Report on proactive monitoring of financial statements in 2023

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Introduction

The body of this report (the "2023 report") discusses the findings of the proactive monitoring activities (the "review process") undertaken by the JSE during the period October 2022 to September 2023 ("the period"). The objective of the JSE's process of reviewing Annual Financial Statements ("AFS") and Interim results ("interims") is both to ensure the integrity of financial information and to contribute towards the production of quality financial reporting of entities with securities listed on our market. This aligns with one of the general principles of the JSE Listings Requirements (the "Listings Requirements") namely, to enhance investor confidence in our market. The healthy debate that often surrounds a review process is in of itself important for the credibility of our markets.

The aim of this report is to highlight matters and provide details around our expectations for financial reporting to help prevent the misapplication of IFRS. The target audience for this report is entities whose securities have a primary listing on the JSE. Secondary listed issuers may also find benefit therein. The 2023 report sets out important findings identified during the year to date, which we request issuers to consider.

Finally, this report provides statistical findings that highlight the regulatory value of the review process. For the benefit of new directors and issuers we provide details of the review process (see annexure 1). Annexure 2 includes feedback on the activities of the FRIP. Annexure 3 includes an easy-to-use list of documents for audit committee's consideration.

Consideration by audit committees

The JSE acknowledges the important role that audit committees play in ensuring the integrity of financial reporting. As our reports on the review process are intended to highlight areas of potential concern in the preparation of financial statements, the JSE specifically requests every issuer's audit committee to consider this 2023 report together with certain other information previously published by the JSE. Annexure 3 contains a checklist of the information that the audit committee must consider, together with appropriate links to website references where that information may be found.

We ask that audit committees ensure that issuers take appropriate action to respond to the information detailed in annexure 3 when preparing both their AFS and interims. To the extent necessary, the JSE may write to an issuer and ask that they explain how their audit committee has complied with the request set out above.

Detailed reviews

Material cases

Annually we provide feedback on key aspects of cases where the IFRS impact of the misstatement was material to the results of the issuer. It is important to highlight that our findings are based on our consideration of the specific facts and circumstances of each case.

Whilst we have intentionally provided more details in this section than in previous years, it is not possible to provide all the facts and circumstances around the cases. We trust that the additional detail will assist issuers in determining whether or not they may have a similar situation, but remind them that they must still consider their own facts and circumstances.

Statement of Cash Flows

We queried an issuer's classification of increases/ decreases in certain investments as *financing activities* in the statement of cash flows ("SCF"). Paragraph 6 of IAS 7 *Statement of Cash Flows* defines financing activities as those that result in changes in the size and composition of contributed equity and borrowings of the entity. The investments were short term *assets* of the issuer. We queried how movements in these assets met the *financing activities* definition of IAS 7.

This interest rate issuer routinely issues debt instruments in our market to raise financing for long term capital projects. The issuer deemed movements in investments to be financing activities, as these had a direct result on reducing funding requirements (i.e. less debt needed to be raised). They argued that these were 'temporary' investments whilst the issuer waited for the capital spend to commence. The issuer also pointed to recent under-expenditure on capital projects as being a significant contributor to the high investment values.

Whilst we note the issuers intention to hold 'near cash' assets on a temporary basis, when viewing the quantum of investments and their growth in recent years, we found that investments had grown exponentially. Investment assets were now the second largest asset on the statement of financial position, comprising roughly 36% of total assets. The growth in investments even surpassed cash capex spend in some financial periods. We were not convinced that these were 'temporary' investments, or that the movements met the definition of financing activities in IAS 7.

We asked for details of the investment assets and were advised that they comprised: term deposits with financial institutions; call investments held with banks; and money market funds. Certain call investments and money market funds were found to meet the definition of 'cash equivalents' per IAS 7.6 and .7 – noting that this classification requires significant judgement to be exercised in certain cases.
The issuer agreed to restate the SCF to classify:

- Call investments and certain money market funds as cash equivalents (i.e. at the bottom of the SCF) – with disclosure about the significant judgement applied; and
- The remaining movements in investments as investing activities.

Partial write offs

We understand that a critical indicator for investors in the financial services sector is the health of an entity's performing loan book versus its non-performing loan book. Inappropriate (or early) derecognition of loans and receivable balances (along with the reversal of their expected credit loss ("ECL") allowances) prejudices this assessment by elevating the perceived health of the non-performing book. Entities that write off loan balances too early will often record higher post write-off recoveries.

What began as an enquiry with one issuer into the high levels of post-write off recoveries led us to question the way the issuer applied the partial derecognition requirements of IFRS 9. We summarise the key aspects of this fact-specific case below.

The issuer advances a high number of (mainly) low value loans to customers. The issuer follows the general 'three stage' impairment model of IFRS 9 *Financial Instruments*. They measure lifetime ECL allowances on a collective basis (as provided for by IFRS 9 B 5.5.4) and similarly assess significant increases in credit risk on a collective basis (IFRS 9. B5.5.5). We did not disagree with the issuer's application of a collective basis when assessing ECL impairment.

