Despite these difficulties, APSA continues to provide a valuable platform for young researchers who want their initial research articles to be reviewed by leading South African accounting academics.

This issue unintentionally contains an emphasis on integrated reporting, highly relevant in today’s environment and clearly of interest to researchers.

Thus the first article deals with themes of disclosure reported by listed South African companies, but confined to the financial services sector – thus opening the way for further research into the areas which companies are emphasising in their integrated reports.

The second article deals with the types of assurance provided for the disclosures made by companies in their integrated reports. It provides an interesting quantitative sequel to the last article in the previous issue of the journal, a qualitative study giving insight into the views of preparers and auditors with regard to assurance.

The third article addresses the vexing question of materiality in the integrated report, doing so from three different perspectives, or logics, namely professional, market, and stakeholder.

Next, a novel article deals with a topic close to the heart of many chartered accountants - remuneration. Using a triangular approach, it suggests that there is now a growing oversupply of chartered accountants in South Africa.

Finally, we deal with the public sector via an article dealing with the accrual and modified cash bases of accounting in relation to practice in Provincial Departments of Health.

We are grateful that the generosity of Citadel Wealth enabled us to continue with an annual award of R10 000 for the best article in the journal. This was awarded to Pieter Swart for his article on load-shedding in last year’s issue.

We continue to be very dependent on the Universities of Cape Town and the Witwatersrand for contributions (though our reviewer base is much wider) and wish to encourage contributors from other universities and from the accounting profession.

Geoff Everingham and Kurt Sartorius
Editors
December 2016
STAKEHOLDER PERCEPTIONS – INTEGRATED REPORT
NOLIN NAYNAR – WITS
PAGES 3 - 10

ASSURANCE OVER INTEGRATED REPORTS
GGOOLAM MODACK, TARYN MILLER
AND JESSICA BADER – UCT
PAGES 11 - 17

UNDERSTANDING MATERIALITY – LOGICS
PHILIPPA JOFFE – WITS
PAGES 18 - 28

THE SUPPLY OF CAS(SA):
A MALTHUSIAN TRAP?
PHILLIP DE JAGER – UCT, AND
PIETER VAN DER SPUY – STELL
PAGES 29 - 35

IMPACT OF USING DIFFERENT ACCOUNTING FRAMEWORKS IN THE PUBLIC SECTOR
ILSE LUBBE AND WANDISILE MKUBUKELI – UCT
PAGES 36 - 44
Exploring company and stakeholder perceptions of what is of value in an integrated report

The success of integrated reporting depends on whether corporate South Africa communicates with its stakeholders to gauge their perceptions, allowing for their interests and expectations to drive the content of the reports. This study will explore the consistencies between the emphasis placed on certain integrated reporting themes by companies within the financial services sector of the Johannesburg Stock Exchange, and the perceived importance of those themes by stakeholders. This research will further explain how the uncertainty of how to apply the guiding principles, together with the adoption of a procedural approach to integrated reporting has resulted in different perceptions of what is of value in an integrated report between companies and their stakeholders.

Nolin Naynar – University of the Witwatersrand

1. INTRODUCTION

According to the International Integrated Reporting Council (IIRC), one of the guiding principles which underpin the preparation of integrated reports is the formation of effective stakeholder relationships (IIRC, 2013). Whether or not this principle is being adequately fulfilled within the integrated reports of South African listed companies has, however, been subject to criticism, with some raising concerns about the relevance of certain non-financial information in creating value for stakeholders (Baker, 2011), and the excessive detail or repetitive information within integrated reports (Solomon and Maroun, 2012). These concerns are shared by the Financial Reporting Council (FRC) and the International Accounting Standards Board (IASB), which have stated that a ‘disclosure-overload problem’ has developed due to too much immaterial information being provided in the integrated reports, inhibiting users from recognising and understanding relevant information (FRC, 2012; IASB, 2013).

This study explores the consistencies between the emphasis placed by JSE listed financial services companies on select integrated reporting themes, and the perceived importance of those themes by stakeholders. Following a similar approach to that used by Gold et al. (2012) this study will consider the views of experts (i.e. chartered accountants and auditors) and final year accounting students, representing both sophisticated and unsophisticated users of integrated reports as surrogates for real-world stakeholders. The findings of this research will then be used to ascertain whether a type of perception gap may exist between corporates and stakeholders in recognising what is deemed to be of value in an integrated report.

Contact: nolin.naynar@wits.ac.za
2. BACKGROUND

2.1 AGENCY THEORY
Companies listed on the Johannesburg Stock Exchange (JSE) encounter a natural separation of ownership due to management owning only a small proportion of the company under their stewardship. Applied in terms of the agency theory, this means that management (agents) engage with stakeholders (principals) to manage the affairs of the company on behalf of the stakeholders (Jensen and Meckling, 1976).

However, the problematic nature of an agency relationship is that, assuming both parties are utility maximisers, management (agents) may pursue their personal interests at the expense of the stakeholders (principals) of the company (Jensen and Meckling, 1976). In order to limit any divergences between the principal and the agent, it becomes necessary for corporate reporting to provide stakeholders with the information they require to assess management’s accountability, as well as their stewardship over the resources of the company (Ravenscroft and Williams, 2009; IIRC, 2013). Integrated reporting is an essential means of addressing this incongruence as it embeds management’s accountability to stakeholders in the operational performance of companies (Solomon and Maroun, 2012; Atkins et al., 2015; Raemaekers et al., 2015).

In order to pioneer the widespread adoption of stakeholder orientated corporate reporting, the JSE mandated the compliance with (or to explain non-compliance) integrated reporting amongst all listed companies via the application of King-III (JSE, 2013; IoD, 2009). This move was lauded by many as it strengthened the usefulness of integrated reports from JSE listed companies, as well as emphasising the fact that the impact of a company on the environment and society is interrelated with its financial performance (King-III, 2013; Atkins et al., 2015).

2.2 THE CHALLENGE OF CREATING SHARED VALUE FOR STAKEHOLDERS
The IIRC states that the objective of integrated reporting must be to provide ‘high quality, comprehensive and succinct information to stakeholders’ (IIRC, 2013). In order to achieve this, the framework advises that the preparation and presentation of integrated reports be underpinned by the ‘seven guiding principles’ (IIRC, 2014).

While integrated reporting has assisted in preserving accountability and improved communication about value creation, many companies still encounter difficulties applying these principles and signalling their performance to stakeholders (Hartmann, 2011).

A recent study conducted by Black Sun Plc, in partnership with the IIRC, revealed that creating shared value between the organisation and its stakeholders was a challenge for 97% of companies which issued an integrated report (BlackSun, 2014). The findings indicate that, of the seven guiding principles, companies consider the principles of stakeholder responsiveness and materiality to be obscure. The research went further to highlight that as companies issued subsequent annual integrated reports and engaged further with stakeholders, they learned to align their reports to material issues that were more relevant to the company’s business model. In contrast to this, some companies found that content that they had previously reported on did not relate directly to value creation for stakeholders and was subsequently omitted from future integrated reports (BlackSun, 2014).

Other research offers additional reasons that contribute to stakeholders finding it cumbersome to extract their desired value from integrated reports. This includes the fact that information is presented in an excessive and repetitive manner; and that
there exist issues with the format in which information is presented to stakeholders (Solomon and Maroun, 2012; Carels et al., 2014; Arnold et al., 2012). The research findings mentioned indicate that integrated reporting remains a challenge for both companies and their stakeholders. This is due to companies using their own judgement in applying the guiding principles and because little is known about the extent to which users of an integrated report consider certain information relevant (Cheng et al., 2014). Stakeholders will not be able to assess effectively the performance measures that they consider important since the integrated report is prepared based on the company’s perception of what creates value, while also being presented in a manner that makes interpretation difficult (Baker, 2011).

2.3 THE EFFECT OF SOPHISTICATION ON THE EXPECTATION GAP

The definition of what constitutes a ‘stakeholder’ is broad and interpretative, resulting in it being both difficult and resource intensive to identify, seek out and engage with all applicable stakeholders. In response to such predicament the researcher followed a similar approach to that adopted by Gold et al. (2012), by performing the research using surrogate respondents.

Gold’s study of the auditor’s expectation gap found that there were fewer differences between the auditors and educated students, as well as consistent perceptions between practising auditors and those with considerable business experience (Gold et al., 2012; Monroe and Woodliff, 1993; Gay et al., 1997). Since prior literature finds that both experience and education has an effect on the expectation gap, this study includes respondents with different levels of experience and education as surrogates for real-world stakeholders. By surveying the perceptions of respondents with varying levels of experience and education, the responses will be representative of different groups who have perceptions consistent with that of different real-world stakeholders (Gold et al., 2012).

The respondent group selected for the study comprised of 64 Johannesburg based chartered accountants, auditors and students in their final year (CTA) of the SAICA accredited chartered accounting degree program. The chartered accountants and auditors who participated in the study are the ‘sophisticated’ respondents. These respondents are representative of stakeholders with a high level of financial literacy and who have investment experience either in their personal capacity or via their employment (SAICA, 2015). The CTA students who participated are the ‘unsophisticated’ respondents. This group possesses basic knowledge relating to the function and interpretation of integrated reports and, for the purposes of this study, will represent other interested stakeholders.

3. METHOD

The top ten companies by market capitalisation listed within the banking and financial services sector of the JSE were selected for the purpose of the study. These ten companies represented 82.45% of the market capitalisation of the sector at 17 April 2015. Information was collected from the 2013/2014 annual integrated reports during the second quarter of 2015 in order to examine the perception gap between these companies and the respondents.

1 The research is limited by the fact that not all stakeholders are engaged.

2 The banking and financial services sector of the JSE includes banks, insurers and fund management companies.
Each of the ten integrated reports was analysed in order to identify individual non-financial reporting themes. A tally was kept to record the number of times that the specific theme was reported. Where a theme was included in an annual report, a value of ‘1’ was assigned. A nil score was provided when a theme was not found in a report. The criterion for which a theme was considered to be specifically reported upon and earned a value of ‘1’ on its tally was as follows:

- A section or sub-section in the integrated report dedicated to that theme.
- A mention of that theme within text that has been specifically highlighted, typed in bold or quoted to the reader.
- Where a theme has been placed on a page of the report with some degree of prominence. For example through the use of an illustration, a diagram, header, footer, or within shapes and graphics.

A spreadsheet was used to aggregate the final results for each of the companies studied across the identified disclosure themes. Similar themes, such as closely linked BEE initiatives, were grouped together, resulting in a final set of 60 themes across the ten financial service companies.

