ACCOUNTING STANDARDS BOARD

RESEARCH PAPER

REVIEW OF AMENDMENTS TO THE STANDARDS OF GRAP ON *INVESTMENT PROPERTY* AND *PROPERTY, PLANT AND EQUIPMENT*

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Executive summary

The Accounting Standards Board (the Board) amended some of the requirements in the Standards of GRAP on *Investment Property* (GRAP 16) and *Property, Plant and Equipment* (GRAP 17), as part of its objective to simplify and improve the Standards of GRAP. These amendments were made in response to the results of the post-implementation review of GRAP 16 and GRAP 17 undertaken in 2014. These amendments, along with their consequential amendments to other Standards of GRAP, were effective on 1 April 2016.

The Board agreed to review the effectiveness of those amendments in 2018. The objective of the review was to determine whether the amendments have been applied correctly, and to evaluate the effectiveness of the amendments in addressing the key issues identified during the post-implementation review.

This Research Paper provides an analysis of the results of the desktop review of entities' financial statements and direct consultations with affected stakeholders. Section 1 provides an outline of the activities undertaken to solicit input for the project.

The desktop review and feedback from participants revealed positive results as discussed in Section 2. Generally, most entities applied the amendments to GRAP 16 and GRAP 17 correctly. Participants confirmed that the amendments have enhanced their understanding of the requirements in the Standards of GRAP. The Board analysed the results of the review and concluded that the amendments have responded to the issues raised in the post-implementation review.

Section 3 of the Research Paper provides the specific actions agreed by the Board as an outcome of the review. In light of the results of the review, the Board did not consider it necessary to make further amendments to GRAP 16 and GRAP 17, instead recommendations were made for the Secretariat to review and amend existing Frequently Asked Questions[1] (FAQs), and/or develop new FAQs in response to the issues raised by participants.

[1] FAQs are prepared by the Secretariat of the ASB in consultation with the technical division of the Auditor-General of South Africa and Office of the Accountant-General at the National Treasury. These FAQs are non-authoritative and are not approved Board.

Introduction

The Board undertook a post-implementation review of GRAP 16 and GRAP 17 which resulted in certain amendments being made to those Standards. These amendments included:

- Clarifying the distinction between investment property and property, plant and equipment (PP&E).
- Introducing an indicator-based approach for the review of useful lives and residual values.
- Clarifying the use of external valuers.
- Deleting encouraged disclosures.
- Introducing additional disclosures on capital work-in-progress
- Introducing additional disclosures on repairs and maintenance.

Following the implementation of the amendments in the 2016/17 reporting period, the Board agreed to add a project to its work programme to review the effectiveness of the amendments.

The purpose of the review was to determine whether the amendments have been applied, and to evaluate their effectiveness in addressing the key issues identified during the post-implementation review.

The Research Paper is set out in three sections:

Section 1 – Analysis of the consultation process

Section 2 – Results of the review

Section 3 – Key actions arising from the review

Authority of this Research Paper

The Board publishes Research Papers to outline its research into issues such as the results of any reviews undertaken on the application of Standards of GRAP and/or current practice in applying the Standards. This Research Paper is not authoritative.

Section 1 – Analysis of the consultation process

This section outlines the consultation process undertaken to solicit input for the project. Several activities were undertaken by the Secretariat, including:

- Desktop review of entities' financial statements.
- Questionnaire for both preparers and users.
- Face-to-face meetings, presentations and workshops.

Desktop review

The Board agreed that the initial phase of the project should include a desktop review of entities' financial statements. Since the amendments became effective from 1 April 2016, the review considered the audited financial statements for the 2016/17 reporting period for selected entities.

The focus of the desktop review was to determine the extent to which the amendments were applied correctly, and if not, what was done incorrectly. Given the nature of the amendments, the desktop review was limited to the statement of financial position and related notes, including accounting policies of each entity selected.

