Accounting Standards Board

Newsletter June 2022 Edition

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Message from the CEO - The problem with assets

As the ASB, we always receive comments from stakeholders that accounting for assets using Standards of GRAP is too difficult, and as a result, the requirements in the Standard should be reviewed, or should be made less onerous for certain entities.

Over the years, the Board has undertaken various projects to uncover exactly what issues preparers have with applying the Standards of GRAP on assets. These projects include:

- A post-implementation review of GRAP 17 on *Property, Plant and Equipment* and GRAP 16 on *Investment Property*
- A post-implementation review of GRAP 103 on *Heritage Assets.*
- A review to identify if certain entities should have different reporting requirements.

Based on feedback from both users of the financial statements and preparers during the reviews, changes were made to GRAP 16, 17 and 103 to ensure better, more consistent application of the Standards. Based on the issues raised by stakeholders about the need for different reporting, most issues raised were practical rather than conceptual.

All three of these projects highlighted systemic issues that cannot be addressed through changing accounting Standards. These include:

Poor record keeping

One of the most common questions we get is how the Standards deal with valuing assets when the supporting documents cannot be found. This is not a Standards-issue; this is a practical issue that preparers need to solve in a way that best satisfies the accounting principles.

Poor control environments

As examples, entities do not update asset registers on an ongoing basis, do not reconcile the physical asset register with the system generated asset register.

Poorly designed policies and processes

Entities should design asset management policies that adhere to planning and asset management disciplines, and reporting policies that reflect how assets are managed. Asset and financial reporting functions need to collaborate and co-operate on an ongoing basis to ensure that they both understand how assets are managed and how they need to be reported. Processes should be designed accordingly.

Severe lack of skill and capacity in both financial reporting and asset management disciplines.

Entities need to ensure that they have skilled staff that understand (a) how assets should be managed to achieve service delivery commitments, and (b) how the Standards of GRAP should be applied to reflect the way in which assets were managed for a reporting period.

Using consultants to execute activities which should have been performed by the staff at the respective entity.

Consultants – who are appointed to assist with the more complex areas of the Standards – are often used to address the issues highlighted in the points above. Where there are officials in an entity to perform these tasks, consultants should not be used to do, re-perform or re-create these activities or records.

It is true that aspects of the Standards are complex and require judgement, for example, assessing useful lives and determining impairments. However, there are aspects that good management of assets should identify, e.g. whether assets can be used for as long as, or in the manner, anticipated. The Standards of GRAP are not intended to explain how assets should be managed, but are a tool used to report on these issues in the financial statements.

So what needs to be done? There are several municipalities, public entities, colleges and others that are able to report relevant, credible information about their assets in the financial statements. Their ability to do so is getting the basics right. If entities cannot get the basics right, it does not matter what accounting framework is used.

When should an entity recognise land?

Stakeholders have raised uncertainties recently about who should recognise land, for many types of entities including municipalities and TVET Colleges. The issue arises when one entity is the legal owner of land, while another entity occupies the land and has certain rights to use the land.

What are the requirements in the Standards of GRAP?

The Interpretation of the Standards of GRAP on *Recognition and Derecognition of Land* (IGRAP 18) provides the requirements for recognising land.

Land is recognised based on control, which is assessed by applying the principle of economic substance over legal form. An entity controls land in one of two scenarios:

1

Legal ownership

+

The right to direct access and restrict or deny access of others

2

The right to direct access and restrict or deny access of others

A legal owner of land may grant the right to direct access and restrict or deny access of others to the future economic benefits and/or service potential of land to another entity. The entity with this right will control land when the legal owner grants it the right:

- in a binding arrangement (contract, legislation or similar means);
- for an unlimited period of time; and
- that is presently exercisable.

When an entity has a right to use land but the right does not meet these requirements, it should account for the right in accordance with the applicable Standard of GRAP, e.g. GRAP 13 on *Leases.*

Applying the requirements…

An entity's assessment of whether it controls land should consider the following.

- If an entity is not the legal owner, there must be a binding arrangement which gives the entity the right to direct access and restrict or deny access of others. A binding arrangement does not need to be in writing but to meet the qualitative characteristics of financial reporting, there should be evidence of the arrangement.
- Since a binding arrangement can exist in legislation, the entity should understand the legislative environment. This is particularly important for land where legislation often provides rights and responsibilities to custodians of land which results in the custodian controlling land. For example, where legislation designates the department of public works as custodian over certain land, the department controls that land and should recognise it.
- The assessment of control of land is separate from the assessment of control of buildings and other structures on land. An entity may control and recognise a building on land, without controlling or recognising the land.

An entity that occupies land and is not the legal owner, without evidence of a binding arrangement, is unlikely to demonstrate that it controls the land. The entity should seek clarity on the rights it has from the legal owner.

