REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2017

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INTRODUCTION

This report (the **"2017 report"**) provides an overview of the proactive monitoring activities (the "**review process**") undertaken by the JSE during 2017. 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. The review process leads in healthy debate which we believe is important for the credibility of our markets.

The target audience for this report is entities whose equity or debt securities have a primary listing on the JSE. The 2017 report sets out the important findings identified during the year, which we request issuers to consider and highlights focus areas that issuers should be aware of for 2018. The JSE specifically requests that the audit committee of every issuer considers the findings contained in this 2017 report when preparing their next set of AFS and interims and to provide the JSE with confirmation of this fact. Audit committees should also consider the content of our previous reports issued from 2011 to 2016 (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 2017 ("**the 2016 report**").

This report also provides details of the review process in order to assist new issuers in understanding the process. On an annual basis we reconsider the detail behind our review process to ensure that we remain aligned with international trends and are attuned to local market developments. Finally, in this report we provide statistics on our findings, in order to highlight the regulatory benefit of the review process.

DETAILED FINDINGS

We implemented a procedural change in 2017, requiring written confirmation from audit committees that the 2016 report was tabled at a meeting of the audit committee for their consideration. This change had a positive impact on certain of our findings, specifically in the area of declutter.

Feedback on the 2017 focus areas

<u>Decluttering of AFS</u>

Decluttering the AFS of superfluous information has been a longstanding focus area of our reviews. The table below illustrates a dramatic reduction in the number of findings in this area following the issue of the 2016 report.

	Pre-issue of the 2016 report ("pre period")		**Post-issue of the 2016 report ("post period")**	
	Equity	Debt	Equity	Debt
Accounting policies	16	5	3	2
Other clutter	5		1	
Total	**26**		**6**	
AFS reviewed and closed	38		41	

The types of examples of <u>superfluous accounting policies</u> identified in the pre period were similar to those already detailed in the 2016 report and are not repeated here. Additional examples from the post period include:

- a discussion of significant estimation uncertainty for property, plant and equipment ("**PPE**"). The carrying amount of PPE to the Group was however immaterial and therefore the estimation uncertainty would not have had a 'significant' impact on the results;
- an accounting policy and discussion of significant estimation uncertainty for provisions when there were none; and
- a discussion of the policy for changes in ownership levels and disposals when there had been no changes in the composition of subsidiaries or associates.

Examples of other clutter in the pre period were similar to the 2016 report examples. Two further examples identified in the post period are as follows:

- assets comprising 0.5% of the group's asset value were presented as the first two notes and were discussed in great detail, yet insufficient emphasis and content was provided for assets comprising 82% of the total assets; and
- there was an enormous level of detail provided in the deferred tax movement note, with various immaterial components being disclosed separately.

Issuers are reminded that whilst the individual IFRS standards contain more than 2 000 potential disclosure items, paragraph 31 of IAS 1 *Presentation of Financial Statements* 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".*

During 2017 the International Accounting Standards Board ("**IASB"**) issued certain documents under the banner of their 'Better communication in Financial Reporting' project. IFRS Practice Statement 2: *Making Materiality Judgements* (issued by the IASB in September 2017) is a useful tool to assist issuers in making their AFS more useful and concise. Furthermore, a report compiled by the staff of the IFRS Foundation entitled *Better Communication in Financial Reporting: Making disclosures more meaningful* (issued October 2017) uses real-life examples to illustrate how companies are improving their communications.

Adoption of new standards

The disclosure required in terms of paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a window into issuers' readiness for the application of new standards. The review process only commenced probing those disclosures towards the end of 2017. Our findings generally pointed to disclosure that was neither entity specific, nor did it provide sufficient detail that would enable a user to make an adequate assessment of the possible impact thereof to the issuer's financial statements. We will continue to challenge disclosures in these circumstances in future reviews.

