ACCOUNTING STANDARDS BOARD

ANALYSIS AND RESPONSES TO VERBAL COMMENT RECEIVED ON

PROPOSED TRANSITIONAL PROVISIONS FOR THE STANDARD OF GRAP ON FINANCIAL INSTRUMENTS (REVISED 2019)

(ED 177)

RESPONSES TO THE VERBAL COMMENT RECEIVED ON THE PROPOSED TRANSITIONAL PROVISIONS FOR THE STANDARD OF GRAP ON FINANCIAL INSTRUMENTS (REVISED IN 2019)

The Accounting Standards Board (Board) approved an Exposure Draft of the Proposed *Transitional Provisions for the Standard of GRAP on Financial Instruments* (ED 177). Notice was published in the Government Gazette on 19 July 2019 (Notice 42584). The comment period closed on 29 November 2019.

The proposed transitional provisions were discussed with preparers, auditors, consultants and other interested parties by way of roundtable discussions and other meetings as listed in the table on the next page. The verbal comment on ED 177 is summarised in this document and includes the Board's responses.

The summary of written comment received is included in a separate analysis.

CLASSIFICATION OF VERBAL COMMENT RECEIVED ON THE PROPOSED TRANSITIONAL PROVISIONS FOR THE STANDARD OF GRAP ON FINANCIAL INSTRUMENTS (REVISED IN 2019)

No.	Name/Organisation	Preparers	Users	Auditors	Other interested parties
1.	Public Sector Accounting Forum (October 2019)	X	X	X	X
2.	Municipal Accounting Working Committee (Western Cape)	X			
3.	Roundtable discussion with preparers (public entities)	X			
4.	Roundtable discussion with preparers (municipalities)	X			
5.	Roundtable discussion with technical specialists			X	

NO.	COMMENT	BOARD's RESPONSE
1.	**Public Sector Accounting Forum**	
1.1	*Credibility of data on debtors* Members explained that the accounting for debtors has been neglected by many municipalities. The accounting issues relate to basic bookkeeping and daily/monthly controls not being implemented. This has resulted in the following: • Entries and adjustments to 'debtors' are processed through the debtors' control account rather than through the sub-ledger. This means that individual debtor's accounts are often incomplete. • Billing for goods and services provided by municipalities is inaccurate or incomplete. The result is that individual debtor balances are incomplete and inaccurate. This means that any meaningful analysis of credit risk exposure is not possible. While it is accepted that the challenges that exist are not those of the standard-setter, without credible data available on debtors, the implementation of the new requirements of GRAP 104 is not feasible.	Noted. The MFMA requires municipalities to maintain full and proper records of the financial affairs in accordance with the prescribed norms and standards. It is therefore a legal requirement to maintain adequate records for receivables. The three-year period leading up to the effective date of the Standard will allow entities time to correct underlying data on debtors so that the information needed to apply GRAP 104 is available. This issue has been discussed with the National Treasury. The General Report published by the Auditor-General of South Africa in 2018 for local government indicated that 25% of municipalities had issues with receivables. The audit 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. The concerns raised reflect a poor financial management environment as a result of a lack of basic internal controls. These issues will remain irrespective of the accounting requirements.
	One of the key underlying reasons for the situation is the education of preparers of financial statements and finance officials. A co-ordinated effort is needed to educate preparers and financial officials on basic accounting concepts and the application of the principles in GRAP 104.	The introduction of a reference group during the transitional period may assist entities to understand the accounting requirements and identify areas where potential issues exist.

