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TO: MEMBERS OF THE TECHNICAL COMMITTEE
FROM: SIYASANGA NONDLAZI
SUBJECT: DESKTOP REVIEW OF GRAP 20 ON *RELATED PARTY DISCLOSURES*
DATE: 21 JUNE 2024
FILE REF: ATTACHMENT 3(a)

BACKGROUND TO THE PROJECT

1. The objective of this desktop review is to assess compliance with GRAP 20 on *Related Party Disclosures* and evaluate the practices applied by preparers in disclosing related party relationships and transactions.
2. The findings from this review will help the Board assess whether changes to the Standard, additional guidance, Frequently Asked Questions (FAQs), and/or other actions are necessary.
3. The approved project brief that outlines the project objective and key issues is included as Attachment 3(b).

OBJECTIVE OF THIS MEMORANDUM

4. The objective of this memorandum is to present to the Technical Committee a summary of the identified issues, root causes and proposed responses from the desktop review, for the Technical Committee to recommend proposed ways forward to the Board.

APPROACH TO UNDERTAKING THE DESKTOP REVIEW

Scope of the review

5. The review considered the latest available audited financial statements, being the 2022/2023 reporting period. Where the 2022/2023 financial statements were not available, the 2021/2022 audited financial statements were considered.
6. Given the nature of the review, it was not possible to review compliance with the requirements where the information was not readily apparent, or could not have been derived from the financial statements.
7. To identify pervasive issues and other areas where corrective action may be necessary, the Secretariat also reviewed the following sources of information:
 - General Report issued by the AGSA, and the annual reports.

Board Members: Mr A van der Burgh (Chair), Ms A Carstens, Mr A Hardien, Ms W de Jager,
Mr D Dlamini, Mr S Gcwabe, Mr S Khan, Ms A Muller, Ms L Senne, Prof R Small,
Chief Executive Officer: Mrs J Poggiolini

- Queries responded to by the Secretariat.
- Matters discussed at the Public Sector Accounting Forum (PSAF).
- Queries raised by auditors with the Technical Audit Support (TAS) unit of the AGSA.
- Issues raised by stakeholders with the Office of the Accountant General (OAG).

Sample selected

8. The desktop review included a representative selection of financial statements of entities in all spheres of government that apply Standards of GRAP.
9. The entities' financial statements that were included in the sample were selected on a random basis. A sample equivalent to approximately 10% of all types of entities applying the Standards of GRAP was selected.
10. The Secretariat considered that the number of entities' financial statement reviewed was sufficient to identify the transversal issues and other areas where actions may be necessary. The issues noted from the desktop review were pervasive throughout the financial statements included in the selection.

Key stakeholders consulted

11. During the review, key stakeholders were consulted to provide context on the issues and root causes. Stakeholder inputs were crucial in proposing a way forward to address these root causes, as included in this memorandum. Stakeholders consulted include representatives from:
 - All public sector entities applying the Standards of GRAP, such as public entities, local government, Parliament, legislatures, TVET and CET colleges.
 - Technical advisors and consultants involved in financial statement preparation.
 - National Treasury, including the Office of the Accountant-General and provincial treasuries.
 - Auditors, including technical divisions of audit firms and representatives from the Auditor-General of South Africa (AGSA).

MATTERS FOR DISCUSSION

RESULTS OF DESKTOP REVIEW

12. The results of the review communicated in this memorandum do not highlight non-compliance with the Standards of GRAP in any individual set of financial statements reviewed. The instances of non-compliance with GRAP 20 and the number of issues identified in this memorandum are limited to pervasive issues.
13. The Secretariat has classified the issues from the review into the following categories:
 - (A) Identification of related parties and related party transactions
 - (B) Disclosure of related parties and related party transactions
 - (C) General issues identified

(A) Identification of related parties and related party transactions

GRAP 20 requirements

14. GRAP 20.10 states: "...a related party is a person or an entity with the ability to control or jointly control the other party, or exercise significant influence over the other party, or vice versa, or an entity that is subject to common control, or joint control.