Quality of disclosures regarding risks and uncertainties

In the 2016 report we highlighted four items that we would focus on under this heading. One of the main areas where we found insufficient disclosure was the application of IFRS 7 *Financial Instruments: Disclosures*. We remind issuers that disclosure of liquidity risk must be provided for all financial liabilities on an undiscounted basis (IFRS 7:39 and IFRS 7:B11D). Furthermore, market risk disclosures should cover all financial instruments if the impact thereof is material to the AFS (IFRS 7:40).

Matters where action was required

This section does not discuss all the cases dealt with in 2017. Instead we focus on specific findings for the twelve material cases and also discuss certain matters which have not been discussed in our previous reports.

Transparency when reporting errors

Item 1 of annexure 2 of this 2017 report details a case that was referred to the Financial Reporting Investigation Panel ("**FRIP**"). The conclusion reached in that case was that the issuer had previously incorrectly accounted for advertising rebates it received. The retrospective application of a revised policy should have been treated as the correction of a prior period error and not a change in accounting policy as had been reflected in the AFS.

We remind issuers that we have emphasised in our previous reports that we expect issuers to be transparent in their disclosure regarding the correction of material prior period errors (IAS 8). Masking material prior period errors in a non-transparent manner runs contrary to the general principles of the JSE Listings Requirements ("**the Requirements**") and in these instances the JSE will require an Issuer to take corrective action.

Statement of cash flows

IAS 7 *Statement of Cash Flows* was the single biggest contributor to material infringements for 2017. Whilst we note that we are not unique in this position[1] we believe that this is an area issuers should pay specific attention to in future periods.

IAS 7 highlights that the statement of cash flows is useful in providing users with a basis to assess the ability of the entity to generate cash and the needs of the entity to utilise those cash flows. We have previously advised issuers that the classification of an item within the statement of cash flows (i.e. whether it relates to operating, financing or investing activities) ("**SCF classification**") is equally as important to users as the final net cash position presented.

In the 2017 review we instructed several issuers to take corrective action for incorrect SCF classifications presented in the statement of cash flows. The matters identified included:

- dividends paid to non-controlling interest ("**NCI**") shareholders being incorrectly reflected as investing activities when they should rather be treated in the same manner as dividends paid by the holding company and (IAS 7.34);
- changes in ownership at subsidiary level, that did not result in a loss of control, being incorrectly treated as investing as opposed to financing activities (IAS 7.42A); and
- the following instances of non-cash flow items being incorrectly reflected as cash flow items (IAS 7.43):
    - interest capitalised on a NCI shareholders loan;
    - the amortisation of a debt raising fee;
    - referencing the value of assets purchased under instalment sale agreements as a cash outflow rather than the actual cash payments made under the instalment sale arrangement; and
    - shares that were issued as part of a BEE transaction where the issuer assisted the party by providing them with funding.

Whilst we encourage the application of IAS 1.30 as it relates to materiality and aggregation (as it fits into the decluttering theme), issuers are reminded that the aggregation should be with similar items. Audit committees would do well to interrogate the approach that management has taken with respect to aggregation. In one instance, an issuer appeared to use the line item 'other non-cash flow

[1] Per the ESMA report entitled "Enforcement and Regulatory Activities of Accounting Enforcers in 2016", the statement of cash flows was included as a common enforcement priority for 2015. Out of the resultant sample size of 136 issuers, an 18% action rate was required.

items' (in the reconciliation of profit before taxation to cash generated by operations) as a 'dumping ground' for various items. Whilst their initial response was that materiality had led to their decision not to disclose the various items, an unpacking of the reconciliation revealed certain items that should not have been included in the reconciliation to begin with. Items incorrectly included in the reconciliation to cash generated by operations were:

- the purchase of treasury shares (which should have been a financing activity);
- movements in other comprehensive income (which are not included in the opening reconciling item 'profit before taxation');
- foreign exchange movements on the purchase of PPE by subsidiaries; and
- a transaction with a minority shareholder.

