

Departmental Financial Reporting Framework



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

COMBINED
FINANCIAL
STATEMENTS

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1. Introduction

1.1 Objective and legislative requirements

In South Africa, the government is divided into three spheres, namely the national, provincial and local spheres of government. Constitutionally each sphere has a level of autonomy, i.e. it can decide how it will achieve its objectives both financially and operationally. The Public Finance Management Act (PFMA), 1 of 1999 recognises this autonomy and for accountability purposes requires the national government and each province to prepare and publish a consolidated financial report on the utilization of its resources to achieve its objectives.

The relevant sections of the PFMA are provided below:

Section 8(1)(a): The National Treasury must prepare consolidated financial statements in accordance with generally recognised accounting practice for each financial year in respect of—

- (i) national departments
- (ii) public entities under the ownership control of the national executive;
- (iii) constitutional institutions;
- (iv) the South African Reserve Bank;
- (v) the Auditor-General; and
- (vi) Parliament.

Section 19(1)(a): A provincial treasury must prepare consolidated financial statements, in accordance with generally recognised accounting practice, for each financial year in respect of—

- (i) provincial departments in the province;
- (ii) public entities under the ownership control of the provincial executive of the province; and
- (iii) the provincial legislature in the province.

From the above it is clear that the national and provincial spheres of government must prepare a consolidation encompassing all of the entities that contribute towards achieving their objectives. The basis of preparation is as described above, “in accordance with generally recognised accounting practice”.

Generally recognised accounting practice is defined in the PFMA as “an accounting practice complying in material respects with standards issued by the Accounting Standards Board.” The Accounting Standards Board (ASB) issued GRAP 6 on Consolidated and Separate Financial Statements which outlines the principles for preparing a consolidation.

Ordinarily this accounting standard would be applied by each of the treasuries in preparing the consolidation. However due to the different bases of accounting applied by departments (modified cash) and public entities/constitutional institutions (accrual) compliance with GRAP 6 is difficult to apply.

In 2005 the treasuries decided that the most suitable interim solution would be to prepare separate reports for entities on the modified cash basis and those entities on an accrual basis of accounting. To date the methodologies followed by the treasuries have not been formalized.

The purpose of this document is to prescribe the “generally recognised accounting practice” to be followed by the national and provincial treasuries.

1.2 Current process applied by the treasuries

The table below summarises the scope of the two reports issued by the treasuries on an annual basis:

	Departmental Consolidation	Entity Aggregation
Coverage (boundary)	All departments & revenue fund (including Parliament and provincial legislatures)	All public entities (listed or otherwise) All identified trading entities, trusts or other types of legal entities which fall under the control of government
Basis of accounting	Modified cash (all accounting policies are aligned)	Accrual using: <ul style="list-style-type: none"> • Standards of GRAP; • Statements of GAAP; • IFRS; (consistency of accounting policies unknown)
“Consolidation” process	Combine financial statements line by line by adding like items of assets, liabilities, net assets, revenue and expenses together (information collected from template submitted)	Combine financial statements line by line by adding like items of assets, liabilities, net assets, revenue and expenses (information collected from template submitted)
Elimination process	Revenue and expenditure between the departments and the revenue fund is eliminated in full. Limited elimination of inter-departmental services.	No elimination of inter-entity transactions / balances. (the extent of such transactions / balances are not considered)
Reporting dates of individual entities	All have 31 March year-ends	All have 31 March year-ends with exception of the water boards with a 30 June year-end. These entities submit management accounts for the period ending 31 March

1.3 Due dates and timelines

The process is driven by the PFMA provisions dealing with the preparation, audit and tabling of the final statements:

