Accounting Standards Board

Newsletter May 2022 Edition

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What is the purpose of the session?

In preparation for the year ending 30 June 2022, the ASB will be hosting a GRAP Update for municipalities and municipal entities.

The ASB will share high-level information on the following topics:

09:00 to 09:15	GRAP Reporting Framework effective from 1 April 2021	Elizna van der Westhuizen
09:15 to 09:45	Applying economic substance over legal form	Jeanine Poggiolini
09:45 to 10:30	The effect of past decisions about materiality on future financial statements	Jeanine Poggiolini
10:30 to 10:45	Comfort break	
10:45 to 11:15	Preliminary results of the review of compliance with GRAP 24 on presenting budget information in financial statements	Elizna van der Westhuizen
11:15 to 11:35	Newly issued FAQs	Elizna van der Westhuizen
11:35 to 12:00	Overview of Exposure Drafts available for comment	Amanda Botha
12:00 to 12:30	What's new internationally?	Amanda Botha

Logistics

The meeting will be held virtually on Teams. Please send an email to julliannev@asb.co.za to receive the electronic invitation. There is no cost for attending the session.

We look forward to interacting with you.

As the PFMA reporting deadline looms, it is often all about whether the financial statement numbers are accurate and complete, compiling supporting evidence for the auditors and just generally focusing on the minutia. It is easy to lose focus on the big picture of why we prepare financial statements.

While all the things I have mentioned are necessary, it is important not to lose sight of who is going to use this information and what decisions they are likely to take. This is broadly what materiality is about. We have been advocating throughout the year that entities apply the voluntary *Guideline on The Application of Materiality to Financial Statements*. If applied as intended, this would have resulted in entities considering materiality throughout the reporting period by identifying their users, what decisions they are likely to take, developing materiality thresholds and criteria, and using these to formulate accounting policies, identifying what information should be disclosed, and how it should be presented. However, if entities have not applied the Guideline from the start of the year, it is not too late to apply materiality at this stage in the process.

So, how could materiality be applied now? Entities often use automated reporting tools, or a reporting template. A key factor in using these tools should be ensuring that information is specific to the entity and tells its story, rather than being generic. This may mean modifying the output of the reporting tool, or modifying the reporting template. Here are a few simple tips that can be used to make the financial statements more relevant:

- Only present accounting policies that are relevant to the entity's activities. For example, if an entity does not have transfers and mergers, then a policy is not required in the financial statements.
- Explain how the principles in the Standards of GRAP have been applied by an entity when describing accounting policies. Many financial statements merely repeat the principles in the Standards rather than explaining to what transactions they apply and how they are recognised, measured, etc.
- Only present items separately when they are material. Immaterial items should be aggregated together. This helps to avoid cluttering the financial statements with line items that are not important for users to know about individually. A typical example is the correction of prior period errors. Entities often present the correction of each error separately in the statement of changes in net assets or notes, when they could be combined in a more meaningful way.
- Do not repeat information in different parts of the financial statements. Standards may require similar disclosure for different items. These should be combined in a way that is both relevant and understandable to users.

While not relevant to applying materiality, the information in the financial statements should be understandable. Avoid using accounting jargon. The simpler the language in the financial statements, the more likely users are to engage with them.

As a parting thought, it is important to remember that the financial statements prepared play a critical role in strengthening our democracy. The published financial statements ensure that citizens and others have relevant, credible information available to them when they vote, when they engage in public participation on the budget and development plans, etc. It is our duty as accountants to ensure that we understand the role we play in broader society, and that we exercise diligence in doing so.

Jeanine Poggiolini

Chief Executive Officer

Substance over form – when to apply it?

Over the last few months we have focused on explaining substance over form – what it means and when it should be applied. We continue the discussion on what it means to apply economic substance over legal form, and when it would, or would not, be applied.

Why do we apply substance over form?

The financial statements present information about the economic and other phenomena. This means that the focus is on the economic characteristics of items and what this means for a reporting entity. The legal characteristics may provide information about how economic characteristics arise, but following a purely legal classification of transactions, events and economic phenomena in the financial statements is inappropriate.

Substance over form is a fundamental principle in *The Conceptual Framework for General Purpose Financial Reporting*. One of the qualitative characteristics that information in the financial statements should represent is "faithful representation". The Conceptual Framework describes "faithful representation" as follows: "To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. ….Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance — which is not necessarily always the same as its legal form."

In classifying transactions, events or other phenomena as assets, liabilities, revenue, expenses, equity or something else, economic substance is considered and not just legal form, e.g. recognising assets based on control rather than legal title only. Substance over legal form is also important when assessing relationships between parties for accounting purposes, e.g. control relationships, principal-agent arrangements, and service concession arrangements.

Questions have been asked about whether "economic substance over legal form" is applied in all situations, particularly the presentation and measurement of revenue, expenses, assets, liabilities and equity. The Standards often discuss whether the contractual or other legal terms of arrangements or management's intention should be used in, for example, measuring and presenting transactions or events. The Standards provide clear guidance on when substance over form (including management intent) should be applied. Two examples are outlined below.