A representative sample of 51 entities (see Table 1 below) was selected for the review. Generally, a sample size of 10% was selected from the total population of entities that are required to apply the Standards of GRAP. In the case of municipalities, the sample size was lower as it represented the total number of non-delegated municipalities. For provincial public entities, the sample size was doubled as a limited number of entities were expected to participate in the planned face-to-face consultations for logistical reasons.

Table 1: Number of entities' financial statements reviewed

Entity type	Total number of entities that apply Standards of GRAP	Number of entities reviewed
Constitutional institutions	9	1
Parliament and legislatures	10	1
National public entities	153	15
Provincial public entities	56	12
Municipalities	257	17
TVET colleges	50	5
Total		**51**

Questionnaire

The initial findings from the desktop review proved to be inconclusive on their own in some respects. For example, where the amendments did not result in specific disclosures or adjustments to the financial statements, it was difficult to determine the extent to which the amendments had been applied by entities, and what the reasons were where entities had not applied the amendments. As a result, a questionnaire was developed and circulated to stakeholders to supplement the findings from the desktop review. 21 responses were received from preparers. The table below provides details of these respondents.

Table 2: Number of respondents to the questionnaire

Respondent profile	Public entity	Municipality	Department	Total
Preparer - individual	-	2	-	**2**
Preparer - organisation	6	5	8	**19**
Total	**6**	**7**	**8**	**21**

Section 2 of the Research Paper only includes feedback from respondents applying Standards of GRAP, as such the comments received from the departments have not been included in the findings.

Consultations with stakeholders

Based on the information gathered in the desktop review and questionnaire, the next step of the process was to engage directly with stakeholders. This included preparers, auditors and consultants, the National Treasury as well as other interested parties.

The purpose of the direct consultations was to obtain feedback from participants on whether the amendments have addressed the issues identified in the post-implementation, and if there are any other practical challenges that the Board should be aware of.

In total 8 events were held in Gauteng, KZN, Eastern Cape and Limpopo which attracted 87 organisations that were represented by 148 participants. The events in KZN, Limpopo and Eastern Cape were facilitated through two of the ASB's stakeholders.

Table 3 below provides information about the total number of organisations that were represented as these discussions (Note: Participants from provinces other than the host province were also present at these events.)

The Board analysed the results of the review and feedback from discussions. The results of the review and feedback received are summarised in section 2.

Table 3: Number of organisations participating in the direct consultations

Event	Preparers		Users	Consultants	Auditors	Other	Total
	Public entity	Municipality					
Event #1		9	1			2	**12**
Event #2		7				1	**8**
Event #3		13		1		2	**16**
Event #4	2	12	1			1	**16**
Event #5		4					**4**
Event #6	21						**21**
Event #7				3	2	4	**9**
Event #8			1				**1**
	23	**45**	**3**	**4**	**2**	**10**	**87**

Section 2 – Results of the review

This section outlines the results from the desktop review and feedback from participants. Feedback from participants encompasses both written responses to the questionnaire as well as the verbal feedback from discussions with stakeholders.

General observations

Generally, the results of the review were positive, and revealed that most entities have applied the amendments to GRAP 16 and GRAP 17. Participants continued to support the amendments and confirmed that the amendments generally enhanced their understanding of the requirements in the Standards.

In light of the feedback received, the Board is of the view that the amendments addressed the issues identified in the post-implementation review. While there were issues raised relating to some of the amendments, and where more guidance could be provided in the form of FAQs, the Board does not believe that further amendments will be required to GRAP 16 and GRAP 17.

The rest of the section is structured based on the six key areas of amendments made to GRAP 16 and GRAP 17 – highlighting the key findings and the way forward.

Distinction between investment property and PP&E

The post-implementation review indicated that preparers have difficulty classifying land and buildings as either investment property or PP&E. The amendments to GRAP 16 clarify in what circumstances land and buildings are held by entities to deliver goods and services in accordance with their mandated functions, rather than being held for rental or capital appreciation.

