Accounting Update
May 2015

Accounting Standards Board

Overview

- ED 130 – proposed Directive on *The Selection of an Appropriate Reporting Framework by Public Entities.*
- Reporting framework for 2014/15 and 15/16.
- Amendments to GRAP 16 and GRAP 17, and update on proposed amendments to GRAP 21 and GRAP 26.
- ED 129 – Accounting by Principals and Agents.

Proposed Directive on *The Selection of an Appropriate Reporting Framework by Public Entities*

About GBEs project

- ASB initially concluded that GBEs should apply Statements of GAAP
- GAAP was withdrawn from 1 Dec 2012
- Project initiated to determine whether GBEs should apply either:
  - International Financial Standards (IFRS); or
  - Standards of GRAP (GRAP)

About GBEs project

2002

GBEs apply GAAP or IFRSs

Board concluded that profit-oriented entities and those with publicly traded debt apply GAAP

2012

GAAP is withdrawn

Status quo applies until Board's research project is finalised

2013

Board initiates research project

Research conducted in the form of interviews/ workshops with the users and preparers of f/s of GBEs

Board finalises research project

Feedback from consultation with users and preparers informs development of ED 124

Early 2014

Board issues ED 124

Board proposes that Sch2 apply IFRSs and Sch 3B & 3D apply GRAP in proposed Directive

Dec 2014

Board considers responses and deliberates on way forward

Board revises its initial thinking

2015

Board issues ED 130

ED issued for comment in Feb 2015 and Board to make final decision in July 2015

Development of initial proposals in ED 124

Board finalises research and develops ED 124

Board considered 3 options in its proposal:

- Option 1: All public sector entities should apply GRAP
- Option 2: Reporting frameworks applied by entities should be based on the classifications in the schedules of the PFMA
- Option 3: Reporting frameworks applied by entities should be based on a set of principles

Initial proposal and reaction by respondents

- Schedule 2 entities apply IFRSs and other GBEs apply Standards of GRAP
  - users supported proposal
  - no support from preparers but suggested uniform approach for all public sector entities

Respondents' concerns with proposal

- Classifications in PFMA schedules inappropriate.
- Objectives of GRAP not aligned to GBEs' mandates/activities.
- GBEs funded differently to GRAP entities.
- Inability to retain suitably qualified staff.
- Continue with status quo until reclassification completed.
- Other legislation recognises IFRSs as framework.

Development of current proposals in ED 130

Board revises its initial proposal

- Based on feedback in ED 124, Board considered 2 possible approaches:

  1. all p/entities apply GRAP with no exceptions/exemptions; or

  2. all p/entities apply GRAP with possible exceptions/exemptions

Board's objective in ED 130

- Board prescribes the criteria to be applied by public entities in selecting and applying an appropriate reporting framework.

Board's current proposal

- All public entities apply IFRSs unless the Board has approved Standards of GRAP:
  - scope covers schedule 2, 3 public entities currently applying Statements of GAAP/IFRSs
  - IFRSs applied only if certain criteria is satisfied

Proposed criteria

An entity will apply IFRSs if:

a) it is a financial institution;

b) it has ordinary [potential] shares publicly tradable on capital markets; or

c) only an insignificant portion of funding is acquired through govnt grants/other forms of fin. assistance from govnt, and its operations are commercial in nature.

Criteria (a)

Determine if the entity a financial institution as described in the ED:

- entities that provide financial services to clients/members; including deposit taking institutions and/or loan providers.

If yes → entity applies IFRSs

Criteria (b)

Determine if entity has listed ordinary shares or potential ordinary shares?

- regulated markets require financial info to be provided in IFRSs
- e.g. JSE Listing Requirements require financial info to be provided in IFRSs for equity issues.

If yes → entity applies IFRSs

Criteria (c)

Assess if insignificant portion of funding is obtained from government:

- consider overall capital structure → size, complexity, composition
- consider three elements:
  - nature of funding
  - use of the funding
  - level of dependency → frequency of receipt and Rand value (significance)

Criteria (c)

Nature of funding	Use of funding	Frequency of funding
Loan / equity injection	• Initial capitalisation	• Once-off
Loans	• Operational • Capital	• Once-off • Ongoing • Periodic
Highly concessionary loans	• Operational • Capital	• Once-off • Ongoing • Periodic
Grants	• Operational • Capital • Special projects	• Once-off • Ongoing • Periodic

Criteria (c)

Assess if operations are commercial in nature:

- overall financial objective is to generate profits not service delivery
- factors to consider
  - existence/ absence of competitive environment
  - ratio of non-commercial operations to commercial if both exist in one entity
  - level of dependency on govnt funding

Criteria (c)

- If entity can demonstrate that an insignificant portion of funding is from government AND its operations are commercial in nature → entity applies IFRSs

Implications of proposal

- Self assessment framework
  - allows entities to determine the RF most appropriate for them.
- IFRSs applied if criteria is met otherwise GRAP is default RF.
- Basis of the criteria
  - nature of ops., funding structure, users and their info needs.