As a minimum, the following are regarded as related parties of the reporting entity:

a) *A person or a close member of that person's family is related to the reporting entity if that person:*

- (i) has control or joint control over the reporting entity;*
- (ii) has significant influence over the reporting entity; or*
- (iii) is a member of the management of the entity or its controlling entity.*

b) *An entity is related to the reporting entity if any of the following conditions apply:*

- (i) the entity is a member of the same economic entity (which means that each controlling entity, controlled entity and fellow controlled entity is related to the others);*
 - (ii) one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of an economic entity of which the other entity is a member);*
 - (iii) both entities are joint ventures of the same third party;*
 - (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;*
 - (v) the entity is a post-employment benefit plan for the benefit of employees of either the entity or an entity related to the entity. If the reporting entity is itself such a plan, the sponsoring employers are related to the entity;*
 - (vi) the entity is controlled or jointly controlled by a person identified in (a); and*
 - (vii) a person identified in (a)(i) has significant influence over that entity or is a member of the management of that entity (or its controlling entity).*
- (viiA) The entity, or any member of a group of which it is part, provides management services to the reporting entity or to the controlling entity of the reporting entity."*

15. GRAP 20.12 states management as: "... all persons having the authority and responsibility for planning, directing and controlling the activities of the entity, including:

- a) all members of the governing body of the reporting entity;*
- b) a member of the governing body of an economic entity who has the authority and responsibility for planning, directing and controlling the activities of the entity;*
- c) any key advisors of a member, or sub-committees, of the governing body who has the authority and responsibility for planning, directing and controlling the activities of the entity; and*

- d) *the senior management team of the entity, including the chief executive officer or permanent head of the entity.*”

Issue 1: Identification of management as related parties

Issues

16. Entities are unsure whether to identify audit and risk committee members as part of management. This contributes to inconsistent disclosure of these members as related parties.
17. Certain municipalities identified and disclosed traditional leaders as related parties while other municipalities have not considered traditional leaders as related parties.
18. Municipalities do not always identify councillors as management and do not always disclose the remuneration paid to councillors as related party transactions.

Root causes

19. Entities include audit and risk committee members as part of management because they are considered governing bodies of the entity and therefore considered to meet the definition of related parties in accordance with GRAP 20 paragraph .12(a).
20. Certain entities do not disclose audit and risk committee members as related parties because they do not consider the relationship and remuneration paid to these members to be qualitatively or quantitatively material. Other entities assessed that audit and risk committee members do not have control over the activities of the entity and therefore do not meet the definition of related parties.
21. Traditional leaders are in certain instances considered to have authority for planning, directing and controlling some aspects of municipal activities, such as the land distribution or resources distributions and therefore deemed to be related parties.
22. Entities are unclear whether the Standard requires disclosing senior management positions irrespective of who holds the position, or disclosing individuals occupying those positions irrespective of whether those persons were in the position for the full financial year, resulting in inconsistent disclosures. For instance, when a CFO is suspended, entities are unsure whether to disclose only the salary of the permanent CFO, including the suspension period, or to disclose the salary of the permanent CFO for the period not suspended and the acting CFO.

Proposed way forward

23. The Secretariat recommends developing an FAQ that specifically addresses what entities should consider when applying the definition of management in GRAP 20.12.

Issue 2: Identification of entities under common control as related parties

Issues

24. Entities under common control are not identified and disclosed as related parties. Municipalities are unclear about whether entities within a province are considered to be under common control and thus related parties.

Root causes

25. Entities struggle with determining whether common control exists between entities in different spheres of government because GRAP 20 only provides guidance at the national level.

Proposed way forward

26. The Secretariat recommends incorporating guidance in the Standard as part of the next improvements project to explain the relationships within the three spheres of government and clarify which entities can be considered as related parties (incorporating the guidance in GRAP 105 and 106).

(B) Disclosure of related parties and related party transactions

GRAP 20 requirements

27. GRAP 20.27 states: *“Subject to the exemptions in paragraph .32, if a reporting entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph .35 to disclose remuneration of management. At a minimum, disclosures shall include:*

- a) the amount of the transactions;*
- b) the amount of outstanding balances, including commitments; and*
 - (i) their terms and conditions, including whether they are secured, nature of the consideration to be provided in settlement; and*
 - (ii) details of any guarantees given or received;*
- c) provisions for doubtful debts related to the amount of outstanding balances; and*
- d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.”*

28. GRAP 20.34 states: *“Where a reporting entity is exempt from the disclosures in accordance with paragraph .32 the entity shall disclose narrative information about the nature of the transactions and the related outstanding balances referred to in paragraph .27 to enable users of the reporting entity’s financial statements to understand the effect of related party transactions on its financial statements.”*

Issue 3: Inconsistent disclosure of councillors’ remuneration

Issues

29. Municipalities face challenges determining whether to aggregate or disaggregate councillors’ remuneration.
30. Municipalities are unsure whether to disclose only cash paid for remuneration and other transactions with councillors, or to include accrual amounts. For example, they are unsure whether to disclose only bonuses paid, or bonuses accrued.

