Combined findings of the JSE proactive monitoring of financial statements: Reviews done 2011 to 2019

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JSE

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Introduction

Background

The objective of the JSE's process of reviewing Annual Financial Statements (**"AFS"**) and interim results ("**interims**") is to both:

(i) consider the integrity of financial information; and

(ii) contribute towards the production of quality financial reporting of entities listed on our market.

In terms of point (ii) above, firstly, the review process leads to healthy debate on IFRS matters between the JSE and issuers (and their auditors) which we believe is important for the credibility of our markets. Secondly, we have issued an annual report (the **"PM report**") providing an overview of the proactive monitoring activities (the "**review process**") undertaken by the JSE during a particular year. For example, our 2019 PM report (issued in February 2020) related to reviews undertaken in the 2019 calendar year.

The target audience for the PM reports are entities whose equity or debt securities have a primary listing on the JSE. The PM reports set out important findings identified during a particular year and we have request issuers to consider the content thereof. From 2016, the JSE specifically requested the audit committee of every issuer to consider the findings contained in the PM reports when preparing their next set of AFS and interims. From 2017 we requested confirmation of this fact. Audit committees were also requested to consider the content of any previous PM reports (available on the JSE website at https://www.jse.co.za/current-companies/issuer-regulation/accounting-matters) to the extent that the issuer had events or transactions that were not present when our previous PM reports were considered by the audit committee or the issuer was recently listed on our market.

From the 2015 PM report onwards, we included an annexure which set out the advice the JSE received from the Financial Reporting Investigation Panel ("**FRIP**"). The FRIP is an advisory body, providing the JSE with advice on cases of possible non-compliance with financial reporting requirements. Not all FRIP matters were identified through the review process. The JSE may interrogate compliance with International Financial Reporting Standards("**IFRS**") based on, amongst others, formal complaints that it receives from interested parties or through its own risk identification processes. As the intention of the PM reports is to raise awareness of important IFRS findings, the 2018 PM report was expanded to cover other matters not necessarily arising through the review process.

Purpose and format of this report

Our review process continues to reveal common problems which have been addressed in our previous PM reports. The purpose of this report (which combines the content of our 2011 to 2019 PM reports) is to assist issuers in identifying matters which they may have previously overlooked.

This report should also assist audit committees in fulfilling their responsibilities (referred to above) to apply our previous findings against new events or transactions not present at the time the original PM report was issued.

We wish to highlight that our approach to the content of our PM reports has changed over the years. In the initial years we discussed all our findings. For our 2016 PM report we;

- provided feedback on focus areas (highlighted in the previous year) ("**focus area**"); and
- only discussed cases where action was required (i.e. excluding smaller disclosures issues)

From 2017 we included a section ranking the top five disclosure items most commonly found to be wanting in the AFS ("**common disclosure omissions**"). In 2019, we started issuing more detailed educational type of reports (the "**other educational reports**"), which identify both good and poor examples relating to the topic under discussion.

The format of this combined report is as follows:

1. Findings are grouped under a specific topic or IFRS.
2. Matters are extracted from the original PM report:
   a. with a date (in brackets) indicating which PM report the matter was originally set out included. For example, 2014 refers to the PM report with respect to the review process for the 2014 calendar year which was issued in February 2015;
   b. are ordered from the most recent matter to the oldest. If an older matter is identical to a more recent one, the latter was omitted; and
   c. For ease of identification the headings for cases from the latest, 2019 report are in green text.
3. Two additional labels are included (were applicable) being 'focus area' and 'common disclosure omissions'. These tie back to the way the items were identified in the original PM report.
4. FRIP cases are identified as matters in the body of this report.
5. Three annexures are included.
   a. Annexure 1 sets out the activities of the FRIP;
   b. Annexure 2 includes details of cases that were neither identified through the review process nor referred to the FRIP;
   c. Annexure 3 cross refers to other educational documents.

This report has been prepared by combining historic PM reports. The content of those PM reports has not been altered to take into account new or revised IFRSs. We therefore remind issuers to be mindful of changes to IFRS made after the publication of our PM reports as these may have an impact on the applicability of a particular matter highlighted in our PM report.

We issued our first combined findings report on 11 October 2019 (the "2019 CReport"). We have updated that report to includes all PM related reports issued from that date until the end of February 2020. This, the second such report, replaces the 2019 CReport.

The quality of financial information

General (due care)

Matter 1 (2014)
One of the core principles of the JSE Listings Requirements (the "**JSE Requirements**") is to ensure that parties involved in disseminating information into the market place observe the highest standard of care in doing so.

In this 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 for 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.

Matter 2 (2013)
There continued to be several cases of generally poor presentation in AFS including:

- Inconsistencies between information on the face of the financial statements and the notes, and between different notes;
- incorrect and confusing wording within notes;
- carrying forward of irrelevant and incorrect wording or notes from prior reporting periods; and
- general typographical errors.

We also wish to reiterate that our review process is such that we not do review the AFS in isolation. Rather we review the AFS together with the directors' reports, management commentary and SENS announcements made by the Issuer throughout the year. We implore Issuers to ensure that inconsistencies between these various communications are avoided.

Decluttering of AFS

Decluttering the AFS of superfluous information has been a longstanding focus area of our reviews.

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.

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

Matter 1 (2017-focus area)
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 superfluous accounting policies 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 matters. Two further matters 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.

Matter 2: Accounting policies (2018 / 9-common disclosure omissions)
A lack of entity specific accounting policies (focussed on significant policies) as required by IAS 1 paragraphs 31, 117, 119 was the area identified with the greatest number of deficiencies in 2018 and was fifth on the list in 2019.

Matter 3: Accounting policies (2016-focus area)
We have historically highlighted instances where 'boilerplate' accounting policies were included in the AFS and have encouraged issuers to evaluate the appropriateness of information reported. During 2016 we have applied a more assertive approach by requesting issuers to justify the appropriateness of having included accounting policies and other information that could be viewed as being superfluous and possibly lead to obscuring other important information.

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

- Accounting policies were presented for events or transactions not relevant to the reporting entity, for example a policy on cash-flow hedging when the issuer did not make use of cash-flow hedge accounting. Accounting policies should discuss areas significant to the issuer. They should consider the nature of the entities operations and the policies that users would expect to be disclosed (paragraph 119 of IAS 1) rather than present policies that represent any and all policies that could be applicable;
- In one instance the accounting policies of an issuer stated that all borrowing costs were recognised in profit and loss whilst stating elsewhere that borrowing costs on qualifying assets were capitalised against the cost of the asset. It is evident in these instances that, on the back of revised IFRS Standards becoming effective, amendments were made to certain paragraphs within the entity's accounting policy notes without re-evaluating the entire suite of accounting policies to ensure that the policies, as a collective, portrayed the position of the issuer;
- The policy in respect of revenue recognition was too generic. Accounting policies should talk to the specifics of the business and translate the drivers of revenue recognition ;
- Accounting policies resembled a 'cut and paste' of the relevant IFRS standards when such level of detail was not necessary. Many issuers incorporated detailed financial instrument discussions into their policies, including unnecessary repetition of basic IFRS definitions (e.g. that of a derivative). In other instances they included complex derecognition criteria when this was clearly not relevant to the issuer. Disclosures that summarise significant accounting policies without repeating the terminology used in the IFRS standards themselves and that are tailored to the business itself are most useful in articulating the manner in which transactions and events are accounted for; and
- Issuers provided lengthy descriptions of the changes to IFRS Standards which they had concluded had no impact on their AFS. Paragraph 28 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* calls for an analysis of the impact of

future accounting standards on the entity, only where there will be an effect on the current or prior period. It would be appropriate to merely mention the change to the IFRS without a detailed explanation thereof if there is no impact to the entity. Even when there is an impact, IAS 8.28(c) asks for the details of the nature of the change. This should be provided through an entity specific description, as opposed to a lengthy discussion of the IFRS itself. A similar observation was made in respect of the requirement to disclose the effect of IFRS standards issued but not yet effective (IAS 8.30). Certain issuers provided lengthy discussions of forthcoming changes only to conclude that these were not expected to be significant to the entity.

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

Matter 4: Other superfluous disclosures (2016-focus area)
Another area of decluttering that we focused on was the inclusion of superfluous disclosure. Examples of these identified through our review process included:

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

evident when the item occurred in both the current and prior periods, or given the nature of the item.

Matter 5: Accounting policies (2014)
We have in the past cautioned issuers against having a 'boiler plate' approach to accounting policies. We remind issuers that the objective of accounting policies is to inform users so that they can understand the financial statements. 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.

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 in terms of IAS 8.10. We therefore remind issuers of the content of paragraphs 117 to 121 of IAS 1 which discusses the presentation of accounting policies.

Matter 6: Accounting policies (2014)
Whilst accounting policy problems did persist in 2013, questions regarding incorrect or incomplete accounting policies accounted for 9% of the non-compliant disclosure issues, which was an improvement compared to the 22% in 2012. Often the starting point for understanding the accounting for a transaction is the accounting policy. Issuers can therefore reduce the number of questions that they receive during the review process by giving this area more attention.

Problem areas this year were in the following areas:
- share incentive schemes *;
- revenue recognition *;
- black economic empowerment transactions;
- treatment of contractual repurchase obligations for operating leases;
- financial liabilities *;
- unsecured interest free loans;
- rehabilitation liabilities;
- deferred profit on the sale of a subsidiary;
- investments in preference shares;
- investments in associates *;
- measurement of other investments *;
- accounting for the measurement of the separate parts for linked units *;
- deferred equity contributions for an investment; and
- accounting for transactions between shareholders.

** Items marked with an asterisk were also problem areas identified in our previous report and we ask issuers to pay careful attention to these matters.*

Issuers must give careful consideration to the wording of their accounting policies and whether or not the wording aids the user in understanding the financial statements.

Presentation of Financial Statements (aggregation, reclassification, current/non-current, finance costs, OCI)

Matter 1: Aggregation (2014)
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.

Matter 2: Reclassification (2012)
Problems in this area continued. There were cases where the requirements of paragraph 41 of IAS 1 (which contain specific requirements with regards to the nature of the information to be disclosed when an entity changes the presentation or classification of items) were ignored. This creates potential confusion for the reader of the AFS and goes against the principle of ensuring inter period comparability in order to assist users in making their decisions.

Matter 3: Current/ non-current distinction (2019)
An entity incorrectly classified borrowings that were *in the process* of being renegotiated as non-current liabilities.

IAS 1.69 requires an entity to classify a liability as current if it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. IAS 1.74-76 provides further guidance, stating that the renegotiation of a loan after the reporting date does not make that loan non-current, but rather results in disclosure in the AFS (as a non-adjusting event) in accordance with IAS 10 *Events after the Reporting Date*.

Matter 4: Current/ non-current distinction (2014)
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 (IAS 1.61)

Matter 5: Current/ non-current distinction (2013)
Liabilities where the issuer does not have an unconditional right to defer settlement for at least twelve months must be classified as current liabilities.

Matter 6: Finance costs (2014)
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.

Matter 7: Other comprehensive income ("OCI") (2014)

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.

Matter 8: Other comprehensive income (2013)

In this year's reviews we identified instances where the profit/loss on disposal of shares and subsidiaries were incorrectly recognised directly in OCI as opposed to in profit and loss. We remind issuers of the requirements of Paragraphs 90 to 96 of IAS 1 in this regard.

Going concern

Matter 1 (2015)

In annexure 1 we set out a 2015 FRIP case through which we issued specific guidance as it relates to the going concern basis of accounting. In this past year we had another issuer whose disclosure in respect of the going concern assumption was lacking. Paragraph 25 of IAS 1 states that:

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

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

Matter 2 (2011)

There was insufficient and conflicting disclosure of the facts and circumstances that led to the conclusion that the entity was still a going concern. This was contrary to IAS 1 par 25 which calls for the disclosure of any uncertainties regarding the going concern assessment.

Estimation uncertainty

Matter 1 (2018)

An entity was carrying a relatively large deferred tax asset which it had raised on the back of unused tax losses over and above the reversal of taxable temporary differences. The deferred tax asset had been raised some 7 years ago, and had been increasing over time. The recognition of deferred tax assets for assessed losses is a subjective matter which carries a high degree of estimation uncertainty. The following generic disclosure was included in the AFS:

> "Assessing the recoverability of deferred income tax assets requires the Group to make significant estimates related to expectations of future taxable incomes."

This disclosure was not specific to the entity and did not provide any detail about the nature of the assumptions made about the future as required by IAS 1.125. Furthermore, IAS 1.129 states that the disclosure should help users understand the sources of estimation uncertainty and details types of disclosures that should be provided.

After receiving the omitted disclosures and other supporting documentation from the issuer, the JSE raised concerns regarding the recoverability of the deferred tax asset, given:

- that the entities were barely breaking even;
- that the assessed losses were expected to take an exceptionally long time (between 10 to 30 years) to be utilised, under increasingly uncertain economic conditions;
- the nature of various uncertainties on which the estimates were based and the magnitude of their impact; and
- that a large portion of deferred tax assets were subsequently impaired and/or derecognised in the first set of interims published after the AFS under review.

It appeared to the JSE that the circumstances that lead to the subsequent impairment/derecognised either already existed at the date of AFS and /or brought into question the reasonableness of the assumptions made at the date of the AFS.

Matter 2 (2014)

There was an increase in the instances of non-compliance with requirements of 125 of IAS 1 which requires disclosure of the sources of estimation uncertainties. Examples included

- valuation of assets and liabilities;
- calculations for impairments of various assets; and
- calculations for provisions of bad debts.

Matter 3 (2013)

There were several instances of insufficient disclosure for estimation uncertainty including:

- use of the capital gains tax rate to determine deferred tax on an intangible asset; and
- valuation of assets and liabilities.

Change in an accounting estimate

Matter 1 (2018)

Paragraph 14(a) of IAS 18 *Revenue* deals with the timing of the revenue recognition for the sale of goods and states that one of the conditions to be satisfied is that "*the entity has transferred to the buyer the significant risks and rewards of ownership of the goods*". An issuer changed their determination of the point at which the risk and rewards of ownership passed to customers. The issuer dealt with this matter prospectively as a change in estimate.

The JSE contented that a change in estimate was not appropriate in this instance, concluding that it was (at best) a change in accounting policy or (at worst) a material prior period error - given that this fact pattern had existed in the market for some time and was not new. Either of these approaches should have been applied retrospectively – not prospectively as the issuer had done. In addition, transparency when reporting prior period errors is important.

The issuer argued that "*When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in accounting policy.*" (IAS 8.35). Their argument had however omitted the first sentence to paragraph 35 which explains that a change in the application of a measurement basis is a change in an accounting policy and not a change in an accounting estimate. In terms of the definition of IAS 8.5, a change in accounting estimate refers to an adjustment to the carrying amount of an asset or liability or the periodic consumption of that asset. These are examples of matters affecting the way in which financial information is measured – not recognised. The issuer subsequently conceded that the revenue recognition 'trigger' event affected the recognition (i.e. timing) and not the measurement of revenue in the AFS and that their initial assessment of a change in estimate was incorrect.

