GUIDANCE ON THE TERM
‘STATE-CONTROLLED ENTITIES’
IN THE CONTEXT OF IAS 24(AC 126) – RELATED PARTIES

Introduction
This Circular is applicable to ‘state-controlled entities’, which are required to comply with Statements of Generally Accepted Accounting Practice (GAAP). This Circular provides guidance on the term ‘state-controlled entities’ in the South African context as envisaged by paragraphs 9(a)–(c) of IAS 24(AC 126) – Related Parties.

Issue
AC 126 – Related Parties revised in June 2001, exempted state-controlled entities from certain disclosure requirements of the statement. The relevant paragraph of this version of AC 126.05(d) states:

“No disclosure of transactions is required:
(d) in financial statements of state-controlled enterprises of transactions with other state-controlled enterprises.”

A further reference is AC 126.07 (b) (iii) and (iv), which states:

“In the context of this Statement, the following are deemed not to be related parties:
(b) (iii) public utilities, and
(iv) government departments and agencies,...”

The situation has changed with the issue of the improved statement IAS 24(AC 126) – Related Parties issued in March 2004, and effective for reporting periods beginning on or after 1 January 2005. In this latest version of the statement, state-controlled entities have been fully scoped into the statement. Paragraph IN6 states:

“State-controlled entities are within the scope of International Financial Reporting Standards, i.e those that are profit-orientated are
no longer exempted from disclosing transactions with other state-controlled entities”.

Further, paragraph IAS 24(AC 126).11 (c) (iii) and (iv) states:

“In the context of this Standard, the following are not necessarily related parties:

(c) (iii) public utilities, and

(iv) government departments and agencies, ...

simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).”

The issue that arises in the South African context, and where guidance is required, is which state-controlled entities are considered to be related parties.

The Constitution of the Republic of South Africa defines three spheres of government, being:

- national government,
- provincial government, and
- municipal government.

Under the Constitution, all three spheres of government are guaranteed constitutional independence. Control, in terms of Statements of GAAP, is defined as the power to govern the financing and operating policies of an entity so as to obtain benefit from its activities. The constitutional independence means that none of the spheres of government control any of the other spheres. Therefore, all entities within any one of the three spheres of government act autonomously from entities in another sphere, and entities in each sphere have their own legislative powers. No single governmental control is exercised over all three spheres, i.e. there are effectively three different and autonomous ‘blocks’ of government.
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In South Africa, state controlled entities are referred to as public entities in the national and provincial spheres of government and as municipal entities in the municipal sphere of government.

Conclusion

As a result of the constitutional independence of all three spheres of government, it cannot be inferred that public entities across the three spheres of government are related parties in the context of IAS 24(AC 126). However, if a public or municipal entity has a relationship with an entity in another sphere of government, that relationship would need to be assessed in terms of IAS 24(AC 126).

Within the national sphere of government, public entities are related parties in the context of IAS 24(AC 126) and are required to comply with the statement.

Within the provincial sphere, the nine provinces act autonomously from one another. Accordingly, the entities under the control of one province are not related parties to entities under the control of another provinces. Should two or more provinces control an entity jointly, the relationship should be assessed in the light of IAS 24(AC 126) to determine any related parties.

Within the municipal sphere of government, two hundred and eighty four municipalities have been established. A municipality and the municipal entities under its control are related parties. Each municipality is unrelated to another municipality unless a cross-jurisdictional entity has been established by two or more municipalities.

From time to time, through national legislation, an entity in one sphere of government may take temporary control of an entity in another sphere. For example, the department of provincial and local government, an entity in the national sphere of government, may exercise temporary control over a municipality, an entity in the municipal sphere of government. During this period of temporary control, the municipality and the entities it controls are related parties of all the entities within the national sphere of government.
National Treasury is responsible for providing the schedules detailing which public entities fall within the different spheres of government. The list of public entities within the three different spheres is updated from time to time and can be found on its website www.treasury.gov.za. These schedules must be referred to when determining which state-controlled entities are related parties in the context of applying IAS 24(AC 126).

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April 2005                            Executive President