Asset Management Impairment Methodology

1. PURPOSE

This report describes the approach and methodology adopted during the updating of the 2023/24 immovable asset register and summarises the outcomes as recognised in the asset register. This report specifically focuses on the impairment assessment of Centlec immovable assets.

GRAP 17 states that: To determine whether an item of property, plant and equipment is impaired, an entity applies GRAP 21 or GRAP 26, as appropriate. These Standards explain how an entity reviews the carrying amount of its assets, how it determines the recoverable amount or recoverable service amount of an asset and when it recognises, or reverses the recognition of, an impairment loss.

A plan to dispose of an asset before the previously expected date is an indicator of impairment, which requires the calculation of an asset's recoverable amount or recoverable service amount for the purpose of determining whether the asset is impaired.

2. Background to managements decision to apply GRAP 21:

It should be remembered that the public sector as well as the entity's operating within it have a clear mandate to deliver services to the community within their demarcated boundaries. In our application of the definition set out in the standard we have concluded that that all municipal assets are non-cash generating, especially when consideration is given to the specific requirement that assets will only be cash-generating if their primary objective is to generate a commercial return.

In clarifying which assets of a municipality are non-cash-generating, the standard provides further explanations of when an entity is considered to hold assets with the primary objective of generating commercial return as follows: "an asset generates a commercial return when it is deployed in the manner consistent with that adopted by a profit-oriented entity."

From the above management should further consider the way their assets are managed to determine whether their asset management practices are consistent with those in the profit-driven private sector. In a profit-driven environment, assets are deployed with an objective to maximise returns for the owners.

In terms of a profit driven environment where an asset deployed does not yield the profits that management and shareowners have set, these assets are likely to be sold.

In terms of Centlec, the decision of whether to continue deploying an asset that is delivering a service will not primarily be driven by its ability to meet returns expectations, but service delivery objectives are considered key to making this decision.

Further matters which support the non-commercial nature of the return on the entity's assets are:

- Levies are determined annually based on the funds required as per the budget; and on the tariffs set by ESKOM and NERSA
- The Annual Budget is prepared to meet the objective's of the municipality as set out in the IDP and SDBIP;
- The objectives of the municipality set in the IDP and SDBIP is to deliver services to the community and not to generate a commercial return.

None of the infrastructure assets can generate any cash inflow independently as the supply of electricity is dependent on the entire network operating effectively.

For example, if there are no cables, poles, load centre transformers, and substations there won't be a flow of electricity from one point to another point. Without the meters in place, Centlec will not be able to obtain a reading to determine the revenue (inflow) they have generated or what the end-user has consumed. All these assets have to work as a unit to generate a cash inflow.

GRAP 21 defines the following key definitions as follows:

Recoverable service amount is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use.

Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

Value in use of a non-cash-generating asset is the present value of the asset's remaining service potential.

Managements view recoverable amount, fair value less costs sell and value in use is detailed below:

Fair Value less cost to sell.

.31 This Standard defines recoverable service amount as the higher of an asset's fair value less costs to sell and its value in use. Paragraphs .32 to .48 set out the basis for measuring recoverable service amount.

.32 It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

.33 It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. Paragraph .39 sets out possible alternative bases for estimating fair value less costs to sell when an active market for the asset does not exist. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable service amount.

.37 The best evidence of an asset's fair value less costs to sell is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

For electrical assets that are not functional, there is not active market to sell the assets, these assets are disposed as scrap through an auction process in a bulk sale, which makes it impossible to determine fair value of the assets.

- The fair value of the assets is null as there is no active market in which immovable infrastructure trades, the entity did not enter into any binding agreements and the entity will not sell the assets to anyone due to its specialised nature and the fact that it can only be used where installed (E.g. roads, electricity substations, boreholes).
Even when certain components within a facility, such as mechanical equipment (e.g. Motors and pumps) could theoretically be traded, Section 14 of the Municipal Finance Management Act (MFMA) (Act No. 56, 2003) states: "A municipality may not transfer ownership as a result of a sale or other transaction, or otherwise permanently dispose of any capital asset needed to provide a minimum level of basic municipal services." Such a disposal will have to be accompanied with the procurement of a replacement of this item. Practically, this in itself would only be relevant when the said mechanical equipment would be in need of replacement, which would render it without value in any event. In summary, due to the limitation imposed by Section 14 of the MFMA and for practical reasons, even when mechanical equipment in general is tradable in the open market, a Municipality's mechanical equipment which is in working order is not tradeable in the open market and fair value in terms of GRAP 21. From the above explanation as well as examples of damaged Transformer, batteries, and Streetlights which were sold as scrap in bulk, management decided to set the fair value less cost to sell to 0.

