JSE

# FINAL FINDINGS OF OUR THEMATIC REVIEW FOR COMPLIANCE WITH IFRS 9 AND 15

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## BACKGROUND

### Introduction

In December 2018 the JSE advised the market of our intention to embark upon a thematic review process ("**TR process**") for the application of the new financial instruments and revenue standards, IFRS 9 and IFRS 15 ("**the new standards"**). In the month before their year ends we wrote to a limited number of companies ("**the sample entities**"), advising them that their next Annual Financial Statements (**"AFS"**) would be subject to the TR process. We tried to ensure that the sample entities were from a cross section of industries and included both equity and debt issuers ("**issuers**").

### The nature of a thematic review

A thematic review is a limited review focused on a specific matter or accounting standard and is not the typical comprehensive review normally undertaken by the JSE in its proactive monitoring activities. The aim of a thematic review is to advise the market (and specific issuers) of priorities for a future review and then to provide market feedback on the outcome of such reviews. The concept is in line with international practice adopted by fellow regulators in the UK and in jurisdictions falling under the European Securities Market Authority, whom we generally use as a benchmark for our proactive monitoring. The approach has shown significant benefits in improving financial reporting in those jurisdictions and we therefore believe that it is an appropriate tool to apply in our market.

### Why this report?

Our stated intention of this TR process is to provide feedback to the market as a whole, with the aim of identifying examples of good compliance with clear and concise disclosures. In order to provide timely benefit to issuers who had not yet reported under the new standards, we issued a preliminary report in July 2019. Having now completed the TR process, we are issuing this final report, which supersedes the July version.

We believe that all reporters (even issuers who have already applied the new standards) can benefit from considering the content of this report, in identifying gaps in their application of the new standards for either application or correction in their future results publications. Issuer can also consider the lessons learnt from applying the new standards in the context of the adoption of the new leases standard, IFRS 16.

**Caveat**

The contents of this report must be read within the context of the limitations introduced by both the selection process applied and the timing thereof.

We looked to select approximately 20 AFS and created a pool of issuers with a December year ends (with a primary listing on the JSE). From that pool wanted to create a sample that included a cross section of industries or sectors; sizes of issuer; and audit firms. Where there was more than one issuer in the same sector, we applied the filter of the next two criteria. If this did not create an obvious result, we randomly selected an issuer. Two sectors were not represented within our December pool and therefore we looked at February reports from those sectors, applying the same criteria as set out above.

As a consequence of the selection process, whilst we have identified what we regard as useful examples of the application of a specific matter, we have not assessed the sample entities against their competitors and make no assertions in this regard. Inclusion in the sample (and therefore in this report) was a largely random process.

Furthermore, as this is the first year of application of the new standards we would expect disclosures to improve in subsequent periods. Therefore, it is likely that even our good examples will be superseded by better examples over time.

Finally, whilst we have extracted disclosures to emphasise a specific point, it would be incorrect to assume that we believe that all of the disclosure across all of our focus areas in the AFS of those sample entities are necessarily at a level to warrant the description of 'good reporting' or are in full compliance with the new standards.

**What did we consider?**

The TR process is neither an audit nor a detailed interrogation of accounting systems, valuations or business processes. The findings set out in this report should be considered with this in mind. As with our traditional proactive monitoring process, the source for our review is the published

financial results and our main consideration of the disclosures contained therein. The TR process was applied across the following five focus areas for each of the new standards:

1. General, considering consistency and ensuring no clutter
    - How does the information align to other information that has been released in for example interims, provisional, previous AFS, pro formas or in the accompanying integrated report;
    - Are the new disclosures orderly, concise (i.e. not duplicated), coherent and appropriately cross referenced; and
    - How were the new standards applied in the interim results.
2. Accounting polices
    - Are these entity specific; and
    - Do they address all the relevant aspects of the IFRS.
3. Key judgments and assumptions
    - Are all of the relevant key judgement areas and assumptions identified and discussed.
4. Specific disclosure requirements of the standard
    - Have these been applied in an appropriate and entity specific manner.
5. Transitional requirements
    - Is there sufficient presentation and disclosure and is it entity specific.

**Benefits of receiving pre-warning of focus areas**

Several of the sample entities indicated that our December letter was useful to them in implementing the new standards. The implementation of the new standards was for many of the sample entities a large scope experience. The information contained in the December letter was therefore used to:

- assist in determining key focus areas of focus for these new standards; and
- ensure that the information presented was relevant to users i.e. as a guide to test that sufficient level of detail was provided in the identified areas.

In certain instances audit committees used it as a tool, requesting management to report back to them on where and how the highlighted areas were addressed.

We trust that this report can be used by upcoming reporters in a similar manner.

**Collaborative effort**

We wish to express our appreciation to the manner in which the sample entities have embraced the TR process.

It is clear that all sample entities paid attention to the content of our December letter in the various areas when preparing their AFS. They strived to present good disclosures for the new standards, especially for those that they believed would have the greatest impact on them. Through their efforts the first objective of the TR process was achieved.

The sample entities have been engaging with us in a transparent and collaborative manner. Their prompt response to our enquiry letters helped facilitate the timely issue of our preliminary report (issued in July 2019).

The management time and effort taken to provide us with detailed and considered responses has assisted in populating the content of this report. Finally, those responses have provided us with regulatory benefit which we intend to apply during the course our traditional proactive monitoring process.

## SECTION A : FINDINGS APPLICABLE TO BOTH NEW STANDARDS

This section provides an overview of areas where we believe issuers could focus their attentions for their forthcoming results. The headings we have used align with the focus areas set out above.

### General

Alignment between AFS, interim results and 'prior-to adoption' AFS

One of the key findings of the TR process has been the misalignment between the information in AFS and interim results.

Misalignment may have occurred in:

- the initial determination of the impact of the new standards as disclosed in the interims vs to the financial determination as disclosed in the AFS; or
- disclosures that were either omitted or incorrectly provided in the interims.

The misalignment was specifically pronounced in the area of disclosures. In striving for good reporting we ask that upcoming reporters:

(i) Be transparent in identifying and providing meaningful explanations in their AFS of any misalignment that has occurred; and

(ii) Enable investors to have a full understanding of the impact the new standards have on their interim. Therefore they should consider providing any correct/omitted disclosures as it relates the past interims with the year end results, as opposed to waiting for the next set of interims (which maybe some 7 months away).