Increases (or decreases) in ECL allowance are not final or absolute events. These are estimates that can be reversed or amended over time as estimates change. Consequently IFRS 9 permits the evaluation of data on a portfolio (rather than individual loan) basis if no reasonable supportable information is available without undue cost and effort.
In terms of writing off loan balances, the issuer applies a similar collective (portfolio) approach to measure amounts that are written off. Data from statistical financial models of portfolios of assets is used to determine expected receipts and defaults for the portfolio. These expectations are applied to the individual loan balances in the ledger, such that a part of the loan balance is derecognised based on the expectations of the portfolio. The amount derecognised (and similarly amount retained on the ledger) is a consolidated figure. The issuer is unable to identify (or track) the capital or interest components of the balance that is retained.

We disagreed with the issuer's application of the partial derecognition requirements in IFRS 9. A write-off is a distinct event – separate from the IFRS 9 impairment requirements – and therefore not subject to the same portfolio measurement basis. IFRS 9 references derecognition to *a single asset* (IFRS 9 5.4.4 and .B3.2.16(r)). Partial derecognition is further constrained by paragraph 3.2.2(a) of IFRS 9 which explains that a part of a financial asset will 'qualify' for derecognition if, and only if, the part meets one of three conditions:

i) The part comprises only specifically identified cash flows – for example an interest rate strip where the counterparty obtains the right to the interest cash flows but not principal cash flows;
ii) The part comprises only a fully proportionate (pro-rata) share of the cash flows – for example entering into an arrangement whereby the counterparty obtains rights to a 90 percent share of all cash flows; or
iii) The part comprises only a fully proportionate (pro-rata) share of specifically identified cash flow – for example entering into an arrangement whereby the counterparty obtains the rights to 90 percent of interest cash flows from a financial asset.

In all other cases, derecognition is applied to the financial asset in its entirety per IFRS 9 3.2.2(b).

Each of the examples in paragraph 3.2.2(a) identify the occurrence of *a distinct circumstance* (or enforcement of a contract) which identifies the parts (or cashflows) to be retained and those to be derecognised. This is consistent with paragraph B5.4.9 which references an example of an entity's plans to enforce collateral which will result in recovering only a portion of the asset. These examples demonstrate '*something more*' than only management's assessment of amounts that may/ may not be recoverable when applying the partial derecognition requirements.

Consequently, we found that the issuer's application of the partial derecognition requirements of IFRS 9 to be inappropriate. The issuer agreed to change their approach to derecognition by continuing to recognise the full gross carrying amount and ECL allowance until there is no longer any reasonable expectation of recovery for the full amount before recognising any write-offs.

Common findings from detailed reviews

This section discusses common problems identified in our detailed reviews. We group the matters by IFRS standard and ranked the topics by prevalence in terms of the number of entities where the deficiencies occurred. The results are as follows:

Ranking	Topic	Percentage of population affected
1	IAS 1 *Presentation of Financial Statements*	31%
2	IFRS 7 *Financial Instruments: Disclosures*	20%
3~	IFRS 13 *Fair Value Measurement*	11%
3~	IAS 7 *Statement of cashflows*	11%

<u>Presentation of Financial Statements</u>

There were a broad range of findings across various paragraphs of IAS 1. Topics identified and discussed in our previous reports include:

- Paragraph 32: items of income and expenditure cannot be offset unless specifically required or permitted by an IFRS; and
- Paragraph 122: disclosure of judgements that have the most significant effect on the amounts recognised in the financial statements.

A new topic includes:

- Paragraph 82(ba): impairment losses (including reversals) determined in accordance with section 5.5 of IFRS 9 *Financial Instruments* must be disclosed on the face of the income statement.

Included within the 31% affected population above are some more general, but equally common findings. These relate to several instances where conflicting amounts for the same items were presented within different parts of the financial statements/ annual reports. Whilst these cases did not lead to material misstatements, they do raise questions about the robustness of financial controls that should be in place to effectively prepare financial statements. The confusing messages that these mistakes created could have been avoided.

Financial instruments: Disclosures

Our thematic review (discussed below) targeted the disclosures for liquidity risk and credit risk under IFRS 7: *Financial Instruments: Disclosures*. Over and above those findings, IFRS 7 remained an area where we found a significant number of deficiencies in disclosures. As there was overlap between the IFRS 7 findings from our thematic review and detailed reviews, this topic is discussed holistically in the thematic review feedback section below.

Fair value measurement disclosures

Problem areas continued to include either the partial or entire omission of:

- significant unobservable inputs used in the fair value measurement - both identifying them and (in the case of level 3 fair values) quantifying the amounts on a granular, disaggregated basis (IFRS 13.93(d)); and
- the sensitivity analysis for changes in those inputs for level 3 fair values (IFRS 13.93(h)).

New findings include:

- no explanation for the change in a valuation technique (required for level 2 and level 3 fair values) and the reason(s) for making that change (IFRS 13.93(d)): and
- the omission of a reconciliation between the opening and closing balances for fair value measurements within the level 3 fair value hierarchy (IFRS 13.93(e)).

Statement of Cash Flows

The bulk of findings under this heading related to the incorrect application of the definition of cash and cash equivalents. Section 7.4 of our 2022 thematic report (page 13) provides the relevant IFRS context. The material cases section above discusses one of the findings. Two other similar instances (which were not as material) are discussed below.