NO.	COMMENT	BOARD's RESPONSE
	The district municipalities should be used more effectively to communicate and discuss accounting issues.	
1.2	*System issues – mSCOA* With the implementation of mSCOA, some entities were required to change IT systems in order to accommodate the requirements of the chart. While 'opening' data was transferred from the old system to the new system, there is often a process in place with old system vendors to provide access to the detail of the 'opening data'. For example, there will be an opening balance for a debtor when mSCOA was implemented on the new system, but the detail of the opening balance is only available from the old system. This may have potential implications for applying impairment retrospectively, as well as having data available on balances that are written off in GRAP 104 but where the entity still intends to collect outstanding balances. Municipalities would have negotiated with existing system vendors about the length of time data on the system will be made available to the municipality. The ASB should consider this in proposing transitional provisions, and particularly where retrospective application or restatement will be required.	Noted. This is a practical issue rather than one affecting the adoption of the changes to GRAP 104. The issues related to historical data could be overcome if entities understand what historical data they may need into the future and enter into arrangements with service providers to either back up or access this data on an ongoing basis. Consideration will be given as to how, or if, this should be discussed at the reference group.
1.3	*Communication with system vendors* As a result of the implementation of the mSCOA, there is an existing engagement process with system vendors. It would be helpful if the National Treasury could engage with the mSCOA system vendors on the implementation of the changes to GRAP 104. It was suggested that the National Treasury should develop system requirements for the amendments to GRAP 104 and issue these to system vendors.	Noted. This has been communicated to the National Treasury.
1.4	*Timing of implementing changes to GRAP 104* Members made a number of observations regarding the timing of implementing amendments to GRAP 104. They observed that some public entities that implemented IFRS 9 on *Financial Instruments* have reported higher impairment losses as a result of the implementation of the expected credit loss model. Given that the current economic environment is sensitive, they questioned whether it is appropriate to implement accounting principles that would reflect an	Noted. While there is a potential for an increase in impairment losses, this will not automatically be the case in all instances. For some private sector entities, there has not always been a direct correlation between the implementation of IFRS 9 and an increase in impairment losses.

NO.	COMMENT	BOARD's RESPONSE
	increase in impairment losses. They also observed that the increase in impairment losses may have the following effects: • The increased impairment losses may reduce entities' credit worthiness and dissuade investors. • The auditors may highlight issues on whether the entity is a going concern if impairment losses are increased such that they have a significant impact on an entity's financial performance and position. • Municipalities include impairment losses in their budgets, which in turn impacts the cost structure used to determine tariffs charged to users. Increased tariffs as a result of higher impairment losses may cause tariffs to be increased and become unaffordable. This in turn has a negative impact on the financial sustainability of the municipality as users would be unable to pay higher tariffs. Some members were of the view that the new requirements provide better information for users to make decisions as predictive data is provided about exposure to credit risk. Proactive rather than reactive decisions can be taken. It was also observed that the new requirements better reflect an entity's financial position. Any decisions taken about the implementation of the Standards should be based on whether the new information enables users to hold entities accountable and make decisions.	When discussing the issue of increased impairment losses with stakeholders, some observed that many municipalities are already including both past and current information in their impairment tests. General future economic data on its own (e.g. x% unemployment, GDP growth or contraction, etc.) is unlikely to increase impairment losses. Impairment losses may only be affected where specific events exist, e.g. closure of a specific entity in an area. While the Board notes the potential increase in impairment losses, the expected credit loss (ECL) model provides users of the financial statements with better predictive information to make decisions before actual losses arise.
1.5	*Use of financial statements* A member observed that the ASB should consider how analysts, lenders and other users use the financial statements when deciding on the transitional provisions and transitional relief period. They observed that these users become familiar with certain data being provided in private sector financial statements. It is often difficult for these users to understand why certain information is not provided in public sector financial statements.	Noted. The Board is of the view that this is a communication issue and that the link between the revisions to GRAP 104 and IFRS 9 should be communicated clearly. This has been done in the Feedback Statement but ongoing communication on this issue will be considered.
1.6	*Implementation support* The Secretariat explained that the Financial Instrument project group comprised of the preparers suggested undertaking a 'pilot' project to understand the implications of GRAP 104 on entities.	Noted. The establishment of a reference group will be discussed by the Board once the transitional provisions for the revisions to GRAP 104 have been finalised.