Using these 60 themes, an independently hosted, multiple choice online questionnaire was constructed for the respondents to complete. Similar to a study performed by Van Beest et al. (2009), the respondents were then advised to rank each theme according to how important they believed it was for that theme to appear within the integrated report using the scale of 1-5; with ‘1’ being irrelevant, through to ‘5’ being critical to their information needs.

At expiry of the response period of the online questionnaire, the results were extracted to a spreadsheet. For the purposes of being analysed, the 60 themes were grouped into 12 themes each representing a distinct area of focus within the integrated reports. These 12 themes are described in Table 1.

Table 1: List of identified reporting themes

<table>
<thead>
<tr>
<th>Theme reference</th>
<th>Reporting theme description</th>
</tr>
</thead>
<tbody>
<tr>
<td>T1</td>
<td>Management of the company’s affairs including internal controls, internal audit, governance of IT, internal cost savings and operational efficiencies, and maintaining a competitive position within the market.</td>
</tr>
<tr>
<td>T2</td>
<td>Customer satisfaction, including assisting distressed customers, customer reward programs, improving the simplicity and accessibility of financial services and promoting the use of electronic banking.</td>
</tr>
<tr>
<td>T3</td>
<td>Marketing and promotion of the company’s values and services, accolades awarded to the company and reputation management.</td>
</tr>
<tr>
<td>T4</td>
<td>Structuring and simplifying the content of the annual report in accordance with integrated reporting principles, incorporating the use of a balanced scorecard approach and sustainability reporting.</td>
</tr>
<tr>
<td>T5</td>
<td>Communicating and engaging with stakeholders to build trust and confidence within the sector. Managing relationships with regulators, downstream service providers and customers.</td>
</tr>
<tr>
<td>T6</td>
<td>Compliance and response to regulation, management of credit ratings and other legal matters such as white collar crime and fines.</td>
</tr>
<tr>
<td>T7</td>
<td>The findings of the external auditors, economic effects relating to primary stakeholders and the company’s relationship with the South African macroeconomic environment.</td>
</tr>
<tr>
<td>T8</td>
<td>Transformation and Broad Based Black Economic Empowerment</td>
</tr>
<tr>
<td>T9</td>
<td>Corporate governance disclosure, including its structure, committees, ethics, effectiveness, participants and remuneration packages.</td>
</tr>
<tr>
<td>T10</td>
<td>Social, cultural and environmental initiatives, management of human capital, targeted growth and responsible investments.</td>
</tr>
<tr>
<td>T11</td>
<td>Strategy and risk management.</td>
</tr>
<tr>
<td>T12</td>
<td>Responsible financial practices and financial crisis recovery plans.</td>
</tr>
</tbody>
</table>

3 This approach is adapted from Raemaekers et al (2015) to ensure validity but means that the research was unable to gauge the quality of disclosures found in the integrated reports under review. This is an inherent limitation of the study.

4 A breakdown of the responses collected for each of the 60 themes is available from the researcher.
4. RESULTS AND DISCUSSION

Table 2 shows that a perceived level of importance, determined as high, medium or low, was placed on each of the 12 reporting themes based on the data collected from the integrated reports by the researcher (Part 1) and according to the responses from the questionnaire (Part 2). This information is then illustrated in Figure 1, adapted from Drury (2012), which highlights where perception gaps exist.

Table 2: Perceived level of importance of each theme

<table>
<thead>
<tr>
<th>Theme reference (see Table 1 for description)</th>
<th>Average times reported per integrated report</th>
<th>Perceived importance</th>
<th>Average respondent score out of 5</th>
<th>Perceived importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>T₁</td>
<td>14.5 medium</td>
<td>3.46 low</td>
<td></td>
<td>low</td>
</tr>
<tr>
<td>T₂</td>
<td>15.1 medium</td>
<td>3.25 low</td>
<td></td>
<td>low</td>
</tr>
<tr>
<td>T₃</td>
<td>7.2 low</td>
<td>3.24 low</td>
<td></td>
<td>low</td>
</tr>
<tr>
<td>T₄</td>
<td>5.4 low</td>
<td>3.97 medium</td>
<td></td>
<td>high</td>
</tr>
<tr>
<td>T₅</td>
<td>12.6 medium</td>
<td>3.57 low</td>
<td></td>
<td>low</td>
</tr>
<tr>
<td>T₆</td>
<td>17.3 medium</td>
<td>4.00 high</td>
<td></td>
<td>high</td>
</tr>
<tr>
<td>T₇</td>
<td>9.7 low</td>
<td>4.38 high</td>
<td></td>
<td>high</td>
</tr>
<tr>
<td>T₈</td>
<td>6.4 low</td>
<td>3.73 medium</td>
<td></td>
<td>medium</td>
</tr>
<tr>
<td>T₉</td>
<td>86.9 high</td>
<td>3.82 medium</td>
<td></td>
<td>medium</td>
</tr>
<tr>
<td>T₁₀</td>
<td>61.5 high</td>
<td>3.69 low</td>
<td></td>
<td>low</td>
</tr>
<tr>
<td>T₁₁</td>
<td>62.5 high</td>
<td>4.10 high</td>
<td></td>
<td>high</td>
</tr>
<tr>
<td>T₁₂</td>
<td>4.1 low</td>
<td>4.08 high</td>
<td></td>
<td>high</td>
</tr>
</tbody>
</table>

Figure 1: Identification of perception gaps amongst themes
Figure 1 illustrates that significant perception gaps exist between corporates and the respondents across themes T7, T10 and T12, while the emphasis placed by the ten corporates on themes T3 and T11 was consistent with the perceived importance of the respondents.

Both the companies studied and the respondents place a low level of importance on reporting related to the marketing and promotional activities, as well as awards received by the companies (T3). This theme does not seem to be of reporting significance to the companies, while the respondents may feel that the reporting of matters described in T3 do not offer them value, nor does it assist in their assessment of the accountability of management (Ravenscroft and Williams, 2009).

The companies and respondents show consistent emphasis on strategic and risk management reporting (T11). The consistency is not surprising considering the nature of the sector studied. The financial services sector is characteristically associated with risk, and strong performance can only be achieved through meticulous strategic planning by management (PwC, 2015). Statutory compliance is also a key driver of the emphasis placed on theme T11 by companies, as Basel-III, King-III and IFRS require extensive risk and strategic disclosure (Basel-III, 2011; King-III, 2013; IASB, 2014).

Among other reasons why the respondents perceive risk and strategic reporting to be of high importance may be a precautionary measure in the aftermath of the 2008 financial crisis, coupled with the uncertainty of a stable economic environment for South African financial service providers (PwC, 2015). The significant perception gaps which exist for themes T7 and T12 indicate that the respondents do not feel that conventional risk and strategic reporting provides adequate assurance over these threats. The respondents sought greater reporting, namely explaining the company’s plans and procedures in the event of another financial crisis, and details of how management has implemented responsible lending policies to maintain accountability (T12) (Atkins and Maroun, 2015; Ravenscroft and Williams, 2009).

The perception gap for theme T7 revealed that the respondents also placed value on the reporting of macroeconomic volatility unique to South Africa, such as the adverse effects of load shedding, and the threat of nationalisation. In addition to this, the results of T7 showed that the respondents considered the findings of the external auditor to be of importance. This may also be attributed as a response to the 2008 financial crisis, in that stakeholders may have greater confidence in the results of the external auditors than what is communicated by management (ACCA, 2011). Recent changes to the reporting standards contained in the International Standards on Auditing (ISA) also point towards stakeholders placing more reliance on the reports and key findings of the external auditors (Louis, 2015).

Contrary to the high volume of reporting related to social, cultural and environmental initiatives (T10) found in the integrated reports of the companies studied, this theme was perceived to be of little importance to the respondents. Extensive reporting of this theme by the companies may be attributed to the need to comply with the principles of King-III, while applying the integrated reporting approach to provide stakeholders with accountability (Atkins and Maroun, 2015). While this greater emphasis on social and environmental information by companies indicates that corporate reporting behaviour has transformed to embrace stakeholder accountability, the respondents may share the same sentiments as Solomon and Maroun (2012), in that they consider social, environmental and ethical reporting as excessive in nature and of little relevance to communicating value in a company involved in the financial services industry (BlackSun, 2014; Carels et al., 2014).
5. CONCLUSION

The findings of this study show that inconsistencies exist between the focus placed by financial service companies on certain integrated reporting themes, and the perceived importance of those themes by the respondents. This paper also demonstrates that the companies studied are still in the process of fully embracing stakeholder engagement as envisioned by King III.

A key reason for the disparity between the approach to integrated reporting followed by companies and that suggested by the IIRC may be that South African companies are increasingly relying upon the use of disclosure checklists to prepare their reports (Raemaekers and Maroun, 2014). Companies may adopt this approach as it offers comfort amongst the ambiguity of how they should apply the guiding principles toward integrated reporting as suggested by the IIRC (IIRC, 2014). This however results in integrated reporting being applied in a procedural fashion, while neglecting to engage with key stakeholders to gauge their needs and priorities (Raemaekers and Maroun, 2014).

The companies studied require further engagement with their stakeholders, and an improved understanding of how to apply the guiding principles. It is only then when they will create shared value for both themselves and their stakeholders (Cheng et al., 2014; BlackSun, 2014).

5.1 FURTHER RESEARCH

The use of surrogate respondents in this study proved to be effective at highlighting where expectation gaps may exist between stakeholders and companies (Gold et al., 2012). The validity of this paper however has the potential be enhanced through the exploration of other JSE sectors and the inclusion of a broader group of stakeholders amongst the respondents. In addition, the data can in future be analysed using advanced statistical methods, such as factor analysis. Factor analysis is well suited due to it being effective in studying interrelationships. This will allow the researcher to examine consistencies between companies’ and respondent perceptions, which were previously unobserved during the preliminary analysis (Dimi et al., 2014).
6. LIST OF REFERENCES


What assurances are South African listed companies obtaining over their integrated reports?

As South African listed companies begin to implement the International Integrated Reporting (\textit{IR}) Framework, users of the integrated reports will require assurance that the integrated report can be relied upon. Assurance could be obtained over the integrated report as a whole, or over components of information within the integrated report, from a variety of sources. This paper aims to provide insight into the current degree of assurance over South African listed companies’ integrated reports.

