Comments due by 30 November 2016

ACCOUNTING STANDARDS BOARD

INVITATION TO COMMENT ON THE PROPOSED STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE ON

INTERESTS IN OTHER ENTITIES

(ED 144 to ED 148)

Issued by the
Accounting Standards Board

July 2016

ED 144 to ED 148

Commenting on the Exposure Drafts

The Accounting Standards Board (the Board) seeks comment on the Exposure Drafts of the proposed Standards of GRAP on *Interests in Other Entities* that includes the proposed Standards of GRAP on *Separate Financial Statements, Consolidated Financial Statements, Investments in Associates and Joint Ventures, Joint Arrangements* and *Disclosure of Interests in Other Entities*. The objective of the proposed Standards of GRAP is to align the Standards of GRAP on *Consolidated and Separate Financial Statements* (GRAP 6), *Investments in Associates* (GRAP 7) and *Interests in Joint Ventures* (GRAP 8) with the new International Public Sector Accounting Standards (IPSASs) that deals with interests in other entities.

The proposals in these Exposure Drafts may be modified in the final document in the light of comment received. Comment should be submitted in writing so as to be received by **30 November 2016**. Email responses are preferred. Unless respondents to these Exposure Drafts specifically request confidentiality, their comment is a matter of public record once the Standards of GRAP have been issued. Comment should be addressed to:

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INTRODUCTION

Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (the Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

(a) departments (including national, provincial and government components);

(b) public entities;

(c) trading entities (as defined in the PFMA);

(d) constitutional institutions;

(e) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and

(f) Parliament and the provincial legislatures.

The above are collectively referred to as "entities".

The Board has approved the application of International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board for:

(a) public entities that meet the criteria outlined in Directive 12 on *The Selection of an Appropriate Reporting Framework by Public Entities;* and

(b) entities under the ownership control of any of these entities.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard of GRAP and any related Interpretations of the Standards of GRAP.

Any limitation of the applicability of specific Standards or Interpretations is made clear in those Standards or Interpretations of the Standards of GRAP.

All paragraphs in this Standard of GRAP have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Standard should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP,* the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards of GRAP, published in the Government Gazette.

Reference may be made here to a Standard of GRAP that has not been issued at the time of issue of this Standard. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Background and objective of the Exposure Drafts

The International Public Sector Accounting Standards Board (IPSASB) issued five International Public Sector Accounting Standards (IPSASs) during 2014 with the objective to align the IPSASs on

- *Consolidated and Separate Financial Statements* (IPSAS 6);
- *Investments in Associates* (IPSAS 7); and
- *Interests in Joint Ventures* (IPSAS 8)

with the new IFRSs on accounting for interests in other entities, which are:

- IFRS 10 *Consolidated Financial Statements*;
- IFRS 11 *Joint Arrangements*;
- IFRS 12 *Disclosure of Interests in Other Entities*;
- IAS 27 *Separate Financial Statements*; and
- IAS 28 *Investments in Associates and Joint Ventures*.

As the ASB aligns its Standards of GRAP with the equivalent IPSASs, the Board agreed to include a project on its work programme to align GRAP 6, 7 and 8 with the five IPSASs. The objective of the following five proposed Standards of GRAP is to replace GRAP 6, 7 and 8:

- Standard of GRAP on *Separate Financial Statements* (ED 144)
- Standard of GRAP on *Consolidated Financial Statements* (ED 145)
- Standard of GRAP on *Investments in Associates and Joint Ventures* (ED 146)
- Standard of GRAP on *Joint Arrangements* (ED 147)
- Standard of GRAP on *Disclosure of Interests in Other Entities* (ED 148).

In addition, the Interpretations of the Standards of GRAP on *Consolidation – Special Purpose Entities* (IGRAP 11) and *Jointly Controlled Entities – Non-monetary Contributions by Ventures* (IGRAP 12) will also be withdrawn when the proposed Standards of GRAP become effective.

Development of transitional provisions

As with the development of other Standards of GRAP, the Board will consider the transitional arrangements as a separate project, before including the transitional provisions in Directives to 2 to 4 and 8. The transitional provisions to be included in these Directives will therefore follow a separate due process, after the Board has considered the comment received from respondents on the five proposed Standards of GRAP.

Effective date of the proposed Standards of GRAP

Based on comment received from respondents on ED 144 to ED 148, the Board will assess if a new effective date for the Standards of GRAP should be promulgated by the Minister of Finance.

Significant changes to current pronouncements

Even though some of the fundamental requirements have been retained in the proposed Standards of GRAP, entities will be required to reassess the existence of control and joint control, as well as the nature of joint arrangements. The most significant changes from GRAP 6, 7 and 8 are:

- *New definition for control*

  The proposed Standard of GRAP on *Consolidated Financial Statements* includes a new definition for control.