The rights to extend the repayment of debt and how it affects the classification of liabilities

If an entity exercises its contractual discretion to refinance an obligation for at least twelve months after the reporting date under an existing loan facility, it classifies the obligation as non-current even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example there is no agreement to refinance), the potential to refinance is not considered and the obligation is classified as current.

The reason for relying on the contractual rights (i.e. legal form) for presentation, is because the classification should be based on what rights exist and can be exercised at year end. If intention was used, entities would be able to alter debt from current to non-current and potentially improve their financial position.

Calculating the impairment of receivables

In the Standard of GRAP on *Financial Instruments (Revised in 2019)* an entity is required to identify impairment losses based on what it believes its exposure to credit losses will be over a period of time. The expected losses are calculated based on the cash flows that an entity expects to receive and when it expects to receive them. While there are a number of assumptions that management makes about the receipt of cash flows, the underlying cash flows used in the calculation are based on what is contractually agreed. Also, the period over which the cash flows are calculated cannot exceed the contractual period of the instrument.

As with the first example, it is important that, for example, that contractual cash flows are used (i.e. legal form) as this reflects the money the entity is entitled to. Assumptions are then applied to assess how much of these cash flows will be received and when. Using other amounts would enable the entity to manipulate its financial position and financial performance.

The two examples illustrate the importance of reading and understanding the Conceptual Framework as well as the requirements of the individual Standards of GRAP.

Response for Substance over form – when to apply it?

In response to our article on 17 May on "Substance over form – when to apply it?" we have had questions from practitioners about the meaning of the last sentence underlined in the example below:

> *Calculating the impairment of receivables*
>
> In the Standard of GRAP on *Financial Instruments (Revised in 2019)* an entity is required to identify impairment losses based on what it believes its exposure to credit losses will be over a period of time. The expected losses are calculated based on the cash flows that an entity expects to receive and when it expects to receive them. While there are a number of assumptions that management makes about the receipt of cash flows, the underlying cash flows used in the calculation are based on what is contractually agreed. Also, the period over which the cash flows are calculated cannot exceed the contractual period of the instrument.

The combination of the English language and financial instruments demonstrates the complexity that can arise in accounting.

When measuring the impairment of receivables, entities would consider what cash flows it expects to receive and when. The "when" could extend beyond the initial contractual terms particularly in cases where the instrument is credit impaired. Consider an example where a municipal debtor is in liquidation. In this instance, the amount due to the entity will be based on the contractual cash flows, but clearly the cash flows will be received based on the completion of legal proceedings that would extend beyond the contractual period of the instrument. In these situations, it is possible that the contractual cash flows may not be fully recovered if the liquidators decide that Xc will be received for each Rand.

The sentence in the last example was intended to illustrate that there may be instances when broader contractual elements may need to be considered together in assessing impairment. This could include the period of the contractual cash flows of an instrument, along with other contractual elements such as commitments and options that could affect the assessment of the contractual period. For example, in considering the contract period of a loan granted to another party, the period of a loan commitment, the period over which cash flows are due, and options for extension, may be factors in determining the contract period for impairment purposes. Whether or not the cash flows will be received within that contract period may indicate an impairment based on the timing of collection.

The table below may assist deciding what to use when assessing impairment:

Calculating impairment of receivables

Stage of financial asset	Stage 1	Stage 2	Stage 3*
Credit risk	Did not increase significantly since initial recognition	Increased significantly since initial recognition	Credit impaired
Loss allowance	12 months expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses
Period over which to calculate loss allowance	Forward looking - 12 months	Forward looking – Lifetime of receivable (contractual period + consider extension options)	Forward looking – Lifetime of receivable (contractual period + consider extension options + consider other factors/periods as a result of credit impaired receivable)

**Note: Stage 3 does not apply to receivables.*

Have your say

Questions such as these demonstrate the need for a robust discussion on the accounting standards and their interpretation.

We appreciate questions such as these and welcome continued discussions on accounting matters. Feel free to contact us on info@asb.co.za.

IPSASB proposed changes to their Conceptual Framework – what do we think?

The International Public Sector Accounting Standards Board (IPSASB) published proposed changes to their *Conceptual Framework for General Purpose Financial Reports*. We explained these proposals in a series of articles in March 2022, which included the following:

- What is prudence in accounting, and why does it matter?
- Can "obscuring" information affect materiality?
- IPSASB provides more guidance on what a "resource" means in the public sector.
- What is the "Unit of Account"?

The proposals mostly align the IPSASB's Conceptual Framework to the Conceptual Framework of the International Accounting Standards Board.

What do our stakeholders think?

The Accounting Standards Board published the Exposure Draft concurrently as ED 197 and the Secretariat is consulting stakeholders on it locally.