Misalignment may also have occurred between the disclosures provided in terms of IAS 8.30 in the 'prior-to-adoption' AFS compared to the 'post-adoption' interim results and/or AFS. Point (i) above applies equally to this scenario.

We share certain lessons learned by our sample entities, which could assist issuers in preventing similar problems from occurring when they implement the new standard on leases, IFRS 16. Sample entities identified the following problems and preventative steps that could have been taken:

- Given the complexities of the new standards they should have established their implementation project earlier and should have provided more resources to the project;
- By not implementing a comprehensive project and focusing mainly on the larger companies in the group at the interim reporting stage, the sample entity inadvertently did not identify the fact that customer contracts within those smaller group companies were significantly impacted by the new standards. This was subsequently only identified at year-end;
- More careful consideration should have been given before inclusion in the interims (and equally the ‘prior-to-adoption’ AFS) of a statement that there will be no or no material/ significant impact of the new standards, as:
    - Uncertainties are likely to exist at that time of interim reporting which may only crystallise during the year end process; and
    - Such statements may incorrectly be made on the basis of the potential quantitative impact, without certainty of the other qualitative implications, including the disclosure requirements of the new standards;
- The focus was on measurement issues and not enough attention was given to the qualitative and quantitative disclosure obligations under the new standards;
- Consequential changes made to IAS 34 as a result of the issuance of the new standards should have been identified; and
- The annual financial reporting procedures, in terms of consultation with external IFRS experts, should also have been applied for the interim results, in order to test the robustness of management’s understanding and application of the new standards.

Assessment of materiality

Materiality is an important consideration in the application of IFRS. We wish to remind issuers that that assessment of materiality should not only made be from the perspective of the statement of financial position i.e. ignoring profit. For example, whilst a financial asset may not be large in the context of the other assets, a partial impairment of that asset could have a significant impact on the net profit of the entity.

Materiality is also a qualitative assessment and must be considered holistically, including taking into consideration the objective and nature of disclosures.

Finally, a materiality threshold based purely on the auditor's materiality (which is set for the purposes of their audit) is not appropriate. Whilst IFRS practice statement 2: Making materiality judgements is not mandatory in terms of IFRS, it is usefully in both providing a framework and pulling together references relating to the concept of materiality that are already contained in IFRS. We would in any event expect that all reporting entities apply a materiality framework (which is independent of and potentially different to that of the auditors assessment of materiality) when preparing their AFS.

Financial reporting systems

The introduction of new disclosure obligations necessitates system changes well in advance of reporting periods.

The decision not to disaggregate revenue cannot be based on a 'feeling' that, for example the export customers are unlikely to be material. A formal, methodical materiality assessment must be both documented and applied. This necessitates the collection of the underlying data.

In a specific instance the presentation of an aggregation of '120 days' worth of trade receivables from various countries and sectors meant that the issuer clearly did not comply with IFRS 7 and perhaps even IFRS 9. The issuer argued that they did not have the financial systems to capture more disaggregated information, for example to show the large portion of trade receivables that were:

- outstanding for more than a year, or
- originated from the public sector or a foreign country.

Inadequacy of financial systems is not an acceptable excuse for non-compliance with IFRS.

Housekeeping matters

We recognise that the adoption of the new standards requires enormous effort and resources from finance departments both in terms of obtaining a clear understanding of those standards as well as in applying them. It is therefore not surprising that there were several instances of housekeeping matters, where wording relating to the 'old' standards inappropriately survived (i.e. they were unrelated to the hedging requirements of IAS 39). This could have been prevented through a combination of the following techniques:

- A complete rewrite of accounting policies as opposed to amending existing wording. The latter approach runs the risk of incorrect wording being carried forward; and
- Applying a simple 'search and find' to the draft AFS, looking for either direct reference to the old standards or wording used to describe the old standards (for example 'incurred loss model' or 'loans and receivables').

Other housekeeping matters related to:

- the ordering of notes;
- coherency of disclosures in terms of contradictory messages between various sections of the AFS; and
- the inclusion of accounting policies for items that do not apply to the issuer (for example hedging).

The focus for the first set of AFS under the new standards is likely to be on the 'big ticket' matters and we are sure that issuers will redefine their disclosures in subsequent periods. Issuer could accelerate this process in the first year of adoption through tasking an individual (with sufficient IFRS knowledge) who has not been involved in the detail, to perform a cold read of the AFS. Such a review should not be performed too late in the process, otherwise there may be insufficient time to implement any changes that they may recommend.

Inconsistencies between the AFS and the audit report

In certain instances the auditors included a Key Audit Matter ("**KAM**") in their report relating to some aspect of the application of new standards. The disclosures in the AFS on that same matter were thin, which resulted in further engagement between the JSE and the sample entities.

Whilst from a quantitative perspective the matter may not have resulted in a material amount being raised, the existence of the KAM often triggered the need for the issuer to also address qualitative materiality through disclosures such as:

- what significant judgements (and related sources of estimation uncertainties) were applied (IAS 1.122); and
- why the KAM had indicated certain risks (for example a concentration of risk).

The adoption of the new standard was material from a qualitative perspective and therefore warranted more than just cursory disclosure.

Impact of transition to the new standards

In our December letter we laid out our expectations for issuers to be transparent as it related to changes made at the time of applying the new standards clearly distinguishing between the:

- impact of the new standard; and
- correction of errors identified, in hindsight, when considering the new standards.

We urge upcoming reporters to pay careful attention to this area in preparing their AFS.

There were several instances within our sample entities where we challenged statements to the effect that 'all amendments were due the adoption of the new standards'. This was particularly the case when the impact of the new standard was contrary to market expectations. One such example being when the expected credit loss allowance for trade receivables decreased under IFRS 9 compared to IAS 39.

It appeared to us that certain amendments were actually correction of errors. There have been cases where our concerns were valid. In other instances, our questions were avoidable, had those sample entities provided full disclosure of the key judgements that lead to this change in accounting.

