Reporting framework debate continues

The Accounting Standards Board proposes alternative reporting frameworks for major public entities and Government Business Enterprises to give effect to the constitutional mandate of a uniform reporting framework for all entities in the public sector.

The Accounting Standards Board (the Board) is yet to make a final decision about the reporting framework to be applied by government business enterprises (GBEs) locally. To date the Board has undertaken two consultations on the appropriate reporting framework for GBEs, and both consultations yielded mixed reactions. As a result, the Board has changed its approach to one that is more principles-based to ensure a long term solution for GBEs.

The Board's initial proposals in Exposure Draft 124

Given the impending withdrawal of Statements of Generally Accepted Accounting Practice (Statements of GAAP) during 2012, the Board initiated a research project to determine which reporting framework best satisfies the information needs of the users of GBEs: Standards of GRAP or International Financial Reporting Standards (IFRSs). The Board agreed that until the completion of the project, GBEs would continue to apply either:

(a) Statements of GAAP, as codified by the Accounting Practices Board (APB) and issued by the South African Institute of Chartered Accountants (SAICA) at 1 April 2012; or
(b) IFRSs published by the IFRS Foundation for those GBEs applying IFRSs.

The outcome of the research project was the development of the Board's first proposal in the Exposure Draft on the proposed Directive on *The Application of Standards of GRAP to Government Business Enterprises (Schedule 3B and 3D)* (ED 124). In that Exposure Draft issued for comment in May 2014, the Board considered three options:

- *Option 1: All public sector entities should apply Standards of GRAP.*

  Under this option, the Board considered whether all public sector entities should apply Standards of GRAP, but argued that this option is inappropriate and should be informed by the business objectives of entities. For example, entities which operate to generate a commercial return should apply IFRSs, while those with a social objective should apply Standards of GRAP.

- *Option 2: The reporting frameworks applied by entities should be based on the classifications in the schedules of the Public Finance Management Act 1 of 1999, as amended (PFMA).*

  This option relied on the classifications in the schedules of the PFMA. Under this option, entities listed in schedule 2 of the PFMA would continue to apply IFRSs in preparing their financial statements, while those listed in schedules 3B and 3D would apply Standards of GRAP.

- *Option 3: The reporting frameworks applied by entities should be based on a set of principles.* This option required development of principles that would enable entities to make their own determination of the appropriate reporting framework. Given the urgency of the project, the Board concluded that it would not be possible to develop such principled approach in a short period of time.

The Board was of the view that option 2 was the best way forward because it was the most pragmatic option. Consequently, the Board proposed in ED 124 that schedule 2 entities should apply IFRSs, while schedule 3B and 3D apply Standards of GRAP.

An analysis of the comments received from constituents revealed mixed views from those that participated in the comment process. The preparers of financial statements of GBEs preferred option 1 where all entities in the public sector would apply a uniform reporting framework. On the other hand, the users of the financial statements of GBEs supported the Board's proposal under option 2. Option 3 was the least supported by constituents. Those who did support this option noted that a set of principles would enable entities to make their own assessment of which reporting framework was appropriate for them, rather than the Board deciding on a framework that is based on classifications, in the schedules of the PFMA, that may change over time.

Preparers who supported option 1 indicated their dissatisfaction with option 2. Some of the reasons noted by preparers as to why schedule 3B and 3D entities should not apply Standards of GRAP included:

- Some GBEs have been misclassified in the schedules of the PFMA.
- GBEs' mandates, and as a result their activities, are not aligned with the objectives of those entities that apply Standards of GRAP.
- GBEs are funded differently to those entities that apply Standards of GRAP.
- GBEs would be unable to attract and retain suitably qualified staff.
- A change in reporting framework should only be done after the reclassification of entities in the PFMA schedules has been completed.
- Specific legislation or equivalent may require the application of another reporting framework for entities that undertake certain activities.

Development of the Board's current Exposure Draft

At its Board meeting held in December 2014, the Board considered if a uniform reporting framework should be applied by all public sector entities. However, the Board had its reservations about this option. While consideration of a uniform approach responds to the request from constituents, the Board noted that it would be met with resistance by some entities, such as the major public entities listed in schedule 2 of the PFMA. Constituents in their support for option 1 also suggested that exemptions should no longer be granted by the National Treasury, as this will enhance uniformity in the public sector. This would however take away the National Treasury's power to grant exemptions as allowed in section 79 of the PFMA. Given the diverse nature of the business activities undertaken by entities, and the regulated sectors in which some entities operate to deliver on their mandates, the Board agreed that it may be appropriate for some GBEs to apply IFRSs.

After consultation with the National Treasury and based on legislative prescripts, the Board came to the conclusion that public entities should apply generally accepted accounting practice (which is determined to be IFRSs) when certain criteria are met. These criteria are outlined in the Exposure Draft of the proposed Directive on *The Selection of an Appropriate Reporting Framework by Public Entities* (ED 130). The objective of ED 130 is to prescribe the criteria to be applied by public entities listed in schedules 2 and 3 of the PFMA in selecting and applying an appropriate reporting framework.

Unlike option 2 in ED 124, the proposed criteria consider the nature of entities' operations and their funding, and also who the users of the financial statements are likely to be and their information needs. The proposed criteria require entities to perform a self-assessment of whether they should apply IFRSs, based on whether they satisfy the following:

(a) the entity is a financial institution;

(b) the entity has ordinary shares or potential ordinary shares that are publicly tradable on capital markets; or

(c) only an insignificant portion of the entity's funding is acquired through government grants or other forms of financial assistance from government, and its operations are such that they are commercial in nature.

Therefore, if entities do not meet these criteria, then they should apply Standards of GRAP. Entities listed in schedules 3A and 3C of the PFMA will continue applying Standards of GRAP, as the Board has already approved Standards of GRAP to be their reporting framework.

As ED 130 introduces a new reporting framework into the public sector for public entities, the previous exemptions issued by National Treasury will no longer be valid. Since the purpose of the proposed Directive is to allow entities to perform a self-assessment to determine the reporting framework most appropriate for them, the Board anticipates that the self-assessment may negate the need for an exemption process. In terms of the PFMA, the National Treasury retains the authority to provide exemptions.

Request for comment

The Board has published this Exposure Draft on its website http://www.asb.co.za/ in February 2015, and encourages those with an interest in public sector financial reporting to comment before 12 June 2015.

The Board intends that the future process of selecting an appropriate reporting framework should be more principles-based, transparent, credible and consistent. As entities will perform a self-assessment to determine which reporting framework should be applied by them going forward using the criteria in the proposed Directive, the Board needs to understand the implications of this approach on each entity. Face-to-face consultation sessions with the Secretariat of the Accounting Standards Board

(ASB) are planned during the exposure period, to afford entities an opportunity to present and demonstrate whether the proposals in this proposed Directive can be applied, and the conclusions reached in applying the criteria outlined in the proposed Directive. Specific consideration will be given to the assumptions made by entities in determining the appropriate reporting framework. A registration form is available on the ASB's website, where entities can book their preferred date and time-slot to present their findings.

Feedback from this consultation process, and the responses received to ED 130 will be considered by the Board at its next meeting in July 2015.

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