REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2016

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INTRODUCTION

This report (the **"2016 report"**) provides an overview of the proactive monitoring activities (the "**review process**") undertaken by the JSE during 2016. The objective of the JSE's process of reviewing Annual Financial Statements (**"AFS"**) and interim results ("**interims**") is both to ensure the integrity of financial information and to contribute towards the production of quality financial reporting of entities listed on its market. For the first time our report gives feedback on our review process of entities who have listed debt instruments ("**debt Issuers**").

The target audience for this report is entities whose equity or debt securities have a primary listing on the JSE due to the fact that it:

- provides details of the review process that they will be subjected to;
- provides statistics on our findings which highlights the regulatory benefit of the review process;
- sets out the important findings identified during the year; and
- highlights focus areas that Issuers should be aware of for 2017.

The JSE specifically requests that the audit committee of every Issuer considers the findings contained in this 2016 report when preparing their next set of AFS and interims. They should also consider the content of our previous reports from issued from 2011 to 2015 (available on the JSE website at https://www.jse.co.za/current-companies/issuer-regulation/accounting-matters), to the extent that they are a new listing, or if they have events or transactions that were not present when they considered our report issued in February 2016 ("**the 2015 report**").

All Issuers are reminded that the 2015 report contains details of the 2015 FRIP referrals and specifically guidance on the application of the going concern basis of accounting and the disclosure thereof which they must take into consideration should they find themselves in a situation where the going concern assumption is questionable.

REVIEW PROCESS

Annexure 1 contains a high-level overview of the review process for the benefit of those readers who are not familiar with the process. The review process itself remains largely unchanged from previous years and from that contained in the 2015 report other than as discussed below.

Historically, we had addressed our communication to entities listed on the JSE ("**Issuers**") in two separate sections. The first set out matters of a potentially immaterial nature which we indicated could assist an Issuer in improving the quality of their financial reporting. The JSE did not require any further action or ask for any response on these matters but simply encouraged Issuers to take account of them with their next results. The second and more important section contained matters that could be price sensitive and therefore required further clarity.

In 2016, we removed the first section in our letters. An ongoing focus area for the JSE is to declutter the AFS. We were therefore concerned that Issuers might incorrectly think that all the matters contained in the first section should be addressed.

AFS covered

Equity Issuers

We commenced our process of reviewing the AFS of equity Issuers in April 2011. In 2015 we expanded the scope of the information considered, whereby the Issuer's interim results were simultaneously considered with their AFS. By the first quarter of 2016 we had reviewed the AFS of every equity Issuer (excluding secondary listings), who was listed on the JSE before January 2015. Ignoring cases brought forward from the previous year, our reviews on equity Issuers during the 2016 calendar year covered AFS for years ending between 28 February 2015 and 30 June 2016.

The timing of reviews is impacted by two factors. Firstly, Issuers currently have 6 months after their year-end within which to distribute their AFS. Secondly, the detailed reviews are performed in batches, four times a year, as opposed to being done on a continuous basis.

Debt Issuers

We advised the market in October 2015 that the AFS of debt Issuers would also be included into our review process. We did not include any feedback on the outcome of those reviews in our 2015 report due to the small sample of debt Issuers covered at the time of issuing that report. Therefore, the AFS of debt Issuers covered in this feedback are for the years ending between 31 December 2014 and 31 March 2016.

RESULTS

The purpose of this section is two-fold. Firstly, it enables Issuers to understand the process that is followed. Secondly, it highlights the fact that, both in South Africa and internationally, a clean auditors' report is no guarantee that the AFS will not be subject to regulatory challenge and forced correction. The reason for this is best understood in light of the types of matters that we have found (as discussed in the detailed findings section) as well the concept of materiality. In the bulk of the cases where we have requested action, we have done so to ensure that there is no future investor prejudice for matters which fortuitously may not have been material in the results that we reviewed.

Statistics – what we did

Between January to December 2016, 56 equity Issuer's AFS and interim results were reviewed and by January 2017 eight of the cases were still pending. As 2016 marked the commencement of our second 5-year-review-cycle, for equity Issuers there were 45 repeat reviews.

As discussed above, the 2015 report did not provide feedback on the review process for debt Issuers, even though certain reviews had been completed. This report therefore covers a wider review period for debt Issuers, where from October 2015 to December 2016 31 AFS were reviewed and completed.

	Equity	Debt	Total
Letters of query	49	22	71
Cases closed immediately	7	9	16
Number of AFS reviewed	**56**	**31**	**87**
Cases b/f from previous year	2	0	2
Total cases reviewed during period	*58*	*31*	*89*
Cases still pending	(8)		(8)
Cases completed during period	50	31	81

We wrote letters of enquiry to 71 of the Issuers, with 16 cases being closed immediately with no questions being asked of the Issuer. There were no further referrals to the FRIP during the current year (2015 - 3 referrals).

