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Vacancies amongst Board Members of the Accounting Standards Board

The ASB currently has three vacancies available for outstanding candidates with demonstrable technical excellence to join the Board, starting in March 2021 and running for a three-year term (with a possible extension available). Please contact Erna Swart (ernas@asb.co.za) for more information.

Common mistakes in preparing the cash flow statement

The cash flow statement is an integral part of the financial statements. This statement informs users about the actual cash received by the entity during a particular reporting period, and how these funds were spent to meet service delivery objectives. The cash flow statement:

- can be used as a comparison with budgeted amounts when the budget is prepared on the cash basis;
- can assist management in making decisions on how changes in funding will impact the scope and nature of the entity's activities;
- is valuable in predicting an entity's future cash requirements; and
- is useful to assess the entity's ability to generate cash flows in the future.

Some entities may have given the preparation of the cash flow statement less prominence in comparison to other statements in the financial statements. The cash flow statement remains an important part of the financial statements.

Practice has shown that a number of common mistakes are made by preparers when preparing the cash flow statements.

Adjusting for non-cash flow items

A mistake that is often made in preparing the cash flow statement, is not adjusting for all the non-cash flow items. Very often, the software programs that are used to prepare financial statements do not adjust for non-cash flow items such as good and/or services in-kind or adjusting for the straight lining of operating lease expenses.

Goods in-kind comprise tangible assets that are received by the entity in a non-exchange transaction and are measured at fair value on date of acquisition. Similarly, when services in-kind are significant to the entity's operations and a value can reliably be determined, these services are recognised in the statement of financial performance at fair value. Goods and/or recognised services in-kind, including donations other than cash, are not cash transactions and should therefore be adjusted as non-cash items in the cash flow statement.

GRAP 13 on *Leases* requires lease payments under operating leases to be recognised as an expense on a straight-line basis over the lease term. Straight lining the lease expense does not represent an actual cash payment. An adjustment for the non-cash portion of the operating lease payment should therefore be made when preparing the cash flow statement.

Presenting cash flow items at net amounts

Most cash flow items are reported separately in the cash flow statement. GRAP 2 on *Cash Flow Statements* only allows the presentation of cash flows on a net basis in the following instances:

- (a) the cash receipts and payments are made on behalf of third parties – thus where the reporting entity acts as an agent in accordance with GRAP 109 on *Accounting by Principals and Agents*; and
- (b) cash receipts and payments are made for items in which the turnover is quick, the amounts are large, and the maturities are short. This will be, for example, the purchase and sale of an investment.

Items such as interest received and finance costs, and dividends received and paid, should therefore be presented separately in the cash flow statement rather than presented as net amounts.

Classification of bank borrowings and investments as cash and cash equivalents

Entities are sometimes unsure which items are “cash and cash equivalents” in the cash flow statement. An item is part of “cash and cash equivalents” if it is held to meet short-term commitments, rather than for investment or other purposes.

Bank borrowings, that are generally considered to be financing activities, are not cash equivalents. The exception is, however, if the bank overdraft is repayable on demand and forms an integral part of the entity’s cash management activities. This will typically be evident where the bank balance often fluctuates between positive and negative.

Management’s intention for having or holding an investment plays an important consideration in determining whether the investment qualifies as a cash equivalent. An investment is a cash equivalent if it is:

- Short term and highly liquid – GRAP 2 explains that an investment may have a maturity date of three months or less from the acquisition date. This does, however, not automatically excludes investments from being cash equivalents if they have a maturity date of more than three months.
- Readily convertible to known amounts of cash – for an investment to be a cash equivalent, it must be convertible into cash without an undue period of notice, and without the entity incurring significant penalties on withdrawal. The amount of cash to be received on withdrawal must be known to the entity when the investment is made.
- Insignificant risk of changes in values – this means that the investment is similar to cash and any changes in its value are insignificant.

The Secretariat of the ASB has issued a Frequently Asked Question that explains what items should be included in “cash and cash equivalents”. The FAQ can be accessed by following this link: <http://www.asb.co.za/frequently-asked-questions/>.

Reconciliation of net cash flows from operating activities to surplus/(deficit)

In preparing the cash flow statement, a reconciliation is prepared to reconcile the surplus/(deficit) in the statement of financial performance, with the net cash flows from operating activities. A common mistake is to not adjust for items that are shown separately on the face of the cash flow statement.

Depending on the nature of the entity’s activities, interest received is disclosed separately in the cash flow statement as either operating or investing activities. Likewise, finance costs are separately disclosed as either operating or financing activities. As these elements are included in the surplus/(deficit) for the period, they should be adjusted in calculating the net cash flows from operating or investing activities. Interest received is deducted from the surplus/(deficit), while the finance costs are added back.

ASB projects on GRAP 2

The ASB is currently undertaking a project to review entities' compliance with the presentation requirements in GRAP 2. This project also involves identifying and understanding practices that entities apply in the compilation and preparation of the cash flow statement. The results of the review will be presented to the ASB Board in March 2021.

