



Frequently Asked Questions on the Standards of GRAP

Disclaimer

These Frequently Asked Questions have been prepared by the Secretariat of the Accounting Standards Board in consultation with the technical division of the Auditor-General of South Africa (AGSA) and the Office of the Accountant-General at National Treasury (OAG). These Frequently Asked Questions have not been approved by the Board. Consequently, they are not authoritative and do not form part of the Standards of Generally Recognised Accounting Practice (GRAP).

The questions and responses outlined in this document are based on queries commonly received by the Secretariat, the AGSA and the OAG and have been compiled to assist preparers of the financial statements. The questions and responses provide a summarised analysis of topical issues and are not comprehensive. Any examples provided are illustrative only and do not represent a comprehensive list of scenarios or circumstances that may exist in practice. As a result, the examples are not prescriptive and should not be used by analogy to other circumstances. In all instances, readers are encouraged to refer to the relevant Standard of Generally Recognised Accounting Practice (GRAP), Interpretation or Directive.

The Standards of GRAP apply only to material items. Consequently, the FAQs have been drafted on the basis that a particular issue is material. When considering the FAQs, entities should apply judgement in determining whether an issue outlined in the FAQs is material to its operations.

The questions and responses focus on issues that are of interest to public entities, constitutional institutions, municipalities, municipal entities, Parliament and the provincial legislatures, trading entities and Public Further Education and Training Colleges collectively called "entities" in this document (unless indicated otherwise).

Action	Date	Description of change
Issued	15 February 2011	Publication of combined FAQs for all entities.
Updated	26 November 2019	Added FAQ 2.9 on the impact of land invasions on land recognition.



FAQ's on the Standards of GRAP

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FAQ's on the Standards of GRAP

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FAQ's on the Standards of GRAP

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FAQ's on the Standards of GRAP

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Section 1 – Reporting Framework and Related Issues

1.1 What reporting framework should be used by entities for the 2018/19 reporting period?

Entities use Directive 5 on *Determining the GRAP Reporting Framework* in preparing their financial statements for the financial years ended 31 March and 30 June 2019. Appendix C: 1 April 2018 to Directive 5 lists the Standards of GRAP and other pronouncements that should be used by entities to prepare financial statements for the years ended 31 March and 30 June 2019.

1.2 Are entities allowed to early adopt Standards of GRAP for which the Minister of Finance has determined an effective date?

Entities are not prohibited from early adopting the Standards of GRAP for which the Minister of Finance has determined an effective date.

Entities may not early adopt Standards of GRAP if the Minister of Finance has not determined an effective date for that Standard, but may consider that Standard in developing an accounting policy.

1.3 What Standards of GRAP have been issued by the Board but are not yet effective, and what effect do these Standards have on the GRAP Reporting Framework for 2018/2019?

Standards of GRAP that have been issued by the Board but for which the Minister of Finance has not determined an effective date cannot be early adopted. They should however be used to formulate an appropriate accounting policy, but only if a specific IPSAS or IFRS has not been included in the Appendix to be applied for a particular reporting period.

The Minister of Finance has published effective dates for a number of Standards in April 2018, including GRAP 18 on *Segment Reporting*, GRAP 20 on *Related Party Disclosures*, GRAP 32, GRAP 105, GRAP 106, GRAP 107, GRAP 108 and GRAP 109. For the 2018/19 reporting period, the following Standards of GRAP have been issued but are not yet effective:

Public entities, constitutional institutions, municipalities and municipal entities, and public TVET colleges

No.	Title of Standard	Impact on GRAP Reporting Framework
GRAP 32	Service Concession Arrangements: Grantor	Full compliance with GRAP 32 not required but entities should formulate an accounting policy for any service concession arrangements.
GRAP 108	Statutory Receivables	Full compliance with GRAP 108 not required but entities should formulate an accounting policy for any statutory receivables.
GRAP 109	Accounting by Principals and Agents	Full compliance with GRAP 109 not required but entities should formulate an accounting policy for principal – agent arrangements.

GRAP 20 has also been issued, but is not yet effective. See FAQ 1.6 below.

Although GRAP 18 is effective for public entities, constitutional institutions and public TVET colleges, it is not yet effective for municipalities and municipal entities. See FAQ 1.4 below.



Trading entities, Parliament and provincial legislatures

In addition to the list above, including GRAP 18 (see FAQ 1.4 below), the following Standards of GRAP are not yet effective for trading entities, Parliament and the provincial legislatures:

No.	Title of Standard	Impact on GRAP Reporting Framework
GRAP 105	Transfer of Functions Between Entities Under Common Control	Full compliance with GRAP 105 not required (see FAQ 1.7 below) but entities should formulate an accounting policy for any transfer of functions concluded between entities under common control.
GRAP 106	Transfer of Functions Between Entities Not Under Common Control	Entities may continue to apply IFRS 3 or entities may use GRAP 106 to formulate an accounting policy. Full compliance with GRAP 106 not required (see FAQ 1.7 below).
GRAP 107	Mergers	Full compliance with GRAP 107 not required (see FAQ 1.7 below) but entities should formulate an accounting policy for any mergers concluded.

As a result of the timing when the Directive on *Determining the GRAP Reporting Framework* (Directive 5) is finalised, some Standards of GRAP approved and issued by the Board but not yet effective may not be included in the Directive. An entity may consider such Standards in formulating its accounting policy.

1.4 Are entities required to apply GRAP 18 on Segment Reporting?

Municipalities, municipal entities, trading entities, Parliament and the provincial legislatures are not required to apply GRAP 18, or IFRS 8 on Operating Segments. The Minister of Finance delayed the effective date of GRAP 18 for municipalities and municipal entities in order to align the effective date to the implementation of the municipal Standard Chart of Account (mSCOA), and the Standard is not yet effective for trading entities, Parliament and provincial legislatures.

However, all other entities applying the GRAP reporting framework are required to apply GRAP 18.

1.5 Do entities use IAS 20 on Government Grants to account for grants, transfers and other types of non-exchange revenue?

No, entities should apply the requirements of GRAP 23 on *Revenue from Non-Exchange Transactions (Taxes and Transfers)* to account for grants, transfers and other non-exchange revenue (e.g. taxes and fines received). Paragraphs .21 and .22 of Directive 5 indicate that IFRS Standards should not be applied if they are in conflict with the ASB's *Framework for the Preparation and Presentation of Financial Statements*¹ or existing Standards of GRAP or IPSAS. IAS 20 may therefore not be applied.

¹ In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.



1.6 Does an entity have to apply GRAP 20 on Related Party Disclosures for the 2018/19 reporting period?

Entities were required to apply IPSAS 20 on *Related Party Disclosures* in previous reporting periods. For the 2018/19 reporting period, entities have a choice to either continue to disclose related party transactions using IPSAS 20, or they may consider GRAP 20 in formulating these disclosures.

1.7 Per Directive 5, what does it mean to formulate an accounting policy?

To formulate an accounting policy using Standards of GRAP that are not yet effective means that:

- Entities use the Standards of GRAP that are not yet effective (as outlined in 1.3 above) to determine the recognition, measurement and presentation of a transaction or event. Accounting policies should describe, depending on the nature of the item, transaction or event, the classification, recognition, initial and subsequent measurement and derecognition.
- Entities consider the disclosure requirements in the Standards of GRAP that are not yet effective for disclosing a particular transaction or event.

Where an entity changes its accounting policy, it must consider the requirements of GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors*.

When an entity has not applied a new Standard of GRAP that is not yet effective, GRAP 3.32 requires the entity to disclose:

- (a) this fact; and
- (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Standard will have on the entity's financial statements in the period of initial application.

An entity is only required to disclose this information for Standards that are applicable to the entity.

1.8 What disclosures should entities make about Standards that it will adopt in future reporting periods?

GRAP 3.30 prescribes the following:

“When initial application of a Standard of GRAP has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

- (a) the title of the Standard;
- (b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
- (c) the nature of the change in accounting policy;
- (d) when applicable, a description of the transitional provisions;
- (e) when applicable, the transitional provisions that might have an effect on future periods;
- (f) for the current period and each prior period presented, to the extent practicable, the amount



- of the adjustment for each financial statement line item affected;
- (g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
 - (h) if retrospective application required by paragraph .21(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.”

For the information required by GRAP 3.30 to be useful to users, entities should provide information about its future adoption of the Standards of GRAP. It would be particularly useful if entities could disclose possible differences between the existing accounting applied and the Standards of GRAP both qualitatively and, if available, quantitatively. For example, an entity may disclose that by applying GRAP 106 on *Transfer of Functions Between Entities Not Under Common Control*, it no longer recognises goodwill that was recognised under its previous policy, which was based on IFRS 3 on *Business Combinations*. The excess of the purchase consideration paid, if any, over the fair value of the assets acquired and liabilities assumed, is now recognised in surplus and deficit.

1.9 At what date should deemed cost be determined using Directive 7 if an entity did not complete its adoption of Standards of GRAP within the specified time frame?

Directive 7 allows an entity to determine the deemed cost of its assets when cost information is not available for these assets on the initial adoption of Standards of GRAP. The deemed cost of the assets is determined at the “measurement date” and is defined in Directive 7 as follows:

“Measurement date is either (a) the date that an entity adopts the Standards of GRAP and is the beginning of the earliest period for which an entity presents full comparative information, in its first financial statements prepared using Standards of GRAP; or (b) the transfer date or the merger date.”

Municipalities were required in terms of the applicable Government Gazette to adopt Standards of GRAP on 1 July 2008 (for high and medium capacity municipalities), and 1 July 2009 (for low capacity municipalities). Medium and low capacity municipalities were permitted a three year period within which to measure certain assets. Applying this transitional relief period, along with the relief to use deemed cost, meant that the measurement date for medium and low capacity municipalities was either 1 July 2007, or 1 July 2008, respectively.

Some entities have not yet completed the process of adopting Standards of GRAP as prescribed by the Minister of Finance. These entities have indicated that determining the deemed cost of assets as at either 1 July 2007 or 2008, as prescribed by Directive 7, may not be possible given the period of time that has elapsed.

Where entities have not yet determined the deemed cost of those assets within the scope of Directive 7, they should consider GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, and consider whether this change in accounting policy can be applied retrospectively from this date, or whether it is impracticable to do so. GRAP 3.26 states that:

“When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable....”



An entity should consider whether it is impracticable to retrospectively adjust comparative information using the following criteria, which are defined in GRAP 3:

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

- “(a) the effects of the retrospective application or retrospective restatement are not determinable;*
- (b) the retrospective application or retrospective restatement requires assumptions about what management’s intent would have been in that period; or*
- (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:*
 - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and*
 - (ii) would have been available when the financial statements for that prior period were authorised for issue from other information.”*

In applying the GRAP 3, an entity assesses whether it is impracticable to determine the deemed cost of assets retrospectively as at 1 July 2007 or 2008 as required by Directive 7. It may be impracticable to determine the deemed cost retrospectively if, for example, the following circumstances exist:

- (a) Relevant data may not have been collected in the prior period and cannot be obtained by alternative means that allows for retrospective application.*
- (b) The entity is required to make significant estimates and assumptions about conditions that existed at a point in time in the past and cannot do so objectively without using hind-sight.*

However, it should be kept in mind that impracticability regarding the retrospective determination of deemed cost can only be claimed after the entity has made, and can demonstrate that it made every reasonable effort to comply with the requirements of Directive 7.

1.10 What is the intention of the phrase “effective for financial periods commencing on or after 1 April 201X”, when referring to the applicability of the GRAP Reporting Framework to different entities?

Directive 5 *Determining the GRAP Reporting Framework* prescribes the Standards of GRAP and pronouncements that are applicable to entities effective for financial periods commencing on or after 1 April of each year.

An entity’s financial period is the period of time for which information is reported in its annual financial statements. Annual financial statements cover the accounting cycle of an entity from the start to the end of the reporting period. The start date is the first day of a financial period and the end date, which is also known as the “reporting date”, is the last day of an entity’s financial period.

The application of the meaning of “effective for financial periods commencing on or after” can be illustrated using the following scenarios:



- Entities, such as public entities, constitutional institutions, Parliament and the provincial legislatures, have a financial period commencing on 1 April. They are required to apply the GRAP Reporting Framework that is prescribed from 1 April 2018 in preparing their financial statements for the 2018/19 financial period.
- Municipalities and municipal entities have a financial period commencing on 1 July. They are required to apply the GRAP Reporting Framework that is prescribed from 1 April 2018 in preparing their financial statements for the 2018/19 financial period.
- Public TVET colleges have a financial period commencing on 1 January. They are required to apply the GRAP Reporting Framework prescribed from 1 April 2018 in preparing their financial statements for the year 1 January 2019 to 31 December 2019.

1.11 When does the three year transitional period relating to the initial adoption of Standards of GRAP expire?

Directives outline the transitional provisions and transitional arrangements for the different entities that adopt Standards of GRAP.

In some of the Directives, the transitional provisions are such that entities are not required to measure items for reporting periods beginning on or after a date within three years following the date of initial adoption of the relevant Standard of GRAP.

This three year transitional period commences on the date that an entity initially adopts the Standards of GRAP, i.e. at the beginning of a reporting period. Full compliance with the relevant Standard of GRAP is required by the end of the third year. For example, if an entity adopts Standards of GRAP on 1 April 20X1, and decides to take advantage of the relief period in the Directive, it must comply in full with the Standards of GRAP by 31 March 20X4.

1.12 What are the implications on compliance with the Standards of GRAP when an exemption is granted by the Minister of Finance?

Background

The Minister of Finance (the Minister) has in some instances granted entities exemption from applying a Standard(s) of GRAP or a requirement thereof. This FAQ provides guidance on the implications of such an exemption on asserting compliance with the Standards of GRAP.

Requirements

GRAP 1.26 states the following:

“Departures from the requirements of a Standard of GRAP in order to comply with statutory or legislative reporting requirements do not constitute departures that conflict with the objective of financial statements set out in paragraph .21 of this Standard. If such departures are material an entity cannot claim compliance with Standards of GRAP.”

Section 92 of the Public Finance Management Act, Act No. 1 of 1999 (PFMA) grants the Minister the power to approve an exemption from any specific provision of the PFMA, including an exemption from applying a Standard(s) of GRAP or a requirement thereof, for a period as determined by the Minister.

An exemption granted by the Minister can be seen as a departure from applying a Standard(s) of GRAP, or a requirement thereof, as a result of statutory or legislative reporting requirements.



The *Framework for the Preparation and Presentation of Financial Statements*² (the Framework) describes the objective of financial statements and materiality as:

“.26 The objective of financial statements is to provide information ... that is useful to a wide range of users. Financial statements also show the results of the stewardship of management, and the accountability of management for the resources entrusted to it.”

“.47 Information is material if its omission, misstatement, or non-disclosure could influence the decisions of users made on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission, misstatement, or non-disclosure in the financial statements.”

When an entity departs from a requirement of a Standard of GRAP in accordance with GRAP1.21, it shall make the following disclosures as per GRAP 1.22:

- “(a) that management has concluded that the financial statements present fairly the entity’s financial position, financial performance and cash flows;*
- (b) that it has complied with applicable Standards of GRAP, except that it has departed from a particular requirement to achieve a fair presentation;*
- (c) the title of the Standard of GRAP from which the entity has departed, the nature of the departure, including the treatment that the Standard of GRAP would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements in the Framework for the Preparation and Presentation of Financial Statements, and the treatment adopted; and*
- (d) for each period presented, the financial impact of the departure on each item in the financial statements that would have been reported in complying with the requirement.”*

Assessment of the requirements and disclosure

Although an exemption granted by the Minister would make it permissible and within the regulatory framework of an entity to depart from applying a Standard(s) of GRAP or a requirement thereof, an entity would still need to assess such a departure with reference to GRAP 1.21. Therefore, even though an exemption granted by the Minister may be legal, it remains necessary for an entity to assess the impact thereof on compliance with the Standards of GRAP for financial reporting purposes.

In the *extremely rare and exceptional* circumstances that an entity departs from a Standard of GRAP, or a requirement thereof, because of an exemption granted by the Minister, an entity assesses (with reference to GRAP 1.21) if it is necessary because compliance with a Standard of GRAP, or a requirement thereof, would be so misleading that it would conflict with the objective of financial statements and the qualitative characteristics as described in the Framework.

In addition, an entity should also determine how it would have accounted for the transactions if it complied with all the requirements of the Standards of GRAP and discloses this information to the users, together with the rest of the disclosures required by GRAP 1.22. This is to ensure that the objective of financial statements is still met.

² In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.



Conclusion

If an entity concludes that an exemption granted by the Minister meets the objective of financial reporting, the entity shall assert compliance with the Standards of GRAP in the notes, in accordance with GRAP 1.18, and shall disclose the information required by GRAP 1.22.

If an entity concludes that an exemption granted by the Minister is not in terms of GRAP 1.21, or is unable to disclose the information required by GRAP 1.22, the objective of financial statements will not be met and an entity that applies such an exemption is not able to assert compliance with the Standards of GRAP.

1.13 What versions of the Standards of GRAP should be applied on first time adoption?

An entity that adopts the Standards of GRAP for the first time should apply the versions of the Standards effective for the first GRAP reporting period. The versions of the Standards that are applicable can be determined with reference to the annexure to the Directive on *Determining the GRAP Reporting Framework* (Directive 5) and by reference to the ASB's website.

An entity should use the same accounting policies, based on the versions of the Standards of GRAP effective at the end of the entity's first GRAP reporting period, for both the current and comparative information presented.

An entity is not permitted to apply earlier versions of the Standards of GRAP that were effective at earlier dates. An entity may, however, early adopt a new Standard of GRAP for which the Minister of Finance has determined an effective date which is in the future. Other Standards of GRAP for which the Minister of Finance has not yet determined an effective date, may be used by an entity to formulate its accounting policies.

The following **example** illustrates the principle.

The end of Entity A's first GRAP reporting period is 31 March 20X8. Entity A presents comparative information in those financial statements. Therefore, its date of transition to the Standards of GRAP is 1 April 20X6. Entity A is required to apply the Standards of GRAP in Directive 5 effective for the 31 March 20X8 period in preparing and presenting its:

- a) statement of financial position, statement of financial performance, statement of changes in net assets, statement of cash flows and notes for 31 March 20x8 (including comparative information for 31 March 20X7); and
- b) a comparison of budget and actual amounts and notes for the year 31 March 20X8.

The transitional provisions in other Standards of GRAP apply to changes in accounting policies made by an entity that already applies the Standards of GRAP.

1.14 What is the role of the Conceptual Framework and when is it applied?

The Board issued its new *Conceptual Framework for General Purpose Financial Reporting* (the Conceptual Framework) in June 2017. It replaced the *Framework for the Preparation and Presentation of Financial Statements*.

Objective of the Conceptual Framework

The purpose of the Conceptual Framework is to establish concepts that are to be applied in developing Standards of GRAP for the preparation and presentation of general purpose financial statements (GPFs) of public sector entities. The Board broadened the scope of the Conceptual



Framework so that it covers concepts for the preparation and presentation of general purpose financial reports (GPFs) which deals with information reported outside the financial statements, and which complements and supplements the information in the financial statements.

The Conceptual Framework can be applied by various parties. It is intended to:

- (a) provide the Board with a conceptual basis for developing Standards of GRAP;
- (b) promote the advancement of financial reporting so that the preparation and presentation of GPFs by preparers is comprehensive, cohesive and consistent with the concepts used to prepare and present GPFs;
- (c) assist preparers of GPFs in applying Standards of GRAP and in dealing with topics where there is no Standard of GRAP;
- (d) provide users of GPFs with information on the basis on which GPFs are prepared and to assist them to hold entities accountable and make decisions;
- (e) assist users of GPFs in interpreting the information contained in GPFs prepared in conformity with the Standards of GRAP; and
- (f) provide auditors with a framework to form an opinion as to whether financial statements conform with Standards of GRAP.

Authority of the Conceptual Framework

The Conceptual Framework is not authoritative. This means that it does not establish authoritative requirements for financial reporting by public sector entities that adopt Standards of GRAP, nor does it override the requirements of any specific Standard of GRAP.

The authoritative requirements relating to the recognition, measurement and presentation of transactions are specified in the Standards of GRAP. However, the Conceptual Framework can provide guidance when dealing with topics that are not covered in a particular Standard of GRAP. In such cases, the Conceptual Framework may be considered by preparers and others to determine the applicability of the definitions of the elements used in the financial statements, recognition criteria, measurement principles and other concepts identified in the Conceptual Framework.

Similarly, the Conceptual Framework does not override any existing legislative or similar requirements issued by other organisations that prescribe requirements for the preparation and presentation of information in the GPFs. As a result, it does not establish requirements for what information should be included in the GPFs – it only sets out the broad principles on how that information can be prepared and presented.

Since the Conceptual Framework introduces new concepts, including new recognition criteria and measurement bases, there may be inconsistencies between the concepts in the Conceptual Framework and the existing principles in the Standards of GRAP. In such cases, the principles in the Standards will take precedence up until the Board amends the principles in existing Standards.

