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The Technical Director

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International Federation of Accountants

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Per e-mail

26 October 2012

Dear Stephenie,

CONSULTATION PAPER ON CONSULTATION ON IPSASB WORK PROGRAM 2013-2014

We welcome the opportunity to provide comments on the Consultation Paper issued by the IPSASB on the IPSASB's Work Program for 2013-2014.

In preparing this comment letter, we have consulted individually with a number of stakeholders including our Board, the National Treasury and the Auditor-General of South Africa. The Board also issued the Consultation Paper as a concurrent exposure draft locally, requesting inputs from a range of constituents.

This letter has been prepared and issued by the Secretariat of the ASB and not the Board.

Our response is set out in two parts: Part A which outlines our general comments and observations about the proposed projects and, Part B which outlines our responses to the specific matters for comment included in the Consultation Paper.

Should you have any questions on the comments in our letter, please feel free to contact me.

Yours sincerely

Erna Swart

Chief Executive Officer

Part A – General comments and observations on the proposed list of projects

(a) *Borrowing Costs* (Update of IPSAS 5 - underlying standard IAS 23) –

When we initially issued our equivalent Standard locally, we followed the revised IAS 23 on *Borrowing Costs* which requires the capitalisation of borrowing costs. We followed IAS 23 rather than IPSAS 5 as the IAS established "newer" thinking on the topic. Following the adoption and application of our equivalent Standard, a number of our constituents indicated that they do not support the capitalisation of borrowing costs both for conceptual and practical reasons. Conceptually, some were of the view that the cost of assets is skewed depending on how they were acquired. Practically, many constituents indicated that it is often difficult to attribute borrowings to specific assets as the entity may borrow centrally to fund an overall shortfall rather than to fund specific assets. The attribution of borrowing costs in these instances is often theoretical and subjective.

These comments have led the Board to reconsider its approach to borrowing costs. At present, an exposure draft of proposed changes to the local equivalent has been issued. These proposed changes essentially require the expensing of borrowing costs, which would bring the local equivalent in closer alignment to the requirements of IPSAS 5. The ASB Board is of the view that while capitalisation may be feasible in certain instances, it wanted to limited the accounting policy choices available to entities in order to achieve comparability.

While we are of the view that this project is important, from our experience, the current guidance is appropriate and we would therefore not give this project a high priority as there are other, more urgent issues to address. This project is also likely to have linkages with Phase 3 of the Conceptual Framework.

(b) *Emissions Trading Scheme*

There are no, or a very limited occurrence, of emissions trading schemes in South Africa. Consequently, this is not a high priority from a jurisdictional perspective. We are however aware of the significance of these schemes in other jurisdictions. If the IPSASB chooses to pursue this project, we would strongly encourage the Board to work with the IASB in developing guidance on this issue. This would not only maximise the amount of resources used to develop the guidance, but would also ensure that symmetry is achieved between the accounting requirements of the issuer and the holder of these instruments.

(c) *Extractive Industries* (IFRS 6 interim standard but no comparable IPSAS)

Similar to emissions trading schemes, the South African public sector undertakes a limited amount of mining or extractive activities. As a result, this project is not seen as a priority. Through consultation with AFROSAI-E (African Organisation of English speaking Supreme Audit Institutions), it was noted that the revenue arising from mining and extractive industries is an area of concern in a number of African countries. This may be an area in which further work could be undertaken by the IPSASB in future.

(d) *Heritage Assets* (Public sector specific)

The ASB has issued a local Standard on *Heritage Assets* which requires the recognition of heritage assets where they can be measured reliably. As heritage assets could be significant in a number of jurisdictions (including other African countries), we support adding this project to the IPSASB's work programme. It is possible that the information needs of users are currently being met through other reports (such as stewardship reports). As a result, we are of the view that other projects should take priority.

(e) *Improvements to IPSAS 23 – Revenue From Non-exchange Transactions (Taxes and Transfers)*

Our constituents have recently adopted the local equivalent of IPSAS 23. In applying this Standard, a number of issues have been identified:

