

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 (where applicable) collectively called "entities" in this document (unless indicated otherwise).

	Date	Action
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 reporting framework for 2010/11. • 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

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		<p>application to the National Treasury for early adoption of Standards of GRAP where the Minister of Finance has determined an effective date</p> <ul style="list-style-type: none"> • 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.

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Section 1 – Reporting Framework and Related Issues

1.1 What reporting framework should be used by entities for the 2010/11 reporting period?

Entities use Directive 5 on *Determining the GRAP Reporting Framework*¹ in preparing their financial statements for the financial years ended 31 March and 30 June 2011. The following appendices to Directive 5 lists the Standards of GRAP and other pronouncements that should be used by the following entities to prepare financial statements for the years ended 31 March and 30 June 2011:

- Appendix C – Public entities, constitutional institutions, municipalities and municipal entities.
- Appendix D – Parliament and provincial legislatures. The effective dates for the adoption of Standards of GRAP by Parliament and the provincial legislatures is prescribed in their financial management legislation governing these entities either nationally or within each province. Directive 5 should thus be read in conjunction with this legislation (see also Gazette 33991 issued on 2 February 2011). The effect is that if legislation requires that Parliament or a provincial legislature adopts Standards of GRAP from 1 April 2010, appendix D of Directive 5 is applied.

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.

Part A – Applicable to public entities, constitutional institutions, municipalities and municipal entities

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?

Standards of GRAP that have been issued by the Board but which are not yet effective 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.

For the 2010/11 reporting period, the following Standards of GRAP have been issued but are not yet effective:

No.	Title of Standard	Impact on GRAP Reporting Framework
GRAP 18	Segment Reporting	No segment reporting required for the 2010/11 reporting period (see response to 1.4 below)
GRAP 21	Impairment of Non-cash-generating Assets	Full compliance to GRAP 21 not required. Entities may use GRAP 21 to formulate an accounting policy for the impairment of non-cash-generating assets (see response to 1.7 below).
GRAP 23	Revenue from Non-exchange Transactions (Taxes and Transfers)	Full compliance to GRAP 23 not required (see response to 1.5 below).
GRAP 24	Presentation of Budget Information	Full compliance to GRAP 24 not required (see

¹ Also consider the Supplement to Directive 5 that outlines which pronouncements of other Standard-setters should be considered in preparing financial statements for a particular reporting period.

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		response to 1.6 below).
GRAP 25	Employee Benefits	Full compliance with GRAP 25 not required (see response to 1.8 below).
GRAP 26	Impairment of Cash-generating Assets	Full compliance to GRAP 26 not required. Entities may use GRAP 26 to formulate an accounting policy for the impairment of cash-generating assets (see response to 1.7 below).
GRAP 103	Heritage Assets	Entities may use GRAP 103 to formulate an accounting policy for heritage assets (see response to 1.9 below).
GRAP 104	Financial Instruments	Full compliance with GRAP 104 not required (see response to 1.10 below).

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

Entities are not required to apply GRAP 18 or IFRS 8 on *Operating Segments*. The Minister of Finance delayed the effective date of GRAP 18 as entities are not yet ready to comply with segment reporting.

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

Public entities

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

Note: Entities should consider GRAP 23 in formulating an accounting policy for non-exchange revenue; they are not required to comply in full with GRAP 23 as the Minister of Finance has not yet determined an effective date for GRAP 23.

Municipalities and municipal entities

No, municipalities use paragraphs .29-.35, .39-.54, .61(b)(iii), (vi), (viii), (ix) and .62(a) and (b) of GAMAP 9 on *Revenue* (see paragraph .44 of GRAP 9) to account for government grants, transfers, equitable share allocations, property rates, fines and donations received by a municipality.

To the extent that a transaction or event is not adequately addressed in GAMAP 9, a municipality uses GRAP 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers)* to develop an appropriate accounting policy.

Paragraphs .20 and .21 of Directive 5 indicate that IFRSs should not be applied if they are in conflict with the ASB's *Framework for the Preparation and Presentation of Financial Statements* or existing Standards of GRAP or IPSASs. As a result, IAS 20 may not be applied.