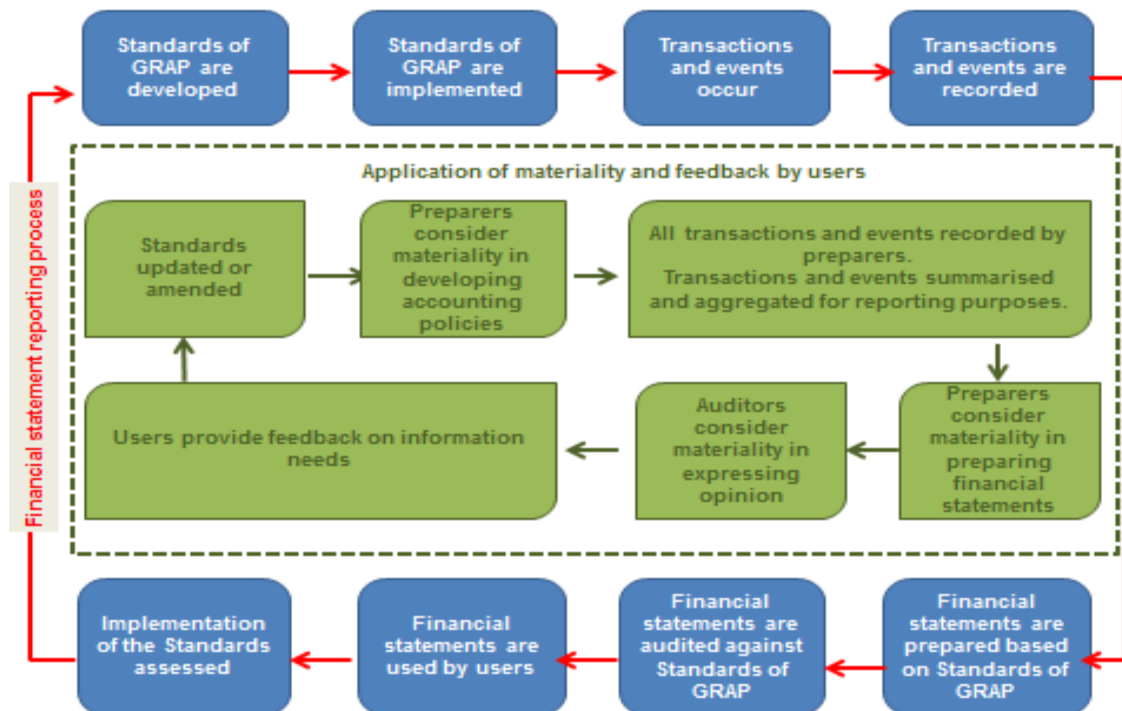
1.15 What is the effective date of the Conceptual Framework?

Since the Conceptual Framework is not authoritative, it does not have an effective date or transitional provisions. The Conceptual Framework is applicable from the date when it was issued by the Board, i.e. June 2017.

1.16 What is the role of materiality in the reporting of information in the financial statements?

In the public sector, resources are raised from taxpayers, donors, and other resource providers and allocated to entities for use in the provision of services to citizens and other service recipients. The objective of financial reporting is to provide relevant information about the entity that is useful to the users of the financial statements to hold management accountable and to make decisions.

The diagram below illustrates the financial reporting process.



The Standards of GRAP set out the principles for the preparation of financial statements. The Standards ensure that relevant, credible and consistent information is provided in the financial statements which enhances accountability³, comparability and informed decision-making.

Legislation sets out which entities are required to prepare financial statements using the principles in the Standards of GRAP. Management is responsible for the preparation of the financial statements that comply with the requirements in the Standards of GRAP. This means that management is responsible for ensuring that the financial statements provide *relevant* information about the resources entrusted to an entity for service delivery, and compliance with legislation, regulation, or other authority that governs the entity's operations and service delivery.

The *relevance* of the information included in the financial statements is affected by its nature and *materiality*. Information is material if its omission or misstatement could influence the discharge of accountability by management, or the users' decisions. Materiality is considered both when preparing and auditing the financial statements.

³ Accountability is the cornerstone of financial reporting in the public sector. It is based on the belief that citizens have the right to know, a right to receive openly declared facts that may lead to a public debate.



The Guideline on *The Application of Materiality to Financial Statements* provides guidance to preparers when making materiality assessments and decisions in applying the Standards of GRAP. The Guideline introduces a process that may be followed by preparers when applying materiality in the financial statements.

The Standards of GRAP set out accounting policies that the Board has concluded result in financial statements containing relevant and reliable information about the transactions, other events, and conditions to which they apply. The requirements of the Standards apply only to material items, transactions and events. Items, transactions and events are material if their nature or size (or both) affects users' decisions. Materiality therefore ensures that the most relevant information is provided to users in the financial statements.

Preparers should consider materiality in (a) developing accounting policies, which dictate how items, transactions and events are recognised, measured, presented and disclosed in the financial statements, and (b) assessing misstatements, errors and omissions. When transactions and events occur, they are recorded by entities. Preparers apply the accounting policies developed in identifying, aggregating and summarising the information about those transactions and events in the financial statements.

Since the accounting policies set out in the Standards of GRAP are subject to materiality considerations, management may conclude that those requirements need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from the Standards to achieve a particular presentation of an entity's financial position, financial performance, or cash flows. Applying the Guideline will ensure that materiality is applied properly when applying the Standards and improve the quality of the financial statements by reducing clutter.

By law, the financial statements are required to be audited as this will give the users of the financial statements assurance that management has fairly presented the state of affairs of an entity. Auditors consider materiality in the context of expressing an audit opinion, and in determining the nature, timing and extent of their audit procedures. As a consequence, auditors assess materiality based on whether the omission or misstatement of information could influence the decisions of users, and they evaluate the information in the financial statements against the principles in the Standards of GRAP to determine whether or not the financial statements are materially misstated.

While the definition of materiality is the same for both preparers and auditors, they consider materiality from different perspectives. As a result, differences in the application and assessment of materiality by preparers and auditors are inevitable.

Note: This FAQ only deals with materiality in relation to the application of the Standards of GRAP. It does not apply to assessments or decisions related to materiality in relation to legislation, regulations or similar.

1.17 What disclosures should an entity provide on newly effective Standards of GRAP?

GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to make certain disclosures related to Standards of GRAP that are issued but not yet effective. Two issues have arisen regarding these disclosures.

Issue #1 – Quality of the required disclosures

GRAP 3.32 and 3.33 require entities to disclose (a) the existence of issued but not yet effective



Standards of GRAP, and (b) known or reasonably estimable information relevant to assessing the possible impact of the application of the new Standard of GRAP on the entity's financial statements in the period of application (Note: "Standards of GRAP" includes all pronouncements issued by the Board).

It has been observed that entities generally only comply with part (a) listed above. A list of issued but not yet effective Standards is provided in the financial statements, but the impact of the requirements is not often provided. It is insufficient to merely list the Standards. Entities should consider what the potential impact of the new Standard would be on their financial statements. This means both qualitative (e.g. what transactions might be affected, how different the old and new accounting policies could be regarding recognition, measurement etc.) and quantitative information (e.g. if determinable, an estimate of the potential Rand-value of the impact).

The provision of this information in the financial statements serves two purposes:

- Preparers are able to assess the implications of new Standards early. This helps to ensure that accounting policies, systems and processes are changed in time to accommodate new accounting requirements.
- Users are provided with predictive information that is useful for planning and making decisions. It also ensures users can adequately understand the new requirements and assess entities' readiness.

Issue #2 – Extent of the required disclosures

Directive 5 on *Determining the GRAP Reporting Framework* is issued in September each year. The Annexures to Directive 5 outline the Standards issued but not yet effective. It is possible that the Board issues new Standards of GRAP after the update of Directive 5, i.e. there may be more issued but not yet effective Standards compared to the list included in the Annexures to Directive 5 when an entity prepares its financial statements. Questions have been raised about whether only the list in Directive 5 should be applied, or whether the disclosures required by GRAP 3 apply to all issued but not yet effective Standards.

As Directive 5 is formally approved by the Board, the list included in the Annexures is authoritative and outlines the minimum disclosures required in the financial statements. Entities may voluntarily provide information on other issued but not yet effective Standards not yet included in the Annexures, if they are relevant to the entity. In those instances, entities should however still provide the disclosures outlined in (a) and (b) above.



Section 2 – Asset Related Accounting Issues (GRAP 16, 17, 27, 31, Directive 11)

2.1 ***Must an asset always have a residual value?***

No, an asset does not always have a residual value. There are also different requirements for residual values of tangible assets and intangible assets.

For tangible assets, such as property, plant and equipment or investment property, an asset only has a residual value when the useful life of an asset (the period the asset is used or available for use by the entity) is shorter than the economic life of an asset (the period the asset is used or available for use by all users or owners of the asset). As entities in the public sector often plan to use an asset for its entire economic life, the residual value may be negligible or even zero.

For intangible assets with a finite useful life, the residual value is always deemed to be zero unless:

- (a) a third party has committed to purchase the asset at the end of its useful life; or
- (b) there is an active market for the asset and:
 - (i) the residual value can be determined by reference to that market; and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.

2.2 ***What is the treatment of fully depreciated assets still in use (other than on the initial adoption of the Standards of GRAP)?***

The response to this question has been developed on the basis that the assets, and any facts and circumstances surrounding those assets, are material.

An entity may have fully depreciated assets that are still being used. The decision tree and related discussions outline when and how an entity should adjust its financial statements.

Principles to be considered in the Standards of GRAP

In terms of GRAP 17 on *Property, Plant and Equipment*, an entity is required to assess the useful lives, residual values and depreciation methods of assets at every reporting date. This is done by assessing at each reporting date whether there is any indication that the entity's expectations about the useful lives and residual values of an asset have changed since the preceding reporting date. Indications of a change in the expected useful life or residual value of an asset are included in GRAP 17.57 and .58. When such indications exist, an entity is required to revise the expected useful life and/or residual values accordingly.

If an entity has fully depreciated assets at the reporting date that it continues using, appropriate adjustments to the financial statements may be required, if those assets are material.

In deciding whether any adjustments are required, an entity considers whether the existence of fully depreciated assets results from a change in estimate or an error in the application of the Standards.

GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* defines estimates and errors as follows:

"A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and



liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were authorised for issue; and*
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.*

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.”

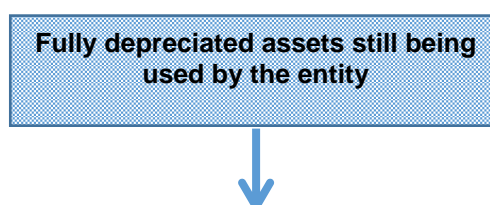
Determining whether adjustments are required to fully depreciated assets in use

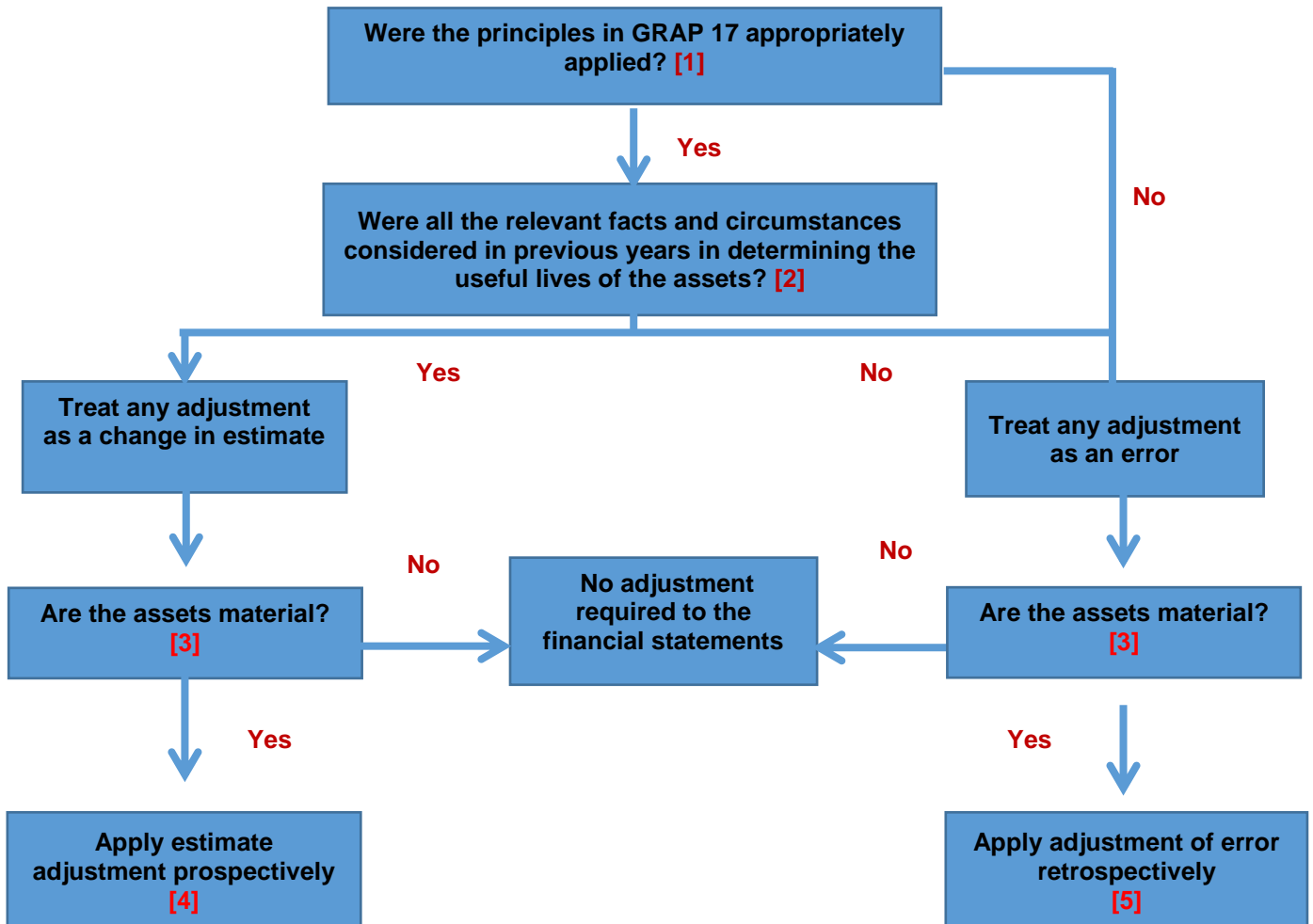
The following decision tree, along with the narrative that accompanies it, illustrates whether adjustments are required to fully depreciated assets still in use:

1. Were the principles in GRAP 17 appropriately applied?

An entity is required to assess the appropriateness of the useful lives, residual values and depreciation methods of assets at every reporting date.

Where an entity has fully depreciated assets because it did not appropriately apply the principles of GRAP 17, and as a result did not assess the useful lives or residual values of assets at previous reporting dates, any adjustment is treated as an error. The manner in which an error is adjusted is discussed in (5) below.





2. Were all the relevant facts and circumstances considered in previous years in determining the useful lives of the assets?

The useful life of an asset is defined in terms of the asset’s expected utility to the entity and may be shorter than its economic life. However, when an entity intends using an asset for its entire life, the useful life and economic life are the same. 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 considers all facts and circumstances in estimating the useful lives of assets, which could include technical, financial and other information. For example:

- Technical information from engineers about the performance, maintenance and replacement of assets can affect the useful lives of assets. Such information could also signal new developments with certain assets that change the period over which the asset will be used.
- Financial information such as budgets, forecast, plans, and any other relevant information. Policy decisions to delay the disposal or replacement of assets due to budgetary constraints affect the period over which the asset may be used (as well as its residual value).
- Other information indicating how an entity intends using its assets.



If the requirements of GRAP 17 were correctly applied in prior periods, and all available information and relevant facts and circumstances considered, but expectations of how the asset is or will be used is subsequently changed, then the adjustment is a change in accounting estimate. The manner in which a change in accounting estimate is accounted for is discussed in (4) below.

If all the available information and relevant facts and circumstances were not considered by the entity, then any adjustment is treated as an error.

If an entity is not able to determine if the information, and facts and circumstances available at previous reporting dates were appropriately considered, an entity treats any adjustment as an error as discussed in (5) below.

3. Are the fully depreciated assets still in use material?

Fully depreciated assets still in use may be material quantitatively and/or qualitatively. These assets, and their effect on the statement of financial performance and statement of financial position, may be:

- Qualitatively material if, as a result of their nature, the asset is critical to an entity's operations and delivering on its mandate.
- Quantitatively material if the extension in the asset's useful life results in an adjustment to depreciation and accumulated depreciation that is material in value and would affect users' decisions of the statement of financial position and statement of financial performance.

An entity should correct the effects of fully depreciated assets still in use, unless their possible effects are immaterial.

4. Prospective adjustments for a change in accounting estimate relating to fully depreciated assets still in use

When management has assessed that it needs to adjust the financial statements for the effect of fully depreciated assets still in use, and that adjustment is a change in estimate, an adjustment is made to the carrying amount of the asset.

In the year in which the change is made, a portion of the accumulated depreciation is reversed to surplus or deficit. The cost or revalued amount of the asset is then depreciated over its revised useful life.

The portion of the accumulated depreciation that is reversed is calculated as the difference between:

- the total depreciation recognised in the previous periods using the previous expected useful life of the asset; and
- the total depreciation that would have been charged for those periods based on the revised useful life of the asset.

The depreciation is recognised in accordance with GRAP 17.

In addition to the disclosure requirements prescribed in GRAP 3, an entity should, in the year during which the adjustment is made, disclose the gross movements in depreciation relating to the asset in the notes to the financial statements.



For assets other than those that are fully depreciated and are still in use, an entity may continue to apply its existing method when making prospective adjustments relating to a change in accounting estimate.

5. Retrospective adjustments relating to an error

An entity corrects material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and net assets for the earliest prior period presented.

A prior period error is corrected by retrospective restatement except where it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity restates the opening balances of assets, liabilities and net assets for the earliest period for which retrospective restatement is practicable (which may be the current period).

When it is impracticable to determine the cumulative effect of an error on all prior periods at the beginning of the current period, an entity restates the comparative information to correct the error prospectively from the earliest date practicable.

2.3 How does a municipality account for rainwater?

Part of the definition of an asset is that “...it is a resource controlled by an entity ...”. Control is demonstrated by an entity’s ability to access and regulate the benefits of an asset. It may be difficult to argue that naturally occurring resources are always under all circumstances under the control of a municipality.

A municipality would therefore only recognise inventory once it can demonstrate that it controls the resource, for example, once the water enters the purification process, and that the recognition criteria in GRAP 12 on *Inventory* have been met. Once the municipality can demonstrate that it controls the water, it is recognised and initially measured as follows:

- As a gain, using a replacement cost model; plus
- Costs of conversion and other costs incurred to bring the inventory to its current location and condition.

The water is initially recognised as a gain and not as non-exchange revenue because no transaction has occurred. A municipality has, however, obtained control of an asset which gives rise to a gain.

Note: The example is illustrative only; other circumstances may indicate that control exists and that the recognition criteria have been met.

2.4 Can the valuation roll be used to measure an entity’s assets at fair value?

GRAP 16 *Investment Property* and GRAP 17 *Property, Plant and Equipment* allow an entity to subsequently measure its assets using the fair value (investment property) or revaluation model (property, plant and equipment). These Standards require fair value to be used in either of these



models, unless there are items of property, plant and equipment that are of a specialised nature, in which case depreciated replacement cost can be used.

It has been noted in practice that many entities use the municipal valuation roll to determine fair value for purposes of revaluing their assets in accordance with GRAP 16 or GRAP 17. The suitability of the valuation roll as a basis for measuring assets depends on both the measurement basis that is used to value properties in the valuation roll, as well as how often the values in the valuation roll are updated. An entity should assess whether the measurement basis and valuation frequency are consistent with, or aligned to the concept of fair value envisaged in the Standards.

“Fair value” in GRAP 16 and GRAP 17 means: *“The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”*.

GRAP 16 states that: *“Fair value of investment property shall reflect market conditions at the date of reporting.”* GRAP 17 states that: *“The fair value of land and buildings is usually determined from market based evidence by appraisal”* and that *“revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date.”*

From both GRAP 16 and GRAP 17, it is clear that fair value should reflect market conditions. Fair value should also reflect the market conditions that exist at a reporting date, which means that periodic valuations should be undertaken. The Municipal Property Rates Act outlines the basis on which a municipal valuation roll should be prepared, including the basis on which properties should be valued and the frequency of the valuations. Each municipality develops its own policies in implementing the provisions of the Municipal Property Rates Act.

Where an entity intends using the municipal valuation roll in measuring assets for accounting purposes, it should assess the municipality’s policies for preparing the valuation roll and determine whether the measurement basis used in the valuation roll is consistent with, or aligned to, both these criteria in determining fair value.

2.5 How should an entity apply the requirements in Directive 11 retrospectively in the absence of cost records for assets on the date of adoption of the Standards of GRAP?