The requirements for expenditure on long term assets (PPE) are set out in in IAS 7 (IAS 7.6 and 16(a)). IAS 7.16 explains that the classification of cash flows as investing activities is important because it represents the extent to which expenditures have been made for resources that will generate future income and cash flows. Acquisitions of capital assets that are regarded as the replacement of existing assets should still treated as investment activities and not operating activities, as was reflected by an issuer. The reference in IAS 7.13 to 'maintaining the operating capacity' of the issuer would be more appropriate for repair and maintenance activities. Should issuers wish to highlight the different types of capital expenditure, this can be achieved by disclosing replacement and expansionary capital spend as separate line items within investing activities in the statement of cash flows (IAS 7.50(c) and 51).

Issuers are also referred to case 2 set out in annexure 2, which details a specific case regarding the impact on the statement of cash flows for an equity-settled share based payment. In this instance the issuer incorrectly classified cash flows related to the purchase of their own shares (used to settle an equity-settled share obligation to employees) as an operating cash flow. The FRIP concluded that the cash flow should have been classified as a financing activity.

Property, Plant and Equipment

Some issuers account for property (land and buildings) on the revaluation model under IAS 16 *Property, Plant and Equipment* (IAS 16.31). We identified two separate instances where issuers incorrectly recognised the cumulative balance of the revaluation reserve as a transfer through other comprehensive income ("**OCI**") in the statement of comprehensive income when disposing of the property.

IAS 1.7 defines OCI items as *"items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by another IFRS"* and goes on to describe the components of OCI in the sub-paragraphs. The impact of the 'components' cited in the above mentioned definition leads to changes in the carrying amounts of assets/liabilities being recognised in equity. The 'reclassification adjustments' referred to in the OCI definition are further described in IAS 1.93 as those which were previously recognised in OCI and are <u>reclassified to profit and loss</u> (emphasis added). As the transfer of revaluation reserve is not one which is subsequently reclassified to profit and loss, it is not a reclassification adjustment as contemplated by the OCI definition in IAS 1.7. IAS 16.41 states that "*the revaluation surplus … may be transferred directly to retained earnings when the asset is derecognised*." A 'direct' transfer is just that, directly (in the statement of changes in equity), not via OCI.

We identified two instances involving issuers with asset intensive businesses who incorrectly applied the requirements of IAS 16.51. IFRS requires entities to review the residual values and useful lives of PPE annually and to update the accounting estimate if expectations differ from previous estimates. Issuers should therefore be mindful of an increasing amount of 'fully depreciated assets still in use'. Our reviews highlighted an increase in the extent of fully depreciated assets which pointed to an inappropriate assessment of the useful lives and residual values assigned to PPE. Careful attention should be given where the issuer has a significant number of assets with a low carrying amount. When considered on a cumulative basis, an inappropriate application of IAS 16.51 can become material. Where fully depreciated assets contribute to a significant increase in repairs and maintenance costs, this also raises questions as to the correct application of IAS 16: 13 and 14.

<u>Calculation of headline earnings per share ("**HEPS**")</u>

The requirement to disclose HEPS is a specific obligation imposed under the Requirements. This performance measure divides the IFRS reported profit between re-measurements that are more closely aligned to the operating activities of the issuer and those aligned to the capital platform used to create the results. The starting point of HEPS is "earnings" as determined by IAS 33 *Earnings per Share*. SAICA Circular 2 of 2015 on Headline Earnings ("**the Circular**") explains which items are excluded from "earnings" as reported under IFRS. In addressing items accounted for under IAS 39

Financial Instruments: Recognition and Measurement, the Circular states that, apart from certain exceptions, all re-measurements recognised in profit or loss should remain in headline earnings. This does not imply that items recognised in other comprehensive income should be adjusted for in the calculation of HEPS as these items were not recognised in profit or loss to begin with. Similarly, adjustments should only be made for the deferred taxation consequences of the underlying items eliminated from HEPS and not the total movement in deferred taxation, which would include the deferred tax consequences of items reported in OCI.