- We have a number of arrangements in place where entities provide services to other entities which currently do not meet the strict description of "services in-kind" in IPSAS 23. IPSAS 23 describes services in-kind as those services provided by an individual. In many instances, entities make assets available to other entities to use in their operations, most often, land and buildings. In these instances, because the entity only has a right to use an asset and not the underlying asset, these transactions do not qualify as "goods in-kind", but, the transaction is also not consistent with the description of "services in-kind". The use of other entities' assets at no charge is an area that we believe should be considered in the revision to IPSAS 23.
- In addition to these arrangements, entities may also agree to pay or share the salary costs of employees and other operational costs. For individual entities, this could represent a significant amount of their expenditure. As IPSAS 23 currently does not require the recognition of elements related to the receipt of services in-kind, fair presentation may not be achieved in many instances. Although IPSAS 23 does indicate that if these services critical to an entity's operation then recognition should be considered, this is not considered strong enough. As a result, we would also urge the IPSASB to reconsider the current requirements of IPSAS 23 in this regard.
- As transfers which are not subject to conditions are recognised as revenue in the year that they accrue, it is possible that an entity may have a large surplus in a year, and a large deficit in another when the related expenditure is incurred. While we agree that this reflects the events that occurred in the relevant periods, entities have indicated to us that users misinterpret or do not fully understand what this surplus or deficit means and why it could vary from one year to the next. We are of the view that the disclosure requirements, both in IPSAS 23 and IPSAS 1, could be enhanced to make this clearer to users.

Apart from these issues, there is a potential opportunity to align the accounting principles for exchange and non-exchange revenue, depending on the direction taken by the IASB on its revenue project. Any revisions to IPSAS 23 may also be dependent on the outcome of Phase 2 of the Conceptual Framework project, particularly in relation to deferred inflows and outflows.

It is clear that there are probably two aspects of this project: (i) address more immediate application issues, and (ii) address longer term conceptual issues. It is possible that these two phases could be undertaken independently.

Given the significance of non-exchange revenue transactions, we would see this as a priority project.

(f) *Insurance Contracts* (IFRS 4 interim standard but no comparable IPSAS)

There are a number of schemes in the South African public sector which are similar to insurance schemes operated in the private sector. One of the key differences between the public and private sector schemes is the absence of a contractual arrangement between the parties, as well as the fact that some participants in these schemes do not pay any contributions. These peculiarities have made accounting for these schemes challenging.

While this project is important from a South African perspective, we are of the view that this project should only be progressed by the IPSASB once the IASB has finalised its insurance project. As a result, we would urge the IPSASB to retain this project on its future agenda, but to postpone any work until the IASB has completed its project.

(g) *Leases*

The application of lease accounting in the public sector is always contentious and subject to a high degree of judgement, particularly the assessment of whether an arrangement is a finance or an operating lease. It is therefore important that a less subjective method of accounting be identified. We are however of the view that leases are "sector neutral" and as a result, the accounting requirements applied in the public and private sectors should be the same. As a result, we would not undertake any work on this project until the IASB has completed its project on leases and the accounting requirements stabilised. It has taken a significant amount of time for the IASB to develop this Standard with a number of delays experienced during its development. For this reason, it may be more appropriate to identify other projects that can be progressed that are not dependent on the actions of external parties.

(h) *Non-current Assets Held for Sale and Discontinued Operations* (IFRS 5 but no comparable IPSAS)

The ASB issued a local equivalent of IFRS 5 in 2005. Recent feedback from our constituents has indicated a number of issues with the requirements of this Standard, in particular that:

- The requirements to complete the sale of the asset in one year are not feasible in the public sector because of the regulatory environment. Evidence locally suggested, in some instances, completion of the sale in 3-5 years (especially for significant assets such as property). The time taken to complete the sale means that separate classification and presentation on the statement of financial position as "held for sale" can be misleading.
- The requirements of IFRS 5 only apply to sales "at fair value". The occurrence of these transactions in the public sector is often limited. Transfers of assets or disposal groups in non-exchange transactions are more likely.
- The requirements of IFRS 5 are only applied once an entity has a highly committed plan to sell an asset. This provides limited information to users of the financial statements for accountability and decision-making purposes. To be of value for accountability and decision-making, users of the financial statements should be

aware of any intention of management to dispose of certain assets (for example, these assets may be of importance to a community and may provoke reaction from the affected community about the intended disposal). Information should therefore be provided much earlier than what is currently required by IFRS 5.

- The requirements to disclose discontinued operations are often ignored if the "held for sale" requirements are not met.

Based on the feedback received, the ASB Board is revisiting the requirements of the local equivalent of IFRS 5 and has proposed to withdraw the "held for sale" requirements and replace these with disclosure requirements about the intention to dispose of any assets, as well as the timing and circumstances thereof. The requirements of IFRS 5 regarding the disclosure of discontinued operations will however be retained.

Based on our local experience, we would therefore not support the development of an equivalent of IFRS 5, particularly in relation to the measurement and presentation requirements for non-current assets held for sale. We would however strongly urge the IPSASB to consider whether the disclosures in the existing IPSASs provide sufficient, relevant information to users about the intended disposal of assets. We would also urge the IPSASB to consider developing presentation and disclosure requirements for discontinued operations, particularly in the light of the project on public sector combinations.