Directive 11 on *Changes in Measurement Bases Following the Initial Adoption of the Standards of GRAP* allows an entity that has initially adopted the fair value model for investment property or the revaluation model for property, plant and equipment, intangible assets or heritage assets, to change its accounting policy on a once-off basis to the cost model.

In accordance with the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity is required to apply the change in accounting policy retrospectively.

If the entity, on the initial adoption of the Standards of GRAP, used deemed cost where the acquisition cost of an asset was not available, the deemed cost will be the acquisition cost at that date.

Therefore, when the entity applies the change in accounting policy retrospectively, it uses the deemed cost at the date of adoption, as “cost” when changing its accounting policy from the revaluation model or the fair value model to the cost model.



If an entity has cost records for its assets as at the date of initial adoption of the Standards of GRAP, it would apply the change in accounting policy retrospectively using the cost of assets as at that date.

2.6 What are the implications of non-recognition of certain assets when permitted by Standards of GRAP?

Background

Some preparers of financial statements have indicated that they are unsure if they can still assert compliance with the Standards of GRAP if they do not recognise certain assets in their statement of financial position because a reliable measure for certain assets does not exist.

This FAQ does not apply to first time adoption of the Standards of GRAP. The relevant Directive should be referred to for any transitional provisions when an entity initially adopts the Standards of GRAP.

Requirements

The *Framework for the Preparation and Presentation of Financial Statements*⁴ (the Framework) requires an entity to recognise all items that meet the definition and recognition criteria of an asset. An asset is recognised in the statement of financial position when it is probable that the future economic benefits or service potential will flow to the entity and the asset has a cost or value that can be measured reliably. This refers to the existence of a reliable measure for an asset, rather than an entity's ability to determine a reliable measure.

The Framework further discusses reliable measurement in paragraphs .116 to .118, as follows:

"In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the statement of financial position or statement of financial performance.

An item that, at a particular point in time, fails to meet the recognition criteria ... may qualify for recognition later, because of subsequent circumstances or events.

An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered relevant to the evaluation of the financial position, financial performance and changes in net assets of an entity by the users of financial statements."

Assessment of requirements

A Standard of GRAP might indicate that an entity should not recognise an asset if a reliable measure for an asset does not exist. The relevant Standards of GRAP outline principles on when a reliable measure for an asset does not exist. The principles may vary from Standard to Standard. For example:

⁴ In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.



- The Standard of GRAP on *Heritage Assets* (GRAP 103) includes principles in paragraph 58 such as when market-determined prices or values are not available and alternative estimates of fair value are determined to be clearly unreliable.
- The Standard of GRAP on *Living and Non-Living Resources* (GRAP 110) also includes these principles in paragraph 31 and is described as an absence of a market; the range of possible fair values is so wide that there is no reliable measure; as well as where an acceptable valuation technique commonly used to price the asset is not available. GRAP 110.45 does, however, state that the fair value of an asset for which comparable market transactions do not exist is reliably measurable if:
 - (a) the variability in the range of reasonable fair value estimates is not significant for that asset; or
 - (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

The applicable Standard of GRAP should be considered to determine whether a reliable measure exists for an asset in a particular circumstance.

These principles outlined above should be distinguished from an entity's inability to reliably measure an asset for other reasons, such as time or resource constraints. Such reasons do not demonstrate the lack of a reliable measure.

Where a reliable estimate for an asset does not exist, the Standards often require information about the asset to be disclosed in the notes to the financial statements, for example, GRAP 103.17.

Where an entity does not recognise an asset, questions have been asked about how to account for any initial and subsequent costs incurred in relation to such an item. The relevant Standard of GRAP will describe how any initial and subsequent costs incurred relating to such an item should be treated, for example GRAP 103.20 states that any initial and subsequent costs should be recognised in surplus or deficit as incurred.

Conclusion

If an entity does not recognise assets because a reliable measure for the assets does not exist, there is no impact on an entity's ability to assert compliance with the requirements of the Standards of GRAP. Such an entity can still assert compliance with the Standards of GRAP.

If, however, an entity does not recognise assets because of its own inability to reliably measure assets, e.g. due to time or resource constraints, it cannot assert compliance with the Standards of GRAP.

2.7 Should an entity always use an external valuer or expert to determine the fair value of an asset?

Where an entity has elected to apply the revaluation or fair value model as its accounting policy to measure its assets subsequent to initial recognition, the Standards of GRAP allow an entity to use a valuer or another expert, including an employee, to determine the fair value of an asset if the:

- (a) valuer is a member of a valuation profession and holds a recognised and relevant qualification; or



- (b) the other expert has the requisite competence to undertake such an appraisal in accordance with the requirements of the Standards of GRAP.

2.8 Are changes to useful lives, residual values and depreciation methods changes in an accounting policy or a change in accounting estimate?

In terms of the Standard of GRAP on *Property, Plant and Equipment*, an entity is required to assess the useful lives, residual values and depreciation methods of assets at every reporting date. Paragraph .56 states that where there is an indication that the useful life and residual value of an asset has changed since the preceding reporting date, such changes should be accounted for as a change in accounting estimate in accordance with the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* (GRAP 3), unless an error has occurred as explained in FAQ 2.2 above.

Similarly, paragraph .72 requires that significant changes to the expected pattern of consumption of the future economic benefits or service potential (i.e. depreciation method), should be accounted for as a change in accounting estimate in accordance with GRAP 3.

Other asset-related Standards i.e. the Standards of GRAP on *Investment Property* (if the cost model is applied) and *Intangible Assets* have similar requirements that should be considered.

2.9 Do land invasions affect whether an entity recognises land?

Questions have been raised about whether the land invasions or similar illegal occupations of land means that an entity loses control of land when this occurs.

IGRAP 18 on Recognition and Derecognition of Land

IGRAP 18 indicates that land is recognised based on control. Control of land is evidenced by the following criteria:

- (a) legal ownership; and/or
- (b) the right to direct access to land, and to restrict or deny the access of others to land.

IGRAP 18 outlines the following:

Legal ownership

.18 *Legal ownership refers to the owner being the registered title deed holder of the land. Legal ownership also arises where the land is transferred from the legal owner to another entity or party, through legislation or similar means. For example, when a change in ownership is recorded by way of an endorsement on the existing title deed, rather than a formal transfer or change in ownership reflected on the title deed. References to legal owner or legal ownership in this Interpretation include both situations.*

.19 *In the absence of an entity demonstrating that it has granted the right to direct access to and restrict or deny access of others to the land to another entity, the legal owner controls the land as it retains the right to direct access to land, and to restrict or deny the access of others to land. The legal owner is thus able to demonstrate both criteria in paragraph .16.*

The right to direct access to land, and to restrict or deny the access of others to land

.20 *In assessing whether the rights that have been granted to an entity in a binding arrangement result in control of the land, it is important to distinguish between*



substantive rights and protective rights. Only substantive rights are considered in assessing whether an entity controls land.

- .21 *Substantive rights grant the entity the ability to make decisions about, and benefit from, certain rights and assets, such as how to use the land to provide services, and when to dispose of the land, to whom and at what price. For the right to be substantive, the holder of the right must have the present ability to exercise that right.*

Analysis

The accounting for land is based on the rights that an entity is presently able to exercise in terms of its ownership of the land or other rights granted in terms of a binding arrangement.

Legal ownership

The invasion of land may be an illegal act. Although the illegal occupants may have certain rights, these rights do not supersede or eliminate the entity's currently exercisable rights in terms of its legal ownership of the land. Land ownership means that the entity has substantive rights to direct or restrict access to the economic benefits or service associated with the land. The fact that the entity may not execute these rights because of political, socio-economic or other factors, is irrelevant in establishing whether control exists for accounting purposes.

An entity would need to assess if its ownership rights are subsequently changed through another legal action, such as the outcome of a court process such as the outcome of court case, court order, etc.

The illegal occupation of land may indicate that an impairment loss should be recognised. An entity should apply the principles in either GRAP 21 on *Impairment of Non-cash-generating Assets* or GRAP 26 on *Impairment of Cash-generating Assets* when these occupations occur (and throughout their duration).

Rights to use land other than through legal ownership

When an entity controls land through other rights, it is likely that the entity would need legal advice as to the rights of the various parties to understand which party has substantive rights to direct or restrict access to the economic benefits or service potential of the land.



Section 3 – Presentation and disclosure

3.1 *In preparing the financial statements, should a municipality use the presentation requirements and bases of preparation outlined in the Standards of GRAP or the budget regulations?*

The financial statements and the budget are two separate documents with separate objectives:

- The financial statements are external reports which are issued to a wide range of users such as Parliament or the legislatures, the public, financiers and other creditors, other governments, ratings agencies and analysts, to meet their specific information needs. The financial statements are prepared using Standards of GRAP.
- Budgets, while they might be publicly available, are not designed to meet the information needs of a wide range of external users. Budgets are primarily prepared as a management and accountability tool for use by councillors, the relevant treasuries and officials of a municipality. The preparation of the budget is regulated by the Municipal Budget and Reporting Regulations (issued in Gazette 32141) and should be applied in preparing the budget.

As the objectives of the two reports are different, there may be differences between the types of information reported, as well as the bases used to prepare the information.

Consequently, when an entity presents and discloses information in its financial statements (statements of financial performance, financial position, changes in net assets, cash flows and notes), it should apply GRAP 1 *Presentation of Financial Statements*, along with the requirements in the individual Standards of GRAP. Similarly, in determining the recognition and measurement requirements for transactions and events, the Standards of GRAP must be applied. There is however one possible exception to this principle, which is the preparation and presentation of information comparing actual and budget information using GRAP 24 *Presentation of Budget Information in Financial Statements*. For purposes of applying GRAP 24, the Standard allows two ways in which the information can be presented:

- (a) Include additional columns in the financial statements, but only where the budget and financial statements are prepared using the same basis (as described in GRAP 24).
- (b) Present a separate statement in the financial statements called the “Comparison of Budget and Actual Information”. This alternative must be used where the basis used to prepare the budget and financial statements differs, and may be used where the basis is the same. Where this presentation method is used an entity presents the actual and budget information in a separate statement. Where the budget information is prepared on a different basis to the financial statements, an entity adjusts the financial statement information to make it comparable to the basis used to prepare and present the budget (referred to in the Standard as “actual information on a comparable basis”).

3.2 *How does an entity decide which accounting policies should be included in its financial statements?*

An entity includes accounting policies in its financial statements for those material transactions or events included in the entity’s financial statements for the current or prior years (either recognised or included in a specific component of the financial statements, e.g. the statement of



financial position or the comparison of budget and actual information, or disclosed in the notes to the financial statements).

An entity would not include accounting policies in its financial statements that are not relevant to the transactions and events undertaken for the current or prior years. For example, an entity would not include an accounting policy in its financial statements for internally generated intangible assets if it has not undertaken such transactions in the current or prior years.

3.3 Should a municipality disclose the councillors' remuneration on an individual basis or in aggregate?

Note: This question arose in the context of municipalities with a large number of councillors, some of whom are remunerated at standard amounts, and it was unclear whether or not the remuneration for those councillors should be disclosed separately on an individual basis or in aggregate.

GRAP 20 *Related Party Disclosure* provides guidance on the identification of related parties and outlines the minimum information that shall be disclosed for those transactions in the notes to the financial statements.

GRAP 20.28 specifies how related party transactions should be categorised and includes a separate category for management. As the council of a municipality plays a prominent decision making role, councillors are considered part of management in a municipality. Thus, the disclosure requirements prescribed for management are applicable to councillors of a municipality.

GRAP 20.31 states that related party transactions may be disclosed in aggregate when they relate to the same related party, and are of a similar nature, except when separate disclosure is necessary to provide relevant and reliable information for decision-making and accountability purposes.

GRAP 20.35 prescribes that an entity shall disclose the remuneration of management per person and in aggregate, for each class of management. Therefore, where an entity has major classes of management, it shall provide separate disclosures on remuneration for those classes of management. The structure of a municipality and its council is known to vary but if there are major classes of councillors then the remuneration of each class shall be disclosed per person and in aggregate.

GRAP 1.36 requires that each material class of similar items shall be presented separately in the financial statements; and items of a dissimilar nature or function shall be presented separately unless they are immaterial. Therefore, if a line item is not individually material, it is aggregated with other items either on the face of the financial statements or in the notes.

GRAP 1.38 prescribes that when an entity applies the concept of materiality, it means that the specific disclosure requirements of a Standard of GRAP need not be satisfied if the information is not material. Materiality as defined in GRAP 1 depends on the nature (quality) or size (quantity) of the line item, or a combination of both.

Consequently, when a municipality presents and discloses the councillors' remuneration in its financial statements it shall apply the specific disclosure requirements of GRAP 20 (i.e. disclose the remuneration of councillors, as a category of management, per person and in aggregate) after considering materiality (i.e. qualitative and quantitative factors), particularly at an individual line item level. In accordance with GRAP 1.36, if a line item is not individually material, then it is



aggregated with other similar items either on the face of the financial statements or in the notes. Aggregation may be applied on the basis of GRAP 1.38 if it can be demonstrated that the disclosure of the remuneration of management per person is considered not to be material. In addition to the disclosures required by GRAP 20, an entity should also identify any disclosures required by legislation in this regard.

3.4 What does it mean to analyse expenditure by either nature or function?

The Standard of GRAP on *Presentation of Financial Statements* (GRAP 1) paragraph .104 requires an entity to present an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is reliable and more relevant. Management applies its judgement to select the most relevant and reliable presentation for the entity. Entities are encouraged to present this analysis on the face of the statement of financial performance.

Analysing expenses by nature

Analysing expenses by nature identifies costs and expenses in terms of their character and groups expenses according to the kinds of economic benefits or service potential received in incurring those expenses, irrespective of their application in the entity's operations and/or where the expenses are incurred. The entity therefore analyses the direct goods or services acquired or assets consumed – i.e. the main inputs that are consumed in order to accomplish an entity's activities (what has been bought or used), and not the ultimate use thereof. For example, the entity will analyse expenses into categories such as depreciation, purchases of materials, transport costs, employee costs, advertising costs, etc. Under this method, the expenses are not allocated among various functions within the entity.

It has been observed that line items such as "repairs and maintenance", "grant expenditure", "contracted services" and "project expenditure" are presented separately in the financial statements where entities have chosen to present an analysis of expenses by nature. These line items usually consist of a combination of different elements of expenditure by nature. This presentation may not be in accordance with the requirements of GRAP 1 where the nature of expense method is chosen.

For example, it may be inappropriate to present the following:

- A line item "repairs and maintenance" that consists of different elements of expenses by nature, such as labour costs, consumable materials, other overhead costs, etc.
- A line item "grant expenditure" that consists of different elements of expenses by nature related to a specific grant, such as labour costs, raw materials, transport costs, administrative expenses, etc.
- A line item "contracted services" that consists of different services by nature, such as cleaning services, professional services, security services, etc. It may be particularly inappropriate where "contracted services" includes the procurement of goods, such as cleaning materials, while a separate line item is presented for similar goods procured.
- A line item "project expenditure" that consists of different elements of expenses by nature, such as professional fees (engineers and valuers), labour costs, raw materials, electricity, water, lease of equipment, etc.



This incorrect presentation should be distinguished from when an entity procures a complete service from an outside party for e.g. maintenance services, project management services, etc. This may qualify for separate presentation when expenses are analysed by their nature as the entity has in this case procured a turn-key service. For example, if material, an entity could conclude it is appropriate to present a line item “maintenance services” where the entity procures a completed maintenance service from an outside party.

GRAP 1 does not require separate presentation of each material item in the statement of financial performance. An entity would need to assess what information is appropriate for the face of the statement compared to the notes. For example, an entity may determine it appropriate to present services procured as one item in the statement of financial performance, with information on each material service presented in the notes. Immaterial items should not be presented separately in the financial statements.

An entity should always consider if the information presented to users provides information about the nature of what the entity has procured, for material items separately.

Analysing expenses by function

The function of expense method analyses expenses according to the programme, activity from which the item arises, or purpose for which they were incurred. For example, health expenses, education expenses, administrative expenses, etc. GRAP 1.110 requires entities that analyse expenses by function to also disclose additional information about the nature of those expenses.

Unlike the nature of expense method, an entity that presents its expenses based on the entity's functions will allocate the elements of expenses such as “labour costs”, “consumable material” and “transport costs”, among the functions of the entity, for example, “water”, “electricity”, “roads”, “housing” and “administration” functions are presented, with each function including its share of total expenses.

It is unlikely that an entity has functions such as “repairs and maintenance”, “grant expenditure”, “contracted services” and “project expenditure” that are presented separately in a statement of financial performance presented by function; however, it would need to be assessed. An entity that has, for example, a repairs and maintenance function for a large asset base that is maintained in-house through an internal works department, which is significant, may conclude that “repairs and maintenance” is a function that should be presented separately.

An entity that previously incorrectly presented line items that combine different elements of expenditure by nature on the face of the statement of financial performance, e.g. “repairs and maintenance”, “project expenditure”, “grant expenditure” and “contracted services”, should reclassify these items by either the nature or function thereof, depending on the entity's choice of presentation. The comparative amounts should also be restated, and information about the nature, amount, and reason of reclassification disclosed, as required by GRAP 1.33 and 1.49.

Specific presentation requirements in the Standards of GRAP

Standards of GRAP may require specific items to be presented in the financial statements. Questions have been asked about where and how this information should be presented, if presenting certain items as a separate line item in the statement of financial performance is inappropriate.



To determine how to appropriately present information where a Standard of GRAP requires specific items to be presented separately, the requirements of the various Standards of GRAP should be read together.

For example, GRAP 1 states the following regarding information to be presented either on the face of the statement of financial performance or in the notes:

“.101 When items of revenue and expense are material, their nature and amount shall be disclosed separately.

.102 Circumstances that would give rise to the separate disclosure of items of revenue and expense include:

(c) expenditure incurred on assets to repair and maintain them.”

The Standard of GRAP on *Property Plant and Equipment* (GRAP 17), states that the following presentation should be made in the notes:

“.88 An entity shall separately disclose expenditure incurred to repair and maintain property, plant and equipment in the notes to the financial statements.

.89 As entities may apply different bases for determining expenditure on repairs and maintenance, an entity shall disclose information about the specific costs included in the amount of repairs and maintenance disclosed in the notes. In determining the amount disclosed in the notes to the financial statements on expenditure incurred to repair and maintain property, plant and equipment, an entity may include amounts paid to service providers, as well as amounts spent on materials and time spent by employees in repairing and maintaining the asset(s).”

When reading the requirements of GRAP 1.102(c) and GRAP 17.88 and .89 together, an entity that incurs material expenditure to repair and maintain assets, and concludes it is inappropriate to present a separate line item in the statement of financial performance, will disclose the information in the notes.

An entity that concludes it is appropriate to include a “repairs and maintenance” line item in the statement of financial performance, will present a “repairs and maintenance” line item according to nature or function for all repairs and maintenance incurred. The entity will present the information required by GRAP 17.88 and .89 in the notes, for property, plant and equipment only, and including the specific costs the entity determines to be appropriate.

Other asset-related Standards have similar disclosure requirements that should be considered with the requirements of GRAP 1.

3.5 What items should be included in “cash and cash equivalents”?

Some preparers questioned the requirement in the Standards of GRAP that “cash and cash equivalents” should only include those investments with a maturity of 3 months or less.

The Standard of GRAP on *Cash Flow Statements* (GRAP 2) includes the following definitions of cash and cash equivalents:

“Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.”



GRAP 2 describes cash equivalents as those items that meet the definition and are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

Bank overdrafts that are repayable on demand usually form part of an entity's cash management activities and are part of cash and cash equivalents.

GRAP 2 also clarifies that the following items are not cash and cash equivalents:

- Equity investments, unless they are cash equivalents in substance.
- Bank borrowings.

Neither GRAP 2 nor the National Treasury Guideline on GRAP 2 provides specific guidance on which investments are considered to be cash equivalents. GRAP 2 (and IPSAS 2 *Cash flow statements*) is based on the principles of IAS 7 *Cash Flow Statements*. Guidance provided in the private sector was therefore considered. The IFRS Interpretations Committee (IFRIC) received questions in the past about which items could be included in cash equivalents, but has not issued any guidance as it believed the requirements in IFRS, which are the same as GRAP 2, are clear.

Entities therefore need to assess their investments to determine if they should be classified as cash and cash equivalents, by considering:

1. The definitions in GRAP 2, and
2. The purpose of holding the investments.

1. Definition

The definition of cash equivalents comprises three elements that entities should consider, as follows:

a) Short term, highly liquid

An investment requires a short maturity to meet the definition of a cash equivalent. GRAP 2 is not definitive, but it makes reference to an investment with a maturity date of three months or less from the date of acquisition, as an example of this. This does not automatically mean an investment with a maturity date of more than three months cannot be classified as a cash equivalent. Note that the maturity period is measured from the date of acquisition, not the reporting date.

b) Readily convertible to known amounts of cash

This implies that an investment must be convertible into cash without an undue period of notice and without incurring a significant penalty on withdrawal. Known amounts of cash means that the amount of cash that will be received must be known at the time of the initial investment. The IFRIC concluded that investments in shares or units of money market funds that are redeemable at any time are not considered cash equivalents, even though they can be converted to cash at any time at the then market price in an active market. This is because the share price or unit price fluctuates and the amount of cash for which the shares or units of money market funds can be exchanged are not known at initial investment.

c) Insignificant risk of change in value

This implies that an investment must be so similar to cash that any changes in value are insignificant. For this reason, a short maturity period is necessary because a longer maturity period exposes an investment to fluctuations in value. Entities should consider the effect on



the redemption amount of e.g. cancellation clauses, termination fees or usage restrictions and whether they create a more than insignificant risk of change in value.