Implications of proposal

- Exemptions previously issued by NT are no longer valid.
- NT still retains authority to provide exemptions as per PFMA.

Due process

- Deadline for comment is 12 June 2015
- Separate consultation sessions with public entities
  - 45 min presentation to test and demonstrate how proposals in ED were applied
- Review comments and make final decision at July 2015 Board meeting

Reporting Framework

Snapshot - Reporting framework

	31 March 2015	31 March 2016
GRAP	Report in terms of new Standards: GRAP 5 ,100	Report in terms of new Standards: GRAP 1, 2, 3, 10, 11, 13, 17, 18, 19, 21, 23, 24, 25, 26, 31, 103,104, 105, 106, 107 Directive 11
IFRS/ IPSAS	No change	IFRIC 21
Not yet effective	Accounting policy: •GRAP 32, 105, 106, 107, 108 •IGRAP 17 Disclosure: •GRAP 20 or IPSAS 20 Early adopt: •GRAP 1, 2, 3, 10, 11, 13, 17, 19, 21, 23, 24, 25, 26, 31, 103,104 •Directive 11	Accounting policy: •GRAP 32, 108 •IGRAP 17 Disclosure: •GRAP 20 or IPSAS 20
Not	GRAP 18	GRAP 18 [for some entities]

Newly effective Standards

Standard	Public entities, constitutional institutions, FET colleges	Municipalities and their entities
GRAP 18 *Segment Reporting*	1 April 2015 1 January 2016	Not effective
GRAP 105 Transfers of Functions Between Entities Under Common Control	1 April 2015 1 January 2016	1 July 2015
GRAP 106 Transfers of Functions Between Entities Not Under Common Control	1 April 2015 1 January 2016	1 July 2015
GRAP 107 *Mergers*	1 April 2015 1 January 2016	1 July 2015

Amendments to *Investment Property* and *Property, Plant and Equipment*

Focus areas affected

- Investment property vs property, plant & equipment distinction.
- Useful lives & residual values.
- Use of external valuers.
- Disclosure on WIP.
- Encouraged disclosures.
- Repairs & maintenance disclosure.

Investment property

- No amendments to principles – clarify application in GRAP 16
  - asset used in production or supply (social housing, recreational facilities) → mandate specified in legislation or similar
  - asset contributing to specific good and service in conjunction with other property
  - hold asset for disposal as part of ordinary course of operations

Investment property

- Clarify application in GRAP 16
  - amount of revenue earned not important – rather why/how property is used
  - existence of lease in itself does not mean property is investment property
  - rent does not need to be market related for property to be classified as investment property

Property, plant and equipment

- Indicator based approach to assess useful lives and residual value
  - annual assessment at each reporting date may be to onerous
  - introduction of indicator based approach
    - list of indicators
    - only conduct detail assessment if one or more of indicators are triggered

Property, plant and equipment

- Use of external users
  - Independent and external vs internal → member of valuation profession or another competent expert
- Capital-work-in progress
  - Disclosure of cumulative expenditure capitalised per class of asset
  - Construction of assets taking a significantly longer period of time to complete than expected
  - Construction of assets stopped → reason and if assets impaired.
  - Flexibility in disclosure.

Property, plant and equipment

- Review encouraged disclosures
  - Eliminate all
- Repairs and maintenance
  - Separately disclose expenditure incurred to repair and maintain an asset in notes (GRAP 16, GRAP 17, GRAP 103)
  - Include information on specific costs in amount disclosed → comparability

Transitional provisions

Amendment	Prospective application	Retrospective application
Separate disclosure on repairs & maintenance on all assets.	✔	
Indicator based approach.	✔	
Disclosure on capital WIP.	✔	
Use of external valuers (professional valuer or another expert)	✔	
More explanations, guidance and examples to distinguish IP and PP&E.		✔
Deletion of all encouraged disclosures		✔

Effective date

- Recommended 1 April 2016 as effective date to Accountant-General.
- Approval pending.