31. Municipalities are unsure about the link between GRAP 20 and the MFMA requirement to disclose outstanding balances.
32. Entities are uncertain how to treat related party transactions and events that are not recognised but only disclosed in the financial statements. For example, they are unsure whether contingent liabilities involving councillors should be disclosed as related party transactions.

Root causes

33. Municipalities aggregate remuneration paid to councillors because they do not consider the remuneration paid to councillors as individually material.
34. Entities struggle to distinguish between MFMA (legislative) and GRAP 20 disclosure requirements, resulting in disclosures that are compliant with legislation but not compliant with GRAP 20.

Proposed way forward

35. The Secretariat recommends addressing the issues in FAQ 4.3 on *Should a municipality disclose the councillors' remuneration on an individual basis or in aggregate?*
36. The Secretariat recommends updating FAQ 4.15 on *What is the interaction of Standards of GRAP where two or more Standards have similar requirements?*

Issue 4: Balances and commitments not disclosed

Issues

37. Entities do not consider and disclose outstanding balances or commitments to related parties in their financial statements.
38. Entities have different interpretations of whether the Standard requires narrative descriptions of balances and commitments or the amounts.

Root causes

39. Entities are reluctant to disclose certain balances and commitments as they deem certain cases confidential or too sensitive. For example, entities are reluctant to disclose a misconduct case against a Mayoral committee member that might lead to dismissal.
40. Confidentiality agreements might result in entities not disclosing related party transactions, balances and commitments e.g. a CCMA agreement restricting parties from disclosing settlement amounts or conditions.
41. Entities misunderstand the exemption provided in GRAP 20.32 and omit the disclosure of commitments and balances as they consider these to be in the normal course of business.
42. The requirement in GRAP 20.34 to disclose narrative information about the nature of the transactions and the related outstanding balances is seen to have dual meaning.

Proposed way forward

43. The Secretariat recommends developing an FAQ to clarify the principle in GRAP 20.32.
44. The Secretariat recommends clarifying paragraph .34 with the next Improvements project.

Issue 5: Goods in kind provided to related parties

Issues

45. Municipalities inconsistently identify and disclose goods provided in kind to municipal councillors as related party transactions.

Root causes

46. Municipalities are not aware that goods in kind provided to related parties should be disclosed. For example, mayoral vehicles, accommodation and computer equipment provided to councillors.

47. Entities conclude that goods in kind are provided within the normal course of business and therefore do not disclose these as related party transactions.

Proposed way forward

48. The Secretariat recommends providing guidance in an FAQ on how entities should treat goods in kind provided to related parties.

(C) General issues identified

Issue 6: Materiality not considered in the application of the Standards

Issues

49. The extent to which materiality should be considered in the application of the Standard is unclear for preparers and auditors.

Root causes

50. Auditors require consistency without considering materiality in financial statements. Auditors question omitted disclosures when comparing one entity's financial statements to disclosure checklists or other entities' financial statements, without considering materiality of the reporting entity.

51. Materiality being subjective leads entities to hesitate in making judgments, preferring instead to disclose all information to avoid audit queries.

Proposed way forward

52. The Secretariat recommends addressing the root causes through the materiality project proposed for the next work programme consultation.

53. The Secretariat recommends engaging with the AGSA on issues raised by preparers relating to auditors requiring consistency and not considering materiality of the reporting entity.

Issue 7: Boilerplate information included in the financial statements

Issues

54. Entities disclose boilerplate information in the financial statements, such as disclosing the definitions contained in GRAP 20 as accounting policies.

Root causes

55. Entities are not aware of when they are expected to develop accounting policies, for example, they are unsure whether there should be accounting policies for disclosure items.

56. Entities have inadequate quality review processes for the preparation of financial statements resulting in errors or the use of boilerplate information.

Proposed way forward

57. The Secretariat recommends addressing the root causes by raising awareness about the previously published recording on *Improving the quality of financial statements*.

ACTION REQUESTED

The Technical Committee is requested to:

(a) NOTE the issues and root causes identified during the review; and

(b) RECOMMEND the proposed ways forward to the Board.

NEXT STEPS

58. The results of the desktop review and proposed actions will be presented to the Board to decide what further work needs to be undertaken regarding the issues identified.