Disclosure of judgements and estimates

Matter 1 (2019-focus area)

The disclosure requirements of IAS 1 *Presentation of Financial Statement*s applicable to judgements (paragraph 122-124) and estimates (paragraph 125-133) were identified as a focus area in both our 2017 and 2018 reports. Our number of findings for 2019 increased to fifteen. Eight of those related to similar group accounting matters previously reported. In these instances, the AFS provided little information about decisions on when and how to consolidate, not consolidate or deconsolidate group entities.

Within the context of group accounting, we challenged issuers not only on the omission of detailed accounting policies, but also where there was insufficient information regarding the judgement applied in developing that policy. For example:

- treatment of a loan in the separate company accounts; and
- policy on put options held by non-controlling shareholders.

The remainder of the findings covered the following wider range of IFRSs:

- inventory: three separate instances relating to valuations, write downs and determination of net realisable value;

- the decision to present items as investing as opposed to operating activities within the statement of cashflows;
- the starting rate for a tax rate reconciliation for a multi-jurisdictional company;
- the decision by a business in distress not to raise a restructuring provision;
- the change in reporting currency; and
- the determination of the composition of revenue in the company accounts.

Given the wide range of IFRS impacted by our findings (as detailed above), we believe that issuers do not appear to consider IAS 1.122 in the broader context of their AFS, where the impact of their accounting policy is significant.

There was one finding for IAS 1.125, where expected changes in production capacity had a significant impact on the recoverable amount of an impairment calculation, yet the issuer provided no disclosure.

Matter 2 (2018-focus area)
We discussed the importance of disclosing significant judgements in our 2016 report and indicated in our 2017 report that it would be a specific focus area. There were six instances where the disclosures of judgements made by management in applying their accounting policies were not in line with paragraph 122 IAS 1. These included:
- the trigger point to determine when revenue should be recognised;
- whether an acquisition was a business combination or an asset acquisition;
- why an entity was regarded as an associate despite a 51% shareholding;
- the move to equity accounting for associates previously accounted for at fair value through profit and loss; and
- accounting for common control transactions and put options involving non-controlling interests\shareholders.

We again emphasise that the factual nature of the information supporting the judgement does not negate the need to provide disclosures under IAS 1.122. The focus should be on how management applies that information against its accounting policies to achieve compliance with IFRS.

Transparent and fact specific discussion of judgements and estimates applied to financial reporting is necessary to enable users to have a full understanding of the impact that these significant matters have to the AFS.

Matter 3 (2016)
The application of certain IFRS standards (such as determining whether an entity exercises control or significant influence over another entity), requires management to assess the facts and circumstances of the transactions against the relevant accounting policies. This assessment is a judgement made by management, and disclosure should be made in terms of IAS 1.122, paragraphs 7 and 9 of IFRS 12 *Disclosure of interests in Other Entities* for those aspects that have the most significant effects on the amounts recognised in the AFS. Similar 'disclosable judgements' may also be made in cases where judgement is needed to determine whether a property qualifies as investment property (paragraph 14A of IAS 40 *Investment Property*). The disclosure should not be omitted on the basis that the answer was obvious to

management based on the facts as, absent any disclosures, the user of the AFS does not have those facts and would be unaware of the details regarding this area of judgement.

Matter 4 (2014)
There was an increase in the findings of non-compliance with requirements of paragraph 122 of IAS 1, which requires disclosure of the significant judgements that management makes in the process of applying the entity's accounting policies.

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

There instances of insufficient disclosure included the:

- application of the accounting policies for two different share incentive schemes;
- application of IFRIC 15 *Agreements for the Construction of Real Estate* and whether revenue was within the scope of IAS 11 *Construction Contracts* or IAS 18;
- recognition of a property before the legal transfer occurred;
- tax position of the entity and the applicability of deferred taxation;
- consolidation/deconsolidation of entities within a group; and
- consolidation of an empowerment trust.

Matter 5 (2013)
There were several instances of insufficient disclosure for significant judgements and estimation uncertainty including:

- consideration of agent vs principle in the context of revenue recognition;
- recognition of revenue in the context of services delivered over time;
- determining whether an acquisition was regarded as a business combination or the acquisition of an asset;
- the appropriateness of the going concern assumption; and
- determining whether a contribution from a minority shareholder was equity or a liability.

Adoption of new standards

Matter 1: IFRS 9 and 15 (2019-focus areas)
We refer you to annexure 3, which talks to the thematic review undertaken on IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*

Matter 2: IFRS 9 and 15 (2018-focus areas)
We advised the market in both our 2017 and 2016 reports that the adoption of the new standards would be a focus area in our review process. We therefore believe that the findings set out below should reflect issuers' reactions to that notification.

For 72% of the (55) reviews closed by the JSE no questions were asked regarding the disclosures provided under paragraph 30 of IAS 8 for the application of new standards (most significantly IFRS 9 and IFRS 15). Given our ongoing message to the market of the importance

of the new standards (since 2016) we would have expected higher compliance rates in this area.

In one instance the issuer incorrectly stated that they had early adopted the new standards. For the remaining 14 cases deficiencies were identified relating to the use of generic wording in the AFS, where qualitative and/or quantitative information was lacking. This caused the JSE to question the readiness of those issuers to apply the new standards. In all but one instance, we obtained comfort that (after the release of results considered during our review) the issuer had made sufficient progress on the recognition and measurement aspects of their implementation projects.

From our engagement with issuers we identified 3 instances where it was apparent that the issuer's accounting systems did not adequately capture the information necessary to report correctly under IAS 18 and by extension the impact of the changes brought about by IFRS 15. In one instance we were of the view that the issuer would not be able to publish (interim) results that would comply with IFRS 9 and 15. That listing was subsequently suspended for late publication of financial information.

We will continue to challenge the sufficiency of disclosures as it relates to the adoption of IFRS 16 *Leases* in our future reviews and urge issuers to pay careful attention to this aspect of IFRS.

Matter 3: State of readiness (2017-focus area)
The disclosure required in terms of paragraph 30 of IAS 8 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.

Transparency when reporting errors

Matter 1 (2019 -common disclosure omission)
The third greatest number of deficiencies identified through the review process in 2019 was not reflecting the correction of errors in a transparent manner.

Matter 2 (2018)
We remind issuers that we have emphasised in our previous reports (2017, 2016 and 2015) that we expect transparent disclosure regarding the correction of material prior period errors (IAS 8). Whilst providing the disclosures set out in IAS 8.49 is an important first step, it is equally important to explain that the restatement is due to an inappropriate action or interpretation of application of IFRS by the issuer. Masking material prior period errors in a non-transparent manner (including referring only to the 'representation' or reclassification' of the numbers without explaining that these are the result of an error) runs contrary to the general principles of the JSE Listings Requirements. In these instances, the JSE will require an issuer to take corrective action.

Matter 3 (2017)

The conclusion reached by the FRIP in 2017 (set out in annexure 1) 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.

Matter 4 (2016)

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

- the item was labelled as merely being a 'restatement' or 'representation' and not identified as being an error;
- the disclosures required in terms of IAS 8.49 were provided;
- whilst the impact of the error was disclosed in terms of paragraph 49(b) of IAS 8, the item was not labelled as being an error;
- a material error was incorrectly referenced as being a change in accounting policy; and
- the issuer failed to explain and highlight the fact that there was a material error.

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

Availability of information

Matter 1 (2019 -common disclosure omission)

On challenging issuers on the usefulness of generic or omitted information, we were often referred to other publicly available information (which in some instances did include useful entity specific facts). We reminded issuers that financial statements are required to be comprehensive documents which disclose material information regardless of whether such information is available in other sources (paragraph 25, Materiality practice statement).

Specific Standards

Inventory

Matter 1 (2017)

Annexure 1 details a 2017 FRIP case regarding the accounting treatment of advertising rebates from suppliers, which IAS 2 *Inventories,* was misapplied.

Statement of Cash Flows

Paragraph 10 of IAS 7 *Statement of Cash Flows,* states that the statement of cashflows ("**SCF**") shall report cash flows classified by operating, investing and financing activities ("**SCF classification**"). Whilst the incorrect application of these three definitions does not affect the net movement in cash the JSE regards material misallocations between the categories in a serious light. 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.

Matter 1 (2019)

An issuer presented cashflow items and non-cash flow adjustments interchangeably on the face, incorrectly applying a combination of the 'direct' and 'indirect' methods described in IAS 7.18. Consequently, there was no distinction between actual cash flows and adjustments made in respect of non-cash flow items. The error was compounded by poor note disclosure hampering an understanding of the true operational cashflows.

Matter 2 (2019)

IAS 7.16(g) and (h) cannot be read in isolation, but must be read in conjunction with the concluding paragraph in IAS 7.16 which explains that "*when a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged*".

IAS 39.IG.G.2 also states that:

> "*Cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. While the terminology in IAS 7 has not been updated to reflect IAS 39, the classification of cash flows arising from hedging instruments in the statement of cash flows should be consistent with the classification of these instruments as hedging instruments under IAS 39*".

The cash flows for a derivative instrument used to hedge an employee share scheme and where hedge accounting is applied, should not have been reflected as a financing activity, but rather as an operating activity. The error led to a 68% overstatement of the cash from financing activities.

Matter 3 (2019)

We identified an instance where the acquisition of the remaining shares in a (non-wholly owned) subsidiary should have been classified as financing and not investing activities (IAS 7.42B). This resulted in a 59% overstatement of cash flows from investing activities, whilst cash flows from financing activities were understated by 40%.

Matter 4 (2019)

A cash payment to acquire treasury shares should have been disclosed as financing and not investing activities (IAS 7.17(b)). The incorrect application of IAS 7 resulted in the misstatement of financing activities by 100% and investing activities by 66%.

Matter 5 (2018)
We identified an instance where the acquisition of additional shares in a (non-wholly owned) subsidiary should have been classified as financing and not investing activities (IAS 7.42A). The result was that cash flows from investing activities were misstated by 35%, whilst cash flows from financing activities were misstated by 61%.

Matter 6 (2018)
The cash payment of a cash-settled share-based payment of a subsidiary company should have been classified as an operating cash flow and not a financing cash flow in the SCF. IAS 7.6 defines financing activities as "*activities that result in changes in the size and composition of the contributed equity and borrowings of the entity*". Furthermore IAS 7.14(d) lists "*cash payments to and on behalf of employees*" as an example of a cash flow from operating activities. The incorrect application of IAS 7 resulted in financing activities being misstated by approximately 25%.

Matter 7 (2018)
An investment was made into a company, which in turn held shares in the listed issuer. The investee was regarded as a subsidiary to the group and consequently consolidated. The resulting shares in the listed company were therefore treated as treasury shares and not an asset in the Group AFS.

IAS 7.16 explains that "*Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities*". IAS 7.17(b) lists the cash payment to owners to acquire or redeem shares as an example of a financing activity.

The issuer had incorrectly treated the acquisition of treasury shares as investing activities. The error accounted for 56% of the reported cash flows from investing activities and would have changed the net cash generated from financing activities to a net cash utilised in financing activities.

Matter 8 (2018)
In this instance, the issuer incorrectly presented cash inflows and outflows on a net basis in the SCF. The cash flows from interest paid/received must be disclosed separately (IAS 7.31). Furthermore, in terms of:

- IAS 7.32 the SCF must identify and separately reflect the actual cash flows paid with respect to finance costs (inclusive of borrowing costs capitalised); and
- IAS 7.21 requires an entity to report separately major classes of gross cash receipts and gross cash payments from investing and financing activities (with paragraph 22 and 24 limiting the instances in which cash flows may be presented on a net basis). Movements into and out of investments such as 'other financial assets' must therefore be disclosed on a gross basis and the interest elements must also be disclosed separately.

Matter 9 (2017)
In the 2017 reviews 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.

Matter 10 (2017)
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 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.

Matter 11 (2017)
The requirements for expenditure on long term assets 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).

Matter 12 (2017)

Issuers are referred to a case considered by the FRIP in 2017 (set out in annexure 1) which deals with 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.

Matter 13 (2016)

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

Matter 14 (2016)

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

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

Matter 15 (2016)

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

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

Matter 16 (2016)

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

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

Matter 17 (2015)
Non-cash flow items should not be reflected as cash flow items. Examples of errors identified include:

- fair value movements;
- deferred consideration payable for a business combination;
- share based payment expenses; and
- imputed interest.

In one instance, whilst the non-cash flow transactions were correctly excluded from the statement of cash flow, the necessary disclosure of these transactions elsewhere in the AFS was however incorrectly omitted.

Matter 18 (2015)
There were instances of misclassifications, with issuers incorrectly reflecting amounts between the three categories of activities within the statement of cash flows. Examples of this include:

- the purchase of additional shares in an existing subsidiary incorrectly being reflected as an investing instead of financing activities;
- the payment of the contingent consideration for an acquisition incorrectly being reflected as an operating instead of financing activities; and
- cash held by a subsidiary on acquisition being incorrectly reflected as a financing activity, as opposed to being deducted from the purchase consideration and thus being shown as an investing activity.

Matter 19 (2014)
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'.

Matter 20 (2014)
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.

Matter 21 (2014)
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.

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.

Matter 22 (2014)
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.

Matter 23 (2014)
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.

Matter 24 (2013)
The following errors were identified in the statement of cash flows:

- the inclusion of various non-cash flow items as a cash flow items. These included fair value adjustments, an increase in goodwill, an increase in a provision, the injection of assets from a non-controlling shareholder and accrued interest;
- reflecting the proceeds on the disposal of shares held by the entity after the closure of its share incentive scheme as part of operating activities;
- showing investing activities as financing activities and visa versa; and
- the omission of the detailed notes regarding the acquisition and disposal of subsidiaries and businesses.

Matter 25 (2013)
There were two instances where the issuers presented conflicting messages.

- certain rental assets were reflected as inventory in the statement of financial position yet the proceeds from the disposal thereof were reflected as investing activities; and

- dividends received were reflected as part of revenue, yet these were shown as investing activities in the statement of cash flows as opposed to operating activities.

We remind issuers that Paragraph 14 of IAS 7 is clear that cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Investing activities on the other hand represent expenditure made for resources that are intended to generate future income and cash flows (or proceeds from the disposal of such asset).

Matter 26 (2012)
The following errors were identified in the statement of cash flows:

- reflecting intercompany items eliminated in the group on consolidation as group cash flows;
- showing transfers between current and non-current assets as cash flows;
- the inclusion of a non cash flow group restructuring as a cash flow item;
- the revaluation of an asset was reflected as a cash flow; and
- the netting of a purchase and a sale of investment property leading to the reflection of the purchase of investment property as a cash inflow.

Matter 27 (2012)
We identified the following cases of incorrect classifications:

- transaction costs (including due diligence costs) were classified as operating activities as opposed to investing activities;
- a dividend of post-acquisition reverses paid immediately prior to (and as part of) a disposal was reflected as operating as opposed to investing activities; and
- the insurance proceeds received on the derecognition of property plant and equipment was reflected as operating activities as opposed to investing activities.