An issuer included a loan receivable repaid by a foreign-based company within the closing balance of cash in its SCF. At financial year end, these monies were not yet held by the issuer in their bank account, but rather held by their authorised dealer (a third-party financial institution). The reason being that approval by the South African Reserve Bank was outstanding. Classifying the amount as cash was inappropriate as, at financial year end, the amount receivable from the third-party financial institution did not meet the definition cash (i.e. a demand deposit or cash on hand per IAS 7.6).

In another case, the movement in amounts held in foreign bank accounts were incorrectly reflected as financing activities. These bank accounts are a cash balance and form part of cash and cash equivalents. Financing activities result in changes in the size and composition of contributed equity and borrowings (IAS 7.6).

Another matter that we wish to highlight relates to an issuer who did not fully apply the requirements of IAS 7.44A. This paragraph requires disclosures to enable users to evaluate changes in liabilities arising from financing activities. Whilst they did so for some liabilities, they did not provide the required disclosures for all liabilities arising from financing activities (e.g. lease repayments). Section 7.8 of our 2022 thematic report (page 19) discussed similar completeness deficiencies.

2023 emerging issue: Segmental report disclosure of material income and expenses

Our 2022 report highlighted an emerging issue on the extent of information disclosed in segmental reports under paragraph 23 of IFRS 8 *Operating Segments*. During the period, we engaged with 15 issuers on this topic. We concluded on 11 cases, whilst 4 remain open.

As part of our process, we engaged with the FRIP to elicit their views on the topic and received feedback from 13 of the 15 FRIP members. We discuss the matter below under the following two questions.

Is disclosure required if the Chief Operating Decision Maker does not separately review an item?

Paragraphs 23(f) and (i) of IFRS 8 *Operating Segments*, together with the preamble, state that: "An entity shall also disclose the following about each reportable segment if the specified amounts are *included* in the measure of segment profit or loss reviewed by the chief operating decision maker ("CODM"), *or* are otherwise regularly provided to the CODM , even if not included in that measure of segment profit or loss:

- material items of income and expense disclosed in accordance with paragraph 97 of IAS 1 *Presentation of Financial Statements* (as revised in 2007); and
- material non-cash items other than depreciation and amortisation."

Paragraph 97 of IAS 1 states that: "When items of income or expense are material, an entity shall disclose their nature and amount separately."

We identified instances where separately disclosed items of income/ expense were included in the profit measure disclosed on a per-segment basis in the segment report, but the items themselves were not separately disclosed on a per segment basis in the segment report.

Upon inquiry, issuers advanced the following arguments:

- the CODM does not consider the per-segment amounts of the individually material income and expenses for decision-making purpose; and
- their interpretation of the objective of the segment report is that it provides users with information on the same basis as reported internally to the CODM for decision-making purposes.

The JSEs view is that such an approach is inappropriate as paragraph 23 of IFRS 8 does not require the expense items to be regularly provided to the CODM to qualify for per-segment disclosure. This is due to the '*or*' requirement of paragraph 23. In other words, if a material income/expense item is included in a profit measure set out in the segmental disclosures, then that material income/expense item must be individually disclosed on a per segment basis, irrespective of whether or not the item is regularly provided to the CODM.

The 13 FRIP members unanimously agreed with the JSE on this specific consideration i.e. the items did not have to specifically presented to the CODM, but rather just had to be included in the measure. There was however not consensus in unpacking what were the material items of income and expenditure caught by paragraph 8.23(f) of IFRS 8, as discussed below.

<u>What are the IAS 1.97 disclosures?</u>

Four separate arguments were advanced by issuers in terms of their understanding of IFRS 8.23(f)'s cross reference to IAS 1.97:

- issuers disclose the line item in terms of their obligations under another IFRS paragraph (for example IAS 1.104) – i.e. these are not being disclosed because of IAS 1.97 and are therefore not be 'caught' by IFRS 8.23(f);
- IAS 1.97 only requires disclosure of items that are material on a *qualitative basis*, such as unusual items;
- items that are an aggregation of individually quantitatively immaterial items are excluded; and
- the materiality assessment should be limited to an income statement level and is not undertaken at a segment level.

There was less consensus from the FRIP members as to what items fall within the ambits of IAS 1.97, with varying degrees of sympathy for the above arguments. As a result, the JSE has referred the matter to the IFRS Interpretations Committee of the IASB. The JSE awaits the outcome of the process. We understand that the matter is due to be tabled for discussion at the end of November 2023 IFRIC meeting.

Thematic reviews

We carried out two different types of thematic reviews in the past year. The first related to concerns regarding inconsistency in reporting of earnings per share figures for seemingly similar structures. We made material findings in two instances - the details of which are set out below.

As it relates to the second theme, the common findings section of our 2022 report revealed that for 1 in every 5 completed reviews, we found a deficiency in the issuers' IFRS 7 disclosures. These trends were also in line with our international counterparts. It was for this reason that the topic selected for our 2023 thematic review was credit and liquidity risk matters for financial instruments.

Earnings per share for dual class share structures

We considered the presentation of earnings per share, headline earnings per share and other related 'per share' measures (collectively per share measures) under IFRS by companies with dual class share structures. These companies have more than one class of share – each classified as an equity instrument – with different rights associated to the share classes.

