ASB, NATIONAL TREASURY AND AGSA WORK TOGETHER TO IMPROVE FINANCIAL REPORTING

The state of the public sector’s finances has gained increased attention in recent times with the focus being on poor financial management, poor audit outcomes, and lack of service delivery. As the information in financial statements is a key mechanism used to hold officials accountable and to make decisions, there has been increased scrutiny of this information.

The Accounting Standards Board (ASB), the National Treasury and the Auditor-General of South Africa (AGSA) each have a key role to play in ensuring that the information in the financial statements is relevant to these assessments and decisions, and that the information is credible and reliable:

- the ASB sets the principles that entities’ should use to prepare their financial statements,
- the National Treasury facilitates the implementation of these principles by prescribing specific frameworks; and
- the AGSA expresses an opinion on whether entities’ financial performance, financial position and cash flows are fairly presented, using the principles prescribed by the ASB.

Although each party has a different mandate with respect to financial reporting in the public sector, each of these parties has an interest in improving financial reporting. While specific actions are undertaken individually to improve financial reporting, the ASB, National Treasury and OAG (referred to hereafter collectively as the “trilateral parties”) have agreed that a collaborative, co-ordinated approach in certain areas will have a greater impact. It is to this end that the three organisations have worked together to address issues identified by stakeholders in the ASB’s post-implementation review of the Standards of GRAP on Investment Property and Property, Plant and Equipment.

What we heard as part of the review

The ASB completed its first post-implementation review of selected Standards of GRAP in March 2014. The focus of the review was on the asset-related Standards as the AGSA’s general reports had identified this an area where significant improvement is required.

The objective of the post-implementation review was twofold: to assess whether relevant information is being provided to users of the financial statements to hold officials accountable and to make appropriate decisions; and to understand the key challenges preparers face in applying the requirements of the Standards. The detailed results of the post-implementation review, including the users and preparers consulted, are available on the ASB’s website www.asb.co.za.

The results of the post-implementation review, generally, indicated support for the Standards and confirmed the relevance of the information in the financial statements that result from applying the Standards. While the adoption of Standards of GRAP was characterised as successful, challenges remain.
Working together to respond to feedback received as part of the review

Do users get the information they need from the financial statements?

The first question the post-implementation review aimed to answer is “Do users get the information they need from the financial statements”? The requirements of the Standards are designed to provide users of the financial statements with relevant information for accountability and decision-making purposes. Users broadly comprise those that provide resources to public sector entities, e.g. taxpayers, lenders, creditors, and those that receive the services of the public sector (as well as those elected individuals that represent the interests of either of these groups).

While users found the information useful, they indicated that the following improvements could be made:

Issue #1 – Clear alignment between strategy, budget and financial statements

- There should be clearer alignment between how information is presented and classified in the strategy, budget and financial statements so that greater scrutiny can be exercised on what entities planned to do, what resources were made available to meet these plans, and how those resources were ultimately utilised and what was delivered.
- The trilateral parties have added a specific project to their collective strategy to deal with aligning the requirements.

Issue #2 – Educating users on the financial statements

- The Standard, and as a result, the financial statements use terminology and jargon that is not well understood by all users. More should be done to explain the requirements of the Standards simply, and to educate users on how the information in financial statements should be used.
- The trilateral parties, both individually and jointly, have embarked on various initiatives to educate users about the role of financial statements and how they should be used through APAC, MPACs, and partnering with organisations such as IMFO and SALGA.

Issue #3 – More information on capital work-in-progress

- More comprehensive information is necessary on capital work-in-progress reflected by entities. Users noted that significant amounts of money are spent on constructing assets, but it is unclear what assets are being constructed, and why there is often little movement from assets being under construction to being completed.
- The ASB has amended the asset-related Standards to require entities to disclose information about the nature of the assets being constructed, situations where the construction of assets is taking longer than anticipated to complete, and where the construction of assets has been halted. This information will be required for the 16/17 reporting cycle.

Issue 4 – Information on repairs and maintenance
• Information is needed on repairs and maintenance incurred by entities so that an assessment can be made of whether adequate resources are being spent on existing assets.

• The ASB has amended selected Standards to require the disclosure of repairs and maintenance in the notes to the financial statements to enable this assessment. This information will be required for the 16/17 reporting cycle.

Are preparers able to prepare the financial statements in accordance with the requirements in the Standards?

The second part of the review aimed to identify challenges that preparers face in the ongoing application of the Standards.

While preparers indicated that they have broadly been able to implement the requirements of the Standards, ongoing application issues have been identified. These include:

(a) Classifying land and buildings held by entities as property, plant and equipment or investment property can be difficult, particularly when a fee is received for the use of such properties.

(b) The assessment of the useful lives and residual values of assets at each reporting date is onerous given the nature and volume of the assets held by entities.

(c) The type of expert necessary to measure assets in accordance with the Standards, including testing whether assets are impaired.

(d) The accounting for land, specifically the recognition and derecognition of land and whether this should be based on legal title or control.

(e) The accounting for housing schemes, in particular establishing requirements to ensure consistency across entities.

For (a), the ASB has provided additional guidance in the relevant Standards clarifying the application of the definitions, for (b) the ASB has simplified the requirements by introducing an indicator-based assessment, and for (c) the relevant wording in the Standards amended to make it clear that an entity may use an independent expert, or an internal expert competent to undertake valuations in accordance with the Standards. These key amendments have been approved by the ASB, and are effective from 1 April 2016.

The ASB has added projects on its work programme to address (d) and (e) above to provide guidance on the accounting for land and housing arrangements. The AGSA and OAG have actively participated in the research work already undertaken in these areas.

Preparers highlighted practical issues where standardised guidance is needed. These areas include providing guidance on the classification or expenditure as repairs and maintenance, standardising the components of assets, and rates for determining replacement cost. The OAG has embarked on a project to develop guidance in these areas.

Preparers also noted challenges experienced in the auditing of certain asset-related issues. These centred on the nature, type and sufficiency of audit evidence to support entities' assessments of the useful lives, residual values, impairment, as well as demonstrating the completeness of assets. Other issues were raised about the use of experts to undertake valuations and other assessments and whether they are required to be used.

The AGSA also issued additional guidance to its auditors on the "auditing of infrastructure assets" to address the issues raised by preparers. The guidance provided aimed to clarify
the requirements of the Standards, and to provide an indication of the procedures that should be performed by auditors. It is also anticipated that the guidance being developed by the OAG will assist in finding common ground and understanding between preparers and auditors on the accounting for infrastructure assets.

**Way forward**

Strengthening financial management in the public sector to facilitate holding entities accountable and facilitating better decision-making is at the core of the mandates of the ASB, the OAG and AGSA. It is thus critical that the trilateral parties work together to facilitate such an environment. The effectiveness of the measures implemented will be assessed to determine if they have had the desired outcomes.

For further information or questions please contact Jeanine Poggiolini at the ASB.