JSE

REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2014

Date of issue: 19 February 2015

TABLE OF CONTENTS **Page**

INTRODUCTION	**3**
REVIEW PROCESS	**4**
RESULTS	**5**
DETAILED FINDINGS	**9**
LOOKING TOWARDS THE 2015 REVIEW CYCLE	**21**
ANNEXURE 1 – REVIEW PROCESS	**22**
ANNEXURE 2 – JSE GUIDANCE LETTER	**25**
ANNEXURE 3 – FRIP CASES IN 2014	**27**

INTRODUCTION

The integrity of financial information is a critical element of a well-functioning market. The objective of the JSE's process of reviewing Annual Financial Statements (**"AFS"**) is to contribute towards the production of quality financial reporting of entities listed on its market. This report provides an overview of the proactive monitoring activities (the "**review process**") undertaken by the JSE during 2014.

This report is intended to be of interest to all market participants, including listed entities (**"Issuers"**), investors, auditors, other regulators and the general public. In addition to providing statistics on our findings, it sets out the important points which came to our attention during the year with a view to assisting Issuers. We have also once again highlighted specific focus areas that Issuers should be aware for 2015. By presenting the points in an uncomplicated manner, we also hope that this will help demystify International Financial Reporting Standards (**"IFRS"**) for the public.

For the first time this report includes details of cases reviewed by the Financial Reporting Investigation Panel (**"FRIP"**). In the past, feedback on the activities of the FRIP were reported separately and published on the website of the South African Institute of Chartered Accountants ("**SAICA"**).

We continued to seek a pragmatic approach to our review process. This requires a fine balance between not getting bogged down in trivial matters but also not overlooking something that, once unravelled, could materially alter the users understanding of the financial position of an Issuer.

REVIEW PROCESS

Annexure 1 contains a high level overview of the review process. The information set out therein remains unchanged from that contained in our report issued in February 2014 other than to highlight that our reviews during the 2014 calendar year covered AFS for the years ending between 28 February 2013 and 30 June 2014.

No amendments were made to the review process, which we believe is running efficiently.

RESULTS

Statistics –what we did

From January to December 2014, 85 AFS were reviewed. We wrote query letters to 67 of the Issuers, of which 2 cases (2014-1, 2012-3, 2011-2) resulted in a further referral to the FRIP for advice. By January 2015, 10 of the cases were still pending finalisation.

	2011	2012	2013	2014
Letters of query	40	68	59	67
Cases closed immediately	16	14	19	18
Number of AFS reviewed	**56**	**82**	**78**	**85**
Cases b/f from previous year		11	15	9
Total cases reviewed during period	*56*	*93*	*93*	*94*
Cases still pending	(11)	(15)	(9)	(10)
Cases completed during period	45	78	84	84

Eighteen cases were closed either with no comments or with a letter of potential areas of improvement being sent to the Issuer.

Whilst our objective is to cover every Issuer at least once within a 5 year cycle, we have indicated that we may select Issuers more than once. To date therefore, we have reviewed the AFS of 301 Issuers, with 26 repeat reviews.

Statistics – what we found

Six cases resulted in restatements of the AFS and public announcements. In consultation with the Issuers, these restatements were made as soon as possible. For a further 5 cases the misstatement was such that we agreed with the Issuer that it could be corrected within the next published results. For a further 12 cases, whilst fortuitously there was no material misstatement, adjustments needed to be made within the next published results to avoid potential investor prejudice. The remaining 36 cases revolved around the smaller disclosure issues that will be clarified or corrected in the future by the Issuer.

	2011	2012	2013	2014
AFS needed restatement and public announcement made	2	7	3	6
Non-compliance such that we agreed to a correction within the next published results	2	2	8	5
Non-compliance not material this year, but must be corrected in the next results in order to avoid potential investor prejudice	10	10	7	12
Subtotal of forced corrections	**14**	**19**	**18**	**23**
Smaller disclosure issues that will be corrected in the future	15	28	33	36
Subtotal of cases with corrections	**29**	**47**	**51**	**59**
Other AFS in respect of which no issues were identified, or only potential areas of improvement were identified	16	31	33	25[1]
Total cases closed	**45**	**78**	**84**	**84**

In 2014, material infringements were identified in 7.1% of the closed cases (2013-3.6%, 2012-9%, 2011-4.4%). The cases where corrections were required in future reporting periods was at 20.2% (2013-17.8%, 2012-15.4%, 2011-26.7%) bringing the total number of forced corrections to 27.4% of the closed cases (2013-21.4%, 2012-24.4%, 2011-31.1%). This increase in 2014 is contrary to the previous declining trend, but is due to a more risk based selection approach undertaken by the JSE in this period. In this regard, the JSE has in certain instances also interrogated the quality of their reporting processes as a whole and handed the Issuers over to the Issuer Regulation Investigation Unit for their separate consideration.