Goolam Modack, Taryn Miller & Jessica Bader – University of Cape Town

1. INTRODUCTION

Since the 1 March 2010 adoption of King III, South African companies have attempted to develop integrated reports that meet the broad objectives of King III. This early adoption of Integrated Reporting (\textit{IR}) has placed South Africa firmly at the forefront of integrated reporting and the surrounding discussion (Eccles, Cheng and Saltzman, 2010; Ernst & Young, 2014). This paper investigates whether South African companies have been similarly advanced in their assurance practices, by assessing the way and extent to which these companies are obtaining assurance over their integrated reports.

2. BACKGROUND

The International Integrated Reporting Council (IIRC) (2014a) believes assurance in relation to \textit{IR} provides an independent conclusion on whether an organisation’s integrated report presents its strategy, governance, performance and prospects in accordance with the \textit{IR} Framework. Obtaining assurance over an integrated report would add credibility to non-financial information, just as an audit opinion provides credibility to financial information (Ackers, 2009; Deegan, et al, 2006; Eccles et al, 2010; Marx and van Dyk, 2011).

However challenges exist in how such assurance can be obtained. The \textit{IR} Framework contains guiding principles at a high level (IIRC, 2014a) and Ernst & Young (2014) suggests that the current format of the \textit{IR} guidance is not sufficiently
robust to constitute suitable criteria against which to provide assurance.

The IIRC (2014b) addresses the notion that assurance could be obtained at different levels over different aspects of the integrated report. This is in line with the nature of an integrated report, as a single document, being a reference point for other communications such as investor presentations, detailed financial information, operational data and sustainability information (IIRC, 2011). This separate information could be separately assured, thereby providing users with enhanced confidence over this information. However, the IIRC (2014b) is concerned that separating assurance into components would be contrary to the holistic approach to reporting that is inherent in the <IR> Framework. A further concern is that separating assurance into components with different assurance practitioners for each component will undermine the key concept of connectivity outlined in the <IR> Framework (IIRC, 2014b).

Assurance can be obtained through mechanisms other than an external practitioner (IIRC, 2014a). Effective leadership and oversight over the <IR> process, internal systems, internal audit and stakeholder review, are mechanisms suggested by the IIRC (2014a) to enhance user confidence in the integrated report. A ‘combined assurance model’ as described in King III, comprising of management, internal and external assurance providers, has been suggested by the South African Institute of Chartered Accountants (SAICA) as an appropriate model in developing assurance for the users of the integrated report (SAICA, 2014). Therefore the type of assurance provider as well as the components for which assurance is required, remain key considerations in the development of an appropriate assurance model.

A potential solution to these concerns is the development of an integrated assurance approach which the IIRC (2014b) suggests will involve “a single engagement team rather than a patchwork of different assurance engagements by various assurance practitioners.” However, this approach is yet to be developed, and is beyond the scope of this paper.

3. METHODOLOGY

The research for this paper was conducted by analysing the integrated reports of the largest 40 companies, according to market capitalisation on the JSE’s All Share Index at 21 July 2015 (by which time 2014 integrated reports for all listed companies had been issued). The 2014 integrated reports were chosen as they reflect the first full reporting cycle since the release of the <IR> Framework.

Companies with primary listings in countries other than South Africa were removed from the sample. The reason for this exclusion was that most of these companies do not prepare a report that is explicitly called an integrated report. Dual-listed companies in the Top 40, such as Investec Ltd and Investec PLC were counted as one entity, as these companies produce a combined report. Having made these adjustments the sample consists of 30 companies.
4. RESULTS

4.1 ENDORSEMENT BY THOSE CHARGED WITH GOVERNANCE

The <IR> Framework requires those charged with governance to explicitly endorse the integrity of the integrated report (IIRC, 2013). King III (IoD, 2009) perceives those charged with governance to be the board of directors.

Table 1: Explicit endorsement of integrated reports

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endorsed</td>
<td>24</td>
<td>80%</td>
</tr>
<tr>
<td>By Board</td>
<td>20</td>
<td>66.7%</td>
</tr>
<tr>
<td>By Audit Committee</td>
<td>4</td>
<td>13.3%</td>
</tr>
<tr>
<td>Not endorsed</td>
<td>6</td>
<td>20%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>30</td>
<td>100%</td>
</tr>
</tbody>
</table>

We found that explicit endorsement of integrated reports by those charged with governance is largely common practice in South Africa with 80% of selected companies’ integrated reports including such an endorsement. It is noteworthy that 67% of companies are doing so through those primarily responsible – the board of directors. The fact that this reporting cycle is the first since the release of the <IR> Framework may explain why not all companies have adhered to the requirement of an explicit endorsement of the integrated report.

Of the 24 integrated reports that have been endorsed, this paper further investigated how many have been signed as evidence of the endorsement. We found that 17 have a signature as evidence of approval.

Table 2 below shows that the Chairman is the most common individual endorser of the report. Tasked with leadership of the board as well as the King III requirement for independence, it seems appropriate that the Chairman authorise the integrated report on behalf of the board. The large majority (70.6%) of companies used a combination of authorisation as can be seen in Table 2 below. The most common combination is the signature of the Chief Executive Officer (CEO) and the Chairman.

Of the four integrated reports approved by the audit committee, three were signed and all three signatures were those of the Chairman of the audit committee. The Chief Financial Officer (CFO) authorised four integrated reports but always did so in combination with the CEO and Chairman.

Table 2: Details of signatories

<table>
<thead>
<tr>
<th>Only:</th>
<th>Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Chairman</td>
<td>3</td>
<td>17.6%</td>
</tr>
<tr>
<td>Audit Committee Chair</td>
<td>2</td>
<td>11.8%</td>
</tr>
<tr>
<td>CFO</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>5</td>
<td>29.4%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>A combination of:</th>
<th>Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO and Chairman</td>
<td>7</td>
<td>41.2%</td>
</tr>
<tr>
<td>CEO and Audit Committee Chair</td>
<td>1</td>
<td>5.9%</td>
</tr>
<tr>
<td>CEO, Chairman and CFO</td>
<td>4</td>
<td>23.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>12</td>
<td>70.6%</td>
</tr>
</tbody>
</table>

| Total             | 17     | 100.0% |
4.2 INDEPENDENT ASSURANCE

While explicit endorsement by management of the integrated report may provide users with some degree of confidence in the content of the report, this would not be considered independent assurance nor would it grant users the same degree of confidence as an opinion from a third party. For the purpose of this section of this study, assurance exists only if it has been obtained from a provider other than those charged with governance.

Explicit statement of non-assurance over the integrated report as a whole

Two integrated reports in the sample of 30 (6.67%) contained an explicit statement that no assurance had been obtained over the integrated report. These were the integrated reports of the Standard Bank Group limited and Mr Price limited. In the integrated report of Mr Price (2014) the preparers of the report make reference to the introductory stage of integrated reporting and the related assurance, stating:

“The Board is satisfied with the level of integrated reporting, but recognises that it is premature to subject the Annual Integrated Report to external assurance at this point.”

The Standard Bank Group’s integrated report contained a similar explicit statement.

Information subject to assurance in the integrated reports

No integrated reports, as a whole, were assured. However assurance was provided over certain information in the integrated reports, as shown in Table 3 below.

<table>
<thead>
<tr>
<th>Note Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assurance limited to financial information only</td>
<td>i</td>
</tr>
<tr>
<td>Assurance over more than financial information</td>
<td>i</td>
</tr>
<tr>
<td>All sustainability information</td>
<td>0</td>
</tr>
<tr>
<td>Selected sustainability indicators</td>
<td>ii</td>
</tr>
<tr>
<td>Only BEE information</td>
<td>iii</td>
</tr>
<tr>
<td>All quantitative data</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
</tr>
</tbody>
</table>

i. Assurance over only financial information seems to be an outdated practice with 80% of the selected companies providing at least some form of assurance over other information in the integrated report.

ii. Assurance is predominantly limited to selected sustainability indicators (22 companies). This is not unexpected, as there is an established set of assurance standards (ISAE3000 and AA1000AS) governing the external verification of sustainability information. However, this is clearly far from the IIRC’s aim of assurance being provided over the whole integrated report. The consequence of this is that users of the report will have to rely on other mechanisms to establish complete trust in the integrated report.

All 22 companies provided users with details as to what indicators had been assured. Thirteen companies provided the detail in their integrated reports while others provided this detail in separate documents referenced within the integrated report. The use of referencing is encouraged by the IIRC (2011) as a means of incorporating the guiding principles of ‘conciseness’, ‘materiality’ and ‘connectivity of information’. Possible reasons for companies referencing a separate document with details of the
sustainability indicators may be: the large number of sustainability indicators, the different types of assurance obtained over different types of indicators, or as a result of specific requirements from the assurance provider.

iii. Discovery Limited’s integrated report was the only report that made an explicit assurance statement over all quantitative data:

“Discovery Group Internal Audit performed a limited review of the statements and quantitative data contained in the Discovery 2014 Integrated Annual Report... In our opinion the Report contains quantitative data which is free from material misstatement.”

Such assurance is not necessarily unexpected, given that quantitative information is measurable and thus easier to assure (Ballou et al., 2005; Manetti and Becatti, 2009; IIRC, 2014b). The practice of Discovery to assure all quantitative data may be a consideration for other companies and is an idea which has also been explored by the IIRC (2014b).

Assurance providers
Assurance over information was obtained by either the external auditor, internal auditor or an independent external assurance provider (being either another audit firm or some other independent assurance provider). In some instances, more than one type of provider was used. The results are presented in Table 4 below.

Table 4: Providers of assurance over information in the integrated report

| Assurance over selected sustainability indicators | 22 |
| Assurance provided by: | |
| Only: | |
| External auditor | 6 |
| Independent external assurance provider | 10 |
| Audit firm | 4 |
| Other independent assurance provider | 6 |
| Internal audit | 1 |
| A combination of: | 5 |
| External auditor and (non-audit firm) independent assurance provider | 2 |
| Internal auditor and (non-audit firm) independent assurance provider | 1 |
| External audit, internal audit and (non-audit firm) independent assurance provider | 2 |
| Assurance over only BEE information | 1 |
| Other independent assurance provider | 1 |
| Assurance over quantitative data | 1 |
| Internal audit | 1 |

Using the data in Table 4 it is clear that a majority of companies (17 of the 22) are using a single party to assure their sustainability indicators. Independent assurance providers are being used more frequently than the external auditor in providing this assurance, despite the argument by Ackers (2009) that using the same provider for financial and non-financial information assurance is more cost effective and logistically convenient. This may be explained by the fact that sustainability indicators vary between companies and management may require the work of a specialist to obtain assurance on a chosen sustainability indicator.