In response to our December letter, one of our sample entities amended their disclosure regarding the impact of the new standards. In their interims they had stated that the changes were as a result of the new standards, whilst in their AFS they more correctly identified that the changes were necessary to correct errors made under the old standards. Such action is to be commended as it demonstrates a clear commitment to transparent reporting and supports the JSE in its objectives to improve confidence in financial reporting.

**Transitional requirements**

The nature of the sample entities' businesses meant that the new standards impacted them differently. IFRS 15 did have a significant impact on certain sample entities. The example set out below is an extract of the type of narrative that one sample entity included in their AFS. They did this for each significant impact of the new standard, providing concise information to understand the differences and accounting impact of the adoption of IFRS 15. This narrative linked directly to their 'reconciliation of the adjustment to retained earnings on adoption of IFRS 15', with the separate disclosure of the quantum of the impact of each significant impact (example 1).

| Nature, timing of satisfaction of performance obligations, significant payment terms | Nature of change in accounting policy | Impact |
|---|---|---|
| The group recognises revenue when the customer takes possession of the device. For mobile devices sold separately, customers pay in full at the point of sale. For mobile devices sold in bundled packages, customers usually pay monthly in equal instalments over a period of 24 months. | *Earlier recognition of mobile device revenue*<br>The group previously anticipated early contract upgrades and based the subscriber contract period on the expected term and accounted for any consideration received beyond the anticipated upgrade period as network services revenue as it was earned (mainly in its South African operation).<br><br>Following the adoption of IFRS 15, the group bases the subscriber contract period on the contractual term and accounts for early upgrades as contract modifications. The effect of the modification is that the contract asset at modification date is treated as a payment to a customer and results in a reduction of the revenue from the subsequent contract. | This has resulted in an increase of the transaction price in postpaid contracts and an increase in revenue allocated to devices.<br><br>As device revenue has increased and is recognised upfront, this has resulted in a larger contract asset balance that is impaired when customers default on payments on their postpaid contract, i.e. an increase in impairment of trade receivables and contract assets. |

We remind issuers that the consideration of the impact of the new standards, and the materiality of the transitional disclosures, should be considered not only from a quantitative perspective, but also qualitatively. We do not believe that merely saying that the impact is insignificant is appropriate to ensuring that the reader obtains a full understanding.

We support the approach of one specific sample entity in this regard. Even though they assessed, and stated, that the reclassifications under IFRS 9 did not have a significant impact for them, they supplemented this statement. They provided a concise and complete qualitative narrative in tabular form (together with quantitative information) to enable the user to understand the impact of the transition to IFRS 9 as it related to the classification requirements and changes in measurement of those categories (example 2).

**Classification, initial recognition and subsequent measurement**

IFRS 9 introduces new measurement categories for financial assets. The impact of the measurement categories of IFRS 9 on the group's financial instruments is illustrated in the table below. From 1 January 2018 the group classifies financial assets in each of the IFRS 9 measurement categories based on the group's business model for managing the financial asset and the cash flow characteristics of the financial asset.

| | Measurement category | | Carrying amount | |
|---|---|---|---|---|
| | IAS 39 | IFRS 9 | 31 December 2017 IAS 39 Rm | 1 January 2018 IFRS 9 Rm |
| **Non-current financial assets** | | | | |
| Loans and other non-current receivables | Loans and receivables | Amortised cost | 2 574 | 2 574 |
| Investments* | Available for sale | FVOCI | 27 686 | 27 686 |
| **Current financial assets** | | | | |
| Trade receivables | Loans and receivables | Amortised cost | 15 162 | 15 189 |
| Other receivables | Loans and receivables | Amortised cost | 9 719 | 9 719 |
| Current investments** | Loans and receivables | Amortised cost | 2 040 | 2 040 |
| Current investments*** | FVTPL | FVTPL | 1 669 | 1 669 |
| Current investments** | Held-to-maturity | Amortised cost | 1 500 | 1 500 |

* The group has designated the investment in S and other unlisted equity investments as at FVOCI as these instruments are not held for trading.
** This comprises treasury bills whose cash flows represent solely payment of principal and interest and is held within a business model to collect contractual cash flows.
*** This represents investments in cell captives and treasury bills held for trading.

**Classification, initial recognition and subsequent measurement (continued)**

The reclassification into the new measurement categories of IFRS 9 did not have a significant impact on the group.

The total impact of the reclassifications on the financial asset measurement categories are as follows:

| | FVTPL Rm | FVOCI (Available for sale under IAS 39) Rm | Held-to-maturity Rm | Amortised cost (Loans and receivables under IAS 39) Rm |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Closing balance at 31 December 2017 | 1 874 | 28 029 | 1 500 | 47 880 |
| Change in carrying amount due to change in measurement under IFRS 9 | – | – | – | 27 |
| Change in carrying amount due to change in measurement category under IFRS 9 | – | – | (1 500) | 1 500 |
| IFRS 9 Opening balance | 1 874 | 28 029 | – | 49 407 |

Putting aside standard specific transitional provisions, IAS 8 already governs the disclosure for the impact of adoption of a new standard. We found the following problems in this area:

- the presentation of an aggregated impact of both IFRS 9 and 15 (which we believe is unhelpful and contrary to IAS 1.29);
- the omission of disclosure of the amounts by which <u>each</u> line item in the AFS is affected (IAS 8.28(f)(i); and
- the omission of disclosure of the impact of the new standards on earnings per share (IAS 8.28(f)(ii).

**SECTION B : FINDINGS-IFRS 9**

**General**

There was an instance where certain financial assets were reclassified in applying IFRS 9 when compared to their IAS 39 classification. Further engagement with the sample entity revealed that this reclassification was not in fact due of the adoption of IFRS 9, but rather that the items were incorrectly regarded as financial assets when they were never under the scope of IAS 39 in the first place. The settlement of the contractual obligation for these assets did not result in receipt of cash or another financial asset.

Several issuers focussed all their attention on trade receivables and neglected their other material financial assets, leading to an incomplete application of IFRS 9 and the disclosure provisions of IFRS 7. Problem areas were in the context of loans receivable, loans to joint ventures/ associates, contract assets and 'other receivables'. This matter was compounded by the (inappropriate) aggregation of 'other receivables' into one total figure.