In assessing the potential impact of the matter, 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 61% of the 59 cases that needed correction dealt with IFRS disclosures matters (2013-55%, 2012-68%, 2011-66%), with the remaining 39% impacting both IFRS disclosure and measurement (2013-45%, 2012-32%, 2011-34%). These

[1] this includes the 18 cases that were closed off immediately

figures are calculated based on the year of completion of the review and not the period covered by the AFS and can therefore be distorted when matters carried forward from one year to the next contain measurement issues. If the analysis is done based on the year of initial review, then 65% of the cases closed in 2014 dealt with disclosure matters (2013-58%,2012-61%, 2011-66%).

International comparison

Whilst our counterpart enforcers in Europe (through the European Securities Markets Authority (**"ESMA"**)) have not yet released their 2014 findings, their 2013 activity report provides a useful comparison. The report indicates that of the 1 900 reviews undertaken by the 30 European enforcers during the calendar year to December 2013, 8.9% of those reviews identified material infringements, requiring public announcements or reissuing of AFS. For a further 17.1%, whilst classified as material, the enforcers accepted a correction in the next AFS.

A direct comparison of the data is difficult as the JSE reports in February every year, with pending cases being carried forward to the next period. ESMA on the other hand only produces its report in the last quarter of the following year, when all their reviews for the previous calendar year are completed. Nevertheless our findings are broadly in line with these international trends and it is interesting to note that ESMA also reported an increasing trend in the total forced corrections.

	South Africa	South Africa	ESMA[2]	ESMA[3]
Coverage				
Period of review	2013	2014	2012	2013
Reporting date	Feb 2014	Feb 2015	July 2013	May 2014
Reviews closed at reporting date	84	84	2 250	1 900
Percentage coverage of population	25%	25%	37%	25%
Findings				
Material infringement, requested re-issuance or immediate public announcements	3.6%	7.1%	8.9%	8.9%
Corrections required in future financial statements	17.8%	20.2%	13.6%	17.1%
Total forced corrections	21.4%	27.4%	22.5%	26%

[2] Information extracted from the ESMA report entitled “Activity report on IFRS enforcement in the Europe in 2012”

[3] Information extracted from the ESMA report entitled “Activity report on IFRS enforcement in the Europe in 2013”

DETAILED FINDINGS

The objective of providing the information set out in this section is to advise Issuers of the potential pitfalls and to highlight where the quality could be enhanced. In order to be concise, this report does not deal with all non-compliance matters. Certain matters identified during 2014 have been discussed in previous reports and we have not repeated information that was already communicated. Issuers reading this report for the first time should therefore refer to our previous three years' reports in order to obtain an understanding of all the matters that the JSE have raised, with a continuing view to avoiding similar mistakes.

Overview

The following areas accounted for 65% of the number of issues identified:

- Instances where we were faced with sloppy drafting;
- Presentation of Financial Statements (IAS 1) and specifically problems with accounting policies and lack of disclosure regarding significant judgements;
- Statement of Cash Flows (IAS 7);
- Income Taxes (IAS 12)[4];
- Earnings per Share (IAS 33) and the Headline Earnings circular;
- Financial instruments: Presentation, Recognition and measurement (IAS 32 and IAS 39);
- Impairment of Assets (IAS 36); and
- Financial Instruments: Disclosures (IFRS 7)[4].

In our 2013 report, we advised Issuers that we would be reviewing their application of the new standards IFRS 10, 11, 12 and 13, which were all effective for year-ends commencing on or after 1 January 2013. Our 2014 reviews identified problems in the application of IFRS 12 and IFRS 13. Other new problem areas compared to 2013 included Investment property (IAS 40) and Agreements for the Construction of Real Estate (IFRIC 15). We have also decided to include a discussion on the application of Property, Plant and Equipment (IAS 16) and Business Combinations (IFRS 3) in this report as we identified a number of measurement issues with these standards, which often resulted in a material impact.

[4] Matters falling into this standard were not discussed in our 2013 report as there was, at that time, a reduced number of problems identified with compared to 2012. This trend seems to have reversed.

