Accounting Standards Board

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Message from the CEO: Accounting, ethics, and the fight against corruption

I had the pleasure of speaking at the National Treasury's recent public finance management (PFM) conference on "Innovative and ethical public financial management in challenging times". In the panel where I participated with others, we discussed how to build ethical systems and practices in government. The act of accounting, how accounting standards are developed and implemented, and those who prepares the financial statements have a role to play in the fight against corruption.

I was asked to answer these two questions, and these were my responses…

Question 1 - How can the development and implementation of robust accounting standards contribute to the prevention and detection of financial irregularities and corruption in public financial management?

Accounting standard-setters are often asked this question. There is an expectation that there will be a line item somewhere in the financial statements that identifies "fraud/corruption". This is of course not the case.

Detection

The basic principles underlying the development of accounting standards facilitate the interrogation of financial statements by users that can aid in the detection of irregularities.

A key principle in the preparation of financial statements is comparability. This principle aims to ensure that like items look alike, and unlike items don't. This means that if you look at financial statements across the sector you should be able to understand if a certain entity has the same transactions/items but has a different accounting result. What you see – or don't see in the financial statements – can lead you to ask questions about a particular transaction or event. There could be deliberate manipulation of the accounting principles to have a particular outcome that is favourable to the entity and its officials.

Secondly, the financial statements provide predictive information. By reviewing the current and previous financial results, you would likely be able to determine whether you would see upward or downward trends. If the information is not "behaving" as anticipated, this should be interrogated.

Prevention

A key deterrent to fraud, corruption and financial irregularities more broadly is the use of accrual accounting. This means that all assets and liabilities are reported in the financial statements. This would certainly stop entities from "hiding" the state of their assets and possible liabilities. The requirement to recognise assets and liabilities and to measure them in certain ways means that entities have to comply with these prescripts, unless they are immaterial. Non-compliance with the Standards may only be done if a better fair presentation can be achieved. Departures from the accounting standards can indicate a desire to achieve a particular outcome, which is fraud – not honestly reflecting transactions and events on the financial statements to intentionally mislead users, knowing it will influence their decisions.

It is critical that all entities in the public sector apply accrual accounting. It is critical that National and Provincial Departments adopt accrual accounting to provide a more comprehensive view of government's financial position and performance.

Question 2 - What are some best practices in ensuring that accounting standards align with transparency and accountability principles?

It is critical that accounting standards – and any other principles that are prescribed in the PFM environment – follow a robust due process. If we think about accounting standards, their application should result in information in the financial statements that enables entities to be held accountable and to aid decision-making of a wide range of users.

In this instance, the users of the financial statements are those people that:

- provide resources to an entity;
- rely on government's services; or
- representatives of these users, including members of Parliament, legislatures and municipal councils.

A robust consultation process means that the standard-setter consults with parties that are affected by, or have an interest in, government's financial statements. It is critical that the potential users of the financial statements are identified at the start of any project and that they are involved in the process of development and public consultation.

Once the users are known, users' needs need to be identified and how the principles in the Standards can be developed to meet these needs.

Another key aspect of the standard-setting process is reviewing the effective implementation of Standards, and/or whether they are meeting their stated objective. As the ASB, we undertake two reviews and one post-implementation review in every three year cycle.

Reviews are a way of assessing the implementation of the Standard by entities, mainly to identify compliance issues and any emerging issues in practice. Our reviews are based on published financial statements, although we may consult with stakeholders to understand results and/or confirm findings.

Post-implementation reviews assess whether a Standard is meeting its objective. These reviews include a robust consultation process with users, preparers, auditors and other interested parties to assess a Standard's effectiveness, and identify any application or implementation issues.

A last observation on the role of ethics and accounting

We are probably keenly aware of the role of ethics and the Code of Conduct for auditors. It is easy to forget that professional ethics is just as important for preparers of the financial statements as it is for auditors. The application of sound ethical principles within a robust system of financial management is critical for the production of relevant, credible, transparent financial statements. As accountants, we have a critical role to represent the public's interest and to act ethically.

Social benefits – what information should be provided to users of financial statements?

The Accounting Standards Board approved an Exposure Draft on S*ocial Benefits* (ED 205) at its July 2023 meeting. Previous articles explained the Board's proposals to define, recognise and measure social benefits in the scope of the ED. In-kind social benefits are outside the scope of the ED; the Board will consider guidance on these benefits in a future project.

Arguably the most important question a standard-setter should answer in developing a standard is "what information do users need about this transaction or event to hold entities accountable and make decisions"? The Board often asked this question when it developed the definition, recognition and measurement requirements. This was also the core question considered in developing the disclosure requirements for the ED. The disclosure requirements ensure the needed information is provided to users – through numbers and narrative.

Risks and uncertainties

The Board identified that a key part of information about social benefits that should be provided in the financial statements relates to an entity's present obligations to provide social benefits to beneficiaries. As a result of the recognition and measurement requirements for social benefit liabilities, entities will use estimates to provide the required information in the financial statements. When an entity uses estimates in lieu of precise information, there are inherently more risks and uncertainties that need to be considered.

The ED proposes that a user would need information about the risks and uncertainties that affect measurement to enable them to use the information. A part of using information to hold entities accountable and make decisions is that a user should be able to compare information between entities, and from one year to the next. Information on risks and uncertainties allows a user to make these comparisons.