Statistics – what we found

Two cases resulted in restatements of the AFS and public announcements being made. In consultation with the Issuers, these announcements were made as soon as possible. For a further 6 cases the non-compliance was material from an IFRS perspective, but not necessarily price sensitive, often due to the presence of other mitigating factors. As such we agreed with the Issuer that the matter could be corrected in their next results announcement. For a further 14 cases, whilst fortuitously there was no material misstatement, amendments needed to be made within the next published results to avoid potential investor prejudice. The remaining 37 cases revolved around smaller disclosure issues that the Issuer will clarify or correct in the future.

	2015 Equity	**2016 Equity**	**2016 Debt**	**2016 Total**
AFS needed restatement and public announcement made	7	2	-	2
Non-compliance such that we agreed to a correction within the next published results	6	4	2	6
Non-compliance not material this year, but must be corrected in the future in order to avoid potential investor prejudice	17	11	3	14
Smaller disclosure issues that will be corrected in the future	25	25	12	37
AFS in respect of which it was concluded that there were no issues	17	8	14	22
Total cases closed	**72**	**50**	**31**	**81**

As it relates to equity Issuers, in 2016 material infringements were identified in 4% of the closed cases (2015-9.7%). The number of cases where corrections were required in future reporting periods was at 30% (2015-31.9%) for equity Issuers and 16.1% for debt Issuers.

As in the past, in assessing the potential impact of matters, consideration was given to the number of different issues as well as whether the impact was an IFRS disclosure matter and/or affected the measurement of items within the AFS. For the current period the cases impacting both IFRS disclosure and measurement for equity Issuers was at 33.3% (2015-40%) and at 17.6% for debt Issuers.

It is difficult to draw a meaningful conclusion in the trends of non-compliance when looking between 2015 and 2016 as our findings are influenced by the:

- types of Issuers we have selected, for example are these repeat reviews; and
- impact of new accounting standards.

The trends reveal that disclosure matters remain a key area of non-compliance. Under the umbrella of disclosure matters, we refer not just to a lack of disclosure, but also excessive or confusing disclosures. We discourage Issuers from including immaterial disclosures in the AFS in an attempt to avoid enquiries from ourselves and we have taken a more assertive approach in insisting that Issuers 'de-clutter' their AFS.

International comparison

Our counterpart enforcers in Europe (through the European Securities Markets Authority (**"ESMA"**)) publish an annual activity report, which covers only equity Issuers. We have included an extract from its reports and compared this against our current and previous findings for equity Issuers for information purposes.

A direct comparison of the data against international trends, particularly to the information covered in this report, is difficult due to the different reporting and cut off periods. Furthermore, regulators have varying powers as it relates to their ability to require correction action. The 2015 ESMA activity report (issued in March 2016) is the latest available information, which should theoretically be compared to the data contained in our 2015 report.

	South Africa	South Africa	South Africa	ESMA[1]	ESMA[2]
Coverage					
Period of review	2016	2015	2014	2015	2014
Reporting date	Feb 2017	Feb 2016	Feb 2015	Mar 2016	Mar 2015
Reviews closed at reporting date	50	72	84	1228	1 533
Examination rate (percentage coverage of population)	17%	25%	25%	20%	24%
Actions					
Material infringement: requested re-issuance or immediate public announcement	4%	9.7%	7.1%	9.1%	8.7%
Corrections required in future financial statements	30%	31.9%	20.2%	14.9%	12.7%
Action rate (total number of instances where action was taken)	34%	41.6%	27.4%	24%	21.4%

The 2015 ESMA activity report indicates that of the 1 228 reviews undertaken by the 30 European enforcers during the calendar year to December 2015, 9.1% of those reviews identified material infringements, requiring public announcements or reissuing of AFS. For a further 14.9%, whilst classified as material, the enforcers accepted a correction in the next AFS. Whilst the JSE saw a similar percentage of material infringements in the 2015 period of review, the total number of instances where we took action was higher due to more instances where we required corrections in future financial periods.

[1] Information extracted from the ESMA report entitled "ESMA Report on Enforcement and Regulatory Activities of Accounting Enforcers in 2015"

[2] Information extracted from the ESMA report entitled ESMA Report on Enforcement and Regulatory Activities of Accounting Enforcers in 2014"

DETAILED FINDINGS

Our previous reports discussed various detailed findings, irrespective of the action we had taken on those cases. We did so in order to assist Issuers, as much as possible, in improving the overall quality of their reporting.

This year we have adopted a revised approach to our reporting, and provide information (under separate headings for debt and equity Issuers) on two areas:

- reporting back on our 2016 focus areas; and
- discussing matters in cases where action was required.

We have therefore specifically not included any discussions on those cases where action was not required. Even though Issuers should have already considered the content of our 2015 report (which includes cross reference to our previous reports) reconsideration thereof is important. This will enable Issuers to identify events or transactions that were not present during the compilation of their previous AFS and to consider findings relating to similar events set out in the 2015 (and prior) reports. The importance thereof is evident in the matter discussed below under the heading 'Non-current assets held for sale and discontinued operations'. In that instance an Issuer had published their AFS before we had issued the 2015 report and the Issuer was thus unable to consider our findings. Nevertheless, this type of error was discussed in the 2015 report and is therefore avoidable.