Whilst not discussed in this report, we wish to highlight the fact that three standards which were without problems in 2013 raised concern again in 2014. These included Events after the reporting period (IAS 10), the Effects of Changes in Foreign Exchange Rates (IAS 21) and Intangible Assets (IAS 38). Issuers are referred to our previous reports to familiarise themselves with the types of issues identified with those standards.

General

One of the core principles of the Listings Requirements (the "**Requirements**") is to ensure that parties involved in disseminating information into the market place observe the highest standard of care in doing so.

In the current review period 16% (2013-11%) of the matters that we identified related to poor presentation in the AFS (including contradictory messages with information published on SENS) and could have been avoided. We are concerned that we continue to find these types of errors, as it points to a potential disregard of one of the core principles of the Requirements. We implore Issuers to ensure that they have the necessary processes and procedures in place in order to prevent these types of problems from occurring. Errors often occurred when there were last minute changes to the AFS and Issuers should be extra vigilant in these instances.

Presentation of Financial Statements

IAS 1 contains the overall requirements for the presentation of financial statements. There were various cases where some of the matters covered by this Standard were not adequately addressed. Some of these are discussed below.

Accounting policies

Problems with accounting policies continued at the same rate as in 2013 with accounting policy matters accounting for 9% of the matters identified.

We have in the past cautioned Issuers against having a "boiler plate" approach to accounting policies. During 2014 we amended our approach to the extent that we are now instructing Issuers to tidy up their accounting policies where they have included irrelevant or immaterial polices. We are concerned that a poor approach to accounting policy disclosure may obscure the understanding of important matters and to an extent diminish the fair presentation of the AFS.

At the other end of spectrum, it is inappropriate to omit an accounting policy for a significant item or not to apply the disclosed accounting policy. We remind Issuers that the objective of accounting policies is to inform users so that they can understand the financial statements. IAS 1 requires a summary of *significant* accounting policies that are relevant to an understanding of the financial statements. It is therefore critical to include accounting policy disclosure where an accounting policy has been created in terms of paragraph 10 of IAS 8.

The problems encountered ranged from a complete lack of an accounting policy, to incomplete polices, to inaccurate or confusing polices. Of concern was the lack of an accounting policy when the items had a significant impact on the financials. As a reminder, this is contrary to the requirements of IAS 1 which require a summary of *significant* accounting policies that are relevant to an understanding of the financial statements. Problems often occurred for transactions that were unusual for the Issuer or where IFRS is not specific on a particular issue and the Issuer had to develop their own accounting policy. We therefore remind Issuers of the content of paragraphs 117 to 121 of IAS 1– *Presentation of Financial Statements* which discusses the presentation of accounting policies.

Significant judgments and assumptions

There was an increase in the instances of non-compliance with requirements of paragraph 122 and 125 of IAS 1 which require:

- disclosure of the significant judgments that management makes in the process of applying the entity's accounting policies; and
- sources of estimation uncertainties.

IAS 1 goes on to highlight that these disclosures relate to management's most difficult, subjective or complex judgments.

There were several instances of insufficient disclosure including:

- the application of the accounting policies for two different share incentive schemes;
- the application of IFRIC 15 and whether revenue was within the scope of IAS 11 (Construction Contracts) or IAS 18 (Revenue);
- the recognition of a property before the legal transfer occurred;
- the tax position of the entity and the applicability of deferred taxation;
- the consolidation/deconsolidation of entities within a group;
- the consolidation of an empowerment trust;
- valuation of assets and liabilities;
- calculations for impairments of various assets; and
- calculations for provisions of bad debts.

Other comprehensive income ("OCI")

Amendments were made to IAS 1 for changes in the presentation of other comprehensive income. This resulted in the requirement for entities to group items presented in OCI on the basis of whether they are potentially reclassifiable to profit and loss subsequently. The changes were effective as of 1 July 2012. Issuers should be careful to ensure that all amendments to IFRS are given consideration within the applicable reporting period.

Current/ non- current distinction

Trade receivables can only be disclosed as current where that asset is expected to be realized within the normal operating cycle or within twelve months after the reporting period.

Finance costs

In terms of paragraph 82(b) of IAS 1 finance costs must be disclosed separately and should not be aggregated with other line items. The unwinding of interest relating to a rehabilitation liability must therefore be reflected separately as finance expenses.

