



Accounting Standards Board

## **POSITION PAPER**

# **DIFFERENTIAL REPORTING IN THE SOUTH AFRICAN PUBLIC SECTOR**



The Chief Executive Officer  
Accounting Standards Board  
P.O. Box 74219  
Lynnwood Ridge 0040  
Fax: +2712 348 4150  
Email address: [info@asb.co.za](mailto:info@asb.co.za)

**Copyright © 2011 by the Accounting Standards Board**

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior permission of the Accounting Standards Board.

Permission to reproduce limited extracts from the publication will not usually be withheld.



## Executive summary

Differential reporting is the idea that different standards of accounting apply for different entities. Suggestions have been made that South Africa should adopt a two-tier standard of accounting for the public sector, one of which should be less difficult than the other and should apply to medium- and low-capacity municipalities.

This Position Paper is a summary of the research by the Accounting Standards Board (Board) into differential reporting. Having considered the various opinions about differential reporting, the Position Paper also explains the Board's recommendations about differential reporting.

Two views were given by the respondents to the research undertaken by the Board:

View 1 is that there should be a single reporting framework for the public sector. The reasons for this view are:

- All public sector entities receive public funds and should all have the same level of accountability.
- If an entity only undertakes simple transactions, only certain Standards, or parts of them, are applied.

View 2 is that there should be different reporting standards for medium- and low-capacity municipalities. The reasons for this view are:

- They do not need to prepare whole-of-government financial statements;
- Their operations are not complex;
- They do not have the necessary skills or capacity to comply with the full Standards of GRAP and it is costly for them to do so.

As a result of the initial research conducted by the Board, its view was that it will not be correct to have a two-tier reporting framework in the public sector. Following the consultation on the Board's initial research, it has not changed its view, i.e. it does not support a two-tier framework.

The Board does however acknowledge that amendments can be made to certain aspects of the existing Standards to reduce their complexity. The Board will undertake a "GRAP Simplification Project".

In making its decision, the Board considered two main aspects:

- The users of financial statements: There are three main users of financial statements. Their need for information is the main factor in deciding on the accounting framework. They are:
  - Those who provide resources to entities, such as financial institutions, taxpayers, ratepayers and creditors;
  - Those who receive such services; and
  - Those who represent the interests of resource providers and service recipients.



Since their use of financial statements for all entities in the public sector is the same, differential reporting is inappropriate. It is also important for oversight structures, such as Parliament, provincial legislatures and municipal councils, to receive the same information about all entities.

- Legislation requires that the entities in the South African public sector prepare consolidated financial statements. While at this time, consolidated financial statements for the whole of government are not prepared, the government intends to move towards this position. Introducing another reporting framework will conflict with this intention and not support whole-of-government consolidated financial statements.

The Board also considered other reasons in making its decision. These include:

- Restructurings at local government level occur. Differential reporting will result in much restatement having to be made;
- The information in financial statements is used for other reporting purposes.

In response to the concerns about skills and capacity at municipalities, the Board noted:

- Differential reporting will still require skilled financial staff;
- A differentiated reporting framework will not address the challenge of a shortage of people with expertise and accounting knowledge.
- While the initial cost of complying with Standards of GRAP may be high, the cost should decrease once the initial information required has been sourced.



## Introduction

### Purpose and objective

This Position Paper has been published by the Accounting Standards Board (the Board). This Paper outlines the Board's current position on differential reporting in the South African public sector, based on comments received on Discussion Paper 5, *Comparison of the Standards of GRAP to the IFRS for SMEs*. A full analysis of the comments received on differential reporting, as part of the consultation on the Discussion Paper, is available on the ASB's website.

This Position Paper deals only with the issue of differential reporting.

### Background to the debate on differential reporting in the South African public sector

With the publication of the IFRS for SMEs in the private sector, the notion of "differential reporting" was introduced. As a result it became acceptable for some entities to apply an alternative, less onerous accounting framework.

Dialogue held by the ASB with stakeholders in 2009 indicated that medium- and low-capacity municipalities, as well as small-to-medium public entities, could benefit from a reporting framework that was less onerous than the existing Standards of GRAP. During these discussions, certain stakeholders advocated the use of the IFRS for SMEs, as it stands, in the public sector. Others indicated that a public sector equivalent of the IFRS for SMEs should be developed.