Feedback on the 2016 Focus areas

We were pleased to see a dramatic decrease in the number of matters relating to IFRS 10 to 13 for equity Issuers. IFRS 13 *Fair Value Measurements* was however the second biggest problem area for debt Issuers and is discussed below in more detail.

Our second focus area related to decluttering the AFS. We have intentionally raised more questions on this topic than ever before, which resulted in it being the biggest problem area for both equity and debt Issuers. We detail some of our lines of questioning below and ask the Issuers consider whether or not they would fall foul of questions raised along those lines.

Debt Issuers and Fair value measurements

The interest rate valuation team of the JSE issued a report in 2014 titled "Debt Market, Mark to market valuation rules". That report inter alia highlighted the following:

- the majority of listed debt instruments (especially corporate) rarely trade, and pre and post trade information is infrequent; and
- there is currently no real centralized price discovery venue for corporate debt.

In nearly all instances, debt Issuers, in applying IFRS 13 *Fair Value Measurement,* classified their own debt instruments as being within the level 1 hierarchy. IFRS 13.76, which describes level 1 inputs is clear that it is not only when an entity can access the quoted price at the measurement date but also that the quoted price must be from an 'active market'. The very definition of 'active market' in Appendix A of IFRS 13 requires "*transactions for the asset or liability* (to) *take place with sufficient frequency and volume for pricing information to be provided on an ongoing basis"*.

We therefore challenged the level 1 classifications given the inactivity of trade in listed notes on the South African interest rate market. Even when trade does occur, it is not usually of sufficient frequency and volume to meet a level 1 classification. At best, corporate debt in South Africa is likely to be a level 2 classification, and perhaps even a level 3. Similarly, we concluded that a special purposes vehicle that issued mortgage bond securities had incorrectly classified their debt instruments as a level 1 fair value.

When dealing with a level 3 classification, Issuers are reminded that they must provide detailed disclosure of the inputs used in their valuation, together with a narrative description of the sensitivities (IFRS 13.93(d-h)), if the debt instruments are measured at fair value. Where debt instruments are measured on a basis other than fair value but fair value is disclosed, disclosures are less onerous but are still required (see IFRS 7.97). Several Issuers' disclosure was lacking in this regard.

There was also an instance where an Issuer owned investment property and had incorrectly classified this as a level 2 fair value. Given the requirement that these inputs be observable (IFRS 13.81), it is highly unlikely that property in the South African market will meet the criteria for a level 2 fair value classification.

Applicable to all Issuers -Decluttering of AFS

The average length of AFS has grown steadily over the years on the back of new standards and interpretations issued by the International Accounting Standards Board (“**IASB”**). Whilst appreciating that Issuers continue to operate in a complex business environment, there is a risk that unnecessarily long and protracted AFS may fail in their stated objective of providing information about the entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the company (OB2 of the Conceptual framework). The IASB has responded to the concern of the IFRS preparer community by way of a series of disclosure initiative projects aimed at exploring opportunities to improve and simplify existing disclosures currently required by specific standards.

We have historically highlighted instances where ‘boilerplate’ accounting policies were included in the AFS and have encouraged Issuers to evaluate the appropriateness of information reported. During 2016 we have applied a more assertive approach by requesting Issuers to justify the appropriateness of having included accounting policies and other information that could be viewed as being superfluous and possibly lead to obscuring other important information.

Accounting policies

Accounting policies should be used as a lens through which a reader understands and interprets the information presented in the AFS. Our reviews highlighted instances where:

- Accounting policies were presented for events or transactions not relevant to the reporting entity, for example a policy on cash-flow hedging when the issuer did not make use of cash-flow hedge accounting. Accounting policies should discuss areas significant to the Issuer. They should consider the nature of the entities operations and the policies that users would expect to be disclosed (paragraph 119 of IAS 1 *Presentation of Financial Statements*) rather than present policies that represent any and all policies that could be applicable;
- Conflicting accounting policies were present. In one instance the Issuer reported that actuarial gains and losses with respect to defined benefit plans were accounted for on the corridor method (coincidently removed from IAS 19 *Employee Benefits,* in 2013) whilst stating elsewhere that actuarial gains and losses were recorded in other comprehensive income. In another instance the accounting policies of an Issuer stated that all borrowing

costs were recognised in profit and loss whilst stating elsewhere that borrowing costs on qualifying assets were capitalised against the cost of the asset. It is evident in these instances that, on the back of revised IFRS Standards becoming effective, amendments were made to certain paragraphs within the entity's accounting policy notes without re-evaluating the entire suite of accounting policies to ensure that the policies, as a collective, portrayed the position of the Issuer;