2. Purpose of holding an investment

An entity should assess why it is holding an investment, which would be reflected in the way in which the entity has invested the item. For example, if the purpose of holding an investment is to meet short-term cash commitments to fund on-going operations or settle liabilities in the short-term, an entity would invest it for only a short period of time in a way that resembles cash.

Accounting policy

GRAP 2 recognises that entities may have a variety of cash management practices and banking arrangements that will influence which items are classified as cash and cash equivalents. For this reason, GRAP 2.47 requires that, in order to comply with the Standard of GRAP on *Presentation of Financial Statements*, an entity should disclose the policy which it adopts in determining the composition of cash and cash equivalents.

3.6 **What are the requirements for entities to classify revenue as exchange or non-exchange?**

The Standard of GRAP on *Presentation of Financial Statements* (GRAP 1) requires in paragraph .103 that an entity presents a sub-classification of total revenue on the face of the statement of financial performance or in the notes, classified in a manner appropriate for the entity's operations. The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfer)* (GRAP 23) requires an entity to disclose either on the face of, or in the notes to the financial statements, the amount of revenue from non-exchange transactions recognised during the period by major classes. Similarly, the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9) requires an entity to disclose the amount of each significant category of (exchange) revenue recognised during the period.

GRAP 1, GRAP 9 and GRAP 23 also require an entity to disclose the accounting policies adopted for the recognition of revenue from exchange and non-exchange transactions respectively in the notes to the financial statements.

Entities should read the requirements of the Standards of GRAP together. This means entities are required to classify revenue recognised in accordance with GRAP 9 or GRAP 23 as either exchange or non-exchange respectively, on the face of the statement of financial performance or in the notes, and to disclose accounting policies.

GRAP 23.10 explains if it is not immediately clear whether transactions are exchange or non-exchange, an entity should examine the substance of the transaction by applying judgement.

The requirements of the Standards of GRAP apply to material transactions or events. Entities should not present immaterial items separately in the financial statements. This means entities should not unnecessarily disaggregate information in the statement of financial performance or related notes in an attempt to present exchange and non-exchange revenue separately.

Entities should also apply materiality to determine which accounting policies are significant and should be presented. Entities may make this information available on another platform, such as the entity's website.



3.7 What should be considered when presenting information in addition to what is required by GRAP 24 on a comparison of actual and budget information?

The Standard of GRAP on *Presentation of Budget Information in Financial Statements* (GRAP 24) requires entities that are required to, or elect to, make publicly available their approved budgets and for which they are held publicly accountable, to present a comparison of actual information with the approved budget in the financial statements.

The objectives of financial statements are to provide information about the entity that is useful to users for accountability and decision-making purposes. The attributes that make information useful to users are relevance, faithful representation, understandability, timeliness, comparability, and verifiability of the information reported, as discussed in the Board's *Conceptual Framework for General Purpose Financial Reporting* (Conceptual Framework).

Entities may be required or encouraged to present information in addition to what the Standards of GRAP require. For example, the National Treasury requires entities to present more information about the entity's actual financial results compared to its budget than what the Standards of GRAP require.

Presenting information in the financial statements in addition to what the Standards of GRAP require is not prohibited. Entities may include additional information in the financial statements if it is presented in a way that meets the objectives of financial statements and attributes of useful information, as discussed in the Conceptual Framework.

For example, entities that present a statement of comparison of budget and actual information and an appropriation statement (information used by the National Treasury), often present information that is similar, but not the same, more than once in the financial statements. The information is therefore largely repeated. It is likely that this repetition of information would be more misleading to a user than provide useful information.

To comply with the Standards of GRAP, while providing additional information to specific users, it may be appropriate for entities to present:

- information required by Standards of GRAP, together with the additional information entities are required or encouraged to present, once in a single statement or note; or
- information required by Standards of GRAP in the financial statements, with additional information provided as an annexure to the financial statements.

3.8 How should entities determine the amount of repairs and maintenance expenditure incurred?

The Standard of GRAP on *Property Plant and Equipment* requires an entity to disclose expenditure incurred to repair and maintain property, plant and equipment in the notes to the financial statements. The Standard does not prescribe how the amount to be disclosed should be determined, it acknowledges that expenditure may be incurred either internally or externally.

In particular, to determine the amount to be disclosed, an entity considers whether the expenditure arose from (a) procuring the service to repair and maintain assets from service providers and/or (b) an internal function or department that is responsible to repair and maintain assets, in which case the expenditure may comprise the amounts incurred on materials and time spent by employees.



The Standard requires that entities disclose how they have determined the disclosed amount so that the users of the financial statements can make comparable assessments.

Other asset-related Standards have similar disclosure requirements that should be considered.

3.9 When should an entity present revenue and receivables from exchange and non-exchange transactions on the face of the financial statements or in the notes?

The Standards of GRAP set out various requirements for the presentation of revenue and receivables from exchange and non-exchange transactions, either on the face of the financial statements or in the notes. The table below summarises these requirements:

	Presentation requirements for revenue	Presentation requirements for receivables
GRAP 1 on <i>Presentation of Financial Statements</i>	<p><u>GRAP 1.96</u></p> <p>As a minimum, the face of the statement of financial performance shall include line items that present the following amounts for the period:</p> <p>(a) revenue ...</p> <p><u>GRAP 1.98</u></p> <p>Additional line items, heading and sub-totals shall be presented on the face of the statement of financial performance when such presentation is relevant to an understanding of the entity's financial performance.</p>	<p><u>GRAP 1.79</u></p> <p>As a minimum the face of the statement of financial position shall include line items that present the following amounts:</p> <p>...</p> <p>(i) receivables from non-exchange transactions (taxes and transfers);</p> <p>(j) receivables from exchange transactions;</p> <p>...</p> <p><u>GRAP 1.85</u></p> <p>An entity shall disclose, either on the face of the statement of financial position or in the notes to the statement of financial position, further sub-classifications of the line items presented, classified in a manner appropriate to the entity's operations.</p>
GRAP 9 on <i>Revenue from Exchange Transactions</i>	<p>GRAP 9.39</p> <p>An entity shall disclose the amount of each significant category of revenue recognised during the period including the revenue arising from:</p> <p>(i) the rendering of services</p> <p>(ii) the sale of goods;</p> <p>(iii) interest;</p> <p>(iv) royalties; and</p> <p>(v) dividends or similar distributions.</p>	
GRAP 23 on <i>Revenue from</i>	GRAP 23.115	GRAP 23.115

	Presentation requirements for revenue	Presentation requirements for receivables
<i>Non-exchange Transactions (Taxes and Transfers)</i>	<p>An entity shall disclose, either on the face of, or in the notes to, the financial statements:</p> <p>(a) the amount of revenue from non-exchange transactions recognised during the period by major classes showing separately:</p> <p>(i) taxes, showing separately major classes of taxes; and</p> <p>(ii) transfers, showing separately major classes of transfer revenue.</p>	<p>An entity shall disclose, either on the face of, or in the notes to, the financial statements:</p> <p>.....</p> <p>(b) the amount of receivables recognised in respect of non-exchange revenue;</p> <p>...</p>
GRAP 108 on <i>Statutory Receivables</i>		<p><u>GRAP 108.35</u></p> <p>The carrying amount of statutory receivables shall be disclosed separately in the notes to the financial statements, clearly distinguishing statutory receivables from receivables which are financial assets and other receivables.</p>

As the Standards of GRAP set out various requirements for the presentation of revenue and receivables, an entity needs to consider materiality when preparing its financial statements. The requirements in the Standards of GRAP should be read together when presenting revenue and receivables in the financial statements. Note: The discussions below assume that the items are material to the financial statements and/or the disclosures in the notes.

Where one Standard of GRAP requires presentation on the face, while another Standard of GRAP:

- (a) allows presentation either on the face, or in the notes to the financial statements; or
- (b) does not have specific requirements for presenting an item,

revenue and receivables should be presented on the face.

Revenue

As required by GRAP 1, revenue is presented on the face of the statement of financial performance.

If revenue is presented on the face of the statement of financial performance, additional line items, distinguishing between exchange and non-exchange revenue, may be included on the face of the statement of financial performance, if:

- (a) the exchange or non-exchange revenue is material; and
- (b) relevant information is provided to the users in understanding the entity's financial performance.



If the distinction between exchange and non-exchange revenue is not included on the face of the statement of financial performance, it is disclosed in the notes to the financial statements.

The notes to the financial statements may also separately present the major classes of non-exchange revenue, and the significant categories of exchange revenue.

Receivables

As required by GRAP 1, receivables from exchange transactions and receivables from non-exchange transactions are presented on the face of the statement of financial position.

The notes to the financial statements should separately present statutory receivables from contractual and other receivables.

3.10 Should all errors be accounted for using GRAP 3 on Accounting Policies, Changes in Accounting Estimates and Errors?

In discussions on the projects the ASB should undertake during 2021 to 2023, stakeholders indicated a trend of disclosing extensive information on the corrections of prior period errors – both in the statement of changes in net assets as well as the notes. Stakeholders indicated that the information provided detracted from the overall quality of the financial statements as it was not relevant to users of the financial statements. The disclosures often related to immaterial amounts, and the aggregation of information was not considered.

This practice means that the principles in GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* – particularly materiality - are not being considered by entities when preparing their financial statements.

GRAP 3 explains that the Standards of GRAP are only applied to transactions and events that are material. This should always be considered by entities in deciding what accounting treatment should be applied, as well as what and how information should be presented in the financial statements and disclosed in the notes.

The Guideline on *The Application of Materiality to Financial Statements* provides guidance on the treatment of immaterial errors. The guidance is outlined below.

What are errors?

GRAP 3 explains that prior period errors are omissions from, and/or misstatements in, an entity's financial statements arising from failure to use, or misuse of reliable information that is available, or could reasonably be expected to be obtained.

Material errors

Material errors are errors that individually or collectively could reasonably be expected to influence the users' decisions taken on the basis of those financial statements. Errors could affect both numbers and qualitative descriptions provided in the financial statements. An entity must correct all material errors in accordance with GRAP 3, i.e. retrospective correction and restatement of the error, with disclosure in the notes to the financial statements.

Immaterial errors

As the Standards of GRAP only apply to material items, and entity should consider the following in deciding how to treat errors that are immaterial:

- Errors need to be assessed both quantitatively and qualitatively.



- Immaterial errors do not need to be corrected, unless the errors are made to achieve a particular presentation of an entity's financial position, financial performance or cash flows.
- When an entity assesses an error not to be material individually, it considers whether it may be material in aggregate with other immaterial errors. The netting of errors is inappropriate.

3.11 Should all errors be accounted for using GRAP 3 on Accounting Policies, Changes in Accounting Estimates and Errors?

When entities are required to apply a new pronouncement issued by the Board, the transitional provisions of that pronouncement should be applied to account for any resulting adjustments. In the absence of any transitional provisions, an entity applies the requirements of GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* to account for the adjustments.

Even if a pronouncement has transitional provisions, if some of the requirements of the previous pronouncement are the same as the requirements in the new pronouncement but were previously incorrectly applied, any resulting adjustment should be treated as a prior period error in GRAP 3 rather than a change in accounting policy.

When a pronouncement does not have any transitional provisions, an entity applies GRAP 3. The following paragraphs are relevant in considering whether the adoption of a new pronouncement will give rise to a change in an accounting policy or a change in an accounting estimate. An entity should also consider if any adjustments could be prior period errors.

Changes in accounting policy

GRAP 3.06 indicates the following: “A change in the accounting treatment, recognition or measurement of a transaction, event or condition within a basis of accounting is regarded as a change in accounting policy”. This is typically when the new pronouncement outlines new or different requirements or criteria for when a transaction is recognised, and how it is measured (e.g. cost, fair value or another measurement bases).

Changes in accounting estimates

GRAP 3 indicates the following regarding changes in accounting estimates:

- Paragraph .35 – “The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability”.
- Paragraph .36 – “An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error”.
- Paragraph .37 – “A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate”.

Errors

GRAP 3.04 indicates the following: “Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:



- (a) was available when financial statements for those periods were authorised for issue; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.”

Judgement should be applied to the relevant facts and circumstances when applying a new pronouncement. Similar principles to those outlined in this FAQ should also be applied when implementing the revisions to existing pronouncements.

3.12 When should GRAP 109 Accounting by Principals and Agents be applied?

It has been observed that entities incorrectly apply GRAP 109 *Accounting by Principals and Agents* to arrangements that are not principal-agent arrangements.

This FAQ outlines the process that should be followed to determine if GRAP 109 should be applied. Note: This FAQ does not deal with the first-time adoption of GRAP 109.

Step 1: When should GRAP 109 be considered?

Before accounting for an arrangement with another party, an entity should consider whether GRAP 109 should be applied. As GRAP 109 provides guidance on assessing the nature of an arrangement, it is considered before applying other Standards of GRAP.

Step 2: Is the arrangement a principal-agent arrangement?

To determine if GRAP 109 should be applied, an entity needs to determine if the arrangement it has entered into is a “principal-agent arrangement”.

A “principal-agent arrangement” is defined as follows in GRAP 109.05:

“A principal-agent arrangement results from a binding arrangement in which one entity (an agent), undertakes transactions with third parties on behalf of, and for the benefit of, another entity (principal)”.

There are two important aspects to consider in assessing whether a principal-agent arrangement exists:

1. The existence of a binding arrangement between the principal and the agent.
2. The arrangement is such that one entity (the agent) represents the interests of another party (the principal), in dealing with identified third parties.

The definition refers to undertaking transactions with third parties “on behalf of, and for the benefit of, another entity (principal)”. By definition, the entity on whose behalf the activities are being undertaken and who ultimately benefits (or bears losses), is the principal in the arrangement. The assessment of whether an entity is a principal or an agent in an arrangement is not undertaken as part of the initial assessment of whether a principal-agent arrangement exists. Only after it is concluded that a principal-agent arrangement exists, is **step 3** of this FAQ undertaken to determine which entity is the principal and which entity is the agent in the arrangement.

The assessment of whether an arrangement is principal-agent arrangement is made at the arrangement-level rather than for individual transactions.

Is there a binding arrangement?

A binding arrangement (for purposes of GRAP 109) is any arrangement that confers enforceable rights and obligations on parties to the arrangement. These rights and obligations could arise from:

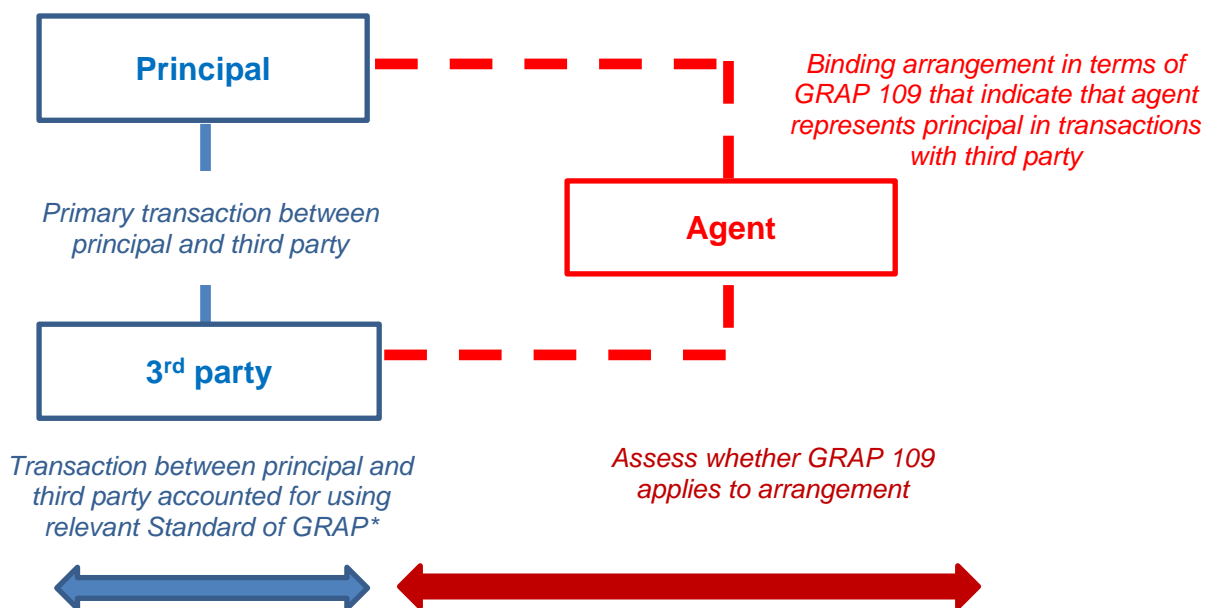
- contracts;
- legislation or similar means; and/or
- common law.

Some arrangements may be governed by both legislation (which sets the overarching framework within which certain transactions occur) and contracts (which set out the specific details of an arrangement between a principal and an agent, e.g. the activities to be undertaken, reimbursement of costs, fees, service standards etc.). Both should be considered in deciding the nature of the arrangement and what rights and obligations exist for either parties.

Who are the parties to the arrangement?

A common misconception is that any transaction with more than two parties is a principal-agent arrangement. This is not the case. A principal-agent arrangement is where one entity (the agent) represents the interests of another entity (the principal) when that entity (the principal) transacts with third parties.

Representing the interests of another entity could include undertaking specific transactions, or it could include having interactions with third parties on an entity's behalf, e.g. negotiating a contract. Where there are specific transactions that are undertaken between the principal and the third parties, the agent would be involved in facilitating or executing the transaction but would not be responsible for fulfilling the rights and obligations in the transaction. A key characteristic of these transactions is often that the principal and the third parties are the counterparties to the transaction rather than the agent and the third parties (although there are exceptions). The diagram below illustrates the relationships in a principal-agent arrangement:



**Transaction between third party and principal will be governed by a separate binding arrangement.*



The examples below illustrate when a principal-agent arrangement exists.

Examples where a principal-agent arrangement exists

Example #1: Issuing of motor vehicle licences

- Fact pattern:

The relevant Department of Transport issues motor vehicle licences to motorists in each province in exchange for a prescribed fee. Given the geographical location of municipal offices, it is convenient for motorists to be able to renew their licences at these locations. The municipality facilitates the issuing of these licences and the collection of the prescribed fees.

- Analysis:

The municipality acts on behalf of the Department to issue licences to, and collect money from motorists, i.e. there are three parties to the arrangement. The transaction is however between the Department of Transport – the entity responsible for issuing the licence, and the motorist, i.e. the municipality is not a party to the transaction with the third parties.

Example #2: Project management services to an entity

- Fact pattern:

A Department is responsible for executing an infrastructure development project within a municipal boundary. In executing the project, the Department asks the municipality to provide it with spatial planning services, as well as project managing the contractor appointed by the Department for the development of the infrastructure. As the municipality has the necessary technical expertise, they will also negotiate the contract between the Department and contractor. The Department is liable to pay the contractor, and the contractor is liable to deliver the `completed infrastructure.

- Analysis:

The municipality fulfils two roles:

- The municipality acts on behalf of the Department in negotiating and managing the contract between the Department and the contractor, i.e. there are three parties to the arrangement. The transaction is however between the Department and the contractor, i.e. the municipality is not party to the transaction with the third parties. Note: In some instances, agents may be asked to facilitate the supply chain management process and may be a party to the contract (particularly construction contracts). The agent will usually have no substantive rights or obligations in the arrangement.
- The municipality provides spatial planning services to the Department and will receive compensation for those services.

Examples where a principal-agent arrangement does not exist

Example #3: Delivery of services to a third party

- Fact pattern:

A municipality contracts with a service provider to deliver food parcels to a community affected by a disaster. This relief is automatically provided by the municipality when



specific events occur.

- Analysis:

Although the food parcels are delivered to identified third parties, these parties are not party to the arrangement – they are merely a beneficiary of the municipality’s activities. Therefore, only the municipality and the service provider are parties to the arrangement. In this instance, there is no agent, as there are no third parties in the arrangement.

Example #4: Legal services provided to an entity

- Fact pattern:

An entity contracts with senior counsel to provide it with legal representation for environmental claims against the entity. Senior counsel advises the entity that it needs to contract with environmental and other experts to assist with the case.

- Analysis:

Although the experts will effectively act on behalf of the client (the entity), there are essentially two contracts:

- One between the entity and senior counsel for the provision of legal services.
- One or more contracts between senior counsel and the expert(s). Contracts between senior counsel and the experts are for the provision of services to senior counsel to ensure relevant legal services are provided to the client (the entity).