Matter 28 (2011)
The following problems / misapplication of this standard were found:

- the reflection of non-cash flow items as cash flow items; and
- inconsistencies between amounts on the face of the statement of cash flows and note disclosures elsewhere in the AFS.

Events after the Reporting Date

Matter 1 (2012)
In one case, the directors' report alluded briefly to two substantial business developments. In response to queries raised it was agreed these should have been dealt with in the AFS in terms of IAS 10 *Events after the Reporting Period*, and that the level of disclosure in terms of IFRS was not only lacking, but that the reference within the directors' report was confusing. In the resultant proposed disclosure, the company indicated that both transactions were non adjusting material transactions for the issuer. IAS 10 states that non-disclosure of these sorts of events could influence the economic decisions that users make on the basis of the AFS and thus prescribes certain disclosures.

Matter 2 (2012)

Another area within this Standard that was neglected was disclosure of the impact of changes in tax legislation, which in certain instances is material to the AFS. Issuers therefore are reminded that assessments in this regard must be made.

Income Taxes

Matter 1 (2017/ 8 /9 -common disclosure omissions)
The greatest number of deficiencies identified through the review process in 2017 and 2019 were in the area of insufficiently detailed tax rate reconciliations (paragraph 81(c) of IAS 12 *Income Taxes*). Whilst still featuring as one of the top common issue in the 2018 reviews, its severity was reduced to third of the total number of findings in 2018.

Issuers often use generic descriptors for reconciling items such as “non tax-effective income/loss”, “different rates of tax”, “disallowable charges/expenditure”, ”non-tax deductible items”, “non-allowable expenditure”. These descriptors are not only generic, but there is often too much aggregation which does not provide sufficient information with respect to the nature of the item/s or whether they are temporary differences or exempt/non-deductible items.

In the 2018 reviews there were three specific instances where we challenged the disclosures for multi-jurisdictional entities. Given the likely complexities of multi-jurisdictional entities, they are required to be even more vigilant in their disclosures to ensure a full understanding of the drivers of the effective tax rate.

Issuers should ensure that the tax rate reconciliation and the descriptions used therein allow the reader to ascertain:

- the real nature of the reconciling items and their impact on the effective tax rate;
- the relationship between accounting profit and the tax expense (IAS 12.81(c)); and
- whether or not the relationship between the tax expense and accounting profit is unusual and if there are significant factors that could affect the relationship in the future (IAS 12.84).

Matter 2 (2016)
An issuer had entered into various interest rate swaps, which were accounted for as cash flow hedges. Whilst correctly accounting for the fair value consequences for these derivative instruments, the issuer neglected to consider the deferred tax consequences thereof. Not only did this result in other comprehensive income being overstated, but the case also concerned us in that there were no accounting processes in place to ensure that the tax consequences for all class of assets had been considered.

Matter 3 (2015)
Issuers continued to present tax rate reconciliations with insufficient and confusing information. We also identified arithmetic errors in tax rate reconciliations. The inclusion of one line item called ‘non-deductible expenses’ is insufficient disclosure, even as it relates to permanent differences. The reason being that paragraph 84 of IAS 12 explains that the purpose of the tax rate reconciliation is to enable users to understand whether the relationship between the accounting profit and taxation is unusual and importantly to

understand significant factors that could affect that relationship in the future. It is therefore important, for example, to understand if a permanent difference is recurring in nature.

Matter 4 (2015)
We continued to identify problems regarding the tax rate used for the purposes of deferred taxation. 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.

Matter 5 (2014)
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'.

Matter 6 (2014)
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 raises concern as to whether or not the deferred tax asset should have been raised. The disclosure must be detailed and specific to the issuer.

Matter 7 (2014)
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.

Matter 8 (2012)
Problems were found with numerous issuers with regards to their tax rate reconciliations. These included:

- a complete lack of the required reconciliation;
- the reconciliation not balancing to the average effective tax rate of the group;
- the exclusion of a numerical reconciliation;
- the inclusion of incorrect line items/ amounts in the reconciliation in order to ensure that it balances; and
- the inclusion of incorrect and confusing descriptions of line items within the tax rate reconciliation.

IAS 12 continues to be poorly applied and we ask that issuers give it the necessary attention when preparing their AFS. We understand that many investors regard the effective tax rate (tax charge as a percentage of profit before tax) as a helpful performance measure and seek to understand factors that could affect it in the future. The information contained in these reconciliations is therefore regarded as important by analysts in understanding the tax consequences of the activities of the entity.

Another disclosure problem relating to the application of this Standard was the omission of the required disclosure of unused assessed losses.

Matter 9 (2012)
In addition to the incorrect recognition of deferred tax assets we also uncovered an instance where a deferred tax asset on the revaluation of land and buildings was erroneously not raised.

Matter 10 (2011)
A deferred tax asset can only be raised if certain criteria are met. To this end it is crucial that an issuer that is incurring losses complies with the disclosure requirements of IAS 12 and provides sufficient justification for the raising of the deferred tax asset. Whilst for most of our enquiries the matter could be cured by providing the necessary disclosure, in one instance our enquiry led to the realisation that there was no justification for the entity to raise the deferred tax asset. This resulted in a restatement of the statement of financial position

Property, Plant and Equipment

Matter 1 (2019)
An issuer performed major plant overhauls on an annual basis (the “overhaul”). They expected the overhaul ‘component’ to be used within 12 months, i.e. it failed the one financial period asset recognition test per paragraph 6(b) of IAS 16 *Property, Plant and Equipment*. The overhaul was not ‘spare part, standby-equipment and servicing equipment’ to be classified as inventory in terms of IAS 16.8. The issuer recognised the overhaul at year end as a ‘current asset’ and then fully depreciated it in the next financial year.

As these overhauls were done *every* year, the JSE questioned the difference in the treatment between annual day-to-day repairs and maintenance (which are expensed as incurred) and overhauls. The nature of these overhaul costs appeared to be more closely related to repairs and maintenance expenses given the one-year (or less) lifecycle of both of these types of costs. (One may reach a different conclusion if the overhaul was performed say every 3 to 4 years.)

On further interrogation it was revealed some general monthly costs (such as salaries, transport and general overheads) were also rolled up into the overhaul cost category. The issuer incorrectly applied a process of deferring costs onto its balance sheet.

Matter 2 (2015)
The FRIP considered a case regarding the residual value of property when applying the revaluation model under IAS 16 *Property, Plant and Equipment*, the details of which are set out in annexure 1

Matter 3 (2014)
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) that 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.

Matter 4 (2014)
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 *Fair Value Measurements*, which considers the price received at the current date, with the asset in its current condition.

Matter 5 (2014)
Annexure 1 contains a case referred to the FRIP regarding the revaluation of property accounted for in terms of IAS 16.

Matter 6 (2013)
In one instance an issuer incorrectly depreciated an asset that was not yet available for use in line with the rate used for its other assets that were being used in production. Another issuer incorrectly did not provide for depreciation on an asset because it was being measured under the revaluation model.

We remind issuers of paragraph 60 of IAS 16 which states that the depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Par 55 of IAS 16 is also clear that the depreciation of an asset only commences when the asset is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Revenue

Matter 1 (2019)
In terms of their accounting policy, an issuer recognised revenue on the sale of properties when:

- the relevant agreements were unconditional and binding on the purchaser;
- the purchaser paid a meaningful deposit/ secured payment of the purchase price;
- zoning and final conditions of establishment were obtained; and
- servicing arrangements and costs were substantially finalised.

Further interrogation revealed that the issuer has incorrectly applied IAS 18 *Revenue*. IAS 18.15 explains that "in most cases, the transfer of risks and rewards of ownership coincides with the transfer of legal title or the passing of possession". The issuer acknowledged that revenue recognition should have been delayed until the date of transfer. Until this date the

purchaser did not have the ability to unilaterality affect changes to the asset, thus they did not have the significant risks and rewards of ownership (IAS 18.14).

Matter 2: Triggered by poor trade receivables disclosures (2019)

The disclosure around trade receivables was an additional trigger leading the JSE to question the revenue recognition matter discussed above. More specifically:

- the size of the receivables book was increasing with credit quality deteriorating significantly;
- the provision for impairments were not increasing; and
- the credit risk disclosures were not in compliance with paragraph 32A of IFRS 7 *Financial Instruments: Disclosures.*

The initial response by the issuer was to explain that the 'cure' was to improve the disclosure in the AFS and highlight that there was a delay in obtaining the necessary permissions to register transfer of the property and collect the cash. On further reflection, the issuer concluded that the sales were incorrectly recognised in the first place. This was why trade receivables were not being collected.

Matter 3 (2018)

The concept of considering the probability of the future economic benefits exists under both IAS 18 and the replacement standard IFRS 15 *Revenue from Contracts with Customers.* The FRIP considered a case (see annexure 2) where this concept was not correctly applies, hence the full revenue number was recognised, and was later subject to impairment provisioning.

Matter 4 (2017-common disclosure omissions)

The omission of interest and dividends received as 'revenue' in the Company AFS (per IAS 18.7) was the area of the third most number of deficiencies identified through the review process in 2017.

Matter 5 (2016)

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

Paragraph 7 of IAS 18, defines revenue as being:

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

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

Matter 6 (2013)

There were some cases where we engaged in lengthy debate with issuers as to whether they were acting as agent or principle regarding monies they received from their customers. The

concern was whether or not the amount reflected as revenue was complete. Again, this was an area of significant judgement and at the very least the AFS should have included the necessary detailed disclosure in support of management's application of IFRS.

The Effect of Changes in Foreign Exchange Rates

Matter 1 (2012)
We had one specific case whereby the issuer used US$ as their presentation currency in terms of IAS 21 *The Effects of Changes in Foreign Exchange Rates*. Questions were raised with regards to the translation of the share capital and share premium of the South African registered holding company (where the functional currency was Rand). After a lengthily debate it was accepted that the accounting policy developed and applied by the issuer was within the ambits of IFRS, but it was agreed that the disclosure surrounding these items throughout the AFS had to be amended. The existing disclosures (which included an incomplete accounting policy note) were insufficient, confusing and potentially misleading.

Related Party Disclosures

Matter 1 (2012)
We identified the following deficiencies in related party disclosures as per IAS 24 *Related Party Disclosures*:

- omitted disclosure of the terms and conditions of outstanding balances with related parties;
- no disclosure of the value of the transactions with related parties; and
- the omission of related party disclosures in their entirely, in circumstances where it was clear from a review of announcements made on SENS that these existed.

We remind issuers that disclosure of related party transactions is an important feature in the JSE's regulatory approach as wells as an IFRS requirement. For this reason, there are specific and detailed JSE Requirements dealing with these types of transactions. By their very nature, related party transactions are usually material and the disclosure requirements of IAS 24 complement these JSE Requirements and provide valuable information to investors.

Matter 2 (2011)
Readers need to be presented with a comprehensive and clear understanding of all the relationships that exist as well as the financial consequences thereof. This is a requirement for both the statement of financial position and statement of comprehensive income level, where the ongoing obligations of a single expense item such as a royalty or management fee could have a material impact on the understanding of the entity. The related party disclosures for intercompany transactions were also inadequate.

Investment in Associates

Matter 1: Venture capital exemption (2019)
An issuer incorrectly applied the venture capital exemption of IAS 28 *Investments in Associates and Joint Ventures*. This matter was the subject of a referral to the Financial

Reporting Investigation Panel ("**FRIP**") and is discussed in detail under the heading Case 1 of Annexure 2.

Matter 2 (2012)
In one instance, an issuer erroneously applied the requirements of IAS 28. The issuer erroneously continued to account for its share of losses of these associates even after the losses had eliminated the initial investment made by the issuer. This was despite the fact that they had no legal or constructive obligation to make payments on behalf of the associate.

Earnings per Share

Matter 1 (2015)
The FRIP considered a matter regarding the treatment of recallable shares in the calculation of IAS 33 *Earnings per Share,* the details of which are set out in annexure 1.

Matter 2 (2013)
Our reviews identified certain errors in the application of the earnings per share standard, specifically as it related to diluted earnings per share. These included:

- the omission of the dilutive effect of options granted and shares due to be issued at a future date;
- incorrect adjustments to the numerator for items falling outside the ambits of paragraph 33 of IAS 33 particularly in respect of options;
- calculation errors in determining the denominator; and
- the omission of the necessary disclosure regarding instruments excluded from the diluted earnings per share calculation due to their antidilutive effect for the period under review (for example convertible loans).

Matter 3 (2013)
We also encountered an instance of the incorrect application of paragraph 24 of IAS 33 relating to share incentive scheme shares. As the share incentive scheme shares were contingently returnable (i.e. subject to recall) they should have been excluded from the calculation of basic earnings per share.

Matter 4 (2012)
Our reviews identified certain errors in the earnings per share calculations. These included the:

- incorrect weighting for repurchased shares;
- omission of the reconciliation between basic and diluted weighted average shares in issue; and
- use of an incorrect numerator.

The lack of disclosure was not only in itself contrary to IAS 33, but led to questions regarding the accuracy of the measurement of the earnings per share calculations themselves.

Headline Earnings per Share

The requirement to disclose Headline Earnings per Share ("**HEPS**") is a specific obligation imposed under the JSE 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.

Matter 1 (2019)
The SAICA Headline Earnings Circular has very explicit rules for each type of re-measurement. An issuer incorrectly added back the impairment reversal on an IAS 39 loan.

What was further noteworthy from this matter was the way the error impacted the results. The error led to an understatement of headline earnings per share ("**HEPS**") of 6%, but furthermore the narrative on the results in the subsequent year highlighted a 20% increase in HEPS compared to the prior year. Considering the corrected HEPS, the discussion of the percentage increase in HEPS would have been more moderate. The misstatement of HEPS had a material impact to the manner in which results were presented.

Matter 2 (2018)
The rules set out in the table for calculating headline earnings apply equally to the underlying earnings of an associate – i.e. a 'look through approach' is followed. Where an associate impairs an asset in terms of IAS 36 *Impairment of Assets*, that amount must be removed from headline earnings in the listed company's results.

Matter 3 (2017)
The starting point of HEPS is 'earnings' as determined by IAS 33. 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.

Matter 4 (2017)
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*".

Matter 5 (2017)

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.

Matter 6 (2015)

Annexure 1 contains the details of a case referred to the FRIP regarding the treatment fo the loss on discontinued operations in the HEPS calculation.

Matter 7 (2014)

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.

Matter 8 (2013)

Various problems were identified with the calculation of headline earnings. These included the incorrect inclusion of:

- impairments of assets (IAS 36); and
- profit on disposal of tangible and intangible assets (IAS 16 and IAS 38);

And the incorrect exclusion of:

- impairments of loans (IAS 39); and
- the profit on disposal of an associate for an entity applying Issue 1 of the sector specific rules.