1.6 Do entities have to apply GRAP 24 on Presentation of Budget Information in Financial Statements?

Entities do not need to comply in full with GRAP 24 for the 2010/11 reporting period as the Minister of Finance has not determined an effective date for GRAP 24. Entities may however use the principles outlined in GRAP 24 as guidance to inform compliance with the requirements of GRAP 1 paragraphs .11-.15 (see question 3.3 below).

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1.7 Does an entity need to assess its assets for impairment for the 2010/11 reporting period, if yes, what Standards are used?

Entities should assess their assets for impairment and account for any resulting losses for the 2010/11 reporting period. Entities do however have the following choices to account for impairment losses.

Public entities

Impairment of cash-generating assets

- As entities previously applied IAS 36 on *Impairment of Assets*, entities may continue to apply IAS 36; or
- They can use GRAP 26 on *Impairment of Cash-generating Assets* to formulate an accounting policy.

Impairment of non-cash-generating assets

Entities may formulate an accounting policy on the impairment of non-cash-generating assets using GRAP 21 *Impairment of Non-cash-generating Assets* (unless they previously used IPSAS 21 to formulate their policy; in which case they can continue to apply such a policy).

Municipalities and municipal entities

Municipalities should assess their assets for impairment and account for any resulting losses (consideration should be given to the transitional provisions in Directive 4 in this regard). Municipalities do however have the following choices to account for impairment losses.

Impairment of cash-generating assets

- Some municipalities may have previously applied IAS 36 on *Impairment of Assets*. These municipalities may continue to use IAS 36.
- Municipalities can use GRAP 26 on *Impairment of Cash-generating Assets* to formulate an accounting policy.
- Where a municipality did not previously have an accounting policy for impairing its assets, it may use GRAP 26 to formulate an accounting policy for the impairment of cash-generating assets.

Impairment of non-cash-generating assets

Municipalities may formulate an accounting policy on the impairment of non-cash-generating assets using GRAP 21 *Impairment of Non-cash-generating Assets* (unless they previously used IPSAS 21 to formulate their policy; in which case they can continue to apply such a policy).

1.8 Does an entity have to apply GRAP 25 on Employee Benefits for the 2010/11 reporting period?

Entities applied IAS 19 on *Employee Benefits* in previous reporting periods. For the 2010/11 reporting period, entities have a choice of the following:

- Continue applying IAS 19; or
- Formulate an accounting policy based on GRAP 25.

1.9 Does an entity have to apply GRAP 103 to account for heritage assets?

Entities are required to apply GRAP 17 on *Property, Plant and Equipment*. GRAP 17 provides limited guidance to entities on the treatment of heritage assets and allows, but does not require, entities to recognise heritage assets. Where entities recognise heritage assets, they are required to provide disclosure about such assets.

Entities may, but are not required to, formulate an accounting policy based on GRAP 103.

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Where entities do hold heritage assets and they have not accounted for such assets using GRAP 17 or using an accounting policy based on GRAP 103, it may be appropriate for entities to consider whether disclosure, including a description of the nature and extent, of these assets is useful to the users of the financial statements.

1.10 Does an entity have to apply GRAP 104 on Financial Instruments for the 2010/11 reporting period?

Entities applied IAS 32, 39 and IFRS 7 in previous reporting periods. For the 2010/11 reporting period, entities have a choice of the following:

- Continue applying IAS 32, 39 and IFRS 7; or
- Formulate an accounting policy based on GRAP 104.

Part B – Applicable to Parliament and provincial legislatures

1.11 Which Standards of GRAP are not effective for Parliament and the Provincial Legislatures for the 2010/11 reporting period and what is the impact on the reporting framework?

Standards of GRAP that have been issued by the Board but which are not yet effective 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.

For the 2010/11 reporting period, the following Standards of GRAP have been issued but are not yet effective for Parliament and the Provincial Legislatures:

No.	Title of Standard	Impact on GRAP Reporting Framework
GRAP 25	Employee Benefits	An accounting policy must be formulated for employee benefits using GRAP 25 as a basis. Appropriate disclosures should be made in the financial statements to ensure fair presentation.
GRAP 104	Financial Instruments	An accounting policy must be formulated for employee benefits using GRAP 104 as a basis. Appropriate disclosures should be made in the financial statements to ensure fair presentation.

1.12 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, 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. See question 1.13 below.