We wrote letters of enquiry to two equity issuers, both of whom had two classes of shares. For illustrative purposes we call these 'X' and 'Y' shares. The shares have different dividend rights:

- Whilst neither class of share could claim a right to payment of a dividend in any one period (dividends first had to be approved by the Board), once a dividend declaration was made, the share of dividends available to 'Y' shareholders was less certain (or quantitatively less) than that paid to 'X' shareholders.
- 'Y' shareholder participation in available distributions was contractually stipulated as being declared and paid only after a minimum threshold first being paid to 'X' shareholders.

This meant that:

- In certain periods, dividends were declared and paid only to 'X' shareholders; or
- Where dividends were declared for both classes of shares, 'X' and 'Y shareholders received a different quantum of dividends.

In their financial statements, both issuers presented equal per share measures for both 'X' and 'Y' shares. This implied that 'X and 'Y' shares had equal rights to the earnings (dividends) of the company – which was not the case. We queried whether the per share measures should not have been different for 'X' and 'Y' shares.

Paragraph 11 of IAS 33 *Earnings per Share* explains that the objective of basic earnings per share information is to provide a measure of the interest of each ordinary share in the performance of the entity over the reporting period. IAS 33.6 acknowledges that an entity may have more than one class of ordinary shares and explains that shares of 'the same class' are those that have the same rights to receive dividends.

Paragraph A14 of IAS 33 states that, for non-convertible instruments *profit or loss for the period is allocated* to the different classes of shares *in accordance with their dividend rights or other rights to participate in undistributed earnings*. A14 goes on to describe a methodology for calculating basic and diluted earnings per share in which:

a) Profit attributable to ordinary shareholders is adjusted (reduced) by the amount of dividends being:
    - dividends declared in the period; and
    - dividends that must be contractually paid for the period (e.g. unpaid cumulative dividends).
b) The remaining profit is allocated to the extent that each instruments shares in earnings, as if all the profit had been distributed. This is the participation feature; and
c) The total amount of profit allocated to each class of equity instrument is divided by the number of outstanding shares.

If the participation feature is equal, the above methodology will return different per share measures in periods where different dividends were declared for 'X' and 'Y' shares. Whilst significant judgement was required to determine the allocation of the participation feature between 'X' and 'Y' shareholders ((b) above), both issuers conceded that the performance measures previously disclosed did not comply with paragraph A14 of IAS 33 and a restatement was required.

IFRS 7: Liquidity risk disclosure

We considered issuer's liquidity risk disclosures against, amongst others, the following aspects of IFRS 7:

- IFRS 7.31 requires an entity to disclose information that enables users to evaluate the nature and extent of risks arising from financial instruments.
- IFRS 7.33 requires entities to disclose their exposure to each type of risk (which includes liquidity risk) and how it arises, the objectives, policies and processes for managing the risk, and the methods used to measure the risk.
- IFRS 7.39 requires entities to disclose a maturity analysis for financial liabilities showing remaining contractual maturities as well as a description of how the entity manages the liquidity risk inherent in these financial liabilities.
- IFRS 7.B11 indicates that an entity uses judgement in determining the appropriate number of time bands used in the maturity analysis required by IFRS 7.39 and provides a suggestion for appropriate time bands.
- IAS 1.30A emphasises that, in aggregating information an entity must not reduce the understandability thereof.

In one instance liquidity risk was a significant risk to the issuer. Their financial liabilities were more than double the amount of their financial assets. These liabilities accounted for 80% of the total liabilities and 46% of the net asset value.

The above-mentioned issuer elected to present the maturity analysis in 4 bands: on-demand, less than 1 year, between 1 – 5 years, and more than 5 years. Both the 'less than 1 year' and 'between 1 – 5 years' bands comprised of several financial liabilities, with different maturity and risk profiles. Considering the significance and varied sources of liquidity risk exposure, disclosure of narrower (more) time bands was warranted to enable an understanding the issuer's liquidity risk exposure.

We were not convinced that the AFS provided sufficient information for users to fully understand the entity-specific measures taken to manage the liquidity risk exposure for the current financial period and the liquidity risk as a whole.

In their response to our questions the issuer highlighted that certain information relating to their proposed resolution of the liquidity risk had been provided to the market, largely through separate SENS announcements. They accepted that the liquidity risk disclosures in their AFS should have been more detailed and agreed to provide such disclosures in the future.

Two further issuers did not provide sufficiently disaggregated liquidity risk disclosures. By way of example, one issuer presented a contracted maturity analysis for interest bearing liabilities (which represented 99% of all their cashflows) within a single 'time band' of 1-5 years. Whilst they did disclose the maturities of these liabilities in the interest bearing liabilities note, this information was presented on a discounted basis and therefore did not meet the requirements of IFRS 7.39 and .B11D.

IFRS 7: Expected credit loss allowances

We considered credit risk disclosures against, amongst others, the following aspects of IFRS 7:

- IFRS 7.31 requires an entity to disclose information that enables users to evaluate the nature and extent of risks arising from financial instruments.
- IFRS 7.35B explains that credit risk disclosures should enable users to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. IFRS 7.35B(b) refers to both quantitative and qualitative information and explains that users need to understand the changes in amounts of expected credit losses and the reasons for those changes.
- IFRS 7.35D explains that an entity shall consider how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, and whether users need additional information to evaluate the quantitative financial information disclosed.
- IFRS 7.35F requires an entity to provide entity-specific disclosures to explain its credit risk management practices and how they relate to the recognition and measurement of ECLs.
- IFRS 7.35G requires an entity to explain the inputs, assumptions and estimation techniques used to apply the requirements of section 5.5. of IFRS 9 (impairment).
- IFRS 7.35I explains that for users to understand the changes in loss allowances, an entity shall explain how significant changes in the gross carrying amounts contributed to changes in the loss allowance account. Both qualitative and quantitative information is required to be disclosed.