Furthermore, we wish to highlight the following from the Circular:

- paragraph 3(iv) states that the Circular provides rules for calculating headline earnings for every relevant IFRS and IFRIC;
- paragraph 18 indicates that the main purpose for creating detailed rules with respect to the calculation of HEPS is in order to achieve consistency by all companies listed on the JSE; and
- paragraph 19 goes on to state that "*(a)ny deviation from the rules would result in undesirable inconsistencies. Companies are therefore not permitted to override a rule even if they believe that the operating/ trading and platform distinction set out in the rules is inappropriate for their specific business*".

The detailed rules table with respect to IAS 16 states that impairments (and the subsequent reversal of impairments) are re-measurement items that are excluded from HEPS. Specific mention is also made of the gains and losses on sale of assets previously held for rental and now transferred to inventory in terms of IAS 16.68A. The rules table indicates that these items are only dealt with in terms of IAS 2 *Inventories* after their transfer from PPE to inventories has occurred. From the above it is clear that in the instance of a dual use asset, it is only when it is reclassified from PPE to inventory that any changes in the fair value remain in HEPS. Impairment loss recognised in respect of rental assets whilst these were still classified as PPE should therefore be added back in the calculation of HEPS.

<u>Interim results</u>

The detailed information relating to the acquisition of a subsidiary/ business (per IAS 7.40) is only required in the AFS, and not for interim results. This can however lead to unintended consequences as in one case, as the issuer had not prepared this note they did not correctly calculate the cash flows arising from the acquisition of a business. As a result the issuer misapplied IAS 7 and incorrectly included loan repayments made by the subsidiary after the acquisition date as part of the cash flows relating to the acquisition.

Financial instruments-debt issuer

We noted a case in which a special purpose vehicle ("**SPV**") was created for the purpose of issuing debt securities on the JSE. The SPV acquired certain trade receivables, which were partially financed through an agreement with the vendor in which payment of the purchase consideration was deferred, without the SPV incurring any interest charge for the duration of the repayment period. This resulted in a day-one gain arising on recognition of the purchase consideration.

Paragraph AG76 of IAS 39 limits the extent to which day one gains/ losses may be recognised immediately. Paragraph AG76 is specifically referenced in paragraph AG64 when it states that:

> *"The fair value of a financial instrument on initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received, see also IFRS 13 and paragraph AG76)….*(emphasis added)*".*

The issuer incorrectly reflected the day one gain immediately in profit or loss. The gain should have been amortised over the life of the deferred purchase consideration in line with IAS 39.AG76.

Business combinations

An issuer raised a contingent consideration liability for a business combination. In terms of paragraph 58 of IFRS 3 *Business Combinations*, a financial liability must be re-measured at year end, with the change in fair value being recognised in profit and loss. We found that the issuer inappropriately split out an imputed 'finance cost' element (calculated on an amortised cost basis) and recognised this separately from the remainder of the fair value movement. Not only was the split profit or loss inappropriate, but the issuer also made a consequential error of misstating the amount of finance costs paid in their statement of cash flows as a result of the non-cash flow nature of the item.

Non-current assets held for sale

In one case we found insufficient IFRS justification for the classification of a business unit as a non-current asset held for sale in the subsequent period. Two factors triggered our concern. Firstly, certain assets (and liabilities) of the business unit remained unsold more than one year after the date of initial classification. Paragraphs 8, 9 and B1 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are important considerations in the regard. Secondly, whilst the issuer had in fact sold certain key assets in the previous year, the bulk of the remaining assets comprised trade and other receivables and bank balances. On reviewing the matter we found that these assets were to be realised through collection as opposed to through sale and they therefore failed the criteria of IFRS 5.6.

Other common disclosure omissions

Putting aside the issue of declutter, the concerns regarding the adoption of new standards and the liquidity risk disclosures required by IFRS 7 (all of which have already been discussed in the 'feedback on the 2017 focus areas' section of this report), we wish to highlight the disclosure items most commonly found to be wanting in the AFS. The table below ranks the top five issues in terms of the number of different issuers tackled on the topic. We have not included a detailed discussion on each of the topics as the matters have been dealt with extensively in the 2016 report and our reports issued before that date.

