Combined findings of the JSE proactive monitoring of financial statements

Date of issue: 31 October 2024

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 who listed securities 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.

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. The JSE has requested issuers and specifically their audit committee to consider the findings contained in the latest PM report when preparing their next set of AFS and interims.

Issuers and their audit committees must also consider the content of any previous PM reports to the extent that:

- there are events or transactions not present when they considered a specific annual PM reports; or
- for newly listed entities or securities on our market.

Purpose and format of this report

Our review process continues to reveal common problems which were identified in our previous PM reports. The purpose of this report 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.

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 onwards 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 separate detailed educational type of reports (the "**other educational reports**"), which identify both good and poor examples relating to the topic under discussion. Our reports include a section indicating the focus areas/s for the subsequent year. In 2021 we expanded

the section to provide more technical insight into the matters we were and intended addressing and called it 'emerging issues'.

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.

The body of this report combines the content of our 2011 to 2023 PM reports. To reduce the length of this report some 2011 cases have been removed as similar findings were made in subsequent years. Our thematic reports and other educational material are referenced separately in Annexure 3.

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 discussed. 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 is omitted; and
    c. For ease of identification the headings for cases from the latest, 2023 report are referenced in green text.
3. Additional labels are included (where applicable) being 'focus area', 'common disclosure omissions' and 'emerging issues'. 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; and
    c. Annexure 3 incorporates, by reference, other PM related educational documents.

This report has been prepared by combining historic PM reports. Unless otherwise indicated, 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.

This is our sixth combined findings report and replaces the one dated October 2023. It incorporates all PM related reports issued before October 2024.

The quality of financial information

General (due care)

Matter 1 (2023 common finding)

Common findings related 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.

Matter 2: Presentation of financial statements (2021 focus area)

IAS 1 was the single largest contributor to our findings in 2021. The following paragraphs (ranked in order of prevalence) featured in those findings:

- paragraph 117 - providing accounting policies (here our findings related to unusual transactions and unusual accounting treatments);
- paragraphs 17 (c) and 31 - providing additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable a full understanding (our cases dealt specifically with unusual and complex transactions);
- paragraph 25 - detailed disclosure to support the going concern assumption; and
- paragraph 113 - consistency of presentation between various notes.

Matter 3 (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 4 (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 do not 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 (now paragraph 1.2) 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.

Negative confirmations

Matter 1: (2021 focus area)
Where economic circumstances may have changed significantly due to a specific event (covid-19; the July 2021 civil unrest), users may want to understand why a particular event did not have an impact on an issuer. For example, in an industry where the credit risk of debtors has deteriorated significantly, users may expect a similar increase in the ECL, and may be left with unanswered concerns if this does not occur.

In these circumstances, a 'negative confirmation' and supporting explanation as to why the economic event did not significantly impact the issuers' financial results is often as useful as the detailed disclosures that are provided in cases where the economic event did have an impact (IAS 1.17(c); IAS 1.31). These types of disclosures apply equally to year-end financial statements and interims and if included should also avoid a question being raised during the review process.

Presentation of Financial Statements (the 'geography' of the income statement)

Matter 1: The geography of the income statement (2022 focus area)
The 'shock events' of covid 19 and the July 2021 riots caused us to focus on the way issuers present their profit/loss on the face of the statement of comprehensive income ("income statement"). Such presentation typically has knock on implications to management commentary which accompanies such results. Inappropriate messaging can be misleading to investors.

Whilst the 'shock events' brought this matter to our attention, in many instances issuers had not changed their approach to the 'geography' of their income statement. In other words, the problems we identified pre-dated these events. This serves as a reminder that, given the approach to our reviews, new matters may arise on the same set of AFS if reviewed in a subsequent year, given that a new lens may be applied.

We engaged with 11 different issuers on this topic.

The use of subtotals

Most of our engagements with issuers under this focus area centred around the use, or more specifically the naming, of sub totals in the income statement. After such engagements, issuers either agreed to remove or rename subtotals that were labelled as 'operating profit' yet excluded items such as:

- depreciation, amortisation and impairments (of property plant and equipment, intangible assets and goodwill);
- fair value adjustments on biological assets (which were the issuers business);
- lease exit/ modification gains (on property plant and equipment used in the business);
- legal settlement costs (relating to a trademark dispute);
- profit on sale of an owner occupied building;
- restructuring costs; and
- share based payment expenses.