For credit risk exposure and credit risk rating grades, we unpacked the following aspects of IFRS 7:

- IFRS 7.35M states that: "To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts." IFRS 7.35M expands on the sub-categories for which such information needs to be disclosed; and
- IFRS 7.B8I states that: "The number of credit risk rating grades used to disclose the information in accordance with paragraph 35M shall be consistent with the number that the entity reports to key management personnel for credit risk management purposes."

We remind issuers that when approaching disclosures, credit risk (and the concentration thereof) is not represented only by the quantum of the ECL allowance recognised. A quantitatively immaterial ECL allowance may be raised despite a significant gross carrying amount for the receivables. Understanding the credit risk rating grates represented within the gross carrying amounts and the reasons why the issuer deems it appropriate to carry insignificant ECL's is qualitatively material to users of the AFS.

We found deficiencies in disaggregated disclosures for credit risk (including credit risk rating grades) in 7 of our thematic reviews and in a further 7 of our detailed reviews. The themes from these findings are discussed below. By now issuers should be familiar with the fact that IFRS 7 (and IFRS 9) are not limited to the financial sector only.

Default events and write-offs

IFRS 7.35F(b) requires an entity to disclose its definition of default including the reasons for selecting those definitions. We found the below disclosure to be insufficient as it lacked detail supporting the definition of default:

> Financial assets are considered to be in default when contractual payments are 60 days past due.

The issuer agreed to provide the following additional disclosure.

> ….past due the standard credit terms which is 30 days to 45 days and, the repayment profile of customers. 85% of all customers have payment terms of 30 days or less. 60 days past due is considered to be an appropriate indicator of default when considered against the group's customer base, the trading terms for which are predominantly 30 days. This is also informed by the group's extensive experience with its customer base.

IFRS 7.35F(e) requires disclosure of an entity's write off policy, including the indicators that are used to assess that there is no reasonable expectation of recovery. The following write-off policy did not provide the entity specific information:

A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

The issuer undertook to include the following additional information.

Once all internal measures to collect contractual cash flows have been exhausted, the group will engage the assistance of a debt collection agency in an attempt to secure payment. Twice a year an assessment of the outstanding amounts owed by the customer together with detailed information from the debt collection agency is undertaken and the decision made as to whether collection efforts should continue or be suspended. The timing of this decision is uncertain and will depend on the facts and merits of the collection efforts and is based on the cost versus benefit of continuing the collection effort.

One issuer provided the following disclosure.

Trade receivables that are written off include trade receivables handed over for collection.

The contractual amounts still outstanding on such financial assets was required to be disclosed (IFRS 7.35L). This was necessary given that these amounts, whilst written off, were still subject to enforcement activity. The fact that management regarded the possibility of recovery of these monies as being very low was not a valid basis to omit such disclosures.

Reason for the ECL allowance

In one case, an issuers' most significant asset was a loan to the holding company. They recognised a substantial ECL allowance against this loan.

Their accompanying disclosures were generic and largely a repetition of the requirements of IFRS.

The issuer agreed to expand its disclosures to provide qualitative and fact-specific information explaining:

- the factors that led to the loan being impaired (IFRS 7. 35B(b) and .35F(d));
- how the ECL allowance was determined and whether the ECL allowance represented a 12-month or lifetime expected credit loss (IFRS 7. 35G);
- the assumptions that were used (IFRS 7. 35B(a)) and how forward-looking information was incorporated into the determination of ECL allowance (IFRS 7.35G(b)); and
- how the issuer had determined whether the credit risk of the loan had increased since initial recognition (IFRS 7. 35F(a)).

Part of the revised proposed disclosures were as follows:

Assessing the probability of default has been made with reference to guidance from external credit rating of a global institution. In the current year, assessment of credit risk relating to the loan was assessed to be low. The asset has an external credit rating of 'investment grade' in accordance with ratings from a global institution.' The loan has therefore been assessed to be in stage 1, and the resultant ECL represents a 12-month expected credit loss.'

Analysis of ECL rate

In our reviews we considered the ECL rate (being the ECL allowance as a percentage of each category of receivables) for that year.

We expected receivables identified as being of a higher risk to attract a higher ECL rate and questioned the lack of an explanation when this was not the case.

If the gross carrying amount of a particular category of receivables increases, we expect the ECL rate to remain at a similar level – unless there are specific macro-economic or other factors present. Where ECL allowance rates differ from prior years, we expect to see disclosures:

- to explain any changes in the estimation techniques or significant assumptions applied to the receivables (IFRS 7.35G(c)); and
- entity-specific qualitative information to enable users to understand the changes in expected credit losses and the reasons for those changes (IFRS 7.35B(b)).