NO.	COMMENT	BOARD's RESPONSE
	In exploring potential ideas, the Secretariat explained that one of the suggestions was to establish a 'reference group' which would be comprised of users, preparers across the public sector, auditors, technical specialists and other parties that would convene at specific intervals to discuss the accounting implications of specific transactions. The purpose would be to identify potential issues and agree how they could be resolved. Members broadly supported this approach. They indicated the following: • The group should at least include the metropolitan municipalities as it is likely that they are most significant affected. The other non-delegated municipalities would also likely be affected. • While the reference group could discuss and agree on how to address issues, the potential issues and solutions should be discussed with a broader group of entities (including those with poor audit outcomes and/or low capacity).	
2.	**Municipal Accounting Working Committee (Western Cape)**	
2.1	*Data on debtors* Participants noted issues with the data for debtors. These are as follows: • They indicated that most municipalities currently have a single view of a debtor or a property, e.g. one debtor with several services provided, or one property with several services provided - the information is not currently segmented. To ensure that impairment losses are calculated in accordance with the new requirements of GRAP 104, municipalities will need to be able to better segment their data. • It was observed that part of the rates paid by some municipalities may be used for settling debts for other services provided. This information will be needed to determine the expected credit losses for the various services provided (this is particularly an issue in separating statutory and contractual receivables and how impairment losses are determined for each). • It was observed that debtors often become indigent and may revert back to a 'normal' debtor (or vice versa) within a financial year. This will create a level of complexity when calculating expected losses.	Noted. These are potential implementation issues that could be discussed by the reference group.

NO.	COMMENT	BOARD's RESPONSE
2.2	*Transitional provisions* As the requirements of the revised GRAP 104 are new and complex, it is difficult to judge whether the transitional provisions are appropriate. Some entities are currently trying to undertake a gap analysis to understand the impact of the changes.	Noted. While it is important for entities to undertake their own gap analysis, this was done by the Board when developing the transitional provisions and proposing transitional relief. No other areas requiring transitional relief were identified by stakeholders.
2.3	*Transitional relief* Some respondents observed that entities frequently wait until the end of the transitional period to act on changes to the Standards. It was suggested that the Board should consider developing a specific timetable of what should be done and by when.	Noted. This suggestion has been made to the Board in other projects, but because the Standards are applied by different entities, some entities may find it easier/harder to implement certain requirements at specific points in time. As a result, the adoption of the requirements and the timing thereof is left to individual entities to decide.
2.4	*Proposed effective date* Participants discussed the proposed effective date of 1 April 2024. They observed that in the municipal environment, the budget requirements need to be determined at least 18 months before the start of the financial year. The budget also needs to be submitted well in advance of the commencement of the reporting period. As the budget includes a line item for impairment losses, the budget requirements issued by the National Treasury will need to include the revised principles of GRAP 104. Similarly, the municipalities will need to ensure that the calculation of impairment losses in the budget and financial statements is the same otherwise unauthorised expenditure could be incurred. The Board should factor the budget implications into the determination of the effective date of GRAP 104. This should be considered in the context of the comment on the data issues with debtors.	Noted. This was discussed with the National Treasury.
3.	**Roundtable discussion with preparers (public entities)**	
	Discussion on changes to GRAP 104	
3.1	<u>Loan commitments</u>	Noted. Loan commitments only apply to loans and not to grants. Specific guidance has been included