- The policy in respect of revenue recognition was too generic. Accounting policies should talk to the specifics of the business and translate the drivers of revenue recognition ;
- Accounting policies resembled a 'cut and paste' of the relevant IFRS standards when such level of detail was not necessary. Many Issuers incorporated detailed financial instrument discussions into their policies, including unnecessary repetitions of repeating basic IFRS definitions (e.g. that of a derivative). In other instances they included complex derecognition criteria when this was clearly not relevant to the Issuer. Disclosures that summarise significant accounting policies without repeating the terminology used in the IFRS standards themselves and are tailored to the business itself are most useful in articulating the manner in which transactions and events are accounted for; and
- Issuers provided lengthy descriptions of the changes to IFRS Standards which they had concluded had no impact on their AFS. Paragraph 28 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* calls for an analysis of the impact of future accounting standards on the entity, only where there will be an effect on the current or prior period. It would be appropriate to merely mention the change to the IFRS without a detailed explanation thereof if there is no impact to the entity. Even when there is an impact, IAS 8.28(c) asks for the details of the nature of the change. This can be provided through a high level description/summary in the note discussing the impact thereof, as opposed to a lengthy discussion of the IFRS itself. A similar observation was made in respect of the requirement to disclose the effect of IFRS standards issued but not yet effective (IAS 8.30). Certain issuers provided lengthy discussions of forthcoming changes only to conclude that these were not expected to be significant to the entity.

We recommend that Issuers pay particular attention to the matters included in their accounting policies. They should ensure that they are specific to their business and resist the temptation of automatically 'rolling' prior period policies over into the current financial reporting period without also re-reading the suite of accounting policies to ensure that they remain relevant to the current reporting period.

Other superfluous disclosures

Another area of decluttering that we focused on was the inclusion of superfluous disclosure. Examples of these identified through our review process included:

- Detailed share-based payment disclosures provided in an equity-settled share-based payments scheme in which no new grants had been made since 2004, and all of remaining awards having been exercised in the prior year ;
- The repetition of detailed information pertaining to business combinations concluded and accounted for in the prior year. In instances where a business combination involves the payment of contingent consideration (or similar) having an impact on the current period it may have been appropriate to have summarised the appropriate facts relating to the current year as opposed to repeating the prior year disclosures (which are available in prior year AFS) verbatim in the current year AFS. Absent an outstanding contingent consideration or similar retention payment, detailed disclosures of business combinations made in the previous year are likely to be superfluous;
- Disclosures of retirement benefit information for a debt Issuer which accounted for 10% of their total note disclosure. Considering the quantum of the balance involved, it was difficult to believe that the extent of disclosure on this topic was relevant to debt security holders. In this instance the entity was a wholly owned subsidiary, whose unlisted holding company had one shareholder; and
- Immaterial items of income or expense were presented as being ‘exceptional’/‘non-recurring’ or similar. We remind Issuers that IAS 1.87 does not allow the presentation of items of income or expense as ‘extraordinary’ and the AFS should refrain from trying to achieving a similar presentation format by merely changing the word. In addition, the presentation of immaterial information and aggregation of items that are dissimilar in nature is contrary to IFRS (IAS 1.29 and IAS 1.30A) and this type of generic labelling can be misleading. If items are material (and therefore require separate disclosure) disclosing the nature thereof clearly, for example ‘impairments’, would be more meaningful to users of the AFS (an in line with IFRS) than labelling the item as ‘exceptional’. Furthermore, the term ‘extraordinary’ implies that an expense will not occur again. This was rarely the case for most of the items labelled as such, as was evident when the item occurred in both the current and prior periods, or given the nature of the item.

In closing, Issuers should remember that, whilst the individual IFRS standards contain more than 2 000 potential disclosure items, IAS 1.31 also states that:

> *"…an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material".*

Matters where action was required

This section does not discuss all the cases or matters where action was required. Instead it focuses on specific findings that were significant to the Issuer concerned. In certain instances we required action as a result of a number of smaller matters which, whilst in isolation may not have been significant, on a cumulative basis cased us concern. Examples of those instances are also included below.

For ease of use, the matters are set out in line with the ordering of IFRS Standards as used by the IASB in their publications.

Debt Issuers

Financial instruments disclosures

Issuers are reminded that IFRS 7 *Financial Instruments: Disclosures,* affects all entities that have financial instruments. It is not limited to financial institutions.

The information required by IFRS 7 is critical to a typical to debt Issuers to enable users to understand the relative pattern of payments of the assets that underpin the listed debt instruments. IFRS 7 paragraphs 36(c) and 37 require detailed information on the entire pool of receivables: those that are current and performing; those that past due; and those that are impaired. A brief age analysis is insufficient to provide investors with insight into the potential credit risk. (As a reminder, the above mentioned credit risk disclosures of IFRS 7 have been significantly modified for Issuers applying IFRS 9 as opposed to IAS 39).

Information must also be provided in respect of the concentration of risks for each type of risk arising from financial instruments (IFRS 7.34(c)). Furthermore, a reconciliation of the movement on allowances of credit losses in respect of receivables is required (IFRS 7.16).

Segmental information

We remind Issuers that IFRS 8 *Operating Segments,* does in fact apply to entities whose debt instruments are traded in a public market.

