight-line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit.

For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the income statement on a straight line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

Lessees should, in addition to the requirements of the statement on financial instruments: disclosure and presentation, make the following disclosures for operating leases:

- (a) The total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
 - (i) Not later than one year.
 - (ii) Later than one year and not later than five years.
 - (iv) Later than five years.
- (b) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.
- (c) Lease and sublease payments recognised in income for the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments.
- (d) A general description of the lessee's significant leasing arrangements including, but not limited to, the following:
 - (i) The basis on which contingent rent payments are determined.
 - (ii) The existence and terms of renewal or purchase options and escalation clauses.
 - (iii) Restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Appendix E (continued)

Leases

Leases in the financial statements of lessors

Finance leases

Lessors should recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease.

Under a finance lease substantially all the risks and rewards incident to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services. The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment outstanding in respect of the finance lease.

A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the lessor's net investment outstanding in respect of the finance lease. Lease payments relating to the accounting period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the lease term is revised and any reduction in respect of amounts already accrued is recognised immediately.

Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in income or allocated against this income over the lease term. The latter may be achieved by recognising as an expense the cost as incurred and recognising as income in the same period a portion of the unearned finance income equal to the initial direct costs.

Manufacturer or dealer lessors should recognise selling profit or loss in income for the period, in accordance with the policy followed by the enterprise for outright sales. If artificially low rates of interest are quoted, selling profit should be restricted to that which would apply if a commercial rate of interest were charged. Initial direct costs should be recognised as an expense in the income statement at the inception of the lease.

Appendix E (continued)

Leases

Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

- (a) the profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts, and
- (b) the finance income over the lease term.

The sales revenue recorded at the commencement of a finance lease term by a manufacturer or dealer lessor is the fair value of the asset, or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a commercial rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the policy followed by the enterprise for sales.

Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest were quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged.

Initial direct costs are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.

Appendix E (continued)

Leases

Lessors should, in addition to the requirements in the statement on financial instruments: disclosure and presentation, make the following disclosures for finance leases:

- (a) A reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:
 - (i) Not later than one year.
 - (ii) Later than one year and not later than five years.
 - (iv) Later than five years.
- (b) Unearned finance income.
- (c) The unguaranteed residual values accruing to the benefit of the lessor.
- (d) The accumulated allowance for uncollectible minimum lease payments receivable.
- (e) Contingent rents recognised in income.
- (f) A general description of the lessor's significant leasing arrangements.

As an indicator of growth it is often useful to also disclose the gross investment less unearned income in new business added during the accounting period, after deducting the relevant amounts for cancelled leases.

Operating leases

Lessors should present assets subject to operating leases in their balance sheets according to the nature of the asset.

Lease income from operating leases should be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

Appendix E (continued)

Leases

Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in income on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

Initial direct costs incurred specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the income statement in the period in which they are incurred.

The depreciation of leased assets should be on a basis consistent with the lessor's normal depreciation policy for similar assets, and the depreciation charge should be calculated on the basis set out in the statement on depreciation accounting, and the statement on property, plant and equipment.

To determine whether a leased asset has become impaired, that is when the expected future economic benefits from that asset are lower than its carrying amount, an enterprise applies the statement dealing with impairment of assets that sets out the requirements for how an enterprise should perform the review of the carrying amount of its assets, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

Appendix E (continued)

Leases

Lessors should, in addition to the requirements of the statement on financial instruments: disclosure and presentation make the following disclosures for operating leases:

- (a) For each class of asset, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date:
 - (i) The depreciation recognised in income for the period.
 - (ii) Impairment losses recognised in income for the period.
 - (iii) Impairment losses reversed in income for the period.

- (b) The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:
 - (i) Not later than one year.
 - (ii) Later than one year and not later than five years.
 - (iv) Later than five years.

- (c) Total contingent rents recognised in income.

- (d) A general description of the lessor's significant leasing arrangements.

Sale and leaseback transactions

A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payment and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount should not be immediately recognised as income in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term.

If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortised over the lease term.

Appendix E (continued)

Leases

If a sale and leaseback transaction result in an operating lease and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

If the leaseback is an operating lease, and the lease payments and the sale price are established at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the statement dealing with impairment of assets.

Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the significant leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

Sale and leaseback transactions may meet the separate disclosure criteria in the statement on net profit or loss for the period, fundamental errors and changes in accounting policies.