NO.	COMMENT	BOARD's RESPONSE
	Participants questioned how loan commitments should be accounted for, i.e. debits, credits and presentation on the statement of financial performance and position. It was questioned whether commitments to provide grants would be loan commitments. Participants indicated that there should be clear definitions for loan commitments in the revised GRAP 104.	on loan commitments in the Application Guidance of GRAP 104, as well as examples that illustrate the accounting entries. A Fact Sheet has also been issued on loan commitments. Loan commitments will also be highlighted to the National Treasury so that guidance can be included in the GRAP Guideline.
3.2	Impairment of assets Participants indicated that it would be difficult to apply the impairment model for loans to SMEs that have no credit history/credit data. It questioned how practical it is to apply the model to these loans. Participants provided a scenario of a concessionary loan provided to a construction company to develop certain assets which will be used to promote economic development. They questioned whether delays in construction would be an indicator of impairment.	Noted. The difficulty with determining the initial fair value of loans to SMEs, along with any impairment assessments, is acknowledged. These challenges exist under the existing Standard of GRAP. Measuring instruments with SMEs could be a potential implementation issue that could be discussed by the reference group. The delay in construction will not necessarily affect an entity's credit risk. If the delay results in cash flow or other issues that may result in an inability to pay the loan, then the delay might give rise to a change in credit risk. The delayed payment, if material, may have an impact on the value of any impairment loss calculated. An entity will need to apply judgement to each circumstance.
	Awareness of auditors	
3.3	Questions were raised by participants about whether the auditors are aware of the changes to GRAP 104 and how they will audit the revised requirements, particularly the new impairment model.	Noted. The IRBA has issued guidance on auditing estimates in response to the implementation of IFRS 9. Awareness about the changes to GRAP 104 and the response by the auditors will be discussed with the AGSA.

NO.	COMMENT	BOARD's RESPONSE
	Transitional provisions	
3.3	Participants did not raise any comments on the proposed transitional provisions.	Noted. No action required.
	Transitional relief	
3.4	Participants questioned whether the proposal to delay the effective date means that an entity can early adopt the requirements of the Standard.	The Standard can be early adopted by entities. An entity cannot early adopt parts of the Standard. The transitional provisions have been amended to make this clear.
3.5	Participants generally agreed with the proposed effective date. They indicated that there would need to be a significant amount of planning done by entities during that period to ensure compliance by 31 March 2025.	Noted. No action required.
3.6	Participants indicated that there will need to be constant communication about the amendments to GRAP 104 and the proposed effective date to ensure that entities take appropriate action.	Noted. The Board will develop a communication strategy once the transitional provisions have been finalised.
3.7	Participants questions what the IPSASB does regarding providing transitional provisions and transitional relief and whether the Board's proposal is consistent with international process.	The IPSASB develops transitional provisions for the first-time adoption of IPSAS as well as for changes to existing Standards. For financial instruments, the transitional provisions are similar (except for transactions that are excluded from GRAP 104 because they are not relevant to the South African environment). The transitional relief period varies depending on the complexity of the changes, but in general, is not longer than 3 years.
	Initiatives to support the implementation of revised GRAP 104	
3.8	Participants indicated that because there is more judgement involved in classifying instruments and applying the impairment model, there needs to be active capacity building initiatives undertaken by the OAG.	Noted. This suggestion was shared with the National Treasury.

NO.	COMMENT	BOARD's RESPONSE
	Some participants suggested having 'tutorials' of how to undertake certain assessments, understand the accounting entries etc.	
3.9	Participants questioned if they can send the ASB examples of transactions with related entries to review.	The Board, or the Secretariat of the ASB, do not review the accounting treatment of specific transactions. It may be appropriate for entities to discuss broad accounting treatments for similar types of transactions at the reference group.
3.10	Participants requested that the Secretariat arrange a session with the IDC, DBSA, Landbank and other entities that have applied IFRS 9 to share lessons learnt.	Noted. The Secretariat will contact these entities to find out if they would be willing to share lessons learnt with the broader public sector.
	Challenges	
3.11	Participants indicated that the key challenges are capacity of officials at entities given the complexity of the Standard, as well as the systems available to deal with the changes. In particular, it was indicated that systems are a challenge for concessionary loans.	Noted. This has been shared with the National Treasury.
3.12	Some participants noted that there is often a lack of understanding about the Standards of GRAP as they are not taught at university. Some participants were of the view that revisions to GRAP 104 bring the Standard in closer to alignment to IFRS. Preparers that are familiar with IFRS 9 are likely to be able to better deal with the changes to GRAP 104.	Noted. No specific action required.
4.	**Roundtable discussion with preparers (municipalities)**	
	Scope	
4.1	Participants indicated support for the change in accounting for issuers of financial guarantee contracts. They indicated that the most significant issuers of financial guarantees still apply the modified cash basis of accounting. These entities should be encouraged to apply Standards of GRAP.	Noted. Similar comments were made during the consultation on the work programme for 2021-2023 and conveyed to the National Treasury.

