ACCOUNTING STANDARDS BOARD

SUMMARY OF RESULTS OF THE POST-IMPLEMENTATION REVIEW OF SELECTED STANDARDS OF GRAP
BACKGROUND

1. The Board agreed to undertake a post-implementation review of GRAP 16 Investment Property and GRAP 17 Property, Plant and Equipment. The objective of the review was to assess whether information produced by applying the Standards is relevant to users, and to identify application and implementation issues that may require resolution.

2. This report, which has been prepared by the Secretariat, provides a high level overview of the results of the post-implementation review and the specific actions agreed by the Board at its meeting on 28 March 2014. This report is set out in three parts. Part A summarises the key actions arising from the post-implementation review; Part B provides an overview of the consultation process itself; while Part C provides a summary of the most significant issues raised by respondents.

3. The detailed written and verbal comments received as part of the review, along with the Board’s responses thereto, are published on the ASB’s website.

PART A - SUMMARY OF PROPOSED ACTIONS

4. This part of the report outlines the actions the Board has agreed to undertake based on the feedback received as part of the post-implementation review. These actions outline changes agreed by the Board its work plan. It also outlines the actions that will be undertaken by the Secretariat.

5. Based on the results of the post-implementation review, the Board has agreed to initiate three new projects, to amend the scope of an existing project, while the Secretariat will issue new or revise existing FAQs to address certain issues raised. These are summarised in Table 1 below.

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<th>Responsibility for action</th>
<th>Action agreed by the ASB</th>
<th>Detail of action agreed</th>
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<tr>
<td>New projects added to the Board’s work plan</td>
<td>Review of GRAP 16 and GRAP 17</td>
<td>• Review principles to distinguish property, plant and equipment and investment property.</td>
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<td>• Consider developing an indicator based assessment of reviewing useful lives.</td>
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<td>• Review disclosures, including those on repairs and maintenance, capital work-in-progress, and encouraged disclosures.</td>
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<td>Clarify accounting of land based on control or legal title.</td>
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<td>Develop an Interpretation on accounting for the recognition and derecognition of land</td>
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<td>Expand scope of existing project on the Board’s work plan</td>
<td>Develop a Guideline on accounting for housing schemes</td>
<td>Outline guidance that could be used to account for accredited and non-accredited housing schemes.</td>
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<td>Expand scope of review of impairment related Standards of GRAP</td>
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<td>Apart from considering a review of the principles to distinguish cash and non-cash generating assets, address the following issues:</td>
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<td>• The impact of componentisation on assessing whether an asset is impaired.</td>
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<td>• Understanding the difference between repairs and maintenance and impairment.</td>
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<td>• Understanding the difference between depreciation and impairment.</td>
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<td><strong>Actions by the Secretariat</strong></td>
<td>Revise existing or develop new FAQs</td>
<td>6. Develop a FAQ on the treatment of “foregone revenue” in the financial statements.</td>
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<td>7. Develop a FAQ on whether certain assets qualify as heritage assets, e.g. statues in towns and living animals and plants.</td>
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<td>8. Develop a FAQ on the application of Directive 7 – apply retrospectively as far as practicable when determining deemed cost.</td>
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<td>9. Develop a FAQ on the use of the valuation roll to determine the fair value of assets, discussing the measurement basis used in the valuation roll as well as the frequency of the valuations.</td>
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<td>10. Review FAQ on fully depreciated assets, ensuring that it is clear that all facts and circumstances should be considered, including both technical and financial</td>
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expectations of the use of the asset.

11. Review existing FAQs and make it clear that the useful lives of assets are estimates, based on the best information available at a point in time, and thus may change as better knowledge and information is gained about the assets operated by the entity.

12. Develop a FAQ on depreciation in relation to assets that are seen as “indefinite” or “perpetual”.

13. Develop a FAQ on the intention of the Standard in relation to the level of componentisation required.

PART B - OVERVIEW OF CONSULTATIONS UNDERTAKEN

14. Part B outlines the consultation process undertaken by the Board to solicit input into the review.

Initiatives undertaken

15. To maximise the input into the review process, a number of different consultation methods were used by the Secretariat.

- Input into the post-implementation review process was solicited through the normal comment letter process followed for other Exposure Drafts. Written responses were received from nine constituents.

- On-line questionnaires were developed for both users and preparers. Three on-line responses were received from preparers, and one on-line response was received from a user.

- Face-to-face meetings, workshops and presentations were made wherever possible (using organisations such as SAICA, SALGA and IMFO). A total of nineteen consultations were undertaken.

16. Given that many of the consultations were undertaken with organisations with regional offices, workshops were held throughout the country. The comments received therefore represent a good geographical diversity.
Municipal focus

17. A substantial number of the comments received are from, or relate to, municipalities and the local government environment. To obtain more representative feedback, letters were sent to the Provincial Accountants General, the CFO’s of public entities and the Directors-General of the national departments to provide inputs from the perspective of the public entities. This yielded limited results.

Consultation with key users

18. Key stakeholders such as Statistics South Africa, the National Treasury (Intergovernmental Relations Unit: Local Government and the Budget/Public Finance Statistics Office), the South African Reserve Bank (SARB), Afrika Ratings, the Banking Association of South Africa, and the Association for Saving and Investment South Africa (ASISA) were consulted. The input received during meetings with these stakeholders was informative and resulted in a number of suggestions to improve disclosures in the financial statements.

