

[DEVELOP PUBLIC SECTOR]

What does the future hold for government business enterprises in South Africa?

INTRO

Tsholo Tshoke investigates the application of Standards of Generally Recognised Accounting Practice to government business enterprises

[END INTRO]

A number of issues have been raised, both locally and internationally, in the last few years about appropriate reporting frameworks for government business enterprises (GBEs), the entities listed in Schedules 2, 3B and 3D of the Public Finance Management Act 1 of 1999, as amended (PFMA).

Locally, many argue that GBEs should apply the same reporting framework as other public sector entities, for the following reasons:

- Many GBEs do not generate a profit and are dependent on government funding for their operations.
- Some GBEs only have other public sector entities as their customers.
- The users of GBE financial statements are similar to those of other public sector entities.
- Complexities arise when consolidating GBEs at national and provincial levels, including the skill and capacity required to deal with different reporting frameworks.

Given these issues, and the withdrawal of the Statements of Generally Accepted Accounting Practice (Statements of GAAP) for financial years commencing on or after 1 December 2012, the Accounting Standards Board initiated a research project to determine which reporting framework is most appropriate to meet the needs of the users of GBEs: Standards of Generally Recognised Accounting Practice (GRAP) or International Financial Reporting Standards (IFRSs).

Pending the results of the research project, the Board agreed that GBEs should retain the *status quo* regarding the reporting frameworks applied in preparing their financial statements. This meant that those GBEs that applied Statements of GAAP in previous reporting periods would continue to do so, while those that applied IFRSs in previous reporting period, would continue to apply IFRSs.

The research project considered the practices adopted by international standard-setting bodies and the feedback obtained from the users and preparers of financial statements of GBEs. In most countries GBEs apply either local GAAP or IFRSs but there is currently no research or conceptual basis for the split.

The International Public Sector Accounting Standards Board (IPSASB) also recently started a project to explore the reporting framework to be applied by GBEs based on their characteristics.

As guidance in South Africa is more urgent, and due to the fact that the IPSASB's project is in progress, the ASB will continue with its own project while monitoring future developments in the IPSASB to assess its impact on local GBEs.

Legislative conflicts with GBEs were revealed during the consultations with preparers and users. These included the definition of GBEs in the PFMA and the classification of GBEs in the schedules of the PFMA.

Many GBEs rely on government funding which contradicts the requirement in the definition of GBEs that they should not be financed by government.

The classification of entities in the PFMA schedules is inappropriate, in some cases, as not all GBEs carry on a business activity as defined in the PFMA. While these conflicts are of concern, the Board agreed not to address them as the National Treasury and the Department of Public Services and Administration have embarked on a project to deal with these issues.

The results of the research undertaken and the feedback obtained assisted the ASB in making a decision about the appropriate reporting framework that should be applied by GBEs in preparing their financial statements.

In arriving at this decision, the Board considered three options:

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

In the first option the Board considered whether a blanket approach should be adopted whereby all public sector entities would apply Standards of GRAP.

This approach assumes that the financial statements prepared using the Standards of GRAP will provide better information compared to IFRS. The Board argued that it would be difficult to justify this approach, as there are exceptions to the assumption.

It concluded that its decision should be based on the objectives of entities. Entities aimed at generating a commercial return (that is, those with a profit objective) should apply IFRSs, while those with a social objective should apply Standards of GRAP.

The Board agreed that the first option would not suffice given the dissimilar objectives of public sector entities.

The second option is a pragmatic approach which might be flawed as it relied on the PFMA schedule classifications which some preparers believe are incorrect.

Since the Board has no authority to reclassify entities that have been inappropriately classified in the PFMA, it was agreed that entities that do not agree with their current classification in the PFMA could follow existing National Treasury processes to either request a reclassification or apply for an exemption from the prescribed reporting framework.

The third option is principle-based and a conceptually pure option. The Board believed, however, that this option might be difficult to develop and apply. As a result, it was agreed that the pragmatic approach should be adopted in the short term. Consequently the Board proposed that Schedule 2 entities should apply IFRSs while Schedule 3B and 3D entities should apply Standards of GRAP.

This proposal is set out in the Exposure Draft on the proposed Directive on *The Application of Standards of GRAP to Government Business Enterprises (Schedule 3B and 3D)*. The objective of the proposed directive is to outline the reporting framework and the transitional provisions to be applied by GBEs (Schedules 3B and 3D).

The Board has published this Exposure Draft on its website <http://www.asb.co.za/> and encourages those with an interest in public sector financial reporting to comment before 29 August 2014.

Tsholo Tshoke CA(SA) is a project manager at the Accounting Standards Board