Transparency when reporting of errors

Issuers are referred to page 20 below which deals with this topic from the perspective of equity Issuers. The disclosures for one debt Issuer were also found to be lacking in this regard and that discussion is therefore also relevant to debt Issuers.

Statement of cash flows

The classification of an item within the statement of cash flows (ie whether it relates to operating, financing or investing activities) is equally important to users as the final net cash position is. We urge Issuers to pay careful attention to classifying cash flows within their correct classifications.

In one instance we raised questions regarding the quantum of finance costs reflected in the statement of cash flows and those expensed in profit and loss, given that there was no evidence of the capitalisation of borrowing costs. The Issuer's accounting policy in respect of the capitalisation of borrowing costs also contradicted statements made in a separate policy note. Our review uncovered certain capital repayments that had incorrectly been reflected as interest paid in the statement of cash flows.

Financial instruments: Recognition and Measurement

We questioned why an Issuer had classified unlisted preference shares within the level 2 fair value hierarchy per IFRS 13 *Fair Value Measurement*. It emerged that unlisted preference shares (some of which were regarded as being level 2 and some level 3 fair values) had been categorised incorrectly as being 'measured at fair value through profit and loss' (in terms of IAS 39 *Financial instruments: Recognition and Measurement*). The corrected categorisation revealed that these instruments were a combination of 'held to maturity' and 'loans and receivables' assets. In both cases the correct measurement basis that should have been applied to these preference shares was amortised cost.

Equity Issuers

Share based payments

In one case, the provisions of an Issuer's equity settled share based payment scheme allowed for the settlement of the scheme shares to be made in cash at the option of the Issuer. The Issuer had not applied paragraphs 41 to 43 of IFRS 2 *Share-based Payments* – the scheme should have been treated as being cash settled. The JSE guidance letter of 10 September 2013, which deals with the accounting treatment for share incentive schemes, was also relevant to the Issuer.

Business Combinations

The assessment of what constitutes "a business" in terms of IFRS 3 *Business Combinations* is a judgement matter and Issuers often incorrectly provide limited or even no disclosure in this regard. Questions around the lack of disclosure could also lead to the identification of measurement issues and improper recognition of additional assets and liabilities.

In one case, an Issuer bought another JSE listed company at a significant premium to its net asset value. The target was a type of investment entity. Whilst the only substantial asset of the target entity at that time was cash, it was a fully functioning company. Appendix A to IFRS 3 defines a business as:

> *"an integrated set of activities that is capable of being conducted and manged for the purposes for providing returns…"*

At the time of the acquisition the target had a detailed business plan, investment strategy and processes such that it was a business capable of being conducted for the purposes of providing a return to shareholders. Were this not the case, the JSE would not have granted the Issuer a listing. We therefore disagreed with the Issuer's accounting treatment which had regarded the acquisition as an asset acquisition as opposed to a business.

Non-current assets held for sale and discontinued operations

In our 2015 report we discussed three separate cases that under this topic. Two of those related to the appropriateness of the discontinued operation classification. The third was a more detailed measurement issue, and our report highlighted the fact that non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property,* are scoped out of the measurement provisions of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (IFRS 5.5).

During this past year we had another Issuer who incorrectly determined the fair value of the investment property as 'fair value less costs to sell' per IFRS 5. IFRS 13 *Fair Value Measurement,* is applicable to determining the fair value of investment property, even if it is subsequently transferred to non-current assets held for sale. In terms of IFRS 13.25 the fair value must exclude transaction costs. Measurement under IFRS 5 is therefore different, as IFRS 5.15 refers to the lower of the assets carrying amount and fair value less cost to sale.

Another measurement error related to an Issuer who incorrectly continued to raise depreciation on assets accounted for under IFRS 5.

<u>Financial instruments disclosures</u>

On page 14 above we have included some details of the problems identified in the AFS of debt Issuers regarding the application of IFRS 7 *Financial Instruments: Disclosures*. Many of these matters are equally applicable to equity Issuers who are therefore requested to consider the detailed contained in that section.

Furthermore, there was a specific instance where an equity Issuer did not provide the required detailed sensitivity analysis for the market risk of certain financial instruments (IFRS 7:40). The entity had significant exposure to foreign currencies and used forward exchange contracts to manage this risk. A detailed sensitivity analysis quantifying the impact on profit or loss and equity should have been provided.

<u>Fair value measurement</u>

The classification of a financial instrument as being within the level 2 fair value hierarchy (in applying IFRS 13 *Fair Value Measurement),* requires inputs into the fair value calculation be observable either directly or indirectly (IFRS 13.81). An Issuer incorrectly classified their operational financial instruments such as trade receivables and trade payables, finance leases, loans receivable and loans payable as being level 2 fair values as opposed to level 3 fair values. As a result of this incorrect classification, inter alia, the additional inputs (see IFRS 13.93(d) and IFRS 13.97) required for level 3 instruments were also omitted.