19. A range of other users were consulted, including, Municipal IQ (which monitors and assesses municipalities based on a range of socio-economic and financial areas), World Bank, and conveners of the Financial Management Improvement Programme (FMIP) sponsored by the European Commission, to discuss how they use the information in the financial statements. These users indicated that they either do not use the information in the financial statements because (a) they can obtain more detailed information from other sources, or (b) other factors dictate the level of support or assistance provided by these entities.

20. The sessions arranged with SALGA were useful, and resulted in a number of engagements with municipal councillors.

21. A session was arranged with the Product Champions at the Auditor-General to receive additional inputs into the process.

Consultations with preparers

22. As anticipated, preparers were keen to participate in the review and a significant amount of consultation was undertaken with them. Preparers of financial statements attended sessions arranged by SAICA, IMFO and SALGA. Many of the preparers who attended the sessions arranged by SALGA were members of management, and thus provided input into the review from both a preparer and a user perspective.

23. Certain entities, SARS, Afrikaanse Taalmuseum, Swartland Municipality and Drakenstein Municipality, wrote comment letters to the Board.
PART B – SUMMARY AND ANALYSIS OF COMMENTS RECEIVED

GENERAL

24. In general, the review was well received by preparers, users, and other interested stakeholders, and valuable input was obtained from the Secretariat’s interactions with these parties.

General observations from consultations with users

Targeted outreach initiatives required

25. The feedback received from users was generally positive, albeit that the technical input obtained from certain user groups was fairly limited. This is largely because many users are unfamiliar with the requirements of the Standards and their potential implications. It was also noted that, in most instances, more emphasis is placed on the budget, and assessing results against the budget, than the financial statements. It was observed that more needs to be done to educate users on the Standards, in a simple, understandable way, including the use of examples and illustrations.

26. The Board agreed that the Secretariat should develop information brochures and presentations for users, including councillors and parliamentary officials, as part of a targeted outreach campaign to explain the role of accounting standards, the usefulness of information in financial statements for accountability and decision-making, and how financial statements contribute to sound financial management.

27. The Board agreed that the Secretariat should also work with various divisions in the National Treasury to ensure that the various Handbooks that have been developed for financial and non-financial officials address these issues.

Alignment of reporting in strategic plans, budget, financial statements and reports on performance

28. Where users did use the information in the financial statements to make certain decisions, they indicated that the financial statements are of even more value when read with all the other reports published. As a result, it was observed that there needs to be better alignment of:

- Information presented in the various reports published by entities, e.g. better alignment of the reporting in strategic plans, budgets, financial statements and performance information.
- Methodological aspects of the financial statements and the budget, e.g. the basis of calculating and presenting items in the budget and financial statements should be more closely aligned.

29. The Board agreed that the Secretariat should liaise with the relevant units at the National Treasury, and other relevant parties, e.g. DPME, about alignment issues between the financial statements and the budget, as well alignment of information reported across the suite of reports published by entities.
Additional reporting requirements identified by users

30. Feedback of a more technical nature was received from other users, such as Statistics SA and internal users (chief financial officers and other senior managers), and has been useful given their understanding of financial statements. A number of recommendations have been made regarding additional information that could be disclosed in the financial statements, and is dealt with in more detail under the analysis of the responses to each question.

General observations from consultations with preparers

31. The input received from preparers was generally positive, and in many instances showed that the implementation of the Standards has had a positive effect on the way in which assets are managed by entities. Some preparers raised concerns about the cost of implementing the Standards, along with skill, capacity and IT issues, but at the same time suggested ways in which these issues could be overcome. Some preparers, albeit a minority, still have the misconception that accounting standards drive the norms and standards for asset management and that many of the requirements of the Standards are merely academic.

32. A number of application, interpretation and practical issues were raised by preparers. Some of these require specific action by the Board or Secretariat, while others are outside the scope of the Board’s mandate. Where action is required by another party, the Secretariat has shared these findings with the relevant parties. Other issues raised are internal management issues and require changes at entities themselves. The most significant issues are outlined in the detailed analysis of responses for each question.

ANALYSIS OF RESPONSES TO QUESTION 1: DISTINGUISHING PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTY

Overview of question

33. Users were asked to provide feedback on whether the distinction between property, plant and equipment and investment property is useful for purposes of accountability and decision-making, and if yes, what assessments it informs.

34. Preparers were asked to comment on whether this distinction has resulted in changes in the way in which assets are managed by entities. Preparers were also invited to share practical challenges experienced in making this distinction.

Analysis of responses from users

35. Users generally noted that the distinction between properties on this basis is useful, and provides valuable information about:

- “Core” and “non-core” assets, i.e. those used in service delivery or not, particularly at municipalities.
- The revenue that could be generated from using assets or selling them.
The allocation of resources. If the objective of holding investment properties is to generate revenue then other resources should not be used to maintain and operate these assets.

36. Stats SA indicated that the distinction between property, plant and equipment and investment property is not specifically relevant to the statistics produced. It was however noted that a distinction on the basis of residential, non-residential and commercial properties is more useful. While this distinction might be relevant for statistical purposes, it is not likely to enhance users’ assessments of accountability about how resources have been used, or affect future decisions such as resource allocations. As a result, further disaggregations of assets on this basis are not deemed necessary for users of the financial statements.

