ACCOUNTING STANDARDS BOARD

SUMMARY OF RESULTS OF THE GBEs PROJECT

Issued October 2016

BACKGROUND

1. During 2012, the Board agreed to initiate 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). This project was necessitated by the withdrawal of Statements of Generally Accepted Accounting Practice (GAAP), effective for financial years commencing on or after 1 December 2012.

2. The Secretariat initiated a research project which led to the development of two Exposure Drafts, the proposed Directive on *The Application of Standards of GRAP by Government Business Enterprises (Schedule 3B and 3D)* (ED 124) that was followed by the proposed Directive on *The Selection of an Appropriate Reporting Framework by Public Entities* (ED 130), issued in May 2014 and February 2015 respectively.

3. This report has been prepared by the Secretariat. Its main objective is to highlight the consultations undertaken, key decisions made by the Board, as well as the outcomes of the GBEs project. The report is set out in three parts to reflect the three consultation processes undertaken by the Board:

   - Part A: Research phase
   - Part B: Development phase - initial proposal
   - Part C: Development phase - final proposal
   - Part D: Pre-implementation phase

4. Each part provides an overview of the consultation process; a summary of the most significant issues raised by respondents; and how the Board responded to those issues.

5. The detailed written and verbal comments received as part of the project, along with the Board's responses thereto, have been published with the relevant consultation document and/or Exposure Draft on the ASB's website.

PART A – RESEARCH PHASE

6. This part of the report outlines the initial phase of the project.

Background

7. During 2002, when the Board initially determined the application of the Standards of GRAP, the issue of the appropriate reporting framework for GBEs arose. At that time, the Board had not developed a full suite of Standards of GRAP so the only appropriate reporting frameworks to be considered by the Board were Statements of GAAP, IFRSs or IPSASs. Internationally, the IPSASB had concluded that GBEs should apply IFRSs rather than IPSASs, as indicated in the *Preface to International Public Sector Accounting Standards*. In the light of the international decision made for GBEs, the Board was of the view that activities of GBEs were more comparable to entities with a

profit motive. Accordingly, the Board approved Statements of GAAP for GBEs, and with the approval of the Accountant-General, some applied IFRSs. This approach is outlined in the *Preface to the Standards of GRAP*.

8. Over the years, the appropriateness of the current reporting framework for, and the definition of, GBEs has been questioned both locally and internationally.

9. Locally, many expressed the view that GBEs should apply the same reporting framework as other public sector entities as:
    - many GBEs do not generate a profit, are dependent on government funding to fund their operations, and 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; and
    - entities responsible for oversight did not have the skill and capacity required to deal with different reporting frameworks.

10. The Financial Reporting Standards Council (FRSC) was established with the promulgation of the new Companies Act in 2008. It was agreed that the FRSC would take over the functions of the Accounting Practices Board (APB) (which codified Statements of GAAP that the South African Institute of Chartered Accountants (SAICA) issued). As a consequence, the FRSC determined that Statements of GAAP would be withdrawn for financial years commencing on or after 1 December 2012.

11. Internationally, questions were being raised about the definition of GBEs, and more specifically how to define which entities should apply IFRSs or IPSASs. As a result, the IPSASB added a project to its work programme to address the issues it identified with the definition of GBEs.

12. Based on the issues observed and the withdrawal of Statements of GAAP, the Board agreed to initiate a research project to determine the most appropriate reporting framework that best satisfies the information needs of users of GBEs.

13. The decision by the FRSC meant that the Board could no longer prescribe the application of Statements of GAAP by public entities. As an interim measure, it was agreed at the November 2012 meeting, that until the Board completed its research project, GBEs should continue to apply either:
    - Statements of GAAP, as codified by the APB and issued by SAICA as at 1 April 2012; or
    - IFRSs published by the IFRS Foundation for those GBEs already applying IFRSs.

Objective of this phase of the project

14. The objective of the research project was to solicit feedback from the users of the financial statements of GBEs to determine which reporting framework best satisfies the information needs of the users of GBEs financial statements: Standards of GRAP or IFRSs.

15. The research project and the Board's ultimate decision impacted the following public entities:

Public Entities	No. of entities applying IFRS	No. of entities applying SA GAAP
Schedule 2	17	4
Schedule 3B	16	10
Schedule 3D	-	16

Overview of consultations undertaken

Methodology

16. The research was conducted in the form of a desktop review, and interviews and workshops with the users and preparers of financial statements.

Desktop review

17. Financial statements of the Schedule 2, 3B and 3D entities were reviewed to identify the stakeholder groups that should be consulted, and a stakeholder consultation plan was developed.

18. Key stakeholders identified in the consultation plan included oversight committees, relevant executive authorities, the National Treasury and Provincial Treasuries, the public, funders and financial supporters, economic and financial analysts, and senior management.

Questionnaires for users and preparers

19. A consultation document and questionnaire were compiled which were circulated to the users of the financial statements of GBEs to obtain written input on specific areas. The comment date for the consultation document closed on 30 September 2013.

20. Although the primary focus of the research project was to obtain feedback from the users of the financial statements, the Board agreed to develop another questionnaire aimed at the preparers of financial statements. The comment date for input on this questionnaire closed on 28 February 2014.

21. A total of six written responses were received from users, and four written responses were received from preparers.

Face to face consultations and workshops

22. Direct face-to-face meetings were held with internal users, external users with an oversight role, other users, and preparers between August 2013 and mid-March 2014.

23. The outcome of the consultations is summarised in the Table 1 to Table 4 of the Annexure.

Summary and analysis of comments received - users

24. This section of the report highlights key points raised by respondents from the questionnaires received, and verbal comments provided by respondents during consultations.

25. Consultations with users focused on understanding the information needs of the users when considering the information in the financial statements of GBEs. Additionally, users were requested to indicate which reporting framework they thought would be appropriate for GBEs in general or their specific GBE.

