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TO: MEMBERS OF BOARD
FROM: ELIZNA VAN DER WESTHUIZEN
SUBJECT: RESEARCH PAPER ON APPLICATION OF STANDARDS OF GRAP BY SMALL ENTITIES
DATE: 16 SEPTEMBER 2020
FILE REF: ATTACHMENT 5(a)

BACKGROUND AND OBJECTIVE

1. The Board considered the results of research on the financial reporting environment of small entities at its meeting in March 2019. The Board agreed that the following steps should be taken:
 - The specific challenges the research identified should be mapped to the existing and upcoming projects of the Board, and existing guidance of the Board and/or Secretariat. This should be done to consolidate current or future work to address the challenges so that areas where further actions are required, if any, can be identified. Proposals on guidance that the Board can develop to address remaining challenges, if any, should be included in this analysis. The analysis should also consider where actions have or could be taken by other stakeholders when it is not within the Board's mandate.
 - A meeting should be held with the trilateral parties to establish the roles of the ASB and OAG in providing guidance, including to small entities.
 - A Research Paper should be developed outlining the results of the initial phase of the research as it would be useful for stakeholders.
2. The objective of this memorandum is to present the following to the Board for its consideration:
 - (a) an analysis of the challenges identified through the research and the proposed responses thereto; and
 - (b) the draft Research Paper (see attachment 5(b)).

CHALLENGES IDENTIFIED THROUGH THE RESEARCH AND PROPOSED ACTIONS

3. The Board's research identified a number of challenges that small entities face to prepare GRAP compliant financial statements. The challenges were categorised as (a) accounting challenges, and (b) challenges related to the broader small entity

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environment. The research noted that assisting entities with accounting challenges may indirectly assist them with the broader small entity environment challenges, and vice versa. It was therefore found to be most helpful if a holistic approach is followed to assist small entities with their challenges.

4. The challenges have been mapped to the Board's projects, existing guidance of the Board and guidance issued by the Secretariat. The challenges were further discussed with the trilateral parties to assess the actions that could be taken by the parties, considering each party's mandate.

(a) Accounting challenges

5. The challenges related to accounting were found to most often relate to areas where judgement is required. The research also noted that in some instances there is a misunderstanding of the requirements of the Standards of GRAP. For example, the requirements of GRAP 104 on *Financial Instruments*, GRAP 103 on *Heritage Assets*, and the application of materiality were misunderstood.
6. An analysis of the accounting challenges and the proposed actions are included in Annexure A.

(b) Challenges related to the broader small entity environment

7. The Board noted that addressing challenges related to the broader small entity environment is outside of its mandate. These challenges are included in the Research Paper and have been communicated to the trilateral parties.

Further steps to address identified challenges

8. As indicated in Annexure A, no actions have been identified for the Board. This was supported by the Technical Committee.
9. For noting by the Board, the Secretariat identified that it could take / has taken the following steps:
 - Stakeholders that participated in the research (including many who see themselves as "small") will be added to the Secretariat's mailing list, if not already included. This will ensure they remain up-to-date on developments.
 - Communication will be drafted to stakeholders that participated in the research to inform them of the publication of the Research Paper.
 - As part of the annual process to update the handbook, communication can be drafted on all the changes for the next reporting period.
 - The Secretariat has shared the results of the Board's research with those responsible for the IPSASB Research Forum item on *Differential Reporting (Financial Reporting for Small and Medium Sized Public Sector Entities)*. The Secretariat will continue to monitor the topic and outcomes of their research.

ACTION REQUESTED #1

The Board is requested to:

- (a) NOTE the analysis and proposed actions on the accounting and broader small entity environment challenges; and**
- (b) CONFIRM that no further actions are required.**

RESEARCH PAPER

10. The draft Research Paper, which includes the Secretariat's analysis of the challenges, is included as attachment 5(b). The draft Research Paper has been recommended by the Technical Committee to the Board for approval.

ACTION REQUESTED #2

The Board is requested to CONSIDER the draft Research Paper and, if appropriate, APPROVE it for publication.

Annexure A

Analysis of accounting challenges and proposed actions

Challenge	Description	Linkages to existing or upcoming projects of the Board	Linkages to existing guidance of the Board or Secretariat	Other stakeholder actions	Further possible actions
Non-current assets: Measurement, applying judgement and accounting for fully depreciated assets	Determining fair value, which was raised as an on-going challenge and not once-off. The challenge was frequently raised in the context of heritage assets.	The Board is currently undertaking a post-implementation review of GRAP 103 on <i>Heritage Assets</i> . The challenges identified from this research related to GRAP 103 are being considered as part of the post-implementation review.	-	<ul style="list-style-type: none"> The OAG has issued an updated GRAP Accounting Guideline on <i>Non-current Assets</i> (February 2020), providing practical guidance on the challenges identified. The IPSASB is developing guidance on heritage assets and infrastructure assets, including on measurement and componentisation. 	No further actions are proposed.
	Applying judgement to separate assets into components.	-	The Board has published the Guideline on <i>The Application of Materiality to Financial Statements</i> (materiality guideline), which will assist small entities in deciding when it is necessary to apply the requirements to separate assets into components.		
	Applying judgement to determine e.g. useful lives and residual values of assets.	-	<ul style="list-style-type: none"> The materiality guideline will assist entities to determine 		

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	Adjusting for fully depreciated assets still in use, and the cost to do so.	-	<p>when it is necessary to adjust the financial statements for changes to useful lives and residual values, and for fully depreciated assets, based on materiality.</p> <ul style="list-style-type: none"> As an outcome of developing the materiality guideline, the Secretariat updated an FAQ on <i>What is the treatment of fully depreciated assets still in use (other than on the initial adoption of the Standards of GRAP)?</i>. Awareness is being raised on the FAQ through a webcast and social media. The Secretariat has an existing FAQ on <i>Must an asset always have a residual value?</i>. 		
GRAP is complex	The Standards of GRAP are complex and difficult to understand and apply, especially when a reader is not financially literate.	The Board aims to simplify the requirements in the Standards of GRAP and eliminate accounting policy choices, where possible and appropriate. This will	<p>The materiality guideline assists preparers in making materiality decisions when preparing financial statements.</p> <ul style="list-style-type: none"> Entities should develop accounting policies that are appropriate for their nature, size and complexity of their 	The OAG has issued updated GRAP Accounting Guidelines in February 2020 to assist entities with implementing the Standards.	No further actions are proposed.