In this instance, senior counsel is not an agent representing the entity when contracting with the experts. Senior counsel will act for him or herself when dealing with the experts as the one primarily responsible for fulfilling the contract.

Principal-agent arrangements and control relationships

The structure and operation of the public sector means that entities frequently control other entities. Although these control relationships mean that the controlling entity is able to direct the activities of an entity so that it benefits from those activities, these relationships by themselves do not indicate the existence of a principal-agent arrangement. Only where a controlling entity specifically directs a controlled entity to undertake transactions with third parties for the controlling entity’s benefit will a principal-agent arrangement exist. In control relationships, it is possible for one or more principal-agent arrangements to exist within the context of a control relationship. This is particularly relevant in assessing the nature of grant and transfer arrangements between controlled and controlling entities.

Substance over form

In assessing whether a principal-agent arrangement exists, an entity applies the principle of substance over form. Arrangements might stipulate that “this arrangement is (or is not) a principal-agent arrangement”, or “entity X is (or is not) the agent and entity Y is (or is not) the principal”, or that an entity “acts on behalf of XXX or is the implementing agent”. An entity needs to assess if the definition of a principal-agent arrangement in GRAP 109 is met when accounting for the arrangement, irrespective of the terminology used in the binding arrangement.

Step 3: Is an entity a principal or an agent in the arrangement?

Only if an entity concludes that an arrangement is a principal-agent arrangement, are the criteria



in GRAP 109.25 applied to assess if an entity is a principal or an agent:

An entity is an agent when, in relation to transactions with third parties, all three of the following criteria are present, except as outlined in paragraph .26:

- (a) It does not have the power to determine the significant terms and conditions of the transaction.*
- (b) It does not have the ability to use all, or substantially all, of the resources that result from the transaction for its own benefit.*
- (c) It is not exposed to variability in the results of the transaction.*

GRAP 109 provides detailed guidance on the application of each of these. Illustrative examples are provided in the Appendix A of GRAP 109.



Section 4 – Accounting for Non-exchange Revenue

Public entities

4.1 *How should entities account for non-exchange revenue, such as transfer payments received?*

Transfer payments and government grants would have been accounted for historically using IAS 20. From 1 April 2012, entities are required to apply the principles in GRAP 23 to account for the recognition and measurement of revenue arising from non-exchange transactions.

A few key differences between IAS 20 and GRAP 23 regarding the recognition of government grants and transfer payments are as follows:

- IAS 20 prescribes different accounting treatment for grants related to operational and capital expenditure. GRAP 23 makes no such distinction.
- IAS 20 requires that revenue related to operational expenditure is recognised when expenditure is incurred. This generally resulted in deferred revenue being recognised initially as a liability until the expenditure is incurred. Subsequently, the liability is reduced and revenue recognised as operational expenditure is incurred. Under GRAP 23, revenue is recognised unless an obligation exists to use the transferred resources (in this instance, the grant or transfer payment) in a certain way or return the resources to the transferor (i.e. the transfer of resources is subject to a “condition”). If an entity is only required to use the resources received in a certain way with no corresponding requirement to return those resources to the transferor, then no obligation exists and revenue is recognised.
- IAS 20 requires that revenue related to the acquisition or construction of an asset is recognised either as a reduction of the asset acquired/constructed (resulting in a reduced depreciation charge) or deferred revenue being recognised as a liability on initial recognition. Subsequently, the liability would be reduced and revenue recognised based on the depreciation of the asset. Under GRAP 23, revenue is recognised unless an obligation exists to use transferred resources in a certain way or return the resources received to the transferor (i.e. the transfer of resources is subject to a “condition”). If an entity is only required to use the resources received in a certain way with no corresponding requirement to return those resources to the transferor, then no obligation exists and revenue is recognised.

For example: Entity A receives an annual transfer payment from Department X. Part of the transfer payment for the 20X9/X0 reporting period is specifically allocated to the acquisition of infrastructure. The stipulations of the transfer payment do not require repayment of the whole or part thereof if it is not utilised to acquire the specified infrastructure. Based on the fact that no condition exists, Entity A would recognise the transfer payment as revenue when it is probable that the transfer payment will be received and the amount can be estimated reliably (which may be at the start of the financial year).

The recognition of an asset and the related liability and/or revenue should be based on the specific stipulations of each grant, transfer payment, donated funds/assets and using the recognition, measurement and presentation requirements of GRAP 23.

Entities should treat the change in accounting for non-exchange revenue using GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. GRAP 3.21(b) requires that:



“...when an entity changes an accounting policy upon initial application of a Standard that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.”

Therefore, where an entity changes its accounting policy from IAS 20 to one based on GRAP 23, it should apply that change retrospectively using GRAP 3.24 – .33.

In applying a policy retrospectively, an entity would examine the terms of its non-exchange revenue arrangements and assess whether conditions or restrictions exist. In particular, an entity would assess whether:

- Any deferred revenue recognised as a liability using IAS 20 would qualify for recognition as a liability using the principles in GRAP 23 (i.e. are there any conditions imposed on the use of the transferred resources received that are yet to be fulfilled). If any deferred revenue recognised using IAS 20 does not meet the requirements to be recognised as a liability using GRAP 23, the deferred revenue (liability) should be derecognised and recognised as revenue (by restating the prior year statement of financial performance and position or by adjusting the opening balance of accumulated surplus or deficit for the earliest period presented). [See GRAP 3.24].
- Any revenue recognised using IAS 20 would qualify for recognition as a liability using the principles in GRAP 23 (i.e. where revenue was recognised in prior periods using IAS 20, but unfulfilled conditions exist if the principles in GRAP 23 are applied). Where unfulfilled conditions exist, a liability should be recognised and revenue/accumulated surplus or deficit adjusted (by restating the prior year statement of financial performance and financial position, or by adjusting the opening balance of accumulated surplus or deficit for the earliest period presented). [See GRAP 3.24]

An entity would also assess whether any changes in presentation result in a change in accounting policy. For example: An entity may have used IAS 20.27 and deducted grants from the carrying amount of assets. This presentation is not allowed under GRAP 23 and would result in a change in accounting policy, requiring the restatement of the statements of financial performance, financial position, and net assets.

4.2 Should revenue received from licence fees and similar transactions⁵ be accounted for as exchange or non-exchange revenue by the issuer?

Public sector entities frequently issue licences to undertake certain activities or operate certain assets, e.g. motor vehicle, drivers', fishing, gambling and similar licences.

For purposes of the discussion that follows, the entity issuing the licence is the issuer and the entity receiving the licence is the licence holder.

For the issuer of licences, the consideration received can either be treated as exchange or non-exchange revenue. Whether the revenue is exchange or non-exchange depends on the nature and circumstances of the transaction.

In formulating an appropriate accounting treatment, the following steps should be considered:

⁵ This FAQ could be extended to other transactions that might not be called “licences” but have the same characteristics. As an example, certain industries require the payment of “subscription fees” when in fact these fees are similar to “licences” (and vice versa).



- Whether the entity entered into a principal – agent arrangement, and acts as an agent or a principal.
- The definitions of exchange and non-exchange transactions.

Step 1: Agent or principal

An entity should firstly assess whether it has entered into a principal – agent arrangement. In making this assessment, it uses the principles in GRAP 109 on *Accounting by Principals and Agents*⁶.

If an entity has entered into a principal – agent arrangement, it considers whether it acts as an agent or a principal in such arrangements. When an entity acts as the principal and is the issuer of the licence, it considers step 2 below.

If a principal – agent arrangement does not exist, an entity considers step 2 below.

Step 2: Exchange or non-exchange revenue

An issuer considers the definitions of both exchange and non-exchange transactions in the Standards of GRAP:

“Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange (i.e. non-exchange revenue), or gives value to another entity without directly receiving approximately equal value in exchange (i.e. non-exchange transactions such as social benefit transactions).”

In determining whether the revenue is exchange or non-exchange revenue, the following is important:

- Whether the issuer provides goods and services directly (or through an agent) to the licence holder in return for the consideration received.
- The value of the goods and services provided in relation to the consideration received.

Goods and services provided by the issuer

The goods and services provided in an arrangement may vary. Sometimes the goods and services provided may be significant in relation to the arrangement as a whole, e.g. the issuer performs regulatory services such as checking competence, compliance, the safe and effective functioning of particular assets and other forms of control, and other times they are not, e.g. an issuer merely registers a particular asset on a database or performs a similar administration function.

⁶The Minister of Finance has not yet determined the effective date for the Standard of GRAP on *Accounting by Principals and Agents* (GRAP 109). Entities may consider GRAP 109 in developing an accounting policy for principal-agent arrangements.



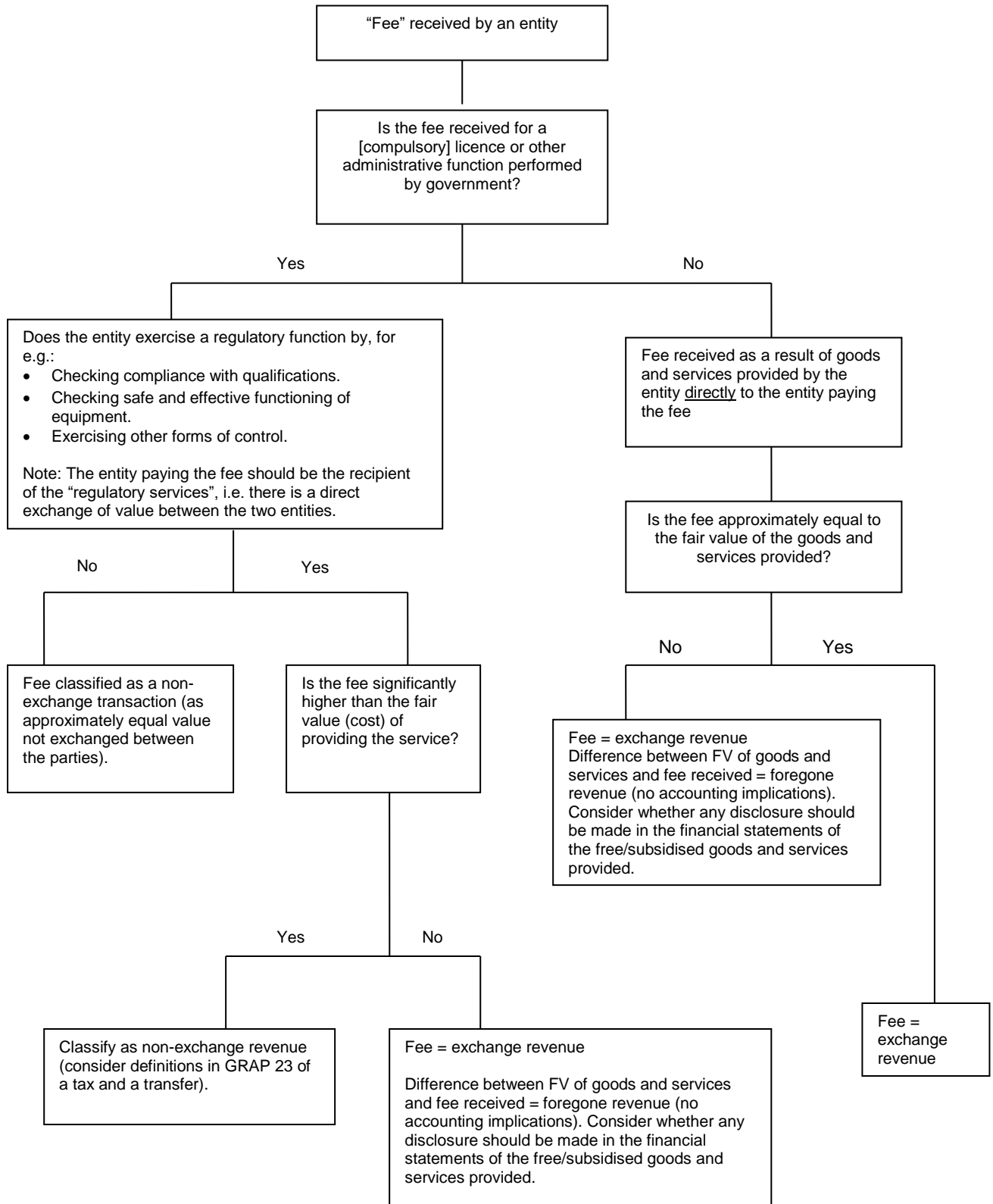
Consideration received by the issuer

The extent of the consideration received by the issuer for the goods and services provided may also vary from arrangement to arrangement. The issuer should therefore consider the value of the goods and services provided in relation to the consideration received in assessing whether the transaction results in exchange or non-exchange revenue, using the following basic principle (based on the definition of exchange and non-exchange transactions):

- Where the consideration received by the issuer is significantly greater than the fair value of the goods and services provided, the revenue could be non-exchange revenue as it may be tax or similar revenue (the issuer has received consideration and not provided approximately equal value in return)⁷.
- Where the consideration received by the issuer is less than the goods and services provided, the revenue could be exchange revenue. Any foregone revenue may be indicative of the provisions of a social benefit (the issuer has provided goods and/or services and has not received approximately equal value in return).

The following decision tree may be useful in classifying revenue received by issuers of licenses, particularly in relation to revenue from compulsory or legislated receipts:

⁷ An entity should apply judgement in these circumstances as it may be that an entity provides goods and services at a profit. These arrangements would not necessarily result in non-exchange revenue.





4.3 Do in-kind benefits only involve goods and services provided by individuals and how should in-kind benefits be accounted for?

The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) states that gifts and donations are voluntary transfers of assets including cash and other monetary assets, goods in-kind and services in-kind that one entity makes to another, normally free from stipulations. The transferor may be an entity or an individual.

Goods in-kind are described as tangible assets transferred to an entity in a non-exchange transaction, without charge. GRAP 23 requires that goods in-kind be recognised as assets when the definition and recognition criteria are met. On initial recognition, goods in-kind are measured at their fair value as at the date of acquisition.

GRAP 23.100 provides the following examples of services in-kind that can be received by entities under voluntary or non-voluntary schemes:

- (a) technical assistance from other governments or international organisations;
- (b) persons convicted of offences may be required to perform community service for an entity;
- (c) public hospitals may receive the services of volunteers;
- (d) schools may receive voluntary services from parents as teachers' aides or as board members;
- (e) local governments may receive the services of volunteer fire fighters;
- (f) office rent may be paid on behalf of an entity by another entity; and
- (g) an entity may make use of fully furnished accommodation paid on its behalf by another entity.

GRAP 23 requires the recognition of services in-kind that are significant to an entity's operations and/or service delivery objectives as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably. As these services are immediately consumed, an entity will recognise an asset and revenue, as well as a decrease in the asset and an expense.

GRAP 23.116(d) and (e) require disclosure of the nature and type of major classes of goods and services received in-kind, including services in-kind that are not significant to the entity's operations and/or service delivery objectives and/or do not satisfy the criteria for recognition, i.e. services in-kind not recognised.

For example, services in-kind that are significant to an entity's operations could be an entity's employees being paid by another entity, or office rent being paid on an entity's behalf. These services in-kind should be recognised when they meet the definition of an asset and satisfy the criteria for recognition, and the nature and type should be disclosed. Some entities in the public sector share certain services, such as internal audit, audit committee and enterprise risk management services, e.g. a department and its entities, a municipality and its municipal entities, or a district municipality and its local municipalities. These services are often paid by the department or municipality on behalf of all entities that make use of it. An entity that received these services for free may determine that they are not significant to its operations and therefore not recognise those services. Information about the nature and type of these services received in-kind should still be disclosed even though the services in-kind have not been recognised.



4.4 What is the effect of IGRAP 1 on traffic fines?

The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23), requires that revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured.

IGRAP 1 clarifies that an entity should recognise the full amount of revenue at the transaction date when there is uncertainty about the entity's ability to collect such revenue based on past history, as the entity has an obligation to collect all revenue due to it. Entities should not consider or assess the probability of collecting revenue at the transaction date because this is a subsequent measurement event. Subsequent to initial recognition and measurement, an entity should assess the collectability of the revenue and recognise an impairment loss where appropriate.

Although IGRAP 1 requires an entity to recognise the full amount of revenue at the transaction date, an entity may need to use estimates to determine the amount of revenue that it is entitled to collect. For example, an entity may offer early settlement discounts, or may offer reductions in the amount payable by the debtor in certain circumstances. Where these exist, an entity considers past history in assessing the likelihood of these discounts or reductions being taken up by debtors.

For example, motorists qualify for a discount of 50% on a fine imposed if payment is made within a period of 32 days. Based on past history, 10% of motorists take advantage of this reduction. The entity will therefore recognise 90% of the fines at their full value and 10% of the fines at half their value.

4.5 What is the interaction between GRAP 20 and GRAP 23 for services in-kind?

The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) prescribes the requirements for recognising and measuring revenue from non-exchange transactions.

Paragraph .99 deals with the accounting treatment of services in-kind:

“.99 Except for financial guarantee contracts as described in paragraphs .108 and .109, an entity shall recognise services in-kind that are significant to its operations and/or service delivery objectives as assets and recognise the related revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably. If the services in-kind are not significant to the entity's operations and/or service delivery objectives and/or do not satisfy the criteria for recognition, the entity shall disclose the nature and type of services in-kind received during the reporting period.”

In accordance with GRAP 23.116(e), entities are required to disclose the nature and type of services received in-kind during the reporting period, including where an entity does not meet the recognition and measurement requirements outlined in GRAP 23.99.

The Standard of GRAP on *Related Party Disclosures* (GRAP 20) is applied to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and surplus or deficit may have been affected by the existence of related parties, and by transactions and outstanding balances with such parties. GRAP 20 requires the disclosure of related party relationships, transactions and outstanding balances, including commitments.



The disclosure requirements for related party transactions are prescribed in GRAP 20.27 as follows:

“.27 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, and the 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.”*

Entities that receive services in-kind from related parties should first apply GRAP 23 when recognising and measuring revenue from non-exchange transactions. It is possible that in applying GRAP 23, an entity may conclude that it will not be able to recognise and measure certain services received in-kind as it does not meet the requirements prescribed in GRAP 23.99. In such cases, an entity should disclose the nature and type of services received in-kind in accordance with GRAP 23.99 and GRAP 23.116(e) in its financial statements. When the services in-kind are received from a related party, an entity should also consider the disclosure requirements in GRAP 20.

The disclosures provided by the entity for purposes of GRAP 20 will be guided by information that is available to the entity after applying GRAP 23. This is because GRAP 23 is applied to determine how an entity recognises and measures the services received in-kind during the reporting period. Therefore, an entity cannot satisfy the disclosure requirement in GRAP 20, to disclose an amount of the transaction, if it could not provide a reliable measure of the services in-kind under GRAP 23.

While this question was raised in the context of services in-kind in GRAP 23, it could apply equally to GRAP 20 and other Standards of GRAP that outline the accounting treatment of transactions.



Section 5 – Accounting for Employee Benefits

5.1 How should vacation leave be accounted for?

Note: Examples have been used to illustrate the explanations below. They are illustrative only and should not be applied to situations without careful consideration of the facts and circumstances as they may differ.

A. Recognising and measuring liabilities

Vacation or annual leave is a short-term employee benefit. Vacation leave can either be vested or non-vested⁸. “Vested” vacation leave means that the employee is entitled to a cash payment for unused leave, e.g. after a certain period of time has elapsed or on resignation. “Non-vested” leave means that if employees do not use their leave, it is forfeited. The effect of vested and non-vested leave is illustrated below through the use of examples.

Example 1

Entity X grants its employees 20 days leave a year (assume that the leave cycle and the financial year are the same). At the end of the leave cycle, employees can either elect to have any unused leave paid out, or they can elect to carry the leave days forward to the next leave cycle. If employees resign, they are entitled to a cash payment for any leave due. At the end of the year, a total of 500 leave days have not been used.

In terms of the policy, the entity has an obligation to either pay out unused leave or allow employees to carry over unused leave to future cycles. As a result it has a present obligation for the full 500 unused days at year end.

Example 2

Entity A provides its employees 20 days leave a year (assume that the leave cycle and the financial year are the same). Any unused leave at year end must be used within a 6 month period, otherwise it is forfeited. Based on past history, employees forfeit 10% of their unused leave. At year end, the entity has 300 unused leave days.

At year end, the entity has an obligation of 300 leave days. However, it knows that based on history, 10% is forfeited. Therefore in measuring the obligation, it considers the percentage leave that is not utilised. A liability of 270 days is recognised [$300 - (300 \times 10\%)$].

B. Classification of leave as current or non-current

Consider the following example:

Entity X grants its employees 30 days leave a year (assume that the leave cycle and the financial year are the same). Employees can elect to have leave paid out or carried over to future leave cycles. There is no restriction on the number of leave days that can be accumulated.

Policies such as this may result in leave being utilised or paid out in the future, often more than 12 months after the reporting date.

Short term benefits are those benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service.

⁸ For purposes of this discussion, it is assumed that vacation leave is vested.



Unless an entity has an enforceable right to defer the encashment or utilisation of leave, the liability is treated as a current liability. E.g. An entity does not have an unconditional right to defer settlement if employees can utilise their leave due at any time or demand that their unused leave be paid.

