FACT SHEET – DIRECTIVE 12

OBJECTIVE OF THE DIRECTIVE	
What is Directive 12?	Directive 12 on *The Selection of an Appropriate Reporting Framework by Public Entities* prescribes a set of criteria that affected public entities need to assess in determining what reporting framework they should apply - i.e., International Financial Reporting Standards (IFRS® Standards) or Standards of GRAP.
SCOPE OF THE DIRECTIVE	
Who are the affected public entities?	Affected public entities are those listed in Schedules 2, 3B and 3D of the PFMA, including entities under their ownership control, which: • applied Statements of GAAP[1] or IFRS Standards when Directive 12 became effective; or • are newly established.
Which public entities are exempt from applying the Directive?	Directive 12 exempts those public entities where the Minister of Finance has already approved Standards of GRAP as their reporting framework.
Can entities request exemptions from the National Treasury in order not to apply a specific reporting framework?	Entities may apply to the National Treasury for exemptions to apply a specific reporting framework. <u>Reclassification of entities</u> There may be entities that are already applying Standards of GRAP (i.e. those listed in Schedules 3A and 3C) that believe that IFRS Standards are more appropriate. In particular, entities that have been incorrectly classified in the PFMA Schedules. In such cases, entities should engage with the National Treasury which has a process in place for reclassification and/or exemption from the prescribed reporting framework.
Why did the Board not consider the entity's classification in the PFMA Schedules as a basis for selecting the appropriate reporting framework?	Initially, the Board considered that the selection of a reporting framework should be based on the classification in the PFMA Schedules. It was observed that some entities, although they were set up to be financially viable, were substantially funded by government while others were incorrectly classified. As a result, the Board agreed that the entity's classification should not be used in Directive 12 as it may lead to some entities applying an inappropriate reporting framework.
When should the Directive be applied?	The Directive became effective on 1 April 2018. This is the date that affected entities could first apply the Directive, however earlier application was permitted. After initial application, entities are not required to annually re-assess whether they still meet, or do not meet, the criteria in the Directive. However, when a significant change occurs in an entity's operations indicating that the initial assessment may have changed, the entity is required to undertake a re-assessment.

[1] Statements of GAAP refers to those statements codified by the Accounting Practices Board and issued by the South African Institute of Chartered Accountants until 1 December 2012 when they were withdrawn.

This Fact Sheet explains the Secretariat's views on the accounting and other issues related to the application of Directive 12. This Fact Sheet should be reviewed with the Directive 12. This Fact Sheet has not been reviewed, approved or otherwise acted on by the ASB.

FACT SHEET – DIRECTIVE 12

SELECTING AN APPROPRIATE REPORTING FRAMEWORK	
When should affected entities apply IFRS Standards?	Entities that meet one of the following criteria should apply IFRS Standards: (a) the entity is a financial institution; (b) the entity has ordinary shares or potential ordinary shares that are publicly traded on capital markets; or (c) the entity's operations are such that they are: i. commercial in nature; and ii. only an insignificant portion of the entity's funding is acquired through government grants or other forms of financial assistance from government.
When should affected entities apply Standards of GRAP?	Entities that do not meet the criteria to apply IFRS Standards should apply Standards of GRAP as their reporting framework. The Standards of GRAP are appropriate for entities with the following characteristics: • they are responsible for the delivery of goods or services to benefit the public and/or to redistribute income and wealth; • they mainly finance their activities, directly or indirectly, by means of taxes and/or transfers from other spheres of government, social contributions, debt or fees; and • they do not have a primary objective to make profits.
What is a financial institution?	For purposes of the Directive, a financial institution is an entity: • as defined in the *Financial Sector Regulation Act No. 9 of 2017*, or • that undertakes activities similar to a financial institution, including the provision of loans and credit in accordance with the *National Credit Act, Act No. 34 of 2005*.
Should entities with publicly traded debt instruments automatically apply IFRS Standards?	As there is no requirement in the JSE listing requirements for debt issuers to provide financial information that is based on IFRS Standards, the Board agreed that it was not necessary to expand the criteria to include publicly traded debt. The criteria to apply IFRS Standards only considers entities with ordinary shares that are publicly traded. Entities with publicly traded debt instruments should assess whether they meet, or do not meet, the criteria in the Directive.
What should entities consider when assessing whether their operations are commercial in nature and government funding is insignificant?	Assessing whether the operations are commercial in nature and the funding from government is insignificant requires management to exercise judgement. There are strong linkages between the nature of the entity's operations and how it is funded. Therefore, these two elements need to be assessed together and entities should satisfy both criteria to apply IFRS Standards. This is because both elements contribute to the financial viability of an entity – the nature of the funding received in relation to an entity's operations will provide an indication of who the users of that entity's financial statements are, and the information they will require from the financial statements.

This Fact Sheet explains the Secretariat's views on the accounting and other issues related to the application of Directive 12. This Fact Sheet should be reviewed with the Directive 12. This Fact Sheet has not been reviewed, approved or otherwise acted on by the ASB.