As a result of these views, the Board undertook research to consider whether differential reporting is appropriate for the public sector. It also looked at whether the IFRS for SMEs is suitable as an alternative reporting framework for the public sector and whether the Standards of GRAP could be simplified using the IFRS for SMEs.

The Board's research on these issues was outlined in Discussion Paper 5, published in July 2010. This called for respondents' views and comments on:

- differential reporting;
- proposed simplifications to the recognition and measurement approaches in a number of Standards of GRAP. These had been identified by comparing the requirements of each Standard of GRAP with the requirements in the IFRS for SMEs; and
- whether any of the disclosures in the existing Standards of GRAP could be simplified.

The Board received a significant amount of comment as part of the due process on Discussion Paper 5.

Based on its analysis of the comments received, the Board agreed to:

- (a) Issue a Position Paper outlining the Board's views on differential reporting.



- (b) Amend certain Standards of GRAP as part of its Improvements Project for 2011.
- (c) Undertake a “GRAP simplification” project.

As indicated at the outset, this Position Paper deals only with the issue of differential reporting.

A summary of the amendments to the Standards of GRAP and possible items identified for the “GRAP simplification” project, entitled “Outcome of Proposals in Discussion Paper 5” has been published as supplementary information to the comments received on Discussion Paper 5. This is available on the ASB’s website.

A detailed analysis of the responses received on the proposed simplifications to the existing Standards included in Discussion Paper 5, together with the Board’s responses, is also available on the website.



## Is differential reporting appropriate in the South African public sector?

### The Board's position

1. The Board's preliminary view on differential reporting, in Discussion Paper 5, was that it would be inappropriate to have two reporting frameworks in the public sector. Respondents were asked to express their opinions on this view. The Board based its initial view on the inherent public accountability of all public sector entities to a wide range of stakeholders and to legislative and other requirements that are critical in preparing consolidated financial statements, using Standards of GRAP.
2. After giving consideration to all comments received on the Discussion Paper, the Board's position remained unchanged. The arguments supporting the Board's position, as well as its analysis and response to comments made by respondents on the Discussion Paper, are outlined in paragraphs 5 to 30 below.
3. While the Board does not support differential reporting, it acknowledges that the existing Standards of GRAP could be simplified. Based on comments received, the Board has agreed, in principle, to
  - review specific requirements in the existing Standards based on the proposals in Discussion Paper 5, and
  - undertake a broader GRAP simplification project.

Some amendments have been included in the Improvements Project for 2011/12. Other identified changes will be considered in the GRAP simplification project. A document entitled "Outcome of Proposals in Discussion Paper 5" provides a summary of areas in the Standards of GRAP that will be considered for amendment.

4. Internationally, the International Public Sector Accounting Standards Board (IPSASB) has tentatively agreed that it would not develop an additional reporting framework for the public sector. It has agreed, however, to consider the impact of differential reporting frameworks, such as the IFRS for SMEs, on individual International Public Sector Accounting Standards (IPSASs). This approach lends support to the Board's position as the IPSASB develops accounting and reporting requirements for both developed and developing economies, as well as for a range of international organisations.

### Views and arguments for and against differential reporting

5. There were two views expressed by respondents during the consultation on Discussion Paper 5:

View 1: There should be a single reporting framework for the public sector because:

- All public sector entities receive public funds and they should therefore all have the same level of accountability.
- The relative complexity of accounting is as a result of the transactions undertaken by an entity. As accounting standards deal with both simple and



complex transactions, certain Standards, or parts of the Standards, are not applied if an entity undertakes only simple transactions.

View 2: There should be different reporting for medium- and low-capacity<sup>1</sup> municipalities because:

- It is not a requirement to prepare financial statements for the whole-of-government.
  - The operations of medium- and low-capacity municipalities are not complex and a simpler reporting framework is therefore appropriate.
  - Medium- and low-capacity municipalities currently do not have the necessary skill or capacity to comply with the full suite of Standards of GRAP.
  - It is costly for medium- and low-capacity municipalities to comply with the Standards as they have limited resources.
6. The Board noted that respondents to its Discussion Paper had a range of comments, some supportive of differential reporting and some against it. When considering the comments received on the initial position expressed by the Board, primacy was given by the Board to the following considerations:
- the users of financial statements and their information needs; and
  - the preparation of consolidated financial statements.
7. While the Board's deliberations focused on these two issues, the Board would be willing to consider any other arguments that should be given primacy in the debate on differential reporting.
8. The paragraphs that follow outline the rationale for the Board's position based on the primary issues it considered in paragraph 6. Other issues considered by the Board related to the importance of a uniform reporting framework, as well as the Board's analysis of other issues, raised by respondents, which it did not believe formed a sufficient technical basis for justifying differential reporting.