Ref	
40(1)(c) 55(1)(c)	The accounting officer / accounting authority must submit the financial statements within two months [end May] after the end of the financial year to <ul style="list-style-type: none"> - the Auditor General for auditing; and - the relevant treasury to enable the treasury to prepare consolidated financial statements
8(1)(b) 19(1)(b)	The National / Provincial Treasury must submit the consolidated financial statements for audit to the Auditor General within three months [end June] after the end of that financial year.
40(2)	The Auditor General must audit the departmental financial statements and submit an audit report to the accounting officer within two months [end July] of receipt of the statements.
40(1)(d) 55(1)(d)	The accounting officer / accounting authority must submit within five months [end August] of the end of the financial year to the relevant treasury the financial statements for that financial year after those statements have been audited.*
8(2) 19(2)	The Auditor General must audit the consolidated financial statements and submit an audit report on the statements to the National / Provincial Treasury within three months [end September] of receipt of the statements.
8(3) 19(3)	The Minister / MEC must submit the consolidated financial statements and the audit report on those financial statements within one month [end October] of receiving the report from the Auditor General, to Parliament / Provincial Legislature for tabling.
8(4) 19(4)	The consolidated financial statements must be made public when submitted to Parliament / Provincial Legislature.

* under section 6(2)(g) the National Treasury requires public entities to submit their audited financial statements (in the form of the prescribed template) by end July.

2. Identifying the accounting principles

2.1 Consolidated vs. combined financial statements

Consolidated financial statements are defined in GRAP 6 as the financial statements of an economic entity presented as those of a single entity. An economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

At a provincial level the economic entity would comprise of all institutions under the control of the executive (i.e. the Premier and the Executive Council). This would include the revenue fund, the departments and all public entities, trading entities and trusts¹.

Similarly the “national” economic entity would comprise of all institutions under the control of the President and Cabinet such as the revenue fund, the departments and government components, as well as all public entities, trading entities and trusts.

From the discussion in Section 1 it is clear that it is not presently possible to prepare a single consolidation for each economic entity (i.e. the national and each provincial sphere of government). The interim solution splits the economic entity into two parts – the consolidation of departments and the aggregation of entities. These two reports don’t meet the definition of an economic entity and thus making it impossible to call either one of them a “consolidation”.

An alternate solution is to consider the concept of “combined” financial statements. Combined financial statements are the aggregate of the financial statements of entities which fail to meet the definition of an economic entity. The entities within the combined financial statements are usually under common control but have no controlling entity.

The IFRS for SME’s provides guidance to entities that elect to prepare combined financial statements. These requirements, along with a comparison to GRAP 6 are summarized below.

	IFRS for SMEs (combination)	GRAP 6 (consolidation)
Consolidation / combination procedures	<ul style="list-style-type: none"> All intercompany transactions and balances must be eliminated Profits or losses resulting from intercompany transactions that are recognised in assets must be eliminated in full 	<ul style="list-style-type: none"> Balances, transactions, revenues and expenses between entities within the economic entity must be eliminated in full Surpluses and deficits resulting from transactions within the economic entity that are recognised in assets must be eliminated in full
	<ul style="list-style-type: none"> The financial statements of the entities included in the combined 	<ul style="list-style-type: none"> The financial statements of the individual entities must be

¹ Only applicable when the trust is controlled by an entity within the sphere of government (e.g. a department or public entity).

	IFRS for SMEs (combination)	GRAP 6 (consolidation)
	financial statements must be prepared as of the same reporting date (unless it is impracticable to do so)	prepared as at the same date. When the end of the reporting period of a controlling entity is different from that of the controlled entity, additional financial statements as of the same date should be prepared unless it is impracticable to do so
	<ul style="list-style-type: none"> Uniform accounting policies must be followed for like transactions and other events in similar circumstances 	<ul style="list-style-type: none"> Uniform accounting policies must be followed for like transactions and other events in similar circumstances
	<ul style="list-style-type: none"> No elimination is required, as there is no controlled entity No non-controlling interests are identified 	<ul style="list-style-type: none"> The carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of the net assets of each controlled entity must be eliminated The non-controlling interests must be identified

The main difference between the IFRS for SMEs and GRAP 6 is the elimination of the investments. This would however not be applicable in the departmental consolidation or entity aggregation.

