Accounting Standards Board
Newsletter May 2023 Edition

In this edition of the newsletter:

- Message from the CEO – Don't discount your discount rates
- The Board is proposing revisions to the Standards of GRAP on *Transfer of Functions and Mergers*
- If you missed our MFMA GRAP Update, watch it on YouTube
- The Board requests your comment on revisions proposed to GRAP 105

Message from the CEO – Don't discount your discount rates

We know all too well the impact the increase in inflation and interest rates has had on our household purses. Inflation was 5.9% in March 2022 and 7.1% in March 2023. The prime lending rate for the same period was 7.75% and 11.25% respectively. So, what do these changes mean for the financial statements?

Inflation and interest rates are used frequently in the financial statements to value assets and liabilities, both throughout the year and at the reporting date. Examples where interest rates are used to value assets and liabilities include the:

- Replacement cost of assets where the revaluation model is applied.
- Value-in-use of assets for impairment purposes.
- Fair value of financial assets at year end.
- Present value of provisions for rehabilitation of assets, e.g. landfill sites.
- Fair value of assets held to fund defined benefit plans.
- Present value of liabilities to pay retirement benefits under defined benefit plans and other employee benefits.

Changes in price indices, like CPI, can impact what discount rate is used and/or how cash flows are determined for certain valuations. Entities should be sure when they perform their valuations whether they are using price adjusted cash flows (or not), and real or nominal interest rates.

Given the changes in interest rates over the last year entities should consider:

- Whether past valuations need to be updated (if they are not required at every reporting date).
- Whether the effect of discounting an asset or liability is material in the current year (where this was assessed as immaterial and not accounted for in the past).
- What information users will need in the financial statements to assess the impact of the changes in interest rates (and potentially price indices) on the financial statements. Providing boilerplate wording from the Standards about rates used are unlikely to meet users' needs. Where changes in interest rates have a material impact on the financial statements, information that could be provided about the changes in rates include how

the rates were determined; how changes in rates have or will affect the valuation of assets and liabilities; and the judgement applied in determining the rates so that users can assess how changes in rates could affect the financial statements.

While the Standards often provide guidance on the type of information to disclose, it is important to remember that preparers should disclose any additional information if it will be relevant to users' information needs.

Wishing you all the best for your financial statement preparation!

The Board is proposing revisions to the Standards of GRAP on *Transfer of Functions and Mergers*

Why are these changes needed?

When the Board developed GRAP 105 on *Transfer of Functions Between Entities Under Common Control*, GRAP 106 on *Transfer of Functions Between Entities Not Under Common Control* and GRAP 107 on *Mergers* (the local Standards), no equivalent International Public Sector Accounting Standard (IPSAS) existed. The Board used the IFRS Accounting Standard® on *Business Combinations* (IFRS 3) to develop parts of the local Standards.

The International Public Sector Accounting Standards Board (IPSASB) issued IPSAS 40 on *Public Sector Combinations* during 2017 with an effective date of 1 January 2019. IPSAS 40 applies to public sector combinations and classifies them as either an:

(a) amalgamation – a combination that gives rise to a resulting entity, i.e. an entity that is the result of two or more combining operations; or

(b) acquisition – a combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination does not have the economic substance of an amalgamation.

The Board compared the principles in IPSAS 40 with the local Standards to identify similarities and differences. Guidance from IFRS 3 that was issued since the approval of IPSAS 40 was also considered for the local Standards.

What has changed in the local Standards

The Board agreed to:

- update the local Standards with additional guidance from IPSAS 40 and IFRS 3;
- retain the format of the local guidance as three separate Standards. Local stakeholders understand which Standard to apply in specific circumstances and have not raised significant application issues to date; and
- retain any relevant guidance in the local Standards.

The revisions to the local Standards are issued as ED 204 on *Proposed Revisions to the Standards of GRAP on Transfer of Functions Between Entities Under Common Control (GRAP 105), Transfer of Functions Between Entities Not Under Common Control (GRAP 106) and Mergers (GRAP 107)*.

New proposed guidance from IPSAS 40

The ED proposes to add the following guidance from IPSAS 40 to the local Standards:

- scope exclusions relating to the formation of a joint arrangement and the transfer of an investment entity as defined in GRAP 35 on *Consolidated Financial Statements;*
- an additional factor to consider whether a transaction is part of a transfer of functions or a separate transaction;
- additional exceptions to the recognition and measurement principles;

- examples of how an entity may obtain control of a function in a non-exchange transaction;
- additional disclosures, such as providing disclosures for immaterial transfers of functions or mergers that are collectively material, the composition of the combined entity's first set of financial statements following a merger, and disclosures where the initial accounting for a transfer of functions or merger is incomplete and amounts have been determined provisionally; and
- illustrative examples on the application of principles in the local Standards.