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

1.13 If an entity applied IAS 32, 39 and IFRS 7 in previous reporting periods but chooses to formulate an accounting policy using GRAP 104 going forward, does it have to comply with all the disclosure requirements in IFRS 7 until it formally adopts GRAP 104?

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Directive 5 is not specific about the disclosures that should be made in such circumstances. The qualitative characteristics in the *Framework for the Preparation and Presentation of Financial Statements* (the Framework) can however be used in assessing what disclosures would be appropriate in such circumstances.

As entities have made certain disclosures in the past, it is important that issues such as relevance, comparability and materiality are considered. As a result, it is suggested that, at a minimum, the following disclosures are made:

- If an entity disclosed information under IFRS 7 and the disclosure of such information is also required in GRAP 104, it should continue to make such disclosures.
- If an entity disclosed information under IFRS 7 and the disclosure of such information is encouraged in GRAP 104, an entity should assess whether it should continue to make such disclosures by, for example, assessing whether such information is useful to the users of the financial statements. The same assessment should be made where information was disclosed under IFRS 7 but is not a required or encouraged in GRAP 104.

A similar approach may be adopted for other situations where an entity changes its accounting policy from an IFRS or IPSAS to a Standard of GRAP that is not yet effective.

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Section 2 – Asset Related Accounting Issues (GRAP 16, 17, 101, 102)

2.1 *When should an entity start depreciating major spare parts and stand-by equipment?*

An entity starts depreciating major spare parts and stand-by equipment when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operation in the manner intended by management. This implies that depreciation may commence while the item is held in storage. Under a usage based depreciation, the depreciation of items held in storage may be zero.

If major installation of the spare part is however required, it may be argued that the spare parts are not immediately available for use in the manner intended by management. In these instances, depreciation may only commence once the installation is complete.

Management should exercise judgement in applying the requirements in GRAP 17 regarding the depreciation of major spare parts and standby equipment.

2.2 *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(s) 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.

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

It may happen that an entity has fully depreciated assets that are still being used by the entity. A question that is commonly asked is whether this results in a prior period error or not.

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.

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If an entity made an appropriate estimate of the useful lives, residual values and depreciation of an asset based on the information available at the previous reporting dates, it continues to measure the assets at R0, and discloses the fact that it has fully depreciated assets still in use. An example of such an instance may be as follows: An entity has a policy of replacing assets at specified intervals. At the end of a reporting period, an entity fully depreciates certain assets knowing that in the following year, it is scheduled to replace these assets in accordance with its policy. In the subsequent period however, management changes its policy of replacing assets, resulting in it holding fully depreciated assets that are still being used by the entity.

Where an entity has fully depreciated assets because it did not appropriately apply the principles of GRAP 17 on *Property, Plant and Equipment*, e.g. because it did not review the useful lives or residual values of assets at previous reporting dates, or because it did not use information that it had available at previous reporting dates appropriately, this results in an error in accordance with GRAP 3.

Note: This response assumes that the assets in question are used for their full economic life by the entity and thus have no residual value.

2.4 How should cell phone contracts be accounted for?

Cell phone contracts are negotiated for a period of time with mobile phone operators, and often include the provision of a handset as well as a specified amount of talk-time or SMSs. An entity must assess each contract to determine the appropriate accounting treatment. In particular, an entity assesses whether:

- the contract involves the purchase of an asset and related services for an agreed period of time; or
- the arrangement involves the use of an asset over a period of time, considering the principles in GRAP 13 on *Leases*.

The accounting may vary between entities depending on the specific terms of each contract.

2.5 How does an entity distinguish heritage assets from “old assets”?

Entities frequently own items of property, plant and equipment, intangible assets, inventories and other types of assets that are old but are still being used functionally. For example, an entity may own old furniture such as desks and chairs that are being used for administrative purposes and meet the definition of property, plant and equipment.

“Old assets” are not the same as “heritage assets”. “Heritage assets”, as defined in GRAP 103 on *Heritage Assets* are assets that have cultural, historical, environmental, natural, scientific or technological significance that are held indefinitely for the benefit of present and future generations.

One of the key features of heritage assets is that they are held indefinitely for the purposes of preserving such assets for the benefit of present and future generations. This means that entities often incur expenditure to preserve and extend the life of an asset so that it can be enjoyed by future generations. As a result of the preservation of heritage assets, their value often increases over time, making the effect of depreciation negligible.