We also looked at the ECL rate (for the individual receivable brackets disclosed) from one year to the next. Examples of the types of enquiries we followed are set out below.

Case study 1

Fact pattern

- The ECL allowance matrix disclosed that the ECL rate for the 'Over 1 year' ageing bracket decreased from 50% (FY2021) to 30% (FY2022)
- By contrast there was an increase in the gross carrying amount of receivables within this ageing bracket.

Narrative provided in the AFS

- Changes in ageing of debtors - there is an increase in the 'Over 1 year' debtors, which attracts a higher default rate; and
- Although default rates reduced slightly post the COVID-19 pandemic and subsequent economic recovery, default rates applied in the group's calculation of ECL have been conservatively kept in line with prior year, considering the uncertainty surrounding the post-pandemic operating environment.

Our concerns

- The narrative does not adequately explain why there was a material reduction in the ECL rate for the 'Over 1 year' bracket;
- A change from 50% to 30% does not appear to be a 'slight reduction'; and
- The 30% does not appear to be 'conservatively kept in line with the prior year' of 50%.

Part of the explanation that should have been provided in the AFS (per IFRS 7.35B(b) and 7.35I) includes the following:

- Although the value for the comparative year's trade receivable increased, the risk profile of the current year's trade receivables has significantly improved; and
- A reconciliation of the changes in the ECL revealed, inter alia, that that one third of the FY2021 ECL balance was utilised for amounts written off.

Case study 2

Fact pattern

- ECL rates increased in all but the 120+ day age bracket, with the ECL rate in the 90 days category increasing from 30% (FY 2022) to 80% (FY2023).
- Gross carrying amounts doubled in the 120+ day age bracket. Despite this significant increase, the ECL rate decreased from 90% (FY2022) to 70% (FY2023).

Narrative provided in the AFS

- A loss allowance of 100% is recognised against receivables over 90 days past due – except in cases where payment arrangements are in place.

Our concerns

- Given the change in quantum of provision raised in prior years, we had expected the AFS to provide more details on how the 'payment exception' was applied in the current and prior year;
- We also expected disclosures to have been made for the 120+ day aging bracket to explain the decrease in ECL rate, especially given the doubling of the gross carrying amount and the increases in all other brackets; and
- Insufficient qualitative information was provided with respect to the above.

Credit risk rating grades

Information about credit risk is important as it enables users to understand the entity's credit risk exposure and significant credit risk concentrations (IFRS 7.35M). To be useful, disclosures should offer an insight to extent of the disaggregation being presented.

An issuer grouped their receivables under the following credit risk characteristics:

Performing receivables				
Low risk	Medium risk Level 1	Medium risk Level 2	Medium risk Level 3	Defaulted receivables

Their disclosures were lacking as there was no narrative explanation of either:

- the specific factors considered in grouping the performing receivables as either low or medium risk (IFRS 7.35F(a)(i)); or
- what differentiated a level 1, 2 or 3 medium risk performing receivable (IFRS 7.35F(c)).

In another matter, an issuer included credit risk rating grade classifications previously mandated for disclosure by IAS 39, stating that:

> Loans are classified as being 'neither past due nor impaired'.

It was not clear how this (the previous IAS 39) classification tied into the method of provisioning under IFRS 9. The issuer agreed to amend their disclosures in line with IFRS 7.35M, by providing both a definition for Stage 1, 2 and 3 assets and reconciling these to the disclosure of the loans into the (previous IAS 39) buckets that were used internally by management.

Another issuer provided disclosures of the gross carrying amount by credit risk rating grades for low, medium, and high risk (stage 1,2 and 3) assets to comply with IFRS 7.35M(a) and (b). During our engagement, it become clear that credit concentrations by both geographic location and industry were also presented to key management personnel for credit risk management purposes. Geographic and industry disclosures should therefore also have been provided in the AFS (IFRS 7.BI)

Reconciliations

IFRS 7.35H calls for a reconciliation of the changes in the ECL allowance, showing the changes for 'stage 1, 2 and 3' separately. An issuer presented the following:

	R'mil
Reconciliation of allowances for expected credit losses	
Opening balance	2981
Charge to the statement of other comprehensive income	844
	3825

The above reconciliation is lacking. A more detailed breakdown must be provided for the R844 mil, splitting the amount between the changes for 'stage 1, 2 and 3'.

Another issuer neglected to include the required reconciliations (IFRS 7.35H) for all of its ECL allowances and undertook to include the reconciliation for its finance lease receivables in the future.

In another instance the issuer had reduced the ECL allowance significantly over the previous three years. In addition to the overall decrease, the default rate applied to the 90-day bracket of trade receivables decreased by nearly a third in the period reviewed, whilst the gross receivables balance in this category (after specific amounts impaired) more than doubled. No qualitative information was provided to explain the reason for these movements (IFRS 7.35B(b)).

Collateral

An issuer held collateral over certain of its loans. It presented the assets that it had repossessed as part of the loans and advances balance on the face of the statement of financial position. Very little further information was provided, leaving us with questions as to why these repossessed assets:

- were reported with loans and advances; and
- did not meet the recognition criteria of the asset in question under another IFRS.

IFRS 9. B.5.55 states that collateral obtained as a result of foreclosure is not recognised as a separate asset from the collateralized financial instrument unless it meets the relevant recognition criteria for an asset under IFRS 9 or another standard.