Key findings

The desktop review relied on the information presented in an entity's accounting policies. Most accounting policies are boilerplate and are not adapted to reflect an entity's circumstances. It was difficult to assess based on the accounting policies the extent to which entities had considered the amendment. The accounting policies would typically only indicate where entities had difficulties distinguishing between investment property and PP&E. It was therefore unclear in the review of financial statements how many entities had applied the amendment.

Feedback from most participants indicated that they had applied the amendments, and that the amendments were useful in enhancing their understanding of the principles in GRAP 16.

Some participants shared practical challenges involved in applying the amendments where the distinction was difficult in past. It was noted that to properly apply the amendments it meant that entities had to review the asset registers which was an extensive exercise. For some entities, the review resulted in reclassifications as well as corrections of errors in the financial statements.

Participants confirmed that the examples added as part of the amendments are helpful. When asked if there were any other examples or scenarios where the distinction was still challenging

– participants noted that additional guidance on the classification of these specific assets would be useful:

- Distinguishing between inventories and investment properties.
- Classification of airports and stadiums as either PP&E or investment property.
- Classification of cemeteries as either PP&E or heritage assets.
- Accounting for transfers to, or from, investment property when there is a change in use.

Way forward

The Board considered whether detailed guidance could be provided in these scenarios and concluded that there is sufficient guidance between the Standards of GRAP and the asset decision tree[2] to assist with the distinction between inventories and investment properties, as well as the classification of airports and stadiums.

The Board agreed that guidance on the classification of cemeteries could be added in one of the existing FAQs dealing with heritage assets. With regards to guidance on the transfers to, or from, investment properties, the Board considered the recent amendments by the International Accounting Standards Board (IASB®) to IAS 40® on *Investment Property* in *Transfers of Investment Property (Amendments to IAS 40)*. These amendments clarify that transfers of property to, or from, investment property should occur when, and only when, there is evidence of a change in use. The Board agreed that these amendments should be included in the Improvements Project for 2019.

Assessing useful lives and residual values

The post-implementation review revealed that the annual review of useful lives and residual values can be burdensome to entities. The Board introduced an indicator-based assessment to alleviate this burden. Entities are only required to undertake detailed assessments and make revisions when there is an indication that the entity's previous expectations have changed.

Key findings

The review of financial statements suggested that entities had considered the indicator-based assessment in the accounting policy. Most accounting policies are generic and boiler-plate in nature. However, based on the information provided in the accounting policies many entities reviewed assess useful lives and residual values using the indicators, while others continued to disclose that they undertake detailed reviews annually.

While most participants indicated that the indicator-based assessment is useful and alleviated the burden of annual reviews, it was apparent from the feedback that there are significant numbers of assets that are fully depreciated assets but still in use. The increased occurrence of fully depreciated assets was confirmed by the continued disclosure of these assets in the financial statements (refer to section dealing with Encouraged disclosures on page 13).

[2] Link to the ASB website - http://www.asb.co.za/asset-decision-tree/.

The feedback received also pointed out some of the reasons for entities not making appropriate adjustments for fully depreciated assets still in use. These are as follows:

<u>Uncertainty about the accounting</u>

Participants shared that entities do not review useful lives of assets as they do not know how to adjust fully depreciated assets. Even though an FAQ was published that explains when and how these adjustments should be made – there was still uncertainty about the principles in the Standards. Some participants believed that it is appropriate to continue valuing fully depreciated assets at R1 as this is a reflection that assets are used beyond their economic functionality. It was also noted that there is a misconception that changes to useful lives and depreciation rates should always be accounted for as a change in accounting policy.

<u>Delayed asset replacements</u>

Due to budgetary constraints, entities are required to keep assets as long as possible before they can be replaced. This means that the period of use usually extends beyond the asset's expected useful life or economic life. The practice is to extend the useful life by one year annually until the asset is replaced instead of considering the additional expected average time that assets will be used before being replaced.

Participants also noted that they usually estimate useful lives using the useful lives set out in the National Treasury Asset Management Framework. They explained that there is insufficient guidance to assist them in determining what the appropriate extended useful life (for example economic life) should be if an asset has already been used beyond the useful lives set out in the National Treasury Framework.