**Accounting Policies**

Problems that existed with accounting policy disclosures as it relates to IFRS 9 link in to some of the matters set out in section A above under the 'housekeeping' heading including:

- accounting policies carried over from IAS 39 as if they applied financial instruments in the current year (This comment does not relate to the sample entities that disclosed their old accounting policies adjacent to their new standards-based accounting policies, with clear reference that the old accounting policy relates to the comparative period);
- inconsistencies between commentary around IFRS 9 in the management commentary and accounting policy section;
- duplicate disclosure of the same accounting policies in different sections of the AFS; and
- accounting policies that were irrelevant to the entity (for example hedging or a policy on the classification of financial assets measured at fair value through other comprehensive income ("**FVOC**I") and financial assets measured at FVOCI equity investment)).

In another instance the policy was generic, stating merely that financial asset classification was based on the business model and the contractual cash flow characteristics. It should rather have been tailored to the specifics of the entity by discussing the actual business model of the entity and

the contractual cash flow characteristics of the related instrument, linking this to the IFRS 9 classification of the financial asset.

Some policies were also confusing, stating that the financial instruments were recorded at fair value, but were classified as amortised cost. It would have been clearer to simply state that they were 'initially recorded at fair value and classified as subsequently measured at amortised cost'.

In discussing their accounting policy a sample entity referred to 'lifetime expected credit losses', without specifically stated that they used the simplified approach to measure expected credit losses. In discussing this matter with the sample entity, they indicated to us that 'life time expected credit losses' means that they applied the simplified method. Upcoming reporters should remember that this is not the case and 'life time expected credit losses' is covered under both the simplified and the general approach to determining expected credit losses.

Whilst the reconciliation of the expected credit loss ("**ECL**") for certain sample entities reflected write offs, these entities omitted their accounting policy for such write offs. The example below is deficient in providing entity specific indicators on reasonable expectation of recovery (IFRS 7.35F(e)), but is at least an entity specific policy (example 3).

***Write-off policy***
The group writes-off a financial asset when there is information indicating that the counterparty is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the counterparty has been placed under liquidation or has entered into bankruptcy proceedings, or in the case of trade receivables, when the amounts are over two years past due,

One sample entity had different distinct business operations and therefore included two different accounting policies for its ECL calculation; one on the simplified method and the other using the general approach. The financial assets were however not split accordingly in the statement of financial position, making it difficult to understand which assets fell within which category.

**Key judgements and assumptions**

The inclusion of entity specific (as opposed to generic) disclosures of the assumptions relating to ECL's will be more in line with our understanding of an entities obligations not only under IAS 1.122 but also in terms of the various requirements of IFRS 7. Linked to this is the obligation to provide entity specific disclosures of estimation uncertainty (IAS 1.125). Generic disclosures are of limited use

A useful test to assess whether something is generic or entity specific is as follows:

- copy those disclosures into the AFS of any other issuer operating in that sector;
- determine how they 'read' within the context of those AFS;
- is there is any relevant differentiating characteristics between the way that it reads in the context of your AFS compared to when it is read in the context of the other issuer's AFS;
- if the answer is no, then the disclosures are likely to be generic.

A sample entity included in their AFS the following specific forward-looking information about economic variables that impacted their ECL calculation (per IFRS 7.35G read in the context of IFRS 7.35B) (example 4).

**Economic variable assumptions**

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below. The scenarios "base", "bear" and "bull" were assigned weightings of 60%, 25% and 15% respectively, and used for all categories within the company's mortgage portfolio.

| 2018 | Base | Bear | Bull |
|---|---|---|---|
| **Interest Rates** | 0.25%-0.50% increase over the next 12 months, followed by a further increase of between 0.25%-0.50% over the period 2019-2020 | 0.75%-1.00% increase over the next 12 months, followed by a stabilisation thereafter | No increase in rates over the 12-month period following the reporting date, with an increase of 0.50%-0.75% over the period 2019-2020 |
| **Consumer Price Inflation** | Averaging 5% in 2018 increasing to around 5.5% in 2019 and 2020 | Breaches upper end of target band (6%) in 2019 and falling back below thereafter | Averaging 5% in 2018 increasing to around 5.5% in 2019 and 2020 |
| **Domestic GDP** | 1% in 2018 increasing to close to 2% thereafter | 0.5% in 2018 increasing slowly thereafter | 1.2% in 2018 and on an increasing path towards 3% thereafter |
| **Mortgage Extension levels** | Inflationary growth through forecast period | Nominal contraction in mortgage extension levels | Growth exceeding inflation through forecast period |
| **House Price Index** | Below CPI in 2018 followed by an improvement thereafter | Negative nominal house price growth in 2019 | House price inflation above CPI from 2019 onwards |

The AFS then included further scenarios (i.e. illustrating estimation uncertainty) as to how changes in these weightings could impact their calculation.

Set out below are the changes to the ECL as at 31 December 2018 that would result from reasonably possible changes in these scenario weightings from the actual weightings used by the company in measuring ECL at the reporting date:

| | Base | Bear | Bull |
|---|---|---|---|
| **Upward Stress** | 0% | 100% | 0% |
| **Actual weightings** | 60% | 25% | 15% |
| **Downward Stress** | 0% | 0% | 100% |

The impact of the "stress" adjustments on the ECL allowance is reported in the table below:

| | 2018 | 2017 |
|---|---|---|
| | R'000s | R'000s |
| **Upward Stress** | 4,387 | N/A |
| **ECL based on actual weightings** | 4,240 | N/A |
| **Downward Stress** | 4,118 | N/A |

Certain of the other sample entities did not identify the estimation of the ECL allowance as an area of significant judgement and estimation uncertainty. This decision was made taking into account the relative size of the trade receivables (within the context of the statement of financial position only) or where they deemed the credit risk to be zero (which in itself is a judgement area warranting disclosure-how many entities will never bear any risk of loss?). Material 'other receivables' balances also appeared to have been overlooked. The JSE challenged these assertions given its approach to materiality as discussed under section A above.