	Ranking
IAS 12 *Income tax* , paragraph 81 A sufficiently detailed tax rate reconciliation	1
IAS 36 Impairment of Assets, paragraphs 130-134 Insufficient information regarding impairment calculations	2
IAS 18 *Revenue*, paragraph 7 Interest and dividends received are classified as 'revenue' in the Company AFS	3
IFRS 13 *Fair value Measurement*, paragraph 93 Details regarding unobservable inputs used in valuation models	4
IAS 34 *Interim Financial Reporting*, paragraphs 10,15,25 Three line statement of cash flows	5

THE FINDINGS IN NUMBERS

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 subsequently be subject to regulatory challenge and correction where these are found to contain material misstatements. 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.

Review process

The review process itself remains unchanged from that contained in the 2016 report. Annexure 1 contains a high-level overview of that process for the benefit of those readers who are not familiar with it. The areas of potential risk are however updated on an annual basis. This is driven by both the entities specific business circumstances and our reconsideration of general risk areas both locally and internationally. The review of the same issuers AFS from one year to the next (if this were to be done) may therefore identify different matters.

We commenced 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. In October 2015 we advised the market that the AFS of debt issuers would also be included into our review process. We provided feedback on debt issuers for the first time in the 2016 report.

Ignoring cases brought forward from the previous year, during the 2017 calendar year our reviews (on both equity and debt issuers) covered AFS for years ending between 31 March 2016 and 2017.

The timing of our reviews is impacted by two factors. Firstly, until recently, issuers had 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.

Statistics – what we did

Between January to December 2017, 62 equity issuer's AFS and interim results were reviewed and by January 2018 six of the cases were still pending. During the same period 18 debt issuers AFS were reviewed and 3 were pending completion.

	Equity	Debt [2]	Total
Letters of query	56	15	71
Cases closed immediately	6	3	9
Number of AFS reviewed	**62**	**18**	**80**
Cases b/f from previous year	8	0	8
Total cases reviewed during period	*70*	*18*	*88*
Cases still pending	(6)	(3)	(9)
Cases completed during period	64	15	79

We wrote letters of enquiry to 71 of the issuers, with 9 cases being closed immediately with no questions being asked. Included in these cases, two further referrals were made to the FRIP during the current year (2016-zero, 2015 - 3).

Statistics – what we found

Two cases resulted in the restatement of AFS and public announcements being made. In consultation with the respective issuers, these announcements were made as soon as possible. For 10 cases the non-compliance was material from an IFRS perspective, but often, due to the presence of other mitigating factors, not necessarily price sensitive. As such we agreed with the issuer that the matters would be corrected in their next results announcement. For a further 15 cases, whilst fortuitously there was no material misstatement for the period reviewed, amendments needed to be made within the next published results to avoid potential investor prejudice. The remaining 34 cases involved smaller disclosure issues that the issuer agreed to clarify or correct in the future.

[2] Other hybrid instruments are also being reviewed and are included in this category

	2017 Equity	2017 Debt	2017 Total	2016 Equity	2016 Debt[3]
AFS needed restatement and public announcement made	2	-	2	2	-
Non-compliance such that we agreed to a correction within the next published results	9	1	10	4	2
Non-compliance not material this year, but must be corrected in the future in order to avoid potential investor prejudice	13	2	15	11	3
Smaller disclosure issues that will be corrected in the future	27	7	34	25	12
AFS in respect of which it was concluded that there were no issues	13	5	18	8	14
Total cases closed	**64**	**15**	**79**	**50**	**31**

As it relates to equity issuers, in 2017 material infringements were identified in 3.1% of the closed cases (2016-4%). The number of cases where corrections were required in future reporting periods was at 34.4% (2016-30%) for equity issuers and 20% for debt issuers (2016-16.1%).

In assessing the potential impact of matters it is worth noting that for the current period the number of cases impacting measurement was at 33.3% (2016-33.3%) for equity issuers and at 20% (2016-10.6%) for debt issuers. The remaining 66.7% and 80% (for equity and debt issuers respectively) therefore related to disclosure issues . The data reveals that disclosure matters remain a key area of non-compliance. Under the umbrella of disclosure, we refer not just to a lack of disclosure, but also excessive or confusing disclosures in terms of the more assertive approach we have taken in insisting that issuers declutter their AFS.