NO.	COMMENT	BOARD's RESPONSE
	Impairment model	
4.2	Participants discussed the change in impairment model and the implication for bank accounts. They observed that because they are only permitted to invest with the big four banks, it is likely that the bank accounts will be classified as having a 'low credit risk' and therefore 12-month losses will be assessed.	Noted. No specific action required. This could be a potential area that is discussed by the reference group.
4.3	In developing data for the expected credit loss model, participants indicated that it is likely that they will need to use an actuary to assist them with the identification of the data needed as well as building the model. This might be only once-off on initial adoption, or it might be ongoing.	Noted. No specific action required.
4.4	It was questioned whether the ASB had engaged with actuaries about the project, and whether the actuaries are aware of the changes to GRAP 104 and that they may be asked by entities to assist with the impairment model.	Noted. Many entities in the private sector have used quantitative analysts to assist with the implementation of IFRS 9. These specialists are aware of the requirements of the Standard and would be able to assist should public sector entities make similar requests.
4.5	It was noted that there may be issues with drawing debtors' age analyses at a point in time to assess if debtors are in default – this would be the case if impairment needed to be assessed retrospectively.	Noted. The issues related to historical data could be overcome if entities understand what historical data they may need and download the necessary data. Based on feedback received, the transitional provisions have been amended to require expected credit losses for receivables to be assessed on the date of adoption.
4.6	It was suggested that the Secretariat review the General Report for the last MFMA cycle to determine what issues have been raised on debtors, as well as to establish how widespread issues are relating to debtors.	Noted. See the response to 1.1 above.
4.7	It was suggested that a discussion be held with the firms that have been involved in the implementation of IFRS 9 to identify what the system requirements are to implement IFRS 9. It was also observed that because there are a limited number of system vendors in the municipal	Noted. Consideration will be given as to how, or if, this should be discussed with the reference group.

NO.	COMMENT	BOARD's RESPONSE
	environment (less than 10), it would be easy to identify which vendors may have issues if the system requirements can be clearly articulated up-front.	
	Transitional provisions	
4.8	Participants supported the transitional provisions related to the classification of financial instruments as well as the related disclosures.	Noted. No action required.
4.9	Participants debated the transitional provisions for measurement, and in particular, the impairment model. Participants indicated that applying the requirements retrospectively may be difficult as it may be difficult to access data from prior periods. The credibility of the current (or past data) may also be questionable. If the effective date is delayed, then it may be possible to overcome these challenges. Participants discussed whether applying the impairment model prospectively would be helpful, i.e. only apply to new debtors' balances. They were however of the view that running two impairment models would be practically difficult and would not provide users with meaningful information.	Noted. Based on feedback received, the transitional provisions have been amended to require expected credit losses for receivables to be assessed on the date of adoption.
4.10	A participant indicated that it would be useful if the Board undertakes a post-implementation review of the current version of GRAP 104. Preparers would find it helpful if they knew whether they are applying the current version of GRAP 104 correctly.	Noted. The Board has already agreed what reviews it will undertake for the period 2021-2023. As GRAP 104 was in the process of being revised, the Board did not believe that undertaking a review would be helpful.
4.11	A participant indicated that the outcomes of the reviews are helpful. The Board should however consider when the results of the reviews are published. To allow entities sufficient time to implement the findings between audits, it was suggested that the results should be published in December.	Noted. This will be considered when publishing the results of the reviews.
	Effective date	
4.12	Participants supported the proposed effective date of 1 April 2024. They noted that the period of time would allow municipalities to start thinking about how to implement the changes and build on lessons learnt during this process. However, they indicated that there is a risk that entities will	Noted. A communication plan will be developed once the transitional provisions have been finalised.