Matter 9 (2012)

Various problems were also identified with the calculation of headline earnings. These included the incorrect inclusion of:

- a gain from a bargain purchase (IFRS 3);
- exchange rate translations differences on monetary items treated as part of the net investment in a foreign operation (IAS 21);
- impairments of assets (IAS 36);
- loss on disposal of intangible assets (IAS 38); and
- re-measurements to investments properties (IAS 40).

Matter 10 (2012)
The Headline Earnings Circular also requires a detailed line-by-line reconciliation for each re-measurement. Paragraph 29 states that these re-measurements can be aggregated per type of re measurement per IFRS, unless the re-measurement is material within the context of the total adjustments. We found instances where this rule was not correctly applied with aggregation of re-measurements across IFRS standards and this reduced the usefulness of the information and raised unnecessary concerns regarding the accuracy of the headline earnings calculations.

Interim Financial Reporting

Matter 1 (2017/ 8-common disclosure omissions)
The issue of a three-line statement of cash flows (see 'matter 5' below) featured as a common disclosure issue for both 2017 (fifth most common) and 2018 (third most common).

Matter 2 (2017)
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.

Matter 3 (2016)
Paragraph 16A of IAS 34 *Interim Financial Reporting,* details certain mandatory disclosures not linked to significant events or transactions that occur during the interim period. Presentation of segmental information is mandatory (IAS 34.16A(g)), and provides relevant information to investors. Similarly, certain fair value disclosures must be provided (IAS 34.16A(j)).

Matter 4 (2016)
Whilst IAS 34.15 calls for an explanation of events and transactions that are significant to an understanding the changes in the results since the publication of the AFS, paragraph 15B of IAS 34 mandates certain disclosures if they are significant within the context of the interim results themselves (i.e. unrelated to changes since the publication of AFS). Several issuers failed to provide disclosure of related party transactions despite the requirements of IAS 34.15B(j).

A review of the subsequent AFS also revealed significant related party information which the market should have been advised of at the interim stage.

Matter 5 (2016)
We also refer you 'matter 12' under the heading statement of cash flow above, which discusses a concern raised in the context of interim results.

Matter 6 (2015)
Our consideration of interim reports not only gave us an understanding of the application of IAS 34, but it also added value to our reviews. Specifically, there were several instances where inconsistencies in the disclosure and measurement of items in the interims led to the identification of problems with the application of other Standards in the AFS.

Matter 7 (2015)
As it relates to IAS 34 itself, the recurring theme was the non-application of paragraph 16A(j), which requires certain disclosures for financial instruments. Whilst paragraph 15 of IAS 34 requires disclosure of events and transactions that are significant to understanding *changes* for an issuer since the publication of the last AFS, the reference the *changes* is not included in the wording of the other disclosures required by paragraph 16A. Therefore, entities should provide disclosure on financial instruments in their interim reports, even if there is no change to the value thereof.

Impairment of Assets

Matter 1 (2019-common disclosure omissions)
IAS 36.134 requires (amongst others) qualitative information

- of *each key assumption …to which the unit's (group of units') recoverable amount is most sensitive*." (paragraph 134(d)(i)); and
- a description of how the value assigned to each key assumption was determined (paragraph 134(d)(ii)).

In addition, quantitative disclosure of the value assigned to each key assumption is required if a reasonable possible change could trigger an impairment (IAS 36.134(f)(ii)).

In its value in use calculation an issuer believed that the only key assumption and disclosable item was the growth rate and discount rate used in the terminal value calculation. It quantified both of these amounts. Whilst IAS 36 does not necessarily require management to quantify the assumptions made in the cash flow projections for the period covered by the forecasts (IAS 36.BC209(c)) the obligation exists to distil and disclose qualitative information with respect to the assumptions made by management.

The JSE is concerned when impairments result from items that were not previously disclosed as key assumptions. Even if the assumptions applied in the forecast period leading up to the terminal rate are not as sensitive as items in the terminal value, they do create the base forecast value used in the terminal calculation. As such, qualitative disclosures on those assumptions should be provided i.e. identification of those assumptions and a narrative description of the factors that affect them. These disclosures should give a better indication to alert users to 'surprise' impairments in subsequent periods if there is a major shock change to the business affecting the forecast for the next few years.

Matter 2 (2017/ 8 /9-common disclosure omissions)
Insufficient information regarding impairment calculations (paragraph 103-134 of IAS 36 *Impairment of Assets*) was the second most common disclosure omission identified in the 2017, 2018 and 2019 reviews.

Matter 3 (2016)
Compliance with the disclosure provisions of IAS 36 should illustrate the fact that various recoverable amounts were calculated and that goodwill is not necessarily a homogenous balance. The disclosures should not be broad and vague. This is especially the case when issuers impair goodwill shortly after completing a business combination, as it calls into question the authenticity of the purchase price allocation exercise performed at the acquisition date. Careful attention must also be given to all aspects of paragraphs 130 and 134 of IAS 36.

Matter 4 (2016)
The disclosure provided in terms of IAS 36 should give the user a full understanding of the circumstances that led to impairments. This information provides justification that the impairments have been accounted for in the correct period, i.e. that past impairments were not understated, and that future impairments are not currently envisaged. Importantly too, these disclosures are required for both the recognition and reversal of impairment losses.

Matter 5 (2016)
Issuers should also be mindful of the fact that paragraphs 51 and 55 of IAS 36 require the use of pre-tax cash flows and discount rates when computing a recoverable amount based on value in use. IAS 36.BCZ85 explains that the pre-tax discount rate will not always be the grossed up post-tax discount rate.

Matter 6 (2015)
The application of the disclosure requirements of IAS 36 continues to be problematic. The majority of the issues revolved around partial compliance, but there continued to be instances where the required disclosure was omitted entirely.

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.

Matter 7 (2015)
Our interrogation of the disclosure around impairments is rooted in a concern of the potential incorrect measurement and the overstatement of assets. In one specific instance, the lack of disclosure did confirm this concern, and we found that no impairment testing had been performed. In another instance, measurement issues were identified after we raised concern that the same discount rate was used for different cash-generating units.

Matter 8 (2014)
Insufficient detailed application of all 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.

Matter 9 (2013)
Whilst it was not the only problematic asset class, disclosure regarding impairment testing for goodwill was the biggest problem area that we encountered.

Non-compliance in this area ranged from partial compliance on one hand to complete omission of the required disclosure on the other hand. We again remind issuers that paragraph 134 of IAS 36 requires:

- full details of the key assumptions on which cash flow projections were based;
- a description of managements' approach to determining the value assigned to those key assumptions and how those relate to past experience;
- periods used for cash flow projections;
- growth and discount rates used in those cash flow projections and a justification where the growth rates exceed the norm;
- disclosure for each significant cash generating unit; and
- disclosure, even if there is no impairment in that specific year, as evidence of goodwill impairment testing.

Paragraph 130 of IAS 36 was also poorly applied and there was a lack of information regarding the nature of the asset and the events and circumstances that led to the recognition/reversal of impairment losses.

Detailed questions were asked where the discount rate used in the impairment calculation was the same across all business units and where issuers used their historic entity weighted average cost of capital as the discount rate. Issuers should refer to paragraphs 55 to 57 of IAS 36 when determining the discount rate to apply.

In addition to encountering disclosure problems our reviews also identified instances of overstatement of assets when the measurement provisions of IAS 36 were not correctly applied.

Provisions

Matter 1 (2012)
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* sets out the specific and detailed disclosure requirements for provisions. In one instance this information was omitted entirely. What compounded our concern was that in that specific year there was a large reversal of impairments, which accounted for 25% of the issuer's bottom line.

Financial Instruments

Matter 1 Capital raising (2019)
An issuer embarked upon a substantial capital raising exercise through a book building process, not by way of a rights issue. Critically, from an accounting perspective, the capital raising did not occur in solely the functional currency of the issuer and a substantial amount was raised in a foreign currency. The amount to be received by the issuer in terms of its functional currency would be subject to variation as exchange rates fluctuated. Therefore, the capital raising did not meet the 'fixed for fixed' requirement of paragraph 16(b) of IAS 32

Financial Instruments: Presentation. (It is irrelevant whether or not there was any exchange rate movement). As the arrangement was not pro rata to existing shareholders, it failed to meet the exemption of IAS 32.16(b)(ii). The contractual obligation to issue shares was therefore a financial liability and not an equity instrument.

As is typical in a book building process, the offer was made at a discount to the market price. The issuer should have accounted for its obligation to issue shares measured at the fair value of the derivative (which simplistically was the difference between the offer and market prices). There was a timing difference between the date that the offer was made to the investors and the shares were issued, which further exacerbated the accounting impact. The changes in the measurement of the derivative liability between initial recognition and settlement of the liability should have been recognised in profit and loss (IFRS 9.5.7.1).

Matter 2 (2018)

The same revenue 'matter 3' set out earlier in this report considered the appropriateness of impairments of receivables. The details of this FRIP case are set out in annexure 1 under the heading 'recognition and measurement of impairment losses on receivables.' Whilst IAS 39 *Financial Instruments: Recognition and Measurement*, was the applicable standard at that time, the considerations of the FRIP are equally relevant under IFRS 9 *Financial Instruments*.

Matter 3 (2018-debt issuer)

In this instance an issuer incorrectly classified its listed debt instruments as equity and subsequently also incorrectly re-measured the notes in equity. Paragraph 36 of IAS 32 *Financial Instruments: Presentation* states that "*changes in the fair value of an equity instrument are not recognised in the financial statements*".

To support their classification the company stated in its accounting policy that all of the conditions pertaining to puttable financial instruments had been met (i.e. IAS 32.16A). The nature of the notes was as follows:

- that the company issued a series of notes;
- each note was secured against separate identifiable assets of the company; and
- the recourse for noteholders was limited to the proceeds of the specifically identified secured assets.

In addition to the above notes, the company had also issued ordinary shares.

On the basis that the redemption terms for each series of notes would be different (i.e. linked to reference assets) the JSE argued that the requirements of IAS 32.16A(c) would not have been met. The different series of notes would ultimately be redeemed at different amounts. IAS 32.16A(c) states that:

> "*all financial instruments in the class of instruments that is <u>subordinate to all other classes of instruments</u>* (must) *have <u>identical features</u>*"….and that *"the <u>formula or method used</u> to calculate the repurchase or redemption price…* (must be) *the <u>same for all instruments in that class</u>"* (emphasis added).

The issuer subsequently agreed that their classification was incorrect.

Matter 4 (2018-debt issuer)
An issuer classified a subordinated loan (from a related party) as an equity instrument. The JSE raised concerns as to the issuer's right to avoid paying cash (or deliver another financial instrument (IAS 32.16(a)) as the AFS:

- described it as being an *unsecured loan*, implying that the issuer had an obligation to repay the capital portion of the loan; and
- reflected the recognition of an interest expense, as the loan bore interest.

The issuer argued that:

- the loan met the balance sheet classification of a puttable financial instrument; and
- there was a specific minimum amount of the loan that could not be repaid in order for the company to meet its required subordinated funding ratios.

The JSE questioned how the full value of the loan would be classified as equity if only a portion thereof would not be repaid until liquidation. In any event, whilst having referred to the puttable instruments references in IAS 32.16A-D, the issuer could not motivate how their fact pattern correlated to the features set out in IAS 32.16A(a)-(d).

The issuer had both ordinary and preference shares. Whilst explaining that the terms of subordinated debt placed the priority of payments behind the claims of 'other secured creditors', the company did not explain why the loan was the most subordinate class of *equity*.

Furthermore, the issuer did not provide an IFRS based argument in response to our concern that an instrument containing an obligation to pay interest should be classified as a financial liability, or at the very least as a compound financial instrument per IAS 32.28. From the loan agreement we noted that:

- the outstanding amount of each advance bore interest (which accrued on a daily basis);
- interest was due and payable on each payment date (subject to the priority of payments);
- interest not paid on a payment date (due to insufficient cash in terms of the priority of payments) remained owing by the issuer; and
- the loan amounts were due and payable at specified repayment dates (subject to the priority of payments).

It appeared to us that the priority of payments was a mechanism to manage the liquidity and cash flow requirements within the securitisation vehicle rather than one that placed the instrument within the most subordinate category of equity.

The classification of the subordinated loan as equity was not in accordance with IFRS and it should have been classified as a financial liability.

Matter 5 (2017)
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 terms thereof 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.

Matter 6 (2015)
Various problems identified within the application of IAS 32 and IAS 39 were considered by the FRIP in 2015 in the context of property entities (see annexure 1).

Matter 7 (2015)
The determination of whether to classify an instrument as equity or as a financial liability can be complex and is dependent on the facts and circumstances. We continued to challenge issuers in this regard and identified the following areas of non-compliance with IFRS:

- the terms of a redeemable preference share were such that the holders were granted the right to redemption through either the issue of equity or the payment of cash. Whilst the issuer believed that the intention of both parties was to give the holder the right to an increased equity interest, the contractual terms were not aligned with this view. As such, the preference shares should have been classified as debt and not equity.
- an issuer argued that the use of paragraph 25 and AG28 of IAS 32 in support of not raising a financial liability. An assessment of the facts revealed that the issuer did not have the unconditional right to avoid delivery of cash, and there was no evidence to support a statement that the liability was not genuine.
- loans from non-controlling shareholders of a subsidiary were incorrectly classified as equity. The issuer did not have an unconditional right to avoid payment of cash if requested to do so, and thus the amount should have been classified as a liability.

Matter 8 (2015)
The transactions costs associated with capital raisings need to be carefully analysed, as not all costs are deductible from equity. Costs that relate jointly to more than one transaction (for example a capital raising and a listing of shares on the JSE) must be allocated between those two transactions.

Matter 9 (2015)
The application of IFRS to interest free loans continues to be misapplied. The contract value of such a loan is not its fair value.

Matter 10 (2014)

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 for this specific issuer meant that they did not meet those limited circumstances.

Matter 11 (2014)

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.

Matter 12 (2014)

We also identified problems with the subsequent measurement of financial liabilities (under IAS 39), 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 in annexure 1 as it was the subject of a FRIP case and a guidance letter.

Matter 13 (2014)

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.

Matter 14 (2014)

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.

Matter 15 (2012)
IAS 39 requires liabilities to be initially measured at fair value, net of transaction costs. In one instance an issuer ignored IAS 39 (and its own stated accounting policy) when accounting for a debt structuring fee that it had paid.

Matter 16 (2012)
We once again identified a problem with the accounting for interest free loans receivable. Whilst the issuers' accounting policy correctly stated that this financial instrument was measured at fair value, this policy was in fact not applied. This was evident from the fact that despite market interest rate changes over the period, there were no resultant fair value changes reflected in the issuer's accounts.

Matter 17 (2012)
We identified an instance where, as part of a discontinued operation, the issuer had an available-for-sale financial asset which had been impaired. The fair value movement on this financial asset was incorrectly reflected in Other Comprehensive Income as opposed to the cumulative impairment loss being recognised in profit and loss.