It transpired that the assets were in fact inventory, per IAS 2, and measured according to those principles. The issuer undertook to expand their disclosures as follows.

Example of corrective disclosures
Repossessed assets are presented as part of loans and advances as these assets represent the foreclosed security for defaulted loans. Their balance represents the cashflows that are expected from realising/ selling the collateral and affect the credit risk that lenders are exposed to in terms of outstanding loans and advances. Repossessed assets are included as a non-financial asset in the categorised statement of financial position and are also removed from the credit risk disclosures provided by IFRS 7.

The issuer also undertook to more fully explain how the impairment provision for repossessed assets was determined.

Inventory was effectively measured at the higher (not ‘lower’ per IAS 2) of cost and net realisable value. Where the issuer erred was that cost was determined exclusively with reference to the fair value of the repossessed asset cost. This meant that loans (carried at amortised cost) were in some cases being revalued upwards.

The findings in numbers

The purpose of this section is to enable issuers to understand the process that is followed by the JSE. It also highlights the fact that a clean auditor's report is no guarantee that the AFS will be free from regulatory challenge and correction.

In the bulk of cases where we have requested action, we have done so to ensure that there is no future investor prejudice for matters which, fortuitously, may not have been material in the results that we reviewed.

Review process

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

The bulk of our completed reviews covered AFS for years ending between 30 September 2021 and 31 December 2022.

Statistics

What we did

We look to obtain a desired coverage ratio of our population through performing a combination of detailed and limited scope thematic reviews. The table below provides details of the types of reviews completed and examination rate over the past three years.

	Equity	**Debt** [1]	**Total 2023**	**Total 2022**	**Total 2021**
Detailed reviews completed	25	10	35	50	62
Limited scope reviews completed	10	6	16	18	-
Reviews completed	**35**	**16**	**51**	**68**	**62**
Examination rate (Percentage coverage of population)			17.1%	21.2%	18.1%

The number of reviews covered in 2023 was at the lowest level due to a combination of a reduction in both the examination rate and the population of listings over the three years.

Detailed reviews
The table below shows that between October 2022 and September 2023 we performed new detailed reviews on 26 equity issuers and the 8 debt issuers.

[1] to avoid double counting , issuers that are both an equity and debt issuers are included in the numbers for equity issuers only

	Equity	Debt [2]	Total
Letters of query	17	5	23
Cases closed immediately	9	3	12
Number of new AFS reviews	**26**	**8**	**34**
Cases b/f from previous year	7	2	9
Total cases reviewed during period	33	10	43
Cases still pending	(8)	-	(8)
Cases completed during period	25	10	35

We wrote letters of enquiry to 23 of the issuers, with 12 cases being closed immediately without any questions asked. At 30 September 2023 eight of the (equity) cases were still pending.

Limited scope thematic reviews
In the previous cycle the format for our thematic review was desktop based. Our interaction with issuers was limited to a few rare instances. In contrast, we decided to apply the same interactive process applied to our detailed reviews to this years' thematic reviews. In other words, we wrote to them where we had questions.

The sample for this years' thematic reviews is 21 issuers. In the past we issued our thematic review findings report only once all the reviews were completed. Even though we have not concluded on 7 cases (being the pending cases plus those still to be assessed) we decided not to delay providing feedback to the market.

This report contains the outcome of the 16 thematic reviews we completed between 1 October 2022 and 23 October 2023.

	Equity	Debt	Total
Letters of query	9	7	16
Cases closed immediately	2	1	3
Cases still to be assessed	2	-	2
Number of new thematic reviews	**13**	**8**	**21**
Cases still pending	(3)	(2)	(5)
Cases completed during period	10	6	16

<u>What we found</u>

Detailed reviews
In two cases we identified non-compliance that was material from an IFRS perspective. For a further 3 cases, whilst fortuitously there was no material misstatement for the period reviewed, amendments needed to be made within the next published results to avoid potential investor prejudice.

[2] Other hybrid instruments and asset back securities are also reviewed and are included in this category

Therefore, the number of cases requiring corrections was at 8% (2 cases) for equity issuers (2022-32%) and 30% (3 cases) for debt issuers (2022-23%).

Sixteen cases involved smaller disclosure matters that issuers agreed to correct in the future.

	2023 Equity	2023 Debt	2023 Total	2022 Equity	2022 Debt
Non-compliance material	-	2	2	1	-
Non-compliance not material this year, but must be corrected in the future in order to avoid potential investor prejudice	2	1	3	11	3
Smaller disclosure issues that will be corrected in the future	12	4	16	15	6
AFS in respect of which it was concluded that there were no issues	11	3	14	10	4
Total cases closed	**25**	**10**	**35**	**37**	**13**

Limited scope thematic reviews

In two cases we identified non-compliance that was material from an IFRS perspective. Eight cases involved smaller disclosure matters that issuers agreed to correct in the future.

	2023 Equity	2023 Debt	2023 Total
Non-compliance material	2	-	2
Smaller disclosure issues that will be corrected in the future	4	4	8
AFS in respect of which it was concluded that there were no issues	4	2	6
Total cases closed	**10**	**6**	**16**

Overall

Looking at both the detailed and limited scope reviews, we closed 51 cases. We made findings in 31 instances. Of those the number of cases impacting measurement was at 15% (2022-7.4%) for equity issuers and 15.4% (2021-22%) for debt issuers. The data continues to reveal that disclosure matters remain the main area of non-compliance.

