Accounting Standards Board

Newsletter November 2023 Edition

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Message from the CEO: Can accounting standards help SA's budget crisis?

For several years, we spent more revenue than we generate as a country. We need to fund the excess expenditure somehow, and this has been through borrowing. In simple terms, we are spending more than our monthly salaries, and we are using credit cards and other debt (i.e. other people's money at a cost) to fund our excess expenditure. From your own personal finances, you would know that, while borrowing may be needed in certain instances, for example buying assets, the constant reliance on debt is not sustainable. By 2026/2027, 22% of South Africa's spending will go towards paying interest. This is 22% that can be used on things that matter; things that improve the lives of citizens.

The Finance Minister said in his speech on 1 November that… "*Under these circumstances, measures to stabilise public finances and reform the economy to generate higher growth are essential. We recognise that alongside these measures, our most effective way of funding government is through an efficient tax administration and by broadening the tax base.*"

When the benefits of accrual accounting are discussed, the focus is usually on government spending, unrecognised liabilities, and unrecognised assets. I would like to focus on the part of his speech that mentions improving tax administration. While our colleagues at SARS are working hard to modernise the tax system and improve efficiencies in tax collection, it would be useful for government to have accrual based information about the taxes due to the fiscus.

Applying the accrual-based principles for tax revenue, revenue and corresponding receivables will be recognised when the tax event occurs, i.e. the event that "generates" the tax revenue. For example: VAT, when goods and services are sold; corporate tax, when activities that generate taxable revenue occur; customs duty, when goods cross the border; etc. This means that tax revenue will be accounted for in the period it arises, assuming it can be measured reliably when the tax event occurs. Recognising taxes in this way will require more reliable data about taxpayers and their activities to make appropriate estimates.

While this may seem difficult, municipalities, public entities and others have applied accrual accounting for several years, while national and provincial government do not. While applying accrual accounting in itself will not help the budget crisis, using the information from applying it, will. We need better information about events when they occur so that appropriate decisions can be taken to maximise revenue, make spending more efficient, and fiscal discipline improved.

It should no longer be a debate about why accrual accounting, but when accrual accounting.

For the full Budget Speech, click here: https://www.gov.za/speeches/minister-enoch-godongwana-medium-term-budget-policy-statement-1-nov-2023-0000

IGRAP 22 on Foreign Currency Transactions and Advance Consideration is published

IGRAP 22 is an Interpretation of the Standards of GRAP. IGRAP 22 was approved by the Board in September 2023. The Interpretation is effective for financial periods beginning on or after 1 April 2025.

The Board based IGRAP 22 on IFRIC 22 issued by the International Accounting Standards Board. IFRIC 22 clarifies which exchange rate to use in transactions that involve advance consideration paid or received in a foreign currency. IFRIC 22 was adapted for the local public sector environment. The IGRAP supports the application of the Standard of GRAP on *The Effects of Changes in Foreign Exchange Rates* (GRAP 4).

As with any foreign currency transaction, the exchange rate at which the transaction should be translated must be determined. The transaction date usually drives the exchange rate the entity should use.IGRAP 22 addresses how to determine the transaction date for the initial recognition of the related asset, expense or revenue, when the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration is derecognised..

When an entity pays or receives consideration in advance in a foreign currency, it generally recognises a non-monetary asset (prepayment) or a non-monetary liability (revenue received in advance) before the recognition of the related asset, expense or revenue. The related asset, expense or revenue is the amount recognised by applying the relevant Standard of GRAP, which results in the derecognition of the prepayment or the revenue received in advance.

IGRAP 22 clarifies that the exchange rate to use on the initial recognition of the related asset, expense or revenue is the exchange rate that was used on the date on which the entity initially recognised the prepayment or the revenue received in advance.

To illustrate this, assume an entity imports inventory. The *inventory* is the *related asset* referred to in the Interpretation. The entity makes payment in foreign currency before the inventory qualifies for recognition as an asset. The entity therefore recognises a *prepayment* which is the *non-monetary asset* referred to in the Interpretation. When the inventory qualifies for recognition as an asset, the prepayment is derecognised. According to IGRAP 22, the exchange rate to use when recognising the inventory is the same exchange rate that was used when the prepayment was recognised.

Access IGRAP 22 here.

GRAP 20 on *Related Party Disclosures*: Standard vs Application

The ASB Board (the Board) approved a project brief on GRAP 20 *Related Party Disclosures* at the September 2023 Board meeting. The purpose of the project is to assess compliance with the requirements of GRAP 20 and obtain insights into the practice applied by preparers in presenting *Related Party Disclosures.*

As the project is primarily a desktop review, the intention is to identify transversal issues across entities subject to the review and to communicate findings and actions to constructively improve financial reporting.

There will be limited stakeholder engagements however, engagements may be held to solicit inputs on the practical application of the Standards.

Although the objective is to assess compliance with all GRAP 20 disclosure requirements, certain areas have been identified which may require specific review and include:

- The application of the definition of related parties.
- Disclosure of related party relationships between entities in the National and Provincial spheres of government respectively.

- Omitted qualitative disclosure of e.g., the terms and conditions of outstanding balances, including commitments with related parties; whether they are secured, and the nature of the consideration to be provided in settlement.
- The non-disclosure of the amount of the transactions with related parties.
- The non-disclosure of balances owed to or receivable from related parties.
- The omission of related party disclosures in their entirety, in circumstances where related party transactions are expected based on the other information contained in the financial statements or based on knowledge of the public sector e.g., services in kind that can be reliably measured.
- The disclosure requirements prescribed for management remuneration, particularly the disclosure of councillors' remuneration on an individual or aggregate basis.
- The impact of materiality (qualitative and quantitative) considerations on the presentation and disclosure of related parties.

The desktop review will be completed in quarter one of 2025, and the findings will be tabled to the Board by June 2025. Depending on the nature of the findings a Review Report may be prepared to outline the findings of the review and the Board's actions (if any).

The findings from this review will assist the Board in assessing whether changes to the Standard are required, whether guidance is required, and/or whether awareness should be raised about specific issues through communication and other activities.

The ASB is starting their Measurement Project

The Board approved a project brief in September 2023 to develop principles on the measurement for assets and liabilities in the Standards of GRAP. The project will draw from the new IPSAS guidance on measurement and also aim to address other measurement issues on assets and liabilities raised by stakeholders.

The IPSASB made amendments to the measurement principles for assets and liabilities in the IPSAS Conceptual Framework and issued a new IPSAS on *Measurement* called IPSAS 46. IPSAS 46 provides guidance in a single standard addressing how commonly used measurement bases should be applied in the public sector. The IPSAS includes guidance on fair value and a new current value measurement basis called 'current operational value' (COV).

The addition of COV is due to the limitations of applying the fair value measurement basis to assets held for operational capacity. In the public sector, many assets are used for the delivery of services which can result in them not meeting the requirements of fair value, such as being put to their highest and best use. With the introduction of COV, entities are able to apply a measurement basis that is designed to reflect the value of assets held to deliver service potential. COV takes into account the remaining service potential of an asset at the measurement date.

The ASB's Measurement project will assess the appropriateness of adopting the guidance in IPSAS for the local environment. The output of the project will likely include amendments to the *Conceptual Framework for General Purpose Financial Reporting* and a new Standard of GRAP on *Measurement.*

Consultations with stakeholders will be necessary to test whether the adoption of the new measurement principles will be appropriate. Various stakeholders will be consulted during the development of the project. Stakeholders include preparers and users of the financial statements, valuation experts and standard setters. The project is planned over 4 years starting in 2024.

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