Going concern

In the Annexure 3 of our 2015 report we issued specific guidance as it relates to the going concern basis of accounting. In this past year we had another Issuer whose disclosure in respect of the going concern assumption was lacking. Paragraph 25 of IAS 1 *Presentation of Financial Statements,* states that:

> *"… When management is aware, in making its assessment* (of the entity's ability to continue as a going concern)*, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties… ".*

In July 2010, an IFRIC update stated that, to be useful the disclosure must identify the uncertainties that may cast doubt upon the entities ability to continue as a going concern. The disclosures provided by an Issuer related mainly to the rectifications that were in place and did not also deal with the material uncertainties (in this instance why the entity was loss making and in a position where its liabilities exceeded its assets). A useful test that Issuers could therefore consider is "does the disclosure sufficiently answer the question of 'what went wrong'?"

Significant judgments

The application of certain IFRS standards (such as determining whether an entity exercises control or significant influence over another entity), requires management to assess the facts and circumstances of the transactions against the relevant accounting policies. This assessment is a judgement made by management, and should be disclosed in terms of IAS 1.122, IFRS 12.7 and IFRS 12.9 for those aspects that have the most significant effects on the amounts recognised in the AFS. Similar 'disclosable judgements' may also be made in cases where judgement is needed to determine whether a property qualifies as investment property (IAS 40.14A). The disclosure should not be omitted on the basis that the answer was obvious to management based on the facts as, absent any disclosures, the user of the AFS does not have those facts and would be unaware of the details regarding this area of judgement.

Statement of cash flow

We have advised Issuers on numerous occasions that the classification of an item within the statement of cash flows, i.e. whether it relates to operating, financing or investing activities (the **"SCF classification**") is equally important to users as the final net cash position is. SCF classification errors identified in our review process generally had a material impact on the total cash flow for that type of cash flow activity, and resulted in many Issuers having to take corrective action.

The two common SCF classification errors that we found included the incorrect classification of:

- Acquisitions of additional interests in subsidiaries (i.e. transactions involving the non-controlling interest). These are financing and not investing activities (IAS 7.42B); and
- share transactions in terms of a share incentive plan (for example issuing treasury shares or repurchasing of shares). These are financing and not operating activities (IAS 7.17(b)).

Furthermore, contrary to paragraph 43 to 44 of IAS 7 *Statement of Cash Flows*, Issuers continued to incorrectly reflect certain non-cash transactions as being actual cash flows. Some of the problem areas identified in this period are discussed below. This list is not comprehensive, but rather highlights matters which were found to be material, with materiality being assessed against the impact on the SCF classification. Problem areas included:

- failing to add back depreciation and amortisation charges;
- reflecting the gain on disposal of a subsidiary on the face of the statement of cash flow, as opposed to the full cash proceeds;
- incorrectly reflecting cash flows (being 'additions to assets' and 'proceeds from finance leases') for assets purchased in terms of an instalment sales agreements; and
- incorrectly reflecting imputed interest on a deferred vendor loan (for a business acquisition) as a cash flow.

Finally, we tackled the concern relating to Issuers whose statements of cash flows in their interim results were limited to only presenting the results of operating, investing and financing activities i.e. "a three-line SCF". The International Financial Reporting Interpretations Committee ("**IFRIC**") previously discussed this issue. In an agenda decision published in July 2014 the IFRIC noted that:

> *'to meet the requirements in paragraphs 10, 15 and 25 of IAS 34, a condensed SCF should include all information that is relevant in understanding the entity's ability to generate cash*

flows and the entity's needs to utilise those cash flows. It also noted that it did not expect that a three-line presentation alone would meet the requirements of IAS 34'.

Transparency when reporting errors

Our 2015 report contained a section entitled 'correction of errors'. We had further instances where Issuers were not transparent in their disclosure regarding the correction of material prior period errors (IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). In these instances we encountered one or a combination of the following problem areas:

- the item was labelled as merely being a 'restatement' or 'representation' and not identified as being an error;
- none of the disclosures required in terms of IAS 8.49 were provided;
- whilst the impact of the error was disclosed in terms of paragraph 49(b) of IAS 8, the item was not labelled as being an error;
- a material error was incorrectly referenced as being a change in accounting policy; and
- the Issuer failed to explain and highlight the fact that there was a material error.

As discussed in the 2015 report such an approach runs contrary to the general principles of the JSE Listings Requirements and in these instances the JSE will require an Issuer to make a correction and to advise the market accordingly.

Revenue in the company AFS

The JSE approaches the review process largely from the perspective of the relevance and materiality of the information for investors. Nevertheless, it has come to our attention that IFRS has been misapplied in this instance as it relates to information that is of relevance to another regulator in South Africa. As such, we discuss the matter below to avoid any unnecessary reputation risk that could arise due to the misapplication of IFRS.

Paragraph 7 of IAS 18 *Revenue,* defines revenue as being:

> *"..the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity.."*

In the context of company AFS, the entity is often an investment entity, and does not engage directly in any operating activities itself. Therefore, items such as interest received on loans advanced to subsidiary companies, dividends received and management fees received would be regarded as revenue for the company, and should be presented as such.