Annexure 1 – Understanding the review process

Why the review process

Our 2020 report includes a reminder that the JSE undertakes the review process because it was requested to do so by The Financial Services Conduct Authority in 2010. The integrity of financial information is a critical element of a well-functioning market. The objective of the review process is therefore to contribute towards the production of quality financial reporting of entities listed on the JSE.

Details of the review process

An overview of the review process applied in our detailed reviews is included in our 2018 report (and previous reports). We do not repeat that content here. It is recommended that individuals that are unfamiliar with the detailed review process refer to page 21 of the 2018 report (which is available on our website) for a full understanding thereof.

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

Accounting topics examined and risk areas considered are likely to change from year to year. We identify these changes annually as we aim to ensure that the review process remains both attuned to local market developments and aligned to similar international processes.

Selection process amended in 2021

We have based our model largely on the guidelines that the European Securities and Market Authority sets out for the member states of the European Union. Given the changes made to those guidelines, we implemented changes to our process in 2021 and 2022.

In 2021, the JSE made a fundamental change to the selection process. Historically the random selection process was such that we treated all issuers equally, aiming to review every issuer's AFS at least once every 5 years. The JSE's revised approach considers the risk to investors in terms of market concentration. Therefore, as part of the random selection process, we will select issuers (equity and debt) that have a larger market capitalisation and/or who are active in both the equity and interest rate markets more frequently. Furthermore, in order to remove the element of predictability, our review cycles have been amended from a 'once every 5 years' approach to the principle of 'once within a set window'. The selection period will be either a 3, 5, 8 or 10-year window, depending upon the size of the issuer. By way of example, an issuer within the top 40 index will now be selected at least once in the period 2021 to 2023 and then again once somewhere in the period 2024 to 2026.

Types of reviews amended in 2022

The 2022 report called 'Limited scope thematic report: Cash flow information and disclosures of liquidity and going concern' ("the 2022 thematic report") explains the introduction of a limited scope review process to be performed (annually) in parallel to the established detailed reviews.

Detailed reviews consider the AFS and interims ("financial reports") holistically. They are essentially a vertical review of an entire financial report for a specific issuer. Detailed reviews focus on identified risk areas and potentially material IFRS non-compliance matters, with no limit being placed on the scope of the review.

In contrast *Limited scope thematic reviews* apply a horizontal lens to the financial report to focus on a specific area (or theme) across several issuers. These reviews execute an in-depth review of specific focus areas and therefore limit the subject matters considered in those reviews.

The 2022 thematic report (which is available on our website) provides more detail and a comparison between the two types of reviews. Individuals are referred to page 2 of that report for a fuller understanding thereof.

Process applied to ALT^{X} issuers

Our 2020 report includes an explanation of the revised approach that was introduced for issuers listed on the ALT^{X} market. Not only will they be reviewed on a less frequent basis, but the process itself has been amended. Those involved in ALT^{X} market are referred to page 23 of our 2020 report (which is available on our website) for an understanding of that process and our objectives.

Year to year findings

It is possible that a subsequent review of the same issuer may lead to different questions being asked. This could be the case even where matters are treated on an identical basis by the issuer from one year to the next. The reason for this is twofold.

Firstly, for *detailed reviews*, the:

- JSE reconsiders the overall process on an annual basis;
- risk areas change from year to year; and
- materiality of matters within the context of specific set of AFS or business environment may differ.

Secondly, a different lens is applied for *limited scope thematic reviews*. Their process generally involves a 'deeper dive' into a specific topic than is the case with a detailed review. Furthermore, we apply a lower materiality threshold. The reason for this being that a key objective of the limited scope thematic review is publish detailed findings in order to contribute to the quality of future reporting by issuers.

Annexure 2 – Activities of the FRIP

Other than the IFRS 8 discussion on page 4 above, there are no FRIP referred cases that we able to provide feedback on.

Annexure 3 – List of documents for the audit committee's consideration

Annually we consolidate our previous annual reports on the review process into one report entitled 'Combined findings of the JSE Proactive Monitoring of financial statements' ("the Combined Findings Report"). The latest report was issued on 27 October 2023.

For ease of reference, this annexure contains information that all audit committees must consider in fulfilling their responsibilities referred to on page 3 of this the 2023 report.

1. This, the 2023 report;
2. From the Proactive Monitoring Limited Scope Thematic review : Cash flow information and disclosures of liquidity and going concern of October 2022;
    a. Section 7.4: Cash and cash equivalents; and
    b. Section 7.8 : Changes in liabilities arising from financing activities
    c. Section 8: Liquidity Risk
3. Given our common findings, the following sections from the Combined Findings Report issued in October 2023;
    a. General (due care) (page 7);

Audit committees should consider the entire content of the Combined Findings Report if the issuer:

- is newly listed; or
- had events or transactions that were not present when they considered our previous reports.

The above documents can be accessed via the hyper-link reflected in green or downloaded from the JSE website,
https://www.jse.co.za/current-companies/issuer-regulation/accounting-matters.