The purpose of holding items of property, plant and equipment and other assets is for them to be used in executing an entity's activities. As a result, these assets are “consumed” over time or as they are used.

Entities should therefore ascertain what the purpose is of holding various assets in determining whether they should be treated as “heritage assets” or as other assets in accordance with the relevant Standards of GRAP.

2.6 How should municipalities account for conventional or pre-paid electricity meters?

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A municipality considers whether meters meet the definition of inventory (an asset held for sale, distribution or consumption in the provision of services) or property, plant and equipment (an asset that is used in the production or supply of goods or services and is expected to be used during more than one reporting period). The accounting may vary between municipalities.

2.7 How does a municipality account for rainwater?

One of the recognition criteria for 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 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.

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Section 3 – Presentation and disclosure

3.1 *Is an entity required to disclose information about IFRSs or IPSASs that are not yet effective?*

GRAP 3.30 requires an entity to disclose information about Standards of GRAP that have been issued but that are not yet effective. In particular, information is required about the 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.

As entities are required to apply the pronouncements of other standard-setters in preparing their financial statements, GRAP 3.30 applies to Standards of GRAP as well as any IPSASs, IFRSs or IFRICs that form part of the GRAP Reporting Framework (see Directive 5 on *Determining the GRAP Reporting Framework*). Information should be disclosed only for those IPSAS, IFRSs or IFRICs specifically listed in the Appendices to Directive 5.

3.2 *Are entities required to present a comparison of its actual and budgeted information for the 2010/11 reporting period? (Also see FAQ 1.6)*

Public entities

GRAP 1 requires entities to provide information about whether resources were obtained and used in accordance with the legally adopted budget (paragraph .11) and outlines how this requirement may be met (paragraphs .12-.14).

GRAP 24 on *Presentation of Budget Information in Financial Statements*, which is not yet effective, prescribes detailed requirements for comparing actual and budgeted information. Once GRAP 24 becomes effective, paragraphs .11-.14 of GRAP 1 will be repealed and superseded by the requirements of GRAP 24.

However, until GRAP 24 becomes effective entities are required to comply with GRAP 1.11-.14. The requirement to provide information about whether resources acquired were used in accordance with the legally adopted budget, is typically met by presenting a comparison of budgeted and actual information. GRAP 1 currently states that this can be done in two ways:

- Where the financial statements and budget are on the same basis of accounting, a comparison of the budget and actual amounts for the reporting period shall be included in the financial statements (paragraph .12).
- Where the financial statements and budget are not on the same basis of accounting, a reconciliation between the statement of financial performance and the budget shall be included in the financial statements (paragraph 14).

A direct comparison between the financial statements and budget as described in paragraph .12 is only useful if the financial statements and budget use exactly the same classification and accounting basis.

The approach in paragraph .14 can be met by preparing a reconciliation of the budget and the statement of financial performance in the notes to the financial statements. GRAP 24 can be used as guidance to assist entities in preparing this reconciliation.

The Office of the Accountant-General at National Treasury has issued guidance on the recommended disclosure for the 2010/11 reporting period (please visit <http://oag.treasury.gov.za>).

Municipalities and municipal entities

GRAP 1 requires entities to provide information about whether resources were obtained and used in accordance with the legally adopted budget (paragraph .11) and outlines how this requirement may be met (paragraphs .12-.14).

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GRAP 24 on *Presentation of Budget Information in Financial Statements*, which is not yet effective, prescribes detailed requirements for comparing actual and budgeted information. Once GRAP 24 becomes effective, paragraphs .11-.14 of GRAP 1 will be repealed and superseded by the requirements of GRAP 24.

However, until GRAP 24 becomes effective entities are required to comply with GRAP 1.11-.14. The requirement to provide information about whether resources acquired were used in accordance with the legally adopted budget, is typically met by presenting a comparison of budgeted and actual information. GRAP 1 currently states that this can be done in two ways:

- Where the financial statements and budget are on the same basis of accounting, a comparison of the budget and actual amounts for the reporting period shall be included in the financial statements (paragraph .12).
- Where the financial statements and budget are not on the same basis of accounting, a reconciliation between the statement of financial performance and the budget shall be included in the financial statements (paragraph 14).