Aggregation

Items in the statement of financial position should be presented separately if the nature or function of the assets differs. Paragraph 59 of IAS 1 goes on to explain that the use of different measurement bases for different classes of assets suggests that their nature or function is different and therefore that an entity must present them as separate line items. Paragraph 29 also requires entities to present separately items of dissimilar nature or function unless they are immaterial. It is therefore inappropriate to combine income received in advance as part of trade and other payables, where the latter originates from the purchase of goods from suppliers.

Statement of cash flows

Our engagement with the investment community continues to confirm that information about the cash flows of an entity is important to enable investors to evaluate the ability of that entity to generate cash flows and to understand the timing and certainty thereof. IAS 7 therefore remains a focus area for our reviews and the types of errors that we identified are discussed below.

Non-cash flow items should not be reflected as cash flow items. Examples of errors identified include:

- the inclusion of the 'proceeds' from a share issue, when the shares were issued to fund the purchase consideration for the acquisition of a business combination;
- reflecting an increase in the amount of a deferred consideration liability as a cash outflow; and
- failure to add back the impairment of an intangible asset included in 'profit before interest and taxation'.

The following problems were identified in the reconciliation of 'profit/ (loss) before interest and taxation':

- adjusting for the transfer of a non-controlling interest on the disposal of a subsidiary when that amount was never included in the profit , but was rather accounted for directly in the statement of changes in equity; and
- including, on an unadjusted basis, the line item 'profit for the year from discontinued operations', which is net of taxation and profits attributable to outside shareholders.

The classification of items within the statement of cash flows is equally important for users and the consequence of any such errors is amplified when, in its interim report, an Issuer provides only the headings in a condensed statement of cash flows.

Only expenditure that results in the recognition of an asset in the statement of financial position can be classified as an investing activity. Issuers misapplied this requirement for the items listed below, which should rather have been reflected as financing activities:

- the acquisition by the Issuer of its own shares, and
- shares purchased in a subsidiary from a minority shareholder.

There were other instances of misclassifications, with Issuers incorrectly reflecting operating activities as investing activities. Examples of this include:

- the repayment of monies or loans which were advanced as part of normal operating activities, and
- transaction costs incurred in a business combination.

The fact that a long term loan becomes classified as current liability at the end of its life does not mean that the cash outflows on repayment should be reflected as a movement in working capital. Financing activities are defined as activities that results in changes in contributed equity and

borrowings. Operating activities on the other hand are the principle revenue-producing activities. The capital portion of the loan therefore retains its original nature, being that of a financing activity.

The definition of cash and cash equivalents is very specific. An investment in a preference share should therefore not be reflected as part of 'cash and cash equivalents' when it is neither short dated maturity instruments nor with a liquid market.

Cash flows relating to interest must be disclosed separately on the statement of cash flows, even if they have been recognised in investing activities as a component of a self-constructed asset. The payments of dividends must also be shown on the face of the statement of changes in equity, and should be classified as either financing or operating. They cannot be classified as investing activities.

Taxation

Careful attention should be given to the taxation calculation and the resultant tax rate reconciliation for items such as share based payments and revaluation reserves. We identified problems where the split between current and deferred taxation was incorrect and where the existence of permanent differences were overlooked.

Full details must be provided in the tax rate reconciliation. It is insufficient to merely include one total line item called 'non-deductible expenses'.

Deferred tax assets

Problems were again identified for numerous Issuers with regards to their disclosure justifying the recognition of deferred tax assets. Not only is this disclosure required by IAS 12, but insufficient disclosure could be an indication of a lack of suitable justification and raisings concern as to whether or not the deferred tax asset should have been raised. The disclosure must be detailed and specific to the Issuer.

Deferred tax assets and liabilities can only be offset in limited circumstances. More specifically if they relate to the income taxes levied by the same taxation authority on the same taxable entity (or if there is a legal right of set-off) and the entity intends to settle on a net basis or simultaneously.

IAS 12 is very specific in that the deferred taxation on a non-depreciable asset, such as land, must be measured to reflect the tax consequence of recovering that asset through sale.

Property, plant and equipment

Problems were identified with the application of the depreciation requirements of IAS 16, specifically in the case of land and buildings. These included:

- incorrectly depreciating land;
- separately identifying additional expenditure to a building (a refurbishment of an existing structure) was insignificant to the total cost of the building and thus did not meet the IAS 16 test to be separately identified;
- an unjustified decision that a building was an indefinite life asset; and
- applying the revaluation model but not depreciating the asset.