Furthermore, the nature of the indicator may lend itself to assurance by a party other than an audit
firm. This is evidenced by a number of companies (5 of 22) using a combination of assurance providers. In these instances, there was no instance of the independent assurance provider being an audit firm. Issues such as cost and perceived reliability may help explain this (Ackers, 2009; Percy, 1997). Overall however, 14 of the 24 companies (58%) used audit firms to obtain some, if not all, of the assurance provided.

5. CONCLUSION

The release of the <IR> Framework as well as the principles of King III have resulted in integrated reporting becoming an increased focus for companies and the users of corporate reports. South African companies, as early adopters of integrated reporting are at the forefront of this reporting journey. For the integrated report to be accepted as the primary document of stakeholder communication it should be relevant and credible. However, credibility requires assurance. The study found that no company provides assurance over its integrated report as a whole. The study predominantly found that assurance in integrated reports is limited to selected sustainability indicators and financial information. Most companies appear to be using a single party to provide assurance over sustainability information although the use of a combination of assurance providers is prevalent. Of the external practitioners, audit firms have provided 58% of the total assurance.

These findings support the need for the development of appropriate audit standards for the purpose of providing integrated assurance. Once standards or an assurance model have been developed, a similar analysis to the one undertaken here could be conducted. Until such time, there is scope for research into the type of assurance, i.e. reasonable or limited, that South African companies are obtaining over their integrated reports.

Finally, further research could include assurance provided by management and by internal systems on the related reporting procedures. This may give readers a more complete view of assurance practices in South Africa.
6. LIST OF REFERENCES


Understanding Materiality through the Application of Institutional Logics

Materiality in the integrated report shares a threshold characteristic with accounting materiality but has shifted towards a stakeholder focus, emphasizing the social and environmental impacts of corporate non-financial performance and the importance of stakeholder engagement. Accounting materiality has traditionally been associated with financial impacts where auditors have a moral and legal responsibility to protect investors, as a group, from misleading information. (Edgley et al, 2015) This paper uses three logics to identify material information in the integrated report. First, auditors are said to have a professional logic while, secondly, shareholders have market logic (Edgley et al, 2015). Lastly the stakeholder logic links materiality to social responsibility issues (as opposed to a purely short term, market logic). Key words: Materiality, Institutional Logics, Integrated reporting, Stakeholder

Philippa Joffe – University of the Witwatersrand

1. INTRODUCTION

Materiality functions as a threshold that determines significant errors or omissions relevant to decision-making, for the benefit of shareholders (Edgley, Jones & Atkins, 2015). Materiality thresholds are initially the responsibility of management. Auditors then make independent decisions about materiality in reporting on whether the financial statements offer a true and fair view (Edgley et al, 2015). According to ISA 200, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements by expressing an opinion on whether the financial statements are prepared in all material respects, in accordance with an applicable financial reporting framework (IAASB, 2008a).

Materiality in the integrated report shares a threshold characteristic with accounting materiality but has shifted towards a stakeholder focus, emphasizing the social and environmental impacts of corporate non-financial performance and the importance of stakeholder engagement. The inclusion of non-financial information in the integrated report appears to be changing materiality’s role. Materiality did not just improve the quality of historic data but could critically filter forward-looking information to anticipate important future issues (Edgley et al, 2015).

However, it is problematic to construct a coherent, clearly defined, understanding of materiality when multiple logics underpin its operationalisation (Edgley et al, 2015). The operationalization of accounting materiality has been shaped by two
traditional logics: a market logic that is for the benefit of shareholders and a professional logic, which is embodied in the financial audit. Integrated reporting has introduced a third logic, namely, stakeholder logic that is for the benefit of a wider audience and not just merely the shareholders.

The purpose of this report is to identify the frameworks that are influencing materiality in the integrated report. This report will investigate the concept of materiality in the integrated report and the development of material information presented in the integrated reports through the application of institutional logics.

This study is concerned with the adoption of materiality as a key reporting principle in the integrated report and it focuses on materiality because it is a key factor to be considered when determining the inclusion of information in the integrated report (IIRC, 2013).

2. THEORETICAL FRAMEWORK

2.1 INTEGRATED REPORTING AND MATERIALITY
The King III Report was one of the first major publications to refer to the need for integrated reporting. It defines an “integrated report” as:

“A holistic and integrated representation of the company’s performance in terms of both its finance and its sustainability” (IOD, 2009:121).

The integrated report provides stakeholders with a holistic view of the company by integrating financial and non-financial information in a single report. The International Integrated Reporting Council (IIRC) explains that materiality plays a crucial role in determining the matters to be included in an integrated report. Understanding the concept of materiality assists businesses in knowing which information explains its ability to create and sustain value (IIRC, 2013).

Materiality is not a term with a core meaning. It is a malleable concept (Edgley, 2014). Materiality is a matter of professional judgement. It operates for the benefit of shareholders although no set of rules can be employed consistently to determine materiality in all circumstances (Edgley et al, 2015). However, many have tried to define this concept for preparers and users of integrated reports.

In terms of the IIRC, a matter is material if it is of such relevance and importance that it could substantively influence the assessments of providers of financial capital with regard to the organization’s ability to create value over the short, medium and long-term. The Materiality Principle of the GRI Guidelines defines materiality in the context of a sustainability report:

“The report should cover aspects that: Reflect the organization’s significant economic, environmental and social impacts; or substantively influence the assessments and decisions of stakeholders.” (Global Reporting Initiative, 2015)

The Companies Act 71 of 2008 defines materiality in section 1 as:

“Significant in the circumstances of a particular matter, to a degree that is a) of consequence in determining the matter; or b) might reasonably affect a person’s judgment or decision-making in the matter.”

The Conceptual Framework for Financial Reporting (IASB, 2010) provides the following guidance on materiality:

“Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature
or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.” (IASB, 2010)

Finally, from an auditing perspective, ISA 320, does not define materiality but states that auditors’ determination of materiality is a matter of professional judgement and is affected by the auditors’ perception of the financial information needs of users of the financial statements (IAASB, 2008b).

Materiality is a vague concept and has no set of rules in order to determine what information is or is not material (Edgley et al, 2015). There are different perceptions of what constitutes material information so applying materiality in the integrated report is a difficult task that requires judgement.

2.2 INSTITUTIONAL LOGICS

Edgley et al, (2015) presents three competing logics; market, professional and stakeholder logics. These three logics form the basis of this research and are explored in a review of the integrated reports of various companies (see section 3).

Market logic is a shareholder’s logic that is concerned with the accumulation and maintenance of material financial wealth (Friedland & Alford, 1991). Market rationale has shaped traditional accounting materiality as a concept designed to protect shareholders from misleading information (Edgley, 2014). The concept of materiality in financial audit has been shaped by the market logic, a capitalist rationale (Edgley et al, 2015).

Professional logic bridges the logic of the State (government administration directed at the public interest) and the market. This logic supports professional guidance about financial audit and materiality practices for practitioners and is reflected in the duty that auditors have to shareholders as a group (Edgley et al, 2015). The protection of public interest is inherent in this logic.

The adoption of materiality into sustainability reporting introduces new community-oriented stakeholder logic. It extends the focus of reporting, from a narrow financial account, to the non-financial impacts of organizations on society (Edgley et al, 2015). With the focus broadened to include both financial and non-financial information, stakeholder logic iterates the idea of social responsibility practices. King III defines stakeholders as any group affected by and affecting the company’s operations (IOD, 2009). This can be explained in terms of the “stakeholder inclusive” approach as described in King III where the board of directors must consider the legitimate interests and expectations of stakeholders and not merely the interests of shareholders (IOD, 2009).
3. RESEARCH METHOD

Data was collected from the annual/integrated reports for the 2015 financial year of the top 40 companies listed on the JSE (as at 28 December 2015) (BusinessTech, 2015). The integrated reports of the companies were analysed and themes were identified based on the material information presented in the integrated reports. The chosen method is designed to provide detailed insights into the understanding of the concept of materiality within the integrated report (Edgley et al, 2015).

The annual report is generally split into three parts – sections broadly dealing with the attainment of corporate strategy (the ‘strategic report’), governance matters, and financial statements. The strategic report ordinarily includes the operational performance and business environment of the reporting entity. The governance section includes the director’s report, audit committee’s report and remuneration report. For the purpose of this study, the integrated report was divided into 5 sections namely audit committee report, external audit report, governance report, strategic report and the annual financial statements.

This process involved reading and re-reading all the reports as new themes were identified. These themes emerged through interpretative analysis following the reading and re-reading of the reports (Solomon and Maroun, 2012).

The themes represent the information and disclosures that the company evidently considers to be material and therefore included in the integrated report. The purpose of identifying themes was to identify which themes shared the characteristics of the institutional logics.

Part of the analysis was to identify the frequency of the themes in the integrated report and to document the section in which they were found. This allowed identification of how many sections of each report contained the identified theme. The themes were then categorized into the three logics, namely market, professional and stakeholder logics, based on the characteristics of the logics and the placement in the integrated report. Bar Graph 1 summarizes the findings from the analysis (see section 4).

A spreadsheet was used to collect the results per company for each theme identified and its location. For each theme, where a disclosure relating to that theme was included, a value ‘1’ was assigned. Where no disclosure was made a value of zero was assigned. There are themes that were identified in more than one section of the integrated report and this has been presented in Tables 1, 2 and 3. A spreadsheet was used to aggregate final results. To minimize researcher bias, the reports were only analyzed for the presence or absence of specific disclosures. No effort was made to rank the disclosures according to their perceived usefulness to stakeholders. Similarly, this research does not differentiate between the “required” and “recommended” disclosures per King III (Raemakers, Maroun & Padia, 2015).
4. RESULTS

4.1 DATA ANALYSIS

Data analysis and interpretation was inspired by institutional logics. A detailed reading of all integrated reports resulted in identification of key themes in the sections of the integrated report. The data was then analyzed further using an institutional logics framework to identify whether the themes embody the logics outlined in section 2.

Bar graph 1 provides an overview of the frequency of the themes identified in the sections of the integrated report. This information is further broken down into Tables 1, 2 and 3 in the rest of this section.

As seen in the graph, the stakeholder logic has the highest frequency of themes identified in the integrated report. Social, environmental and ethical information appears throughout in a significantly greater number of sections of the reports (Solomon & Maroun, 2012). There has been greater attention given to non-financial information in the integrated report, which is indicative of the stakeholder logic.

Companies have shifted from an approach which aimed primarily to report to shareholders to one that expounds the directors’ ‘belief’ in stakeholder accountability and stakeholder engagement (Solomon & Maroun, 2012).