Taxation

An Issuer had entered into various interest rate swaps, which were accounted for as cash flow hedges. Whilst correctly accounting for the fair value consequences for these derivative instruments, the Issuer neglected to consider the deferred tax consequences thereof. Not only did this result in other comprehensive income being overstated, but the case also concerned us in that there were no accounting processes in place to ensure that the tax consequences for all class of assets had been considered.

Paragraph 84 of IAS 12 *Income Taxes* explains that the disclosures provided in the tax rate reconciliation (IAS 12.81(c)) are necessary to enable users to understand if the relationship between the tax expense and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. It is for this reason that we asked for corrective action where the description of material reconciling items was non-descriptive, for example it was called a 'temporary', 'permanent' or 'other' difference.

Interim reporting

Paragraph 16A of IAS 34 *Interim Financial Reporting,* details certain mandatory disclosures not linked to significant events or transactions that occur during the interim period. Presentation of segmental information is mandatory (IAS 34.16A(g)), and provides relevant information to investors. Similarly, certain fair value disclosures must be provided (IAS 34.16A(j))

Whilst IAS 34.15 calls for an explanation of events and transactions that are significant to an understanding the changes in the results since the publication of the AFS, paragraph 15B of IAS 34 mandates certain disclosures if they are significant within the context of the interim results themselves (ie unrelated to changes since the publication of AFS). Several Issuers failed to provide disclosure of related party transactions despite the requirements of IAS 34.15B(j).

We also refer you to the last paragraph under the heading statement of cash flow on page 19 above, which discusses a concern raised in the context of interim results.

Impairments

Compliance with the disclosure provisions of IAS 36 *Impairment of Assets,* should illustrate the fact that various recoverable amounts were calculated and that goodwill is not necessarily a homogenous balance. The disclosures should not be broad and vague. This is especially the case when Issuers impair goodwill shortly after completing a business combination, as it calls into question the authenticity of the purchase price allocation exercise performed at the acquisition date. Careful attention must also be given to all aspects of paragraphs 130 and 134 of IAS 36.

The disclosure provided in terms of IAS 36 should give the user a full understanding of the circumstances that led to impairments. This information provides justification that the impairments have been accounted for in the correct period, ie that past impairments were not understated, and that future impairments are not currently envisaged. Importantly too, these disclosures are required for both the recognition and reversal of impairment losses.

Issuers should also be mindful of the fact that paragraphs 51 and 55 of IAS 36 require the use of pre-tax cash flows and discount rates when computing a recoverable amount based on value in use. IAS 36.BCZ85 explains that the pre-tax discount rate will not always be the grossed up post-tax discount rate.

LOOKING TOWARDS THE 2017 REVIEW CYCLE

We remain committed to ensuring that Issuers declutter their AFS and once again look forward to seeing Issuers embracing the principles set out in the IASB's Exposure Draft *Application of Materiality to Financial Statements*. The information set out on page 11 above under the heading of Decluttering of AFS is of relevance to Issuers.

Issuers should pay careful attention to how all of the JSE's past findings could impact their results. The JSE has implemented a process whereby it asks audit committees to consider the possible impact of its reports on their AFS and interim results. Questions will be asked if future review processes highlight problem in the AFS that were set out in previous proactive monitoring reports.

The implementation dates for three new standards IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from contracts with customers* and IFRS 16 *Leases,* are imminent. The first two are applicable as of 1 January 2018, whilst IFRS 16 is applicable as of 1 January 2019. These standards cover topics that are fundamental to the majority of Issuers and the magnitude of the changes and time required to implement these should not be underestimated. Issuers often face challenges when applying new IFRS standards. We therefore urge then to be prepared and vigilant in their adoption of these standards so that this trend does not apply to the new suite of standards.

A window into the entities readiness for the application of new standards can be seen through the disclosure provided in terms of IAS 8:30 (standards issued not yet effective). Issuers should be providing progressively more entity-specific qualitative and quantitative information about the application of the new standards and should not merely be including generic wording just as 'we are still assessing the impact of this standard' or 'the standard is likely to have a material/no impact'. Most Issuers should know the impact (or at the very least the magnitude thereof) and be able to make a reasonable estimate of the impact of the initial application of IFRS 9 and IFRS 15 at the time of preparing their 2017 interim results.

Issuers who have significant leasing arrangements that will be affected by IFRS 16 should also be providing high quality disclosures in relation to;

- the future minimum lease payments under non-cancellable operating leases by periods;
- the general description of leasing arrangements; and

- lease payments recognised as an expense in the period as required by paragraph 35 of IAS 17 Leases.

These disclosures are even more important now, as they can assist users to estimate the potential magnitude of the impact of IFRS 16 on the AFS.

The JSE also urges Issuers to continue to pay careful attention to other new developments in IFRS. The Annual Improvements to IFRSs Cycles 2012-2014 are effective 1 January 2016 and there are numerous other amendments that the IASB has made, with the objective of producing high quality accounting standards, which have the same 1 January 2016 effective date.