#### *Primary considerations of the Board*

##### Users of financial statements and their information needs

9. Those respondents, who did not support differential reporting, agreed with the Board's view that all entities are publicly accountable because each one of them receives public funds. In their view, public accountability means providing the same information to all users of the financial statements through the application of a uniform accounting framework that is designed to support such accountability.
10. In contrast, respondents who supported differential reporting indicated that the relative complexity of entities' operations, particularly medium- and low-capacity municipalities, should be a factor in deciding on the relevance of differential reporting.

---

<sup>1</sup> Medium- and low-capacity municipalities are those defined in Gazette 26511, issued in July 2004 (or any subsequent amendments issued to this classification).





11. In considering the views raised by all the respondents, the Board recognised that its objective is to set accounting standards that will result in information that enables a wide range of users to assess accountability and facilitate decision-making. Broadly speaking, the users of financial statements in the public sector are those,

- that provide resources to entities (e.g. financial institutions, taxpayers, ratepayers and creditors);
- who receive the services provided by government; and
- that represent the interests of resource providers and service recipients.

The Board believes that it is these users, and their information needs, that inform the requirements of the accounting framework - not the relative complexity of an entity's operations (see paragraphs 19 to 22 below). Consequently, a separate reporting framework can be justified only if different users exist for different entities' financial statements.

12. Based on the three broad types of users identified in paragraph 11, the Board concluded that the same users exist for all public sector entities' financial statements. This includes even those entities that are smaller or have less complex operations than others. Since their use of financial statements for all public sector entities is identical, the same information is required from all these entities to make decisions and to assess accountability. Consequently, since the users, and their information needs, are identical for all entities in the public sector, differential reporting is inappropriate.

13. The Board noted that it is particularly important for oversight structures, such as Parliament, provincial legislatures and municipal councils, to receive the same information about all entities as they act on behalf of other users in ensuring that public resources are used appropriately in providing services.

#### The effect of differential reporting on the preparation of consolidated financial statements

14. Legislation requires that entities in the South African public sector prepare consolidated financial statements. This was an important consideration for the Board in arriving at its position set out in the Discussion Paper. Consolidated financial statements are currently prepared for national government, for each provincial government and by each municipality and its entities. Once all entities in the public sector have migrated to accrual accounting, these consolidations will be prepared using Standards of GRAP. There is also an intention to prepare consolidated financial statements for the whole-of-government level.

15. Those respondents who advocated a separate reporting framework for medium- and low-capacity municipalities noted that legislation currently requires municipalities to prepare consolidated financial statements only where they exercise control over a municipal entity. In practice, many medium- and most low-capacity municipalities would not prepare consolidated financial statements as they do not have municipal entities.

16. Medium- and low-capacity municipalities only prepare consolidated financial statements in limited instances, and their financial statements are not used to prepare whole-of-government accounts. It is thus argued that they could apply a less onerous reporting framework compared to high-capacity municipalities and entities in national and provincial government.
17. While there is currently no legal requirement to prepare consolidations across local government or at a whole-of-government level, the intention is that such a consolidation will be undertaken in future. The Board concluded that introducing another reporting framework would not support the preparation of such financial statements.
18. Some respondents also argued that where, or if, the information is needed for consolidation purposes, the financial statements could be prepared using a less onerous reporting framework. Additional or other information would then be reported for consolidation purposes. From the Board's perspective, applying such an approach would increase rather than decrease the reporting burden on entities as it would require the preparers to have the ability to implement both reporting frameworks.