**Specific disclosure requirements of the standard**

Forward looking information

IFRS 7.35G calls for an explanation of the inputs, assumptions and estimation techniques used in recognising the ECL allowance, including how forward-looking information has been incorporated into the determination and how macroeconomic information was used. This is likely to be a high focus area in our traditional proactive monitoring activities as we found disclosures to be lacking in terms of providing information that was both:

- entity specific ; and
- forward looking.

Once again, we found many examples where the disclosures provided were generic. An example (example 5) is as follows:

> "future economic conditions and the impact on our client base are one of the inputs used to determine the probability of default used in our ECL calculation."

It was clear to us from the below disclosures as to how this sample entity changed from an IAS 39, incurred loss model, to a forward-looking expected loss model under IFRS 9 (example 6). We are therefore including as an example from this aspect.

**1 JANUARY 2018**

Application of provision matrix

| | Aging bucket per age analyses (days) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Total R | Current R | 30 R | 60 R | 90 R | 120 R | 150 R | 180 R |
| Gross receivables (excluding VAT) | 106 412 011 | 39 121 651 | 37 300 112 | 10 931 459 | 3 727 581 | 2 069 486 | 1 576 454 | 11 685 267 |
| Adjusted loss ratio (%) | | 1.3 | 3.1 | 9.2 | 15.4 | 28.8 | 48.7 | 93.8 |
| | 15 591 060 | 524 134 | 1 161 794 | 1 006 044 | 575 472 | 596 318 | 768 016 | 10 959 282 |

Adjusted historical loss ratio

| | Aging bucket per age analyses (days) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Current % | 30 % | 60 % | 90 % | 120 % | 150 % | 180 % |
| Historical loss ratio* | 1.0 | 2.2 | 6.6 | 11.0 | 20.6 | 34.8 | 67.0 |
| Forward-looking adjustment** | 0.4 | 0.9 | 2.6 | 4.4 | 8.2 | 13.9 | 26.8 |
| **Adjusted historical loss ratio** | 1.3 | 3.1 | 9.2 | 15.4 | 28.8 | 48.7 | 93.8 |

Historical loss ratios were adjusted for forward-looking information by increasing these ratios by a factor of 40%. This factor was determined through consideration of the business confidence index and other macroeconomic indicators and calculating a probability-weighted range of possible outcomes. The historical loss ratios and the forward-looking adjustment of these ratios used at the date of initial application of IFRS 9 were unchanged at year-end. The Group does not consider that any significant change in credit conditions occurred.

The reference to 'other macroeconomic indicators' is however, we believe, still too generic.

The effect of credit risk

IFRS 7.35B requires credit risk disclosures to enable the reader to understand the effect of credit risk on the amount, timing and uncertainty of future cashflows.

Whilst the sample entities gave their attention to credit risk management disclosures for their trade receivables, there were instances where the disclosures for their other financial assets were lacking. These sample entities often considered these assets to be immaterial, framing this assessment in the context of the statement of financial position. The JSE challenged those assertions given its approach to materiality as discussed under section A above.

Quantitative and qualitative information about amounts arising from expected credit losses

IFRS 7.35H requires a reconciliation of the opening and closing balances of the ECL allowance account showing separate changes in the loss allowance in tabular format for (amongst others) the loss allowance measured at an amount equal to (a) 12-month expected credit losses and (b) lifetime expected credit losses (IFRS 7.35H(a), (b)).

We found instances where sample entities applying the general approach to their ECL calculation did disclose a reconciliation between the opening and closing ECL allowance account, but neglected to disclose the separate changes required by IFRS 7.35H.

IFRS 7.35I calls for both quantitative and qualitative information to explain how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the ECL allowance. Within the sampled entities we identified many examples where only one aspect of this information (i.e. either quantitative or qualitative information) was considered. Most sampled entities leaned towards only disclosing quantitative information. From their quantitative disclosures, we identified changes in their gross carrying amounts for which, we believed, required further qualitative explanations in order for a user to understand how it contributed to the change in the ECL allowance.

Issuers would do well to focus on the ageing bracket that falls into their longer outstanding trade receivables category ("**the oldest bracket**"). The following are examples of further qualitative narrative that were suggested by certain sample entities to address our concerns:

- this bracket includes inactive clients with long outstanding amounts, therefore the provisions is much higher; or
- trade receivables from country X now account for the bulk of our long outstanding category.

The oldest bracket often becomes relatively material and we believe that less aggregation can provide better quantitative information. A large balance of trade receivables of more than 90 days (or depending on the nature of the business even 6 months) doesn't assist in identifying how old the long outstanding debtors really are and therefore how changes in the gross carrying value contributes to changes in the loss allowance.

We caution that the inclusion of a provision matrix and some disaggregation of the older balances may still not be sufficient as, in this instance, the focus is entirely on the quantitative aspect. To illustrative this point, set out below is an example of reporting by one of the sample entities that did not meet the requirements of IFRS 7.35I (example 7).

2018

| Groups | Current | 30 days | 60 days | 90 days | 120+ days | Total |
|---|---|---|---|---|---|---|
| Gross trade receivables | 9 650 659 | 1 475 850 | 518 394 | 354 062 | 2 259 796 | 14 258 761 |
| Allowance for credit loss | (546 324) | - | - | - | (294 553) | (840 877) |
| | **9 104 335** | **1 475 850** | **518 394** | **354 062** | **1 965 243** | **13 417 884** |

2017

| Groups | Current | 30 days | 60 days | 90 days | 120+ days | Total |
|---|---|---|---|---|---|---|
| Gross trade receivables | 6 132 264 | 1 359 834 | 148 478 | 69 224 | 891 558 | 8 601 358 |
| Allowance for bad debts | - | - | - | - | (68 798) | (68 798) |
| | **6 132 264** | **1 359 834** | **148 478** | **69 224** | **822 760** | **8 532 560** |

The unanswered questions arising from these disclosures are as follows:

- why is the ECL allowance at 5.6% for the current receivables compared to zero in 2017
- why is there no ECL allowance for the 30-days; 60-days; and 90 days brackets yet there is an ECL allowance for the current bracket;
- why has the percentage ECL allowance for the oldest bracket jumped to 13% (2017-7.7%);
- why is the older bracket of gross trade receivables at 15.8% of the total trade receivables (2017-10.3%); and
- how material are the trade receivables in the oldest bracket that are say 6 months or older.