As our 2021 report (issued November 2021) provides IFRS references around this topic we do not repeat all the detail here. In summary, paragraph 1 of IAS 1 *Presentation of Financial Statements* requires an entity to faithfully present the effects of transactions, other events and conditions. The International Accounting Standards Board ("IASB") noted (in IAS 1.BC56) that an entity should ensure the amount disclosed in any operating subtotal is representative of activities that would normally be considered to be 'operating'. Their view is that it would be inappropriate to exclude items from such a subtotal on the basis that:

- it is industry practice; or
- they occur irregularly or infrequently; or
- the amount is unusual; or
- do not involve cash flows (for example depreciation/ amortisation).

Furthermore, by analogy, paragraph 6 of IAS 7 *Statement of Cashflows* defines 'operating activities' as 'the principal revenue-producing activities of the entity'.
One of the most common discussion points was the exclusion of depreciation, amortisation and impairments from operating profit. Assets are used in entities operations to produce revenue and generate profits. The depreciation, amortisation, impairment, scrapping and disposal of assets thereof represent costs associated with the use thereof and are thus part of operating activities. Impairment losses are similar in nature to an accelerated depreciation or amortisation charge, representing the deterioration of the carrying amount of the asset that is no longer available to support future cash flows generated from the asset. In responding to our letters of enquiry, certain issuers did not disagree that such items were operational in nature but were focussing on the fact that their occurrence was infrequent.

Consistency in the treatment of associates

We identified instances where there was an inconsistency in the presentation of:

a) the income from associates/joint ventures;
b) profit on sale of shares in associates/ joint ventures; and
c) impairments of investment in associates/joint ventures.

Item (a) was presented outside of a subtotal called 'profit from operations' whilst items (b) and (c) were included within the subtotal. We challenged this inconsistency. All income streams linked to associates should be within the same section of the income statement i.e. either all part of operations or not.

Matter 2: Quantifying the impact of covid-19/ the July 2021 civil unrest (2021 emerging issue)
The discussion set out below deals with IFRS information. Our May 2020 letter to the market included a section (under the heading 'Covid-19 financial analysis') dealing with presenting information outside of the financial statements. The detail under that heading (which is not repeated here) applies equally to an analysis of the July 2021 civil unrest as it does to covid-19.

We agree that highlighting the impact of an expense directly attributable to covid-19 (or the recent civil unrest) may be required or allowed by IFRS. To the extent that it is material, IAS 1.97 requires such disclosure. Our concern however lies with:

a) how such items are labeled;
b) how the judgements to reliably measure what aspects of an expense are directly attributable to covid-19 compared to 'normal operations' are applied and disclosed; and
c) their positioning in the income statement.

This section deals with (a) and (b) whilst item (c) is discussed in the 'use of subtotals' section below.

Labels
Our May 2020 letter reminded issuers of the constraint under IFRS that items of income or expense cannot be presented as being 'extraordinary'. We have challenged issuers who use the term 'abnormal' which we believe is, in substance, the same as 'extraordinary' and therefore prohibited by IAS 1.87.

In noting their reasoning for abolishing the disclosure of extraordinary items (IAS1.BC60 – BC64) the IASB explained the need to eliminate an arbitrary segregation of effects of related external events - some recurring and others not. It is the nature or function of a transaction/event rather than its frequency that should determine its presentation in the income statement (IAS 1.BC63).

The defendable route under IFRS is therefore to describe the nature of the income or expense on the face of the income statement, rather than labelling it 'non-recurring', 'abnormal' or 'extraordinary'. If the issuer applies a 'by function' approach to their income statement they must still ensure they comply with IAS 1.99 (as discussed above).
Faithful representation

The second consideration is to ensure that the information is reliable and ensures faithful representation (IAS 1.15).