The professional logic has the lowest frequency of themes identified in the integrated report and is primarily found in the external audit report and the audit committee report. It appears that with the inclusion of non-financial performance, materiality has shifted towards a stakeholder focus thereby changing materiality’s role. Materiality no longer relates to historic data to be included in the integrated report but provides a filter for forward-looking information for the integrated report.

Tables 1, 2 and 3 summarise the results from the integrated report analysis using the institutional...
logics as a framework, and categorising each theme into one of the logic categories namely: professional, market or stakeholder logic.

Tables 1, 2 and 3 identify the frequency of the theme in the entire report; themes found in multiple sections have been illustrated in all the tables which then indicate the section in the integrated report with the highest theme frequency.

4.2 MARKET LOGIC

The concept of materiality is traditionally founded on market logic and is concerned with the importance of items relative to the users, these being the shareholders. The market logic is for the benefit of shareholders. The concept of materiality in financial audit has been shaped by market logic (a capitalist rationale). It is used to protect investors and restore trust in the markets (Edgley et al, 2015). The themes identified relate to the financial information and the impact on the company’s financial performance. The themes also provide assurance to the shareholders as the company is a steward of their resources. Compliance themes have appeared in most of the sections of the integrated report. The company is providing its investors with assurance that laws and regulations are adhered to, emphasising the company’s role as a steward of shareholders’ resources.

<table>
<thead>
<tr>
<th>Theme</th>
<th>Frequency in integrated report</th>
<th>Highest frequency in a specific section in the Integrated Report</th>
<th>Number of sections in the Integrated Report that contain the theme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impact of global markets, regulation</td>
<td>35</td>
<td>Strategic Report</td>
<td>1</td>
</tr>
<tr>
<td>Risks, risk management and risk appetite</td>
<td>46</td>
<td>Strategic Report</td>
<td>4</td>
</tr>
<tr>
<td>Basis of preparation</td>
<td>57</td>
<td>Annual Financial statements</td>
<td>5</td>
</tr>
<tr>
<td>Compliance with King 3</td>
<td>45</td>
<td>Governance Report</td>
<td>4</td>
</tr>
<tr>
<td>Compliance with Companies Act</td>
<td>54</td>
<td>Strategic Report</td>
<td>5</td>
</tr>
<tr>
<td>Going concern</td>
<td>65</td>
<td>Annual Financial statements</td>
<td>5</td>
</tr>
<tr>
<td>Fines and penalties</td>
<td>23</td>
<td>Governance Report</td>
<td>3</td>
</tr>
<tr>
<td>Director responsibility statement</td>
<td>36</td>
<td>Annual Financial statements</td>
<td>4</td>
</tr>
<tr>
<td>Statement of Compliance</td>
<td>38</td>
<td>Governance Report</td>
<td>5</td>
</tr>
<tr>
<td>Fraud</td>
<td>14</td>
<td>Governance Report</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>332</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.3 PROFESSIONAL LOGIC

The external auditors and the audit committee are representative of the professional logic. The external auditor recognizes its responsibility to a client and users to carry out assurance practices rigorously. In addition, they seek to produce a professional report, emphasizing discipline and accuracy to minimize exposure to legal liability (Edgley et al, 2015). This is evident in the audit reports where the responsibilities of the auditor and the directors are clearly stated and the auditor’s reasonable assurance is given.

Materiality has been objectivized as a moral responsibility to protect investors, a capitalist rationale and a need to protect the material wealth of investors from the damaging consequences of misleading information (Edgley et al, 2015). The role of the external auditor is to provide independent assurance. The objective of independent assurance is to satisfy stakeholders’ demands for managerial accountability, enabling or underpinning financial market stability and assisting the reporting entity to improve its operational performance (Atkins & Maroun, 2015).

In some reports, an audit materiality figure was disclosed in the external auditors’ report. The basis of calculation involved broad rules of thumb and using auditors’ professional judgement. According to ISA 320 materiality is a fundamental concept in the audit process. Due to the nature of materiality, the auditor only provides reasonable assurance and this is made clear in the integrated report (IAASB, 2008b).

Table 2: Professional Logic themes

<table>
<thead>
<tr>
<th>Theme</th>
<th>Frequency in the Integrated Report</th>
<th>Highest frequency in a specific section in the Integrated Report</th>
<th>Number of sections in the Integrated Report that contain the theme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effectiveness of internal controls</td>
<td>48</td>
<td>Audit committee</td>
<td>4</td>
</tr>
<tr>
<td>Declaration of the Auditor’s Independence</td>
<td>47</td>
<td>Audit committee</td>
<td>2</td>
</tr>
<tr>
<td>Materiality</td>
<td>10</td>
<td>External Audit Report</td>
<td>1</td>
</tr>
<tr>
<td>Basis of calculation (rule of thumb)</td>
<td>11</td>
<td>External Audit Report</td>
<td>2</td>
</tr>
<tr>
<td>Disclaimer, limitation of liability</td>
<td>54</td>
<td>External Audit Report</td>
<td>4</td>
</tr>
<tr>
<td>Responsibility of auditor, scope of audit</td>
<td>40</td>
<td>External Audit Report</td>
<td>2</td>
</tr>
<tr>
<td>Auditor’s remuneration</td>
<td>17</td>
<td>Audit committee</td>
<td>3</td>
</tr>
<tr>
<td>Events after year end</td>
<td>39</td>
<td>Annual Financial Statements</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>266</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.4 Stakeholder Logic

Increased importance placed on sustainability by society has extended the concept of ‘materiality’ beyond financial impacts to the significant social and environmental impacts of corporate performance for a stakeholder audience (Edgley et al, 2015).

Stakeholder logic links materiality to social responsibility issues. A stakeholder-based understanding of materiality considers the significant impacts of a company on the environment for a broad audience (Edgley et al, 2015). Table 3 identifies themes that reflect impact on the environment, the communities in which the companies operate and its employees. Stakeholder logic has the highest frequency in the integrated report, as much as the other two logics combined.

A shift to stakeholder logic appeared to be changing materiality’s role. It did not only improve the quality of historic data but could also critically filter forward-looking information to anticipate important, future issues (Edgley et al, 2015). It can also be noted that included in the 27 of the 40 integrated reports, a disclaimer was provided for forward-looking statements. Forward-looking statements are provided for the benefit of stakeholders in order to assess the direction and strategy of a company; however, no assurance can be given on whether future results will be achieved. Various factors could cause actual future results, performance or events to differ materially from those described in these statements.

Stakeholder theory exists by virtue of the fact that the integrated report contains the themes identified in Table 3. The existence of the themes in the integrated report implies its importance to preparers of integrated reports.

The strategic report contains most of the themes and the themes are mostly included in two or three sections of the integrated report. This emphasises the existence of stakeholder materiality throughout the integrated report as it is not confined to only one section in the report.

Materiality, therefore, functioned as a stakeholder-orientated, ethical lens (Edgley et al, 2015). It focuses on issues that mattered, or could matter in the future, in the interaction and engagement between companies and society. A new stakeholder logic links materiality to social and environmental responsibility issues.
Table 3: Stakeholder logic themes

<table>
<thead>
<tr>
<th>Theme</th>
<th>Frequency in Integrated report</th>
<th>Highest frequency in a specific section in the Integrated Report</th>
<th>Number of sections in the Integrated Report that contain the theme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee safety and health, fatalities</td>
<td>45</td>
<td>Strategic Report</td>
<td>3</td>
</tr>
<tr>
<td>Director shareholding and interest (conflict of interests)</td>
<td>73</td>
<td>Governance Report</td>
<td>3</td>
</tr>
<tr>
<td>Definition / Determination of materiality</td>
<td>25</td>
<td>Strategic Report</td>
<td>3</td>
</tr>
<tr>
<td>Litigation with employees</td>
<td>3</td>
<td>Annual Financial Statements</td>
<td>1</td>
</tr>
<tr>
<td>Environmental liability</td>
<td>4</td>
<td>Annual Financial Statements</td>
<td>1</td>
</tr>
<tr>
<td>Impact on environment, climate change</td>
<td>67</td>
<td>Governance Report</td>
<td>3</td>
</tr>
<tr>
<td>Carbon emission, footprint</td>
<td>36</td>
<td>Strategic Report</td>
<td>3</td>
</tr>
<tr>
<td>Litigation/disputes</td>
<td>13</td>
<td>Annual Financial Statements</td>
<td>3</td>
</tr>
<tr>
<td>Human rights</td>
<td>19</td>
<td>Strategic Report</td>
<td>3</td>
</tr>
<tr>
<td>Biodiversity management</td>
<td>5</td>
<td>Strategic Report</td>
<td>2</td>
</tr>
<tr>
<td>Recycling and waste management</td>
<td>29</td>
<td>Governance Report</td>
<td>3</td>
</tr>
<tr>
<td>Impact on society</td>
<td>35</td>
<td>Governance Report</td>
<td>2</td>
</tr>
<tr>
<td>Water management</td>
<td>25</td>
<td>Strategic Report</td>
<td>2</td>
</tr>
<tr>
<td>Energy consumption</td>
<td>35</td>
<td>Governance Report</td>
<td>2</td>
</tr>
<tr>
<td>Forward looking statement, disclaimer</td>
<td>27</td>
<td>Strategic Report</td>
<td>2</td>
</tr>
<tr>
<td>Integrated reporting disclosure (GRI/IIRC)</td>
<td>22</td>
<td>Strategic Report</td>
<td>1</td>
</tr>
<tr>
<td>Stakeholder engagement</td>
<td>22</td>
<td>Strategic Report</td>
<td>2</td>
</tr>
<tr>
<td>Load shedding impact</td>
<td>5</td>
<td>Strategic Report</td>
<td>2</td>
</tr>
<tr>
<td>Broad Based Black Economic Empowerment (B-BBEE)</td>
<td>24</td>
<td>Strategic Report</td>
<td>3</td>
</tr>
<tr>
<td>Product sustainability</td>
<td>10</td>
<td>Strategic Report</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>524</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


5. CONCLUSION

There are different perceptions of what constitutes material information. These perceptions can be said to have arisen through the various logics that are competing and it appears that materiality is still relative to the user as it was long ago (Frishkoff, 1970). Therefore, it is a challenge to determine a consistent, clearly defined understanding of materiality when multiple logics influence its operationalization.