  The revised definition of control includes three elements, namely, a controlling entity's:

  (i) power over the controlled entity;

  (ii) exposure, or rights to variable benefits from its involvement with the controlled entity; and

  (iii) ability to use its power over the controlled entity to affect the nature and amount of the controlled entity's benefits.

  The requirements in the proposed Standard to have power, benefits and a link between power and benefits is similar to the approach taken in GRAP 6. GRAP 6 required that both power and benefit be present, while the proposed Standard requires that an entity demonstrates power, benefit and a link between power and benefits. GRAP 6 defines control as the power to govern the financial and operating policies of another entity so as to benefit from its activities. The focus of the new proposed definition of control is on an entity's ability to influence the nature and amount of benefits through its power over another entity.

  More guidance on assessing control has been included in the proposed Standard of GRAP on *Consolidated Financial Statements*. The proposed Standard also sets out requirements on how to apply the control principle in specific circumstances, such as when voting or similar rights give an investor power, when an investee is designed so that voting rights are not the dominant factor in deciding who controls the investee, and when the investee has control over specified assets of the investee.

- *Introduction of investment entities*

  A new category of entity has been introduced in the proposed Standards, i.e. an investment entity. Specific accounting guidance that is to be applied on consolidation of, or by an investment entity, is not included in GRAP 6, 7 or 8.

  Generally, an investment entity measures its investments in controlled entities at fair value in accordance with the Standard of GRAP on *Financial Instruments*. After thorough consultation the IPSASB decided, for public sector reasons, that an entity which controls an investment entity should retain this method of accounting for an investment entity's investments in its consolidated financial statement, regardless of whether it is itself an investment entity.

  In addition to the guidance on investment entities for consolidation purposes, the proposed Standard of GRAP on *Separate Financial Statements* also requires that where the controlling entity is not itself an investment entity, the investment in a controlled investment entity should be measured either (a) at cost; (b) in accordance with the Standard of GRAP on *Financial Instruments*; or (c) using the equity method as described in the Standard of GRAP on *Investments in Associates and Joint Ventures.*

- *Introduction of structured entities*

  The Standard of GRAP on *Disclosure of Interests in Other Entities* introduces structured entities, a concept which is different to special purpose entities described in IGRAP 12 *Consolidation – Special Purpose Entities*. A structured entity is:

  (a) in the case of entities where legislation is normally the dominant factor in deciding who has control of an entity, an entity that has been designed so that legislation is not the dominant factor in deciding who controls the entity; or

  (b) in the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity, an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity.

  The proposed Standard of GRAP on *Disclosure of Interests in Other Entities* introduces specific disclosure requirements for structured entities that are not consolidated. The objective of these disclosures is to assist users of the financial statements to assess the current and potential future impact of these entities on the economic entity's financial position and financial performance.

  An entity should apply the principles in the proposed Standard of GRAP on *Consolidated Financial Statements* to assess if a structured entity is controlled.

- *New classifications of joint arrangements*

  The proposed Standards of GRAP also introduce new classifications of joint arrangements, i.e., a joint operation and a joint venture. These classifications differ from GRAP 8 which referred to three types of arrangements, namely jointly controlled entities, jointly controlled operations and jointly controlled assets.

  In a joint operation, the parties to the arrangement have rights to the assets and obligations for the liabilities relating to the arrangements. As such, a joint operator is required to account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the Standards of GRAP applicable to the particular assets, liabilities, revenues and expenses. In a joint venture, the parties to the arrangement have rights to the net assets of the arrangement. A joint venturer is required to recognise its interest in a joint venture as an investment. The investment is accounted for using the equity method in accordance with the Standard of GRAP on *Investments in Associates and Joint Ventures*, unless the entity is exempted from applying the equity method. In GRAP 8, the structure of the joint arrangement determines the accounting requirements, while the focus of the proposed Standard is on rights and obligations.

  "Joint control" is defined in the proposed Standard of GRAP on *Investments in Associates and Joint Ventures* as the agreed sharing of control by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. GRAP 8 defines "joint control" as the agreed sharing of control over an activity by a binding arrangement and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

  In addition, investments in associates and joint ventures are combined into a single Standard, i.e. the proposed Standard of GRAP on *Investments in Associates and Joint Ventures*.

- *Removal of proportionate consolidation as a method of accounting for a joint arrangement*

  In GRAP 8, a jointly controlled entity could either be accounted for using the equity method, or proportionate consolidation. The proposed Standard of GRAP removes proportionate consolidation, and an entity is required to apply the equity method to account for its investments in joint ventures.

  Proportionate consolidation was eliminated following a conclusion by the International Accounting Standards Board (IASB) that the method is inappropriate to account for interests in joint ventures when the parties neither have rights to the assets, nor obligations for the liabilities relating to the arrangements. The IPSASB concurred with this conclusion.