<u>Delayed timing of useful life and residual value reviews</u>

It was observed that entities do not review useful lives of assets until one year before the end of the expected useful life, in some cases later. The process to make appropriate adjustments and revise useful lives is often lengthy and affects when the accounting adjustments will be effected.

<u>IT systems</u>

Participants noted that their current IT systems do not allow for changes to be made to useful lives once an asset has reached the end of its expected useful life. As the expected useful lives are usually coded into the system it means that calculations and accounting adjustments must be made manually.

Way forward

From these observations, it was clear that there is generally a lack of understanding of when to review and how to account for fully depreciated assets, and that the existence of fully depreciated assets, which are material, is non-compliance with the requirements in the Standards.

The Board considered whether amendments are required to the Standards to address these issues. The Board observed that the issues raised by participants are not an indication that there are concerns with the requirements in the Standards. Instead, preparers seem to view the occurrence of fully depreciated assets as a technical exercise that results in accounting adjustments rather than good asset management.

The Board agreed to consider how the indicators in GRAP 17 can be used to address the delayed review of useful lives for assets approaching the end of their expected useful lives. It was agreed that the existing FAQs should be reviewed to assess whether changes can be made to make the principles in the Standards clearer.

The Board also believed that raising awareness about the existing FAQ may help to address the current uncertainty about the principles in the Standards of GRAP and to change behavioural issues around fully depreciated assets.

Use of valuers

There was uncertainty about whether an external, professional valuer is required to value assets when the fair value or revaluation model is applied in GRAP 16 and GRAP 17. Amendments were made to revise the existing wording in the Standards to make it clear that the use of an external valuer is not required. The valuer or expert may be employed by the entity and should be able to undertake the valuation in accordance with the requirements in the Standards.

Key findings

None of the entities reviewed in the desktop review made use of an internal valuer or expert. Similarly, a minority of participants indicated that they had valued their assets using an internal valuer or expert.

Most participants supported the fact that the Standards allow the use of internal valuers, although they raised a concern that auditors may not want to place reliance on valuations undertaken by experts employed by an entity. It was noted that valuations, whether done by an internal or external expert, will require that the assumptions, methodologies and techniques used are documented.

Way forward

The Board considered that when the amendments were developed, no issues were identified by the auditors regarding the use of internal experts. The Board noted the concern and agreed that the matter should be raised with the Auditor-General of South Africa (AGSA) as well as other auditors (i.e. section 4(3) auditors) to understand the basis of the concerns, audit implications, if any, and whether any action is required. It was noted that it may be necessary to also monitor, through the AGSA's Audit Research and Development, if there were any audit issues raised in subsequent audit cycles.

It was noted that developing guidance on assessing whether an internal expert has the "required competence" is not within the Board's mandate. However, the request will be shared with the National Treasury when communicating the review findings, as there may be a need for educational material, such as standard working papers, to assist preparers when performing valuations, documenting methodologies and assumptions, assessing competence, when using internal experts.

Encouraged disclosures

Feedback from the post-implementation review indicated that encouraged disclosures provide limited informational value. To simplify the Standards, amendments were made to eliminate the encouraged disclosure requirements in the Standards.

Key findings

The desktop review revealed that there are entities that still provide information on fully depreciated assets still in use and assets retired from use. Most participants confirmed that they no longer provide information related to encouraged disclosures. One participant shared that they decided to continue to disclose fully depreciated assets, as they were experiencing difficulties in completing the process to assess and revise the useful lives of those assets. In their view, disclosing that information to the users of financial statements was necessary.

Some participants noted that disclosing fully depreciated assets for internal reporting purposes is useful. Other participants requested the Board to consider requiring entities to disclose fully depreciated assets, per asset class, as they believe there is a risk that if these assets are undisclosed they could be misused or even misappropriated.

Historically, disclosing fully depreciated assets was used as a reason not to reassess the useful lives of assets. From the discussions, it was clear that participants do not fully understand that the existence of fully depreciated assets, which are material, is non-compliance with the Standards, and that disclosing such information does not remedy the non-compliance.