Value in use:

.42 This Standard defines the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential. "Value in use" in this Standard refers to "value in use of a non-cash-generating asset" unless otherwise specified. The present value of the remaining service potential of the asset is determined using any one of the approaches identified in paragraphs .43 to .47, as appropriate.

There are three methods to calculate value in use:

- - Depreciated Replacement Cost
- - Restoration Cost Approach
- - Service Units Approach

The definition of DRC is as follows:

The replacement cost of an asset less accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired economic benefits of the asset.

Although DRC is a useful tool to determine the value of an asset considering the asset consumption, for assets that are damaged and not functional which are likely be sold as scrap, DRC will not be a true reflection of the asset value as alluded to in the Auditors conclusion above. Therefore, to determine, the fair value, the management considered the functionality of these assets, and it was therefore seen as appropriate to set this value to Zero as the assets were not functional and it will not be reasonable to set the value to DRC as the impaired assets will possibly be derecognised when replaced and / or repaired and sold as scrap.

3. FUTURE CASH FLOW PROJECTIONS

Cash-generating assets (GRAP 26) are assets used with the objective of generating a commercial return. Commercial return means that positive cash flows are expected to be significantly higher than the cost of the asset.

The annual cash outflows generated from the infrastructure assets of the entity are calculated over the last 4 years by taking into account annual revenue and less costs to sell. Refer to calculation below:

AFS line item	2022/2023	2021/ 2022	2020/ 2021	2019/2020	2018/2019	Assessment
Service charges from electricity	2 817 601 682,00	2 804 062 374,00	2 596 825 366,00	2 503 722 302,00	2 336 777 749,00	Revenue generated by the entity through the infrastructure assets
Maintenance	111 768 750,00	- 100 360 173,00	- 65 127 605,00	- 47 655 151,00	- 63 793 166,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Bulk purchase of electricity	- 2 140 676 408,00	-2 061 862 827,00	- 780 067 168,00	- 1 692 794 873,00	- 1 519 656 103,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Employee costs	- 339 933 857,34	- 327 713 553,86	- 06 083 328,32	- 285 796 130,62	- 267 882 965,35	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Cost of replacement of the assets	- 158 939 804,00	- 154 174 821,00	- 129 106 054,00	- 116 135 721,00	- 182 548 423,00	Enhancing the value of the asset or service potential

AFS line item	2022/2023	2021/ 2022	2020/ 2021	2019/2020	2018/2019	Assessment
Commission paid	- 56 919 571,00	- 54 103 632,00	- 48 088 511,00	- 53 807 642,00	- 102 812 607,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Insurance	- 9 096 607,00	- 7 231 925,00	- 5 091 967,00	- 4 665 783,00	- 4 677 481,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
External security	- 5 276 224,00	- 6 317 158,00	- 1 549 800,00	- 869 960,00	- 5 483 762,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Consulting and professional fees	- 15 980 453,00	- 14 267 110,00	- 19 878 380,00	- 22 856 704,00	- 13 653 075,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)

AFS line item	2022/2023	2021/ 2022	2020/ 2021	2019/2020	2018/2019	Assessment
Meter reading	- 2 913 287,00	- 459 339,00	- 953 009,00	- 5 447 444,00	- 7 760 951,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Fuel and oil	- 12 338 543,00	- 10 990 156,00	- 5 623 237,00	- 7 642 862,00	- 7 987 521,00	Costs directly attributable to the functioning of the infrastructure (day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition)
Capital advances	- 11 087 935,98	- 10 924 965,29	- 11 605 306,21	- 14 322 769,28	- 14 806 475,98	Financing cost directly attributable to the infrastructure assets. Loan interest expense & capital redemption on capital advance asset loan.
Shareholders loan	- 165 649 994,64	- 150 956 860,25	- 133 787 468,46	- 439 447 177,62	- 164 965 039,55	Financing cost directly attributable to the infrastructure assets. Interest expense & capital redemption on shareholders loan. Shareholders loan origin was due to all assets transferred to Centlec on inception of the municipal entity.

AFS line item	2022/2023	2021/ 2022	2020/ 2021	2019/2020	2018/2019	Assessment
Cash payments to MMM	- 10 000 000,00	-	- 6 200 000,00	- 70 000 000,00	- 112 276 877,00	These were direct cash transfers to MMM as part of the repayment of the loans originating from the asset transfers.
Net cash flows	**- 222 979 752,96**	**- 95 300 146,40**	**83 663 532,01**	**- 257 719 915,51**	**- 131 526 697,88**	

Average net cash flow	-124 772 596,15
Expected cash flows over 34.3 years (loss)	-4 279 700 047,86
Cost of electricity assets	7 437 000 000

(138433577 x 34.3)

Expected cashflow as a percentage of cost of electricity	**-58%**

During the physical verification, data will be gathered on the various failure modes as indicated in the tables below.