It is therefore possible to apply the principles in the IFRS for SMEs with regards to combined financial statements as an interim solution without departing significantly from the principles that will be required in the future when GRAP 6 will be fully implemented.

For the purpose of this document the entities within the combined financial statements will be referred to as a "group" or "group of entities".

2.2 Combined financial statements of departments

Each treasury will prepare combined financial statements for all departments including the revenue fund, Parliament and the provincial legislatures as well as government components applying the modified cash basis of accounting. Accounting policies should be consistent with the Department Financial Reporting Framework Guide.

The financial statements of each entity within the group must be combined on a line by line basis by adding like items of assets, liabilities, net assets, revenue and expenses together, this includes information in the disclosure notes which are an integral part of the modified cash basis of accounting.

All entities within the group have a 31 March year end. Therefore there is no need to perform additional procedures in this regard.

The basis for preparation paragraph will thus be:

The combined financial statements have been prepared in accordance with the framework issued by the National Treasury in terms of section 18 of the Treasury Regulations, March 2005.

Combined financial statements incorporate the financial statements of all [departments and the revenue fund] OR [public entities] within the [national / provincial] sphere.

Identification and elimination of inter-entity balances and transactions

Each entity in the group is responsible for the identification of inter-entity transactions and balances that have occurred during the period. This guide identifies the main elimination entries, further entries may be supplied as and when identified.

Inter-entity transactions and balances between departments and the revenue fund

Appropriated funds

All appropriations received from the revenue fund are classified as inter-entity transactions and should therefore be eliminated in the combined financial statements as follows:

<i>Elimination of appropriated funds (annual & statutory appropriations)</i>	Debit	Credit
Annual Appropriation* Statutory Appropriation	R xxx <i>The revenue in the AFS of the individual department</i>	
Transfers to departments		R xxx <i>The expenditure recorded in the revenue fund</i>

* This includes conditional grants received by the provincial revenue fund from a national department which is then transferred to the provincial department.

Where the revenue fund still owes a department funds at year-end the payable (in the revenue fund) and the receivable (in the department) is eliminated as follows:

<i>Elimination of appropriated funds due to departments</i>	Debit	Credit
Funds due to departments	R xxx <i>The creditor in the revenue fund</i>	
Voted funds to be surrendered to the revenue fund ("voted funds not requested/not received")		R xxx <i>The debtor in the individual department's books</i>

Where a department has to surrender the unspent portion of the appropriation to the revenue fund at the end of the financial year, the receivable (in the revenue fund) and the payable (in the department) is eliminated as follows:

<i>Elimination of appropriated funds due from departments</i>	Debit	Credit
Voted funds to be surrendered to the revenue fund*	R xxx <i>The creditor in the department's books</i>	
Departmental funds to be surrendered*		R xxx <i>The debtor in the revenue fund</i>

* The above will include funds which should be surrendered resulting from unauthorized expenditure (where applicable).

Departmental Revenue

Departmental revenue is an inter-entity transaction between the department and the revenue fund. This is due to the PFMA requirement that all departmental revenue must be surrendered to the revenue fund.

At the end of the financial year the amount owing to the revenue fund (usually the March receipts) will be eliminated as follows:

<i>Elimination of departmental revenue due to the revenue fund</i>	Debit	Credit
Departmental revenue to be surrendered to the revenue fund	R xxx <i>The creditor in the individual department's books</i>	
Departmental revenue to be received		R xxx <i>The debtor in the revenue fund</i>

Inter-entity balances between departments in the group

There is a rebuttable assumption that there are no inter-entity transactions between departments that must be eliminated in the combined financial statements. Inter-entity transactions arise where one department recognizes revenue for the services rendered and the other department recognises an expense for the cost of services rendered. All departmental revenue arises from the sale of goods and services to individuals and or entities outside the group.

Thus the departments need only identify inter-entity balances that must be eliminated. Inter-entity balances arise where a department procures or pays for a service on behalf of another department and is reimbursed for the expense incurred or collects revenue on behalf of another department which it has to

pay over to that department. The department that renders the service will record a receivable for the cost of the service (the reimbursement will not be reflected as departmental revenue and the expense will not be recognized as expenditure in the records of the service provider).