Understanding the information needs of users

26. The Board noted that financial statements of GBEs were used for various purposes. From the engagements undertaken, it was noted that the use of the information in the financial statements is driven by the primary role of the user. For example, a user that undertakes a shareholder oversight role is more interested in information that will enable it to assess the GBEs sustainability and performance against targets. Other users may look for more detailed operational information that is linked to specific projects, which may not be included in the financial statements; whilst others are interested in key performance indicators.

27. The feedback received from funders and financial supporters indicated that their information needs will still be met should there be a change in the reporting framework of GBEs. In addition, several users also indicated that where information is not readily available from the financial statements, they refer to other sources such as integrated reports.

28. The Board concluded that the framework applied is not a primary factor for most users, and as such, a change in the reporting framework of GBEs would not impact the information needs of users.

Appropriate reporting framework for GBEs

<u>Comments</u>

29. The Board requested stakeholders to indicate which reporting framework they believed is appropriate for GBEs in general. The users' views in this regard were mixed. The responses are summarised in the table below.

Response	**Rationale**
Schedule 2 entities should apply IFRSs	• Entities benchmarked against international companies that are not state-owned. • IFRSs provide a platform for comparability with competitors. • Funding sourced from capital markets due to extensive capital requirements. • Conversion to GRAP is not cost effective given limited public sector specific transactions undertaken.

	• International investors and funders may not fully understand the differences between GRAP and IFRSs.
Schedule 3B and 3D entities should apply IFRSs	Investors and rating agencies understand IFRSs. Appropriate reporting framework is IFRSs, if entity has publicly traded debt.
Schedule 3B and 3D should apply GRAP	• If all Schedule 3 entities applied GRAP, consolidation complexities will be minimised and comparability enhanced. • GRAP improves accountability. • GRAP more appropriate for Schedule 3B and 3D than Schedule 2 entities as their mandates are narrower.
General recommendations	Primary focus of Board's project should be to determine an appropriate reporting framework for Schedule 3B and 3D entities. The impact is that Schedule 2 entities continue to apply IFRSs and should be excluded from the scope of the project.
	If the Board's decision is that GBEs apply Standards of GRAP; it is recommended that these entities include reconciliations from GRAP to IFRSs, where possible, in their financial statements.
	Board requested to consider establishing additional disclosure requirements on assets, including financing and the generation of cash flows and returns by classes of assets. This matter is consistent with the findings from the post-implementation review.

Summary and analysis of comments received - preparers

30. Some respondents supported the view that the Board determines the appropriate framework for the Schedule 3B and 3D entities, while Schedule 2 entities continue applying IFRSs. The preparers' views on the appropriate reporting framework are summarised in the table below.

<u>Comments</u>

Response	Rationale
Schedule 2 entities should apply IFRSs	Schedule 2 entities retain IFRSs as their reporting framework and should be excluded from the scope of the project.
Schedule 3B and 3D entities should apply IFRSs	• GBEs operate a self-sustaining model and exist to carry out business activities despite their current financial challenges. For instance, water boards have a dual mandate and do not rely on government funding to maintain operations or pursue growth. • Activities of water boards cannot be equated to those of municipalities and they should apply IFRSs. • Activities of development finance institutions (DFIs) are similar to financial services institutions - applying GRAP reduces comparability

	with their peers. • Preparers are generally not familiar with GRAP, and therefore have more confidence in IFRSs. • Preparers have a limited understanding of the differences between GRAP and IFRSs. • Conversion to GRAP will be an administrative burden to staff with adverse effects on capacity and skills, as well as financial implications for entities. • Lack of clarity in the legislative requirements in relation to the reporting framework for GBEs. • A reporting framework other than IFRSs may impact investor confidence as investors and funders are not familiar with GRAP.
Schedule 3B and 3D should apply GRAP	• IFRSs are more complex and usually requires entries and disclosures that are not required by users of public sector entities, or does not provide useful information to users. • GRAP is more appropriate if GBEs are primarily funded by way of government budget allocations and where the core mandate is service delivery. • Stakeholder departments are often ill equipped to perform their oversight function, because they do not have adequate knowledge of IFRSs. • IFRSs reporting may result in overstating of returns on assets.
General recommendations	The Board to consider the nature of the services provided by a GBE, and its need to be competitive when assessing the appropriate reporting framework. Thus those entities whose performance is assessed based on the ability to generate sustainable returns should apply IFRSs, while those that are assessed on their ability to deliver government programmes to the public should apply Standards of GRAP.

Observations from international practice

International practice - IPSASB

31. At the time of the research, the Board noted that internationally, the reporting framework for GBEs was also being questioned. The IPSASB agreed to add a project to its work programme to explore the definition of GBEs and the reporting framework they should apply.

32. The development of a draft Consultation Paper was in progress when the Board undertook its initial research project. In the Consultation Paper the IPSASB explored two main approaches for dealing with the issue of GBEs and their reporting framework. In the first approach, the IPSASB proposed outlining characteristics of public sector entities that are in, or out, of the scope of IPSASs as opposed to formally defining GBEs. In the second approach, the IPSASB proposed defining GBEs with some modification to the existing definition. The IPSASB's preliminary view favoured the first approach.

33. Given the urgency of the Board's own project, and due to the fact that the IPSASB had only recently started with its project, the Board agreed to continue with its own project as planned. The Board agreed to monitor developments in the IPSASB's project and assess the impact of the proposed amendments on GBEs in South Africa.

International practice – other standard setters

34. As part of the research project, requests for information were sent to other standard setters in the United Kingdom, Australia, New Zealand, United States of America and Canada, to ascertain if they have undertaken any research on the appropriate reporting framework for GBEs.

<u>Comments</u>

35. In most countries, GBEs apply either local GAAP or IFRSs. There is however no conceptual basis for the split. At the time of the consultation, the Governmental Accounting Standards Board (GASB) had received a request that more GBEs should be permitted to use US GAAP, developed by the Financial Accounting Standards Board (FASB). The reason for the request is that financial statements prepared using FASB standards are deemed more transparent as the framework requires recognition of post-retirement obligations and, in general, had improved disclosure.