A direct comparison between the financial statements and budget as described in paragraph .12 is only useful if the financial statements and budget use exactly the same classification and accounting basis.

The approach in paragraph .14 can be met by preparing a reconciliation of the budget and the statement of financial performance in the notes to the financial statements. GRAP 24 can be used as guidance to assist entities in preparing this reconciliation.

The Office of the Accountant-General at National Treasury will issue guidance on the recommended disclosure for the 2010/11 reporting period.

3.3 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.

3.4 Can an entity disclose information required or encouraged in the Standards of GRAP in appendices?

GRAP 1.09 states the following:The notes to the financial statements may include items referred to as "schedules", "annexures", or "appendices".

Entities may therefore disclose information required or encouraged by the Standards of GRAP in schedules, annexures or appendices to the financial statements. Entities should however clearly indicate whether such schedules, annexures or appendices are part of the financial statements, e.g. by referring the relevant accounting policies and/or notes to the annexures (and vice versa).

Information contained in schedules, annexures or appendices that are not part of the financial statements should clearly be distinguished from information that is part of the financial statements.

Entities should also consider the placement of such schedules, annexures or appendices in the financial statements. For example, it may be appropriate to include those schedules, annexures or



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appendices that are part of the financial statements directly after the notes to the financial statements, and before any other information that is not part of the financial statements.

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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. For the 2010/11 reporting period, entities should apply the principles in GRAP 23 in formulating an appropriate accounting policy for the recognition and measurement of revenue arising from non-exchange transactions, which may represent a change in accounting policy.

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

- IAS 20 prescribed 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 2009/10 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 3.19(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 3.22-.31.

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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 3.22].
- 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 position, or by adjusting the opening balance of accumulated surplus or deficit for the earliest period presented).[See GRAP 3.22]

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, position and net assets.

4.2 How should entities account for revenue related to donated assets, e.g. land and buildings?

Where entities acquire assets through donation and pay no or nominal consideration, they are acquired in a “non-exchange transaction”. Entities account for assets acquired in a non-exchange transaction by formulating an accounting policy using the recognition, measurement and presentation requirements of GRAP 23.

An entity would recognise assets acquired in a non-exchange transactions when they can demonstrate that it controls the asset, it is probable that economic benefits or service potential will flow to the entity, and the asset can be measured reliably [GRAP 23.28-.34]. Assets acquired in non-exchange transactions are measured at fair value in accordance with GRAP 23 and other Standards of GRAP.

In recognising the “credit” side of the transaction, an entity would assess whether the receipt of the asset is a result of a contribution from owners [GRAP 23.35-.36], or results in a liability [GRAP 23.48-.56] or revenue [GRAP 23.42-.45].

Where no condition exists (i.e. there is no requirement to use the asset in a certain way or return it to the transferor) on the assets acquired through the donation, revenue is recognised when the asset is recognised. Where a condition exists, a liability is recognised when the asset is recognised. As and when the conditions are satisfied, the liability is reduced and revenue recognised.

Municipalities and municipal entities

4.3 How should a municipality account for equitable share allocations and conditional grants?

Municipalities are required to use the provisions of GAMAP 9.29-.35 and .39-.54 for the recognition, measurement and disclosure of non-exchange revenue². GAMAP 9.42-.43 state the following regarding the treatment of government grants:

² GRAP 9.44 states that: “Until such time as the Standard of GRAP on *Non-exchange Revenue (Taxes and Transfers)* is effective, paragraphs .29 to .35, .39 to .54, .61(b)(iii), (vi), (viii), (ix) and .62 (a) & (b) of GAMAP 9 will form part of this