Matter 16: Offsetting (2011)
There was a concerning trend of issuers offsetting derivative assets and liabilities and gains and losses on hedging instruments. IAS 32 par 42 indicates that offsetting of financial assets and liabilities is only allowed in terms for IFRS where a legally enforceable right exists for offset and the entity intends to settle on a net basis. IAS 1 par 35 also deals with offsetting gains and losses arising from a group of similar transactions. It specifically states that such offsetting should not occur if the gain/ loss is material.

Matter 19 (2011)
In determining the fair value for initial recognition purposes of a financial asset or liability issuers cannot simply assume that the transaction price is the fair value. This is particularly relevant for an interest free financial instrument. In one instance the issuer ignored these measurement criteria for their long-term interest free loan receivable and recorded it at the initial transaction value.

Financial Instruments: Disclosures

Matter 1 (2019-common disclosure omissions)
Poor or generic IFRS 7.39 (c) liquidity risk disclosures was a common disclosure omission identified in the 2019 reviews. In one example the following narrative was included before a maturity analysis table:

> "The group will utilise undrawn facilities and cash on hand to meet its short-term funding requirements."

The maturity analysis table reflected that 57% of the issuers' liabilities matured in less than one year. The balance comprised largely of long-term liabilities which were due for repayment. The cash on hand (reflected in the same note) and the unused loan facilities (which one could find disclosed elsewhere) only covered 20% of this balance. The liquidly risk disclosures were therefore found to be insufficient.

Matter 2 (2018-common disclosure omissions)
The incorrect inclusion of liquidity risk disclosures on an discounted basis was the fourth most common disclosure issue identified in the 2018 reviews (see paragraph B11D of IFRS 7 *Financial Instruments: Disclosures*).

Matter 3: Quality of disclosures regarding risk and uncertainties (2017-focus area)
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. 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).

Matter 4 (2016)
Issuers are reminded that IFRS 7 affects all entities that have financial instruments. It is not limited to financial institutions.

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

Matter 5 (2016)
Information must also be provided in respect of the concentration of risks for each type of risk arising from financial instruments (IFRS 7.34(c)). Furthermore, a reconciliation of the movement on allowances of credit losses in respect of receivables is required (IFRS 7.16).

Matter 6 (2016)
There was a specific instance where an equity issuer did not provide the required detailed sensitivity analysis for the market risk of certain financial instruments (IFRS 7:40). The entity had significant exposure to foreign currencies and used forward exchange contracts to manage this risk. A detailed sensitivity analysis quantifying the impact on profit or loss and equity should have been provided.

Matter 7: Debt issuers that are special purpose vehicles (2015)
Given the significance of net advances in a securitisation vehicle, we would expect to see extensive credit quality disclosures. The inclusion of such disclosures in the AFS of the SPV was done very well in certain cases, in others the disclosure was bland and did not cover many of the disclosures required by IFRS 7. The types of disclosures that would be required include the credit quality of advances, average loan balances, specific verses portfolio impairments, inter alia.

This information is typically presented to investors as part of the quarterly investor reports, and therefore it would seem to be an unfortunate oversight that has led to the exclusion of

the necessary detail. Whilst the market may have the information, it is not only a specific IFRS requirement, but its inclusion within the AFS will give investors the necessary comfort that the information has been audited.

Matter 8 (2014)

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.

Matter 9 (2012)

We identified omissions in the following areas of IFRS 7:

- the carrying amounts for each of the categories of financial assets and liabilities;
- terms and conditions regarding assets pledged as collateral and collateral help;
- the amount of impairment loss for each class of financial asset;
- disclosures on cash flow hedges *;
- classification of the fair value measurements using the fair value hierarchy;
- qualitative disclosures on the risks relating to different financial instruments *;
- information about the maximum exposure to credit risk *;
- Information on the credit quality of financial assets that are neither past due nor impaired;
- disclosure of trade receivables past due and impaired versus past due and not impaired;
- maturity analysis for liabilities;
- disclosures of a sensitivity analysis for market risk; and
- in one instance, a complete omission of any of the IFRS 7 disclosures.

* These omissions were in respect of items that were of a material nature to that issuer, and we specifically questioned the lack of disclosure as we were concerned that it could have meant that the measurement of those instruments was also incorrect.

Matter 10 (2011)

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. In these current financial times this information is even more crucial. We were concerned about insufficient disclosure of the measurement basis of financial instruments, as required by IFRS 7. This lack of disclosure could have meant that the measurement of those instruments was incorrect.

The required disclosures on hedging (see par 23 of IFRS 7) were often scarce. This lack of information makes it difficult for investors to fully understand the impact of hedging on the financial statements. In one case, with regards to a cash flow hedge, whilst the issuer tried to argue that the disclosure was immaterial to investors, preparation of the necessary disclosure at our insistence resulted in the realisation that in fact the measurement of the item was incorrect and cash flow hedging had been incorrectly applied.

There was also insufficient compliance with the following disclosure requirements of IFRS 7:

- Par 7 and the requirements to disclose collateral for loans receivable;
- Par 27 which deals with the fair value hierarchy disclosure requirements was incomplete. This information becomes even more important when a large part of the assets are measured on a fair value basis;
- Par 36 which deals with the credit quality of receivables. IFRS 7 requires disclosure to allow users of the AFS to understand the assessment of the quality of for example trade receivables. The crux is to understand whether or not the issuer is exposed to any material risk of financial loss; and
- Par 40 as it relates to a sensitivity analysis for foreign exchange and interest rate risk. Again, this information could point to material risks which the users need to understand.

Investment Property

Matter 1 (2014)
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.

Matter 2 (2012)
IAS 40 *Investment Property,* has specific disclosure requirements regarding the methods and the inputs used to determine the fair value, as well as information with regards to which properties have been valued by an independent valuer. We tackled one issuer regarding their lack of the necessary disclosure, specifically as investment property was a material asset class for that issuer.

BEE transactions

Matter 1 (2019)
An issuer incorrectly accounted for its BEE scheme. This matter was referred to the FRIP and is included as Case 3 of Annexure 2

Matter 2 (2018)
Annexure 1 provides details of a case considered by the FRIP regarding a BEE trust.

Matter 3 (2018)
An issuer provided funding to a BEE partner to acquire shares in its existing subsidiary. In accounting for the transactions in their interim results the issuer neglected to give full consideration to the accounting implications of the funding transaction. The substance of the matter was that the issuer did not lose control of the subsidiary (in terms of IFRS 10

Consolidated Financial Statements) and should have continued to consolidate it. The correct accounting treatment was to recognise a share based payment expense in terms of IFRS 2 *Share-based Payments*.

Matter 4 (2012)
We identified another problem with one issuer's share incentive trust, where the entity disregarded the provisions of SIC 12 *Consolidation Special Purpose Entities* (and the FRIP's prior finding in this regard, and the JSE's prior circular specifically dealing with this issue) and failed to consolidate their trust. The original transaction commenced as far back as 2007, yet the issuer continued to perpetuate the incorrect application of IFRS.

Share-based Payments

Matter 1 (2016)
In one case, the provisions of an issuer's equity settled share based payment scheme allowed for the settlement of the scheme shares to be made in cash at the option of the Issuer. The issuer had not applied paragraphs 41 to 43 of IFRS 2 *Share-based Payments,* the scheme should have been treated as being cash settled. The JSE guidance letter FM-10 of 10 September 2013-see 'matter 4' below), which deals with the accounting treatment for share incentive schemes, was also relevant to the issuer.

Matter 2 (2014)
Annexure 1 contains the details of a FRIP case labelled as 'preferred fair value measurement basis', regarding properties due to be acquired through the acquisition of shares on listing.

Matter 3 (2013)
Non-compliance with the disclosure provisions of IFRS 2 persisted throughout this period and included non-disclosure of:

- the details of modifications to share based payments arrangements made during the period (paragraph 47(c));
- a lack of the necessary information to enable the user to understand the nature and extent of share based payment arrangements (paragraph 44); and
- the accounting policy for share based payments.

Matter 4 (2013)
Once again we identified instances where the measurement principles of IFRS 2 were misapplied to share incentive schemes, including:

- neglecting entirely to account for options granted;
- expensing an IFRS 2 charge over a 3 year period as opposed to over the vesting period of the option; and
- not reclassifying the share incentive scheme from equity settled to cash settled.

Matter 5 (2013)
In September 2013, the JSE issued a detailed guidance letter FM-10 entitled "Application of IFRS 2 to share incentive schemes containing cash settled option". This was a FRIP case in 2013 and is set out in annexure 1.

Matter 6 (2012)

Share based payment arrangements remain common, especially in the form of employee share incentive schemes. As in the previous period, we identified several instances of non-compliance with IFRS 2. As this seems to be an ongoing problem we thought that it might be useful to list some of the specific problems we identified, which we hope will assist issuers in ensuring that they do not omit this type of information: The problems included a lack of:

- information to enable the user to understand the nature and extent of share based payment arrangements that existed. (This is specifically important when there were several schemes involved, and we found instances where the disclosure was vague and confusing);
- information regarding the liability arising from the share scheme; and
- compliance with all of the disclosure provisions of IFRS 2, including the disclosure of the amount charged to the profit and loss.

Matter 7 (2012)

We also had some cases where the measurement principles of IFRS 2 were misapplied to share incentive schemes, including:

- incorrectly accounting for a transaction in terms of IFRS 3 *Business Combinations,* when in fact it was if fell into IFRS 2;
- not reflecting shares sold to certain employees as such and incorrectly reflecting the shares as treasury shares; and
- neglecting to account for the option that had been granted to employees in terms of a share purchase scheme, which had to be accounted for as an equity settled scheme.

Many of these measurement problems related to schemes that were initially implemented 3 to 5 years prior to the issue of the current AFS and often before the existing financial directors' appointment. It would therefore appear prudent for issuers to consider revisiting their accounting for their existing schemes to ensure compliance with IFRS.

Business Combinations

Matter 1 (2019-common disclosure omissions)

The following identical IFRS 3.B64(e) wording appeared in the AFS of multiple issuers.

> "Goodwill acquired in a business combination is allocated from the acquisition date to each of the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination."

The lack of richness of such disclosure is particularly evident when the goodwill is subsequently (sometimes immediately) impaired. Goodwill that comprises a large part of the purchase price is material on a qualitative basis (even if quantitatively not that significant) and requires entity specific disclosures.

Matter 2 (2018/ 9 -common disclosure omissions)

A lack of entity specific factors in support of goodwill recognised for each acquisition (per IFRS 3.B64(e)) was a common disclosure omission identified in the reviews for 2018 and 2019, being the fifth and sixth most common areas respectively.

Matter 3 (2018)
Paragraph 37 of IFRS 3 states that, *"The consideration transferred in a business combination shall be measured at fair value"* which is required to be calculated at the acquisition date. In terms of paragraph 24 IFRS 13 fair value is the price that would be received to sell an asset in the principle market at measurement date. The consideration paid cannot be determined using the 'contractual price' of the shares issued to the vendors. The resultant error in this case led to a material understatement of goodwill.

Matter 4 (2018)
IFRS 10.20 states that the "*consolidation of an investee shall begin from the date the investor obtains control of the investee*". An issuer made an error in their consolidation process by incorrectly bringing pre-acquisition amounts into profit and loss.

Matter 5 (2017)
An issuer raised a contingent consideration liability for a business combination. In terms of paragraph 58 of IFRS 3 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.

Matter 6 (2016)
The assessment of what constitutes 'a business' in terms of IFRS 3 is a judgement matter and issuers often incorrectly provide limited or even no disclosure in this regard. Questions around the lack of disclosure could also lead to the identification of measurement issues and improper recognition of additional assets and liabilities.

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

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

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

Matter 7 (2016)
The FRIP considered the appropriateness of accounting for the acquisition of an industrial property as a business combination (see annexure 1).

Matter 8: Interplay between Financial Instruments and Business Combinations Standards (2015)

In one particular case, an entity issued shares as part of an acquisition, but the agreement provided them with the right to repurchase those shares, should certain profit warranties not be met. The intention of the structure was to immediately provide the sellers with voting rights and economic benefits over all of the shares issued for the acquisition.

On initial recognition the issuer raised the entire purchase consideration against share capital and also recognised a liability for the shares they expected to repurchase, through debiting an acquisition reserve (treated as a deduction in equity). This liability for the contingent consideration was restated at year end, with a fair value adjustment going through profit and loss.

IFRS 3 deals specifically with this issue. IFRS 3: Appendix A includes in its definition of Contingent Consideration as follows; "…contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met." IFRS 3.40 provides that "The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 provides guidance on the subsequent accounting for contingent consideration." In this case, not achieving warranted profit levels gives the acquirer the right to repurchase some of the consideration shares.

The repurchase arrangement meets the definition of contingent consideration and is classified as a financial asset. IAS 32 par 11(d) specifically deals with contracts that will be settled in the entity's own equity instruments. In this instance the arrangement does not meet the equity classification as there are a variable number of shares that can be repurchased. The asset is within the scope of IAS 39 and measurement is at fair value with any resulting gain or loss recognised in profit or loss. IAS 39 is a rule-based standard and contains many 'anti-abuse' provisions. We believe that a general substance over form argument carries little weight when applying this Standard.

During the course of the review process, the issuer decided to restate its results to reflect the correct accounting treatment. It reversed the contingent consideration liability together with the subsequent fair value movement as a prior period error. In the restatement they correctly did not raise a contingent consideration asset in the first year of acquisition as at that stage the judgement was made that the profit warranty would be met and all the shares would be issued. In the second financial year however, they recognised a contingent consideration asset (through profit and loss) equal to the estimated clawback of the purchase price on the basis that the profit warranties would not be met.

The question of how to treat these recallable shares in the earnings per share calculation was the subject of a FRIP referral in 2015 (see annexure 1 for the details).

Matter 9 (2014)
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.

Matter 10 (2012)

A large part of the JSE Requirements deal with acquisitions and disposals by issuers. Through these JSE Requirements, investors are provided with price sensitive information to ensure correct price formation for securities. They are also empowered to approve the larger transactions. It is therefore natural that we want to ensure the accounting for these transactions is complete and accurate in the AFS. Transactions can fundamentally alter an issuer and it is important for investors to be able to evaluate the nature and effect of these transactions.

During the 2012 reviews we continued to find that the disclosure requirements of IFRS 3 were incomplete, potentially prejudicing investors with regards to the information they could use to assess the impact of a transaction. In certain instances the lack of disclosure also led us to question whether the measurement of the business combinations had been correctly applied in terms of IFRS 3. The key types of disclosures that were lacking included:

- the primary reason for the business combination;
- a qualitative description of the factors that make up goodwill recognised; and
- a description of the reasons why the transaction resulted in a gain.

Matter 11 (2012)

Other problem areas included the:

- use of misleading descriptions of fellow subsidiaries as being ‘group companies’; and
- incorrect capitalisation of transaction costs.