An issuer looked to quantify the impact of covid-19 by comparing their actual results to budgets and presenting this difference as being attributable to covid-19. We consider that there are likely to be too many moving parts and uncertainties in such a simplistic approach for the outcome to lead to faithful representation. An issuer would need to have absolute confidence that their financial controls over their budgeting system are effective, ensure that the 'budget' amount was not a stretch target, and be able to reliably isolate the impact of other factors that contributed to the non-achievement of the budget. 'Hypothetical' determinations are or can be misleading.

If an issuer is able to overcome the above hurdles and presents a 'covid-19' item, this should be accompanied by detailed disclosure of the judgement applied by management in calculating such figures (IAS 1.122).

Matter 3: The use of subtotals (2021 emerging issue)
Example 1
The use of additional subtotals are required in terms of IAS 1.85 when such subtotals are relevant to the understanding of an entity's performance. The use thereof is however subject to the requirements of IAS 1.85A. Furthermore, IAS 1.15 requires fair presentation and that an entity must faithfully present the effects of transactions, other events and conditions.

We challenged an issuer who included the subtotal 'trading profit' in their income statement but excluded the movement in expected credit loss from the subtotal. We argued that the exclusion did not lead to fair presentation being achieved - particularly as the entity had many banking operations which were considered part of their normal business activities.

Example 2
Paragraph 20(a) of IFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose information that enables users to evaluate the nature, extent and financial effects of interests in joint arrangements and associates. We have identified instances where there is an inconsistency in the presentation of

d) the income from associates; and
e) profit on sale of shares in associates and/or impairments of loans to associates

Item (a) was presented below a subtotal called the 'operating income after impairments' whilst item (b) was included within the subtotal. We challenged this inconsistency. We are concerned that all of the income streams linked to associates should be within the same section of the income statement i.e. either all part of operations or not, in order for the financial effects of the interest to be understood.

Example 3
Issuers may choose to present an 'operating profit/loss' or similar subtotal in the income statement. Whilst the term is not defined in IFRS, when electing to disclose results of operating activities the IASB noted in IAS 1. BC56 that an entity:

> "…should ensure the amount disclosed is representative of activities that would normally be considered to be 'operating'. In the Board's view, it would be misleading and would

impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities, even if that had been industry practice. For example, it would be inappropriate to exclude items clearly relating to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently or are unusual in amount. Similarly, it would be inappropriate to exclude items on the grounds that they do not involve cash flows, such as depreciation and amortisation expenses"

Furthermore, as discussed above, IAS 1.87 prohibits the presentation of any item as extraordinary. A previous (1993) version of IAS 1 required extraordinary items to be disclosed (in the income statement) separately from the profit or loss from ordinary activities. That standard had defined 'extraordinary items' as:

> "income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly" (IAS 1.BC60).

In its revisions to IAS 1, the IASB decided that items treated as extraordinary do result from the normal business risks faced by an entity and do not warrant presentation in a separate component of the income statement (IAS 1.BC63).

It is difficult to envisage which expenses, if any, would not be regarded as being part of the issuer's operating activities. An analogy to IAS 7.6 may be appropriate where 'operating activities' are defined as "the principal revenue-producing activities of the entity….".

Certain issuers have looked to the Headline Earnings Circular to argue that any remeasurements excluded from the headline earnings circular should be excluded from an operating profit subtotal. These arguments fail to give full consideration to the definition section of the Circular which states that.

> "Operating/ trading activities are those activities that are carried out using the 'platform', including the cost associated with financing those activities."
>
> and
>
> "The platform is the capital base of the entity. Capital transactions reflect and affect the resources committed in producing operating/trading performance and are not the performance itself."

Importantly, both definitions include a note that:

> "The meanings of the words 'operating' and 'capital' in this circular are different from their meanings in IFRS."

The platform identified in the Circular is by its very nature linked to the operating activities of the entity from an IFRS perspective. These are the very assets used for operating activities.

Significant impairments (even those attributable to the covid-19 pandemic) may occur as a consequence of 'normal business activities' of the entity. Whilst covid-19 was clearly an unexpected occurrence, for most entities, the consequential financial impact is tantamount to a business risk. We challenged issuers who had separately disclosed the impact that impairments had to the financial performance (IAS 1.97) but included this below an operating profit subtotal on the face of the income statement.