As it relates to applying the revaluation model under IAS 16, Issuers are reminded that paragraph 54 of IAS 16 does require careful consideration. The assessment of residual value should be a factual one, carried out on an annual basis. Residual value must take account of estimated costs of disposal (for example estate agent fees) and is viewed based of the value of the asset at the end of its useful life (which must therefore be discounted to the present day). The fair value calculation on the other hand is undertaken in terms of IFRS 13, which considers the price received at the current date, with the asset in its current condition.

Earnings and Headline earnings per share ('HEPS')

Problems in this area often have a material impact on the markets operated by the JSE and thus, whilst the number of matters identified did reduce, we continue to highlight concerns in order to assist Issuers in avoiding the same mistakes. Errors included:

- The omission of the dilutive effect of options granted and shares due to be issued at a future date;
- The incorrect exclusion of the impairment of a loan receivable from HEPS;
- Including in HEPS items such as profit on the sale of a subsidiary and the amount attributable to the scrapping of property plant and equipment;
- Ignoring the tax consequences of adjusting items for HEPS; and
- Arithmetic errors in calculating HEPS.

Impairment of assets

The application of the disclosure requirements of IAS 36 has been a problem area since the inception of our proactive monitoring process. Non-compliance in this area ranged from partial compliance on one hand to the complete omission of the required disclosure on the other hand. Paragraphs 126 to

137 of IAS 36 are clear and detailed in their requirements, are highlighted in our previous reports and have not been repeated again. Suffice to say that the disclosure must be detailed and specific to the entity concerned.

Insufficient detailed application of all of the disclosure requirements of IAS 36 could point to a more fundamental problem of incorrect measurement and the overstatement of assets. Therefore, where the necessary disclosures are omitted an Issuer could find themselves engaged in lengthy correspondence with the JSE, where we would look to question the supporting evidence regarding the measurement of an asset. In one specific instance, these discussions lead to the Issuer having to raise impairment on their goodwill balance.

Financial instruments: Presentation, recognition and measurement

Various problems identified within IAS 32 and IAS 39 as discussed below.

An Issuer incorrectly classified several financial instruments as designated at fair value through profit and loss ("**FVTPL**"). These included:

- Loans receivable from shareholders;
- Loans to companies within the group; and
- Certain other interest free loans receivable.

Given the nature and terms of the instruments, the initial classification should have been regarded as 'loans and receivables'. The option to designate them as FVTPL in terms paragraph 9(b) as read in conjunction with AG4B of IAS 39 is only allowed in limited circumstances. The facts and circumstances as they related to that specific Issuer meant that they did not meet those limited circumstances.

The application of IFRS to interest free loans continues to be misunderstood. These loans must be measured at fair value plus transaction costs on initial recognition. The contract value of the loan is not the fair value. In one instance, the misapplication of this principle extended to a loan with a fixed interest rate. This principle was also misapplied to trade receivables. In one instance, the receivable balance was large and repayment did not occur in the short term. The impact of discounting therefore became material.

We also identified problems with the subsequent measurement of financial liabilities, specifically debentures. Loans and receivables are to be measured at amortised cost using the effective interest

rate method. One Issuer incorrectly amortised their premium on a debenture instrument on a straight-line basis. They also neglected to include in the debenture premium an amount for an ‘antecedent’ interest payment and reported this as revenue. This matter is discussed in more detail elsewhere in this report and was the subject of a FRIP case and a guidance letter.

The determination of whether an instrument should be classified as equity or as a financial liability can be a complex analysis and dependent on the specific facts and circumstances. It would not be beneficial for us to try and repeat the details of one such case, suffice to say that we did not agree with the Issuers approach to regard monies injected as project finance as an equity contribution. Issuers are cautioned to pay careful attention to their application of IFRS in these circumstances.

In another instance, an Issuer incorrectly accounted for a single stock future for their own shares as a derivative financial instrument. Their specific contract was a forward contract to buy their own shares, which would be settled by a cash payment in exchange for those shares. The purchase by an entity of its own equity instrument should be deducted from equity and no gains or losses should be recognised in profit or loss.

Investment property

Care should be taken when reclassifying property from ‘investment property’ to ‘owner occupied’ to ensure that it is correctly measured under the new IFRS that is applicable. More specifically ‘owner occupied property’ is subject to depreciation.

The decision to classify property as ‘owner occupied’ or ‘investment property’ is an area that requires the exercise of significant judgement. A detailed explanation of the exercise of this judgement to the Issuer’s specific facts and circumstances must therefore be included in the AFS. It is also confusing to assign labels to ‘owner occupied property’ that imply that they are ‘investment property’ and vice versa and Issuers should avoid such practices.