Update on Proposed Amendments to GRAP 21 and 26 on Impairment of Assets

Purpose

- Highlight proposed amendments to GRAP 21 and GRAP 26 in ED 127
- Discuss key issues arising from consultation
- Discuss Board's decision regarding issues raised by respondents
- Next steps

Background

- Project initiated based on feedback during stakeholder consultations and improvements project
  - need for guidance to distinguish between cash and non-cash generating
- Board approved project to review impairment Standards to:
  - assess whether principles could be simplified and streamlined
  - assess feasibility of one Standard for all assets

Background

- ED 127 issued for comment in October 2014
  - comment period closed 31 January 2015
- Board reviewed comments at March 2015 meeting
  - analysis and review of feedback from respondents
  - deliberate on key issues raised by respondents
  - Board decided not to approve proposed amendments as final amendments

ED 127 in a nutshell

- Simplify approach to distinguish CGA and NCGA
  - Classification moved away from use to generate commercial return <u>to</u> measurement basis that best reflects entity's objective
  - If objective is service delivery → DRC most relevant measurement basis to determine value in use
  - If objective is to generate positive cash inflows → higher cash flows used to determine value in use

ED 127 in a nutshell

- Feasibility of one measurement approach in GRAP 21
  - GRAP 21 allows three measurement approaches
  - DRC mostly applied
- Board's view → retain all approaches as selection depends on
  - nature of impairment and data availability

ED 127 in a nutshell

- Feasibility of combining two Standards
  - request to combine Standards into one
  - easier to work with one Standard
- Board's view → no real reason to deviate from international practice therefore retain two Standards

ED 127 in a nutshell

- Addressing misconception from PIR
  - Assets usually impaired for minor damages with no significant impact on value or service potential of an asset
  - Proposal → clarify that assets are impaired when the impairment reflects a permanent or significant decline in value or service potential of asset

Respondents’ views on proposals

Board’s proposals in ED 127	Feedback from respondents
Simplify the impairment approach to make it clearer when an asset is CGA or NCGA.	General support for proposed amendments, but some issues raised (details provided in next slides)
Assess the feasibility of one measurement approach for NCGA in GRAP 21.	Respondents supported Board’s view not to eliminate the other two measurement approaches.
Assess the feasibility of combining the two Standards.	Respondents supported Board’s view not to combine the two Standards into one Standard.
Amendments resulting from post-implementation review.	General support for proposed amendments.

Key issues raised by respondents

1. Simplified approach is not practical.
2. Clarification needed on what is considered an asset level.
3. Presumption that all assets in public sector are NCGA.

Issue 1

- Respondents noted that:
  - the approach is impractical to apply and not clear enough to understand.
  - previous approach didn't clearly define when an entity is "generating a comm. return" but preparers are now familiar with concept.
  - use of "positive cash flows that are expected to be significantly higher than DRC" is a fluctuating measure which is inappropriate.
  - unclear that if positive cash flows and objective is service delivery then asset still is NCGA.

Board’s decision

- Proposed amendments were not approved
  - agreed in principle with approach
  - lack of clarity as to when and how entities should calculate DRC and positive cash inflows
- Resolution
  - re-introduce commercial return
  - redraft proposals so it’s clear what is meant by commercial return in the public sector

Revised proposal

- Combine simplified approach with concept of generating a comm. return:
  - CGA = “assets used with objective of generating a commercial return. Commercial return means that positive cash flows are expected to be significantly higher than the DRC of the asset”
- Aim to provide a better understanding of concepts applied in ED 127
- Develop a criteria-based assessment

Revised proposal

Re-introduction of concept requires these amendments to be made:

- definition of CGA.
- description or clarification of
  - commercial return
  - positive cash flows
- clarification that service delivery and generating a comm. return are not mutually exclusive.

Issue 2

- ED 127 clarified that assessment of asset as CGA or NCGA is done at asset level rather than entity level.
- Respondents noted that:
  - reference to asset level is not clear especially in the case of infrastructure assets.

Revised proposal

- Further clarification required to explain requirements are applied to individual assets or group of assets
  - group of assets are those that are part of a system or network as per GRAP 17.