A good qualitative narrative will help prevent these questions from arising.

Furthermore, under IAS 39 there was a disclosure requirement (in terms of IFRS 7.37(a)) for the age analysis of receivables past due but not impaired ("**the old disclosure**"). This requirement has been removed from IFRS 7 under IFRS 9.

Issuers could consider changing their approach (in order to declutter their AFS) to remove the old disclosure. Under IFRS 9 the old disclosure is still a means of providing quantitative and qualitative disclosures explaining how changes in the gross carrying amount receivables contributes to changes in the loss allowance. Therefore, if it is removed, further narratives would need to be included, in order to address the disclosure requirements of IFRS 7.35I.

Where issuers have a significant quantum of amounts written off they should discuss enforcement activities on those amounts (per IAS 7.35L). Where they manage those losses through insurance policies, a simple statement to that effect is useful in ensuring a full understanding.

<u>Credit risk concentrations</u>

IFRS 7.35M requires information to be provided in order to understand an entity's credit risk exposure and concentrations. We urge issuers adopting the simplified approach to their ECL allowances, to give careful consideration to the requirements of IFRS 7.35N (i.e. to use a provision matrix) to address the requirements of IFRS 7.35M. During the course of our thematic reviews we have found that the provisions matrix approach contributed towards more useful and complete IFRS 7.35M disclosures.

**Transitional requirements**

We identified contradictory messages in the application of IFRS 9 in the following instances:

- the interims stated that IFRS 9 had no significant impact on the entity, and whilst that might have been true in the context of the quantum of the impact on the assets, the fact that certain financial assets were reclassified under IFRS 9 should have been discussed; and
- the AFS included a statement there was no reclassification under IFRS 9, yet from the information included in the AFS it was clear that there were in fact reclassifications of certain assets.

## SECTION C: FINDINGS-IFRS 15

### General

There were several instances within our sample entities where we challenged statements to the effect that amendments were not errors, specifically as it relates to the agent vs. principle classification under IAS 18/IFRS 15. The AFS we reviewed had changes both ways, i.e. resulting in revenue being presented on either a net basis (if acting as agent) or a gross basis (if acting as principal) and vice versa. A detailed entity specific explanation of the performance obligation could have assisted in preventing questions from being raised.

### Accounting Policies

Problems that existed with accounting policy disclosures as it relates to IFRS 15 link to some of the matters set out in section A above, under the 'housekeeping' heading i.e.:

- generic or boilerplate accounting policies; and
- duplicated accounting policies.

An example of generic wording as it relates to the accounting policy for variable consideration from one of the sample entities is as follows (example 8):

> "The variable amount is estimated at the inception of the contract and revenue is recognised at the estimated amount throughout the duration of the contract. When the uncertainty is resolved, the entity allocates the difference to revenue accordingly. A variable consideration is only recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved."

Where performance obligations are satisfied over time, the method of measuring progress towards completion of a contract is typically highly technical and certainly very entity specific. The following is an example of an inappropriate generic policy in this regard (example 9):

> While IFRS 15 represents significant new guidance, management's assessment indicated that the contract's performance obligations and related contract costs are satisfied over time and that the method used to measure the progress towards completion of the contract will continue to be appropriate under IFRS 15.

Furthermore, where multiple revenue streams exist, we would expect to see a clear identification of which of those streams contained a significant financing component to it.

There were sample entities that did not provide the necessary accounting policies for all of their revenue streams. We were able to identify these omitted policies by:

- considering the revenue streams identified by the issuer in their old revenue accounting policy;
- reviewing the disaggregated revenue disclosures; and
- reviewing the assets reflected in the statement of financial position (such as contract assets and claims from customers).

One of the sampled entities incurred contract costs for future activity i.e. there is no contract with the customer. Their disclosures were lacking as there was no accounting policy stating that these were excluded from the measure of progress in terms of the input method to calculate revenue. (IFRS 15.B19)

For our sample entities it appeared to us that the largest part of their resources were dedicated to the new standard that they believed would have the greatest impact. A case in point was a sample entity in the financial services sector who, from our perspective, ticked most of the IFRS 9 boxes. However, their application of the disclosure requirements of IFRS 15, to their non-banking income, was weak. In contrast to this, another sample entity within the financial services sector included an entity specific accounting policy for how the different streams of their non-banking income was recognised, an extract of which is set out below for illustrative purposes (example 10).

- Non-refundable upfront fees
  - Non-refundable upfront fees normally relate to the issuing or administration of a loan facility. These fees will be recognised as revenue when the performance obligation is satisfied. This is applicable when the non-refundable performance obligation can be satisfied over time or at a point in time.
  - To apply this principle the group first assesses if the contract is satisfied over time. Should this be the case, the revenue is spread over the period of the contract on a time proportionate basis. If the performance obligation is not satisfied over time and instead satisfied at a point in time, the revenue is recognised when the service is complete and no further performance obligations are required according to the contract.
  - The group recognises non-refundable upfront fees that are an integral part of a loan in net interest income through the unwinding of the effective interest rate.

- Insurance income
  Insurance income comprises premiums written on insurance contracts entered into during the year, with the earned portion of premiums received recognised as revenue. Premiums are earned from the date of attachment of risk, over the indemnity period, based on the pattern of risks underwritten. Premiums are disclosed gross of commission payable and reinsurance premiums. Claims incurred consist of claims and claims-handling expenses paid during the financial year for the movement in provision for outstanding claims. Outward reinsurance premiums are accounted for in the same accounting period as premiums for the related direct insurance.

**Key judgements and assumptions**

IFRS 15.123 to 126 includes specific requirements to disclosure the judgements and changes in judgements that significantly affect the determination of the amount and timing of revenue from contracts with customer. These obligations are in addition to the general requirements of IAS 1.122 to 123. We found deficiencies in the application of these disclosure requirements by several of the sample entities.