Events

The ASB continues to promote social distancing. As a result, we will host our scheduled events for August 2020 virtually. If any new information becomes available about the regulations for the risk adjusted strategy for COVID-19, we will communicate this in our Newsletter, website and social media.

The events for the various topics the ASB will be hosting are outlined below.

Participate in discussions on IPSASB's proposals for revenue and expenses

We will be hosting roundtable discussions on the new Exposure Drafts issued by the IPSASB on potential changes to the revenue standards and new guidance for government expenses. The Exposure Drafts are as follows:

- ED 181 on *IPSASB Exposure Draft on Revenue with Performance Obligations* (ED 70)
- ED 182 on *IPSASB Exposure Draft on Revenue without Performance Obligations* (ED 71)
- ED 183 on *IPSASB Exposure Draft on Transfer Expenses* (ED 72)

Date	Event	Stakeholder group
19 August	Roundtable discussion – ED 183	Auditors, firms, technical specialists, professional bodies, and academics
31 August	Roundtable discussion – ED 181	Members of the Public Sector Accounting Forum
2 September	Roundtable discussion – ED 182	Members of the Public Sector Accounting Forum
4 September	Roundtable discussion – ED 183	Members of the Public Sector Accounting Forum
14 September	Roundtable discussion – ED 181	Municipalities
15 September	Roundtable discussion – ED 182	Municipalities
17 September	Roundtable discussion – ED 183	Municipalities
1 October	Roundtable discussion – Presentation and Disclosure ED 181 and ED 182	All
2 October	Roundtable discussion – Presentation and Disclosure ED 183	All

The roundtable discussions will focus on discussing issues to be included in the comment letter to the IPSASB on the Exposure Drafts. If you are interested in attending a session, please email elizna@asb.co.za.

Comment on the Exposure Drafts is due locally on 1 October 2020, and the documents can be accessed on the ASB's website by following this link: <https://www.asb.co.za/proposal-feedback/>

Municipal audit outcomes

The MFMA General Report for 2018/2019 was published by the Auditor-General of South Africa (AGSA) on 1 July 2020.

With only 20 municipalities achieving a clean audit, it is hard not to wonder how things will look the next year given the ongoing COVID-19 crisis and the negative effects it has had on the economy.

More debt less cash

Of concern is that municipalities are already cash strapped and overburdened with debt. The AGSA's report indicates that 60% of the money due for basic municipal services, such as water and electricity, will not be collected. A staggering R28.65 billion is owed to Eskom and various Water Boards. The implementation of the new impairment model outlined in the revised Standard of GRAP on *Financial Instruments* (2019) may go some way to help municipalities to better understand their exposure to credit risk, i.e. non-collection.

The new model proposes an estimation of exposure to credit risk rather than just focusing on past "default" events which is the current approach. Having better information about the future means that users of the financial statements may be able to better predict the financial position of an entity. However, if the Standard is to be implemented effectively – which is currently proposed as 1 April 2024 - there will be a clear need for municipalities to have reliable information on the debts it is owed. This may be an area where municipalities may want to focus their attention given the current economic crisis.

Preparing the financial statements

Despite being in a dire financial position, 183 municipalities employed consultants to help with the preparation of the financial statements. Only 7% of these indicated that they used consultants due to internal vacancies. This means that the remaining municipalities had internal teams available to prepare the financial statements, but still chose to use consultants.

The use of consultants is often raised with the ASB and broadly framed under the concern that the "Standards of GRAP are too costly to implement". The Standards of GRAP are designed to be scalable, particularly because the Standards only apply to material items. What this means is that if an entity has complex, material transactions, then the Standards could arguably be complex to apply. These entities should however have appropriately skilled resources to deal with this level of complexity. If an entity does not have complex transactions, then the Standards and related accounting are simple.

The Standards of GRAP are also designed to deal with transactions undertaken by a range of entities in the public sector. As a result, some Standards may be more relevant to particular entities or groups of entities than others.

It is critical for entities to understand which Standards are relevant to them, and what transactions and events are material such that the Standards are only applied to material items.

A critical success factor in preparing financial statements, is a sound control environment. This includes the existence of credible, reliable and complete information for all the transactions and events that have occurred at an entity. It is important that, if consultants are used, they should ideally not be used to fulfil day-to-day or routine activities where existing internal capacity exists.

Access the full report

The full Consolidated General Report on the Local Government Audit Outcomes and the Citizens' Report MFMA2018-19 on the AGSA's website.

Useful links

- Access the Citizens' Report:
<https://www.agsa.co.za/Portals/0/Reports/MFMA/201819/GR/Citizens%20report-MFMA2018-19.PDF>
- Access the full MFMA General Report:
<https://www.agsa.co.za/Reporting/MFMAReports/MFMA2018-2019.aspx>



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