New proposed guidance from IFRS 3

The ED proposes two new areas of application guidance in GRAP 105 and GRAP 106:

- an optional test (the concentration test) to assess whether a transferred set of activities, assets and/or liabilities is not a function; and
- guidance to assess if an acquired or received set of activities, assets and/or liabilities that does not have outputs is substantive.

Illustrative examples are also proposed to explain the application of the new proposed principles and guidance.

How to get involved

The comment period for ED 204 closes on 15 July 2023. The ED can be accessed on ED 204 – ASB, and comment can be submitted to the Secretariat of the ASB at info@asb.co.za.

If you missed our MFMA GRAP Update, watch it on YouTube

We held an update for municipalities and municipal entities on the 19th of May 2023. If you missed the session, watch a recording on our YouTube Channel.

The Board requests your comment on revisions proposed to GRAP 105

Background to the proposed revisions

In March 2023, the Board issued ED 204 on *Proposed Revisions to the Standards of GRAP on Transfer of Functions Between Entities Under Common Control* (GRAP 105), *Transfer of Functions Between Entities Not Under Common Control (GRAP 106) and Mergers (GRAP 107)*. Comment on ED 204 is due by 15 July 2023.

The proposed revisions primarily align the guidance in GRAP 105, GRAP 106 and GRAP 107 (the local Standards) with IPSAS 40 on *Public Sector Combinations*. IPSAS 40 applies to public sector combinations and classifies them as either an amalgamation or an acquisition.

In revising the principles, GRAP 105 was compared to the amalgamation principles in IPSAS 40, as it was deemed closest in substance to a transfer of functions under common control. As the IFRS Accounting Standard on *Business Combinations* (IFRS 3) was used to develop parts of GRAP 105, the ED also proposes additional guidance from IFRS 3 that was issued after IPSAS 40 was approved.

What are the most significant changes proposed to GRAP 105?

(a) Additional scope exclusions

The ED proposes additional scope exclusions for the formation of a joint arrangement in the financial statements of the joint arrangement itself, and the transfer of an investment entity as defined in GRAP 35 on *Consolidated Financial Statements.*

(b) Guidance on an optional test

The ED proposes guidance that allows an entity to choose whether or not it wants to apply an optional test (the concentration test). This test is a simplified assessment to decide if an acquired or received set of activities and assets and/or liabilities is not a function. An acquired or received set of activities and assets and/or liabilities is not a function if substantially all the carrying amounts of the gross assets acquired or received are concentrated in a single asset, or group of similar assets.

(c) Guidance to assess whether a transferred process is substantive

The ED proposes additional guidance to assist an entity to assess if an acquired or received process is substantive where the set of activities and assets and/or liabilities do not have outputs.

A function is an integrated set of activities and related assets and/or liabilities that are managed to achieve an entity's objectives by providing goods and/or services, or generating revenue. Although a function usually has outputs, outputs are not required for the activities, assets and/or liabilities to be a function.

(d) Illustrative examples

The ED proposes illustrative examples on:

- the application of the optional test;
- determining if a particular set of activities, and assets and/or liabilities is not a function;
- the measurement period;
- assessing if a transaction or event is a transfer of functions; and
- the disclosure requirements.

What principles are retained in GRAP 105?

In revising GRAP 105, the Board agreed to retain the following principles, thereby departing from the principles in IPSAS 40:

(a) Measurement period

The ED proposes to retain the two year measurement period that can be applied when the initial accounting for a transfer of functions is incomplete by the end of the reporting period in which the transfer occurs. IPSAS 40 allows a measurement period of one year.

The Board noted from practical experience that locally, entities need more time to obtain the necessary information to identify and measure the assets and/or liabilities in a transfer of functions.

(b) Measurement principle

For an amalgamation, IPSAS 40 requires that the acquirer measures the acquired or received assets and/or liabilities at their carrying amounts. Prior to the transfer of the assets and/or liabilities, the transferring entity (the transferor) should adjust the carrying amounts of the assets and/or liabilities to conform to the accounting policies of the acquirer. Adjustments also need to be made to eliminate transactions between the transferor and acquirer in calculating the excess.

To avoid additional costs to effect the transfer of functions, the ED proposes to retain the measurement principles in GRAP 105. This means that no adjustments need to be made to the carrying amounts prior to the transfer, unless the transferor did not apply Standards of GRAP. Furthermore, transactions between the transferor and acquirer need not be eliminated.

Do you agree with the proposed revisions to GRAP 105?

Share your thoughts by accessing the Exposure Draft on ED 204 – ASB. Contact amandab@asb.co.za for more information.

Contact us
E-mail : info@asb.co.za

Disclaimer

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