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Government grants

- .42 Government grants can be in the form of grants to acquire or construct fixed assets (capital grants), grants for the furtherance of national and provincial government policy objectives and general grants to subsidise the cost incurred by entities in rendering services. Capital grants and general grants for the furtherance of government policy objectives are usually restricted revenue in that stipulations are imposed on their use.
- .43 Government grants are recognised as revenue when:
- it is probable that the economic benefits or service potential associated with the transaction will flow to the entity,
 - the amount of the revenue can be measured reliably, and
 - to the extent that there has been compliance with any restrictions associated with the grant.
- .44 An entity needs to assess the degree of certainty attached to the flow of future economic benefits or service potential on the basis of the available evidence. Certain grants payable by one level of government to another are subject to the availability of funds. Revenue from these grants should only be recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. An announcement at the beginning of a financial year that grants may be available for qualifying entities in accordance with an agreed programme may not be sufficient evidence of the probability of the flow. Revenue should only be recognised once evidence of the probability of the flow becomes available.
- .45 Restrictions on government grants may result in such revenue being recognised on a time proportion basis. For example, equitable share grants per the Division of Revenue Act where the period of use of such funds is stated, should be recognised on a time proportion basis, i.e. over the stated period. Where there is no restriction on the period, such revenue should be recognised on receipt or when the Act becomes effective, whichever is earlier.
- .46 In certain circumstances government will only remit grants on a re-imburement basis. Revenue should therefore be recognised when the qualifying expense has been incurred and to the extent that any other restrictions have been complied with and not when the grant is received.

While GAMAP 9 refers to restrictions and stipulations, it is not specific about how or if these would give rise to a liability. GRAP 23.12-.23, read with the definitions of “conditions on transferred assets” and “restrictions on transferred assets” in GRAP 23.05, provides guidance on circumstances in which a liability arises from stipulations imposed on grants and other types of transfers. These paragraphs may be used by municipalities in formulating an accounting policy on grants, appropriations and other transfers received in a non-exchange transaction if the guidance in GAMAP 9 is insufficient.

Municipalities are given both equitable share allocations and conditional grants through the annual Division of Revenue Act (DORA). The accounting treatment may be different for equitable share allocations and conditional grants because conditional grants are usually provided to municipalities to achieve specific objectives. As a result, “restrictions” are generally placed on the use of conditional grants in the DORA.

Equitable share allocations

Note: The discussion that follows is based on legislation and GAMAP 9 only. Municipalities should in all instances assess whether actual circumstances require a different accounting treatment.

The following common features are associated with equitable share allocations:

- The annual DORA outlines the equitable share allocations to be received by municipalities for a particular municipal reporting period, which are published in schedules to the DORA. This provides municipalities with evidence about the amount (measurement) of equitable share allocations for a particular reporting period.

Standard. “ As these paragraphs form part of GRAP 9 they should be applied for non-exchange revenue transactions regardless of whether GAMAP 9 was applied previously by municipalities.

FAQ's on the Standards of GRAP

- The DORA indicates that should any shortfall arise in the amount of taxes collected by the revenue fund, such losses will be borne by the revenue fund. This provides municipalities with information about the probability of receipt of equitable share allocations for a particular period.
- The DORA does not impose any restrictions on equitable share allocations granted to municipalities, either in terms of their receipt or use, and does not specify that the equitable share allocations should be used over a specific time period. This provides municipalities with evidence about when revenue should be recognised.

Based on the fact patterns outlined above, municipalities should recognise:

- a receivable at the start of the financial year for equitable share allocations to be received for the reporting period (assuming that the DORA has been enacted and no other indications exist that the receipt of the allocation is not probable or cannot be reliably measured)³; and
- revenue at the start of the financial year if no time-based restrictions exist.

Conditional grants

Note: The discussion that follows is generic and is based on common features associated with conditional grants. As the details and requirements of each grant differ, it is important that entities consider the prescripts of the DORA as well as GAMAP 9 in formulating an appropriate accounting policy.

Conditional grants are paid to municipalities to achieve a variety of objectives. Some of the requirements set out in the DORA regarding conditional grants are that:

- The grants are provided to meet specific objectives. Appropriate performance targets are set by the municipalities and are used by both the municipality and the transferring entity to measure whether the objectives of the grant are being met.
- Any unspent conditional grants revert to the National Revenue Fund unless proof can be provided by the municipality that the excess has been committed to identifiable projects.
- The transfer of funds to municipalities in relation to conditional grants may be suspended under certain circumstances.

Initial recognition

Assuming that a municipality has met the qualifying criteria to receive a conditional grant (if any exist) and the receipt of the grant is probable, conditional grants are recognised at the start of the financial year⁴.

At initial recognition, a municipality will recognise:

- a receivable for the amount of the conditional grants to be received; and
- a liability or revenue. The circumstances in which a municipality recognises a liability or revenue will depend on whether its accounting policies are based on GAMAP 9, or GAMAP 9 with some consideration of the principles in GRAP 23 (where GAMAP 9 provides insufficient guidance). For example:

³ The DORA often indicates that payments will be made at specified dates (for both equitable share allocations and conditional grants). These dates merely specify the “payment arrangement” between the transferor and recipient.