Financial instruments disclosures

Both our 2011 and 2012 reports discuss the problems with regards to the application if IFRS 7 and are not repeated again in this report. Nevertheless, we wish to indicate that there were again numerous instances of the incomplete application of this accounting standard. Issuers are therefore reminded that IFRS 7 aims to ensure disclosures are provided that enable users to evaluate the

significance of financial instruments, the nature and extent of risks relating to those instruments and how these risks are managed.

Consolidated financial statements and Business combinations

We asked several questions regarding the application of IFRS 10 and the manner in which issuers were applying the new control definition. Despite all these questions, we were pleased not to find areas of misapplication of the standard.

Regrettably, we continued to identify problems with the application of IFRS 3. In this review period, we witnessed an increasing number thereof. We are concerned that these problems were mainly measurement issues covering issues such as:

- The incorrect identification of intangible assets for an acquisition;
- The incorrect application of the rules for reverse acquisition accounting;
- Not accounting correctly for a step acquisition; and
- Forgetting to discount a contingent consideration payable.

Business combinations are usual transactions for many Issuers and they are urged to ensure that they obtain a full understanding of the IFRS implications of their specific transaction.

Disclosure of interests in other entities

Some omissions were identified in the application of the disclosure requirements of the new IFRS 12. These included:

- The judgements exercised that led to the accounting treatment , for example non-consolidation of a trust or regarding an investment as an associate and not a subsidiary;
- Details of the nature and risks associated with the investment;
- Details of how those interest affect cash flows of the Issuer;
- Summarised financial information together with additional specific line items for associates; and
- Summarised financial information for subsidiaries that have non-controlling interests that are material.

Given that this is a new IFRS, the outcome was not unexpected. Nevertheless, we ask that Issuers pay careful attention to these disclosures, especially as we enter into the second year of implementation.

Fair value measurements

The main area of concern regarding the application of IFRS 13 was the detailed disclosure requirements for level 3 fair value assets/liabilities. Given that this is the lowest priority in the fair value hierarchy, adherence to the disclosure requirements is arguably even more important than for those of level 1 and 2 assets/liabilities. Issuers must take care to ensure that specific qualified information is provided. Furthermore, they are reminded that the fair value disclosure exemptions set out in paragraph 29 of IFRS 7 do not apply to the non-current portion of trade receivables.

LOOKING TOWARDS THE 2015 REVIEW CYCLE

In addition to paying careful attention to how the JSE' s past findings (as set out above) could impact their results, Issuers should pay careful attention to the matters discussed below.

Accounting policies

We ask that Issuers pay careful attention to the language used in their accounting policy notes. Generic wording, as extracted from IFRS, may not explain the manner in which the accounting standards have been applied to the Issuers specific facts and circumstances.

De-cluttering AFS

Linked to the above warning is the concern that a poor approach to disclosure may obscure the understanding of important matters and to an extent diminish the fair presentation of the AFS. In this regard Issuers should not be surprised if we also begin to ask questions such as, “Why is this disclosure provided?”, as opposed to just “Why is this disclosure not provided?”

Interim results

The intention at the onset of the review process was to review the AFS of every Issuer at least once every 5 years. The JSE is comfortably on track with its review process. By the end of 2015 we would have reviewed the AFS of every Issuer that was listed in 2011. In fact, there is some spare capacity in this regard, and rather than automatically commencing with a second review cycle the JSE has decided that in this last year of the first review cycle it will begin to consider the interim results of Issuers.

ANNEXURE 1 - REVIEW PROCESS

This annexure provides a high level overview of the review process and the information set out below remains unchanged from that contained in our report issued in February 2014.

Selection process

We intend to review every Issuer's AFS at least once within a 5 year cycle and therefore our selection process was largely random. However, we aimed to ensure that we had a view of the entire market. Our selection process therefore was directed to proportional representation across all sectors and all markets. In this regard we also ensured 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:

(i) Consideration of a specific accounting standard where, at a point in time, we have concerns with regards to the level of compliance;

(ii) Consideration of issues driven by the business environment ; and/or

(iii) 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 23 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 then engage with the Issuer and consider and debate the responses.

Aiming to be pragmatic, we have addressed our communication to Issuers in two separate sections. The first sets out matters of a potentially immaterial nature which 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 contains matters that could be price sensitive and therefore required further clarity. In our letter we note that some of these matters could be easily resolved if satisfactory responses are provided in the communication.

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:

(i) Complex and technical matters; or

(ii) 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.