[3] As discussed in the 2016 report, the 2016 comparative figures for debt Issuers covers the wider review period of 15 months from October 2015 to December 2016

International comparison

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

A direct comparison of the South African data against international trends 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 2017 ESMA activity report (issued in April 2017) is the latest available information, which from a period perspective is best compared to the data contained in our 2016 report.

	South Africa			ESMA[4]	ESMA[5]
Coverage					
Period when reviews were undertaken	2017	2016	2015	2016	2015
Date of regulator's report	Feb 2018	Feb 2017	Feb 2016	April 2017	Mar 2016
Reviews closed at reporting date[6]	64	50	72	1147	1089
Examination rate (Percentage coverage of population)	22%	17%	25%	19%	17%
Actions					
Material infringement (Requested re-issuance or immediate public announcement)	3.1%	4%	9.7%	8.7%	8.2%
Corrections required in future financial statements	34.4%	30%	31.9%	18.4%	17.4%
Action rate (Total number of instances where action was taken)	37.5%	34%	41.6%	27.1%	25.5%

4 Information extracted from the ESMA report entitled "Enforcement and Regulatory Activities of Accounting Enforcers in 2016"

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

6 Only the ex-post examinations have been considered for this 2017 report. European regulators perform ex-ante examinations, which allow them to report a higher coverage rate. Given the nature of these reviews there is no republication and therefore no action rate to be used for comparative purposes.

The 2016 ESMA activity report indicates that of the 1 147 ex-post examinations undertaken by the 30 European enforcers during the calendar year to December 2016, 8.7% of those identified material infringements (requiring public announcements or reissuing of AFS). For a further 18.4%, whilst classified as material, the enforcers accepted a correction in the next AFS. Although the action rate by the JSE in the 2016 review period was higher (at 34% compared to 27.1%), the JSE did have a lower percentage of material infringements at 4%.

LOOKING FORWARD - THE 2018 REVIEW CYCLE

Previous findings

Issuers should continue to pay careful attention to how all of the JSE's past findings could impact their results. We were pleased to see instances where issuers (who were not necessarily subject to review) voluntarily made changes to their AFS to take account of the 2016 report. We look forward to issuers embracing the content of this report in a similar manner. Questions will be asked if problems are highlighted in the AFS for matters that were set out in this (and our previous) proactive monitoring reports.

New Standards

We will continue to focus on the quality of disclosures provided for the application of standards issued but not yet effect (IAS 8.30). Generic wording such as, 'we are still assessing the impact of this standard' raises concern to the readiness of the issuer with respect to financial reporting procedures – particularly when considering the effective date of many significant new IFRSs. Wording indicating that 'the standard is likely to have no impact' may also be challenged when we consider the business operations of the Group or the industry in which it operates. Issuers should be providing more entity-specific qualitative and quantitative information and wording to the effect that 'the standard is likely to have a material impact' is not regarded as meeting issuers' obligations under IFRS.

Disclosure of judgements and estimates

We ask issuers to reconsider their approach to the IAS 1 disclosure requirements applicable to judgements (paragraph 122-124) and estimates (paragraph 125-133). Disclosures should be entity specific, and generic wording that does not provide useful information should be avoided. Disclosures are not required for all items, and should only be provided in the circumstances detailed in IAS 1. Furthermore, it is important that judgements and estimates are clearly differentiated, failing which the incorrect paragraphs of IFRS may be applied and insufficient information provided.

Judgements

IAS 1:122 deals with disclosure of judgements (other than estimations) relating to accounting policies where the judgement had a significant impact on the reported numbers. Not all judgements need to be disclosed, but where required they must be entity specific and in sufficient detail to help the user of the financials understand how the accounting policies have been applied. They should also 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.