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		<p>remain the Board's policy in existing and future projects.</p>	<p>transactions. The Secretariat has developed material to assist entities with developing appropriate accounting policies, e.g. articles published in the ASB newsletter and presentations available on the ASB website.</p> <ul style="list-style-type: none"> • Entities need not apply requirements of the Standards of GRAP when the effect of applying them is immaterial. 		
Accounting for, and disclosure of, financial instruments	A general inability to account for and disclose financial instruments was raised as the Standard is complex.	<p>Review of GRAP 104 on <i>Financial Instruments</i>, resulted in GRAP 104 (2019), for which an effective date of 1 April 2024 has been proposed. GRAP 104 (2009) is currently effective.</p>	<ul style="list-style-type: none"> • As an outcome of the review of GRAP 104, fact sheets have been developed to explain the basic principles of the Standard for specific types of instruments. Although the fact sheets are based on the revised GRAP 104 (2019), the guidance on the basic principles are relevant for the current GRAP 104 (2009), e.g. which instruments are financial instruments. 	<ul style="list-style-type: none"> • The OAG has published a tool on financial instrument disclosure related to GRAP 104 (2009). • The OAG has published an updated GRAP disclosure checklist for Standards of GRAP effective from 1 April 2019. It includes the 	<p>The National Treasury has received funding from the European Union to develop tools that can assist entities in accounting for financial instruments. Two separate guides are planned: a simplified guide, e.g. for receivables and payables, and a more</p>

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			<ul style="list-style-type: none"> • The materiality guideline will assist entities to develop GRAP accounting policies for material items, and to only disclose information that is material. • The Secretariat has issued FAQs on GRAP 104 (2009): <ul style="list-style-type: none"> ○ <i>When (and/or how) should receivables and payables be discounted in accordance with GRAP 104?</i> ○ <i>What is the effective interest rate and how do you calculate it?</i> ○ <i>How do statutory receivables arise? which provides guidance on distinguishing statutory and contractual receivables</i> 	<p>requirements of GRAP 104 (2009).</p>	<p>comprehensive guide dealing with complex financial instruments.</p>
<p>Keeping up-to-date with changes in the reporting framework</p>	<p>The requirements of the Standards change on an annual basis as new Standards become effective and amendments are made to existing Standards. Respondents indicated an</p>	<p>-</p>	<ul style="list-style-type: none"> • The Board publishes an updated annexure to Directive 5 on <i>Determining the GRAP Reporting Framework</i> annually, which outlines changes in the 	<ul style="list-style-type: none"> • See areas where SAICA is assisting the Secretariat with webcasts and recordings. • CIGFARO invites the Secretariat to give presentations 	<ul style="list-style-type: none"> • Stakeholders that participated in the research (including those who see themselves as “small”) will be

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	inability to keep up-to-date with changes.		<p>reporting framework from one year to the next.</p> <ul style="list-style-type: none"> • The Secretariat annually updates FAQs on the GRAP reporting framework to remain up-to-date. • The Secretariat, with SAICA, creates awareness of newly effective pronouncements during bi-annual GRAP updates in the form of webcasts (this may take on a different form in future). • Recordings are done with SAICA on newly effective Standards and other topical matters. • The Secretariat participates in SAICA's TechTalk webcasts where topical matters are discussed. • The Secretariat has started in 2019 to use social media, and has changed the format of the newsletter. This has broadened the reach to stakeholders and created the opportunity to communicate more information more regularly with stakeholders. 	<p>to municipalities on changes to the Standards and other topical matters.</p> <ul style="list-style-type: none"> • Provincial treasuries have assisted the Secretariat with hosting workshops to present newly effective Standards. 	<p>added to the Secretariat's mailing list, if not already included.</p> <ul style="list-style-type: none"> • As part of the annual process to update the handbook, communication can be drafted on all the changes for the next reporting period.

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Applying materiality, including determining appropriate accounting policies	Preparers are unable to make materiality judgements, including determining appropriate accounting policies, resulting in resources being spent to account for and disclose immaterial transactions and information.		<ul style="list-style-type: none"> The Board published the materiality guideline. The Secretariat issued a FAQ on <i>What is the role of materiality in the reporting of information in the financial statements?</i> 	-	No further actions are proposed.
Disclosures	Disclosures are onerous for a small entity, specifically making judgements about which disclosures to provide.	-	The materiality guideline will assist small entities to only disclose information that is material.	The OAG has published an updated GRAP disclosure checklist for Standards of GRAP effective from 1 April 2019.	No further actions are proposed.
Year-end adjustments	These adjustments usually require technical skills and knowledge as well as capacity which small entities do not have.	-	<p>See the guidance related to the challenge on “non-current assets” above.</p> <p>This challenge was further found to stem from other challenges related to the environment of small entities, such as human resource and budget constraints.</p>	-	No further actions are proposed.