ISSUED MARCH 2020

FEEDBACK STATEMENT – ED 177 PROPOSED TRANSITIONAL PROVISIONS FOR THE STANDARD OF GRAP ON *FINANCIAL INSTRUMENTS (REVISED 2019)*

This feedback statement outlines the comments received on ED 177 and a summary of the transitional provisions for GRAP 104 (2019)	**Overview**	The Board approved amendments to GRAP 104 in 2019 to align it to the international standards on which it is based, i.e. IFRS 9 on *Financial Instruments* and IFRS 7 on *Financial Instruments: Disclosures.* ED 177 outlines proposed transitional provisions for the initial adoption of these amendments.
	Consultation process	The Board approved ED 177 in July 2019 with a comment deadline of 29 November 2019. The final transitional provisions to GRAP 104 were approved by the Board in March 2020.
	Supporting material	Analysis of written and verbal comments received on ED 177. Final amendments to GRAP 104 on *Financial Instruments (2019).* Fact Sheets on specific transactions.
	Next steps	The Board will request the Minister of Finance to approve the effective date of the amendments. The proposed effective date is 1 April 2024.

ASB
ACCOUNTING STANDARDS BOARD

FEEDBACK STATEMENT

ED 177 – PROPOSED TRANSITIONAL PROVISIONS FOR THE REVISED STANDARD OF GRAP ON FINANCIAL INSTRUMENTS

What did we hear?	
General support for the transitional provisions	Respondents generally supported the transitional provisions as well as the proposed effective date of 1 April 2024. While there was general support for the Board's proposals, overarching comments were raised along with issues identified with specific transitional provisions. While the Board's response to the overarching issues is limited because of their nature, these issues have been shared with the National Treasury.
Overarching issues	
Is sufficient data available about debtors?	GRAP 104 introduces an "expected credit loss" model which requires entities to assess the credit risk of financial assets and other instruments using past, current and forward-looking data. This means entities need credible data about financial instruments, including debtors. Some respondents raised concerns about the credibility of data at a municipal level: • Some municipalities process transactions and adjustments through the debtors' control account rather than the individual debtor's account. This means that information about the credit risk of individual debtors may not be reliable. • Municipalities often have a "single view" of a debtor or a property, e.g. one individual, entity or property with several services provided. The information is not segmented into the various services provided. As the credit risk profile may be different for the different services provided, municipalities will need to be able to better segment their data. • Municipalities indicated that the adoption of a Municipal Standard Chart of Accounts may have resulted in a change in IT systems. Arrangements were made with service providers of legacy systems to provide them access to information for a period. This period may need to be extended to ensure that data is available to comply with the impairment model which requires data about past, current and future expectations of credit risk. The General Report 2018 for local government indicated that about 25% of municipalities have issues with debtors. The assertions which were most often not met include completeness, classification, rights and obligations, and valuation and allocation. While 25% is a high number, it does not mean that this is a pervasive enough issue to prevent or delay the implementation of revised GRAP 104.

Overarching issues	
Do the changes have any impact on government policies?	Some respondents to ED 177 raised concerns about the implementation of the expected credit loss model and the potential effect on government's finances, debt ratings and how going concern is assessed. Based on the implementation of the equivalent requirements in the private sector, a deterioration in financial performance and financial position was not always observed. The Board agreed that the potential implications of the change in the impairment model should be explained. This should among others, indicate that entities may need to adjust performance metrics - particularly for bad debt. Municipalities are required to budget on an accrual basis. Respondents indicated that the budgeting requirements for impairment of debtors should be aligned with the revised principles in GRAP 104 to avoid unauthorised expenditure being incurred. It was also observed that the municipal budget requirements are implemented approximately 18 months before the year in which those requirements are applied. The effective date proposed should be long enough to deal with changes required to the budget process. The need to review the budget requirements has been discussed with the National Treasury.
What can the ASB do to provide implementation support?	Given the complexity of the changes, several respondents indicated a need for implementation support. Suggestions included: • 'Piloting' the requirements of the Standard. In response to this suggestion, the establishment of a reference group comprised of preparers, firms, and the ASB and the National Treasury was discussed with stakeholders. The purpose of the group would be to meet prior to the Standard becoming effective. The group could discuss topics with specific preparers and others, with the intention being that preparers would go away and do work on understanding the practical issues in their environment. The group would discuss how these issues could be resolved and/or what further guidance is needed. Support was expressed for this process. • A GRAP Guideline on financial instruments should be issued by the National Treasury. • The publication of an "automated" ECL impairment model. This was communicated to the National Treasury. • The publication of a high-level summary of the differences between GRAP 104 and IFRS 9. The Board agreed that this would be a useful document to publish.

<table>
<tr><th colspan="2">Transitional provisions</th></tr>
<tr><td>What does retrospective application without retrospective restatement mean?</td><td>The transitional provisions in ED 177 required retrospective application of GRAP 104. The retrospective restatement of comparative information was not required for certain disclosures. Entities could voluntarily restate comparative information if they could demonstrate that they did not apply hindsight when restating information.