For the purpose of compliance with this framework, all inter-entity transactions between departments must be eliminated when and only when both departments have a balance on the statement of financial position and to the extent that the balances have been confirmed and agreed.

More specifically, if Department A has a receivable of R1,000 and there is no corresponding payable in Department B's statement of financial position then no elimination is performed. Furthermore, if Department B has a payable of R800 then the treasury will eliminate R800 and the receivable of R200 will remain in the consolidated statement of financial position.

Illustrative example 1: The Department of Works, Roads and Transport constructs a clinic on behalf of the Department of Health at a cost of R15 million. The funds for the construction of the clinic are on the budget of the Department of Health. On completion, the asset will be owned and operated by the Department of Health.

Accounting entries during construction (assuming that payments were made throughout the construction of the clinic):

<i>Department of Works, Roads and Transport as and when it incurs the cost of construction</i>	Debit	Credit
Claims recoverable	Rxxx	
Bank		Rxxx

<i>Department of Health as and when it reimburses the Department of Works, Roads and Transport</i>	Debit	Credit
Payments for capital assets*	Rxxx	
Bank		Rxxx

**This is the classification in the financial statements. The appropriate account in the item, asset and project segment would have been selected to ensure this classification.*

The asset was completed in March 2012, the final invoice of R5 million was sent to the Department of Health on 2 April 2012. Therefore at the end of the financial year, the Department of Works, Roads and Transport would have a balance of R5 million due from the Department of Health.

Scenario A: Department of Health has a recognised payable

The Department of Health recorded the inter-departmental balance in its financial statements due to the fact that the balance was confirmed with DPW. In this instance the Department of Health would have recorded the following entry:

<i>Recording of confirmed inter-departmental balance by the Department of Health</i>	Debit	Credit
Payments for capital assets	R5 million	
Claims payable		R5 million

The eliminating journal entry will be as follows:

<i>Elimination of the inter-departmental receivable and payable</i>	Debit	Credit
Claims payable	R5 million	
Claims recoverable		R5 million

Scenario B: Department of Health has partially recognised payable

The Department of Health recorded the inter-departmental balance of R3,5 million in its financial statements due to the fact that the balance was confirmed with DPW. In this instance the Department of Health would have recorded the following entry:

<i>Recording of confirmed inter-departmental balance by the Department of Health</i>	Debit	Credit
Payments for capital assets	R3,5 million	
Claims payable		R3,5 million

The eliminating journal entry will be as follows:

<i>Elimination of the inter-departmental receivable and payable</i>	Debit	Credit
Claims payable	R3,5 million	
Claims recoverable		R3,5 million

The R1,5 million will remain as a receivable in the combined financial statements.

2.3 Combined financial statements of entities

Each treasury will prepare combined financial statements of all public entities and identified trading entities & trusts & any other entities under common control of the sphere of government applying the accrual basis of accounting. Each treasury is responsible for identifying the entities to be included in the group.

A treasury should refer to GRAP 6, the section on *establishing control of another entity for financial reporting purposes* where there is uncertainty as to whether an entity should be included in the group. If an entity is controlled by a department or public entity it should be included in the group.

The financial statements of each entity within the group must be combined on a line by line by adding like items of assets, liabilities, net assets, revenue and expenses together.

Uniform accounting policies

The template issued by the Office of the Accountant-General sets the accounting policies for recognition and measurement of the information to be included in the combined financial statements. These accounting policies are the “group accounting policies”. Each entity should ensure that it submits the information in accordance with the applicable accounting policy.

It is therefore important for both the entities and the treasuries to participate in the development of this template to ensure that the policies set in the template are as close as possible to the ones used by the entities in their separate financial statements thus minimizing the number of adjustments required in the combined financial statements. Where alternate accounting policies are applied by an entity the entity will be required to submit the adjusting journal entry that needs to be processed in the combination process.