Analysis of responses from preparers

37. Views of preparers were mixed about whether the distinction between property, plant and equipment and investment property has resulted in changes in the way in which assets are managed. Some indicated that there had been changes in the way in which assets are managed, and that a greater awareness had been created about the types of assets held and how they are used. Other preparers indicated that there had been little change in the management of assets, that some entities had already been managing assets in a certain way, and that the distinction was purely academic.

38. A number of issues were raised by preparers on the practical challenges of distinguishing property, plant and equipment and investment property.

Principle in GRAP 16 to distinguish property, plant and equipment and investment property

39. Feedback was received from preparers indicating disagreement with, or shortcomings in, the current principles or explanatory commentary in GRAP 16 Investment Property for distinguishing property, plant and equipment and investment property. These include the following:

- The classification of properties is often based on the current use, which may be temporary.
- Land held for an undetermined future use is classified as investment property. Some preparers were of the view that because entities exist to provide services, particularly municipalities, any land held for an undetermined use is most likely held for future service delivery.
- It was noted that GRAP 16 is prescriptive about the classification of land held for an undetermined future use, but is less prescriptive about how to classify buildings held for an undetermined use. These preparers are of the view that GRAP 16 should prescribe the classification of both land and buildings held for an undetermined future use.
- GRAP 16 does not require that the rentals received should be market related. This seems to have blurred the lines in identifying whether an asset is used to
meet its service delivery objectives. These preparers are of the view that only properties that generate market rental should be classified as investment property.

- There is overlap in the definition of investment property and property, plant and equipment as they both refer to “capital appreciation or rental to others”.

40. The Board agreed to review the principles and explanatory text in GRAP 16 and 17 and propose revisions if necessary. Any proposed amendments will again be subject to the Board’s due process.

Guidance on the classification of specific assets

41. Based on the areas of contention outlined above, preparers noted that specific guidance on the classification of the following types of properties would be useful:

- Social housing (housing provided to low-income households), gap housing (housing provided to middle-income households), employee housing, and other housing (rented on market related terms).
- Land held for sale in the ordinary course of operations.
- Community assets, e.g. caravan parks, golf courses and other recreational facilities.
- Properties developed by municipalities in certain areas, which are rented to other government entities such as departments of home affairs, social development, health, UIF, etc., to provide centralised government services to members of a community.

42. While it is not feasible to provide detailed or definitive guidance on each of these examples listed above, they could be used to explain the principles in GRAP 16 and 17 in a context that is more familiar to entities.

43. Some preparers were of the view that where properties are rented at a below market rental, foregone rental (the difference between a market related rental and the rental actually charged) should be recognised in the financial statements. The Standards of GRAP do not allow the recognition of foregone revenue. The Secretariat will develop a FAQ to explain the treatment of foregone revenue.

ANALYSIS OF RESPONSES TO QUESTION 2: REFLECTING ASSETS IN THE FINANCIAL STATEMENTS AT A VALUE

Overview of question

44. Users were requested to indicate whether reflecting all assets on the statement of financial position provides information useful for accountability and decision-making.

45. This question requested that preparers share their experiences and practical challenges in recognising and initially measuring assets on the statement of financial position.
Analysis of responses from users

46. Users generally agreed that reflecting assets on the statement of financial position provided useful information for accountability and decision-making. Some noted that reflecting assets on the statement of financial position informed decisions about financing and borrowing decisions, as well as resource allocation decisions such as how much to allocate to repairs and maintenance. Many indicated that this provides useful information about the values and nature of assets held, and resources invested in assets. Financial institutions noted that they focus on liquidity rather than assets when making funding decisions.

More detailed information should be disclosed about the management of assets

47. Most users noted that, to enhance the usefulness of the information already reported in municipalities’ financial statements, more detailed information should be reported about assets. This detailed information ranged from providing more detailed information about specific asset classes to information about the age, condition, repair and maintenance strategies, risks and other aspects that provide a more holistic view of integrated asset management.

48. Given that the assets held by municipalities are critical to their service delivery this type of information would be useful to users. The objective of the financial statements is to provide information about the economic value and consumption of assets during a period. Detailed information about the management of assets may therefore be inappropriate for the financial statements. This information would however complement and supplement information in the financial statements, and could usefully be included in an “asset management” report outside the financial statements in an entity’s annual report. Some of the information may also be appropriate for the management commentary accompanying the financial statements and/or in performance information.

49. The Board agreed that it might be useful to engage with the relevant stakeholders about the possibility of developing this type of report, and making the linkages clear with the financial statements. The ASB’s involvement would however be limited as developing this type of reporting is beyond the scope of its mandate.

Disclosure of repairs and maintenance

50. Users observed that “repairs and maintenance” is not disclosed as a line item in the financial statements, but it is specifically included in the budget. Given the ongoing emphasis on properly repairing and maintaining assets, the sufficiency of repairs and maintenance is assessed by users as a percentage of the asset value. The Board agreed to amend GRAP 1 on Presentation of Financial Statements to require disclosure of repairs and maintenance in the notes to the financial statements.