AFS covered

The timing of reviews is impacted by two factors. Firstly, Issuers have 6 months after their year-end within which to distribute their AFS. Secondly, engagement with Issuers only commences once the initial review is performed by UJ and the detailed findings report is delivered to the JSE. Therefore, ignoring cases brought forward from the previous year, our reviews during the 2014 calendar year covered AFS for the years ending between 28 February 2013 and 30 June 2014.

ANNEXURE 2 – JSE GUIDANCE LETTER

9 October 2014

Company Secretaries

Dear Sir/Madam

Guidance letter: Application of IFRS for antecedent interest on linked units

The JSE wishes to bring to your attention a recent matter arising from its pro-active monitoring activities dealing with the treatment of antecedent interest payable by property entities with linked units. This matter was also referred to the Financial Reporting Investigation Panel ("**FRIP**") for their advice.

Fact pattern

In this specific instance a property entity ("**the issuer**") with a debenture linked to an ordinary share ("**linked unit**") issued new linked units between two debenture distribution dates.

The issuer:

(i) Determined the amount of interest attributable to the newly issued linked units from the last distribution date to the issue date ("**antecedent interest**") and accounted for this as income;

(ii) Did not correctly apply their own accounting policy to measure the debenture at fair value plus transaction costs at initial recognition; and

(iii) Thereafter incorrectly fair valued the debenture, instead of measuring it applying amortised cost using the effective interest rate method.

Application of IFRS

The treatment of antecedent interest in terms of the above fact pattern is not in accordance with International Financial Reporting Standards ("**IFRS**"). It is neither revenue in terms of *IAS 18 – Revenue* standard nor income in terms of the *Framework*. The FRIP advised that this antecedent interest forms part of the cash inflow on the issue of the linked units and should be recognised as part of the debenture liability's initial carrying amount using the effective interest rate method (*IAS 18.30 and IAS 39.09*).

IAS 39.43 states that when a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of

the financial asset or financial liability. Thus the fair value of the debenture liability as determined initially should include the antecedent interest portion, since it is a component of the debenture portion's future contractual cash flows.

Furthermore the debenture liability is then amortised using the effective interest rate in accordance with *IAS 39 - Financial Instruments: Recognition and Measurement* for every separate issue of debentures (linked units).

Conclusion

The JSE urges issuers to pay careful attention to their accounting treatment for both antecedent interest and the measurement of debentures. Whilst we understand that the linked unit structures are in the process of being collapsed, we wish to highlight these principles to ensure that issuers do not take the same approach as it relates to dividends that they may believe accrue on the shares issued in place of the linked unit structures.

ANNEXURE 3 – FRIP CASES IN 2014

Background

The JSE referred three matters to the FRIP for consideration in 2014. These matters emanated both from the review process and other internal processes. Generally FRIP referrals relate to AFS of Issuers, however they could also cover other financial information, such as interim results or pre-listing statements.

On conclusion of a case, the FRIP, as an advisory body to the JSE, makes recommendations that will result in compliance with IFRS. The JSE will seek feedback from the Issuer on the FRIP detailed technical view and will then make its decision as to any potential corrective steps after taking the following into account:

- the detailed technical report from the FRIP;
- the response from the Issuer;
- the recommendations made by the FRIP;
- materiality;
- the general principles of the Requirements;
- the importance for investor protection; and
- the potential impact on price formation.

In 2014, the accounting matters that were considered in the FRIP cases are set out below.

Property Industry – Antecedent Interest

Also refer to the JSE Guidance Note, dated 9 October 2014, issued in this regard.

It has been common practice that property entities listed on the JSE have linked units, which comprise both a share portion and a debenture portion. These entities typically determine the fair value of the debenture portion based on the expected forward distributions. The debentures are recognised as liabilities as there is a contractual obligation on the entity to deliver cash to the holders in the form of distributions. Any remaining portion of the value is allocated to stated capital. Furthermore, where linked units are issued between distribution dates, the purchaser of a new unit often agrees to contribute the interest portion from the previous distribution date to the date of issue to the entity. This is done as the units issued between distribution dates will be entitled to the full distribution payment even though it was not in issue during that period and the issue price will include the accrued interest for the period. This practice is meant to ensure that the other unit holders are not prejudiced.

The resulting 'antecedent interest' inherent in the issue price of the linked units is recognised by some issuers as revenue or interest income on receipt.