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

Matter 1: Offsetting (2023 common findings)
In terms of IAS 1:32, items of income and expenditure cannot be offset unless specifically required or permitted by an IFRS.

Matter 2: Financial instruments impairment losses (2023 common findings)
Paragraph 82(ba) of IAS 1 required 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.

Matter 3: 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 4: 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 to assist users in making their decisions.

Matter 5: 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 6: 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 7: 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 8: 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 9: 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 10: 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.

Consideration of going concern

Matter 1: Debt covenant disclosures (2021 focus area)
Our letter of 10 September 2020 ("our September letter") explained that investors need insights regarding the future cash flow position of the issuer in terms of:

a) debt covenant triggers;
b) the proximity to breaching those triggers; and
c) the board's view of debt levels and how any potential debt covenant triggers can be addressed.

This information links to IFRS disclosure requirements regarding:

- going concern (IAS 1.25);
- the management of capital (paragraphs 134 to 136 of IAS 1); and
- the nature and extent of an entities risks exposure from financial instruments, including liquidity risk together with the steps entities are taking to manage those risk (paragraphs 31 to 32A of IFRS 7 *Financial Instruments: Disclosures*).

We challenged several issuers where one or more of these points (a) to (c) were omitted from their disclosures. Whilst some issuers included the required information in a presentation to investors, they had omitted it from their AFS and/ or interims. Our September letter refers to disclosure obligations from a continuing obligations perspective - which relates to the reporting of interims and AFS (inter alia) in terms of section 3 of the Listings Requirements.

The above debt covenant information was a key factor for several issuers in their consideration of the going concern assessment and would have assisted issuers in applying IFRS as discussed in the IASB document titled 'Going concern-a focus on disclosure' . One issuer did quantify both the debt covenant triggers and their actual ratios, which indicated they had breached those triggers. They did not however provide a narrative in either those AFS or their subsequent interims as to how they intended to deal with the liquidity event to explain why they were still a going concern. The breach related to a key source of finance for the issuer. Such disclosures were required under paragraphs 25, 122 and 135 of IAS 1.

Matter 2 (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. 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 International Financial Reporting Interpretations Committee ("**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'?"

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 (2013 and 2014)
There were several 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;
- calculations for provisions of bad debts; and
- use of the capital gains tax rate to determine deferred tax on an intangible asset.

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 (2021 focus area and 2023 common findings)
IAS 1 was the single largest contributor to our findings in 2021. The paragraphs that was most prevalence in those findings was:

- paragraph 122 - including entity specific information about judgements made (apart from estimations) that have the most significant impact on amounts recognised.

Matters covered under IAS 1.122 included (inter alia):

- factors considered when making the determination of the functional currency for a subsidiary;

- why the call option held by the issuer was not substantive and why this did not result in the entity being consolidated;
- what made an acquisition an asset acquisition rather than a business combination (and vice versa);
- why the issuer only identified one cash generating unit when they appeared to have three separate business units; and
- how a specific business met the definition of a discontinued operation.

After reading the disclosure in the AFS, will an independent user have a full understanding of the entity specific circumstances supporting the judgement without needing to ask management for an explanation?

Matter 2 (2020 focus area)
In our reports from 2017 to 2019 we indicated that the disclosure requirements of IAS 1 *Presentation of Financial Statement*s applicable to judgements (paragraph 122-124) and estimates (paragraph 125-133) would be a focus area for the subsequent year. Audit committees should not place undue reliance on the auditor to be the only party sufficiently challenging the judgements applied by management.

Our number of findings is at a similar level for the past year as was the case in 2018. A third of those findings related to poor disclosures of judgments for classifications with the statement of cash flows and the application of various standards applicable to group accounting. As these and many other topics are similar to our findings in previous years, this report does not repeat that detail.

Issuers should ask the following question regarding the application or non-application of a specific IFRS: "Is it clear to the reader why we have reached this decision?"

A new area of (multiple) findings related to fair valuation calculations including the use of:
- a specific earnings multiple; and
- lower vacancy levels when compared to the historical vacancy rates (for a property valuation).

There were also two instances of insufficient disclosure of the factors considered and reasons supporting the conclusion that the entity was a going concern.