Questioning the recognition of certain types of assets

51. Some users questioned the relevance of capitalising specific assets, such as library books. While the Secretariat is aware that this has been an issue at entities, one of the
underlying reasons why users and preparers question the recognition of library books, stems from the fact that materiality is often not considered and applied appropriately by preparers. The project on the Board’s work programme to develop a Paper on the application of materiality in the financial statements may assist with this issue.

Analysis of responses from preparers

Recognition and derecognition of land – legal title versus control

52. Preparers consistently highlighted issues around the recognition and derecognition of land (and to a lesser extent, buildings). There is uncertainty about whether land should be accounted for based on whether an entity has legal title, or whether control should be assessed. Most of the examples raised related to the RDP housing schemes at municipalities, land owned by the Department of Public Works, or land owned by tribal authorities.

- **RDP Housing Schemes**: In the RDP schemes, houses are typically constructed by the Department of Human Settlements on land owned by the municipality. The intention is for the land to be subdivided and transferred to the home owners. Often the house has been transferred to the home owner, but due to administrative delays (either at the municipality or the Deeds Office), the legal title of the land has not yet passed to the home owner. In these cases, municipalities are unsure whether they should derecognise the land when the home owner takes control of the house (as the municipality no longer has control over the land), or only when legal title of the land has passed. While the issue was raised in the context of RDP housing schemes, there are likely to be other scenarios where this issue will arise, for example, redrawing of municipal boundaries and transfers of functions.

- **Land and/or buildings owned by DPW**: In terms of the Government Wide Immoveable Asset Management Act (GIAMA), DPW (either nationally or provincially) is the custodian of land owned by government. In most instances, the legal title of the land vests with DPW. Entities often occupy, or construct buildings or other structures on land owned by DPW and it is unclear who should account for those buildings, and who should account for the land on which those buildings or structures are situated. In most instances the buildings or structures have been recognised by determining who controls the building. Some preparers are of the view that the land should also be accounted for by the entity that constructed the building or structure because, by implication, it also controls the land.

- **Land owned by tribal authorities**: In provinces such as Limpopo, North West and KwaZulu Natal, there is a significant amount of land that is owned by tribal authorities. Government entities often construct assets on this land, and these assets are either for the direct benefit of the community, or the assets are used by the government to perform administrative functions or deliver services. Questions similar to those raised for the RDP and DPW scenarios exist for land owned by tribal authorities.
53. While some of these issues are not new, the recognition and derecognition of land based on legal title or control is a relatively new issue that has emerged. Given the complexity and pervasiveness of this issue, the Board agreed that it may be appropriate to issue an Interpretation providing guidance on this issue and has added a project to its work programme. While the National Treasury has issued guidance on the recognition of land, it only addresses the impact of GIAMA on departments. Any guidance issued will need to be considered jointly between the ASB and the OAG.

**Accounting for RDP Housing Schemes**

54. Municipalities consistently raised issues about the accounting treatment of RDP housing schemes, both “accredited” and “non-accredited” schemes. Accounting for RDP housing has been raised as an issue with the Secretariat before. The Secretariat has however been reluctant to provide detailed accounting guidance on this issue as individual contracts within the schemes may differ. With the introduction of the “accredited” housing schemes a year or so ago, the issue however seems to have been exacerbated. There has also been divergent accounting practice over the last two audit cycles for “non-accredited” schemes which are seemingly similar in nature.

55. The Board agreed that, while specific accounting guidance cannot be provided to deal with both schemes because of the individual contracts that need to examined, it might be useful to issue a document similar to the PPP Guideline outlining high level guidance on these transactions. This document could discuss the key features of the schemes and provide guidance on what accounting principles could be considered in those circumstances. A project has been added to the Board’s work programme to assess what guidance could be provided.

**Standardised guidance on components of assets, useful lives, replacement costs**

56. Many preparers noted that a significant amount of resources are spent separating assets into their component parts, both on the initial adoption of the Standards (for existing infrastructure and other assets) and on an ongoing basis (for any new capital projects undertaken). As entities often do not have the internal skill and capacity to identify the significant components of an asset, external consultants are appointed to do this work. Apart from the enormous cost incurred in appointing these consultants, there has been diversity in practice from consultant to consultant about what constitutes a “component”. This diversity exists from one entity to another, but also within entities themselves, particularly where a different consultant is appointed each year to componentise assets.

57. To avoid this ongoing cost, and to standardise reporting on components, many preparers suggested that standardised guidance should be developed and applied by all entities. This standardised guidance could outline components of specific types of assets (e.g. in a water reticulation system the components are the Xm length pipes, pumps, etc.) and the % of the cost that should be allocated to these components (e.g. 20% of the cost allocated to the pumps). This standardised guidance could be
extended to deal with other issues such as useful lives of various types of assets, replacement costs of assets and their components etc.

58. Given that this issue was identified consistently in all the consultations undertaken, and is likely to save a significant amount of resources going forward, the Board agreed that the Secretariat should discuss this issue with the National Treasury. While the Secretariat is of the view that guidance of this nature would be beneficial, the fact that some entities have spent a significant amount of time developing appropriate systems and policies to componentise their assets and undertake all the other assessments required by the Standard, cannot be ignored. Any guidance developed should still allow entities’ to exercise their own discretion in such areas where they have the necessary skill and expertise to do so.