The FRIP concluded that:

- In applying the effective interest rate method, the calculation of the fair value of the debenture portion of the linked units should include the 'antecedent interest' portion. Therefore, even though the 'antecedent interest', forms part of the cash inflow on the issue of the linked units, it does not represent revenue in terms of IAS 18. Instead, the antecedent interest should be recognised as part of the debenture liability's initial carrying amount. This liability will subsequently be reduced when the cash flows of the debenture interest distributions are recognised on every distribution date.
- In compliance with IAS 39 and IAS 32, any debenture premium should be recognised as part of the interest expense calculated, using the effective interest rate, instead of straight-lining thereof.
- The interest expense calculated on the effective interest method is therefore the only amount that should be disclosed in profit and loss, noting that this includes the impact of the debenture premium, in recognition of the debenture instrument.

Investment property – preferred fair value measurement basis

An entity acquired properties for which it would paid through the issue of shares on listing. The properties were valued, at the date of concluding the acquisition agreements, in terms of IFRS 2 *Share-based Payments* ("IFRS 2"). However, transfer of the properties was subject to certain future events and thus the acquisition had not yet taken place at the time. Hence the properties were correctly, not yet recognised as assets.

Subsequently and shortly before the transfer of the properties became unconditional, the properties were independently revalued, which resulted in significantly higher values being attributed to them.

The question arises as to the most appropriate fair value measurement in terms of IFRS 2, where an asset is obtained and paid for in terms of a share based payment transaction. Therefore, should the market transaction, namely the value of the underlying to-be-listed shares be used in valuing the properties; or should the valuation by the independent valuer be used.

IFRS 2 defines fair value as *"(t)he amount for which an asset could be exchanged, a liability settled, or an equity instrument granted between knowledgeable, willing parties in an arm's length transaction*."

In terms of IFRS 2.10, "*for equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instrument granted*."

The FRIP concluded:

- that IFRS 2 is not explicit on preferential fair value measurement (thus a market transaction or an independent valuation) in determining fair value. Thus on initial recognition the entity could record the properties based on the contract value and reflect the increase in value, based on the independent valuer value, as a gain.

Revaluation of property accounted for in terms of IAS 16 *Property, plant and equipment* ("IAS 16")

An issuer disposed of a property, accounted for in terms of IAS 16. As a condition of the sale, an independent valuation of the property was done immediately prior to the sale of the property. The downward valuation of the property was recognised against the Revaluation Reserve in the Statement of Other Comprehensive Income. As a result, a loss on disposal of the property was not recognised.

The FRIP concluded that:

- It was correct for the Entity to determine the fair value of the asset in order for an impairment test to be performed, as required by IAS 16.40 and IAS 36.60. This correctly resulted in the recognition of an impairment loss in Other Comprehensive Income, to the extent that a revaluation surplus existed for this particular asset.
- It would have been more relevant and hence appropriate to argue that the decision to sell the asset gave rise to an impairment indicator. Therefore, the adjustment to the value of the asset was done in terms of IAS 36, which resulted in impairment loss. Wording referring to 'impairment' would have been more appropriate.

  IAS 36 *Impairment of Assets* ("IAS 36"), paragraph 36.12(f) states that a change in the anticipated manner of use of an asset is an impairment indicator. Plans to dispose of an asset is specifically mentioned. IAS 36.60 refers to the IAS 16 treatment of an impairment loss and states that it "*shall be treated as a revaluation decrease in accordance with (IAS 16)*."
- The sudden decline in the value of the asset, if not attributed to a specific event relating to the particular property only, raises concerns requiring a revaluation and impairment testing of the full class of assets in terms of paragraphs 34 and 36 of IAS 16.

  IAS 16.34 states that *"(t)he frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.*"

  IAS 16.36 states that "*if an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which the asset belongs shall be revalued.*" However, IAS16.38 makes provision of a class of assets to be revalued on a rolling basis, provided that such revaluations are kept up to date and are completed within a short period.
- This should be accompanied with appropriate disclosure as required by IAS 1 *Presentation of Financial Statements* ("IAS 1"), paragraph 125 which states that *"(a)n entity shall disclose information about the assumptions it makes about the future, and other major sources of*

estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year."

- In the specific instance disclosures required in terms of IAS 16.77 were lacking regarding the effective date of a revaluation, whether an independent valuer was involved and details for each revalued class of the carrying amount that would have been recognised had the assets been carried under the cost model as well as the revaluation surplus, indicating the change for the period.
- In addition, IAS 36.126 requires the disclosure of the amount of impairment losses on revalued assets, as well as the amount of reversals of impairment losses on revalued assets recognised in Other Comprehensive Income during the period.