NO.	COMMENT	BOARD's RESPONSE
	do nothing until the year of adoption. They suggested that the Secretariat and the National Treasury ensure that there is continuous engagement on the issues.	
4.13	Participants questioned whether it would be possible to early adopt the changes – either in full or in part.	Noted. Early adoption of the revised Standard (in its entirety) is possible. The transitional provisions have been amended accordingly.
	Supporting the implementation of GRAP 104	
4.14	Participants supported the idea of a work group or reference group leading up to the effective date to facilitate discussions on the changes to GRAP 104 and how they could be implemented. It should however be clear that the entities that participate in the groups would be expected to do work on how the changes could be implemented in their environments and coming up with possible solutions.	Noted. The establishment of a reference group will be considered once the transitional provisions have been finalised.
4.15	It was suggested that the National Treasury should act as the Secretariat for the work group or reference group so that the independence of the ASB is not compromised.	Noted. This suggestion will be shared with the National Treasury.
4.16	Participants indicated that the firms publish guidance on how to apply IFRS in the private sector. There should be an equivalent process for the public sector. It was observed that this should be done by the National Treasury. They indicated that the GRAP Guideline for GRAP 104 should be published soon so as to avoid entities expending resources individually to understand GRAP 104.	Noted. This will be shared with the National Treasury
5.	**Roundtable discussion with firms**	
	General	
5.1	Participants indicated that some auditors were already requiring entities to apply the revised GRAP 104 even though it is not yet effective. They suggested adding a watermark to the revised GRAP 104 to indicate that it is not yet effective.	Agreed. A watermark has been added.
	Transitional provisions	
5.2	Some participants indicated that many municipalities do not have credible data on debtors. They indicated that the data is not credible because of poor record keeping and lack of appropriate systems.	Noted. See the response to 1.1 above.

NO.	COMMENT	BOARD's RESPONSE
5.3	Participants debated what it meant to apply the Standard retrospectively for impairment. Some were of the view that, because there is no retrospective restatement, it only requires consideration of impairment on the date of adoption. Others were of the view that the requirements would need to be applied from the date of adoption. There was also uncertainty about how these requirements would be applied if entities decide to restate prior year information. Based on the issues raised about the credibility of data on debtors, it was suggested that the impairment of debtors should be assessed on the date of adoption rather than being applied retrospectively. It was also suggested that including all the practical expedients or transitional relief for debtors should be relocated to one section.	Agreed. The transitional provisions have been amended to make it clear that expected credit losses are considered on the date of adoption rather than on the date of origination.
5.4	It was questioned whether paragraph 12 should only apply to items designated at fair value. It was suggested that the Secretariat review the IFRS 9 transitional provisions and make a change if needed.	Noted. The transitional provisions in IFRS 9 were reviewed, and it was confirmed that the requirements do not only apply to previously designated items.
5.5	Paragraph .15 was incorrectly interpreted by private sector preparers. As a result, it was suggested that paragraph .15 should be reworded to indicate that entities are not required to restate comparative information, but that they may.	Agreed. The wording has been updated as suggested.
	Proposed effective date	
5.6	Participants supported the proposed effective date. It was questioned whether part, or all, of the Standard could be applied earlier.	Noted. Early adoption of the revised Standard (in its entirety) is possible. The transitional provisions have been amended accordingly.
5.7	Participants noted that there is a risk that entities do nothing until the date of adoption. While this risk was acknowledged, views were expressed that the requirement to disclose information on the effect of newly effective Standards may ensure that entities consider the effects during the transitional relief period provided. It was suggested that the AGSA focus on the disclosures provided to ensure entities are taking appropriate action. There should also be ongoing communication about the changes and their potential implications.	Noted. These issues will be discussed with the AGSA, as well as the AGSA's involvement in the reference group.
	Supporting the implementation of GRAP 104	

NO.	COMMENT	BOARD's RESPONSE
5.8	Participants indicated that the following may be helpful in supporting the implementation of GRAP 104: • A simple impairment model could be developed for use by entities with basic financial instruments. • The National Treasury could publish basic economic data each year to assist entities with developing macro-economic factors that could affect the forward-looking data needed for the impairment model.	Noted. These suggestions have been shared with the National Treasury.