Estimates

Disclosures regarding estimates are required where assumptions (made about the future) and other estimates (where there is uncertainty) have been made at the end of a reporting period that have a significant risk of a material adjustment to the carrying amount of assets and liabilities within the next financial period. IAS 1:127 explains that these relate to estimates that require managements most difficult, subjective and complex judgements. IAS 1:129 gives examples of the types of disclosures that may help users understand the judgements management makes. In this regard it is important to note that it is not only specific standards (such as IAS 36) that require a sensitivity analysis or range of outcomes. When applied correctly one is likely to see a great depth of entity specific detail (including qualified specific amounts), but only on those items that are likely to have a material effect on the next years accounts.

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. We do however aim to ensure that we have a view of the entire market. Our selection process is therefore directed to a 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. There are also instances where, due to the presence of specific risk factors, an issuer will be targeted for review.

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 that the reviewers have comprehensive IFRS knowledge. It is also not just a case of ensuring compliance with a specific IFRS disclosure paragraph. Rather the reviewers have a full understanding of all aspects of IFRS in order to understand the potential implications, the 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 approximately 26 additional qualified personnel.

The following process is applied:

- 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 it 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 IFRS substantiated 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).

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 certain instances the FRIP recommends that the JSE issue guidance to the market on a specific matter. We believe that the inclusion of the details in this report is the appropriate place for such guidance.

Where a restatement is brought about after a FRIP investigation, reference is normally made in the restatement announcement to the FRIP.

ANNEXURE 2 – 2017 FRIP CASES

The JSE referred two matters to the FRIP for consideration in 2017.

Case 1: Accounting treatment of advertising rebates

The issuer receives advertising rebate from suppliers, which are contractually defined as an advertising contribution that the supplier is obliged to make (as an agreed percentage per contract year) on the aggregate value of purchases by the issuer. In terms of the agreement with the supplier, advertising rebates should be used by the issuer towards marketing and advertising expenditure. The following features were established in respect of advertising rebates in this instance:

- The quantum of the advertising rebate is set through negotiations between the issuer and the individual suppliers, hence akin to the purchase price negotiations.
- In instances where an advertising rebate is not agreed upon (e.g. for categories of goods that are not separately identifiable and advertised), the issuer will endeavour to compensate for the lack of advertising rebate by negotiating a lower price for the products or by adjusting the product rebate and settlement discount in order to improve the profit margin on the product.
- The receipt of the advertising rebate is not directly linked to a related advertising obligation on the side of the issuer. The issuer advises its suppliers in more general terms as to its advertising strategy only.

Until 2015, advertising rebates received were set off against advertising costs and hence accounted for as part of marketing and selling expenses of the issuer.

In the financial year ended 30 June 2016, the issuer changed its accounting policy for advertising rebates to account for the rebates as a reduction to the purchase price of inventories, leading to reduced cost of sales when inventories are sold. The issuer ascribed this change to the issuance of IFRS 15 *Revenue from Contracts with Customers* which, in the view of the issuer, provides more clarity on how the supplier should treat the payment of rebates to its customers. The issuer also believed that there should be symmetry in the accounting treatment of rebates by suppliers and customers. Therefore the issuer concluded that, if the supplier treats the rebate as a reduction of revenue in terms of IFRS 15, the issuer (as the customer) should account for rebates as a reduction in the purchase price of inventory.

In considering this matter the FRIP noted the following:

- IAS 2 deals with the recognition and measurement of inventories.
- When principles are clarified and distilled with the issuance of new or revised standards, such as this ‘distinct good and services’ test in IFRS 15, it is customary for the International Accounting Standards Board to make consequential amendments to related standards if it believes that that would be necessary and appropriate. No such consequential amendments were made to IAS 2.
- There is no indication in any standard or the Conceptual Framework that accounting symmetry should or would be achieved in so far as two parties on the different sides of a transaction are concerned. This absence of an objective to achieve symmetry can also be observed in other standards.
- Footnote E3 to IAS 2.11 specifically states that the IFRIC agreed that rebates and discounts received as a reduction in the purchase price of inventories are taken into consideration in the measurement of the cost of inventories. Rebates that specifically and genuinely refund selling expenses are not deducted from the cost of the inventories. This agenda decision was made in November 2004.
- In light of the fact that the guidance provided by the IFRIC already existed since 2004 in respect of such advertising rebates, there is no need to analogise to IFRS 15 or any other IFRS.
- The issuer was incorrect to reduce selling expenses with advertising rebates as these did not meet the ‘specifically and genuinely’ distinction in order to be set off against advertising expenses. This indicates that the issuer did not previously apply IAS 2 correctly.