Way forward

The Board noted that the feedback further amplifies the need to raise awareness about the correct accounting for fully depreciated assets, as proposed in the section on Assessing useful lives and residual lives. The Board also agreed that there should not be a requirement in the Standards permitting the disclosure of fully depreciated assets, as this would contradict the principles to account for fully depreciated assets when they are material. The Board was also concerned that having such a disclosure requirement may perpetuate the issue that entities do not need to review useful lives of assets if they have been required to disclose this information.

Disclosure of capital work-in-progress

Users of financial statements expressed a strong need for additional disclosures about assets that are being constructed or developed, as well as delays experienced in completing capital projects and any reason for those delays so as to promote greater accountability by entities.

Disclosures were added to provide more information on the value of capital work-in-progress (WIP): (a) incurred per class of assets; (b) that is taking a significantly longer period of time to complete than expected and the reasons for the delay; and (c) where work has been halted, and whether any impairment losses have been recognised.

Key findings

From the desktop review, entities either provided all the required disclosures or continued to disclose capital WIP as a separate class of asset in the PP&E note and/or provide supplementary information with the cumulative expenditure per asset type in the notes. The disclosure of information about significant delays was only seen in a limited number of entities. In addition, the review revealed that in most cases, entities provided the capital WIP for the current and comparative period, even though the transitional provisions were prospective.

Participants shared that they found the additional disclosures to be beneficial in enhancing accountability. Some participants explained that in applying the amendments, they identified that there were weaknesses in their internal controls around capital WIP as they were able to identify long-standing projects and hold management accountable for projects that have taken longer to complete.

<u>Standardising disclosures</u>

When the Board developed the amendments, it considered standardising the disclosures. It concluded that it may be inappropriate to do so as entities will not have the same information, and not all entities' operations are capital intensive.

Participants were specifically asked whether the disclosures relating to capital WIP should be standardised or continue to be left to an entity's discretion. The majority of participants indicated that they would prefer if the disclosures are standardised for consistency and comparability, as currently the level of aggregation or disaggregation varies between entities.

Other feedback received suggested that the Board consider disaggregating the disclosures so that information is provided at a project-level for all entities to enhance accountability. Some participants argued that each entity should know who its users are, and what information they would require from the financial statements. As such, entities should be left to decide which level of disclosures will be relevant to its users.

<u>Usefulness of FAQs</u>

Several queries had been received in the past about the level of disclosures required by the additional amendments, and what the amendments mean by "significantly longer". Two FAQs were issued to clarify (a) how information on the cumulative expenditure on assets under construction should be presented, (b) what amount should be disclosed for projects that are taking significantly longer to complete than expected and what does "significantly longer" mean.

Participants were provided an opportunity to provide feedback on the FAQs. Most participants found the FAQ about the information on cumulative expenditures to be useful as it clarified what information should be disclosed. Participants did not suggest any changes to that FAQ.

With regards to the second FAQ, participants did not request additional guidance but noted that some improvements could be made to the example in the FAQ that illustrates how to determine what is meant by "significantly longer". In their view, the example, which uses the % method to determine what is "significantly longer", has been interpreted in practice to be the only method to determine what is "significantly longer" even though there are ways that can be used by an entity.

Way forward

The Board considered the feedback and debated whether to standardise the disclosures for capital WIP. The Board concluded that its reasons for not standardising the disclosures when the amendments were developed are still relevant. The Board believes that standardising the disclosures would be too prescriptive and onerous, particularly for those entities whose operations are capital intensive. The Board observed that since these amendments have only been applied for one reporting period – it should first allow practice to develop before it considers making any amendments to the disclosure requirements. It was agreed that practice should be monitored, and the Board can reassess the need for standardising the disclosures in future.

The Board agreed that the example in the second FAQ may be misleading and that the FAQ should be amended to make it clear that the use of the % method is not the only way that can be used to determine "significantly longer".