Certain sample entities stated that they applied the input method to recognise revenue, but failed to provide the necessary description of how that method was applied in their business (per IFRS 15.124(a)) and did not explain in an entity-specific manner why the specific method they used faithfully depicted the transfer of goods/services (IFRS 15.124(b)). An example of wording included by a sample entity is set out below (example 11):

> "Given the nature of the contracts completed over time, this method provides a faithful depiction of the transfer of goods and services for performance obligations satisfied over time".

This sentence merely repeats the wording included in IFRS 115.124(b) without including the required explanation.

The determination of the transaction price is specifically identified in IFRS 15.123(b) as a significant judgement requiring full disclosures. Several sample entities omitted disclosure of the method used to determine the transaction price (IFRS 15.126) i.e. by explaining their business or contract. In other instances sample entities omitted entity-specific disclosures of the estimates used and judgements relating to customer right of return obligations (IFRS 15.126(d)) An example of how generic these disclosures is as follows (example 12):

> "The group records a liability for estimated returns based on historical rates".

**Specific disclosure requirements of the standard**

Within our sample entities we believe that there were various areas where they should have provided more entity specific disclosures.

Disaggregation of revenue

IFRS 15.114 and 115 requires entities to disaggregate its revenue and provides detailed guidance in this regard. The information provided in terms of these paragraphs would typically go beyond what is presented from an operating segment perspective. We believe that these disclosures will be of critical importance to investors and wish to advise that this will be a key focus area for us in our traditional proactive monitoring process.

We remind issuers that the same level of disaggregation is required in their interim results (per IAS 34.16A(l)) and draw attention to our discussion set out above in section A under the heading ‘Alignment between AFS, interim results and ‘prior-to-adoption’ AFS’. This aspect was one of the most common findings across our sample entities. Disaggregation is one of the areas that we believe is likely to fall within the ambits of out point (ii) on page 7 above.

Issuers should ensure that the AFS, read as a whole, do not provide conflicting messages. We raised questions for several of the sample entities where there was a lack of disaggregation for:

- revenue streams discussed in the accounting policy or elsewhere in the AFS; and
- instances where the AFS revealed the existence of the categories set out under IFRS 15.B89 (e.g. different distribution channels or type of customers).

In response to our questions on disaggregation, certain sample entities argued that the non-disclosed revenue streams were immaterial, but this response was contradictory to the fact that they disclosed another stream of a similar quantum.

Some good examples of how disaggregation was applied by some of our sample entities are set out below. Example 13:

### 7.1.2 REVENUE

Revenue is derived from contracts with customers. Revenue has been disaggregated based on timing of revenue recognition, major type of goods and services, major geographic area and major customer industries.

| GROUP | Coal | | | | Ferrous | Other | |
|---|---|---|---|---|---|---|---|
| | Commercial | | | | | | |
| For the year ended 31 December 2018 | Waterberg Rm | Mpumalanga Rm | Tied Rm | Other Rm | Alloys Rm | Other Rm | Total Rm |
| **Segment revenue reconciliation** | | | | | | | |
| Segment revenue based on origin of coal production | 13 289 | 7 984 | 3 665 | 364 | 169 | 20 | 25 491 |
| Export sales allocated to selling entity | (1 796) | (6 254) | | 8 050 | | | |
| **Total revenue from contracts with customers** | 11 493 | 1 730 | 3 665 | 8 414 | 169 | 20 | 25 491 |
| **By timing and major type of goods and services** | | | | | | | |
| **Sale of goods at a point in time** | 11 493 | 1 730 | 3 441 | 8 050 | 163 | 16 | 24 893 |
| Coal | 11 493 | 1 730 | 3 441 | 8 050 | | | 24 714 |
| Ferrosilicon | | | | | 163 | | 163 |
| Biological goods | | | | | | 16 | 16 |
| **Rendering of services over time** | | | 224 | 364 | 6 | 4 | 598 |
| Stock yard management services | | | 224 | | | | 224 |
| Other mine management services | | | | 364 | | | 364 |
| Other services | | | | | 6 | 4 | 10 |
| **Total revenue from contracts with customers** | 11 493 | 1 730 | 3 665 | 8 414 | 169 | 20 | 25 491 |
| **By major geographic area of customer[1]** | | | | | | | |
| **Domestic** | 11 493 | 1 730 | 3 665 | 364 | 169 | 15 | 17 436 |
| **Export** | | | | 8 050 | | 5 | 8 055 |
| Europe | | | | 4 920 | | 2 | 4 922 |
| Asia | | | | 2 455 | | 3 | 2 458 |
| Other | | | | 675 | | | 675 |
| **Total revenue from contracts with customers** | 11 493 | 1 730 | 3 665 | 8 414 | 169 | 20 | 25 491 |
| **By major customer industries** | | | | | | | |
| Public utilities | 9 101 | 301 | 3 665 | 701 | | | 13 768 |
| Merchants | 141 | 835 | | 6 458 | | | 7 434 |
| Steel | 1 557 | 165 | | 36 | | | 1 758 |
| Mining | 88 | 43 | | 747 | 144 | | 1 022 |
| Manufacturing | 291 | 33 | | 101 | 22 | | 447 |
| Cement | 156 | 202 | | | | | 358 |
| Other | 159 | 151 | | 371 | 3 | 20 | 704 |
| **Total revenue from contracts with customers** | 11 493 | 1 730 | 3 665 | 8 414 | 169 | 20 | 25 491 |

Example 14:

**B. Disaggregation of revenue from contracts with customers**

The group derives revenue from the transfer of goods and services over time and at a point in time. In the following tables, revenue is disaggregated by primary geographical region (domiciled sales), major products and markets as well as the timing of revenue recognition for the year ended 31 December 2018. The tables also includes a reconciliation of the disaggregated revenue with the group's reportable segments.