<u>Analysis</u>

36. The Board observed that in South Africa, financial statements prepared using Standards of GRAP provide more relevant information regarding service delivery in the public sector than those using IFRSs, and therefore the view regarding GASB standards does not hold in South Africa. For instance, IFRSs permits offsetting of government grants against the assets acquired, which is not permitted using Standards of GRAP. Where IFRS-permitted offsetting has occurred, returns on infrastructure appear higher, because the disclosed asset base is lower.

Way forward

General

37. The Board noted that the feedback received from users and preparers was influenced by their familiarity with the existing reporting framework. The general support for IFRSs was attributed to respondents' limited experience and knowledge of GRAP as a reporting framework.

38. The research revealed to the Board the limited exposure that users and preparers had to Standards of GRAP, and that this swayed the discussions in one direction. As a result, respondents could not only provide balanced feedback based on what they considered to be an appropriate reporting framework.

39. While most believed IFRSs to be the most appropriate reporting framework for Schedule 3B and 3D entities, the Board was of the view that these entities are no different from other public sector entities established to fulfil a range of objectives. The feedback from local funders, investors and rating agencies suggested that these users

were not concerned about the reporting framework that an entity applies, and in the Board's view, the providers of funding will not be influenced by the reporting framework.

Appropriate reporting framework for Schedule 2 entities

40. With respect to proposals to the Board to scope out Schedule 2 entities from the project, the Board concluded that, since these entities are known to raise funds internationally and to compete with, and are benchmarked against international companies, applying Standards of GRAP may be inappropriate.

Appropriate reporting framework for Schedule 3B entities

41. A number of entities listed as Schedule 3B entities are water boards. It was noted that the users of their financial statements are mainly the Department of Water and Sanitation, municipalities and the National Treasury.

42. These GBEs raise external funding but only on a national scale, with no international fund raising. Users expressed the view that these entities with nationally significant infrastructure have implicit guarantees that government will provide financial assistance if they experience financial difficulties.

43. The Board was of the view that these entities should use Standards of GRAP as a reporting framework, as it will enhance comparability with other public sector entities, and the same reporting framework will be applied when preparing consolidated financial statements. The departments that they are accountable to would also only need to understand a single reporting framework and the need for additional skills regarding IFRSs will be limited.

Appropriate reporting framework for Schedule 3D entities

44. These provincial GBEs are under the control of the provincial departments. Currently, they are not permitted to issue publicly traded debt. The Board's view was that provincial departments do not have the capacity and skills to support two different reporting frameworks. Furthermore, if a GRAP reporting framework is used it will facilitate provincial consolidations.

45. A number of practical challenges relating to the application of SA GAAP or IFRSs by GBEs were observed by the Board:
    - the use of a reporting framework other than GRAP creates complexities when preparing consolidated financial statements;
    - departments may have insufficient capacity to deal with the different reporting frameworks applied by different entities under the control of various departments: Schedule 3A and 3C apply GRAP whereas Schedule 3B and 3D apply SA GAAP or IFRSs; and
    - it is costly to develop and maintain appropriate financial systems for both reporting frameworks.

46. Thus, the Board concluded that if all Schedule 3 entities apply Standards of GRAP, this would alleviate many of the practical challenges currently experienced. As a result, the Board agreed, at its March 2014 meeting, that all Schedule 3B and 3D GBEs should apply Standards of GRAP, while Schedule 2 entities could apply IFRSs.

PART B – DEVELOPMENT PHASE: INITIAL PROPOSAL

47. The outcome of the research project was the development of an Exposure Draft of the proposed Directive on *The Application of the Standards of GRAP to Government Business Enterprises (Schedule 3B and 3D)* (ED 124).

Board's considerations when developing the initial proposal

48. In developing the ED 124, the Board considered the following 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 of entities in the schedules to the PFMA; or

Option 3: The reporting frameworks applied by entities should be based on a set of principles.

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

49. The first option adopted a uniform approach where all public sector entities apply Standards of GRAP. The approach assumed that the financial statements prepared using Standards of GRAP provide better information compared to IFRSs. The Board had its reservations about this assumption noting that there are always exceptions.

50. The Board concluded that ultimately its decision should be informed by the objectives of entities: entities with a profit motive should apply IFRSs, while those with a social objective should apply Standards of GRAP. As a result, the Board agreed that the first option is inappropriate given these differing objectives.

Option 2: The reporting frameworks applied by entities should be based on the classifications in the schedules of the PFMA

51. The second option was a pragmatic approach which made use of the classifications in the schedules to the PFMA. The users and preparers consulted recommended that the Board consider separating the entities listed in Schedule 2 from those listed in Schedules 3B and 3D when making its decision. The Board therefore proposed that entities listed in Schedule 2 should apply IFRSs while those listed in Schedule 3B and 3D should apply Standards of GRAP.

52. In considering the second option, the Board noted that the research highlighted conflicts within legislation governing GBEs, particularly in the definition of GBEs and their classification in the schedules to the PFMA. Many GBEs rely on government funding which contradicts the definition of GBEs which indicates that GBEs should not be substantially financed by government. It was also noted that, some entities may have been classified incorrectly, while others did not carry on a business activity.

While these difficulties were of concern, the Board noted that the National Treasury and Department of Public Service and Administration had embarked on a project to review the listing of public entities and the classification system. The National Treasury also instituted processes to enable entities that believed they were incorrectly classified to either request a reclassification or apply for an exemption from the prescribed reporting framework.

Option 3: The reporting frameworks applied by entities should be based on a set of principles

53. The third option was to develop principles that entities could be applied in determining the appropriate financial reporting framework. The Board believed that it was not possible to develop such principles in the short term.