Accounting policy vs. accounting estimate

An accounting policy sets the way in which a transaction and or event is recognized and measured in the financial statements. In measuring a transaction and or event, an entity may need to make an estimate. Estimates are determined after considering the present status of, and expected future benefits and obligations associated with the asset or liability being measured. Estimates are often entity specific whereas accounting policies can be similar across entities.

As mentioned above, the information included in the combination must be prepared in accordance with the same accounting policies. Estimates within the group may vary and need not be consistent.

Illustrative example 1: same accounting policies, different accounting estimates

Public entity A and public entity B both depreciate motor vehicles on a straight line basis (which is also the accounting policy for the combined financial statements). Entity A estimates that the useful life of its motor vehicles is 3 years whereas Entity B estimates that the useful life of its motor vehicles is 7 years. Both entities will thus have different annual depreciation charges.

No adjustment is required in the combined financial statements as the accounting policy applied by both entities is consistent with the group accounting policies. The difference in the depreciation is merely a difference in the way in which the entities within the group expect to consume their assets given their own asset management practices and or circumstances.

Reporting dates of entities within the group

Information submitted for inclusion in the combined financial statements must be as at the same reporting date. Where the reporting date of a public entity differs the relevant treasury should obtain management information in addition to the latest financial statements of the entity in order to ensure that the combined financial statements are as complete as possible.

Identification and elimination of inter-entity balances and transactions

Each entity in the group is responsible for the identification of inter-entity transactions and balances that have occurred during the period. This information should accompany the template that is submitted for combination purposes. The information should contain the name and nature of the entity with whom the transaction was concluded.

All material inter-entity balances should be eliminated. The treasury should establish a threshold to aid in the identifying material amounts to be eliminated. This amount could be determined using the principles set out in Chapter 1 of the *Departmental Reporting Framework Guide*.

In order to perform correct eliminations, inter-entity balances need to be confirmed beforehand to ensure that the amounts agree. In the event that an inter-entity balance does not agree, the debtor balance will be deemed to be correct.

Similarly, in the event that an inter-entity transaction does not agree to the corresponding debit or credit amount, the **credit balance** will be deemed to be correct. The corresponding **debit value** will then be adjusted with the difference being taken to accumulated surplus/deficit. The inter-entity transactions may then be eliminated.

Illustrative example 2: transactions between two public entities – sale of assets

Public entity A sells part of its equipment to public entity B (it is not A's business to sell equipment). The equipment is sold for R150 000 and the carrying amount was R130 000. The remaining useful life of the equipment is 5 years

- Eliminate the inter-entity profit of R20 000 (R150 000 – R130 000) using the following journal

	Debit	Credit
Profit on sale of assets	R20 000	
Equipment		R20 000

- Reverse the extra depreciation accounted for by public entity B (R150 000 – R 130 000)/5

	Debit	Credit
Accumulated depreciation	R4 000	
Depreciation		R4 000

Note: There won't be any tax consequences on public entities as they are exempt in terms of s10(1)(cA)(i)

The above adjusting journal would need to be passed in each financial year until the asset is fully depreciated or disposed of outside the group.

Illustrative example 3: transactions between the public entities – tourism and parks board has a restaurant in a park and pays the liquor board licence fees

Public Entity A has a restaurant in a park and pays Public Entity B licence fees to the amount of R200 000 for the liquor licence. Both Public Entity A and B are under the control of the provincial government

- Eliminate the inter-entity transaction

	Debit	Credit
Licence fee income	R200 000	
Licence fees		R200 000

Illustrative example 4: Transactions between Public Entity's involving a suspense account

Public Entity A makes a loan to Public Entity B of R100 000 at an interest rate of 9%. The accountant of Public Entity A did not know how to account for finance income transaction and took it to the suspense account.