Matter 12 (2012)

Another poorly applied area with regards to transactions by issuers related to an unbundling where the two entities were ultimately controlled by the same party before and after the distribution. Our questioning of this Issuer began as there was no accounting policy for the unbundling. It was then discovered that the unbundling was incorrectly accounted for from the legal effective date as opposed to the date that the issuer actually lost control.

Matter 13 (2011)

The following problems/ misapplication were found to exist for this standard:

- The incorrect identification of the date at which effective control passed which had an impact on the measurement of the transactions. The existence in one case of an agency agreement did not override the substance of the transaction and that control of the business had already passed;
- The disclosure requirements of IFRS 3 were incomplete prejudicing investors with regards to the valuable information they could use to assess the impact of a transaction; and
- Incorrect measurement of the contingent consideration applicable to a business combination. The classification of this contingent consideration as either a liability or

equity (which must be done in terms of IAS 32) potentially has implications on the financials on an ongoing basis when re-measurement occurs.

Disclosure of Interests in Other Entities

Matter 1 (2015)

IFRS 12 *Disclosure of Interests in Other Entities*, was effective for financial years on or after 1 January 2013. In last years' report we highlighted various omissions as it relates to the disclosure requirements IFRS 12. Whilst our reviews this year continued to identify numerous problems, it is noteworthy that less problems were identified for Issues in their second year of implementation of this Standard/ where they issued their AFS after we published our 2015 report.

The majority of issues revolved around poor application of paragraphs 7 to 9 IFRS 12, which require disclosure of the significant judgements exercised and assumptions made leading to the accounting treatment in a group situation. These included:

- where an investment was accounted for as an associate despite, various indicators of potential control;
- accounting for an 8% investment as an associate;
- consolidating an entity where less than half of the voting rights are held and vice versa;
- determining that the issuer had a joint operation; and
- the assessment of control for 'cell captives'.

Matter 2 (2015)

As it relates to unconsolidated structured entities, there was a lack of understanding to identify such entities and provide disclosures.

Matter 3 (2015)

There were instances where summarised financial information and other information required for material associates were omitted.

Matter 4 (2014)

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.

Non-current Assets Held for Sale and Discontinued Operations

Matter 1 (2018)
Paragraph 6 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations,* states that a non-current asset should be classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than continuing use.

An issuer bought back stores from departing franchisees with the intention of finding new franchisees to licence the specific sites to. Whilst the classification of acquired stores and related equipment as non-current assets held for sale ("NCAHFS") may have initially been appropriate (year 1), the slow pace of sales of these assets in the subsequent two financial periods demonstrated that the expectation to sell reacquired stores and the related equipment within a one-year period (as required by IFRS 5.8) did not appear to be achievable. Furthermore, subsequent to year 1, a number of the reacquired stores were closed down as they could not be sold. IFRS 5.13 states, assets that are to be abandoned or closed down rather than being sold shall not be classified as held for sale. A significant portion of the carrying amount classified as NCAHFS in year 2 and 3 represented equipment on hand for stores that were being closed down. Despite this fact pattern, the issuer continued to buy back stores and equipment and classify these as NCAHFS.

Given the lack of progress made in selling the reacquired stores and equipment, the majority (if not all) of the reacquired stores and equipment should therefore have been classified as property plant and equipment under IAS 16 rather than NCAHFS in subsequent years. That property plant and equipment should also have been considered for impairment in terms of IAS 36.

Matter 2 (2017)
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 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.

Matter 3 (2016)
During this past year we had another issuer who incorrectly determined the fair value of the investment property as 'fair value less costs to sell' per IFRS 5. IFRS 13 is applicable to determining the fair value of investment property, even if it is subsequently transferred to non-current assets held for sale. In terms of IFRS 13.25 the fair value must exclude transaction costs. Measurement under IFRS 5 is therefore different, as IFRS 5.15 refers to the lower of the assets carrying amount and fair value less cost to sale.

Matter 4 (2016)
Another measurement error related to an issuer who incorrectly continued to raise depreciation on assets accounted for under IFRS 5.

Matter 5 (2015)
Annexure 1 contains the details of a case referred to the FRIP regarding the classification of a discontinued operation.

Matter 6 (2015)
Non-current assets that are accounted for in accordance with the fair value model in IAS 40 are scoped out of the measurement provisions of IFRS 5.

Matter 7 (2015)
Paragraphs 7 to 9 of IFRS 5 explain that the sale must be highly probably and in addition is expected that it will be completed within one year from the date of classification.

Operating Segments

Matter 1 (2016)
We remind issuers that IFRS 8 *Operating Segments,* does in fact apply to entities whose debt instruments are traded in a public market.

Matter 2 (2013)
The misidentification of the chief operating decision maker was discussed in our prior reports and regrettably we continued to have problems in this area. As a reminder, in terms of IFRS 8, operating segments are identified as components of an entity whose results are regularly reviewed by the chief <u>operating</u> decision maker. It is also contradictory when management discusses in great detail a particular component of the business in the annual report or in other communication to investors, but does not then identify that component as an operating segment for segmental reporting purposes.

Matter 3 (2012)
In one instance, there was a complete omission of the segmental report. In addition, certain disclosure requirements of IFRS 8 were poorly complied with. This was even more prevalent where the issuer had not identified any segments and therefore incorrectly disregarded the rest of the IFRS 8 requirements. Problems included:

- the reconciliation not agreeing to total profit and loss;
- a lack of geographical information; and
- a lack of information regarding major customers.

Fair Value Measurement

Matter 1 (2019-common disclosure omissions)
On more than one occasion issuers did not provide required disclosure for 'commercial reasons' i.e. that it could cause competitive harm.

The IASB considered whether entities should be exempted from certain aspects of IFRS if the disclosure could cause competitive damage or erosion of shareholder value (IFRS 8.BC43).

> "*The Board concluded that a 'competitive harm' exemption would be inappropriate because it would provide a means for broad non-compliance with … IFRS (and that) most competitors have sources of detailed information about an entity other than its financial statements*" (IFRS 8.BC44).

Whilst this matter was considered in the IASB's deliberations to the development of IFRS 8, we believe it to be equally applicable to IFRS as a whole. No IFRS specifically exempts an entity from making a required disclosure on the basis of commercial reasons or competitive harm.

If a significant quantitative unobservable input used in the fair value measurement is 'selling price', then this figure must be disclosed in terms of IFRS 13.93(d).

Matter 2 (2017/ 8 /9 -common disclosure omissions)
Lack of details regarding unobservable inputs used in valuation models (per IFRS 13.93) was the fourth most common disclosure omission identified in both the 2017, 2018 and 2019 reviews.

Matter 3 (2016)
The interest rate valuation team of the JSE issued a report in 2014 titled "Debt Market, Mark to market valuation rules". That report inter alia highlighted the following:

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

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

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

Matter 4 (2016)
When dealing with a level 3 classification, issuers are reminded that they must provide detailed disclosure of the inputs used in their valuation, together with a narrative description of the sensitivities (IFRS 13.93(d-h)), if the debt instruments are measured at fair value. Where debt instruments are measured on a basis other than fair value but fair value is disclosed, disclosures are less onerous but are still required (see IFRS 7.97). Several issuers' disclosure was lacking in this regard.

Matter 5 (2016)
There was an instance where an issuer owned investment property and had incorrectly classified this as a level 2 fair value. Given the requirement that these inputs be observable (IFRS 13.81), it is highly unlikely that property in the South African market will meet the criteria for a level 2 fair value classification.

Matter 6 (2016)
We questioned why an issuer had classified unlisted preference shares within the level 2 fair value hierarchy per IFRS 13. It emerged that unlisted preference shares (some of which were regarded as being level 2 and some level 3 fair values) had been categorised incorrectly as being 'measured at fair value through profit and loss' (in terms of IAS 39). The corrected categorisation revealed that these instruments were a combination of 'held to maturity' and 'loans and receivables' assets. In both cases the correct measurement basis that should have been applied to these preference shares was amortised cost.

Matter 7 (2016)
The classification of a financial instrument as being within the level 2 fair value hierarchy (in applying IFRS 13*),* requires inputs into the fair value calculation be observable either directly or indirectly (IFRS 13.81). An issuer incorrectly classified their operational financial instruments such as trade receivables and trade payables, finance leases, loans receivable and loans payable as being level 2 fair values as opposed to level 3 fair values. As a result of this incorrect classification, inter alia, the additional inputs (see IFRS 13.93(d) and IFRS 13.97) required for level 3 instruments were also omitted.

Matter 8 (2015)
The main area of concern related to the omission of detailed disclosure for level 3 fair value assets/liabilities. Given that this is the lowest ranking in the fair value hierarchy, adherence to the disclosure requirements is arguably even more important than for others within the fair value hierarchy. That this information was omitted for assets critical to the businesses of the issuers under review is of concern, and we had specific problems with issuers owning biological assets. issuers must take care to provide specific quantified information. The types of information found lacking for these level 3 valuations included: use of valuation techniques, inputs, sensitivity analysis and the actual amount of the gains/ losses included in profit.

Matter 9 (2015)
Certain assets/ liabilities were incorrectly classified within the fair value hierarchy. These included:

- investment property being classified as a level 2, when it fell within the level 3 category; and

- assets used for hedging purposes of a share incentive scheme being reflected as level 1 as opposed to level 2.

Matter 10 (2015)
There was an instance where there was a complete misunderstanding of the concept of fair value and how this to calculate this for a particular financial instrument.

Company AFS

Company AFS may provide significant additional information for the users of AFS when considering transactions (such as mergers or listing) involving an issuer's subsidiaries. It is for this reason that the review process considers both the group and individual company AFS.

Matter 1: Fair value measurement (2019)
An issuer did not correctly apply IFRS 13 to its fair value calculation for its investments in subsidiaries in the Company AFS, overstating an investment by 35%. Fair value is defined as:

> "*the price that would be received to sell an asset…. in an orderly transaction between market participants*" (Appendix A; IFRS 13).

Understanding the unit of account is critical in a valuation. The holding company's fair value calculation of its equity instrument in a subsidiary ("the equity FV") must be determined independently of any other relationships between the two entities. The issuer determined the fair value on a net asset basis ("NAV") and made inappropriate adjustments in two areas:

- The holding company advanced a loan to its subsidiary. The NAV should not have been increased by adding back the loan when determining the equity FV. The loan is a financial liability of the subsidiary, a separate legal entity. From its perspective (and a market participant) this is external debt. The liability can only be derecognised by the subsidiary when the obligation in the contract is discharged, cancelled or expires. The fact that the issuer impairs the loan (in its own accounts) because it is not expecting to receive repayment has no bearing on the subsidiaries assessment of that liability if the derecognition provisions of IFRS 9.3.3.1 have not been met.
- The subsidiary had deferred tax liabilities representing the potential tax consequences of recording its own assets at fair value. These deferred tax liabilities were used to reduce the NAV of the subsidiary. It was incorrect to subsequently add back the deferred liability when determining the equity FV. (The issuer's arguments were that it was eliminating 'double counting') Any deferred tax consequences of the disposal by the holding company must be recognised separately on the statement of financial position of holding company.

Matter 2: Loans to subsidiaries (2019)
The treatment of loans to subsidiaries was a problem area for several issuers. Accounting policies were either absent or vague. Furthermore, given the significance of the accounting consequences of applying different policies, it is an area that warrants disclosure as an area of significant judgment (per IAS 1.122).

In the separate Company AFS, the loan from a holding company to its subsidiary would either be regarded as part of the net equity investment or as financial asset.

If the loan is classified as a financial asset, rather than part of the net equity investment, it is subject to impairment testing under IAS 39 (now IFRS 9). Such an impairment exercise must take into consideration the contractual cashflows of the loan and the expectation of recovery through repayment. This is a very different calculation to the impairment exercise for an investment under IAS 36 which may (under the discounted cashflow model) consider expected business activities, divorced from the contractual arrangement. Furthermore, the disclosure obligations of any subsequent impairment loss are different under the two routes.

ANNEXURE 1 – Activities of the FRIP

The content set out below reflects extracts from the reports received from the FRIP on these specific matters.

Application of the going concern basis of accounting where business rescue is imminent (2015)

In the specific matter, the issuer was suffering financial difficulty and various material uncertainties existed as to future contracts, the ability to convert preference shares to equity and other matters. Some disclosure on these matters was provided in the entity's 2013 provisional results, 2013 AFS (issued in September 2013) and 2014 interim results (issued in November 2013). Ultimately, the issuer commenced business rescue proceedings in December 2013. The JSE raised a question as to the use of the going concern basis of accounting for the various financial reports.

IFRS do not define the terms '*going concern*' or '*material uncertainties*', nor do these standards give guidance on the assessment thereof.

Paragraph 4.1 of The Conceptual Framework for Financial Reporting states that:

> *"financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations: if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed."*

IAS 1, in paragraph .25 states that:

> "*(w)hen preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do s*o. *When management is aware, in making is assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.*"

As IFRS do not provide guidance on how the going concern assessment should be performed and how judgement in this regard should be exercise, it is evident that the decision to assume that an entity is a going concern and therefore applying the going concern basis of accounting, is one to be made by management. Such decisions require, in most circumstances, a very high degree of judgement.

Even though the FRIP could therefore not conclude on the appropriate use of the going concern basis of accounting, it stressed that IFRS recognise that judgement is required and that disclosure should be provided on the assumptions and uncertainties considered in the exercise of such judgement.

Such disclosure on judgements and assumptions as well as material uncertainties were lacking in the various sets of reports issued by the issuer. Furthermore, where provided, the pieces of information disclosed were fragmented, making it difficult for the reader to understand the full picture in so far as the entity's financial status and related material uncertainties were concerned.

As the entity was not trading on the JSE anymore, no recommendations could be made as to this entity's reporting. However, considering the importance and relevance of the matter in other instances, the FRIP recommended that the JSE consider issuing guidance for listed entities, encouraging them to provide financial statement disclosure on judgements, assumptions and material uncertainties relating to going concern in a single place under the heading '*going concern*'. Furthermore, sufficient emphasis should be given to ensure that readers are pointed to such disclosure. Such disclosure should be required when any one of the following applies:

- technical solvency or liquidity is not reached;
- a 'close call' exists in so far as the appropriateness of the going concern assumption is concerned;
- a material uncertainty exists that cast doubt on the entity's ability to continue as a going concern;
- the entity is in business rescue; and
- the auditor's report is either qualified, disclaims an audit opinion or modifies the audit opinion by placing an emphasis of matter on going concern.

Cash flow Statement: equity-settled share-based payment arrangement (2017)

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 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, states the following:

- 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 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

Determining the residual value of property in the application of the IAS 16 revaluation model (2015)

The issuer concerned had a stated accounting policy that "directors are of the opinion that the fair market value of property equals the estimated residual values and thus that no depreciation is recognised."