54. The Board was of the view that option 2 was the best way forward even though it was a more pragmatic approach. The Board therefore proposed that entities listed in Schedule 2 should apply IFRSs while those listed in Schedule 3B and 3D should apply Standards of GRAP. The proposal was also informed by the feedback from stakeholders during the initial consultations, who recommended that the Board consider separating the major public entities listed in Schedule 2 from those entities listed in Schedules 3B and 3D when making its decision. It is for this reason that the Board sought comment from the Schedule 3B and 3D entities and not Schedule 2 entities, when the ED was published.

55. ED 124 outlined the reporting framework and transitional provisions to be applied by GBEs listed in Schedule 3B and 3D of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA).

Overview of consultations undertaken

56. ED 124 was issued for comment in May 2014. The comment period ended on the 29th of August 2014.

57. A total of 15 comment letters were received through the formal comment process. Comments received from nine respondents representing preparers did not support the Board's proposal for option 2. The rest of the comments received from respondents, which represented a range of users, supported the Board's proposal.

58. The ED was also discussed at two roundtable discussions, one held with the Public Sector Accounting Forum, and one with preparers.

59. The outcome of the consultations is summarised in the Table 1 to Table 4 of the Annexure.

Summary and analysis of comments received

60. The feedback from the consultation process was inconclusive. Preparers indicated no support for option 2, while users agreed with the Board's proposal. Respondents also indicated little support for option 3.

61. Given the unfavourable support indicated by preparers, a follow up roundtable discussion with the preparers was held in October 2014. The purpose of the roundtable discussion was to understand the basis of the objections to option 2 as noted in their comment letters. At this discussion, preparers came to the conclusion that all entities should be treated the same, and should all be required to apply the same reporting framework i.e. option 1.

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

Comments

62. Preparers noted their dissatisfaction with option 2 on the basis that it discriminates between Schedule 3B and 3D entities and Schedule 2 entities. They believed that Schedule 3B and 3D entities should apply the same reporting framework as the Schedule 2 entities as they were also established to carry out activities with a profit motive and to be self-sustaining. Some argued that, in some instances, Schedule 3B and 3D entities were more sustainable than some of the Schedule 2 entities because they operated with independently from government. The Board's conclusion that IFRSs are appropriate for Schedule 2, entities but not for Schedule 3B and 3D entities, was questioned.

63. Preparers preferred option 1 over option 2 because it did not rely on the existing classifications in the schedules to the PFMA. Preparers were concerned that, because of the errors in the classification in the schedules to the PFMA, entities may apply an inappropriate reporting framework.

64. Option 1 was preferred as it supported the use of a single reporting framework for all public sector entities. Preparers explained that this approach will bring uniformity to reporting in the public sector and was further supported by the requirements in section 216 of the Constitution of the Republic of South Africa, 1996, for a uniform reporting framework for all spheres of government. This view was also supported by members of the Public Sector Accounting Forum.

65. The general view was that if option 1 is adopted, exemptions from applying Standards of GRAP should not be permitted by the Board and the National Treasury.

66. It was noted that if option 1 was pursued, the education of users and preparers will be paramount to raise awareness about Standards of GRAP.

Analysis

67. Given the considerable support shown for option 1 during the roundtable discussions, the Board decided to progress this option.

68. Option 1 required that all entities apply a uniform reporting framework, i.e. Standards of GRAP. The Board believed that the application of a uniform reporting framework would:

- promote transparency and accountability in the public sector;

- address the practical challenges inherent to public sector entities applying various reporting frameworks, e.g. the preparation of consolidated financial statements; and
- improve comparability amongst similar entities.

Option 2: The reporting frameworks applied by entities should be based on the classifications of entities in the schedules of the PFMA

Comments

69. This option was generally supported by users but not by preparers.

70. Users agreed that IFRSs represent the appropriate reporting framework for Schedule 2 entities as they are profit-oriented and compete with, and are benchmarked against, international companies. They believed that if Schedule 3B and 3D entities apply Standards of GRAP the current consolidation challenges will be reduced.

71. Preparers were mostly of the view that Schedule 3B and 3D entities should not apply Standards of GRAP for the following reasons:
    - Some Schedule 3B and 3D entities have been misclassified in the schedules to the PFMA.
    - Business activities and mandates of Schedule 3B and 3D entities are not aligned with the objectives of those entities that apply Standards of GRAP.
    - Schedule 3B and 3D entities are funded differently to those entities that apply Standards of GRAP.
    - Schedule 3B and 3D entities 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 requires the application of another reporting framework.

Analysis

72. The Board noted the dissenting views expressed by most respondents against the Board's proposal for option 2, and reflected on the observations and shortcomings identified by respondents.

73. The Board concurred with respondents that, as a consequence of adopting option 2, those entities that are incorrectly classified in the schedules to the PFMA may apply an inappropriate reporting framework. The objectives of financial reporting under Standards of GRAP and IFRSs differ, largely because the users of the financial statements are different. Standards of GRAP are concerned with providing information to resource providers and recipients of government services, while IFRSs provide information to investors only. Although investors are resource providers under Standards of GRAP, a wider range of users is considered because the needs of recipients of government services are also considered.

74. Given the different objectives and users, the qualitative characteristics of relevance and faithful representation of the information provided to users may be compromised if an inappropriate reporting framework is applied. As the requirements of the Standards of GRAP are designed to meet specific users' needs, applying an inappropriate reporting framework would result in inappropriate accounting treatments. For example, for a service-delivery oriented entity it may be inappropriate to measure assets at fair value or on the basis of future net cash inflows rather than service potential.

75. The Board considered the suggestion made by respondents to consider making a decision based on the objectives of GBEs rather than the classification of entities in the schedules to the PFMA. The Board believed that assessing whether an entity's activities are profit-oriented or service-delivery oriented will be challenging, as many GBEs have dual mandates. Many service-delivery oriented entities are also profit-oriented. Objectives are often not mutually exclusive.