If an entity has an unconditional right to defer the encashment or utilisation of leave, it may be appropriate to treat the liability, or a portion thereof, as a non-current liability. It is important to note that in these instances, entities should consider the guidance in IAS 19 on “long term benefits” in measuring such liabilities.

Example 3

An entity may have allowed employees historically to accumulate unused leave. At a point in time it amends the conditions of service to state that:

- going forward, employees will forfeit leave not utilised within a specified time frame; and
- the balance of any unused leave at the date of changing the conditions of service can either be (a) paid out or used immediately or (b) paid out on retirement. The choice made by employees is irrevocable.

Where employees choose to use or have the leave paid out immediately, this portion of the leave liability is treated as a current liability. Where employees elect to have the leave paid out on retirement, this portion of the leave liability should be treated as a non-current liability (assuming that retirement will not occur within 12 months after the reporting date).

C. Classification of leave as an accrual or a provision

Per GRAP 19 on *Provisions, Contingent Liabilities and Contingent Assets*, provisions are liabilities of uncertain timing or amount. Although there is no formal definition of an accrual, GRAP 19 explains the following: “*accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.*”

The following two examples illustrate when classification of a leave liability as an accrual and/or provision may be appropriate (a combination of both may also be appropriate):

- An entity does not have an unconditional right to defer settlement of its leave liabilities and its policies allow leave to be carried forward or paid out without any restrictions. In this case, the timing is certain (i.e. used or due on demand) and the amount is certain (i.e. the value of all leave outstanding). In this instance, classification as an accrual may be appropriate.
- An entity does not have an unconditional right to defer settlement of its leave liabilities and its policies stipulate that leave is forfeited if not used within 6 months after the reporting date. In this case, the timing is certain (i.e. used on demand) but the amount may be uncertain (i.e. an estimate of the leave that will be forfeited should be made in measuring the liability). If uncertainty arises in the measurement, classification as a provision may be appropriate. Note: Where leave is classified as a provision, the disclosure requirements in GRAP 19.98 and .99 must be adhered to.





Section 6 – Sundry Accounting Issues

6.1 **How should a municipality account for free or subsidised goods and services, as well as rebates provided to its consumers and other foregone revenue?**

Note: This question arose in the context of free basic services provided to consumers by municipalities. It may however be appropriate for other entities that undertake similar transactions to consider this FAQ.

In the public sector, entities frequently provide goods and services to consumers for free or at subsidised amounts, while rebates or similar reductions may be granted on taxes or other fees due.

Municipalities often provide free or subsidised goods and services to consumers and households in terms of a specified policy. While each municipality develops and implements its own policy regarding consumers and households, there are commonalities between the types of assistance provided by the various municipalities. Most often, policies provide for the following assistance:

- Free or subsidised basic services such as water and electricity (the amounts vary from municipality to municipality).
- Metered water and electricity in excess of the free or subsidised basic amounts (these are often limited to a specific amount so as to ensure that the consumer can afford the services provided).
- An additional rebate for property rates (the rebate may amount to 100% of the property rates in certain municipalities).

Questions have been raised about whether these subsidies, rebates or similar reductions should be recognised as revenue. IGRAP 1 *Applying the Probability Test on the Initial Recognition of Revenue*, states the following:

“This Interpretation of the Standards of GRAP does not deal with:

- (c) exchange or non-exchange transactions where there is no intention to charge for all or some services. Examples include goods and services provided to indigent consumers or households or rebates deducted on the provision or acquisition of certain goods or services.”*

IGRAP 1 clearly only applies to those amounts that the entity intends to charge and/or collect. As entities do not intend to collect the revenue related to the free or subsidised goods and services or other rebates, these amounts should not be recognised as revenue. This principle is illustrated below:

A. Free or subsidised basic services

Municipalities could provide free or subsidised basic services by either not billing those consumers for those services or where consumers have been billed, providing for an immediate subsidy during the billing cycle. However, since there is no intention to charge or collect any revenue, the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9) should not be applied.

Municipalities should therefore:



- not recognise the revenue in the statement of financial performance as there is no intention to collect the revenue related to the free or subsidised goods and services (i.e. foregone revenue);
- still recognise an expense for the services provided (i.e. the cost of providing the free or subsidised goods and services) in the statement of financial performance. For example the cost of bulk purchases of water and electricity. These expenses should not be reclassified to expense line items such as “revenue forgone” or “free basic services” and should continue to be presented by their nature, or function, depending on an entity’s choice of presentation; and
- consider the requirements of GRAP 1 and the *Framework for the Preparation and Presentation of Financial Statements*⁹ in determining whether any disclosures about such transactions are necessary in the notes to the financial statements.

B. Metered water and electricity in excess of free basic services

Where municipalities provide water and electricity in excess of the free basic services provided, the intention is (usually) to collect such amounts from the consumer. As the intention is to collect revenue from such transactions, GRAP 9, IGRAP 1 and the Standard of GRAP on *Financial Instruments* (GRAP 104) should be applied in accounting for such transactions.

C. Rebates for property rates

The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) defines taxes as “*economic benefits or service potential compulsorily paid or payable to entities, in accordance with laws and or regulations, established to provide revenue to government. Taxes do not include fines or other penalties imposed for breaches of the law*”.

As property rates are paid in terms of legislation on the value of property owned within a specific municipality and, the payment of such taxes does not result in any direct benefits in return for the owners of such property, they are considered to be taxes.

Rebates or reductions in the amount of taxes payable are classified as “tax expenditures” in GRAP 23. Tax expenditures are defined in GRAP 23 as “*preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others*”.

In the case of rebates for property rates, they are reductions in the amounts of property rates payable by property owners within a specific jurisdiction. The rebates provided by municipalities therefore meet the definition of tax expenditures per GRAP 23. GRAP 23, paragraphs .74 and .75, provide the following guidance for tax expenditures:

“.74 Taxation revenue shall not be grossed up for the amount of tax expenditures.

“.75 Tax expenditures are foregone revenue, not expenses, and do not give rise to inflows or outflows of resources – that is, they do not give rise to assets, liabilities, revenue or expenses of the taxing government.”

The effect is that no revenue is recognised in the statement of financial performance for any rebates or reductions granted.

⁹ In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.



D. Transfers from other levels of government to fund activities

Any transfers received from another level of government to fund the activities of the municipality are accounted for using the principles in GRAP 23.

6.2 Are there any accounting considerations relating to World Cup Stadiums after the World Cup?

Classification and re-classification of World Cup Stadiums (Stadiums) subsequent to the World Cup

During the construction of new Stadiums, and/or the upgrading of existing Stadiums to host the World Cup, entities would have recognised the Stadiums under their control in accordance with the applicable Standards of GRAP, either as property, plant and equipment, or investment property. Entities also may have applied the principles in the *Guideline on Accounting for Public-private Partnership (PPP) Agreements* to the initial accounting of the Stadiums as either property, plant and equipment; or investment property. Subsequent to the World Cup entities need to consider whether this classification is still appropriate. Examples of factors that an entity may need to consider in classifying these Stadiums after the World Cup include, amongst others:

- The FIFA requirements in hosting the World Cup.
- Agreements may have been concluded with third parties after the World Cup which changed classification as these Stadiums may now also have a service potential.
- Should the Stadium continued to be classified as an asset.

Stadiums should be classified as investment property when they are used by entities to earn rentals, for capital appreciation, or both. If neither of these criteria is met, the Stadium is likely to be classified as property, plant and equipment. The Standard of GRAP on *Property, Plant and Equipment* (GRAP 17) defines property, plant and equipment as tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than one reporting period. If the Stadium is partly used to earn rentals, for capital appreciation, or both, and is partly owner-occupied property, the entity needs to account separately for these portions if a portion of the Stadium could be sold separately (or leased out separately under a finance lease). If the portions could not be sold separately, the Stadium should be accounted for as investment property only if an insignificant portion is held for use as owner-occupied property. Entities need to consider any agreements entered into with third parties that may have an impact on the classification of the Stadium. The principles in the Standard of GRAP on *Heritage Assets* may also need to be considered in reconsidering the classification of the Stadium subsequent to the World Cup.

If the entity is of the view that the Stadium should be reclassified from property, plant and equipment to investment property, the principles in the Standard of GRAP on *Investment Property* (GRAP 16) should be applied. GRAP 16 requires that transfers to or from investment property shall be made when there is a change in use. This may be evidenced, for example, by commencement of owner-occupation in which case there will be a transfer from investment property to property, plant and equipment. If there is evidence of the termination of owner-occupation, for example when a municipality enters into a lease agreement with a third party that allows the third party to use the Stadium for its own commercial purposes, the Stadium needs to be transferred from property, plant and equipment to investment property.



When the entity applies the cost model, the carrying amount of the Stadium transferred between property, plant and equipment and investment property, or vice versa, will remain unchanged for measurement or disclosure purposes. If the Stadium is reclassified from property, plant and equipment to investment property carried at fair value, the entity should apply the principles in GRAP 17 up to the date of change in use. Thus, an entity should depreciate the Stadium and recognise any impairment losses occurred up to the date of change in use. Any difference between the carrying amount of the Stadium accounted for in accordance with GRAP 17 and its fair value on the date of change, should be accounted for in the same way as a revaluation under GRAP 17.

For a transfer from investment property carried at fair value to property, plant and equipment, the Stadium's deemed cost for subsequent accounting in accordance with GRAP 17, is its fair value at the date of change in use.

Impairment of World Cup Stadiums

At each reporting date, entities are required in terms of the Standard of GRAP on *Impairment of Non-cash-generating Assets* (GRAP 21) or the Standard of GRAP on *Impairment of Cash-generating Assets* (GRAP 26) to assess whether there is any indication that the Stadium may be impaired. The classification of the Stadium at the reporting date as either a cash-generating or a non-cash-generating asset will determine whether GRAP 21 or GRAP 26 should be applied. If the Stadium is primarily held for a commercial return in a manner consistent with a profit-orientated entity, the principles in GRAP 26 should be applied. If, however the Stadium is operated with the objective of not generating a commercial return, the principles in GRAP 21 should be applied in assessing whether an impairment indicator has been triggered.

Indications that the Stadium may be impaired include, amongst others:

- Cessation of the demand or need for the Stadium.
- A significant decline in the Stadium's market value as a result of the passage of time or normal use (only if the Stadium is classified as a cash-generating asset).
- Significant change with an adverse effect on the entity is expected to take place in the near future, such as the Stadium becoming idle.
- Cash flows needed to operate or maintain the Stadium is significantly higher than originally budgeted.
- Actual net cash flows or the net surplus or deficit flowing from the Stadium is worse than those budgeted.
- A significant decline in budgeted net cash flows flowing from the Stadium.

After an impairment loss has been recognised, the entity may need to review and adjust the Stadium's remaining useful life, depreciation method and residual value in accordance with the applicable Standard of GRAP, i.e. GRAP 16 or GRAP 17.

Recognition and measurement of other movable and immovable assets

For guidance on the recognition and measurement of other movable and immovable assets, reference should be made to the applicable Standards of GRAP, for example Standards of GRAP on *Property, Plant and Equipment* (GRAP 17) and *Intangible Assets* (GRAP 31). For example,



liquor licences acquired should be accounted for in terms of the GRAP 31 to the extent that the entity has met the recognition criteria in the Standard.

Agreements with third parties

During the construction of new Stadiums, or the upgrading of existing Stadiums to host the World Cup, some entities may have entered into agreements with third parties concerning the construction or upgrade of the Stadium, and/or the maintenance and the operation of the Stadium during and/or after the World Cup. These agreements should be analysed to determine the nature and identify the different components in order to account for them in accordance with their substance.

PPP agreements

Prior to the World cup, entities may have entered into agreements with third parties to upgrade existing Stadiums or to construct new Stadiums. Where the control approach criteria were met, the Stadium would have been accounted for in terms of the *Guideline on Accounting for PPP Agreements* (Guideline). Subsequent to the World Cup, entities need to assess whether the control approach criteria are still met if there were amendments to existing agreements, or if new agreements with third parties have concluded. Even if the entity did not enter into a PPP agreement as regulated in legislation, the principles in the Guideline could still be applicable, by analogy, to arrangements that have the same characteristics as a PPP agreement, for example a public – public agreement.

The Guideline requires that if the control approach criteria are met, i.e.:

- The entity controls or regulates what services the third party must provide with the associated asset (the Stadium), to whom it must provide them and at what price.
- The entity controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the asset (the Stadium) at the end of the agreement.

any payments to the third party should be distinguished between the portion that relates to the asset element, i.e. where the third party was required to construct and/or upgrade the Stadium, and the portion that relates to the service element, i.e. where the third party performs operational and/or maintenance functions on behalf of the entity.

If payments to the third party involve an asset element, the entity would have recognised a financial liability for its future obligation to compensate the third party for the construction or upgrading done to the Stadium on its behalf. The scheduled payments to the third party relating to the construction or upgrade of the Stadium (the asset element) should be allocated between the amount that reduces the financial liability, and the associated finance charges. Any payments relating to the operational and/or maintenance function (service element) should be recognised when the service is rendered by the third party based on the provisions of the PPP agreement.

Where the third party receives compensation from users, rather than from the entity, for any construction or upgrade activities undertaken, the entity would have recognised an exchange consideration received in advance of performance. As the entity is granting the third party access to the Stadium over an agreed term, the exchange consideration received in advance should be reduced and exchange revenue should be recognised to the statement of financial performance as access to the Stadium is provided.



If the third party was not involved in any construction or upgrade activities for the Stadium, it is likely that any payments to the third party relates to the service element of the agreement involving operational and/or maintenance services. The entity should recognise payments that relates to these services when the service is rendered by the third party based on the provisions of the PPP agreement, irrespective of when payment is made.

The PPP agreement may also involve an arrangement whereby the entity transferred its right to use the Stadium to a third party for an agreed period of time. During the term of the agreement, the third party may then use the Stadium for its own commercial purpose. Under these types of agreements, the entity will usually share a percentage of the revenue generated by the third party under the agreement, for example where the entity shares in a percentage of ticket sales. To determine the appropriate method of recognising the revenue received by the entity under revenue sharing provisions, reference should be made to the principles in the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9). GRAP 9 requires that revenue received should be measured at the fair value of the consideration received or receivable. Revenue is recognised when the amount of revenue can be measured reliably and when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. The amount of revenue is the amount of cash or cash equivalents received or receivable by the entity, as agreed between the entity and the third party.

For more guidance on the accounting of PPP agreements, reference should be made to the *Guideline on Accounting for PPP Agreements* and the Standard of GRAP on *Service Concession Arrangements: Grantor* (GRAP 32)¹⁰.

Lease agreements

If the entity concludes that the agreement does not meet the requirements for recognition as a PPP agreement because one, or both, of the control approach criteria are not met, the entity needs to consider whether the agreement involves a lease arrangement. A lease is an agreement whereby the lessor (the entity) conveys to the lessee (the third party), in return for a payment or series of payments, the right to use an asset (the Stadium) for an agreed period of time.

If the entity concludes that the agreement meets the criteria for recognition as a lease, the entity should then determine whether the lease should be classified as a finance or operating lease. If the agreement will substantially transfer all the risks and rewards incidental to ownership of the Stadium to the third party, the agreement constitutes a finance lease. If the risks and rewards incidental to ownership remain with the entity, the lease constitutes an operating lease.

If the agreement is classified as a finance lease, the entity should recognise the lease payments as a receivable in the statement of financial position, at an amount equal to the net investment in the lease. The recognition of finance revenue should then be based on a pattern reflecting a constant periodic rate of return on the entity's net investment in the finance lease.

¹⁰ The Minister of Finance has not yet determined the effective date for the Standard of GRAP on *Service Concession Arrangements: Grantor* (GRAP 32). Once effective, GRAP 32 will replace the *Guideline on Accounting for PPP Agreements*. Entities may consider GRAP 32 in developing an accounting policy for service concession arrangements.



If the agreement is classified as an operating lease, the entity should recognise the lease revenue on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the leased asset, is diminished.

Other agreements

If the entity concludes that the agreement does not meet the requirements for recognition as a lease, the entity should then consider whether the third party acts in another capacity, e.g. as a service provider or as an agent. Where the third party acts as an agent, the entity will need to recognise any obligations in terms of the agreement in accordance with the Standards of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* and/or *Financial Instruments*.

Where the third party acts as an agent, the entity should recognise revenue based on the terms and conditions of the agreement. For example, where the third party (the agent) sells tickets on behalf of the entity recognises the revenue from the ticket sales in accordance with the Standard of GRAP on *Revenue from Exchange Transactions*. If the entity has ceded its rights of the ticket sales to the third party, the entity will not recognise any revenue from ticket sales, unless it has entered into a profit sharing arrangement, in which case revenue will be recognised as and when it becomes due in terms of the agreement.

The principles in this question could, by analogy, also be applied to other assets.

6.3 How should an entity account for expenses it incurs, but which are settled by another entity?

In the public sector, entities frequently incur expenses as part of their operations, but which will be settled either in full or in part by a third party. In these types of arrangements, the entity typically engages with the service provider or supplier and receives the goods or services. A secondary transaction occurs where the entity engages the relevant third party to settle its outstanding debts, usually directly with the service provider or supplier. A typical example is where the National Treasury pays some or all of the audit fees incurred by qualifying entities for the statutory audits undertaken.

These arrangements give rise to two accounting issues that require consideration in the entity's financial statements:

- Should the expense be recognised in the statement of financial performance, and if yes, at what amount?
- How should the payment by the third party be accounted for in the financial statements?

Should the expense be recognised in the statement of financial performance by the entity?

The *Framework for the Preparation and Presentation of Financial Statements*¹¹ describes expenses as follows:

“Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.”

¹¹ In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.



When the entity receives the goods or services from the relevant service provider or supplier, it has an obligation to the service provider or supplier to pay for the goods or services received. The fact that the entity has received the goods or services means that the definition of an expense has been met.

As a result, the entity receiving the goods or services should recognise the full cost in its statement of financial performance, along with a corresponding liability.

How should the payment by the third party be recognised in the statement of financial performance by the entity?

Non-exchange transactions are defined in Standards of GRAP as follows:

“In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.”

When a third party settles the debts of the entity, this meets the definition of a non-exchange transaction because the entity does not directly give any value to the third party settling the transaction on its behalf. The settlement of the entity's debts by the third party results in non-exchange revenue for the entity, and should be accounted for in the same way as “Debt forgiveness and assumption of liabilities” in GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)*.

When the third party settles the entity's debts with the service provider or supplier, it should reduce the amount of the liability recognised by the amount paid by the third party, and recognise non-exchange revenue.

6.4 What is the interaction between the Standards of GRAP on Service Concession Arrangements, Interests in Joint Ventures and Accounting by Principals and Agents?

Guidance was requested on the interaction between different Standards of GRAP in considering whether an arrangement is a:

- Service concession arrangement in the Standard of GRAP on *Service Concession Arrangements: Grantor* (GRAP 32),
- Joint Venture in the Standard of GRAP on *Interests in Joint Ventures* (GRAP 8), or
- Principal-agent arrangement in the Standard of GRAP on *Accounting by Principals and Agents* (GRAP 109).

Although the Board approved GRAP 32 and GRAP 109, the Minister of Finance must still determine an effective date for them. An entity can, however, currently use these Standards to develop accounting policies.

Refer to table 1 for the requirements of each of the three Standards.

Each of the Standards applies to specific types of arrangements. It is, however, possible for certain types of arrangements to be in the scope of more than one Standard.

GRAP 32 applies to arrangements where an operator uses a service concession asset to provide a mandated function on behalf of the grantor for a specified period of time and is compensated for its services. The service concession asset could remain under the control of the grantor or it could be controlled by the operator. The entity that controls the asset will account for it, together



with the related obligations. The grantor and operator each recognise revenue and expenses according to what they are entitled to in terms of the service concession arrangement.

GRAP 8 applies to binding arrangements where two or more parties have joint control. An entity that is party to a joint venture determines how to account for its share in the joint venture based on the entity's role and the type of joint venture, in terms of the binding arrangement. An entity can be an investor in a joint venture (i.e. a party to a joint venture that does not have joint control) or a venturer (i.e. a party to a joint venture that has joint control). An investor accounts for its investment in the joint venture by applying the Standard of GRAP on *Financial Instruments*. A venturer accounts for its share of the joint venture based on the type of joint venture, which are jointly controlled operations, jointly controlled assets and jointly controlled entities.

Joint ventures are therefore distinctly different from service concession arrangements where only one party to the arrangement controls the service concession asset and incurs the related obligations.

GRAP 109 applies to arrangements where one entity (an agent), undertakes transactions with third parties on behalf, and for the benefit of, another entity (the principal). The principal recognises revenue and expenses that arise from transactions with third parties. The agent recognises only that portion of the revenue and expenses it receives or incurs in executing the transactions on behalf of the principal. The principal and the agent each recognises assets and liabilities arising from the arrangement in accordance with the requirements of other Standards of GRAP, i.e. they will each recognise assets and liabilities that meet the definition and recognition criteria in the applicable Standards of GRAP.