59. Based on the examples provided as part of the review, it is clear that the level of componentisation applied by entities is inappropriate (e.g. componentising street lamps). The Secretariat will review existing FAQs and assess whether a new FAQ could be developed.

Classification of subsequent costs incurred on assets – capitalise or expense as repairs and maintenance

60. Many preparers indicated that there is a need for standardised guidance on the classification of subsequent costs incurred on assets, particularly when these costs should be expensed as repairs and maintenance and when they should be capitalised. The fact that preparers highlighted this as an issue may be a consequence of not having appropriate skills internally to make this assessment. Other issues, such as different budgeting requirements, may also create confusion amongst preparers about how to classify these costs. As an example, in some entities, if the costs are more than a % of the total value of the asset then they are seen as capital costs for budgeting purposes.

61. The Secretariat will discuss this issue with the National Treasury and assess what action can be taken (if any).

ANALYSIS OF RESPONSES TO QUESTION 3: MEASUREMENT OF ASSETS

Overview of question

62. Users were asked to comment on whether the choice of measurement basis used by an entity has affected their assessments or decisions, and if yes, how this has affected those assessments and decisions. Users were also asked whether the choice of cost or fair value has affected users’ ability to assess accountability and/or make decisions and compare results across entities.

63. Preparers were asked to indicate what measurement basis they apply in preparing the financial statements, why this basis is applied, and what, if any, practical challenges are experienced in preparing this information.
Analysis of responses from users

64. General users of the financial statements did not express strong views about the choice of measurement basis. A few specific users indicated their preference for either the cost or fair value models. Some indicated that the choice of measurement basis does not affect their statistics, as long as sufficient information is shown about changes in values from one period to the next in the financial statements.

65. Some users indicated that the choice of measurement basis severely affects comparability across entities, and that accounting policy choices should be eliminated wherever possible. This user noted that the choice of measurement basis affects, amongst others, assessments of:

- The tariffs charged by municipalities. Where the revaluation model is applied by municipalities there is often a direct correlation with higher municipal tariffs charged for services.
- The adequacy of repairs and maintenance undertaken during a reporting period. When assessing the adequacy of repairs and maintenance as a percentage of the asset values, municipalities that apply a revaluation model are generally seen to not be implementing appropriate repair and maintenance strategies. On the other hand, those municipalities that apply a cost model are seen as spending sufficient amounts on repairs and maintenance, while this might not be the case.

66. Other users indicated that, because other types of reporting, i.e. reporting on statistics requires the reporting of assets using market values, fair value is preferable. The potential resource implications were however acknowledged.

67. These users also indicated that, for comparability purposes, a specific measurement basis should be prescribed for specific assets and, if need be, fair value, market value or an equivalent value should be disclosed in the financial statements.

Analysis of responses from preparers

68. Experience amongst preparers indicated that they generally apply the cost model for property, plant and equipment. This was purely on the basis that it is easier and less costly to apply. Some indicated that they apply fair value for land and buildings, and use the valuation roll as a basis for determining fair values.

69. The experience on investment property is mixed, with some applying the cost model, some applying the fair value model, and some indicating that theoretically, only fair value should be permitted for investment property or that the disclosure of fair values of investment property should be required as a minimum. In many instances, fair value might also have been determined using the valuation roll. The Secretariat will issue a FAQ on when use of the valuation roll is appropriate.

70. In general, preparers supported the idea of having a choice of measurement bases that could be applied to different types of assets.
71. Preparers noted a few measurement issues related to the initial adoption of the Standards, in particular that they may have incorrectly assumed that determining deemed cost in accordance with Directive 7 meant adopting a revaluation model going forward. Some indicated that they have corrected this error, or will make use of the proposed Directive on Changes in Measurement Bases Following the Initial Adoption of Standards of GRAP.

72. Preparers generally did not identify significant practical challenges in applying the Standards. It was however noted that where the revaluation model or fair value model is applied, IT systems were not always able to accommodate the changes in values.

Eliminating or prescribing the measurement basis for all or some assets

73. The Board debated whether a specific measurement bases could be eliminated, or whether specific measurement bases should be prescribed for specific assets. The Board agreed that entities should be able to apply judgement in deciding what information is most useful to users of the financial statements for the types of assets they hold. No changes are therefore proposed on the measurement of assets.

Use of external valuers

74. A number of issues were noted during the review about the use of external valuers to determine the value of assets, assess useful lives, impairment, residual values etc. A review of the requirements and disclosures in GRAP 17 on the use of valuers may be useful in resolving the issues noted (GRAP 17 currently does not require the use of a valuers, but the wording may be ambiguous).

Application of Directive 7 Determining Deemed Cost

75. Directive 7 permits an entity to determine a deemed cost for assets on the date of adoption where historical information is not available to support the cost of these assets. Directive 7 requires that the deemed cost be determined on the date of adoption of Standards of GRAP (which was either 1 July 2007 or 2008 depending on whether the municipality was a high, medium or low capacity municipality). A preparer noted that many municipalities have still not completed this process.

76. As a result of not having completed the process in time, these municipalities are effectively required to determine the deemed cost of assets on 1 July 2007 or 1 July 2008. They have indicated that this is not feasible given the time that has elapsed, and have requested that Directive 7 be amended to accommodate these entities. The Secretariat will develop a FAQ on this issue.