Option 3: The reporting frameworks applied by entities should be based on a set of principles

<u>Comments</u>

76. Respondents indicated little support for option 3. The respondents that did support this proposal noted that a set of principles will enable entities to make their own assessment of which reporting framework is appropriate for them, rather than the Board deciding a framework that is based on classifications that may change over time.

77. They also suggested that once the self-assessment process is complete, entities should not be allowed to change their reporting framework, except in certain cases.

<u>Analysis</u>

78. While respondents indicated limited support for option 3, the Board did not believe it would be in the interest of the users of the financial statements to delay the Board's decision by pursuing this option.

79. The Board observed that by continuing with the status quo, the relevance of information made available to users of GBEs that apply Statements of GAAP as at 1 April 2012 will be compromised. This is because Statements of GAAP comprise only those IFRSs or IFRICs up to May 2011[1].

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[1]The IFRSs up to May 2011 excludes IFRS 9 *Financial Instruments* issued May 2011, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 13 *Fair Value Measurements*, IAS 27 *Separate Financial Statements* issued in May 2011 and IAS 28 *Investments in Associates and Joint Ventures* issued in May 2011, IAS 19 *Employee Benefits* revised in June 2011, IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* issued in October 2011, Amendments to existing pronouncements *Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7)* issued in December 2011, Amendments to existing pronouncements *Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)* issued in December 2011, Amendments to existing

80. The Board concluded that development of a set of principles will take time and will have a negative impact on the Board's commitment to respond to stakeholder's issues timeously.

Way forward

81. As noted above, the Board decided at its December 2014 meeting, it will pursue option 1 where one reporting framework is applied by all public sector entities. Given its reservations about this option, the Board considered two approaches to this option:

    - Approach 1: All public sector entities apply Standards of GRAP with no exemptions; or
    - Approach 2: All public sector entities apply Standards of GRAP, with exemptions permissible in certain cases.

82. The Board considered the merits of the two approaches and their legal implications. After consultation with the National Treasury and consideration of the legislative prescripts, the Board came to the conclusion that it should propose that public entities apply generally accepted accounting practice (which is determined to be IFRSs) when certain criteria are met.

83. The Board agreed to develop a framework and criteria that allows entities to perform a self-assessment to determine the reporting framework most appropriate for them.

PART C – DEVELOPMENT PHASE: FINAL PROPOSAL

84. Following the Board's decision to develop a framework and criteria that allows entities to perform a self-assessment in order to determine the reporting framework most appropriate for them, the Board developed the Exposure Draft of the proposed Directive on *The Selection of an Appropriate Reporting Framework by Public Entities* (ED 130).

Board's considerations when developing proposals

85. The Board proposed that public entities apply generally accepted accounting practice (which is determined to be IFRSs) provided that certain criteria are met, unless:
    (a) the Board has approved the application of Standards of GRAP for those entities; or
    (b) they do not meet the criteria to apply IFRSs, and should apply Standards of GRAP.

86. The objective of this proposed Directive was to prescribe the criteria to be applied by public entities, listed in Schedule 2 and 3 of the PFMA, in selecting and applying an appropriate reporting framework. These criteria were developed considering the nature of entities' operations and their funding, and considering who the users of the financial statements are likely to be and their information needs.

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pronouncements *Government Loans (Amendments to IFRS 1)* issued in March 2012, and *Annual improvements to IFRSs (2009 – 2011 cycle)* issued in May 2012.

87. The proposed criteria required entities to perform a self-assessment to determine if they should apply IFRSs, by considering whether:

- the entity is a financial institution;
- the entity has ordinary shares or potential ordinary shares that are publicly tradable on capital markets; or
- 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.

88. Consequently, with the introduction of this framework and criteria, the validity of the exemptions that were previously issued by the National Treasury need to be considered. As the purpose of the proposed Directive was to allow entities to perform a self-assessment to determine the reporting framework most appropriate for them, the Board anticipated that the self-assessment may negate the need for an exemption process. However, it must be noted that in terms of the PFMA, the National Treasury retains the authority to provide exemptions.

Overview of consultations undertaken

89. ED 130 was issued for comment in February 2015 with a comment period ending on the 12th of June 2015.

90. As the Board intended that the future process of selecting an appropriate framework should be more principles-based, transparent, credible and consistent, the Board needed to understand the implications of this approach on each entity. Face-to-face consultation sessions between preparers and the Secretariat were planned during the exposure period, to afford entities an opportunity to test and demonstrate how the proposals in the Exposure Draft affected them individually. A total of nine sessions were held where entities demonstrated how they applied the proposals in the ED by way of presentations.

91. In addition, 22 written comment letters were received through the formal comment process, and verbal feedback was noted at a number of workshops or meetings that were held with preparers, users, auditors and other interested parties.

92. A roundtable discussion with preparers was held after the comment period closed. The purpose of this discussion was to provide general feedback on the outcome of the consultation process and the way forward on the project. At this meeting, issues identified during the comment process were discussed, and participants were given an opportunity to raise additional issues and matters that were not previously raised.

93. The outcome of the consultations is summarised in the Table 5 to Table 9 of the Annexure.

Summary and analysis of comments received

94. Respondents were requested to provide a response to a specific matter for comment on paragraph 11 of the Exposure Draft:

> **Specific matter for comment**
>
> *In accordance with paragraph 11 of this Exposure Draft, entities are required to perform a self-assessment of whether they should apply IFRSs, by considering the following criteria:*
>
> 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.*
> *Paragraphs 12 to 25 provide supporting guidance when assessing the criteria above.*
>
> *Do you agree with the proposed criteria, and supporting guidance to be applied by entities when selecting the appropriate reporting framework? Please provide detailed reasons for your responses, as well as any alternative proposals.*

Comments

95. The proposals in ED 130 were broadly supported. Comments received generally favoured the Board's proposals for prescribing a self-assessment framework.