Issue 3

- Notion applied in practice that all assets in p/sector are NCGA even if used to generate a comm. return
- Secretariat's view
  - notion is easy to apply for preparers
  - but is inappropriate to disregard the cash-generating potential of assets:
    - end result is that assets that are in fact CGA are impaired on the same basis as NCGA

Revised proposal

- Secretariat does not support the notion that all assets in p/sector are NCGA
  - but observed that there may cases where entities are unclear about whether they use assets to deliver services or generate a comm. return (dual purpose assets)
- If objective is unclear for dual purpose assets → default position is necessary
  - presumption is that overall objective is service delivery

Next steps

- Redraft proposed amendments in line with Board's recommendations
- Engage with relevant practitioners on proposals
- Board to debate the proposals at next meeting in July 2015
- If approved, issued as final amendments in 3rd quarter

ED 129 – Accounting by Principals and Agents

Development of the ED

- Discussion Paper developed
- ED 122 approved in March 2014
- Comment closed on 1 Sept 2014
- Key issues raised by respondents led to development of ED 129
  - approved for issue in December 2014
  - comment closed on 17 April 2015

Key issues raised by respondents

1. Level of assessment – activity versus transaction level.
2. Beneficial control – what if certain criteria not demonstrated.
3. Accounting requirements for receivables and payables – clarity needed.
4. Disclosures – clarity and additional disclosures identified.

Issue 1 – Level of assessment

- ED 122 required assessment of beneficial control at an activity level.
- Respondents noted that:
  - “activity” not well enough defined.
  - businesses not managed based on “activities”.
  - using “activities” may result in inappropriate accounting in instances.
  - “activities” undertaken on behalf of another raised issues public entities.

Issue 1 - Proposed amendment

- Change to a transaction-based assessment.
- Clear that transactions with third parties.
- Board had considered during development, but thought it may be too onerous.
- Proposed assessment for groups of similar transactions, not individual; only for those subject to principal-agent arrangement.

Issue 1 - Proposed amendment

- Implications of change:
  - More precise assessment.
  - No “beneficial control”, rather requirements to assess when an entity undertakes transactions for the benefit of another.
  - Changes in definitions of “principal”, “agent”, “principal-agent arrangement”.
  - Pervasive changes to ED 122.

Issue 2 – Beneficial control

- ED 122 proposed assessing whether an entity had beneficial control over an activity: If yes, principal, if no, agent.
- Respondents noted that if answered “no” to criteria, agent should not be in a position to demonstrate those aspects.

Issue 2 – Proposed amendment

- Test whether an entity is an agent. If not an agent, then by default principal.
- Test whether transactions undertaken for the benefit of another:
  - No power to determine significant terms and conditions.
  - No ability to use all, or substantially all, resources that result from transaction.
  - Is not exposed to variability in results of transaction.

Issue 3 – Accounting requirements

- ED 122 required the recognition of receivables and payables by an agent, under certain circumstances.
- ED 122 silent on how recognised and measured.

Issue 3 – Proposed amendment

- Indicates that the following apply
  - GRAP 23, 104 and/or 108 for recognising assets.
  - GRAP 19 and/or GRAP 104 for recognising liabilities.
  - Asset & liability recognised at same time, and same amount initially; subsequent apply relevant Standards.

Issue 4 – Additional disclosures

- Respondents noted concerns about the disclosure requirements for agents → do not provide sufficient information for accountability.
- Recommendation to add disclosures on revenues and expenses of “agency” transactions in notes.

Issue 4 – Proposed amendment

- Required disclosure in agent's financial statements of:
  - Nature of revenue and/or expenses received or accrued on behalf of principal.
  - Amount of revenue and/or expenses received or accrued on behalf of principal.
- Information should be available.

Purpose of ED

- How to identify in what role an entity acts?
  - When is an entity a principal?
  - When is an entity an agent?
- What is:
  - recognised
  - disclosed

  in the financial statements of either party?

Applicability of ED

When does this ED apply, and when should its principles be considered?

- Applies to principal-agent arrangements
- Consider before applying other Standards of GRAP

Principal-agent arrangement

- Results from a binding arrangement
- One entity [agent] acts on behalf, and for benefit of another entity [principal]
- In undertaking transactions with third parties

What is a principal?

- Entity that directs an agent
- Through a binding arrangement
- To undertake transactions with 3rd parties on its behalf and for its own benefit

What is an agent?

- Entity directed by a principal
- Through a binding arrangement
- To undertake transactions with 3rd parties on behalf of, and for benefit of principal

When is an entity a principal or agent in an arrangement?