#### The relative level of complexity of entities' operations

19. As noted in paragraph 10, many respondents indicated that the operations of medium- and low-capacity municipalities are less complex and not as diverse as high-capacity municipalities and entities in other spheres of government. As a result, the scope of topics dealt with in the reporting framework could be significantly reduced for these entities when compared to the full suite of Standards of GRAP.
20. Both the Board and those respondents who did not support differential reporting believe that accounting and reporting is as simple or as complex as the underlying transactions it reports. The scope of transactions and events dealt with in the Standards of GRAP are sufficiently broad to enable management of each entity to apply judgement in identifying those Standards, or parts of Standards, that are relevant in preparing their financial statements. Where an entity does not undertake certain transactions, the applicable Standard or the requirements within a Standard are not applied. As a result, the Board concluded that it is not appropriate to develop a separate accounting framework for entities just because they do not enter into transactions and events that are covered in the broader suite of Standards
21. While the Board does not believe that the level of complexity of an entity's operations justifies the development of a different reporting framework, it does acknowledge that preparers may require assistance on how to identify which Standards, or which parts of Standards, should be applied. The area of materiality is one in particular that should be considered more carefully by preparers in identifying the applicable Standards or parts of Standards.
22. Applying only those Standards that are applicable to material transactions and events will ensure that the most relevant information is included in the financial statements. Applying materiality, along with the other qualitative characteristics in the Framework, in:
  - identifying which Standards or parts of Standards should be applied,



- developing accounting policies specific to the entity, and
- deciding on what information should be disclosed in the financial statements,

will result not only in more useful information to the users of the financial statements, but also in entities focusing on the relevance of the information they provide as opposed to adopting a compliance-based approach to preparing financial statements.

#### *Other considerations of the Board*

23. In addition to the two primary considerations used by the Board in formulating its position, it noted that a uniform reporting framework is important for a number of other reasons. The Board thus also considered the following two factors:
- (a) Restructurings at a local government level are not uncommon. Municipalities (high-, medium- and low-capacity) often transfer functions between, or merge with, other municipalities. If medium- and low-capacity municipalities apply a different reporting framework to that used by high-capacity municipalities, accounting for transfers of functions and mergers would be difficult and result in a significant amount of restatement.
  - (b) The use of information reflected in the financial statements for other reporting purposes. For example, financial statement information is used as the basis for statistical reporting, as well as for regulatory returns. The use of alternative financial reporting frameworks by entities will make the preparation of this information difficult as adjustments will need to be made to the financial statement information, depending on the basis of accounting used.

#### *Other issues raised by respondents*

24. Other issues were raised by respondents in support of differential reporting. While the Board has not focused on these issues in formulating its position as it has given primacy to the technical arguments outlined in paragraph 6, the Board has analysed and responded to these other issues in this Paper. The key issues raised by respondents and the Board's response are outlined below.

#### Skill and capacity constraints at municipalities

25. Respondents to Discussion Paper 5 were of the view that if a less onerous reporting framework is introduced, staff with a lower level of skill will be required and service providers would be used less frequently.
26. A less onerous accounting framework would still require entities, for example, to maintain comprehensive asset registers and undertake other activities fundamental to the financial management of an entity. It would therefore not matter whether a less onerous accounting framework is applied as skilled financial staff would still be needed.
27. Respondents indicated that the shortage of people with the necessary expertise and accounting knowledge is largely due to the lack of formal training on Standards of GRAP. The introduction of another reporting framework will not eliminate this challenge.



### Costs of complying with Standards of GRAP

28. Many respondents indicated that the cost of complying with the full suite of Standards of GRAP is significant in relation to the resources available to medium- and low-capacity municipalities. It was suggested that the volume and complexity of the accounting requirements should be reduced so that compliance with these requirements is affordable for smaller municipalities.
29. The Board is aware that the costs of complying with its Standards can be significant, particularly in the year(s) of their transition and initial adoption. It is anticipated that the costs should be higher during the initial adoption of the Standards because of insufficient or unreliable historical information, resulting in the need to re-create opening balances. Once the information is available, however, the cost of compliance should decrease. While the costs may be significant on initial adoption, the Standards of GRAP provides the municipalities with comprehensive information that can be used for a wide range of decision-making, e.g. planning, informing tariff setting, and assessing performance and sustainability.
30. A factor which contributes to the high costs of complying with the Standards is the fact that many entities use consultants to prepare their financial statements. While it is acknowledged that consultants may be needed as an interim measure where skill and capacity constraints exist, consultants can only use the information available to them from existing accounting records and other internal information to prepare the financial statements. Where sufficient or appropriate information is not available, the scope of consultants' work, and the resulting fees, may be increased to deal with these issues.