96. The one-on-one consultation sessions proved to be invaluable as entities demonstrated how they had systematically applied the proposed criteria. Entities that participated in these sessions welcomed the Board's proposals, and also shared their respective views on how the final Directive could be improved to ensure the consistent interpretation and application of the self-assessment framework by public entities.

97. Many of the issues discussed at the roundtable session with preparers had already been raised by other respondents during the comment process. There was general support for the approach followed by the Board. The most significant concern raised was the application of judgement in applying criterion 11(c).

98. The following issues raised highlighted areas in the Directive that could be improved:

- clarify in the scope paragraph that Schedule 3A and 3C entities should not apply the Directive;
- clarify the level of assessment for groups of entities;
- align paragraph 11(a) to specific legislation defining financial institutions to avoid misinterpretation and misapplication;
- expand paragraph 11(b) to include publicly traded debt; and

- refine the assessment in paragraph 11(c) to make it clearer that the assessment required entities to assess the nature of funding, the use of the funding, and the level of dependency on government funding.

99. Other issues raised related to general issues on how the Board would respond to the consequences of the self-assessment, special purpose reporting requirements and staff retention issues.

Analysis

100. In response to the issues outlined in paragraph .97, the Board agreed that the Directive should be improved to address those issues.

101. When ED 130 was developed, the Board intended that schedule 3A and 3C public entities that apply Standards of GRAP would not be required to apply the Directive. A number of respondents indicated that the scope paragraph did not clearly indicate which entities were excluded from applying the Directive. It was suggested that the scope paragraph should be amended so that it is clear that Schedule 3A and 3C entities should not apply the Directive.

102. Respondents that applied and tested paragraph 11(c) generally supported the criteria. However, some respondents indicated that the proposed Directive could be clearer about when and how the assessment of the two elements is undertaken. For example, many questioned how the Directive should be applied if an entity's performance fluctuates between financial years and the entity is dependent on varying levels of government funding during those years.

103. The Board considered the observation, and concluded that additional commentary should be added that makes a distinction between initial and subsequent assessments. Such commentary clarifies that entities are required to perform the self-assessment when the Directive becomes effective, and thereafter if there is a significant change in the operations of the entity that trigger a re-assessment at a later date. Additionally, the Board agreed that a holistic assessment should be undertaken over an extended period of time that takes into account historic and prospective facts and circumstances. It was also agreed that the assessment in paragraph 11(c) requires entities to consider the nature of the funding, the use of the funding, and the level of dependency on the government funding.

104. Other respondents observed that the proposed Directive does not indicate at what level the assessment is performed for groups of entities. The Board considered that the *Framework for the Preparation and Presentation of Financial Statements* applies to the financial statements of the reporting entity and that of the economic entity (i.e. the term used to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities). Since consolidated financial statements must be presented for the economic entity, the Board concluded that the assessment should be done for the group as a whole. In the Board's view, this will not only ensure that the reporting framework selected for the group faithfully represents the substance

of the group's activities, but the use of a consistent framework will facilitate the preparation of consolidated financial statements.

105. Respondents noted that the Board's description of a financial institution could be misinterpreted and applied incorrectly. Suggestions were made for the Board to define the types of services that are referred to as "financial services" and also explain the types of institutions that are considered to be deposit-taking institutions. The Board agreed to align the definition of financial institutions to existing legislation that regulates such institutions.

106. In the case of the criterion dealing with publicly traded debt, the Board agreed that publicly traded debt should be excluded as the JSE Debt Listing Requirements make allowance for public sector entities to provide financial information based on a reporting framework other than IFRSs. Confirmation was received from the JSE Limited that the Board's proposals were not in conflict with the Listings Requirements. The Board concluded that it should not make allowance reporting requirements for locally traded debt, international debt, international suppliers or any similar requirements.

107. Other respondents suggested that the assessment should be conducted by management in consultation with their executive authority. The Board did not agree with this suggestion as it believed that management is equipped to perform the self-assessment.

108. Some respondents observed that the proposed Directive falls short on addressing how disagreements between the auditors and management regarding the self-assessment will be resolved, particularly where auditors disagree with management's conclusions. The Board's view was that the issue is an audit issue, and cannot be resolved at a Standards-level. However, the Board believed that further engagements with the auditors will be necessary to communicate how the Directive will be applied by entities, and that the assessments will be based on management's judgement.

109. The Board also observed that there are likely to be instances where similar types of entities apply different reporting frameworks because the assumptions applied by management are different. The Board believed that it is inappropriate for it to require similar types of entities to apply the same reporting framework as it will contradict the principles of the self-assessment framework. The Board agreed that this matter should be highlighted when communicating its decisions to stakeholders.

110. Some respondents indicated that they were required to submit audited financial statements prepared in accordance with IFRSs to other users, for example international investors and insurers. The Board was of the view that while information in the financial statements is aimed at addressing the needs of a wide range of users, it is impossible to meet all users' needs through the financial statements alone. The Board concluded that where the criterion in paragraph 11 is not met, and entities have users with special purpose reporting needs, they should consider providing additional information to those users whose needs will not met by the Standards of GRAP.

111. The Board also noted the concern that some entities may not be able to retain and/or recruit staff that is well-versed in Standards of GRAP as the labour market is skilled in IFRSs. It was agreed that while there are sufficient structures in place to support and give guidance on Standards of GRAP, it is necessary to educate and raise awareness about the Standards as part of the Board's outreach activities.

Way forward

112. At the meeting held in July 2015, the Board unanimously approved ED 130 as a final Directive 12 on *The Selection of an Appropriate Reporting Framework by Public Entities* (Directive 12), subject to certain amendments suggested by respondents.

113. In line with the Board's policy on approving effective dates of Standards of GRAP, the Board determined the effective of the Directive to be 1 April 2018 so that entities are allowed a sufficient period of time for the transition. The effective date is expected to be sufficient to facilitate effective change management processes, as well as the Board's planned outreach activities.