The study is limited, as it does not deal with a hybrid logic analysis where a theme could be categorized into more than one logic. Each theme was limited to being categorized into one logic only. This leaves an area for further research where hybrid logics can be used to explore the understanding of materiality. The research evaluates the frequency of themes in the integrated reports and does not focus specifically on the quality of disclosure of those themes identified.

With materiality in the integrated report still in its infancy (Edgley et al, 2015), the findings of this study will be relevant for the current debate about materiality in the integrated report, especially in identifying the frameworks (institutional logics) that drive the presence of information in the integrated report.

Areas for further research include determining whether stakeholders believe that the reports with the evolving stakeholder logic approach, are more decision-useful than earlier annual reports which mainly had a market logic approach. An analysis of the stakeholder engagement and materiality assessment process could provide further insight into the preparation of integrated reports and management’s identification of material information.
6. LIST OF REFERENCES


THE SUPPLY OF CAs(SA): A MALTHUSIAN TRAP?

Is there a shortage of CAs(SA) in South Africa as frequently claimed? An analysis of the membership records of SAICA and the real fixed salaries offered to newly qualified CAs(SA) indicates a likely oversupply.

Phillip de Jager – (UCT) and Pieter van der Spuy – Stellenbosch

1. INTRODUCTION

The South African Institute of Chartered Accountants (SAICA) frequently claims that there is a shortage of CAs(SA) and as a consequence have initiatives in place to reduce the shortage. The most recent business plan of SAICA combines the objectives “to grow the membership of SAICA” and “to grow the number of members in line with transformational targets” into the key result area “stakeholders – volume growth” (South African Institute of Chartered Accountants, 2014:9). Executive director for Nation Building at SAICA, Chantyl Mulder, recently elaborated on these objectives in an interview with Monique Verduyn in the Accountancy SA journal and amongst others referred to a “dire shortage of CAs(SA) in South Africa” and “a desperate need for more CAs(SA)” (Verduyn, 2016:53).

Not everyone agrees. In an article titled “The CA(SA) cake is only so big”, published on the website of the Accountancy SA journal, the question is asked why newly qualified CAs(SA) struggle to find jobs after completing articles (Van Wyk, 2014). The author suggests that factors such as the state of the labour market, the role of audit firms, having sufficient experience, as well as personal choice and perceptions all play a role. Arguments with accounting bodies over the shortage (or not) of accountants is not a uniquely South African phenomenon; it is happening in Australia (Tadros & King, 2014) and in India (according to an opinion poll on the website http://www.casansaar.com/opinion-poll/Do-U-think-Country-have-Shortage-of-CAs-as-stated-by-ICAI-President/32.html with 1719 responses). Finally, some forward looking accounting professors are even arguing that accounting is no longer useful to society and that job losses are inevitable (Lev & Gu, 2016).

This paper seeks conclusion on the matter. What do SAICA’s membership records show about the supply of CAs(SA) and the rate of unemployment amongst members? All else equal, a shortage should translate into a slow growth in numbers and a decreasing rate of unemployment amongst members. Also, according to a SAICA report on skills shortages in financial management, accounting and auditing the information contained in remuneration levels is ideal for concluding on shortages in the job market: “Ideally, research on skills shortages should include research on remuneration levels” (South African Institute of Chartered Accountants, 2008:6). In response, we augment our conclusions based on SAICA’s membership records with information obtained.
from the real fixed salaries offered to newly qualified CAs(SA) in the Accountancy SA journal. Newly qualified CAs(SA), who have limited experience, are those that typically rely most on the CA(SA) brand in their job search as experience tends to differentiate one CA(SA) from another. Compared to the experienced CA(SA) the newly qualified CA(SA) can be seen as a commodity of which the market value can be tracked over time. The current (adjusted for the time value of money) remuneration of the newly qualified CA(SA) contains information about the demand and supply dynamics of CAs(SA). A shortage of CAs(SA) should translate into an increase in the market value of the commodity, conversely an oversupply of CAs(SA) should translate into a decrease.

The rest of the paper is structured as follows. The next section will present the analysis of SAICA’s membership records. Thereafter will follow the analysis of the real fixed salaries offered to newly qualified CAs(SA). This will be followed by a discussion after which we will conclude.

2. ANALYSIS OF SAICA’S MEMBERSHIP RECORDS

Membership of SAICA grew by 5.2% per annum for the period 2002 to 2007 according to a SAICA report on skills shortages in financial management, accounting and auditing (SAICA, 2008:xiii). At 5.2% it would take a little more than 13 years for the membership to double. SAICA membership statistics are available on their website from 2002 until the present and the total SAICA membership, excluding retirees, grew from 18 746 members in January 2002 to 38 449 members in March 2016; indicating an actual doubling in membership in 14 years. In addition to the figures for retirees (that were excluded from this study), the statistics also differentiate between members that are based in South Africa and those that are based elsewhere, as well as members that are unemployed. Figure 1 that follows, summarises the membership numbers over time.

Figure 1: SAICA membership (2002-2016)

The data were sourced from the public membership records of SAICA. A number of months of data were missing. Total membership in South Africa is defined as the total members in South Africa minus retired members in South Africa. Total worldwide membership is defined as total members (in South Africa and elsewhere) less retired members (in South Africa and elsewhere). The percentage of total membership in South Africa unemployed is defined as the total for unemployed members in South Africa divided by total membership in South Africa as defined above.
Figure 1 indicates a doubling in membership (both worldwide and only in South Africa) over the period studied. This can be compared to real GDP per capita that grew by 26% over the same time period. Figure 1 also shows that the proportion of SAICA members based outside South Africa decreased after the global financial crisis. A relative maximum proportion of 23.7% of members was outside South Africa in December 2006 whilst a relative minimum proportion of members outside South Africa was reached in July 2015 of 19.1%. The percentage of total membership in South Africa unemployed reached a relative minimum just before the global financial crisis in June 2007 and consistently and sharply increased from there to reach a maximum in September 2015 (that is 2.7 times higher). The membership records of SAICA thus indicates a material increase in the supply of CAs(SA) since 2002 with the local supply benefitting from relatively few CAs(SA) leaving South Africa after the global financial crisis. The growth in the percentage of total membership in South Africa unemployed, since the global financial crisis, potentially indicates a lack of market clearing demand for CAs(SA). However, this unemployment statistic is solely based on SAICA’s membership records and is expected to underreport actual CA(SA) unemployment as it is unlikely that a long-term unemployed SAICA member will prioritise the payment of their membership fees above more immediate needs.

The next section will detail the work done to gather data on the remuneration levels of newly qualified CAs(SA).
3. NEWLY QUALIFIED CA(SA) FIXED REMUNERATION

Jobs advertised anywhere in South Africa in the Accountancy SA journal were the source of the remuneration data used in this section. Accountancy SA is the journal of SAICA and is sent on a monthly basis to all members. The mid-points of the fixed remuneration offered to a “newly qualified CA” or a “recent CA” or a “new CA” or a “CA with 0 years of experience” were manually gathered from the job advertisements in the journal from January 2000 until June 2016. The mid-point of the fixed remuneration offered was adjusted to January 2016 values by making use of a monthly CPI inflation index from information provider InetBFA. Altogether 1607 observations were gathered with a mean current fixed remuneration level of R628k over the full period. The context for such a high figure is possibly that only the best jobs are advertised in the Accountancy SA journal with requirements such as “exceptional track record”, “academically astute” or “brilliant academic results” listed. These numbers can be compared to R483k “average pay” for a chartered accountant with no experience in Johannesburg in September 2015 according to salary survey website www.payscale.com. Figure 2, which follows, summarises the evolution of newly qualified CA(SA) fixed remuneration over time.

Figure 2 indicates that since the global financial crisis the yearly average fixed remuneration of newly qualified CAs(SA) have been in a decline with a further downturn in the last two years. The number of jobs advertised for newly qualified CAs(SA) also reached a yearly peak immediately after the global financial crisis and have been on the same declining path as the remuneration levels. Yearly average remuneration reached a peak in 2007 immediately ahead of the global financial crisis.

The data were sourced from job advertisements in the Accountancy SA journal and adjusted to January 2016 values. The horizontal line is the 2000 to 2016 average fixed remuneration of R628k.
4. DISCUSSION

The indicators considered showed a shortage of CAs(SA) in 2007 immediately before the global financial crisis; the unemployment percentage was at a minimum and, importantly, the yearly average fixed remuneration level for newly qualified CAs(SA) was at a maximum (as well as the yearly minimum and maximum remuneration levels). The number of jobs advertised per year peaked in 2009. These indicators are thus in accordance with the SAICA report on skills shortages in financial management, accounting and auditing (2008) that identified a skills shortage in 2007 in South Africa.

However, the shortage of CAs(SA) was not a constant through the cycle as 2007 proved to be a highpoint in demand. Since the global financial crisis demand for CAs(SA) has not kept up with supply as shown by the weakening in the indicators mentioned above. The unemployment percentage more than doubled and reached a maximum in 2015 and the yearly average remuneration of newly qualified CAs(SA) has fallen to a level from where it will need to increase by 28% to equal the level reached in 2007 (from R528k to R675k). And this position is likely to worsen further as the increased supply of newly qualified CAs(SA), stimulated by SAICA’s growth initiatives, comes into the market. South Africa seems likely to have an oversupply of newly qualified CAs(SA).

Why did the shortage predicted in the SAICA report on skills shortages in financial management, accounting and auditing (2008) not materialise? First, even the report’s most pessimistic forecast for future growth in the South African financial services sector was overly optimistic. The pessimistic forecast on average, for the period 2008-2016, predicted growth at 4.82% per year with employment at a factor of 0.82 thereof to give a growth in employment prediction of 3.95% per year (SAICA, 2008:94). In contrast, actual growth in employment in the finance, insurance, real-estate and business services sector (4th quarter 2008 to 3rd quarter 2015) was negative (minus 71 000 jobs) according to the South African Reserve Bank (2016:17). Second, the SAICA report assumed that CAs(SA) would emigrate in perpetuity at a rate of 1.5% per year. The membership records show, that when the global economy took a turn for the worse, a large number of the CAs(SA) that had left South Africa returned and few left South Africa since then, generating an actual nil emigration rate.
5. FURTHER RESEARCH

The work done and the conclusions reached have certain limitations. In terms of the remuneration data the first limitation to acknowledge is the choice of sample. Data was only collected from the Accountancy SA journal. It is possible that this data is not representative of the remuneration of newly qualified CAs(SA) in general.