- Public Entity A and B are within the same structure therefore we must eliminate the intragroup loan and the intragroup finance income and finance cost
- In the separate financial statements of Public Entity A to correct the suspense account:

	Debit	Credit
Suspense Account	R9 000	
Finance Income		R9 000

- The journal in the combined financial statements

	Debit	Credit
Finance income	R9 000	
Finance cost		R9 000

	Debit	Credit
Loan from Public Entity A	R100 000	
Loan to Public Entity B		R100 000

The above adjusting journal would need to be passed in each financial year until the loan is paid up.

Illustrative example 5: Intragroup sales of inventory

Public Entity A sells inventory to Public Entity B at a gross profit of 25%. Sales between the entities amounted to R100 000. At year end the closing inventory was R20 000.

Therefore the entity must eliminate the intragroup sales and the unrealised profit at year end.

	Debit	Credit
Sales	R100 000	
Cost of Sales		R100 000

	Debit	Credit
Inventory	R5 000	
Cost of Sales		R5 000

The above adjusting journal would need to be passed in each financial year until the inventory is either consumed or sold to an external party.

Illustrative example 6: Loans between entities

Public Entity A loans R50 000 to Public Entity B at 5% p.a. repayable in a balloon payment after 5 years.

- Elimination of loan

	Debit	Credit
Loan from Entity A	R50 000	
Loan to Entity B		R50 000

- Elimination of interest incurred

	Debit	Credit
Finance income	R2 500	
Finance costs		R2 500

The above adjusting journal would need to be passed in each financial year until the loan is paid up.

Illustrative example 7: Finance lease between public entities

Public Entity A (the lessee) entered into a lease agreement on 31 March 2010 with Public Entity B (the lessor) to lease a machine for a period of three years. The annual lease payment is R60,000 payable in arrears beginning 1 April 2010 and the rate implicit in the lease is 5 %.

The fair value of the machine is R189,000 and the present value of the minimum lease payments is R163,395 (pmt: R60,000; i: 5 %; n: 3). The carrying amount of the machine in the records of Entity B on 31 March 2010 was R170,000.

The amortization table is as follows:

Date	Payment	Interest	Capital	Balance
31 March 2010				R163,395
1 April 2010	R60 000	R8 170	R51 830	R111 565
1 April 2011	R60 000	R5,578	R54 422	R57 143
1 April 2012	R60 000	R2,857	R57 143	R-
Total	R180 000	R16 605	R163 395	

Public Entity A (lessee)

Original entry – on commencement of the lease:

	Debit	Credit
Finance lease asset	R163 395	
Finance lease liability		R163 395

Journal entries on date of first payment – 1 April 2010

	Debit	Credit
Finance lease liability	R51 830	
Interest expense	R8 170	
Bank		R60 000

Journal entries at end of financial year – 31 March 2011

Balance: R111 565

	Debit	Credit
Depreciation (R163 395 / 3)	R54 465	
Accumulated depreciation		R54 465

Public Entity B (lessor)

Original entry in accounting records of Public Entity B (lessor) – on commencement of the lease:

	Debit	Credit
Gross investment in lease	R180 000	
Unearned finance income		R16 605
Loss on derecognition of asset	R6 605	
Carrying amount of machine		R170 000

Journal entries on date of first payment – 1 April 2010

Net investment R163 995

	Debit	Credit
Bank	R60 000	
Gross investment in lease		R60 000
Unearned finance income	R8 170	
Interest received		R8 170

Elimination Journal entries

- Elimination of finance lease liability and net investment in finance lease

	Debit	Credit
Finance lease liability	R111 565	
Unearned finance income (R16 605 – R8 170)	R8 436	
Gross investment in finance lease (R180 000 – R60 000)		R120 000

- Elimination of loss of derecognition of asset (to “restore” carrying value of asset to value at commencement of lease) – i.e. R170 000

	Debit	Credit
PPE	6 605	
Loss on derecognition of asset		R6 605

- Additional journal entry on depreciation

	Debit	Credit
Depreciation (R170 000 / 3) – R54 465	R2 202	
Accumulated depreciation		R2 202

The above adjusting journal entries will need to be passed in each financial year until the end of the lease agreement.