114. Apart from the publishing this report, the Board also agreed to communicate the results of this project by publishing the comments received, along with Board's responses on the ASB's website. It was also agreed that a communication should be shared with the Deputy Minister of Finance, as the project had already been brought to his attention. A submission was made to the Deputy Minister on 30 August 2015. Both the Minister and Deputy Minister acknowledged the submission during December 2015.

PART D – PRE-IMPLEMENTATION PHASE

115. Given the significance of the project on existing and future staff of affected public entities, the Board believed that the successful implementation of the Directive depends on the support and cooperation of staff. The Secretariat will undertake outreach activities (in the form of workshops and/or education sessions) to raise awareness about the Directive, and Standards of GRAP with users and preparers affected by this project.

116. At the date of finalisation of this report, several outreach sessions have been undertaken with preparers and users to provide an update on the requirements of the Directive. The engagements with preparers and users have further confirmed support for the Board's decision. While no significant implementation issues have been identified to date, the Secretariat and the Board will continue to monitor and address any queries raised prior to the implementation of the Directive.

117. The Board's commitment to raise awareness about the Directive and Standards of GRAP will continue until the Directive is implemented. Thereafter, the Board will undertake a review of compliance with the Directive, to identify unintended consequences or propose additional guidance or amendments to Directive 12. The results of this review will also be communicated through the Board's communication channels.

118. The Board has also agreed with the National Treasury for feedback to be shared on types of requests for exemptions received from entities. To date, no information has been shared in this regard.

Monitoring international developments

119. As noted in earlier sections, the IPSASB initiated its project on GBEs in 2012 to determine the applicability of IPSASs to GBEs and other public sector entities. The IPSASB finalised the development of the Consultation Paper on *The Applicability of IPSASs to Government Business Enterprises and Other Public Sector Entities*, which was published in 2014 for comment. This was then followed by Exposure Draft 56 on *The Applicability of IPSASs* (ED 56) in July 2015. A concurrent Exposure Draft of ED 56 (i.e. ED 131) was issued locally in August 2015, seeking inputs from local stakeholders to enable the Secretariat to formulate a response to the IPSASB. Apart from using the responses to formulate a comment letter to the IPSASB on ED 56, these inputs were useful in assessing the impact of the IPSASB's requirements on local pronouncements or projects.

120. At its September 2015 meeting, the Board considered the impact of the IPSASB's proposals in ED 56 on Directive 12. It was agreed that, similar to the IPSASB, the Board should identify a set of characteristics that describe public sector entities for which the Board develops Standards of GRAP. This decision will result in amendments to the *Preface to the Standards of GRAP* to include these characteristics. It is envisaged that these amendments will be considered in 2019 once the Board has considered the results of the review of compliance with Directive 12.

121. During April 2016, the IPSASB published the *Applicability of IPSASs* which provides the characteristics of public sector entities for which IPSAS are designed in the revised Preface; and replaces the term "GBEs" with the term "commercial public sector entities.

122. As noted above, the Board has agreed to delay any amendments to local pronouncements for the reasons outlined above.

Annexure A: Stakeholder consultations

This annexure summarises the stakeholders that were consulted during the project. Table 1 to 4 provide a list of stakeholders consulted for the research project, as well as to solicit feedback on ED 124. Tables 5 to 9 summarise the outcome of the consultations undertaken for ED 130.

Each table indicates whether a response was received from the stakeholder, either through the face to face consultations, completion of questionnaires or commenting on the Exposure Draft.

Consultations undertaken for the research phase and ED 124

Table 1: Schedule 2 Major Public Entities

No.	Name of entity	Research Phase consultation		ED 124 consultation[2]		Respondent's view GRAP or IFRS?
		Written	Verbal	Written	Verbal	
1	DENEL (Pty) Ltd	✔				IFRS
2	ESKOM		✔			IFRS
Total		**1**	**1**			

Table 2: Schedule 3B National Government Business Enterprises

No.	Name of entity	Research Phase consultation		ED 124 consultation		Respondent's initial view GRAP or IFRS?	Respondent's view after roundtable discussion
		Written	Verbal	Written	Verbal		
1	Amatola Water Board				✔		uniform framework
2	Bloem Water		✔			IFRS	
3	Council for Mineral Technology				✔		uniform framework
4	Council for Scientific and Industrial Research			✔		IFRS	uniform framework
5	Lepelle Northern Water		✔			IFRS	
6	Magalies Water		✔			IFRS	

[2] The Board approved the invitation to comment on the Proposed Directive on *The Application of the Standards of GRAP by Government Business Enterprises (Schedule 3B and 3D)* (ED 124) in March 2014. ED 124 was not circulated to schedule 2 entities as the initial proposal by the Board was to exclude these entities from the scope of the project.

7	Mhlathuze Water	✔		✔	✔	IFRS	uniform framework
8	Onderstepoort Biological Products Limited				✔		uniform framework
9	Passenger Rail Agency of South Africa			✔	✔	IFRS	uniform framework
10	Public Investment Corporation			✔		IFRS	uniform framework
11	Rand Water	✔	✔	✔	✔	IFRS	uniform framework
12	SA Bureau of Standards			✔	✔	IFRS	uniform framework
13	Sasria Limited				✔		uniform framework
14	Sedibeng Water		✔			IFRS	
15	Sentech Limited	✔			✔	IFRS	uniform framework
16	State Diamond Trader				✔		uniform framework
17	Umgeni Water		✔	✔	✔	IFRS	uniform framework
Total		**3**	**6**	**7**	**11**		

Table 3: Schedule 3D Provincial Government Business Enterprises

No.	**Name of entity**	**Research Phase consultation**		**ED 124 consultation**		**Respondent's initial view GRAP or IFRS?**	**Respondent's view after roundtable discussion**
		Written	**Verbal**	**Written**	**Verbal**		
1	Mayibuye Transport Corporation	✔			✔	GRAP	uniform framework
2	Cowslip Investments (Pty) Ltd *(absorbed by Ithala Development)*	✔		✔	✔	IFRS	uniform framework
3	Ithala Development Finance Corporation						