Matter 3 (2019 focus area)
The disclosure requirements of IAS 1 *Presentation of Financial Statement*s applicable to judgements and estimates 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 4 (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 5 (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 6 (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.

The instances of insufficient disclosure included the:

- application of the accounting policies for two different share incentive schemes;
- 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 7 (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.

Adopting new standards

Matter 1: 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 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*). 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 2: 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).

Materiality

Our 2019 report explains that where a review process evolved into a discussion on materiality, the JSE would ask issuers to frame their responses to ensure an understanding of how decisions were made within the context of the issuers' materiality framework. Such a framework needs to be robust enough to demonstrate that the treatment in question is appropriate under IFRS from a materiality perspective.

For some materiality discussions, it was clear that the issuer's materiality framework was robust and appropriately applied. This was not the case in other instances.

Matter 1: Appropriate materiality framework (2020)
In one case, the issuer was unable to provide us with convincing arguments for not correcting an error identified in their AFS. From a quantitative perspective alone, the error resulted in

an 11% overstatement of the financial asset in question and was 21% of the profit before tax. Their response did not create the impression that they had developed a robust materiality framework (covering both quantitative and qualitative factors) that they applied to the decision not to correct for the error.

Matter 2: Which aspects of the financial statements (2020)
An issuer's assessment as to the immateriality of an error to the Statement of Cash Flows was based on an argument that:

- users of the AFS rely on specific per share (and other key) measures; and
- the error was confined to the SCF and did not affect any of the identified key measures.

This reasoning assumes that the key measures are 'the only aspect' considered by a user of the AFS – implying that the primary financial statements and related notes are in themselves rendered irrelevant.

The JSE is concerned with issuers adopting a position that certain aspects of the AFS, or even worse that certain 'primary statements' within the AFS, are irrelevant and therefore errors made therein irrelevant. Whilst we appreciate that issuers have an understanding of the information needs of users, it is difficult to isolate the impact that one aspect of financial reporting would have (or would not have) to a user if that misstatement was material. The IASB's materiality practice statement emphasises a similar point when stating in paragraph 20 that:

> "When making materiality judgements, an entity needs to assess whether information could reasonably be expected to influence primary users' decisions, rather than assessing whether that information alone could reasonably be expected to change their decisions."

The AFS present a 'portrait' of an entities position and performance over a year, comprising individual components that work together to satisfy the information needs of users. Users often evaluate different elements within the AFS to measure reported information against. For example, they analyse cash flow information against earnings measures. To use an analogy of a building – what is 'more important' to the functionality of the building, a solid roof, its sturdy foundations or well-constructed walls? Each element of the building is instrumental in the building being able to achieve its stated purpose. Elevating the importance of one structure whilst another is defective leads to a compromise of the entire structure. Correction of errors are often qualitatively material in themselves as they talk to the quality of an issuers' financial reporting process.

Materiality must be considered holistically and not looking at the impact on the bottom line in isolation.

Matter 3: Qualitative considerations of a materiality framework (2020)
Paragraph 41 of IFRS Practice Statement 2: *Making Materiality Judgements* states that:

> "An item of information is material for various reasons. Those reasons include the item's nature or magnitude, or a combination of both, judged in relation to the particular circumstances of the entity. Making materiality judgements involves both quantitative

and qualitative considerations. It would not be appropriate for the entity to rely on purely numerical guidelines or to apply a uniform quantitative threshold for materiality."

The matter discussed below was the subject of a process followed by the Issuer Regulation Investigations Unit, as opposed to a review process. We have included it as we believe that it is of relevance in understanding the JSE's position in this regard.

An issuer determined that a percentage of net asset value was an appropriate benchmark for their materiality for the following reasons:

- the business was in a growth/ recovery stage;
- the earnings were volatile;
- users do not only rely on the profit/ loss of the entity;
- users are more concerned with the progress being made towards the entities stated strategy than the actual level of profit/loss; and
- it's auditor also considered this to be the most appropriate benchmark.

The issuer decided not to adjust for an identified error in the FY1 AFS as, from a quantitative perspective, it was below the materiality threshold. They also took into account the following qualitative perspectives:

- the matter revolved around a complex accounting matter;
- there was no evidence of any intention to misstate the AFS; and
- the error did not arise from fraud or a break down in controls.