The entity explained that it manages its owner occupied property as though it is occupied by a third party tenant and therefore third party valuations are done on a regular basis. They were of the view that as a result of the current trends, based on historical information and third party valuations received, the values of the assets are increasing at a rate higher than inflation. Based on this, the entity's expectation was that the amount to be received on sale (residual value) would be an amount that not only exceeds the fair market value, but also reflects an amount that is higher than current inflation rates.

IAS 16.BC 29 explains that:

> "*the Board concluded that an entity's expectation of increases in an asset's value, because of inflation or otherwise, does not override the need to depreciate it. Thus, the Board changed the definition of residual value to the amount an entity could receive for the asset currently (at the financial reporting date) if the asset were already as old and worn as it will be when the entity expect to dispose of it*".

The FRIP concluded that the fair value valuations method applied by the entity, calculating a future value and to which it applies a discount rate to determine a present value, is not in line with the definition of residual value described in IAS 16.

Furthermore, the entity did not provide adequate disclosure regarding the measurement basis, the assumptions and other relevant information, as required by IAS 16 and IFRS 13.

Revaluation of property accounted for in terms of IAS 16 (2014)

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*, 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*, 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.

Accounting treatment of advertising rebates (2017)

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 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.

Revenue recognition (2018)

IAS 18, paragraph 20(b) requires revenue relating to the rendering of services to be recognised subject to it being probable that the economic benefits associated with the transaction will flow to the entity. Therefore, this probability of future economic benefits is an estimation made at initial recognition and hence a threshold as to whether the rendering of the services meets the recognition threshold, or not.

The issuer's accounting policy in respect of revenue recognition stated that revenue is measured at the fair value of the consideration received or receivable. The accounting policy further states that in order to determine the probability of receipt of payment and expected future economic benefits, historical data was considered.

Over time, as data on revenue collection was gathered, it became apparent that some customers had no intention of paying for the service levied by the issuer, or were not paying for the service in the required 31 days. Both these categories of customers introduced different levels of uncertainty as to the probability of the inflow of future economic benefits, and hence the Issuer's revenue recognition policy. In effect these two new categories that emerged among customers provided the issuer with a basis to segment revenue streams into those that are probable of collection and those that do not meet the revenue recognition criteria.

IAS 1, *Presentation of Financial Statements*, paragraph 122 requires an entity to disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimation, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. IAS 1.125 requires disclosure of information about the future and other major sources of estimation uncertainty at the end of the reporting period, that have significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities.

The FRIP concluded that the revenue recognition policy consisted of boiler plate IFRS language only and provided very little indication to the users of the financial statements as to the assumptions the issuer made about the future and other sources of estimation uncertainty in respect of the various segments of revenue.

The issuer's accounting policy and other disclosures relating to assumptions and risks were unclear as to what assumptions were applied in determining the amount of revenue to be recognised with respect of services rendered, considering delinquent payers and late payers.

The probability of future economic benefits flowing from the latter two was less likely and therefore consideration should have been given as to what portion of such revenue, if any, should be recognised. Furthermore, disclosure in respect of such assumptions should have been provided in the financial statements.

It was evident that revenue recognition in the years under review did not consider the probability of future economic benefits and hence the full revenue number was recognised,

which was later subject to impairment provisioning. As a result, the allocation between revenue and impairment losses was inaccurate. However, as it would have been extremely complex for the issuer to correct the matter in prior financial years, and considering the benefit of hindsight, the FRIP concluded that a prior year correction would be impracticable.

Venture capital exemption in terms of IAS 28 (2019)

The issuer held a number of businesses in another jurisdiction through a structure that was an associate and was previously equity accounted. In the year under review, they elected to measure these operations at fair value through profit and loss, using the venture capital exemption in IAS 28.18.

Whilst paragraphs 18 and 19 of IAS 28 deal with accounting for investments held by venture capital organisations, a venture capital organisation is not defined in IAS 28 or elsewhere in IFRS.

The FRIP concluded that, even though a venture capital organisation is not defined in IFRS, the Basis for Conclusion to IAS 28 provides an indicator (in BC 19I) that such organisations represent "a narrow population" and hence, there are not many entities of this nature. Based on the information presented to the FRIP, the investments did not seem to meet what would reasonably be considered as criteria for, or characteristics of, a venture capital organisation.

Furthermore, the FRIP considered there to be similarities between a venture capital organisation and an investment entity as described in IFRS 10. The structure through which the issuer held its investments in the foreign operations was a common phenomenon in groups and the nature of their structure did not seem to align with the definition of an investment entity, as set out of IFRS 10.

In respect of the appropriateness of the change in accounting policy, the issuer explained that the investment objective through this foreign structure had changed during the financial year, resulting in it being treated as a venture capital division of the group from the date of such change. The FRIP decided that even if it could have been regarded as venture capital organization (which per the above discussion was not the case), IAS 28 (the 2011 version which was applicable for the results under question) specifically required a fair value election to be made only at initial recognition of the investment. There was no option to change the accounting treatment thereafter from equity accounting to fair value. All but one member of the review committee was therefore of the opinion that the change in accounting policy was inappropriate and not in line with the guidance in paragraphs 10 and 11 of IAS 8 and the clarifications provided in the 2016 amendments to IAS 28.

Recognition and measurement of impairment losses on receivables (2018)

In respect of the same issue to which the revenue recognition matter 3 set out above referred, the JSE questioned the level of impairment of receivables which was not aligned to cash collections, the growth in the outstanding receivables, as well as the issuer's disclosure in its annual financial statements in terms of recovering these receivables.

The issuer argued that the non-payment by its customers constituted a criminal offence and, as such, debt never prescribes and it is inappropriate for it to be impaired.

The JSE questioned why the fact that this application of the legal framework, which interferes with the effect of the application of IFRS, was not disclosed as a departure from IFRS in the issuer's accounting policies. The issuer argued that there has been no departure from IFRS in determining the impairment of receivables and explained that, in the following year's financial statements, on the back of more and better data in respect of receivables being available a greater proportion of receivables were impaired. Therefore, the increased impairment charge was accounted for as a change in estimate.

IAS 39.58 requires an entity to annually, at the end of every reporting period, assess whether there is objective evidence that a financial asset or group of financial assets is impaired. Paragraph 59 refers to events that occurred after the initial recognition of the asset and that such loss events have an impact on the estimated future cash flow of the financial asset or group of financial assets. It also refers to possible combined effects of several events that may have caused the impairment. Examples of loss events mentioned include, *inter alia*, a breach of contract, such as a default or delinquency in interest or principal payments; observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, etc.

IAS 39.63 states that *"(i)f there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the <u>present value of estimated future cash flows</u> (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognised in profit or loss*".

IAS 39.64 requires an entity to first assess "*whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph 59). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment*".

IAS 8, in paragraph .5 describes a change in accounting estimates as "*an adjustment of the carrying amount of an asset or a liability … that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.*

Changes in accounting estimates result from new information or new developments and, accordingly, are not correction of errors".

IAS 8.5 describes prior period errors as "*omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements*".

In terms of IAS 8.36 the effect of a change in an accounting estimate is recognised prospectively in the period of the change, whereas paragraph .42 requires an error to be corrected retrospectively in the period on which it occurred, by restating opening balances.

IAS 1, paragraph 32 states that *"(a)n entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS*".

In the specific instances, it was evident to the FRIP that impairment indicators existed for the group of financial assets in that large groups of debtors chose not to pay for the services rendered.

The issuer should, in terms of IAS 39, have segmented its debtors' book in terms of similar risk characteristics for purposes of calculating the level of impairments, taking into account the incurred loss events and after adjusting for the appropriate revenue recognition. Both these aspects would have a material impact on both the revenue and the impairment as reported.

Furthermore, despite the accounting policy stating otherwise, the debtors were not discounted in earlier financial reporting periods. This was corrected in latter periods. Given the change in the methodology, further disclosure should have been provided in terms of how this affected the recognition of revenue. Further, the accounting effect of debiting interest income and crediting the debtor was inappropriate. Instead, the debtors should have been recognised initially at the present value of the expected amounts to be received, if determined to be required in terms of IAS 18 and SAICA's Circular 2/2017, *Determining revenue/purchases as a result of financing components* ("SAICA Circular 2/2017"). Any impairments thereafter, either through a reduction in the amounts expected to be received, or delayed settlement, would result in an impairment loss that should have been recognised separately in the income statement, and not against interest income.

Accounting matters relating to linked units in a property entity (2015)

Measurement of the debenture liability

This issuer, as commonly found in the property sector, has linked units consisting of a share and a debenture portion. The entity recognised the debenture portion of these linked units at a nominal value, similar to the recognition of share capital.

The FRIP concluded that this treatment was not in compliance with IFRS, which requires that each issue of debentures should be recorded initially at fair value. Fair value, as required by

various standards, should be determined by discounting the forecast distributions over the expected life of the debentures. Alternatively, the fair value could be determined by making an adjustment to the quoted price of the linked units to exclude the estimated fair value of the ordinary shares. Such value could be based on the discounted present value of the shareholders' residual interest in the company after the debentures have been redeemed.

Had the debentures been recorded at fair value (instead of nominal value) there would have been either a premium or discount. The premium or discount (as applicable for each issue of the instruments) should be amortised over the expected life of each issue of debentures by inclusion in the calculation of the effective interest rate.

Deferred consideration in relation to the acquisition paid for in shares
The entity was due to issue a number of linked units at a fixed price as the part payment of an investment property acquisition. The entity noted that the linked units were only subscribed for after year end. As a result, the entity recognised the amount at the original unit price as deferred consideration, as part of its unitholders' interest.

The FRIP concluded that deferred consideration should be apportioned between the liability and equity components on the basis of the fair value of the debentures, with the equity portion equal to the difference between that amount and the value attributable to the linked units to be issued.

Each component of the deferred consideration should be presented separately in the Statement of Financial Position, with the equity component reflected appropriately in the Statement of Changes of Shareholders Equity.

Further errors were also identified in the entity's disclosure of this matter, in the notes to the AFS and in the Statement of Cashflows.

Property Industry – Antecedent Interest (2014)

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.

Treatment of recallable shares in the calculation of IAS 33 (2015)

The issuer in this case acquired another entity and settled the purchase price by issuing a set number of shares. Some of the shares were issued without restriction. The remaining shares were issued, but kept in trust by the entity's attorneys as a profit warranty. To the extent that the profit target was not met, the proportionate number of shares would be recalled by the entity. The full number of shares were issued and accounted for as such. Dividends related to the restricted shares were also to be held in trust, to be released to the extent that the profit target was met.

The JSE asked the FRIP to consider the merits of excluding the recallable shares in the denominator for earnings per share.

IAS 33.24 states that:

> "*outstanding ordinary shares that are contingently returnable (i.e. subject to recall) are not treated as outstanding and are excluded from the calculation of basic earnings per share until the date the shares are no longer subject to recall*".

The FRIP concluded that the treatment of the recallable shares were correct.

Share based payment – preferred fair value measurement basis (2014)

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*. 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.

IFRS 2 and share incentive schemes containing a cash settlement option (2013)

The terms of an equity settled share based payment scheme permitted settlement in cash at the option of the issuer. In the first year of vesting the issuer settled certain of the employees share appreciation rights ("SARS") in cash when requested to do so by the employees. In the subsequent years, further SARS were settled in cash, even in instances when no request was made by the employee.

The issuer continued to treat the SARS as equity settled on the basis that the decision to settle in cash was made at settlement date based on an assessment of the commercial and economic factors, and what would be most beneficial to the Issuer. The issuer had no stated policy with regards to cash settlement and contended that it thus did not have a present obligation of cash settlement, and continued to treat the scheme as equity settled.

Given the above fact pattern the SARS should have been treated as cash settled in terms of paragraphs 41 to 43 of IFRS 2. In considering this matter the FRIP noted that:

- Past behaviour and patterns of generally settling in cash shed light on the assessment of the likely conduct in the future indicating a rebuttable presumption of likely conduct;

- In circumstances where the issuer cash settles the majority of SARS, this would be an indicator that a practice has been developed of settling SARS in cash (irrespective of its stated policy in this regard);
- Settlement in cash, even when not requested to do so by the holder of the right, would point to conduct of generally settling in cash, and establishes a business behaviour in relation thereto;
- The settling in cash in those circumstances (without the request from the holder of the right), would in fact be a stronger indication of an obligation to settle in cash than the circumstance in IFRS 2 paragraph 41 which contemplates that the counter-party specifically requests cash settlement;
- Even if the original intention was to settle in shares, in the issuers case, the settlements in cash indicated a practice of cash settlement, which would drive the accounting thereafter; and
- For completeness, the assessment of whether the SARS were cash or equity settled would be a significant judgement that should be disclosed in terms of IAS 1.

Accounting for the acquisition of a property in terms of IFRS 3 (2015)

An issuer obtained an industrial property consisting of a building and some vacant land. One of the reasons for the acquisition to obtain the land that was situated in a location convenient to cater for future expansion of its existing factory. The JSE questioned whether it was appropriate to account for this acquisition as a business combination.

The FRIP recognised that it might be appropriate to recognise the acquisition as a property, however, there was nothing in IFRS 3 which precluded the entity from applying this standard to the acquisition, in these specific circumstances. Nevertheless, the disclosure regarding the manner in which IFRS was applied in these was lacking.

Classification of discontinued operations and the treatment of the loss on discontinued operations in the calculation of headline earnings (2015)

In this case, the issuer recognised a loss from discontinued operations, which it excluded from headline earnings, arguing that the loss related to non-trading activities due to the ceasing of operations. Therefore, the loss related to the winding down of the plant and its related activities.

Upon further investigation during the review process, it was evident that the entity made a decision in the previous financial year to discontinue the specific operation. The business was sold as a going concern after being operational and recognising income and expenses for most of the financial year. No profit was derived from the sale of the going concern business.

In addition to this, some inventory had to be converted and sold separately due it its hazardous nature and the lack of a buyer in its unconverted state. This activity led to the loss on discontinued operations.

The FRIP concluded that this inventory did not form part of the disposal group as it was sold separately, under a separate process, with different timelines and seemingly to different buyers. It therefore had to be accounted for in terms of IAS 2 and not IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations.*

Furthermore, the loss could not be excluded from headline earnings.

Disclosure of non-IFRS performance measures as part of segmental reporting (2019)

This matter involved several issuers (mainly in the REITs sector), relating to the appropriateness of disclosing entity-wide performance measures (non-IFRS disclosures) within the IFRS 8, analysis note of the AFS, as well as the appropriateness of including 'other' information within the AFS, which create the impression that it is IFRS information.

Segmental information
This concept of providing additional disclosures beyond the IFRS requirements is addressed in paragraphs 17(c) and 31 of IAS 1. IFRS 8.20 states that the objective of the standard is to allow the users of the financial statements to evaluate the nature and financial effect of business activities.

The IFRS 8 disclosures focus on the measures of performance of each segment (which per IFRS 8.5 is a component of the entity) used by the chief operating decision maker to allocate resources to, and assess the performance of, the segments.