ANALYSIS OF RESPONSES TO QUESTION 4: DEPRECIATION OF ASSETS

Overview of question

77. Users were asked to comment on whether depreciation assists them in making assessments of, and decisions about, the use management and condition of assets.
78. Preparers were asked to indicate what depreciation method they apply, and what practical challenges were experienced in complying with the Standard.

Analysis of responses from users

79. Generally, users indicated that they currently do not use depreciation to make decisions about the use, condition and management of assets. This can be attributed to the need for more education about the meaning of the information in the financial statements. It was also noted that users do not understand why depreciation is different between the financial statements and the budget. These differences are largely due to how depreciation is funded in the budget, and what quantum of depreciation is included in the determination of consumer tariffs.

Analysis of responses from preparers

80. Almost all of the preparers consulted indicated that they use the straight line method to depreciate assets because it is easier to apply. One preparer suggested deleting the alternative methods. As only one respondent proposed this, no action will be taken at this stage. As anticipated, a number of practical challenges were noted regarding depreciation.

Assessing useful lives of assets

81. The most significant practical issue highlighted by preparers was the annual review of the useful lives of assets. Preparers noted that the annual review of useful lives has proved difficult for the following reasons:

- The volume of assets held by municipalities means that a detailed assessment cannot be done on all assets at year end, and even where this is possible, a significant amount of resources are spent on this assessment.

- Evidence to support management’s assessment of useful lives of assets was not available or not of appropriate quality.

- The status of using the useful lives set out in the National Treasury Asset Management Framework varied during the last reporting cycle. In some provinces, entities used the useful lives set out in the National Treasury document even if internal engineers believed different useful lives were appropriate given the entity’s circumstances. In other provinces, the useful lives in the National Treasury document were not seen as acceptable.

82. Preparers suggested two possible ways of overcoming these challenges. Firstly, introducing an indicator approach similar to that applied for impairment may alleviate the amount of work being done. This indicator approach would require that the Board identify indicators of when the useful lives of assets may have changed, e.g. the performance or use of the asset has increased or decreased, scheduled maintenance has not been undertaken, etc. If any of the indicators identified are triggered during the period, only then would the entity assess and review the useful life of the asset.
Another suggestion was to develop standardised guidance on the useful lives of assets.

83. These two proposals are not mutually exclusive, and could both be developed. Introducing an indicator based assessment would be helpful, and would not compromise the principle of the Standard. Introducing an indicator based approach may also reduce the amount of resources currently spent on ineffective and inappropriate assessments of useful lives. Before making a proposal to the Board, the Secretariat will liaise with the National Treasury about the possibility of standardised guidance to ensure that a holistic approach is taken to revising the approach to assessing useful lives (if any).

84. Preparers indicated a number of areas where the requirements of the Standards are unclear, or additional guidance could be provided. These are as follows:

- **Capital work-in-progress:** Preparers noted that more guidance is needed on when capital work-in-progress is available for use, particularly in relation to infrastructure assets. It was also observed that a perception had been created that capital work-in-progress could not extend beyond one reporting period. Issues were also noted around the capitalisation of employee and labour costs to capital projects, specifically that this was either not being done, or that there is insufficient clarity about when this would be appropriate. The Secretariat will discuss these specific examples with the OAG.

- **Fully depreciated assets:** Preparers noted that they have significant numbers of assets that are fully depreciated but that are still being used. This has arisen because entities either do not review the useful lives of assets, or do not realise that they should make appropriate adjustments if assets have been fully depreciated. Some also indicated that they did not know how to adjust fully depreciated assets. The Secretariat has published a detailed FAQ on this explaining that appropriate adjustments should be made and how they should be made.

- **Changes in useful lives:** There was a general perception that when useful lives of assets are changed, it is a change in accounting policy. The Secretariat will review the FAQs issued on depreciation and assess whether these can be modified in any way to make this clearer, or a new FAQ will be developed.

- **Useful lives of “indefinite” life assets:** It was noted that it is difficult to determine the useful lives of “indefinite life” assets such as infrastructure which are seen to be used into perpetuity. There seems to be a misunderstanding that the useful lives of the components of the infrastructure should be reviewed. As with the previous issue, the Secretariat will review the FAQs issued and assess whether changes can be made to make this clearer, or if the a new FAQ should be developed.
Suitability of IT systems: Many preparers noted that their IT systems were unable to accommodate changes in useful lives of assets. In many instances, the useful lives/depreciated rates had been written into the coding of the system, and could only be changed by an IT specialist.

ANALYSIS OF RESPONSES TO QUESTION 5: IMPAIRMENT OF ASSETS

Overview of question

85. Users were asked to comment on whether reflecting an impairment loss in the financial statements, along with how it is calculated, provides useful information about the condition of an entity’s assets.

86. Preparers were asked to comment on practical challenges experienced in impairing assets.

Analysis of responses from users

87. Some users indicated that they understood the implications of an impairment loss being recognised in the financial statements. The majority of users however indicated that they do not use the information, in part because they do not understand what impairment represents, and do not understand the technical jargon used.