As it relates to the quantitative assessment, the JSE was concerned that it was not necessarily appropriate to apply a uniform quantitative materiality across all components of the financial statements.

In the subsequent year (FY2), the issuer passed an entry adjusting for the (cumulative) error. It did not restate the prior period results.

The JSE found that the manner in which the issuer corrected the prior period errors meant that the year FY2 AFS were materially misstated. Whilst the JSE acknowledged that the error may fall below the quantitative materiality level determined by the issuer, its view was that other qualitative considerations had a significant bearing on the assessment of materiality. These included the following:

- 65% of the adjustment made in the FY2 statement of profit or loss related to the results of previous years;
- Correcting the entire error in FY2 resulted in profit before taxation for FY2 being misstated by 38 %;
- the FY2 statement of profit or loss did not faithfully represent the operating results of the issuer for that year;
- the issuer did not disclose the above fact in its AFS;
- the trend (over a 3 year period, past and future) in the growth profit (and other key ratios) was materiality distorted; and
- the trend in profit was an important matrix for users to assess the issuers delivery of its strategy.

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 (2023)
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.

Matter 2 (2023 common findings)

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).

Matter 3 (2022)

Paragraph 43 of IAS 7 *Statement of Cash Flows* states that: "Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements…"

We had an instance where a repayment was made in the form of gold bullion (i.e. a non-cash item) against a borrowing originally advanced in cash. This repayment was incorrectly classified by the issuer as a cash outflow under financing activities. The issuer acknowledged that the repayment using gold bullion should have been accounted for as a non-cash movement in its cash flow workings, thus leading to a misstatement of both the reported cash flows from operating and financing activities in the SCF.

Matter 4 (2021)

Paragraph 50(a) of IFRS 16 states that a lessee shall classify cash payments for the principal portion of the lease liability within financing activities in the SCF.

We had an instance where cash outflows related to the repayment of the principal portion of lease liabilities was classified under operating activities instead of financing activities. This caused a misstatement to both of these activities on the SCF.

Matter 5 (2021)
The issuer incorrectly classified cash flows associated with the acquisition and disposal of investments in various unit trust portfolios under investing activities in the SCF. In an apparent contrast, changes in the fair value of its investments in unit trust portfolios were presented within a "Loss from operating activities" subtotal in the statement of profit or loss.

Paragraph 16(d) of IAS 7 explains that one of the examples of cash flows arising from investing activities are cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than … those held for dealing or trading purposes).

Paragraph 14 of IAS 7 states that, "Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss."

The issuer confirmed that it actively trades its investments in unit trusts and acknowledged that the associated cash flows should have been classified under operating activities leading to a misstatement of both the reported cash flows from operating and investing activities in the SCF.

Matter 6 (2020)
The issuer classified proceeds from sale of financial investments under investing activities in the SCF. However, its accounting policy described the gain on the sale of financial investments as a principal source of income (i.e. operating in nature). The JSE questioned the apparent inconsistency between the SCF classification and this accounting policy.

We would have expected the proceeds on the sale of the financial investments to have been classified under operating activities if the accounting policy treatment were to be followed. IAS 7.14 states that Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity.

In contrast, if the SCF treatment had to be followed then, we would not have expected such an accounting policy. IAS 7.16(d) states that cash receipts from sales of equity or debt instruments of other entities should be classified under investing activities, unless those instruments are held for dealing or trading purposes.

Matter 7 (2020)
The issuer classified cash outflows related to the repayment of the principal portion of the Group's leases within operating activities instead of within financing activities on the SCF. Paragraph 50(a) IFRS 16 *Leases* states that a lessee shall present cash payments for the principal portion of the lease liability within financing activities on the SCF. In addition, the issuer did not comply with IFRS 16.53(g) which states that a lessee shall disclose the total cash outflow for leases for the period.

Matter 8 (2020 common disclosure omission)
In addition to the two material cases discussed above the misapplication of IAS 7 was the fifth most common topic in the reviews in 2020, specifically in terms of the classification of cash/cash equivalents and restricted cash (paragraphs 6-7 and 48-49).