Stakeholders mostly support the proposals. Potential issues raised to date for the IPSASB's consideration include the following:

Proposal	Potential issue and suggestions
The definition of an asset now reflects that an asset may arise from past events. The IPSASB considered that plural past events, rather than the singular past event, better conveys the point that resources can accumulate over time due to an initial and subsequent past events.	Stakeholders questioned whether there could be instances where this change unintentionally changes the recognition point for some assets, resulting in entities inappropriately recognising an asset earlier. It would be useful to clarify that the change captures existing ways in which assets are acquired and does not intend to change the recognition point.
The description of a resource, in the context of an asset, now reflects a rights-based approach.	The role governments' sovereign powers and rights play in identifying resources would need to be clear. No changes are proposed to the BCs where this role was previously explained. It would be useful for the IPSASB to note in the BCs that the change in approach should not change governments' assessments of their resources resulting from sovereign powers and rights.
The discussions on assets and liabilities respectively include proposed guidance on recognising assets and liabilities in principal-agent arrangements. An agent would not recognise resources of the principal in its custody, and would also not recognise a related liability.	The guidance may result in agents not recognising assets (and related liabilities) when all the elements of the definitions are met. The appropriateness of the guidance should be reconsidered.
Guidance on accounting principles for binding arrangements that are equally unperformed is included in the section on Unit of Account; a separate section was deemed unnecessary.	Although stakeholders support including the guidance in the Conceptual Framework, they questioned the placement. Unit of Account is not the only consideration for binding arrangements that are equally unperformed and such arrangements should be discussed in a broader context.

Are differences between the Conceptual Framework and standards-level guidance acceptable?

For various reasons, there may be temporary and permanent differences between the guidance in the Conceptual Framework and individual Standards. There are divergent views internationally and locally about whether this is appropriate. Some stakeholders, including preparers locally, prefer that the principles in the Standards are aligned to the Conceptual Framework. Other stakeholders accept differences given the role of the Conceptual Framework – it is a tool for a standard-setter to develop Standards, and may be used in specific circumstances by preparers to develop accounting policies. Standards deal with specific types of transactions or events and guidance may differ from the Conceptual Framework to provide useful information to users about those specific types of transactions or events.

How to have your say…

You can submit comment to the ASB by 17 May 2022 at info@asb.co.za, or submit comment directly to the IPSASB by 31 May 2022 here.

IPSASB issues proposed guidance on reporting by retirement benefit plans

Governments operate retirement benefit plans for its employees. Examples locally include the Government Employees' Pension Fund (GEPF), Joint Municipal Pension Fund, and pension funds established by individual municipalities for their employees.

The International Public Sector Accounting Standards Board (IPSASB) issued a proposed IPSAS on *Retirement Benefit Plans.* The proposed IPSAS is based on IAS 26 on *Accounting and Reporting by Retirement Benefit Plans* and has been modified to suit the public sector as well as current accounting concepts. The proposed IPSAS outlines principles for how retirement benefit plans should report in their financial statements. More information can be accessed here.

Retirement benefit plans here are regulated by the Financial Sector Conduct Authority (FSCA). This includes regulating how plans prepare their financial statements. As a result, there is no need for separate accounting guidance to be issued by the ASB. While this is not a project that the ASB will specifically address as part of its work programme, any interested or affected parties should provide comments to the IPSASB by 1 August 2022.

Urgent Clarification on status of Standards of GRAP

1. This is an urgent notice to clarify the status of the Standards of GRAP on *Financial Instruments* (GRAP 104) and *Employee Benefits* (GRAP 25).
2. It has come to our attention that some entities may have applied the incorrect versions of the Standards of GRAP in the preparation of their financial statements for 31 March 2022.

Status of Standards of GRAP?

3. In 2019 and 2021, the ASB revised GRAP 104 and GRAP 25 respectively. The status of these Standards is as follows:

   (a) GRAP 104 on *Financial Instruments* (Revised 2019) is not yet effective. This Standard is effective for financial years commencing on or after 1 April 2025. As the Standard was substantially changed, an entity may not use the version revised in 2019 to formulate its accounting policies. The Standard must be adopted and applied in totality – partial adoption or application is not permitted.

   The differences between the 2009 and 2019 versions of GRAP 104 are significant.

   (b) GRAP 25 on *Employee Benefits* (Revised in 2021) has no effective date. As the Minister of Finance has not determined an effective date, it cannot be adopted or applied in any way.

Which versions to apply?

4. The Standards that are effective and should be applied are as follows:
   - GRAP 104 (Issued October 2009) (Remember to apply the main text and Application Guidance)
   - GRAP 25 (Issued November 2009)
5. The Standards of GRAP that are not yet effective are separately listed on the ASB's website.

6. Disclosure of Standards of GRAP approved but not yet effective should be considered in terms of the relevant Standards of GRAP, Directive 5 and the FAQs issued by the Secretariat.

Where to get more information?

7. For any other queries related to the reporting framework for financial years ending on 31 March 2022 or 30 June 2022, please consult the following sources:

   FAQs – section 2 deals with the reporting framework for 2021/2022 reporting periods.

   Directive 5 – Annexure C for period commencing on or after 1 April 2021 should be applied.

Contact us
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