| 31 December 2018: | Revenue as reported R'000 | H (managed associate) exclusion R'000 | Total segment revenue including H R'000 |
|---|---|---|---|
| **Primary geographical markets** | | | |
| South Africa | 5 925 214 | (1 179 510) | 7 104 724 |
| Turkey and UK | 3 022 186 | | 3 022 186 |
| Romania | 1 329 566 | | 1 329 566 |
| | 10 276 966 | (1 179 510) | 11 456 476 |
| **Major product and service lines** | | | |
| Automotive batteries | 5 691 155 | | 5 691 155 |
| Automotive components and parts | 3 818 339 | (1 179 510) | 4 997 849 |
| Automotive customer tooling and related services | 44 944 | | 44 944 |
| Industrial and non-automotive products | 722 528 | | 722 528 |
| | 10 276 966 | (1 179 510) | 11 456 476 |
| **Timing of revenue recognition** | | | |
| Products transferred at a point in time | 6 748 672 | | 6 748 672 |
| Products and services transferred over time | 3 528 294 | (1 179 510) | 4 707 804 |
| | 10 276 966 | (1 179 510) | 11 456 476 |

| | | Reportable segments | | | |
|---|---|---|---|---|---|
| | | Automotive | | Industrial | |
| ENERGY STORAGE: | Total revenue R'000 | Local R'000 | Direct export R'000 | Local R'000 | Direct export R'000 |
| **Primary geographical markets** | | | | | |
| South Africa | 2 032 105 | 1 279 134 | 273 013 | 448 728 | 31 230 |
| Turkey and UK | 3 022 186 | 2 041 522 | 779 306 | 201 358 | |
| Romania | 1 329 566 | 527 924 | 790 256 | 10 872 | 514 |
| | 6 383 857 | 3 848 580 | 1 842 575 | 660 958 | 31 744 |
| **Major product and service lines** | | | | | |
| Automotive batteries | 5 691 155 | 3 848 580 | 1 842 575 | | |
| Industrial batteries | 692 702 | | | 660 958 | 31 744 |
| | 6 383 857 | 3 848 580 | 1 842 575 | 660 958 | 31 744 |
| **Timing of revenue recognition** | | | | | |
| Products transferred at a point in time | 6 383 857 | 3 848 580 | 1 842 575 | 660 958 | 31 744 |

| | | Reportable segments | | | |
|---|---|---|---|---|---|
| | | Local | | Direct export | |
| AUTOMOTIVE COMPONENTS: | Total revenue R'000 | Original equipment R'000 | Aftermarket / non-auto R'000 | Original equipment R'000 | Aftermarket R'000 |
| **Primary geographical markets** | | | | | |
| South Africa | 5 072 619 | 4 516 489 | 511 842 | 2 681 | 41 607 |
| | 5 072 619 | 4 516 489 | 511 842 | 2 681 | 41 607 |
| **Major product and service lines** | | | | | |
| Automotive components and parts | 4 997 849 | 4 471 545 | 482 016 | 2 681 | 41 607 |
| Customer tooling services | 44 944 | 44 944 | | | |
| Non-automotive products | 29 826 | | 29 826 | | |
| | 5 072 619 | 4 516 489 | 511 842 | 2 681 | 41 607 |
| **Timing of revenue recognition** | | | | | |
| Products transferred at a point in time | 364 815 | | 341 855 | | 22 960 |
| Products and services transferred over time | 4 707 804 | 4 516 489 | 169 987 | 2 681 | 18 647 |
| | 5 072 619 | 4 516 489 | 511 842 | 2 681 | 41 607 |

The disaggregated revenue information may not necessarily align directly to the segmental information. Typically, as would be expected, the sample entities provided more information under IFRS 15 than under IFRS 8. Nevertheless, there needs to be disclosure of sufficient information to

enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and the revenue information disclosed for each reportable segment (IFRS 15.115). For one sample entity, not only was this link lacking, but it was not apparent to us how the segmental information had featured in their assessment of the requirement under IFRS 15.B89.

Performance obligations

We found a lack of disclosure for several of the requirements under IFRS 15.119 including:

(a) when the performance obligations were satisfied (which was over time);

(b) significant payment terms;

(c) obligations for returns; and

(d) details of the types of warranties and related obligations.

In response to our questions on the lack of a discussion of significant payment terms for their retention debtors, certain sample entities argued that this information was irrelevant. We disagreed with this approach, as the retention trade receivables were significant in the context of the total trade receivables.

If the particular obligation (for example an obligation for returns) does not exist for a specific business (or is insignificant) silence within the AFS is not always the best approach. This is especially true in these early days of adopting IFRS 15. It is also important given the expectation of the reader based on their understanding of the business model. Disclosure through a negative statement is not the only option, and instead issuers can provide a narrative that explains the business model to the reader. One entity explained how the fee they received was non-refundable. Through this disclosure the sample entity met their obligations under IFRS 15.119(d), as the reader could then ascertain that there was no refund obligation.

We urge issuers to consider their disclosure holistically as it raises avoidable questions when there is a policy for a right to return goods, but no separate disclosure of:

- a related contract liability ( IFRS 15.116(a)); or
- policy for the related asset for the right to recover the products (IFRS 15.B21).

**Transitional requirements**

We expected to see a detailed explanation where there was a change as a result of the new standard (IFRS 15.C8) and we raised questions of the sample entities where:

- there was no disclosure of the amounts by which each line item in the AFS was affected;
- the discussion of the change in accounting treatment was too generic, seeming to relate to a discussion of the industry as a whole, as opposed to a discussion specific to the entity; and
- fees were previously apportioned (and recognised as the good/service was recognised) verse being recognised up front under IFRS 15.

**LIST OF EXAMPLES**

The list of examples contained in this report is set out below. This report includes both good and poor examples.

*Good examples*

Example 1: Understanding the differences and accounting impact of IFRS 15
Example 2: An explanation of the reclassifications under IFRS 9
Example 3: Accounting policy for write-offs
Example 4: Forward looking information (about the economic variables that impact the ECL allowance) and estimation uncertainty
Example 6: How the ECL allowance is impacted by the forward-looking model
Example 10: Entity specific accounting polices per different type of revenue stream
Examples 13 and 14: Disaggregation of revenue

*Examples of disclosure that we believe are not in compliance with IFRS.*
Example 5: Generic wording of forward looking macroeconomic information
Example 7: Omitted IFRS 7.35I disclosures
Example 8: Generic wording for an accounting policy on the variable considerable in IFRS 15
Example 9: Generic wording for an accounting policy where performance obligations are satisfied over time (IFRS 15)
Example 11: Generic wording to describe the timing of the satisfaction of performance obligations
Example 12: Wording that merely repeats the content of IFRS, without addressing the requirement