(i) *Presentation of Financial Statements* (Update of IPSAS 1 - underlying standard IAS 1)

Many of the amendments that will be required to IPSAS 1 to align it with IAS 1 relate to the notion of comprehensive income and other issues which have limited relevance to the public sector. It would be more useful and resource efficient to wait until the Conceptual Framework project has been completed so that IPSAS 1 can be revised to reflect public sector specific issues related to the presentation of financial statements.

(j) *Related Party Transactions* (Update of IPSAS 20, underlying standard IAS 24)

Our equivalent Standard on related party transaction and disclosures has been updated to reflect recent amendments to IAS 24 to the extent that they are public sector specific. While it is important to consider these amendments and the impact on IPSAS 20, we would not place a high priority on this project.

(k) *Revenue Recognition*

Similar to the lease project, we are of the view that exchange revenue transactions are "sector neutral" and as a result, the accounting requirements applied in the public and private sectors should be the same. As a result, we would not undertake any work on this project until the IASB has completed its project on revenue and the accounting requirements stabilised. It has taken a significant amount of time for the IASB to develop this Standard with a number of delays experienced during its development. For this reason, it may be more appropriate to identify other projects that can be progressed that are not dependent on the actions of external parties.

(l) *Segment Reporting* (Update of IPSAS 18, underlying standard IAS 14, superseded by IFRS 8)

When we started developing our equivalent Standard on segment reporting, we initially used IPSAS 18. On consultation with our constituents, it was indicated the information required by IPSAS 18, particularly in relation to segment assets and liabilities, could not be reported because of system constraints. As an alternative, we considered the requirements of IFRS 8. Our constituents received this approach more favourably. This approach allowed them to report the information that they used internally to report to management and did not require significant changes in existing data collection and processing systems.

We anticipate that similar experiences may exist in other jurisdictions and, as a result, would encourage the IPSASB to consider revising IPSAS 18 using the approach in IFRS 8. We would however not see this as a priority for the 2013-14 period. We do however note that the reporting of segment information has linkages with the service performance information project, and may facilitate reporting on this information.

(m) *Small and Medium Enterprises* (SMEs)

The ASB Board undertook a project in 2009-10 to assess whether (a) differential reporting is appropriate in the public sector (i.e. should there be different reporting frameworks for different types of entities) and (b) assess whether any simplifications in the IFRS for SMEs could be considered for in amending our local Standards.

The Board concluded that differential reporting is not appropriate, primarily because the users of the financial statements are the same for all entities. As a result, it would be inappropriate to report different information to the same users as this would be to the detriment of accountability and decision-making taken as a whole across government.

While there was support for some of the simplifications in the IFRS for SMEs, our constituents indicated that (a) accounting requirements are as complex or simple as the operations of particular entities and the underlying transactions that they enter into, and (b) it is not the requirements in the Standards that are complex, but their application in practice.

While it may be important to explore this as a research topic, we remain strongly of the view that differential reporting is not appropriate on the basis that the users of financial statements in the public sector are largely the same across a range of entities.

(n) *Social Benefits*

There is currently no definitive guidance that can be used to account for social benefit obligations which means that there is a significant amount of diversity in practice. Given the significance and complexity of this topic, our Board tentatively agreed to wait for the IPSASB to develop guidance in this area instead of issuing our own local Standard. Given the significance of these expenses and obligations (particularly in the current economic environment) we would urge the IPSASB to reactivate this project as soon as possible.

(o) *Sovereign Powers and their Impact on Financial Reporting*
Similar to the social benefits project, there is currently no comprehensive guidance on this area, other than the limited guidance in IPSAS 31 on *Intangible Assets.* We propose that the IPSASB commence development work on this project as a priority.

Part B – Responses to specific matters for comment

> Question 1:
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> Considering the additional potential projects identified above and described in Appendix C, are there any other projects that you think need to be added to the list of potential projects?

While we would not support adding any additional projects to the work programme for the 2013-14 reporting period, we would urge the IPSASB to consider dealing with the Interpretations issued by the IASB in a more comprehensive and consistent manner, possibly as a separate project.

> Question 2:
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> Which projects do you think the IPSASB should prioritize for 2013-2014? In your response you could consider providing your assessment of the 3 most important projects or a ranking of all projects on the list. Please explain the reasons for your answers.

Based on our responses above, we are of the view that the IPSASB should prioritise the following projects:

(a) Amendments to IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers).*

(b) Social Benefits.

(c) Sovereign Powers and their Impact on Financial Reporting.

> Question 3:
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> Please provide any further comments you have on the IPSASB's Work Program for 2013-2014.

We do not have any additional comments on the work program itself, but welcome the IPSASB's initiative to undertake this consultation on its work programme.