In debating the transitional provisions with respondents, there were differing views about what the implications are for impairment, i.e. should impairment losses be assessed retrospectively from the origination of the transaction and not retrospectively restated, or should impairment be assessed at the beginning of the year in which the Standard is adopted. One of the key issues in the differing interpretation is the extent of the historic data that needs to be available.

As issues were raised about potential data issues, the Board agreed that the transitional provisions should be amended to indicate that expected credit losses are assessed on the date of adoption. This applies to all instruments subject to the impairment requirements of the Standard.

The Board also agreed that the principle of voluntary restatement of comparative information should be deleted to simplify the initial adoption of the Standard.</td></tr>
<tr><td>Should the Board delay the effective date or allow a three-year transitional period?</td><td>To date, the Board has generally provided a three-year transitional period for the adoption of more complex Standards. The relief has related to recognition, measurement, and/or classification of transactions. The relief period has however not been effective as:

• Entities have waited until the end of the three-year period to change their accounting policies.

• The ability to change accounting policies for transactions based on an entities’ individual needs means that there has been a lack of comparability in the market.

• Providing assurance during the three-year period has been difficult given the varied requirements.

• Disclosure by entities about how the relief period has been applied and any changes during the period has not been well communicated by entities in their financial statements.</td></tr>
</table>

Transitional provisions	
Should the Board delay the effective date or allow a three-year transitional period?	Given the issues identified, the Board proposed delaying the effective date for three-years. The change in approach means that entities will need to comply in full in the year the Standard is adopted. Most respondents supported the change, but some questions were raised about whether early adoption is possible. When debating the comments, some stakeholders were of the view that a three-year relief period should be permitted rather than delaying the effective date. They indicated that they want to be able to adopt the revised requirements on a piecemeal basis as this allows them to learn lessons for certain types of transactions or portfolios of assets/liabilities and implement these lessons in other areas. They also noted that if the effective date is earlier with a three-year transition period, entities may be prompted into action sooner rather than waiting until the year of adoption. Other stakeholders raised reservations about how the three-year approach could be implemented. Over and above the issues identified by the Board, these stakeholders were concerned about how new instruments would be accounted for during the three-year period, i.e. will they be accounted for using the old accounting policies, or the new accounting policies. They also raised issues about the "date of adoption" and how this would be applied during the three-year period. The Board considered the views expressed and noted that the previous approach had not yielded the desired results, particularly that it had not resulted in earlier preparation for the implementation of a Standard. The Board agreed to delay the effective date rather than provide a three-year relief period.

Executive summary of proposed transitional for GRAP 104 (Revised 2019)	
Overarching transitional provisions	The amendments to GRAP 104 should be applied retrospectively with some exceptions. Early adoption of the Standard is permitted.
Classification of financial instruments	Retrospective application is required, except in the following instances: • An entity determines whether financial assets are held for trading as at the date of initial adoption. • An entity assesses the cash flow characteristics of a financial asset without considering the modified time value of money element and prepayment features. • If a hybrid contract is measured at fair value but the fair value was not determined for comparative periods, the fair value is the sum of the non-derivative host and embedded derivative at the end of each comparative period.
Measurement of financial instruments	*Effective interest method* If it is impracticable for an entity to apply the effective interest method retrospectively, an entity can measure the gross carrying amount of the asset using the fair value at the date of initial adoption. *Impairment* Expected credit losses are assessed at the date of initial adoption. Expected credit losses are assessed over a 12-month period or over the lifetime instrument (some exceptions apply). The decision to use a 12-month period or the lifetime of the instrument is based on whether there has been a significant change in credit risk. An entity uses information that is available without undue cost and effort to determine if there has been a significant change in the credit risk of an instrument since initial recognition to the date of initial adoption. If the information is not available without undue cost and effort an entity recognises losses using lifetime expected credit losses.

Executive summary of proposed transitional for GRAP 104 (Revised 2019)	
Disclosures related to the adoption of the revised GRAP 104	An entity is required to disclose the information below. This disclosure is however <u>not</u> required for prior periods. (a) For each class of financial asset and financial liability on initial adoption: - The original measurement category and carrying amount using GRAP 104 (2009). - The new measurement category and carrying amount using GRAP 104 (2019). - The changes in the carrying amount resulting from a change in measurement category. The changes in the carrying amount resulting from a change in a measurement attribute. (b) Qualitative information to enable users to understand (a) how the classification requirements were applied to those instruments where the classification changed, and (b) the reasons for changes in the designation of financial assets and financial liabilities measured at fair value. (c) The fair values of financial assets or financial liabilities at the end of the reporting period for those instruments that are now measured at amortised cost. (d) The effective interest rate on initial adoption and interest revenue or expense recognised for financial assets and financial liabilities previously measured at fair value. The disclosures in (a) to (d) need only be provided in the year that the entity adopts the amendments to GRAP 104.

How to access information	
Access information on the ASB and its work programme online	Visit our website on www.asb.co.za Follow us on Facebook and LinkedIn Subscribe to our Newsletter Access the translated versions of the Standards ASB@ASB_SA https://www.linkedin.com/company/accounting-standards-board https://www.facebook.com/AccountingStandardsBoard/