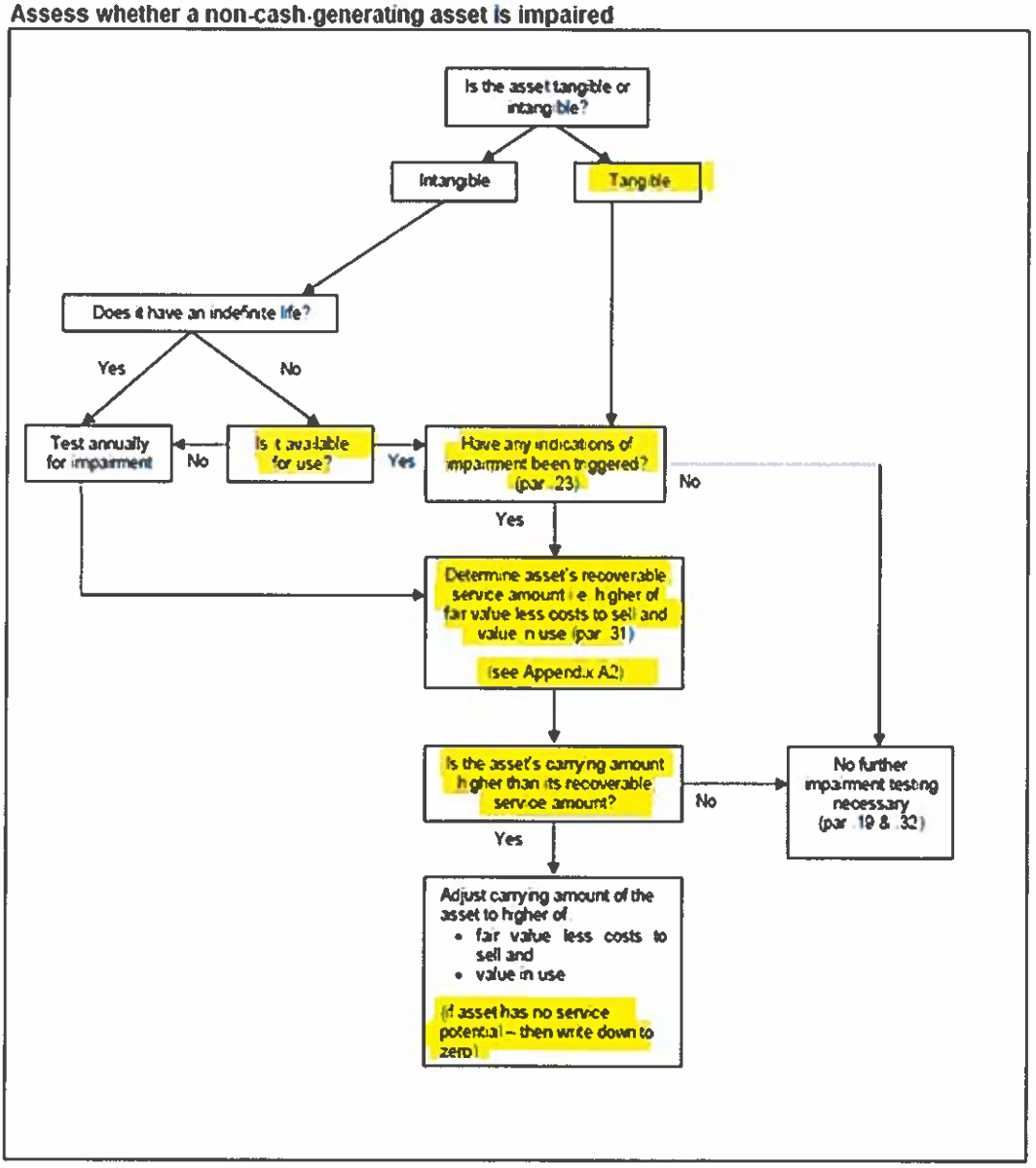
These failure modes can be linked to the minimum indicators stated in GRAP (21 & 26).

6. GRAP 21 DECISION TREE

GRAP 21

Appendix A1

Assess whether a non-cash-generating asset is impaired



7. CONCLUSION

This report indicates the approach used to assess impairment of assets at Centlec for the 2023/24 financial year for all immovable assets.