Amendments in local legislation and the impact thereof on AFS should also be considered. Issuers are reminded of the recent change in the inclusion rate for capital gains tax ("**CGT**") which became effective for financial years commencing on or after 1 March 2016. We would expect evidence of this change to be disclosed in the tax rate reconciliation where deferred tax is measured using the CGT for respective assets and/or liabilities.

Finally, recent events have shown us that we continue to live in uncertain times, both from a South African and global perspective. It is difficult to predict the outcome of political events both locally and around the world and yet we have seen the enormous impact they can have on world economies and the fortunes of companies. Careful attention should therefore be given to:

- the various risk disclosures required by IFRS;
- disclosures of assumptions made about the future and other sources of estimation uncertainty, paying particular attention to ensuring disclosure of the sensitivity of the carrying amounts to the methods, assumptions and estimates underlying their calculation (IAS 1.129);
- disclosures that talk to future cash flows (used in determining fair values); and
- information that provides insight into the geographical positioning of the Issuers operations.

Issuers should ensure that they provide high quality disclosures for these matters so as to provide meaningful information to users of the AFS.

ANNEXURE 1 - REVIEW PROCESS

This annexure provides a high level overview of the review process.

Selection process

We intend to review every Issuer's AFS at least once within a 5 year cycle and therefore our selection process is largely random. However, we aim to ensure that we have a view of the entire market. Our selection process is therefore directed to proportional representation across all sectors and all markets. In this regard we also ensure that we covered Issuers of all sizes from the Top 40 to those with a very small market capitalisation.

Risk based approach

The review process is not a detailed review of the AFS for compliance with every paragraph of IFRS. Detailed IFRS disclosure checklists are often standard armoury for an Issuer and their auditor and we do not intend to replicate this process. Instead, we follow a risk-based approach. Risk areas will change from year to year and from entity to entity and could include:

- Consideration of a specific accounting standard where, at a point in time, we have concerns with regards to the level of compliance;
- Consideration of issues driven by the business environment ; and/or
- Matters that are peculiar to the specific circumstances of an entity in that specific year.

At all times our focus is on aspects that are potentially price sensitive or could impact investors understanding of the business.

Collaboration with the University of Johannesburg ("UJ")

A crucial part of this proactive monitoring process is the partnership that the JSE entered into with UJ. Whilst the initial review is based on the predetermined risk areas it is imperative to ensure that the reviewers have comprehensive IFRS knowledge. It is not just a case of ensuring compliance with a specific IFRS disclosure paragraph. Rather the reviewer needs to have a full understanding of all aspects of IFRS in order to understand the potential implications and impact on the AFS of a particular matter and as well as assessing the potential non-compliance within the objective of financial reporting . Each AFS has at least two reviewers working on it, with the final sign off being done by a senior member of the UJ academic staff. The volume of Issuers covered in a year means a large number of skilled staff is required to do the initial reviews. Through the partnership with UJ, the JSE effectively had access to 25 additional qualified personnel.

The following process is followed:

- The selected AFS are sent to the staff of UJ for the initial review;
- A detailed report is prepared for each set of AFS; and
- The handing over of the report marks the end of the involvement in the case by the UJ staff.

Communication with Issuers

The detailed UJ report forms the basis of a potential enquiry by the JSE. JSE staff members use that report to engage with the Issuer. An initial letter of enquiry will be sent to the chair of the Audit Committee which identifies and asks questions on matters that we believe required further clarity.

The JSE then receives and gives the responses received from Issuers careful consideration. The format of our communication is principally in a letter format. This is necessary not only to create an audit trial of the enquiry, but and also to ensure a complete understanding of all the considerations, in what are often complex IFRS matters. Nevertheless, we welcome meetings with Issuers which can aid in the understanding of the content of their written responses and/or any subsequent questions that we may have.

From the onset we aim to be pragmatic with our approach and look to unravel matters that could be price sensitive. As a result is necessary to ask questions of Issuers in order to understand certain accounting matters and in order to ascertain the materiality of those, either on past, current or future accounting periods. Matters are often easily resolved through the provision of a satisfactory response.

Collaboration with the South African Institute of Chartered Accountants ("SAICA")

In 2002 the JSE and SAICA formed the GAAP Monitoring Panel (**"GMP"**), an advisory body of accounting experts to assist the JSE to enforce compliance with IFRS. With the launch of the proactive monitoring process the GMP was renamed the Financial Reporting Investigation Panel (**"FRIP"**). The role of the FRIP under the new process continued as it did in the past. More specifically, the FRIP provides advice to the JSE on cases of possible non-compliance with financial reporting requirements.

The intention of the review process is that only certain cases may be referred to the FRIP. These would be cases where the JSE needed detailed technical advice, for example:

- Complex and technical matters; or
- Where there is disagreement between the JSE and an Issuer on a specific matter.

Once referred to the FRIP, a case follows the FRIP process as set out in the FRIP Charter (a copy of which is available on the SAICA website). In summary, each case is considered by a review panel of 5 members selected from the 16 FRIP members (the list of names is also available on the SAICA website). Where a restatement is brought about after a FRIP investigation, reference is normally made in the restatement announcement to the FRIP.