Sensitivity analysis

Some standards that require complex measurement of liabilities, often with the use of actuaries, require entities to disclose information that will enable a user to understand how sensitive a liability is to changes in certain estimates. For example, IFRS 17 on *Insurance Contracts* and GRAP 25 on *Employee Benefits.* The ED does not require a sensitivity analysis of social benefit liabilities. The Board considered whether this information may be useful, particularly for social security insurance benefits, and concluded this would be unnecessary.

Provide your comment on the proposals

Access ED 205 on *Social Benefits* on the ASB website. Comment is due by 17 November 2023. Contact elizna@asb.co.za for more information.

ED 205 on Social Benefits – what would the impact be on the local environment?

The Accounting Standards Board approved an Exposure Draft on *Social Benefits* (ED 205) at its July 2023 meeting. Although the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19) includes a description of social benefits, GRAP 19 excludes provisions and contingent liabilities for social benefits that are non-exchange transactions from its scope. There is no Standard of GRAP that provides guidance on accounting for social benefits. This proposed Standard will fill a gap in the existing literature.

In the absence of a Standard of GRAP prescribing requirements for social benefits, entities developed their own accounting policies.

Previous articles explained the proposed recognition and measurement requirements for social security insurance benefits and social assistance benefits. The Board considered the potential impact on preparers and users of the requirements in relation to the current policies applied to the benefits. Although the implementation of the ED will result in changes to the information provided, the proposals in the ED were considered necessary to meet users' needs and are expected to result in improved information in financial statements.

Social security insurance benefits

Current accounting policies for social security insurance benefit liabilities are mostly developed with reference to IFRS 4 on *Insurance Contracts*. The policies result in liabilities recognised when the "incident" occurs, which is comparable to when the event related to the social risk occurs. The most significant impact is likely to be the presentation and disclosure of information on social benefits. The expected impact on the recognition and measurement of the liability will be limited.

Social assistance benefits

Entities providing social assistance benefits mostly recognise liabilities for benefits that are verified to meet eligibility criteria and approved for payment. This recognition point results in limited information in the financial statements about the liability and depends on the effectiveness of the entity's own internal processes to verify and approve applications received.

The proposal in the ED – to recognise liabilities for social assistance benefits when an entity receives an application for social benefits – means entities providing these benefits would recognise the liability at an earlier stage. It also means entities may need to use estimates. For example, an entity would need to estimate which applications for social benefits will meet the eligibility to qualify for social benefits. Initial research indicated that entities providing these benefits would have access to all the information necessary to estimate the liability.

Given the concern about the limited information presently available to users, the recognition point proposed in the ED is necessary to provide more comprehensive information to users.

Provide your comment on the proposals

Access ED 205 on *Social Benefits* on the ASB website. Comment is due by 17 November 2023. Contact elizna@asb.co.za for more information.

A glimpse into the Reporting Framework for the 2024/25 financial year

Role and purpose of Directive 5

Directive 5 on *Determining the Reporting Framework* outlines the GRAP reporting framework for a particular reporting period. The Appendices of the Directive list the standards and pronouncements that are the GRAP Reporting Framework for a reporting period. The Appendices are updated each year.

Directives are authoritative and entities have to apply Directive 5 and the list of pronouncements in the applicable Appendix to prepare financial statements for a particular reporting period.

The Accounting Standards Board (the Board) approved the Appendix to Directive 5 for 2024/25 at the September 2023 meeting.

What were the changes for the 2024/25 financial year?

There are no new or amended pronouncements that are effective for financial periods commencing on or after 1 April 2024. The following pronouncements, approved by the Board, have not yet been approved for adoption by the Minister of Finance:

Pronouncement	Effective date
GRAP 1 on *Presentation of Financial Statements* (Amendments on going concern approved December 2022)	Effective date to be determined
GRAP 103 on *Heritage Assets* (Approved June 2022)	Effective date to be determined
Improvements to the Standards of GRAP 2023	Effective date to be determined.

What about pronouncements and changes to pronouncements that are not yet effective

The Board recently approved changes to pronouncements that are not yet effective. Their impact on the 2024/25 GRAP Reporting Framework is as follows:

Pronouncement	Effective date	Impact on 2024/25
GRAP 104 on *Financial Instruments* (revised 2019)	1 April 2025	Entities may early adopt the Standard before the effective date. In this instance, the entire Standard needs to be adopted early. Piecemeal adoption is not permitted.
IGRAP 22 on *Foreign Currency Transactions and Advance Consideration*	1 April 2025	Entities may early adopt the Interpretation before the effective date.

What about pronouncements of international standard-setters?

The Appendices to Directive 5 include pronouncements issued by the IPSASB and IASB that entities should consider in preparing their financial statements for a particular reporting period. Pronouncements of other standard setters are used to formulate accounting policies; they cannot be adopted by entities. Any IPSAS or IFRS Accounting Standards not included in the relevant Appendix to Directive 5 should not be considered by entities in formulating accounting policies.

Refer to a communication on the IPSAS and IFRS Standards that entities should not consider when formulating accounting policies here.

Access Directive 5 and the related documents on the ASB website here.

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