- *All disclosure requirements are included in one Standard*

  The proposed Standard of GRAP on *Disclosure of Interests in Other Entities* brings together all the disclosure requirements currently included in GRAP 6, 7 and 8. The objective of the proposed Standard is to require an entity to disclose information that enables users of its financial statements to evaluate:

  (a) the nature of, and risks associated with its interests in other entities; and

  (b) the effects of those interests on its financial position, financial performance and cash flows.

  An entity is required to comply with the disclosure requirements in respect of its interests in controlled entities, associates, joint arrangements and structured entities that are not consolidated.

  The proposed Standard introduces new disclosure requirements, including those related to structured entities that are not consolidated, and controlling interests that are acquired with the intention of disposal. In addition, the proposed Standard includes application guidance to assist with the understanding of the disclosure requirements related to interests in other entities.

Due process and timetable

The Board invites comment on the proposals set out in these Exposure Drafts from preparers, users, auditors, standard-setters and other parties with an interest in public sector financial reporting.

Upon the closure of the comment period, the Board will consider the comment received on these Exposure Drafts.

Request for comment

Comment on these Exposure Drafts is invited by **30 November 2016**. The Board requests that respondents express an overall opinion on whether these Exposure Drafts, in general, is supported and to supplement this opinion with detailed comment, whether supportive or critical. Respondents are also invited to provide detailed comment identifying the specific paragraphs to which it relates, explaining the issue and suggesting alternative wording, with supporting reasoning, where appropriate. The basis for accepting or rejecting significant comment will be published on the website.

The Board would particularly appreciate answers from respondents to the questions posed below.

Specific matters for comment

1. The proposed Standard of GRAP on *Separate Financial Statements* (GRAP 34) allows an entity to account for similar investments in controlled entities, joint ventures and associates in its separate financial statements either:

   (a) at cost;

   (b) in accordance with the Standard of GRAP on *Financial Instruments*; or

   (c) using the equity method as described in the Standard of GRAP on *Investments in Associates and Joint Ventures*.

   The accounting policy choice in accounting for investments in an entity's separate financial statements should be applied to similar investments, i.e. controlled entities, joint ventures and associates.

   The Standard of GRAP on *Consolidated and Separate Financial Statements* (GRAP 6) does not permit the use of the equity method, which was in line with the IASB thinking at the time that GRAP 6 was developed. The equivalent IPSAS 6 did, however, allow the use of the equity method to account for other investments in an entity's separate financial statements.

   In August 2014, the IASB reinstated the equity method as an option in separate financial statements, following support from stakeholders to permit the use of the equity method. In line with international practice, the Board has therefore agreed to also permit the use of the equity method in separate financial statements.

   Do you agree with the Board's view to include the equity method as a method to account for investments in an entity's separate financial statements? Please explain your response.

2. The proposed Standard of GRAP on *Disclosure of Interests in Other Entities* (GRAP 38) brought together all the disclosure requirements on interests in other entities. Do you find the inclusion of the disclosure requirements proposed in GRAP 38 useful in meeting the user's information needs, or, in your view, could some of the disclosure requirements be eliminated? Please explain your response.

3. The proposed Standards of GRAP on *Consolidated Financial Statements* (GRAP 35) and *Joint Arrangements* (GRAP 37) include detailed examples to illustrate the application of the principles proposed in the Standards. In line with past practice, these illustrative examples will be removed from the Standards of GRAP when the Office of the Accountant-General develops the implementation guidance for the specific Standard of GRAP.

In your view, do you agree that the proposed illustrative examples included in proposed GRAP 35 and GRAP 37 reflect South African public sector circumstances? Should any of these examples be eliminated, or should any additional examples be included? Please explain your response.

4. Are there any regulatory or other issues that exist in the South African environment that may affect the implementation of the proposed Standards of GRAP?

   If yes, please provide details of these regulatory or other issues that should be considered in finalising the proposed Standards of GRAP.

5. In your view, should the National Treasury consider the development of any other implementation guidance, in addition to the GRAP Implementation Guideline that will be developed? Please explain your response.

6. In your view, overall, does the application of the proposed Standards of GRAP result in financial statements that would be useful to users? Please explain your response.

7. In your view, what are the costs and benefits of the proposals relative to the current accounting that are applied by entities in assessing their interests in other entities. In relation to quantitative financial costs, the ASB would be interested to understand the nature and estimated amounts of any expected incremental costs, or cost savings, of the proposals relative to the existing accounting.

General matters for comment

As with any other Exposure Draft, comment on any other matter contained in these Exposure Drafts would also be welcomed. Comment is most helpful if reference is made to a specific paragraph or group of paragraphs.