The research question “Is there a shortage of CAs(SA) in South Africa as frequently claimed” is not a causal question in the sense that we did not aim to explain what is causing the shortage or not. Ours was a more modest descriptive aim. However, we also have to acknowledge that it is somewhat implied by our choice of title for the paper and by the work done that the lack of a shortage is the result of an oversupply of CAs(SA). And for this causal argument we acknowledge that correlation is not necessarily causation. It is possible that other, unobserved factors, are causing the observed decrease in the yearly average fixed remuneration of newly qualified CAs(SA) and not the supply of CAs(SA). For example, perhaps the remuneration of all professionals in South Africa has been decreasing due to general economic and social pressures. We did not attempt any comparison to other professions as comparing the CA(SA) situation with other professions would imply a comparative research question which was definitely not the aim of the study. Alternatively, perhaps the yearly average fixed remuneration of newly qualified CAs(SA) declined due to the geographical mix of jobs observed changing over time (a general move to more jobs in a lower remuneration region), or similarly, the industry mix of jobs observed changing over time (a general move to lower paid industries). We did not control for the impact of these factors as the data was mostly not available. The fact that we relied on large annual samples in the compiling of Figure 2 somewhat negates this concern as the law of large numbers will tend to average out noise in the data. Finally, it is claimed some occupations, including those of accounting and tax preparers, have a high probability of automation in the next few years that will lead to less jobs (Frey & Osborne, 2013:71-72); perhaps what we are observing in our remuneration data is simply the start of this trend. Again, this last argument does not negate our conclusion that there is no shortage of CAs(SA) in South Africa.

However, it is the triangulation of the evidence from the literature, the evidence from SAICA’s membership records and the evidence from the yearly average fixed remuneration of newly qualified CAs(SA) that emboldens us to conclude that no shortage exists despite possible limitations in the individual methods.

The first opportunity for further research is to compare membership changes and remuneration changes of CAs(SA) with the changes for other professions like actuaries. Perhaps CAs(SA) in a relative sense are scarcer than actuaries? Another opportunity for further research is to investigate what motivates SAICA (and other accounting bodies) to continue to argue that a shortage of accountants exists, despite strong evidence to the contrary.
SAICA claims there is a shortage of CAs(SA) in South Africa. Anecdotal evidence indicates that newly qualified CAs(SA) are having difficulty in finding jobs after completion of articles. It is this contrasting perspective on the supply and demand for CAs(SA) that motivated this study. Do the membership records of SAICA and the remuneration levels of newly qualified CAs(SA) support the notion of a shortage?

The membership of SAICA has been growing at a pace that outstrips real economic growth for a number of years and the local unemployed portion of the SAICA membership has more than doubled since the global financial crisis. Data on fixed remuneration was gathered from job advertisements for newly qualified CAs(SA) in the Accountancy SA journal and adjusted for the time value of money. The remuneration data indicate that the market value of newly qualified CAs(SA) has been falling since the global financial crisis with a further acceleration down in 2015 and 2016. The membership records of SAICA and remuneration data do not support the notion of a shortage.

Policy suggestions based on these results are as follows. SAICA should delink their strategic objectives of transformation and growth. Transformation remains critical in South African society but will have to be achieved by means other than overall growth in SAICA membership. Universities, as important components in the supply chain of new CAs(SA), should be aware that the market value of the newly qualified CA(SA) is falling. Soon, students will start to realise this and migrate away from studying accountancy. Those universities who have assumed an ever increasing demand and allocated resources accordingly might find themselves overextended.

7. LIST OF REFERENCES


The impact of using different accounting frameworks in the public sector

Currently, all South African local government entities (municipalities) prepare their financial statements in accordance with Generally Recognised Accounting Practice (GRAP). However, most national and provincial government entities do so in accordance with the modified cash basis (MCB) which requires the recognition of transactions when cash is received, with supplementary accrual information provided in the notes to the financial statements.

This study investigates and analyses the financial statements of the Provincial Departments of Health, to determine whether the application of the accrual basis of accounting, when compared to the current application of the modified cash basis, will enhance the qualitative characteristics of financial information presented in the Annual Reports of these Provincial Departments.

For purposes of comparison the data collected focuses on the recognition and reporting of two specific elements in the financial statements, namely non-current assets and leases. This study finds that there are significant differences in the quality of financial information reported in accordance with the modified cash basis, compared to the accrual basis, thus emphasising the need for all public sector entities in South Africa to apply the latter.

Ilse Lubbe and Wandsile Mkubukeli – University of Cape Town

1. INTRODUCTION

The different entities and departments within the public sector in South Africa apply different accounting frameworks that are not compatible and thus result in the reporting of financial information that is not comparable, and in some cases, not relevant. Generally Recognised Accounting Practice (GRAP)¹ is currently applied by constitutional entities, Public FET Colleges, Municipalities and Municipal Entities, amongst others. However, most national and provincial departments apply the modified cash basis (MCB) of accounting for the recording and reporting of financial information. They will only be moving to GRAP once National Treasury has developed and implemented the Integrated Financial Management Information Systems. There is currently no indication as to when this process will be completed. Further, some public sector entities are required to apply the International Financial Accounting Standards (IFRS). These include entities that have ordinary shares that are publicly traded on capital markets, or with operations that are commercial in nature with only an insignificant portion of the entity’s funding acquired through government grants, or an entity that is a financial institution².

¹ Refer to Directive 5, Determining the GRAP Reporting Framework (ASB, March 2009)
² Refer to Directive 12, The Selection of an appropriate Reporting Framework by Public Entities (ASB, August 2015)
The current situation has significant implications for the quality of financial information reported by the different spheres of government, specifically relating to the relevance and faithful representation of the information provided. The use of different accounting frameworks seriously affects the comparability of financial information between different entities, and more so the ability to obtain some consolidated picture of the financial position of the combined public sector. However, it is acknowledged that changing from a cash basis to an accrual basis of accounting has its challenges, including that it takes time, requires changes in systems, upgrading of resources and training of staff.

To assess the relevance and faithful representation of financial information reported in accordance with the MCB basis, this article uses evidence from an investigation of the application of the MCB by the nine Provincial Departments of Health (DoH). The presentation of financial information relating to capital assets and leases is compared to the information that would have been reported had the accrual basis of accounting (i.e. GRAP) been applied.

### 2. FRAMEWORKS DESCRIPTIONS

The MCB\(^1\) recognises transactions in the financial statements when there is a cash flow movement, thus when cash is received or paid. A transaction incurred on debt, for example credit purchases, is therefore not recorded in the financial records when the transaction occurs. Under the MCB, supplementary accrual information is provided in the notes to the financial statements of assets and liabilities that would have been recognised had an accrual basis of accounting been applied. MCB reporting requires disclosure in the notes to the financial statements of transactions that have taken place where there has been no cash movement. This is done by stratifying the information into primary and secondary financial information, primary being the information that is recognised in the actual financial statements and secondary information being that which is presented and disclosed in the notes to the financial statements. Despite the fact that one is considered primary and the other secondary, both sets of financial information are considered of equal importance.

GRAP standards, developed and approved by the Accounting Standards Board (ASB), are accrual based, similar to IPSAS (International Public Sector Accounting Standards) and IFRS (International Financial Reporting Standards). Some notable differences between GRAP and IFRS include specific GRAP standards that deal with principal-agent relationships, heritage assets (for assets like museums and national parks), and ‘Statutory Receivables’ (for grants public entities are expecting to receive from national government).

---

1. Modified Cash Standard, National Treasury, December 2015
3. APPLICATION OF ACCRUAL BASIS OF ACCOUNTING

Over the past 20 years, the choice between the accrual basis or the cash basis for accounting and reporting of financial information, specifically for public sector entities has been much debated. The accrual basis of accounting provides users with more reliable and relevant information regarding an entity’s assets, liabilities and any obligations. It also provides users with information regarding how management has used the resources to achieve its service mandate (Berger, 2015). Other benefits include the recording and reporting of payables, such as accruals and provisions, when there is an obligating event. This is specifically relevant in the current economic climate, where the government has several obligations that may result in the recognition of a provision should the accrual basis of accounting be applied, for example the obligation to provide social grants to the elderly.

The accrual basis of accounting has been the subject of criticism, and arguments include:

- The application of accrual accounting depends on the skills base of people in the public sector (Tudor & Mutiu, 2006);
- The accrual basis of accounting is irrelevant for the public sector, as it is based on profitability, and not on delivery of services (Guthrie, 1998; Wynne, 2007);
- Even with the adoption of the accrual basis of accounting, the costing of services is still poor and inconsistent and often leads to overspending of budgets (Wynne, 2007);
- A change from cash accounting to accrual accounting creates conflict between operation and accounting staff as new procedures have to be introduced (Nor-Aziah & Scapens, 2007);
- Entities do not change their day to day operations to comply with the reform, but change documentation that is of use to external users merely to appear as if they have reformed (Nor-Aziah & Scapens, 2007);
- Accrual accounting information is difficult to understand for both users and preparers of financial information which makes the use of the accrual basis a more challenging exercise as it excludes some of the population when in use (Paulsson, 2006);
- The accrual basis opens doors for creativity and/or manipulation by preparers of financial information, as some accounting transactions require the use of judgement for their actual recognition (Paulsson, 2006).

Other criticisms of the adoption of the accrual basis in the public sector include aspects such as that it is adopted for prestige rather than a dire need, and that the public sector is more focused on cash and what the cash is committed for, in line with the budgeting process.

Conversely, a strong argument is made for government accounting and reporting to include the accrual-basis for financial reporting purposes, and to integrate it into the budgeting process. To the public at large and to most government officials, the budget is still the primary financial document and is key for financial decisions, and to hold governments accountable (Warren, 2014). It is therefore suggested that financial information based on the accrual basis should be integrated into the budget process. Accrual budgeting explicitly forecasts and shows how resources are raised and used, and how obligations are incurred and settled. Cash budgeting, on the other hand, only focuses on the forecasting and allocation of one economic resource, that is, cash. Fundamentally, accrual budgeting differs from cash accounting by being transparent about two separate decisions. First, there is a decision on the cost of an item, and secondly, there is a decision on how and when that cost will be settled. Cash budgeting conflates these two separate decisions, and therefore fails at times to fairly forecast their
The conceptual frameworks of both the MCB and GRAP include the following terms as characteristics that enhance the quality of financial information, namely reliability, relevance, and understandability. Reliability is defined under both frameworks as financial information that is free from material error and bias. Relevant information is defined as information that helps users evaluate past, present and future events, and that is useful to the decision making needs of users.