Since the alternative performance measures in question were provided only on an entity-wide basis (they were not calculated and used by the chief operating decision maker at a segment level), the FRIP was of the opinion that the placement of these entity-wide alternative performance measures within the segment report was not in line with the purpose of the IFRS 8 disclosures. Although IFRS 8 does require specified entity-wide disclosures to be provided, the purpose of such disclosures is to provide more disaggregated information on an IFRS basis. For example, information is required about different products and services, different geographical areas and major customers.

Whilst the inclusion of entity-wide alternative performance measures in the financial statements is not prohibited by IFRS (including IFRS 8), the FRIP was of the opinion that the placing of such entity wide performance measures was not intended to form part of the IFRS 8 disclosure.

The inclusion of other information, with specific reference to alternative performance measures, as part of IFRS disclosure, not specifically required by IFRS
The integrity of financial reporting as set out in terms of IFRS should be guarded. Therefore, users should have certainty as to the labelling of information – that segmental information is actually that, and not an alternative performance measure.

This is supported by the principle in IAS 1.85A in respect of the prominence of non-IFRS disclosure, which aims to ensure that other information is not more prominent than IFRS

disclosures, as this could lead to confusion. If alternative performance measures (not defined in IFRS but included among other IFRS required disclosures) are not identified as such, this may not result in faithful representation. Users might be unaware, in the absence of appropriate labelling and explanations, that these are non-IFRS measures.

Property investment – consolidation (2019)

The issuer held a 32.7% share in a company (X Limited), which was increased to 53.5% in the year under review. The purpose of X Limited was to obtain loans to fund the acquisition of buildings, further develop these and lease out the properties. Despite the shareholding exceeding 50%, the issuer continued to account for the investment as an associate on the basis that the shareholding was less than 75 %, which it deemed to be the mandated majority for decisions of reserved matters per X Limited's memorandum of incorporation ("MOI").

Detailed consideration was given to the content of the specific clauses within the MOI and the FRIP agreed unanimously that a number of the reserved matters (that were subject to shareholders approval at a special resolution level) were protective in nature.

A majority of the members of the review committee were of the opinion that some of the reserved matters were of a much more substantive nature and that the ability to direct the relevant activities therefore rested with the shareholders, through special resolution. Therefore, there was no clear indication that the issuer controlled X Limited.

A minority were of the opinion that all of the reserved matters as set out in the MOI of X Limited, were only protective in nature, and not related to the relevant activities as intended by IFRS 10. Therefore, they were therefore of the view that the issuer controlled X Limited and it should be consolidated as required by IFRS 10.

In this particular case, the JSE decided not to pursue the matter any further.

Consolidation of an empowerment trust

In this instance the issuer formed an education trust, with primary objective of introducing an empowerment partner for the group. At the time of formation, the trust purchased 15% of the issued share capital of an operating subsidiary of the group, utilising an irrevocable donation it received from the issuer. The subsequent operating activities of the trust were funded from dividends earned from its shareholding in the operating subsidiary. On an annual basis, a discretionary amount was determined by the issuer and paid via dividends to the trust. This dividend was applied to support the trusts activities, which mainly involved awarding bursaries to students.

In terms of the trust deed, the issuer had the right to appoint the trustees and, since the trusts' formation, the trustees were those selected by the issuer. The trust deed originally required the use of the donation to acquire shares in the operating subsidiary and these remained the investments of the trust. The current and past investment direction was dictated by the trustees appointed by the Issuer.

Despite the fact that the issuer appointed the trustees of the trust, the trustees were not required to obtain approval from the issuer or any other party in order to execute their duties; the issuer had no right to repurchase the shares held by the trust; and the trustees were empowered to dispose of the investments of the trust as they deem fit. The issuer was not, directly or indirectly exposed to any financial returns from the trust and did not guarantee the performance of the trust or provide loan funding in any form to the trust. Furthermore, there were no restrictions precluding the trust from making additional investments or disposing of the original shares.

The focus for the FRIP was the consolidated financial statements of the issuer (i.e. the listed entity) only, and not the financial statements of the trust or the entity itself.

Economic substance of the transaction
Key to considering the transaction was the understanding of the power over the relevant activities of the trust in relation to the shares. Whether it was a direct donation of shares, or seed capital that was required to be used to acquire the shares, was considered to be irrelevant. Prior to the donation, the shares (being unissued), were under the power of the issuer. Subsequent to the donation (considering that the trustees had full discretion over the investment direction) the current and past investment direction were dictated by the issuer. The issuer did acknowledge that it had the power over the relevant activities of the trust.

The FRIP considered that, in substance, the shares issued to the trust and its related dividends were merely a legal conduit to ensure that this discretionary amount of cash was channeled to the trust for distribution purposes in line with the issuer's corporate social investment ("CSI") mandate. The trust was a vehicle to further the issuer's BEE credentials and social investment activities, hence supporting its corporate citizenship role. [In addition to the original BEE status achieved through the establishment of the trust, the impact that the ongoing activities of the trust had on the issuer's reputation was expected to provide an advantage to the issuer when transacting in the South African environment, for example tendering for business.]

As the issuer has no recourse on the donation and there were no put or call options in place between the trust and the issuer, the FRIP further considered whether the shares would be seen as issued (at a later date). It was noted that, if the shares were to be controlled by independent third party, then they would be considered as having been issued. This could occur if, for example, the trust was to dispose of the shares to a third party, or if the issuer relinquished its power (embedded in the trust deed) over the relevant activities of the trust. Notwithstanding these considerations, the FRIP concluded that this had not yet occurred, and the shares should be treated as not having been issued. This further supported that the view that the structure was merely the round tripping of the cash- the issuer did not raise any additional capital through the issue of the shares.

As the shares were, in substance, not considered to have been issued, the FRIP concluded that there was also no non-controlling interest in the equity instruments of the issuer. Beneficiaries of the scheme only benefited to the extent of dividends that were paid as

bursaries. Capital appreciation of the shares remained under the power of the issuer (via the appointment of the trustees).

Further, the dividends relating to the affected shares remained within the issuer. There in substance not paid by the issuer, and should therefore not have been recognised as a distribution to shareholders. Instead, a CSI expense should have been recognised as and when bursaries were granted by the trust. Such expenditure should have been recognised in the Statement of Profit or Loss, rather than in the Statement of Changes in Equity.

Comments on IFRS 10 control criteria
The FRIP considered whether the issuer met the requirements as set out in IFRS 10.07 in respect of controlling the investee. The issuer had the power over the investee's relevant activities by virtue of having the ability to appoint the trustees. This also afforded the issuer the ability to use its power over the trust (through the appointment of trustees) to change and amend arrangements and decisions by the trust. The trust deed clearly stated that the donation by the issuer at the time of establishing the trust, had to be used to buy shares in the operating subsidiary.

In respect of the exposure or rights to variable returns, the issuer obtained, and continued to obtain, non-financial benefits from the trust, most pertinently in the form of its BEE ownership and CSI credentials. Therefore, the FRIP was of the view that there were strong grounds for the trust to be consolidated. However, as the substance of the trust was merely that of a conduit for cash disbursements to (primarily) students, and that the shares were considered in substance not to have been issued (i.e. not an asset of the trust), the accounting consequences of consolidation would result in a similar accounting treatment for the issuer as concluded above.

Consideration as to the existence of a non-controlling interest
The FRIP was of the opinion that, the shares were fully under the control of the issuer and no non-controlling interest existed.

Consolidation of BEE trusts (2018)

Two related matters were involved in this instance. Firstly, the JSE questioned the manner in which the issuer accounted for its arrangements with trusts and whether those trusts should be consolidated. If not, the JSE questioned whether IFRS 12 applies to these trusts, with specific reference to additional disclosure requirements in certain instances.

The issuer has made investments in trusts as charitable institutions which are registered as public benefit organisations. They have been identified as corporate social responsibility vehicles as well as its choice for BEE initiatives. The JSE questioned whether these trusts should have been consolidated since some of the trustees are employees and/or directors of the issuer and the group of companies to which issuer is related, and hence not independent. The JSE also questioned the nature of the returns and to what extent the issuer has power to remove and replace trustees etc. in order to establish whether issuer has control, joint control or significant influence over these trusts. Lastly, if it is appropriate not to be consolidated the

JSE questioned whether the trusts meet the definition of structured entities as defined in Appendix A to IFRS 12 in which case further disclosures are required.

IFRS 10

- Paragraph 5, states that an "*investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee*".
- Paragraph 6 and 7, state that control is achieved when the investor is exposed the variable returns from its involvement in the investee and has the ability to affect those returns through its power over the investee. Power is described as the right that gives the investor the current ability to direct the relevant activities of the investee.

In assessing control and whether such power as described exists, consideration should be given to the nature of the investor's relationships with other parties and whether those parties are acting on the investor's behalf. For example, as per IFRS 10, BC 75, related parties include an investee for which the majority of the members of its governing board or key management are the same as those of the investor or a party that has a close business relationship with the investor. BC 69 states that only one party, if any, can control an investee.

IFRS 12

- Appendix A, defines a structured entity as an "*entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements*".
- B22 – B24 elaborate on features and attributes of structured entities, such as restricted activities, a narrow and well-defined objective, insufficient equity to permit the entity to finance its activities without subordinated financial support and financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks.
- Paragraph 24, requires the investor to disclose information regarding its interest in a structured entity in order to enable users to understand the nature and extent of its interest as well as to evaluate the nature of, and changes in, the risks associated with its interest in the unconsolidated structured entity.
- Paragraph 29, further requires an entity to provide disclosure in respect of the nature of risks, by providing information in a tabular format of "*(c) the amount that best represents the entity's maximum exposure to loss from its interest in unconsolidated structured entities, including how the maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interest in unconsolidated structured entities it shall disclose that fact and the reasons*".

- BC 97 states that an entity would be required to provide additional information about the assets and funding of structured entities, if relevant to an assessment of its exposure risk.

In determining whether the issuer has power to direct the relevant activities of the trusts, consideration should be given to the existing trustees. Extensive questions in this regard were asked and answered in the correspondence between the JSE and the issuer. In essence, the trusts, which perform similar services for another and related issuer, seemed to have very

loose, unstructured and undocumented arrangements by which both issuers have influence on the decision making of the trust, through employees who serve as trustees. Furthermore, both issuers provide material amounts of funding to the trusts, in addition to external debt from a bank.

Based on the information provided, the FRIP could not conclusively determine that the issuer has control over the trusts, or that the two issuers collectively have joint control over the trusts. Although evidence of joint control of the trusts was identified, the lack of rights to the assets and obligations for the liabilities ruled out the classification as joint operations and the lack of rights to the net assets of the arrangements ruled out the classification as joint ventures.

It appears as if these structures and arrangements were very cleverly designed to avoid meeting the control definition and hence the need for either issuer to consolidate the trusts. However, the underlying commercial arrangements, including the lack of documentation, brought into question whether this was a conscious attempt to circumvent IFRS.

The FRIP is however not tasked with making business judgements or investigating the matter by interviewing role players. The role of the FRIP is to consider the appropriate application of IFRS based on information and facts presented. To this end, the FRIP could not conclude that the issuer was incorrect in not consolidating the trusts.

In this matter, the FRIP held the view that it should place on record that huge unease existed in this matter that the issuer, through its joint arrangements with the related issuer in respect of these trusts, appeared to have designed the structures and arrangements in a manner to avoid consolidation.

[By way of feedback, the JSE wishes to advise that it gave careful consideration to the FRIP's concerns set out above. It decided, in this instance, not to pursue this aspect any further given that the other party to the structure had already restated its results to consolidate the trust, and IFRS 3 BC 69 states that only one party can control an investee.]

This led to the next consideration for the FRIP, as to whether the trusts should be classified as unconsolidated structured entities, as defined in IFRS 12. The description of structured entities aligns with the information provided by the issuer in so far as the nature of the trusts and the arrangements of the issuer with the trusts are concerned.

The FRIP therefore concluded that the trusts are unconsolidated structured entities and hence the disclosure requirements in that regard, per IFRS 12, should have been provided. As an unsecured lender, the recoverability of the loans provided by the issuer to the trust is subject to the risks attached to the financial performance of the trusts. Inadequate disclosure was provided, especially in respect of the requirements of IFRS 12 in so far as the nature and changes in the nature of the risks associated with the issuer's interest in the unconsolidated structured entities, is concerned, especially in light of its announcement as to the anticipated impairment of the loans to the trusts.

ANNEXURE 2 – Other activities of the JSE

Loans and security furnished to subsidiaries and for the benefit of directors (2018)

The content of a pre-listing statement is governed by both IFRS (in terms of the historical information included therein) and the JSE Requirements. Following a formal investigation process, the JSE made a finding against an issuer which led to both a fine and a public censure. The details of the accounting matter are set out below.

Applicable IFRSs:

- paragraph 18 of IAS 24 requires disclosure of the amount of related party transactions as well as details of any outstanding balances, commitments and guarantees given or received; and
- IFRS 7.36 read with IFRS 7.B9 and B10 requires disclosure of the amount that best represents the entity's maximum exposure to credit risk which includes activities such as granting financial guarantees i.e. the maximum amount that an entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.

Applicable JSE Requirements:

- paragraphs 7.20 and 7A.22 ask for detailed disclosure (per 7.A20(a) to (i) and 7.A22) of material loans made by the issuer and its subsidiaries;
- paragraph 7A.21 details (per 7.A20(a) to (i) and 7.A22) of loans made or security furnished by the issuer or any of its subsidiaries to or for the benefit of any director or manager of the issuer; and
- paragraph 8.3 and 8.62(b) state that financial information must be prepared in accordance with IFRS

A company issued a pre-listing statement and subsequently listed on the JSE. At listing, the issuer and/or its subsidiaries had the following arrangements in place:

- the issuer's wholly owned subsidiary unconditionally and irrevocably guaranteed the Domestic Medium Term Note Programme for a fellow subsidiary;
- the issuer, through its subsidiaries, provided loans to directors/key management personnel in terms of a management investment scheme through a special purpose vehicle (”SPV”) ; and
- the issuer, through its subsidiaries, was party to a guarantee of third party debt related to the SPV.

These disclosures for the above arrangements were neither included in the pre-listing statement nor in the AFS published by the company post its listing. It is important to note that these disclosures are required even if an issuer is of the view that the likelihood of the events occurring is remote.

ANNEXURE 3 – Other educational reports

Final Findings of our thematic review for compliance with IFRS 9 and 15 (2019)

The JSE performed a thematic review for the adoption of the IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. We issued a report on 6 November 2019 called "Final Findings of our Thematic review for compliance with IFRS 9 and 15" which details our findings in this area.

The format of the above report is different to our annual reports, as it includes examples of good and poor reporting. We have not included the content here as it is a good standalone document and is difficult to integrate it into this report. Instead, wish to advise you that it:

- it is available on the JSE website (see this link); and
- does form an integral part of this report.

All of the JSE proactive monitoring reports can be found here:
https://www.jse.co.za/current-companies/issuer-regulation/accounting-matters