⁴ Note: Some conditional grants are only available to entities through an application process and after satisfying certain “eligibility” criteria. In these instances, a municipality recognises revenue once these criteria have been met and receipt of the conditional grant is probable.

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- If a municipality applied GAMAP 9 only, it would recognise a liability if restrictions exist on the use of the resources received.
- If a municipality applied GAMAP 9 and also considered the requirements of GRAP 23, it may recognise a liability only if restrictions exist on the use of the resources received and it is required to repay any funds not utilised in accordance with those restrictions.

Subsequent measurement

Any liability recognised would be decreased and revenue recognised as and when the municipality complies with the restrictions of the grant.

All entities

4.4 How should municipalities account for revenue related to donated assets?

GAMAP 9.47-49 provides guidance on the treatment of “other grants and donations received”. Using the requirements of GAMAP 9.47, a municipality would recognise revenue from a donated asset when it is probable that economic benefits or service potential will flow to the municipality, that the amount of revenue can be measured reliably, and based on the extent to which the municipality has complied with any restrictions on the use of the asset. Assets acquired in non-exchange transactions are measured at fair value.

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

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

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

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

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

- Whether the entity 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 acts as an agent or a principal in such arrangements. In making this assessment, it uses the principles in GRAP 9 *Revenue from Exchange Transactions*. When an entity acts as the principal and is the issuer of the license, it considers step 2 below.

Step 2: Exchange or non-exchange revenue

Where an issuer concludes that it acts as principal in the arrangement, it should consider the definitions of both exchange and non-exchange transactions, defined as follows in the Standards of GRAP:

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

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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 to the license 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/or services provided in an arrangement may vary. Sometimes the goods and/or 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.

Consideration received by the issuer

The extent of the consideration received by the issuer for the goods and/or services provided may also vary from arrangement to arrangement. The issuer should therefore consider the value of the goods and/or 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/or 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)⁶.
- Where the consideration received by the issuer is less than the goods and/or 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:

⁶ An entity should apply judgement in these circumstances as it may be that an entity provides goods and/or services at a profit. These arrangements would not necessarily result in non-exchange revenue.

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4.6 Is VAT receivable or payable an exchange or a non-exchange receivable or payable?

GRAP 1.79(g),(h),(j) and (k), requires an entity to separately disclose receivables and payables from exchange and non-exchange transactions on the statement of financial position.

VAT is an indirect tax based on consumption of goods and services in the economy. Revenue is raised for the government by requiring certain traders or vendors to register and to charge VAT on taxable supplies of goods or services. The essential characteristics of VAT are:

- it is charged at each stage of the production and distribution process;
- the taxable person (vendor) may deduct the tax paid during the preceding stages; and the burden of the tax is on the final consumer.

The non-exchange transaction is the transaction concluded between the person or entity imposing the tax (national government) and the consumer of goods and services in the South African economy. Where an entity sells final goods and services to consumers, it is responsible to collect taxes from its consumers for the goods and services provided. In collecting and remitting VAT to the national government, an entity acts as an agent. Consequently, VAT receivable or payable is deemed to be an exchange rather than a non-exchange transaction.

Similarly, other types of taxes which are collected by entities as agents, for example, employees' tax and UIF contributions, can be seen as exchange rather than non-exchange transactions.

FAQ's on the Standards of GRAP

Section 5 – Accounting for Employee Benefits

5.1 *How should vacation leave be accounted for?*

(Important: 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-vested⁷. “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 a 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.

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.

⁷ For purposes of this discussion, it is assumed that vacation leave is accumulating.

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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 (a) be 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 19.107 must be adhered to.

5.2 Must an entity appoint an actuary at every reporting date to measure its defined benefit obligations?

IAS 19.57 states the following: “The Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations.”

IAS 19 does not require the use of an actuary; it is merely encouraged. Given the complexity of these calculations, management needs to ensure that whoever performs the valuation of the defined benefit obligations has the necessary skill and expertise.