GRAP 109.08 states that service concession arrangements may be an example of a principal-agent arrangement as one party (the operator, which is usually a private sector entity) carries out certain activities on behalf of the other entity (the grantor, which is usually a public sector entity) in relation to third parties (the public). This is assessed on an arrangement basis, based on the roles and responsibilities in the arrangement. If a service concession arrangement is also a principal-agent arrangement, an entity assesses whether it is a principal or an agent in such an arrangement using GRAP 109 and accounts for the arrangement accordingly.

Principal-agent arrangements are, however, distinctly different from joint ventures where joint control exists.

Conclusion

Service concession arrangements may also be principal-agent arrangements, in which case GRAP 109 is applied to determine the accounting treatment for the arrangement. If a service concession arrangement is not a principal-agent arrangement, it is accounted for in terms of GRAP 32. Joint ventures are distinctly different from both service concession arrangements and principal-agent arrangements and are accounted for in terms of GRAP 8.



FAQ's on the Standards of GRAP

Table 1: Requirements of GRAP 32, GRAP 8 and GRAP 109

	GRAP 32	GRAP 8	GRAP 109
Objective	Prescribes accounting for service concession arrangements by the grantor, a public sector entity.	Establishes principles for financial reporting by entities that have an interest in binding arrangements that establish joint control (i.e. joint ventures).	Outlines principles to be used by an entity to assess whether it is party to a principal-agent arrangement, and whether it is a principal or an agent in undertaking transactions in terms of such an arrangement.
Definition	<p><i>Service concession arrangement</i></p> <p>Contractual arrangement between a grantor and an operator in which:</p> <ol style="list-style-type: none"> the operator uses the service concession asset to provide a mandated function on behalf of the grantor for a specified period of time; and the operator is compensated for its services over the period of the service concession arrangement. 	<p><i>Joint venture</i></p> <p>Binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.</p> <p>Broadly three types:</p> <ul style="list-style-type: none"> - Jointly controlled operations - Jointly controlled assets - Jointly controlled entities 	<p><i>Principal-agent arrangement</i></p> <p>Results from a binding arrangement in which one entity (an agent), undertakes transactions with third parties on behalf, and for the benefit of, another entity (the principal).</p>
Further definitions	<p>A <i>grantor</i> is defined as the entity that grants the right to use the service concession asset to the operator.</p> <p>An <i>operator</i> is the entity that uses the service concession asset to provide a mandated function subject to the grantor's control of the asset.</p>	<p><i>Joint control</i> is the agreed sharing of control over an activity by a binding arrangement and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).</p>	<p>An <i>agent</i> is an entity that has been directed by another entity (a principal), through a binding arrangement, to undertake transactions with third parties on behalf of the principal and for the benefit of the principal.</p> <p>A <i>principal</i> is an entity that directs another entity (an agent), through a binding arrangement, to</p>



FAQ's on the Standards of GRAP

	GRAP 32	GRAP 8	GRAP 109
			undertake transactions with third parties on its behalf and for its own benefit.
Characteristics	<p>a. The operator is responsible for at least some of the management of the service concession asset and related services and does not merely act as an agent on behalf of the grantor;</p> <p>b. The arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement;</p> <p>c. The operator is obliged to hand over the service concession asset to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it; and</p> <p>d. The arrangement is governed by a contractual arrangement entered into, that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.</p>	<p>a. Two or more venturers are bound by a binding arrangement.</p> <p>b. The binding arrangement establishes joint control.</p>	<p>An entity directs another entity to undertake an activity on its behalf, in relation to transactions with third parties.</p> <p>The following must be present:</p> <ul style="list-style-type: none"> - Binding arrangement between principal and agent. - Three parties: agent, principal, third parties - Agent acts on behalf of, and for benefit of, principal with third parties - Agent does not usually undertake activity with third parties in its own name <p>“Transactions with third parties” includes the execution of a specific transaction with a third party, e.g. a sale or purchase transaction, but it also includes interactions with third parties, e.g. when an agent is able to negotiate with third parties on the principal's behalf. The nature of the transactions with third parties is linked to the type of activities carried out by the agent in accordance with the binding arrangement. These activities could include the agent transacting with third parties for the</p>



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	GRAP 32	GRAP 8	GRAP 109
			procurement or disposal of resources, or the receipt of resources from a third party on behalf of the principal.
Examples	<p>Examples of service concession assets are:</p> <p>Roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, and other non-current tangible or intangible assets used for administrative purposes in delivering a mandated function.</p>	<p>Jointly controlled operation:</p> <p>Two or more venturers combine their operations, resources and expertise to manufacture, market and distribute jointly a particular product, such as aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the arrangement.</p> <p>Jointly controlled assets:</p> <p>Two entities jointly control an asset, for example a property, each taking a share of the rents received and bearing a share of the expenses.</p> <p>Jointly controlled entities:</p> <p>Two entities combine their activities in a particular line of service delivery by transferring the relevant assets and liabilities into a jointly controlled entity.</p>	<ul style="list-style-type: none"> • The collection of revenue, including taxes, fees and other charges from specific parties, e.g. motor vehicle license fees collected by municipalities for the provincial government, and taxes collected by the Revenue Authority for the national government. • The construction of assets, e.g. houses built for beneficiaries of the reconstruction and development programme, for national and/or provincial housing departments and organisations. • The provision of goods and services to recipients, e.g. the provision of water to specific communities by municipalities on behalf of water service authorities. • Property management services, which may include the maintenance of properties and collection of revenue, for the Department of Public Works and/or municipalities.



FAQ's on the Standards of GRAP

6.5 What should be considered when determining the discount rate for calculating provisions in accordance with GRAP 19?

Note: This question arose in the context of provisions for rehabilitation of landfill sites but it has been developed to apply to all provisions in general.

The Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19) requires that a provision be measured at the best estimate of the expenditure required to settle the present obligation at the reporting date. In reaching the best estimate of the provision, any risks and uncertainties specific to the provision should be taken into account.

Where the effect of time value of money is material, this best estimate should reflect the present value of the expenditure required to settle that obligation. The discount rate applied to determine the present value is a pre-tax rate that should reflect the a) current market assessment of the time value of money; and b) risks specific to the provision. The discount rate is the rate associated with a liability of a similar risk and maturity as the provision. Therefore, the Standards cannot prescribe a uniform or standardised discount rate that can be applied by entities when calculating provisions. The discount rate should not reflect risks for which future cash flow estimates have been adjusted, i.e. the discount rate and future cash flows should not be adjusted for the same risks.

In determining the best estimate of the expenditure required to settle the obligation, the expenditure can be expressed in either current prices (excluding inflation) or expected future prices (including inflation). When the expenditure is expressed as a future price, it is discounted at a discount rate that includes inflation. When the expenditure is expressed as a current price, the discount rate applied will not include the effects of inflation.

Therefore, the principle in GRAP 19 is that if the expenditure is based on a current price then the discount rate is not adjusted for inflation; but if the future price is used then the discount rate is adjusted for inflation. If this principle is correctly applied, the results of a calculation based on current prices and future prices will yield the same results (i.e. net present value) if the correct discount rate is applied.

6.6 How should an entity account for renegotiated payment arrangements?

Entities in the public sector often have short term payables with a supplier that they are unable to service. Entities sometimes renegotiate the payment of their short term payables to a longer term loan. For example, an entity has a short term payable with a supplier with a 30 day credit period that it is unable to service. The entity renegotiates the payable with the supplier and agrees on a payment arrangement with a term of five years.

Some preparers asked how they should account for a renegotiated payment arrangement when they are the holder of a loan. They specifically asked the following:

- a) Does a renegotiated payment arrangement represent a new financial liability, or an amendment of the original financial liability?
 - b) How should an entity measure a renegotiated payment arrangement initially when it is a new financial liability?
- a) Does a renegotiated payment arrangement represent a new financial liability, or an amendment of the original financial liability?



FAQ's on the Standards of GRAP

The Standard of GRAP on *Financial Instruments* (GRAP 104) states in paragraph .81:

“An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as having extinguished the original financial liability, and a new financial liability recognised. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as having extinguished the original financial liability and having recognised a new financial liability.”

When an entity considers in terms of GRAP 104.81 whether a substantial modification was made to the terms of the original financial liability, an entity considers GRAP 104.AG149:

“For the purpose of paragraph .81, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability.”

- b) How should an entity measure a renegotiated payment arrangement initially when it is a new financial liability?

In accordance with GRAP 104.36, an entity initially measures financial liabilities at fair value.

GRAP 104.AG 81 provides the following guidance:

“The fair value of a financial instrument on initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique. For example, the fair value of a long-term loan or similar receivable that carries no interest can be estimated as the present value of all future cash receipts discounted at the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating...”

GRAP 104.AG103 provides valuation techniques that an entity can use to determine fair value where the market for a financial instrument is not active. GRAP 104.AG104 and AG105 states that the objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. A valuation technique (a) incorporates all factors that market participants would consider in setting a price, and (b) is consistent with accepted economic methodologies for pricing financial instruments.

Therefore, an entity that determines fair value of a loan using a valuation technique establishes an appropriate discount rate with reference to a loan that is similar, for example, a loan that is in a similar currency, for a similar period of time, has a similar type of interest rate, and with a similar credit rating. A government bond rate may be appropriate to use as a discount rate, but an entity should adjust it for specific circumstances of the financial liability.

Entities should also consider whether a renegotiated payment arrangement meets the definition of a concessionary loan. GRAP 104.37 requires an entity to initially analyse a concessionary loan into its component parts and account for each component separately.



FAQ's on the Standards of GRAP

Section 7 – Heritage Assets

7.1 ***Should all assets that are designated as a heritage asset by legislation or similar means be classified as a heritage asset in the entity's financial statements?***

In terms of Section 39 of the National Heritage Resources Act, 1999 (Act No. 25 of 1999) (NHRA), the South African Heritage Resource Agency (SAHRA) is required to compile and maintain an inventory of the national estate, defined as heritage resources of cultural and other significance. This information is contained in the South African Heritage Resources Information System (SAHRIS), and is available on SAHRA's website.

Not all assets that are designated as a heritage asset in terms of the NHRA are classified as a heritage asset in terms of GRAP 103 on *Heritage Assets*. An entity should assess the items included in the SAHRIS using the criteria below before classifying the asset as a heritage asset in terms of GRAP 103:

- (a) The item meets the definition of a heritage asset in GRAP 103.

GRAP 103 defines heritage assets as those assets “...that have a cultural, environmental, historical, natural, scientific, technological or artistic significance and are held indefinitely for the benefit of present and future generations.”

- (b) The item is not excluded from the scope of GRAP 103.02, and if it has more than one purpose, is not recognised in terms of another Standard of GRAP.

GRAP 103.02 indicates the following regarding the scope of the Standard:

“An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the recognition, measurement and disclosure of all assets that meet the definition of a heritage asset, except:

- (a) *the initial recognition and initial measurement of heritage assets acquired in a transfer of functions between entities under common control (see the Standard of GRAP on Transfer of Functions Between Entities Under Common Control) or merger (see the Standard of GRAP on Mergers); and*
- (b) *bearer plants and biological assets related to agricultural activity (see the Standards of GRAP on Property, Plant and Equipment (GRAP 17) and Agriculture (GRAP 27)).”*

For example, the SAHRIS includes a number of heritage items that are designated as natural heritage and consists of items such as trees, botanical gardens, rock formations, waterfalls, etc. Rock formations and waterfalls may already be part of an entity's existing immovable assets (i.e. part of the land). As these assets may not be separately managed and preserved by the entity for future generations, they may not meet the definition of heritage assets, and are therefore not separately recognised as heritage assets. Furthermore, biological assets such as trees and plants are excluded from the scope of GRAP 103 and are recognised in terms of GRAP 17, GRAP 27, GRAP 110 on *Living and Non-living Resources*, or another applicable Standard of GRAP.

GRAP 103.09 further excludes certain heritage assets when they have more than one purpose:

“Some heritage assets have more than one purpose, e.g. an historic building which, in addition to meeting the definition of a heritage asset, is also used as office accommodation. The entity needs to determine whether the significant portion of the asset meets the definition of a heritage asset. The entity must use its judgement to make such an assessment. The asset should be accounted for as a heritage



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asset if, and only if, the definition of a heritage asset is met, and only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. If, however, the definition of a heritage asset is not met, or a significant portion is held for use in the production or supply of goods or services or for administrative purposes, the asset should not be accounted for as a heritage asset. Instead, the entity should account for the asset in accordance with the applicable Standard of GRAP.”

For example, at year-end 50% of the building is used for administrative purposes, 20% is rented out and the remaining 30% is open to public visitors. As management determines that a significant portion of the building is used for administrative purposes, the building is classified as property, plant and equipment and not as a heritage asset or an investment property.

Similarly, a bridge that is designated as heritage on SAHRIS that is used as part of the road network should be classified as an infrastructure asset in terms of GRAP 17 and not as a heritage asset.

7.2 **Should an entity only classify an asset as a heritage asset if it is designated as such in terms of legislation or similar means?**

An entity may have assets that meet the definition and recognition provisions of a heritage asset in GRAP 103 on *Heritage Assets*, without them being designated as such by legislation or similar means. These assets are therefore not included in the South African Heritage Resources Information System (SAHRIS). This can be due to reasons such as:

- An entity has not yet lodged an application with the South African Heritage Resource Agency (SAHRA) for the item to be included in SAHRIS.
- SAHRA has not yet finalised the process of including the item in SAHRIS.
- The item does not meet the criteria in the National Heritage Resources Act, 1999 (Act No. 25 of 1999) to be classified as heritage.

GRAP 103 requires that, once an asset meets the definition of a heritage asset as defined in the Standard, the recognition, measurement and disclosure requirements of GRAP 103 should be applied to that asset, irrespective of whether that asset has been designated as a heritage asset through legislation or similar means.

7.3 **How should an asset be classified if it does not meet the definition of a heritage asset?**

If an asset does not meet the definition of a heritage asset in GRAP 103 on *Heritage Assets*, the entity needs to classify the asset based on its intended use of that asset by applying the principles in the Standards of GRAP, if the item meets the definition of an asset. The asset decision tree can be used as a reference to decide on the classification of an asset, which can be accessed on the ASB's website.

Account for an asset that does not meet the definition of a heritage asset as either:			
An item of property, plant and equipment when the entity intends to:	An investment property when the entity intends to: <ul style="list-style-type: none"> • earn rentals from the asset; 	Inventory when the entity intends to: <ul style="list-style-type: none"> • hold the asset for sale or distribution in the ordinary 	An intangible asset when the asset is: <ul style="list-style-type: none"> • capable of being separated or divided from the



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<ul style="list-style-type: none"> • use the asset over more than one reporting period; and • the asset, or a significant portion thereof, is used: <ul style="list-style-type: none"> (a) in the production or supply of goods or services; (b) for rental to others; or (c) for administrative purposes. <p>Refer to GRAP 17 on <i>Property, Plant and Equipment</i>.</p>	<ul style="list-style-type: none"> • hold the asset, or a significant portion thereof, for capital appreciation; or • both rather than to use the asset in <ul style="list-style-type: none"> (a) the production or supply of goods or services, or (b) for administrative purposes. <p>Refer to GRAP 16 on <i>Investment Property</i>.</p>	<p>course of operations, or</p> <ul style="list-style-type: none"> • use or consume the asset in the production process or in the rendering of services. <p>Refer to GRAP 12 on <i>Inventories</i>.</p>	<p>entity and sold, transferred, licensed, rented or exchanged; or</p> <ul style="list-style-type: none"> • arises from a binding arrangement regardless of whether rights are transferable or separable from the entity. <p>Refer to GRAP 31 <i>Intangible Assets</i>.</p>
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FAQ 7.5 provides guidance on when the heritage asset comprises a biological asset related to agricultural activity and the accounting for living animals and plants.

7.4 **How should specimens held for research be classified in an entity's financial statements?**

Some entities collect specimens in order to undertake research in future to determine whether these specimens should be preserved. The definition of a heritage asset in GRAP 103 on *Heritage Assets* refers to assets being held indefinitely for the benefit of present and future generations.

While collecting the specimens, and before the research is undertaken, the entity cannot conclude that the specific specimen (a) has a cultural, environmental, historical, natural, scientific, technological or artistic significance; and (b) is to be held indefinitely for the benefit of present and future generations. As a result, an asset held for future research is not within the scope of GRAP 103 as the definition of a heritage asset is not met.

FAQ 7.3 explains how an entity should classify an asset if the definition of a heritage asset is not met. The asset decision tree can be used as a reference to decide on the classification of an asset.

7.5 **Can a living animal or plant be classified as a heritage asset?**

Entities in the public sector may control living animals and plants as part of their mandate, for example, living animals and plants held in national parks and botanical gardens managed by entities.

The definition of heritage assets in GRAP 103 on *Heritage Assets* refers to assets that have a cultural, environmental, historical, natural, scientific, technological or artistic significance. It could be argued that living animals and plants are held for their environmental or natural significance and therefore meet the definition of heritage assets.



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The definition, however, also refers to these assets being held *indefinitely* for the benefit of present and future generations. As living animals and plants have distinct lifecycles, they cannot be held indefinitely by an entity. As a result, living animals and plants are not within the scope of GRAP 103.

An entity should apply the principles in other Standards of GRAP if it controls living animals or plants, for example GRAP 110 on *Living and Non-living Resources*. GRAP 103 also requires an entity to consider the principles in GRAP 17 on *Property, Plant and Equipment* and GRAP 27 on *Agriculture* when it manages bearer plants and biological assets related to agricultural activity respectively.

7.6 Are statues, sculptures, monuments, similar structures and replicas classified as heritage assets?

The Standard of GRAP on *Heritage Assets* (GRAP 103) defines heritage assets as follows:

“...assets that have a cultural, environmental, historical, natural, scientific, technological or artistic significance and are held indefinitely for the benefit of present and future generations.”

An entity would need to assess each asset within its control to determine whether it meets the definition of a heritage asset. Statues, sculptures, monuments or similar structures are often erected to commemorate particular people or events. Similarly, replicas are created as a duplicate of the original statue, sculpture, monument or similar structure. While the person, or event being commemorated, or the object that is duplicated, may have significance, the statue, sculpture, monument, similar structure or replica may not. An entity would need to assess whether a statue, sculpture, monument, similar structure or replica is itself being held for its significance and for the benefit of present and future generations. If the statue, sculpture, monument, similar structure or replica does not qualify as a heritage asset, the entity should assess whether it qualifies for recognition under another Standard of GRAP.

Similar considerations should be made to determine whether graves, cemeteries or burial grounds meet the definition of a heritage asset in GRAP 103.



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Section 8 - Financial Instruments

8.1 **When (and/or how) should receivables and payables be discounted in accordance with GRAP 104?**

Part A

How should entities determine when an initial credit period granted or received is consistent with terms used in the public sector, either through established practices or legislation for purposes of applying the discounting exemption in GRAP 104?

A number of queries have been raised regarding the application of GRAP 104 paragraph AG87, which states the following:

AG87. Short-term receivables and payables are not discounted where the initial credit period granted or received is consistent with terms used in the public sector, either through established practices or legislation. For example, it is common practice for municipalities to allow consumers a period of time, after issuing an invoice, to settle their water and electricity accounts. Specific legislation may also prescribe credit terms for specific types of transactions or entities, which provide an indication of what appropriate credit terms are for certain transactions and events. Where the initial credit period granted is not in line with practices or legislation in the public sector, the effect of discounting is considered if it is material.

In determining whether an entity can apply the exemption granted in GRAP 104, it would determine whether the credit received or granted is consistent with terms used in the public sector by assessing the following:

For credit granted (debtors)

1. An entity would assess firstly whether any legislation exists prescribing a credit period for debts owing to the entity. "Legislation" may comprise an Act, or it may comprise secondary legislation such as practice notes, regulations, or by-laws issued by municipal councils.

Legislation prescribes credit period – Entity has no discretion over the period

2. Where legislation prescribes a credit period, the credit period prescribed in legislation should be used to determine whether the credit granted by an entity is consistent with terms used in the public sector.

Secondary legislation prescribes credit period – Entity has discretion over the period

3. Where credit periods are established in secondary legislation such as a by-law, the entity has discretion over the period within which debtors are required to settle their accounts. As a result, in order to determine whether its policy is consistent with terms used in the public sector, an entity should compare its policy with the by-laws of similar entities to establish a norm.

Conclusion

4. In all instances, an entity should use the shortest period, either prescribed in legislation or determined through practice, as the period that is "consistent with terms used in the public sector" as this is most likely to result in the effect of discounting being immaterial.



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Illustration

A brief illustration of the process outlined above is included below. NB: This is merely an illustrative example and is in no way authoritative. The facts and circumstances of each scenario require careful consideration in formulating a judgement on the most appropriate accounting treatment.

Assessing the principle

Municipality A's by-laws prescribes a credit period of 60 days. A number of similar municipalities prescribe a 30-day credit period. As the established practice amongst municipalities is 30 days, then this period is deemed to be the "term that is consistent with those used in the public sector". Thus, in this instance, the municipality would not be able to take advantage of the discounting exemption in GRAP 104 because its credit period is not consistent with the terms used in the public sector.