Analysis of responses from preparers

88. As expected, a number of practical challenges were noted by preparers.

Distinction between cash and non-cash generating assets

89. The most significant issue raised by preparers is the distinction between cash and non-cash generating assets. This was raised with the Secretariat during the Improvements Project for 2012/13, which resulted in the Board adding a project to its work programme to review both GRAP 21 and GRAP 26 on impairment of assets. This project will assess whether the principles in these Standards could be streamlined and simplified.

90. A number of other issues were noted which could be addressed through FAQs issued by the Secretariat. These issues are as follows:

- Impairment of components of assets: There seems to be a misunderstanding that entities need to assess whether components of assets are impaired. The intention of the Standards is to assess impairment of the asset as a whole, or when appropriate, as a cash-generating-unit.

- Damage to assets: During many of the discussions held, it was noted that assets are being impaired for minor issues which could easily be rectified through repairs and maintenance, e.g. broken windows and leaking roofs on buildings. As the intention of the Standards is to reflect significant changes in value or service potential of an asset, the principles have clearly been misapplied in these circumstances.
Derecognition versus impairment of assets: Some preparers expressed the view that for an asset to be derecognised, it first needed to be impaired. Derecognition reflects a loss of control of an asset, while impairment recognises a loss of economic benefits or service potential.

Impairment and the budget: Many preparers noted differences between the way in which impairment is dealt with in the financial statements and the budget.

ANALYSIS OF RESPONSES TO QUESTION 6: DISPOSALS OF ASSETS

Overview of question
91. Users were asked to comment on whether the information in the financial statements is sufficient to enable accountability over the assets disposed of by an entity. Preparers were asked to comment on any practical challenges experienced in preparing this information.

Analysis of responses from users
92. Generally users found the information on disposals to be sufficient. Some however indicated that additional information could be disclosed on the following:

- Information should be presented on the carrying values of the assets disposed of and the proceeds received on disposal their disposal. Some indicated that this could be presented in aggregate for all disposals, while others were of the view that there is merit in showing this separately for individually significant disposals. There was a sense that this type of disclosure may assist users to assess the supply chain management practices and governance exercised over disposals of assets.

- A narrative discussion on how the service potential of an asset will be replaced where it has been disposed of.

- A narrative description of thefts and losses that occurred during the reporting period.

93. The disclosure of thefts and losses is currently prescribed by legislation, so it is not necessary for the Standards to also require these disclosures. Information about how the service potential of an asset will be replaced is unnecessary as the MFMA in particular is clear that assets that are required to provide minimum basic services may not be sold.

94. The Board debated whether to include disclosure requirements of the sale proceeds and carrying values of significant assets disposed of during the period. The Board agreed not to require this disclosure as it may require a high degree of judgement to determine what is significant, and the cost of preparing the information may outweigh the benefits.
Analysis of responses from preparers

95. The only significant issue identified by preparers was the actual identification of assets that had been disposed of during a reporting period. Finance practitioners indicated that they relied on operational staff to identify these disposals. This is a practical issue that needs to be resolved through robust internal processes and procedures.

ANALYSIS OF RESPONSES TO QUESTION 7: ACQUISITIONS OF ASSETS

Overview of question

96. Users were asked to comment on whether the information disclosed on acquisitions of assets is appropriate to assess the level of investment in new assets. Preparers were asked to identify any practical issues in preparing this information.

Analysis of responses from users

97. Users generally indicated that they used the information, mostly because there is a clearer linkage between the budget and the financial statements for capital expenditure.

98. Users and preparers both observed that there needs to be better consistency in the way in which capital work-in-progress is presented, and additional information is needed on specific aspects of capital work-in-progress. The areas where improvement was suggested are as follows:

- Capital work-in-progress should ideally be presented per class of asset. While this suggestion was made by a number of respondents, Statistics SA indicated that this would enhance the usefulness of their financial statistics. Some respondents did however indicate that, while this classification could be done, adjustments between the classes of assets may need to be made once the project is completed.

- Information should be provided about the “ageing” of the capital work-in-progress. Users observed that some capital projects take a significant amount of time to complete, or are not completed at all. Some users noted that providing information about the “ageing” of capital work-in-progress (particularly on specific projects) may be useful in assessing capital performance. This could also be achieved by disclosing information on projects that have been included in capital work-in-progress for a significant period of time.

99. The Board agreed that these additional disclosures could be useful for users for the reasons noted and proposed disclosures will be developed for GRAP 17.

Analysis of responses from preparers

100. Preparers did not identify significant issues related to the preparation of information on acquisitions of assets. Some did however note that more guidance is needed on disclosure of commitments (generally) in the financial statements.
ANALYSIS OF RESPONSES TO QUESTION 8: DISCLOSURES

Overview of question

101. Users were asked to comment on whether any of the additional information disclosed is useful for accountability and decision-making. They were also asked to indicate if there is other information that they use to make these assessments, but which is not disclosed in the financial statements. Preparers were asked to comment on practical challenges related to the preparation of this information.