Entities frequently implement policies that involve the use of external actuaries and internal staff. As an example, an entity may appoint an actuary to carry out valuations periodically, e.g. every 5 years, and then use internal staff to “roll forward” the valuations in the years that an external valuation is not performed.

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These types of techniques are acceptable if they comply with the requirements of IAS 19.56 which states that: "An entity shall determine the present value of the defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period".

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Section 6 – Sundry Accounting Issues

6.1 *How are prepayments for goods and services accounted for?*

Entities may frequently make payments to third parties for goods and services to be provided to them. Often, these prepayments may be settled over a number of years.

The substance of the arrangement is that by making an advance payment to a third party, an entity has a right to the receipt of goods and services in the future. As these arrangements involve a right to receive goods and services rather than cash or a financial asset, they are not financial assets and consequently cannot be accounted for using IAS 32, 39 and IFRS 7.

While GRAP 102 on *Intangible Assets* deals with the accounting treatment of rights created through contracts and other means, it is not specific about the treatment of prepayments for goods and services.

As no standard or pronouncement within Directive 5 deals directly with the treatment of prepayments for goods and services, entities should formulate an accounting policy based on:

- Standards of GRAP for which similar transactions exist;
- The *Framework for the Preparation and Presentation of Financial Statements*.

As prepayments are assets, entities should consider whether principles such as discounting (for example, where the prepayment will be settled over more than one reporting period) and impairment (if there is uncertainty about whether the goods and services will in fact be received) need to be considered in formulating an accounting policy.

6.2 *How does a municipality account for arrangements for the construction of RDP houses?*

Note: This question arose in the municipal environment. It may be appropriate for other entities that undertake similar transactions to consider this FAQ.

Municipalities are frequently involved in the construction of houses as part of the reconstruction and development programme. A municipality determines the appropriate accounting treatment by examining the specific contracts concluded with the relevant parties and considering any applicable legislation.

A municipality would specifically consider whether:

- It acts as a contractor and the construction of the RDP houses meets the definition of a construction contract in terms of GRAP 11 on *Construction Contracts*. In this scenario, the municipality must have been appointed as the contractor, i.e. it must have been appointed to provide services related to the construction of an asset (in this case, the RDP houses).
- It is selling or distributing inventory, either directly to beneficiaries in a housing programme or to another public sector entity. In these instances, a municipality would also consider whether any revenue generated from these arrangements is exchange or non-exchange in nature.

6.3 *How should a municipality account for goods and services provided to indigents?*

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

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

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

Rebates for property rates

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.

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”.

Rebates are reductions in the amount of taxes payable. 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 .71 and .72, provide the following guidance for tax expenditures:

- .71 Taxation revenue shall not be grossed up for the amount of tax expenditures.
- .72 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 granted.

Free Basic Services

Where a municipality provides free basic services, the intention is not to collect any revenue from the provision of such services. As there is no intention to collect any revenue, GRAP 9 should not be applied. Municipalities should:

- not recognise revenue for such transactions in the statement of financial performance;
- recognise an expense for the services provided in the statement of financial performance; and
- consider the requirements of GRAP 1 and the Framework in determining whether any disclosures about such transactions are necessary in the notes to the financial statements.

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 on *Revenue from Exchange Transactions*, IGRAP 9 on *Applying the Probability Test on the Initial Recognition of Exchange Revenue* and the relevant standards or pronouncements on financial instruments should be applied in accounting for such transactions.

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 on *Revenue from Non-exchange Transactions (Taxes and Transfers)*.

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

Classification and/or 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 are 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 the municipality enters into 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.

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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 asset 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/or 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 102). For example, liquor licences acquired should be accounted for in terms of the GRAP 102 to the extent that the entity has met the recognition criteria in the Standard.

Agreements with third parties

During the construction of new Stadiums, and/or the upgrading of existing Stadiums to host the World Cup, some entities may have entered into agreements with third parties concerning the construction and/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 entered into a PPP agreement as regulated in

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legislation, the principles in the Guideline could still be applicable, by analogy, to arrangements that have the same characteristics of a PPP agreement, for example a public – public agreement .

The Guideline requires that if the control approach criteria is 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 and/or upgrading done to the Stadium on its behalf. The scheduled payments to the third party relating to the construction and/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 and/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 and/or upgrade activities involving 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*.

Lease agreements

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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 as an 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 remains 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.

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.