The amendment to the accounting treatment in 2016 is therefore incorrectly dealt with as a change in accounting policy. This should have been accounted for as the correction of an error.

Case 2: Cash flow Statement: equity-settled share-based payment arrangement

The JSE raised two matters with the FRIP relating to equity-settled share-based payment plans.

Share settlement to employees through a broker instruction

In this instance the issuer instructs a broker, who is then paid in cash, to deliver shares to employees in terms of the share scheme. Cash flow therefore takes place between the issuer and the broker.

In this instance, the issuer included the charge in terms of IFRS 2, *Share-based Payment*, is included in the cash flow from operating activities section of the Cash Flow Statement. The non-cash component thereof, namely the difference between the cash paid for the shares and the share-based payment expense, was adjusted in the operating activities section of the Cash Flow Statement as a non-cash item. Therefore, only the cash outflow relating to the shares purchased remained in the cash flow from operation activities section of the Cash Flow Statement. The issuer argued that the shares are purchased for purposes of employees, and hence the items should form part of operating expenses for cash flow purposes.

Shares purchases by the Company and held until settled

In this instance the same issuer purchased its own shares in the open market, to be retained in a share trust or similar vehicle, in order to deliver to employees once employees exercise their share awards.

IAS 7, *Statement of Cash Flow* ("**IAS 7**") states the following:

- in paragraph 6, operating activities are defined as "*the principal revenue-producing activities of the entity and other activities that are not investing or financing activities*"; Cash flows are defined as "*inflows and outflows of cash and cash equivalents*"; and financing activities are defined as those "*that result in changes in the size and composition of the contributed equity and borrowings of the entity*".
- Paragraph 17 specifically includes as an example of a financing activity "*cash proceeds from owners to acquire or redeem the entity's shares*".

IFRS 2 described and equity-settled share-based payment transaction as a transaction in which the entity receives goods or services as consideration for its own equity instruments. Appendix B of the Application Guidance to IFRS 2, in paragraph B49, states that

> *"(t)he entity shall account for share-based payments transaction in which it receives services as consideration for its own equity instruments as equity-settled. This applies regardless of whether the entity chooses or is required to buy those equity instruments from another party to satisfy its obligations to its employees under the share-based payment arrangement. It also applies regardless of whether (a) the employee's rights to the entity's equity instruments were granted by the entity itself or by its shareholders(s); or (b) the share-based payment arrangement was settled by the entity itself or by its shareholder(s)*."

IAS 32, *Financial Instruments: Presentation* states the following:

- Paragraph 33, requires an entity which reacquires its own equity instruments, to deduct those instruments (treasury shares) from equity.
- AG36 states that *"(a)n entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired. Paragraph 33 requires an entity that reacquires its own equity instruments to deduct those equity instruments from equity. However, when an entity holds its own equity on behalf of others, e.g. a financial institution holding its own equity on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.*"

By definition, an equity share-based payment has no cash flow impact, as these awards are settled by the delivery of shares. Cash settlement of an equity share-based payment liability as well as the reacquisition of an entity's own equity instruments will result in a change in the size and composition of the contributed equity of the entity. There are two distinct elements to the transactions described above, namely acquiring shares and using those shares to settle the share-based payment. To the extent that there is a cash flow during a reporting period in this regard, such cash flow is separately reported in the Statement of Cash Flow and classified as part of financing activities. Therefore, irrespective of the mechanism (through repurchase by the issuer in the market, or via a stock broker), the IFRS disclosure in the Statement of Cash Flow is the same, namely the cash flow portion is a financing activity.