- Assess whether transaction undertaken with 3rd parties is for benefit of another or for own benefit
- Based on rights and obligations specified in <u>binding arrangement</u>

Binding arrangement

- Arises from:
  - Contract
  - Legislation
  - Operation of law, including common law
- If not demonstrated by first three, look to past actions → no realistic alternative but to act
- May or may not use term principal and agent, or merely identify the parties in the relationship

Which entity benefits from transactions with 3rd parties?

- If entity undertakes transactions with 3rd parties for benefit of another → it's an agent
- If entity is not an agent → then by default it is principal

Criteria to be an agent

An entity is agent when it is able to demonstrate all 3 of the following, except in specific circumstances:

- it does not have the power to determine significant terms and conditions of transactions
- it does not have the ability to use all, or substantially all, of resources that result from the transaction for its own benefit.
- it is not exposed to variability in the results of the transaction.

Criteria to be an agent

- An entity needs to meet all three criteria, except if legislation or equivalent grants these specific powers to an entity.
- Typical examples include regulators, and others responsible for enforcement.
- May be linkages with the circumstances in which an agent recognises receivables and payables.

No power to determine significant terms & conditions

- Significant terms & conditions, i.e. those that affect the results of the transaction.
- Results = qualitative or quantitative.
- No power = cannot specify what goods and services should be provided, to whom, at what prices or what quality.
- Deferral of significant decisions to another = no power.

No ability to use resources

- All or substantially all resources that result from transactions with 3rd parties.
- Resources = receipts and disbursements for specific goods and services
- No ability use means do not have no unrestricted access to resources and cannot use resources for own benefit.
- Physical possession does not itself mean unrestricted access.
- Payment to Revenue Fund ≠ no ability.

No exposure to variability

- Economic benefits or service potential.
- Both positive and negative results.
- Factors limiting an entities exposure include:
  - another party is responsible for fulfilling rights and obligations in binding arrangement
  - entity has limited inventory risk
  - entity receives fixed fee/margin for undertaking transactions
  - entity is not exposed to significant risk of receipts or other charges not being by 3rd parties

Impact on financial statements

Principal

Recognise revenue and expenses arising from transactions with 3rd parties in an arrangement

Recognise assets and liabilities based on principles in other Standards

Agent

Recognise a portion of revenue and expenses received/ incurred for executing transactions on behalf of principal

Recognise assets and liabilities based on other Standards and Framework

Recognising assets and liabilities - Agent

May need to recognise assets held for the principal:

- Recognition of inventory + liability
- Recognition of cash + payable
- Recognition of receivables and/or payables

Recognising assets and liabilities - Agent

Recognition of receivables and/or payables:

- Specific rights and obligations in binding arrangement may give rise to recognition of receivables and payables.
- E.g. enforce collection, make payments (SARS, SASSA, others).
- Consider the following indicators:

Recognising assets and liabilities - Agent

- Debt is due to or by agent
- Legal right to enforce collection or obligation to settle
- Agent determine amount of receivable or payable based on policies of principal
- Agent determine manner and timing of settlement
- Agent can write off debts
- Agent has an obligation to undertake certain activities

Recognising assets and liabilities - Agent

- Asset & liability recognised at same time, and same amount initially; subsequent apply relevant Standards.
- Agent applies the following to recognise assets:
  - GRAP 23, 104 and/or 108
- Agent applies the following to recognise liabilities:
  - GRAP 19 and/or GRAP 104

Presentation

- No offsetting permitted unless permitted by another Standard of GRAP
- Comply with existing disclosure for revenue, expenses, assets and liabilities in other Standards of GRAP

Disclosure by agent

- Provide:
  - Description of resources (incl carrying value) held on behalf of principal (timing of remittances and risks transferred or assumed)
  - Aggregate revenue earned as compensation
  - Description of liabilities incurred and any corresponding rights of reimbursement
- Provide, if useful for assessing accountability:

Disclosure by agent

- Provide, if useful for assessing accountability:
  - Nature and type of revenue received/receivable on behalf of principal
  - Nature and type of expenses paid/accrued on behalf of principal
  - Amount of revenue received/receivable or expense paid/accrued on behalf of principal during reporting period – per type of revenue or expense

Disclosure by principal

- Resources under custodianship of agent and whether or not agent has recognised the resources and information on timing of flow of remittances back to entity or to 3rd parties
- Discussion of the resource or cost implications for the principal if the arrangement is terminated

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