[Note: In determining whether a municipality is "similar", an entity may consider whether the other entities are district or local municipalities, perform similar functions, have similar customer bases (e.g. consumer, industrial, corporate, rural etc.)].

Illustrating the entries

Assume the value of the transaction is R100. Calculating the effect of discounting using a market related rate of interest, the effect of the 60-days interest free credit is R10. The entries are as follows on initial recognition:

Day 1

Dr Receivable	R90	
Cr Revenue from sales...		R90

After initial recognition

Dr Receivable	R10	
Cr Interest revenue		R10

For credit received (creditors)

Specific legislation governs the period within which certain entities are required to pay creditors. Entities do however often settle their accounts after the prescribed period for a variety of reasons.

In assessing whether the discounting exemption can be applied in GRAP 104, an entity compares:

- the period outlined in legislation; and
- the period determined using its practice or, the practices of similar entities in settling creditors, and

uses the shortest of those two periods to determine whether the period is "consistent with terms used in the public sector". This period should be used as it is most likely to result in the effect of discounting being immaterial.



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Where no legislation exists, an entity assesses its practices to those of similar entities to establish a norm. This norm will be used to determine whether the period is “consistent with terms used in the public sector”.

Part B

Can the exemption in GRAP 104.AG87 be applied to receivables if the interest rate is not market-related?

GRAP 104.36 requires a financial asset to be recognised initially at fair value. GRAP 104.AG81 provides further guidance on the determination of fair value as follows “the fair value of a financial instrument on initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique. For example, the fair value of a long-term loan or similar receivable that carries no interest can be estimated as the present value of all future cash receipts discounted at the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating”.

GRAP 104.AG87 however provides that “short-term receivables and payables are not discounted where the initial credit period granted or received is consistent with terms used in the public sector, either through established practices or legislation” (own emphasis added). GRAP 104.AG88 goes on to state that: “Once the due date for short-term receivables has elapsed and payment is not received, an entity shall consider whether there is any indication that the receivable may be impaired, either because interest is not levied on outstanding amounts (using a market related rate of interest), or because the principal amount may not be collected (see paragraphs .57 to .64 and AG120. to AG129.)”

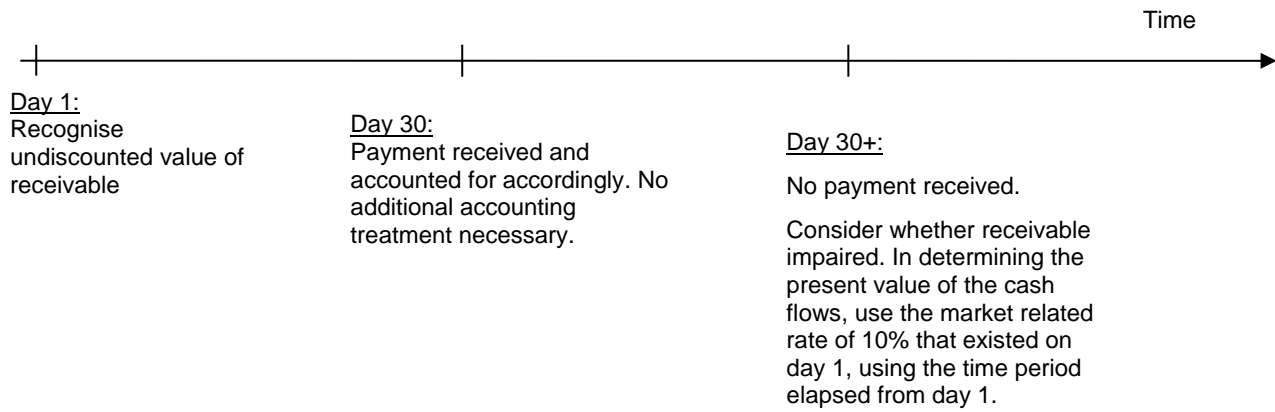
The effect of these two paragraphs is as follows:

- (a) If the initial credit period granted by an entity is consistent with “terms used in the public sector” (see FAQ 8.1 Part A) for further guidance on this issue), then an entity will not apply discounting on initial recognition, even if the interest rate charged is not market related.
- (b) If the entity does not charge a market related rate of interest, there are two possible scenarios:
 - (i) The entity receives payment on the due date for payment, which means that the effect of the financing transaction is immaterial.
 - (ii) The entity does not receive payment on the due date for payment, which means that the effect of providing below market-interest may be material. Consequently, this will be considered in determining whether the receivable is impaired. In determining the present value of the cash flows, the entity uses the period from the date the transaction was entered into.

As an illustration: a municipality grants 30 days interest free credit to all consumers of water and electricity. If payment is not received within 30 days, then interest is levied at 8%. A market related rate of interest is 10%.



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Part C

What are some common misconceptions about the discounting requirements?

Discounting versus impairment

Entities often confuse discounting and impairment.

The purpose of discounting debtors is to determine if the presentation of revenue in the statement of financial performance is correct, i.e. should the transaction be separated between the revenue for the value of the goods or services provided, and interest.

The purpose of impairment is to present a loss in the value of the financial asset as a result of credit losses and/or delayed receipt of the contractually agreed cash flows.

Entities often (erroneously) calculate interest revenue by taking the outstanding debtors' balance at year end and multiplying it by the (effective) interest rate, and apportioning revenue between sales and interest.

The discounting of debtors is done at initial recognition based on the contractually agreed credit terms. The fact that payments may be subsequently delayed is an issue that affects impairment and not the recognition of interest (see paragraph AG5.10).

Discounting and IGRAP 1 on Applying the Probability Test on Initial Recognition of Revenue

Questions have been raised about whether the separate recognition of revenue from the sale/provision of goods or services and interest revenue is consistent with the principles in IGRAP 1.

IGRAP 1 indicates the following:

Paragraph .09: *“At the time of initial recognition of exchange and non-exchange revenue it is not appropriate to assume that revenue will not be collected as the entity has an obligation to collect all revenue and this would be contrary to normal business principles. Accordingly, the Board concluded that the full amount of exchange and non-exchange revenue should be recognised at the initial transaction date.”*

Paragraph .10: *“Assessing and recognising impairment is an event that takes place subsequent to the initial recognition of revenue charged. An entity assesses the probability of collecting revenue when accounts fall into arrears. Such an assessment should not be made at the time of initial recognition.”*

IGRAP 1 deals with the potential non-recognition of revenue as a result of an entity's past history of not collecting or receiving amounts due to the entity as a result of exposure to credit risk (i.e. impairment).

When discounting applies, the transaction is still recognised in full and reflected as revenue – it is merely reflected in different line items in the statement of financial performance. There may also be a delay between the initial recognition of the revenue from the sales or goods or services and interest revenue as interest would only accrue subsequently.



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Section 9 – Interests in Other Entities

9.1 *How should the definition of investment entities be applied?*

Questions have been raised about the application of the definition of an investment entity, particularly by entities that have large portfolios of investments and are in the business of providing social benefits. While the question was raised in relation to these types of entities, the same considerations outlined in this FAQ could be applied by other entities. Social benefits for purposes of this FAQ are cash payments made to beneficiaries.

Background

The entities in question typically receive contributions and invest these contributions to sustain or maximise the benefits required to be paid in terms of legislation. Some of the investments made include acquiring controlling interests in other entities. To understand whether these investments should be consolidated or measured at fair value, questions have been raised as to whether the entity is in fact an investment entity.

GRAP 35 on *Consolidated Financial Statements* indicates that investments held by an investment entity need not be consolidated and are instead measured at fair value.

Investment entities are defined in GRAP 35 as follows:

An investment entity is an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;*
- (b) has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and*
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.*

It is important to note that an entity is required to meet all 3 the criteria listed above.

Criterion (a)

To meet criterion (a), the entity must be able to demonstrate that it has more than one investor. It is possible that there is a single investor, but where this is the case, the entity supports the interests of a wider group of investors, e.g. a pension fund.

In making the assessment in (a), an entity would need to consider whether the contributions it receives are direct contributions from a participant to the scheme, or whether the contributions received are taxes on individuals, other fees, or transfers received from the Revenue Fund. Where this is the case, it is unlikely that the entity will be able to demonstrate that it has “investors”.

Criterion (b)

To meet criterion (b), the entity exists to invest solely for returns from capital appreciation, investment revenue, or both. There are a number of factors to consider:

- An entity's purpose should be evaluated based on its objectives outlined in its legislative mandate, founding documents, etc. An entity that has additional objectives that are inconsistent with the



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purpose of an investment entity would not meet the definition of an investment entity. This includes an investor whose objectives require it to be aligned with the economic, social or environmental policies of another entity, e.g. owning certain operations or improving employment outcomes. For entities that are established to provide social benefits, their core mandate is the provision of benefits in accordance with the scheme (the rules of which are usually outlined in legislation). The investment of contributions or other revenue received is merely to sustain this core mandate. The purpose of these entities is not to exist solely to invest to maximise returns.

- An entity should also consider its investment plans and how these plans evidence its purpose. One such feature that evidences that an entity is an investment entity is that it does not plan to hold the investments indefinitely. An investment entity has an exit strategy documenting how the entity plans to realise capital appreciation from substantially all its equity and non-financial asset investments. There should be an exit strategy for debt instruments that could be held indefinitely (e.g. perpetual debt instruments).

Criterion (c)

An entity would need to provide investors with fair value information that substantially all its investments are measured at fair value in its financial statements whenever fair value is required or permitted. It would also need to report fair value internally to an entity's management.

In assessing this criterion, it would need to be established whether there are indeed investors (as discussed in the analysis of criterion (a)), and that the management receives information about the fair value of the investments on an ongoing basis so as to make investment decisions.



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Tracking table		
Action	Date	Description of change
Issued	15 February 2011	Publication of combined FAQs for all entities.
Updated	15 February 2011	The following amendments were made: <ul style="list-style-type: none"> • Section 1 updated to reflect the 2010/11 reporting framework. • Amendment to question 1.7. • Added question 1.13 on the disclosure of information when changing from an IPSAS or IFRS to an accounting policy formulated using Standards of GRAP that are not yet effective. • Amendments to question 1.12.
Updated	16 May 2011	The following amendments were made: <ul style="list-style-type: none"> • A footnote reference to the Supplement to Directive 5 has been added to question 1.1. • Delete requirement in question 1.2 to submit an application to the National Treasury for early adoption of Standards of GRAP where the Minister of Finance has determined an effective date. • Editorial amendments to questions 3.1 and 4.1.
Updated	12 July 2011	Add a question in section 6 on accounting considerations relating to World Cup Stadiums.
Updated	4 October 2011	Delete questions 2.4, 2.6, 2.7, 2.10, 2.11, 6.3 and 6.4 that are included in the GRAP Manuals issued by the Office of the Accountant-General. Renumber remaining questions where appropriate.
Updated	9 February 2012	Section 1 updated to reflect the reporting framework for 2011/2012. Add Question 1.11 to reflect the application of GRAP 105, 106 and 107 in the 2011/12 reporting framework.
Updated	11 June 2012	Add questions in section 1 on disclosures to be made by trading entities and in section 7 on applying the exemption in GRAP 104 when considering the credit period granted or received.
Updated	25 July 2012	Add questions in section 4 on the accounting and disclosure relating to services in-kind and in section 7 on whether the



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		exemption in GRAP 104.AG87 can be applied to receivables if the interest rate is not market-related.
Updated	27 August 2012	Add a question in section 3 on the presentation requirements and bases of preparation to follow in preparing financial statements and budget information, and add section 8 dealing with questions on transfer of functions and mergers.
Updated	19 September 2012	Add two questions in section 8 dealing with: <ul style="list-style-type: none"> • Distinguishing a transfer of functions under and not under common control; and • Deciding whether a transaction or event is a merger.
Updated	26 September 2012	Amend the wording in question 2.3 as follows: <ul style="list-style-type: none"> • The example was deleted; • Clarify that if the entity did not appropriately apply GRAP 17 then this results an error in accordance with GRAP 3 and <i>vice versa</i>; • To discuss rare instances, where an entity may hold fully depreciated assets which it still uses; and • Add reference to disclosure requirements in GRAP 3 which should be applied whether it is a change in estimate or a prior period error.
Updated	7 February 2013	Sections 1, 3, 4 and 6 have been updated to reflect the reporting framework for 2012/13.
Updated	11 February 2013	Add a question in section 3 on the disclosure relating to councillor's remuneration for purposes of GRAP 20.
Updated	25 June 2013	Add a question in section 1 on the basis of preparation for Government Business Enterprises (GBEs) when they apply Statements of GAAP.
Updated	03 July 2013	Add a question in section 2 on accounting for heritage assets that were previously accounted for in terms of GRAP 17 and where the deemed cost was determined in terms of Directive 7.
Updated	13 January 2014	Sections 1, 3, 4 and 6 have been updated to reflect the reporting framework for 2013/14.
Updated	28 February 2014	Delete questions 2.1, 2.4, 2.5, 2.6, 2.8, 3.1, 3.4, 4.2, 4.4, 4.6, 5.2, 6.1, 6.2, 7.1, 7.2, 8.1, 8.2 and 8.3 that are included in the GRAP Manuals issued by the Office of the Accountant-General. Renumber remaining questions where appropriate; and delete sections 7 and 8.



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Updated	22 May 2014	<p>The following amendments were made:</p> <ul style="list-style-type: none"> • Add a question in section 4 dealing with the effect of IGRAP 1 on traffic fines. • Add a new section 7 on provisions and a question dealing with determining the discount rate for calculating provisions in accordance with GRAP 19.
Updated	27 June 2014	Add a question in section 6 on accounting for expenses incurred by an entity but which are settled by another entity.
Updated	15 July 2014	<p>The following amendments were made:</p> <ul style="list-style-type: none"> • Amend question 2.2 to clarify when an adjustment is required, what information should be used to assess the useful lives of assets and when the adjustment is a change in accounting estimate or error. • Add three questions to section 2 on whether: <ul style="list-style-type: none"> - the valuation roll can be used to measure assets at fair value; - statues, sculptures, monuments and similar structures are always classified as heritage assets; and - living animals or plants can be classified as heritage assets. • Add a question to section 4 on whether revenue foregone is recognised in the statement of financial performance.
Updated	03 November 2014	Add a question in section 1 on what date should deemed cost be determined using Directive 7 if an entity did not complete its adoption of Standards of GRAP within the specified time frame.
Updated	16 April 2015	Sections 1 and 4 have been updated to reflect the reporting framework for 2014/15.
Updated	18 May 2015	Add a question to section 2 on how an entity should apply the requirements in Directive 11 retrospectively in the absence of cost records for assets on the date of adoption of the Standards of GRAP.
Updated	28 July 2015	Add a question to section 1 on what is meant by “effective for financial periods commencing on or after 1 April 201X”, when referring to the applicability of the GRAP Reporting Framework to different entities.
Updated	8 September 2015	The following amendments were made:



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		<ul style="list-style-type: none"> Combine old question 4.5 with question 6.1, and amend question 6.1 for consistency. Delete the old question 4.5 on whether revenue foregone is recognised in the statement of financial performance. Add a question to section 4 on the interaction between GRAP 20 and GRAP 23 for services in-kind.
Updated	29 February 2016	<p>The following amendments were made:</p> <ul style="list-style-type: none"> Sections 1 and 4 have been updated to reflect the reporting framework for 2015/16. Amend question 4.2 to reflect that principal-agent arrangements are assessed in accordance with the Standard of GRAP on <i>Accounting by Principals and Agents</i>.
Updated	21 April 2016	<p>Question 2.2 was replaced with an updated version on how to account for fully depreciated assets that are still in use. The new version provides:</p> <ul style="list-style-type: none"> A decision tree in assessing whether adjustments are required to fully depreciated assets still in use. Clarification on how to make prospective adjustments for a change in accounting estimate.
Updated	13 September 2016	<p>Add a question to section 1 on when does the three year transitional period relating to the initial adoption of Standards of GRAP expire.</p>
Updated	30 March 2017	<p>Amend section 1 as follows:</p> <ul style="list-style-type: none"> Add a question on the implications on compliance with the Standards of GRAP when an exemption is granted by the Minister of Finance. Add a question on the versions of the Standards of GRAP to be applied on first time adoption. Update section 1 to reflect the reporting framework for 2016/17. <p>Add three questions to sections 2 and 3 on asset related matters:</p> <ul style="list-style-type: none"> The implications of non-recognition of certain assets when permitted by Standards of GRAP. Whether all items that are listed by SAHRA as heritage items meet the definition of heritage assets in terms of GRAP 103, and vice versa.

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		<ul style="list-style-type: none"> Add a question to section 3 on where in the financial statements expenditure on repairs and maintenance should be presented.
Updated	19 December 2017	<p>Update section 1 for the 2017/18 reporting framework.</p> <p>Delete question 1.7 on GRAP 105, 106 and 107. Relevant information is included in question 1.3.</p> <p>Amend question 3.4 to address with the analysis of expenses by nature or function more broadly and better explain what each analysis means, with examples.</p> <p>Add question 3.5 on the items to be included in cash and cash equivalents.</p> <p>Align question 4.3 to the current requirements of GRAP 23, include examples of in-kind benefits that may be significant to an entity and include the disclosure requirements of services in-kind not recognised.</p> <p>Clarify in question 6.1 that the expenses related to providing free basic services should not be reclassified from its nature or function to items such as “free basic services”.</p> <p>Add question 6.4 on the interaction between the Standards of GRAP on Service Concession Arrangements, Joint Ventures and Accounting by Principals and Agents</p> <p>Add a footnote reference throughout the document to the new Conceptual Framework approved by the Board in June 2017, which replaces the previous framework.</p>
Updated	28 May 2018	<p>Add question 2.7 on use of a valuer to determine fair value.</p> <p>Move question 7.1 on determining the discount rate for calculating provisions to section 6 as question 6.5.</p> <p>Remove the reference to GRAP 103 from the name of section 2.</p> <p>Rename section 7 to “Heritage Assets”, and amend the section as follows:</p> <ul style="list-style-type: none"> Move question 2.9 to section 7 as questions 7.1 and 7.2 on classification of assets as a heritage asset in the entity's financial statements. Add question 7.3 on how an asset that does not meet the definition of a heritage asset should be classified. Add question 7.4 on how specimens held for research should be classified.



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		<ul style="list-style-type: none"> • Move question 2.6 to section 7 as question 7.5 and explain when a living animal or plant can be classified as a heritage asset. • Move question 2.5 to section 7 as question 7.6 and explain when statues, sculptures, monuments, similar structures and replicas are classified as heritage assets.
Updated	1 June 2018	<p>Amend question 1.3 to clarify status of a Standard issued but not listed in the reporting framework.</p> <p>Amend question 1.7 to clarify disclosure requirements.</p> <p>Amend question 3.4 to add examples, and clarify the reasons the examples are inappropriate.</p> <p>Amend question 3.5 to clarify the purpose of holding an instrument.</p> <p>Add question 6.6 on accounting for renegotiated payment arrangements.</p>
Updated	13 July 2018	<p>Add question 3.6 on the requirements for entities to classify revenue as exchange or non-exchange.</p> <p>Add question 3.7 on the considerations when presenting information in addition to what is required by the Standards of GRAP.</p>
Updated	19 November 2018	<p>Add question 1.15 on the role of the Conceptual Framework and when it is applied.</p> <p>Add question 1.16 on the effective date of the Conceptual Framework.</p>
Updated	28 March 2019	<p>Update section 1 for the 2018/19 reporting framework.</p> <p>Remove FAQ 1.8 on <i>What should Government Business Enterprises (GBEs) describe as their basis for preparation when they apply Statements of GAAP?</i> as it is no longer relevant from 1 April 2018.</p>
Last updated	10 September 2019	<p>Added the following FAQs:</p> <ul style="list-style-type: none"> • 1.16 on the role of materiality in reporting information in the financial statements. • 2.8 on whether changes to useful lives, residual values and depreciation methods are changes in estimates or errors. • 3.8 on how entities should determine the value of repairs and maintenance.



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		<ul style="list-style-type: none"> • 8.1 (Parts A to C) on the discounting of receivables and payables. <p>Amended the following FAQs:</p> <ul style="list-style-type: none"> • 2.2 on fully depreciated assets still in use. • 7.6 on whether graves and cemeteries are heritage assets.
	4 October 2019	<p>Added the following FAQs:</p> <ul style="list-style-type: none"> • 3.9 on the presentation of revenue and receivables from exchange and non-exchange transactions. • 9.1 on the definition of an investment entity.
	7 November 2019	<p>Added the following FAQs:</p> <ul style="list-style-type: none"> • 1.17 on the disclosures entities should provide on newly effective Standards of GRAP. • 3.10 on whether all errors should be accounted for using GRAP 3. • 3.11 on adjustments related to the adoption of a new pronouncement. • 3.12 on the application of GRAP 109.
	26 November 2019	<p>Added FAQ 2.9 on the impact of land invasions on land recognition.</p>