Resources available

Access the following resources on the ASB website:

- IGRAP 18, which includes a decision tree and examples: https://www.asb.co.za/igrap-18/

A recording on IGRAP 18: https://www.asb.co.za/asb-webcast-updates/

The inclusion of post-monitoring and inspection costs when calculating the landfill site provision

A number of municipalities operate and manage landfill sites in undertaking waste disposal activities. The environment within which these sites are operated, is highly regulated. License holders operating a landfill site, are required under the Waste Act, Act No 59 of 2008, to adhere to the Minimum Requirements issued in terms of the Act.

As per section 4 of the *Guideline on Accounting for Landfill Sites* [https://www.asb.co.za/guidelines] the cash flows that should be considered in calculating the landfill rehabilitation provision include:

- costs to dismantle, remove, rehabilitate and/or restore on an ongoing basis and on closure of the landfill site;
- pre-closure planning and approval costs;
- final rehabilitation and closure costs; and
- post-monitoring and inspection costs to be undertaken after the closure of the landfill site.

What do the Minimum Requirements say about post monitoring and inspection costs?

In terms of the Minimum Requirements, and based on an entity's license conditions, it needs to undertake post-monitoring and inspection activities after the closure of a landfill site. This is to ensure that any post-closure problems are identified and addressed in a timely manner when the site no longer receives waste. The monitoring and inspection of a site needs to be undertaken at regular intervals.

Monitoring and inspection costs form part of the obligation to restore the landfill site, and to rehabilitate the environmental damage to the land after closure of the site. The Minimum Requirements indicate that an entity remains responsible for the monitoring of the landfill site for a period of up to thirty years after the closure of the site. However, consideration should also be given to the specific license conditions when an entity estimates its obligation for post-closure monitoring and inspection.

Even if an entity's license conditions are silent about the time period over which the monitoring and inspection should take place, the entity should consider the Minimum Requirements.

Useful lives of assets

Determining the useful life of an asset has its place in the Standards of GRAP on *Property, Plant and Equipment, Intangibles Assets, Investment Property, Living and Non-Living Resources and Heritage Assets,* and affects the subsequent measurement of these assets.

Useful life as defined in GRAP 17 is:
(a) the period over which an asset is expected to be available for use by an entity; or
(b) the number of production or similar units expected to be obtained from the asset by an entity.
From this we can deduce that the useful life of an asset is the asset's *expected utility* to an entity. The expected utility of an asset is entity specific and is usually set out in an entity's asset management policy. Because useful lives are entity specific and can differ between entities, it will most likely be different from its economic life or its design life.

The estimation of the useful life of an asset is a matter of judgement based on the experience of an entity with similar assets. An entity must consider all facts and circumstances in estimating the useful lives of assets, which includes the consideration of financial and technical factors. The asset's economic life and design life can be used as a 'sense-check' when determining the useful life.

Each significant part of an asset can have a different useful life. The significant part is depreciated separately according to its allocated useful life.

Useful lives of assets must be assessed at each reporting date to determine whether there is any indication that an entity's expected useful life has changed since the preceding period. This assessment should be documented. GRAP 17.57 includes a non-exhaustive list of indicators that an entity should consider. If an entity applied the principles of useful lives in GRAP appropriately - in both current and prior years - and concludes that an asset's useful life should be revised, the entity treats this change as a change in accounting estimate in terms of GRAP 3. If the principles of useful lives in GRAP have not been applied appropriately, the entity may have a prior period error that requires correction. Similar considerations are required for fully depreciated assets still in use. When deciding whether any adjustments are required to fully depreciated still in use, an entity considers whether this results from a change in estimate or an error. See also the Frequently Asked Questions 3.2 on Fully depreciated assets.

The determination of useful lives are particularly important for intangible assets as the useful life of an intangible asset drives it accounting treatment. The useful life of an intangible asset is either finite or indefinite. An intangible asset has an indefinite useful life when there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for, or provide service potential to, an entity. Intangible assets with finite useful lives are amortised while intangible assets with indefinite useful lives are not. The useful life of an intangible asset that is not amortised must be reviewed at each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in accounting estimate in accordance with GRAP 3.

<u>The relationship between depreciation and the different asset classifications</u>

	Property, Plant and Equipment		**Intangible Assets***		**Investment Property**		**Living Resources**		**Heritage Assets**	
Model	Cost	Revaluation	Cost	Revaluation	Cost	Fair value	Cost	Revaluation	Cost	Revaluation
Depreciate/ Amortise	X	X	X	X	X		X	X		
Do not depreciate/ amortise						X			X	X

*The table provides for intangible assets with finite useful lives. Note that intangible assets with indefinite useful lives are not amortised.

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