

Recognition and derecognition of land

The Accounting Standards Board (the Board), issued a proposed Interpretation of the Standards of GRAP (IGRAP) on *Recognition and Derecognition of Land* (ED 139) for comment during December 2015. The comment deadline for ED 139 is 15 June 2016.

The proposed IGRAP notes that “various laws and regulations govern immovable assets in the South African public sector that impact the recognition, and derecognition of land in an entity’s financial statements”. During the Accounting Standards Board’s (the Board) Post-implementation Review project on the Standards of GRAP on *Investment Property* (GRAP 16) and *Property, Plant and Equipment* (GRAP 17), respondents highlighted a number of recognition and derecognition issues on land, which resulted in inconsistent accounting of land by entities. Respondents specifically requested clarification on whether land should be recognised based on legal title, or whether the concept of control should be applied.

In this article, Amanda Botha CA(SA), Project Manager at the Accounting Standards Board explains the objective of the proposed IGRAP and highlights the requirements that an entity needs to consider in assessing whether land should be recognised as its asset, or whether land should be derecognised from its statement of financial position. The proposed IGRAP also considers the legislative requirements and how these requirements impact on the recognition and/or derecognition of land.

Scope of the proposed IGRAP

The proposed IGRAP applies to the initial recognition and derecognition of land in an entity’s financial statements. The classification, initial and subsequent measurement, presentation and disclosure requirements of land are not addressed in the proposed IGRAP as entities need to refer to the applicable Standards of GRAP for this guidance.

GRAP 17 clarifies that buildings and other structures are accounted for separately. As the focus of the proposed IGRAP is only on land, the proposed IGRAP excludes from its scope the recognition and derecognition of buildings and other structures.

Recognition of land based on control

In developing the proposed IGRAP, the Board considered the principles in existing pronouncements. These included:

- The Framework for the Preparation and Presentation of Financial Statements.

- The International Public Sector Accounting Standards Board's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.
- The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* that provides guidance on control of an asset.
- The definition and recognition criteria of an asset as addressed in a number of asset related Standards of GRAP.

Based on the principles and the requirements in existing pronouncements, the IGRAP concludes that to meet the definition of an asset, control over the asset must be demonstrated by the entity. Substance over form requires that information should represent faithfully the transactions and other events that it purports to represent. Transactions and events should therefore be accounted and presented in accordance with their substance and economic reality and not merely their legal form. Even though legal title and physical possession are good indicators of control, the right of ownership is not essential.

Control may be evidenced in a number of ways. As a result, the Board developed indicators of control that reflect situations that individually, or in combination, will assist an entity to assess whether it controls land. These indicators are:

- legal ownership; or
- the right to access the land, and to restrict or deny the access of others to the land; and/or
- the existence of an enforceable right to service potential or the ability to generate future economic benefits arising from the land.

An entity should apply professional judgement to assess whether these indicators of control are met.

The indicators of control are evidenced through a binding arrangement. As the binding arrangement confers enforceable rights and obligations on the various parties, the indicators of control need to be assessed based on the binding arrangement entered into between parties. A binding arrangement arises from a contract concluded between the parties, legislation or similar means, or through the operation of law, including common law. If there are any changes made to the binding arrangement, the entity needs to assess the impact of these amendments at each reporting date to understand the impact of the changes on its initial control assessment.

Protective and substantive rights

An entity needs to establish whether the rights in the binding arrangement are protective or substantive. Legislation or similar means may grant an entity a protective right to exchange, dispose of, or transfer land, while another entity is granted a substantive right over the land. The objective of the protective right is to protect particular interests or assets in the public sector, while the entity with the substantive right will be able to demonstrate control over the asset or interest. This is because the entity with the substantive right has the ability to make decisions about, and benefit from, certain interests and assets.

Given the different objectives of a protective and substantive right, the IGRAP concludes that because a protective right is designed to protect the interests of the holder without giving the entity power over the land to which the right relates, a protective right on its own does not indicate control over land. For the purposes of assessing control over land, an entity should therefore consider substantive rights rather than protective rights.

Control over land when only legal ownership is evident

In the absence of the last two indicators of control, namely when the entity:

- cannot demonstrate that it has the right to access and restrict or deny access of others to the land, and/or
- does not have an enforceable right to service potential or the ability to generate future economic benefits arising from the land,

the legal owner will conclude that it controls the land.

In terms of the legislative requirements, the state may act as the custodian over land whereby it is responsible to hold the land in trust for the public at large. Although an entity may act as the custodian of land in terms of legislation, it is not in all instances the legal title deed holder of that land.

The proposed IGRAP concludes that in these situations, the custodian, rather than the legal title deed holder, should recognise the land as its asset. This is because the custodian is in terms of legislation

required to acquire the land, manage the land through its life cycle, and dispose of the land subject to the required legislative requirements.

Application of substance over form

Substance over form determines that, if one entity has the right to access and restrict or deny the access of others to the land and/or has an enforceable right to service potential or the ability to generate future economic benefits arising from the land, while another is the legal owner of the land, the land should be recognised as an asset by the entity that has the right and/or the enforceable right. Where the entity has an enforceable right to service potential or the ability to generate future economic benefits, the enforceable right has to be long enough to reflect the indefinite nature of the land.

Assessing control over land

When the entity concludes that it controls the land after assessing the indicators of control, the land should be recognised as its asset. If, based on the assessment of the indicators of control, the entity concludes that it does not control the land, the land should be derecognised from its statement of financial position if recognised as an asset.

When more than one entity assesses control over land after considering the indicators of control, the IGRAP concludes that the principles in the Standard of GRAP on *Interests in Joint Ventures* should be applied whereby each entity recognises its interests in the jointly controlled asset. The land should be classified according to each entity's assessment of the nature of that land.

Disclosure in an entity's financial statements

In providing relevant information to the users of the financial statements for accountability and decision-making purposes, the proposed IGRAP requires the following disclosures:

For the entity that is not the legal owner but concludes that it controls the land, it shall disclose:

- in aggregate, the carrying value of the land that is recognised as its asset; and
- judgements made and assumptions applied to conclude that it controls the land.

For the entity that is the legal owner but concludes that it does not control the land, it shall disclose the judgements made, and assumptions applied to conclude that it does not control the land.

Commenting on the proposed pronouncement

As always, the Board encourages the various preparers, users and other stakeholders to provide comment on the proposals set out in the Exposure Draft.

A copy of ED 139, along with the Invitation to Comment, is available on the Board website at <http://www.asb.co.za>. For more information, contact Amanda Botha on (011) 697-0660 or at amandab@asb.co.za