Disclosure of repairs and maintenance

Users in the post-implementation review observed that "repairs and maintenance" is not disclosed as a line item in the financial statements. Given the importance of that information to the users, a requirement to disclose this information was added to the Standard of GRAP on *Presentation of Financial Statements*. Additional requirements were added to GRAP 16, 17 and GRAP 103 on *Heritage Assets*.

Key findings

The desktop review revealed varying disclosures. A significant number of entities had either not applied the amendments or not applied them as required by the Standards. Similarly, the information was disclosed for the current and comparative period even though the transitional provisions are prospective. Few entities disclosed a reclassification of expenditure as a result of the amendments.

Unlike the other amendments, this amendment received mixed views from participants. Support for these amendments also varied. Those in favour of the amendments, shared some of the practical difficulties experienced in providing the information required by the Standards.

It was noted that it is usually difficult to allocate any repairs and maintenance expenditure on an asset-by-asset basis when the actual maintenance is not performed at this level.

Based on discussions held with participants, these disclosures were also topical during the 2017/18 PFMA cycle. The key issue raised by participants is that entities struggle with the allocation of repairs and maintenance to the different asset types, and/or there is still uncertainty about what it means to present expenditure by nature or function.

There seemed to be a general misunderstanding of the requirements in the Standards. In particular, some participants in the local government raised a concern that mSCOA disaggregates the expenditure between contracted services, materials and employee costs and that when the expenditure is incurred internally it becomes difficult to allocate or reliably estimate the other components of the expenditure (i.e. the employee costs) to a specific asset.

Way forward

The Board considered the feedback received and noted that in developing the amendments it had observed that there were entities that included a portion of employee costs in the amount of repairs and maintenance whilst others did not. This practice of applying different bases when measuring repairs and maintenance, prompted the Board not to preclude or require the inclusion of specific costs in determining the amount of the repairs and maintenance to be disclosed. The Board's view was that since the Standards do not specify how the amount should be determined, that the Standards should at least require entities to disclose information about the bases used to determine the disclosed amount.

In the light of the feedback, the Board concluded that participants have misunderstood the requirements in the Standards, and that it is necessary to clarify in the existing FAQ that the Standards do not set out how the amount to be disclosed should be determined.

Section 3 – Key actions arising from the review

This section of the Research Paper outlines the actions that the Board has agreed to undertake based on the results of the review and feedback received. These actions include both undertakings by the Board and the Secretariat.

Table 4: Summary of proposed actions agreed by the Board

Action agreed by the Board	Responsibility for action	Status
Clarifying the distinction between investment property and property, plant and equipment		
Review the existing FAQs on heritage assets and provide guidance on the classification of cemeteries as either heritage assets or PP&E.	Secretariat	Completed.
Consider including the IASB's *Amendments to IAS 40* in the Improvements Project for 2019 to clarify what triggers a change in use.		Completed.
Indicator-based approach for reviewing useful lives and residual values		
Review existing FAQ on fully depreciated assets and clarify when and how to treat fully depreciated assets.	Secretariat	Completed.
Use of external valuers		
Engage with AGSA and section 4(3) auditors to understand if there are any audit implications when valuations are undertaken by internal experts and consider whether any action is required.	Secretariat	Outstanding.
Additional disclosures on capital WIP		
Monitor practice and to reconsider standardising the disclosures in future.	Board	To be reviewed in subsequent reporting cycles.
Review the existing FAQ on capital WIP disclosures and clarify that the use of a % model is not the only way to determine what "significantly longer" means.	Secretariat	Completed.
Additional disclosures on repairs and maintenance		
Review the existing FAQ on repairs and maintenance and clarify that paragraph .89 does not prescribe how to calculate the amount disclosed as repairs and maintenance.	Secretariat	Completed.
Communication with stakeholders		
Communicate findings of the review with key stakeholders based on the stakeholder communication plan.	Secretariat	Ongoing.

Action agreed by the Board	Responsibility for action	Status
Raise awareness about the issues identified in the review through articles and newsletters.	Secretariat	Ongoing.