Commercial operations

The Directive does not define commercial in nature. It explains that management should consider whether the primary objective of the entity is to generate profits – i.e., it has a commercial objective. Entities will need to look to their mandate to assess whether their operations are commercial.

The criterion is concerned with an entity's financial viability. If the operations are commercial in nature, then it means that the entity can support/sustain its operations without depending on government for funding. In such cases, the users of the financial statements (i.e., providers of capital) will measure the performance of the entity based on profits generated as they are interested in their return on investment in that entity. As a result, IFRS Standards are appropriate for the types of decisions that the users of financial statements will be making about the "buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit".

Depending on the entities' activities, the level of participation in competitive markets may demonstrate the nature of the entities' operations. When it is unclear whether the operations are commercial or not, for example semi-commercial operations – it may be useful to consider the different revenue-generating activities of an entity to determine the primary activity, and whether or not it generates profits. However, if there is still uncertainty, entities may need to consider whether they support government's service delivery objectives even though they were established to undertake commercial activities.

Government funding

Assessing the significance of government funding requires entities to consider their capital structure and funding model. IFRS Standards would be more suitable for entities that usually borrow in capital markets and are not reliant on government funding to sustain their operations.

If an entity receives government funding, it should consider the type of funding (i.e., nature) and how it uses that funding (i.e., operational, capital expenditure, project-related etc.) to assess the level of dependency on government funding. As such, the higher the proportion of government funding, the more reliant an entity is on government funding.

Government guarantees

The assessment of the significance of funding from government only considers direct funding and financial assistance, for example grants, loans, equity injections as well as highly concessionary loans. The Board agreed that for purposes of the Directive, guarantees, letters of support or subordination agreements are considered government funding.

In recent years, there have been entities that received ongoing financial assistance in the form of bailouts. Since the self-assessment is holistic, entities with ongoing financial assistance should consider past, current and future information over an extended period of time to determine the level of dependency on government funding, and the impact thereof on the entity's operations.

	Newly established entities For newly established entities, assessing the level of dependency on government funding may not be straightforward, as the entities may initially require ongoing financial assistance from government even though they were established to be financially viable. Management should consider current and future information about the new entity to assess if the criteria in the Directive are met to apply IFRS Standards.
How, and by whom is the assessment undertaken?	The assessment is an entity-specific assessment that is undertaken by management (i.e., a self-assessment). As this is a holistic self-assessment, management should apply its judgement and consider past, current and future information about the entity to assess if the criteria in the Directive are met to apply IFRS Standards. The assessment should cover an extended period (i.e., more than one reporting period) so as to avoid management changing its assessment, and the entity's reporting framework frequently. Since the Directive requires a self-assessment to be undertaken, it is possible for similar entities to reach different conclusions about whether they meet, or do not meet, the criteria to apply IFRS Standards.
	Entities under the ownership control of affected entities When undertaking the assessment, management assesses the criteria for the economic entity (i.e., group) rather than the individual entities. This will ensure that the individual entities within the group apply the same reporting framework. However, in some cases, it may be necessary for management to consider other factors such as regulatory requirements affecting the individual entities in its assessment for the economic entity.
APPLICATION OF AN APPROPRIATE REPORTING FRAMEWORK	
How should entities account for the change in reporting framework?	When entities adopt a new reporting framework it should be accounted for as a change in accounting policy as follows: • entities that change from Statements of GAAP to IFRS Standards should account for the change in accounting policy and provide the relevant disclosures in accordance with the International Accounting Standard® on *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8); and • entities that change from Statements of GAAP or IFRS Standards to Standards of GRAP should account for the change in accounting policy and provide the relevant disclosures in accordance with the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* (GRAP 3).
Which transitional provisions apply when a new reporting framework is adopted?	Entities that change from Statements of GAAP to IFRS Standards need to apply the requirements in IFRS 1 on *First-time Adoption of International Financial Reporting Standards* which sets out the procedures that should be followed when IFRS Standards are adopted.

	Entities that change from Statements of GAAP or IFRS Standards to Standards of GRAP should apply Directive 2 on *Transitional Provisions for Public Entities, Trading Entities, Technical and Vocational Education and Training Colleges, Municipal Entities and Constitutional Institutions* that sets out the transitional provisions.
What is the appropriate accounting treatment when the initial assessment was incorrect, and entities applied an inappropriate reporting framework?	Entities that applied an inappropriate reporting framework due to an incorrect assessment of the Directive should apply the requirements in either GRAP 3 or IAS 8 to account for the change in reporting framework correctly. It may be necessary for management to consult their auditors on the potential audit consequences.
DISCLOSURES	
Are there specific disclosures required by Directive 12?	The Directive requires entities to disclose the judgements made by management when applying the criteria initially or subsequently in the case of a re-assessment. These disclosures should be made in the summary of significant accounting policies or the notes to the financial statements. Depending on the reporting framework adopted, entities should also apply the relevant requirements in IFRS Standards or Standards of GRAP when preparing and presenting their financial statements.