Both frameworks recognise that a user is a person who has an understanding of government and the activities being analysed. Users include parliament, the legislatures and municipal councils, who require information to assist them to assess whether proper stewardship is exercised. However, the recording and reporting of transactions and events in accordance with these two frameworks are significantly different, raising the question whether the current application of the MCB affects the quality of financial information reported, specifically with reference to the relevance of the information, understandability and informing user decisions.

4. CURRENT APPLICATION OF THE MCB IN PROVINCIAL DEPARTMENTS OF HEALTH IN SOUTH AFRICA

To assess the relevance of the application of the MCB, the financial statements of all nine the Provincial Departments of Health (‘DoH’) included in their respective annual reports for the fiscal period 2012-20134, have been scrutinised. Reference is made to two specific types of transactions, namely the recognition and measurement of capital assets/property, plant and equipment (PPE) and leases. These two elements are particularly relevant as capital assets, and assets used in terms of lease contracts, are significant for use in hospitals and other medical care.

4.1 FINDINGS ON CAPITAL ASSETS/PPE

- There is no distinction drawn between capital assets that are tangible or intangible and both are included in the MCB capital assets chapter. GRAP includes several standards dealing with various capital assets, such as tangible, intangible and heritage assets. The GRAP requirements for classification of non-current assets give more reliable financial information, for example the identification criteria included in GRAP 103, Heritage Assets and the indication of economic benefits flowing from the intangible asset if it is self-generated, included in GRAP 31, Intangible Assets.

- The MCB divides capital assets into minor and major assets, separated through a value threshold set by National Treasury. In the analysis of the financial statements of the provinces, there was no amount disclosed as the value threshold so it was not possible to understand why certain assets were minor and why the others were major assets. This indicates a compromise of the qualitative characteristic of financial information being understandable and informing decision-making.

- MCB requires the measurement of an asset at its fair value if it was acquired for no consideration or in exchange for another asset; and where the fair value cannot be ascertained, an asset is measured at R1. GRAP requires that an asset is initially measured at cost or fair value, with specific mention of the steps to be taken to ascertain the assets’ fair value, while the MCB standard does not contain such steps. GRAP leads to more reliable information, as the user is able to follow how the asset’s fair value was ascertained.

* The reason for referring to the 2012-2013 fiscal period, is that, at the time of the study in 2016, this was the most recent reporting period where information was available for all nine provinces.
• The accrual basis requires that an asset is recognised when the transaction happens, thus when control of the asset is obtained. GRAP also states that an asset acquired outside normal credit terms includes a finance component, and is measured at the present value of the future payment, thus taking into account the interest component. The MCB basis has no mention of assets acquired beyond normal credit terms. The analysis of information included in the respective DoH’s Annual Reports shows that assets are included at their actual cost in the capital assets reconciliation note and the accompanying note states that those are assets received before payment. Once the assets are paid for, they are then deducted in the capital assets reconciliation note as a form of reversal of their previous addition and there is no explanation of this procedure in the notes. This form of presentation is not understandable to a user, as it seems like the asset has been disposed of in the next year. An asset should not on initial recognition be measured at its fair value if the asset is acquired beyond normal credit terms.
• Under the MCB basis, capital assets are initially and subsequently measured at cost and there is no depreciation or impairment recognised. PPE under GRAP is subsequently depreciated and impaired (if necessary). Depreciation is the cost of using the asset, in other words how economic benefits flow from the use of the asset, resulting in a decrease in the carrying amount. The application of accrual accounting requires that the cost of using an asset is recognised over its useful life reducing to its residual value. Information under GRAP is more reliable as the user is able to identify the cost of using an asset for service delivery, as well as the future economic or service delivery potential of the asset. The MCB presents an unrealistic value of the assets if recorded at cost throughout their useful life.
• GRAP allows the revaluation model as an alternative subsequent measurement basis. An asset is revalued at regular intervals to its fair value and depreciated over its remaining useful life. The application of the revaluation model results in more relevant and comparable information regarding the current value of non-current assets. This may be appropriate in the health sector, specifically relating to highly specialised, technical equipment.
Table 2: Differences between GRAP and MCB for Capital Assets/PPE:

The table below indicates the quantity and quality of information required in terms of the two reporting frameworks of capital assets, highlighting the differences when recording and reporting financial information in accordance with the accrual basis (i.e. GRAP), compared to the cash basis (MCB).

<table>
<thead>
<tr>
<th>Property, plant and equipment</th>
<th>MCB Chapter: Capital Assets</th>
<th>GRAP17, Property, plant and equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Recognition</td>
<td>Cost or Fair Value, or R1 if neither</td>
<td>Cost or Fair Value, or Present Value if beyond normal credit terms</td>
</tr>
<tr>
<td>Subsequent Measurement</td>
<td>Cost at all times</td>
<td>Cost less accumulated depreciation, recognising cost of using the asset. Land not depreciated.</td>
</tr>
<tr>
<td>Policies used</td>
<td>Cost model at all times</td>
<td>Cost model, less accumulated depreciation and impairment; or revaluation model, less accumulated depreciation and impairment</td>
</tr>
<tr>
<td>Depreciation Method</td>
<td>None</td>
<td>Depreciated in accordance with usage. Component approach if there are components that are significant with a different depreciation method. Useful life and residual value must also be disclosed and changes in estimates accounted for</td>
</tr>
<tr>
<td>Components of reconciliation note</td>
<td>Opening balance, additions, disposals and closing balance</td>
<td>Opening balance, additions, disposals, depreciation charge, impairment charge, accumulated depreciation, closing balance</td>
</tr>
<tr>
<td>Impairment testing of the asset</td>
<td>No impairment</td>
<td>Impairment test when there are indications of impairment, resulting in an impairment loss or reversal</td>
</tr>
</tbody>
</table>

The analysis of the DoH’s Annual Reports further highlights that, in the capital assets reconciliation, for assets that have been acquired in the current year, there is no distinction made between assets acquired under a finance lease and additions arising from the capitalisation of expenses that meet the criteria to be capitalised. The separation of the assets controlled under a finance lease and capitalisation of expenses (including borrowing costs) would have resulted in reliable and more relevant information being presented.
4.2 FINDINGS ON LEASES

Similar comparisons are made of the accounting treatment for leases, focussing on the DoH as the lessee. The following differences are identified in the reporting and presentation of leases under the MCB, compared to the accrual basis in accordance with GRAP:

- For an operating lease, the statement of financial performance under the MCB basis will have the actual cash flows paid by the lessee. GRAP requires that lease payments are straight-lined and the difference between cash outflow and the straight-lined lease payments is recognised as an asset or a liability. The accounting treatment of operating lease payments in accordance with the accrual basis results in the lease expense being recognised evenly over the period of the lease, relevant when lease payments are deferred, or upfront payments are made.

- In accounting for finance leases, applying the MCB, the asset is not recognised at the transaction date when the lessee has obtained control of the asset. The asset is only recognised at the end of the lease term. Thus assets controlled by the entity are not recognised, resulting in financial information being presented that does not fairly represent the substance of the lease transaction.

- MCB does not differentiate between the interest and capital payments for finance leases. All payments are treated as a repayment of the capital portion. In accordance with the accrual basis, a liability for the minimum lease payments is recognised (together with the asset) when the lease is entered into and there is a distinction between the interest and capital portions. The finance cost is separately recognised in the statement of financial performance, thus allowing users to identify the cost associated with the lease.

- In a sale and leaseback transaction for finance leases, the asset is removed from the lessee’s records under the MCB basis while the asset is maintained in the lessee’s books under GRAP as in substance the risk and rewards have not been transferred to the lessor. Relevant information is reported with the application of the accrual basis (GRAP) as the substance of the transaction is recorded and recognised.
The table below identifies the differences in the quality of financial information relating to leases reported in accordance with the accrual basis (i.e. GRAP), compared to the cash basis (MCB).

<table>
<thead>
<tr>
<th>Leases</th>
<th>MCB Chapter: Leases</th>
<th>GRAP13, Leases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating lease payments</td>
<td>Lease payments are all outflows</td>
<td>Lease payments are straight-lined and the differences between accrual and cash flows are treated as a liability or asset</td>
</tr>
<tr>
<td>Finance leases</td>
<td>Capital expenditure in statement of financial performance for lease payments</td>
<td>Lease asset and lease liability recognised at the start of the lease period</td>
</tr>
<tr>
<td>Finance leases</td>
<td>No separation of interest and capital payments</td>
<td>Interest and capital payments separated and only interest expense shown in statement of financial performance</td>
</tr>
<tr>
<td>Sale and leaseback transaction</td>
<td>Lessee derecognises asset upon entering into a sale and leaseback for finance leases</td>
<td>Lessee keeps the asset in its books as transaction is in substance a loan for finance leases</td>
</tr>
</tbody>
</table>

The presentation of financial information by the nine provincial DoH’s, in accordance with the MCB, raises concerns about the relevance, reliability and decision usefulness of financial information presented. The investigation revealed that the application of the accrual basis (GRAP) enhances the quality of financial information for the following reasons:

- For PPE, assets are depreciated and impaired, resulting in a faithful representation of financial information since the assets are recognised at their carrying amount each year and users are able to identify the economic benefits that have been derived from the use of the asset and the remaining economic benefits. Under the MCB, assets are kept at cost throughout their useful life and are not depreciated, which means the value presented in the financial statements is not a true reflection of the economic benefits expected to be derived from the use of those assets.
- For leases, assets are recognised when the lease is entered into for finance leases as the control of the asset passes to the lessee when the risks and rewards of ownership are transferred. Under the MCB, upon entering into a finance lease, the lessee only recognises the asset at the conclusion of the lease, which does not truly reflect the substance of the transaction. The leased asset, as well as the corresponding lease liability, is not recognised.
5. CONCLUSION

Accrual accounting is a key element of modern public management, as it increases transparency of government accounting and provides information that is more reliable. Financial reporting plays a major role in fulfilling government’s duty to be publicly accountable for the collection of taxation and other revenue, and its use in the rendering of public services. Stewardship and accountability for the use of public funds and the safekeeping of resources is of paramount importance. The differences in the quality of financial information reported in accordance with the MCB compared to the accrual basis (in accordance with GRAP and IFRS) are highlighted. This has significant implications for the consistency and comparability of financial reporting in the public sector in South Africa. There is an clear need for the application of accrual accounting to be extended to all spheres of government, including the challenges associated with the preparation of budgets and their comparability to the reported financial results, setting and meeting predetermined objectives and key performance indicators. These will improve government’s ability to assess whether fiscal policies are sustainable over the long term.

6. LIST OF REFERENCES