4	Limpopo Development Corporation			✔		IFRS	
5	Casidra (Pty) Ltd	✔				IFRS	
Total		**3**		**2**	**2**		

Table 4: Other stakeholders

No.	**Name of entity**	**Research Phase consultation**		**ED 124 consultation**		**Respondent's initial view GRAP or IFRS?**	**Respondent's view after roundtable discussion**
		Written	**Verbal**	**Written**	**Verbal**		
1	Altimax			✔		Sch2: IFRS Sch3: GRAP	
2	Afrika Rating		✔			IFRS but if GRAP then recons explaining differences	
3	ASISA - Old Mutual		✔			If GRAP then recons explaining differences	
4	Auditors - Deloitte - KPMG - AGSA - SNG		✔			GRAP	
5	Auditor-General South Africa		✔	✔	✔	Sch2: IFRS Sch3: GRAP	
6	City of Cape Town	✔				GRAP	
7	Department of Public Enterprises - CFO's office - Manufacturing sector - Energy / Broadband sector - Transport sector - Support		✔	✔		Sch2: IFRS Sch3: GRAP	

8	Department of Water Affairs: Water Trading Entity	✓			✓	No clear view provided	uniform framework
9	Institute of Municipal Financial Officers			✓		Sch2: IFRS Sch3: GRAP	
10	Limpopo Provincial Treasury			✓		Sch2: IFRS Sch3: GRAP	
11	National Treasury - Office of Accountant-General (OAG) - Budget office - Public Finance		✓		✓	<u>Budget office</u> GRAP <u>Public Finance</u> Sch2: IFRS Sch3: GRAP	
12	Public Sector Accounting Forum		✓		✓	Sch2: IFRS Sch3: GRAP	uniform framework
13	SAICA (with Eskom)		✓			Sch2: IFRS Sch3: GRAP	
14	Statistics SA		✓			Support either framework provided info needs are met	
15	The Banking Association South Africa	✓	✓	✓		Sch2: IFRS Sch3: GRAP	
Total		**3**	**10**	**6**	**4**		

Consultations undertaken for ED 130

Table 5: Schedule 2 Major Public Entities

		Consultation session	Written response	Verbal response (Roundtable discussion)
1	Air Traffic and Navigation Services Company Limited			✔
2	Airports Company of South Africa Limited		✔	
3	Armaments Corporation of South Africa Limited		✔	
4	Development Bank of Southern Africa		✔	
5	ESKOM	✔		
6	Independent Development Trust			
7	South African Broadcasting Limited			✔
8	South African Nuclear Energy Corporation Limited			✔
9	Small Enterprise Finance Agency			✔
10	Trans-Caledon Tunnel Authority			✔
11	Transnet Limited		✔	
Total		**1**	**4**	**5**

Table 6: Schedule 3A National Public Entities

No.	**Name of entity**	**Consultation session**	**Written response**	**Verbal response**
1	South African National Roads Agency Limited	✔		✔

Table 7: Schedule 3B National Government Business Enterprises

No.	**Name of entity**	**Consultation session**	**Written response**	**Verbal response**
1	Amatola Water Board		✔	
2	Bloem Water			✔
3	Council for Mineral Technology			✔
4	Magalies Water	✔		✔
5	Mhlathuze Water		✔	✔
6	Passenger Rail Agency of South Africa	✔		✔
7	Public Investment Corporation		✔	
8	Rand Water	✔	✔	✔

9	SA Bureau of Standards	✓		✓
10	Sasria Limited	✓		✓
11	Sedibeng Water			✓
12	State Diamond Trader			✓
13	Umgeni Water	✓	✓	✓
Total		**6**	**5**	**11**

Table 8: Schedule 3D Provincial Government Business Enterprises

<table>
<tr><th>No.</th><th>Name of entity</th><th>Consultation session</th><th>Written response</th><th>Verbal response</th></tr>
<tr><td>1</td><td>Mayibuye Transport Corporation</td><td></td><td></td><td>✓</td></tr>
<tr><td>2</td><td>Free State Development Corporation</td><td></td><td>✓</td><td></td></tr>
<tr><td>3</td><td>Cowslip Investments (Pty) Ltd (absorbed by Ithala Development)</td><td rowspan="2"></td><td rowspan="2">✓</td><td rowspan="2">✓</td></tr>
<tr><td>4</td><td>Ithala Development Finance Corporation</td></tr>
<tr><td>5</td><td>Limpopo Economic Development Agency</td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>6</td><td>Mafikeng Industrial Development Zone (Pty) Ltd (absorbed by North West Development Corporation)</td><td rowspan="2"></td><td rowspan="2"></td><td rowspan="2">✓</td></tr>
<tr><td>7</td><td>North West Development Corporation</td></tr>
<tr><td>8</td><td>Casidra (Pty) Ltd</td><td></td><td>✓</td><td></td></tr>
<tr><td colspan="2">Total</td><td>1</td><td>4</td><td>4</td></tr>
</table>

Table 9: Other stakeholders

No.	Name of stakeholder	Written response	Verbal response
1	Limpopo Provincial Treasury	✓	
2	Free State Provincial Treasury	✓	
3	Western Cape Provincial Treasury	✓	
4	Bianca Branford	✓	
5	Nyamu Makhuvha	✓	
6	Office of Accountant-General -	✓	
7	SARS	✓	
8	EY	✓	

9	SAICA	✔	
10	ASB update webcast hosted by SAICA		✔
11	Public Sector Accounting Forum		✔
12	National Treasury's workshop for public entities		✔
13	JSE Limited - Members of the Advisory Committee		✔
14	The Banking Association South Africa - Members of the Banking Association		✔
Total		**9**	**5**