Overview of responses from users

102. General users of the financial statements did not express clear views in this area. Other users did however request that specific information be disclosed in the financial statements. These users requested that additional information should be disclosed on the following:

- Sales and purchases of water and electricity. This information was previously disclosed in an annexure, but is no longer provided. This information is useful in assessing, and deriving statistics on, losses of water and electricity.
- Number of consumer units that receive water and electricity.
- An analysis of whether property rates are levied on residential, non-residential or commercial property.
- A more detailed analysis of the statement of financial performance.
- Detail of intergovernmental transactions. As economic statistics need to be determined for the sector as whole, any intergovernmental transactions need to be eliminated.
- Unauthorised, irregular and fruitless and wasteful expenditure be disclosed in the financial statements.
- Amendments to existing presentation and disclosure, and also proposed additional information, on the following areas (over and above other areas that may have been raised by respondents and discussed earlier in this memo):
  - A separation between grants for capital and operational purposes in the statement of financial performance.
  - The presentation of capital grants as revenue from investing activities rather than operating activities in the cash flow statement.
- An analysis of revenue between domestic and commercial residents.
- Disclosure of actual collection rates on debtors.
- Statistical reporting, e.g. number of houses built by category, number of roads constructed, by category (tar or gravel) etc.
103. The Board concluded that much of the additional information requested is outside the scope of financial statements and may be more useful to report in performance information, would not be relevant to a wide group of users, or is already required to be disclosed by legislation. The Board agreed to consider disclosure of thefts and losses of water and electricity as these have a direct link with the financial statements. The Board did not make specific decisions about presentational aspects in the financial statements and will be considered when revising GRAP 16 and GRAP 17.

Analysis of responses from preparers

104. Preparers generally did not experience challenges in complying with the disclosure requirements of the Standard. Many indicated that they use Caseware to prepare their financial statements.

105. Many preparers indicated that the encouraged disclosures in GRAP 17 are not provided in the financial statements, and as such, should be deleted from the Standard. These relate to the disclosure of fully depreciated assets still in use, the fair values of assets where the cost model is used, and the value of any assets that were not used during the reporting period. The Board agreed that these disclosures should be reconsidered as part of the review of GRAP 16 and GRAP 17.

ANALYSIS OF RESPONSES TO QUESTION 9: FINANCIAL MANAGEMENT

Overview of questions

106. Preparers were asked to respond to four questions related to financial management:

- Is management information prepared (which includes a statement of financial position), and if yes, how often is the information prepared and who reviews it?
- Is the asset register complete, how often is the asset register updated, and how often is it reviewed and by whom?
- What audit issues were identified and have they been resolved?
- What are the main factors, drivers and inputs that are required to achieve ongoing compliance with the Standards?

Overview of responses

107. Preparers generally noted that they prepare management information that includes a statement of financial position. Many noted that this is a legislative requirement in local government. In most instances, senior managers reviewed this information.

108. Preparers noted that the asset registers are complete and comply with the Standards of GRAP. While some preparers indicated that the asset register is updated daily or weekly and regularly reviewed, others noted that asset registers are sometimes only updated and reviewed annually.

109. It is clear that the need for regular management reporting needs to be stressed amongst preparers.
110. The main factors and drivers noted by preparers are:

- Implementing appropriate policies and procedures.
- Employing appropriately skilled finance and technical staff, at all levels within the organisation.
- Being informed, and staying up-to-date with Standards of GRAP.
- Sufficient capacity at all levels.
- Stringent controls over assets.

111. The OAG asked preparers to respond to the following question. Please indicate, on a scale of 1 to 5, the extent to which each of the following challenges compromise your ability to comply with the Standards (1 implies that it has no impact and 5 implies that the impact is extensive):

(a) The institutional environment comprising relevant legislation, regulations and accounting system (such as an IT system, Standard Chart of Accounts). Please indicate which aspect of the institutional environment affects your ability to comply with the Standards.

(b) The organisational environment comprising the asset management system (policies, processes, procedures, information technology, etc.). Please indicate which aspect of the organisational environment affects your ability to comply with the Standards.

(c) The individual skills and competencies of staff. Please indicate which level of staff lack capacity and identify the specific skills and competencies that are lacking.

(d) The dependence on stakeholders. Please indicate which stakeholders.

112. Some preparers rated the challenges, many did not. Where they did rate the challenges, they were either “1”, “3” or “5”. The ratings provided therefore do not provide any real insight into the challenges experienced at entities. Valuable commentary was however received on each of the challenges raised, and is outlined below. This is included merely for information purposes. The detailed analysis and results will be passed on to the National Treasury and are merely provided for information purposes.

**Institutional environment**

- Continuous changes in the Standards make compliance difficult, and have an effect on IT systems as they constantly require change.
- Many IT systems cannot accommodate requirements of GRAP.

**Organisational environment**

- Proper policies and procedures are not implemented.
Asset systems and asset registers are kept outside the financial system and, as a result, they do not interface with the finance systems.

**Individual skill and capacity**
- Asset management is often delegated to lower level officials who do not understand the requirements of GRAP, have only basic accounting skills (if any), do not have the necessary technical (engineering) skills, and do not understand the importance of sound internal controls such as reconciliations.
- Salaries offered are insufficient to attract suitably qualified staff, and alternative retention strategies do not exist.
- Staff often gains experience at smaller municipalities, but move whenever a better opportunity arises at a bigger municipality.
- There is insufficient capacity which results from poor human resource planning.
- Establishing shared service centre or “pools of experts” in each province may alleviate skill and capacity issues.

**Reliance on stakeholders**
- There is an over reliance on consultants.
- Finance staff relies on operational staff for information, who do not necessarily understand accounting or asset management.
- Assistance is needed from the provincial and national treasuries to resolve issues.