Cash equivalents are defined in IAS 7.6 as:

- short term, highly liquid investments;
- that are readily convertible into known amounts of cash; and
- are subject to insignificant risk in changes in value.

IAS 7.7 expands the definition of cash equivalents and explains the:

- intention with the classification is that these funds are to be applied to meet short term commitments;
- funds are utilised/ recycled within a relatively short period (say 3 months); and
- classification as a cash equivalent is done when the funds are initially invested. Funds do not therefore 'become' cash and cash equivalents when an instrument is nearing maturity.

We challenged issuers who classified cash balances as being 'restricted' where the issuer was not subject to any external restriction as to how the funds could be used. The ring-fencing or restriction on utilization of funds was due to an internal management decision that could subsequently be revoked should the need arise. The JSE directed these issuers to refrain from referring to the balances as being 'restricted' as this did not faithfully represent the true cash position available to the issuer to satisfy liquidity obligations in future periods.

Matter 9 (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 10 (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 11 (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 12 (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 13 (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 14 (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 15 (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 16 (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 17 (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 18 (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 19 (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 20 (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 21 (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 22 (2016)
The two common SCF classification errors 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 23 (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 24 (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 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 25 (2015)
Non-cash flow items should not be reflected as cash flow items. Examples of errors identified include:

- fair value movements;
- raising a 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 26 (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 subsequent 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 27 (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 28 (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 29 (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 cash flows and should be classified as either financing or operating. They cannot be classified as investing activities.

Matter 30 (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 31 (2014)
The definition of cash equivalents is very specific. An investment in a preference share should therefore not be reflected as part of 'cash equivalents' when it is neither short-dated maturity instruments nor with a liquid market.

Matter 32 (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 33 (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 assets).

Matter 34 (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 35 (2012)
We identified the following cases of incorrect classifications:
- 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.

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 (2022 common finding)
We found shortcomings in the tax rate reconciliations (per IAS 12*)* for 6 issuers. These were concentrated in the requirements of paragraphs 81(c) and 84 in terms of:

- not separately disclosing items that were material to the tax position (i.e. over aggregation of items); and
- using vague labels.

Matter 2 (2022 common finding)
Another matter involving IAS 12 related to deferred tax. Paragraph 61A of IAS 12 states that: "Current tax and deferred tax that relates to items that are recognised, in the same or a different period:

a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).
b) directly in equity, shall be recognised directly in equity (see paragraph 62A).

In other words, the tax effects effectively 'follow' the original item when being recognised in OCI or directly in equity.

In FY2020, the effects of a deferred tax liability on the fair value movement of a cash flow hedging instrument were correctly recognised in other comprehensive income ("OCI"). In FY2021 there was a significant change in the fair value of cash flow hedge such that the deferred tax liability moved to a deferred tax asset. To account for the related deferred tax movement in the FY 2021 the issuer:

a) reversed the original deferred tax (liability) directly via equity; and
b) recognised an additional deferred tax (asset) via OCI for the remaining fair value movement.

After engaging with them, this issuer acknowledged that the full deferred tax movement (i.e. including item (a)) should have been recorded in OCI. The effect of this error was an overstatement in the other comprehensive loss for the year.

Matter 3 (2021 focus area)
We found shortcomings in the disclosure of IAS 12 *Income Tax* issuer across three topics:

- the tax rate reconciliation not providing meaningful information for multi-jurisdictional entities (paragraphs 81(c) and 84);
- over aggregation of items within the tax rate reconciliation (paragraphs 81(c) and 84);
- insufficient entity specific disclosure supporting the recognition of deferred tax asset (paragraph 82).

Matter 4 (2020)
Paragraph 51 of IAS 12 *Income Taxes* explains that the measurement of deferred tax balances shall reflect the tax consequences that follow from the way the entity expects to recover or settle the carrying amount of the respective asset or liability. Land and buildings are separate asset classes. Land is not depreciated, whilst buildings are depreciated over the period the entity expects to use them.

On querying the extent of the deferred tax movement for revaluation gains on owner occupied land and buildings, it emerged that an issuer had erroneously raised a deferred tax liability at the capital gains tax ("CGT") rate for the revaluation of both land and buildings elements.

The CGT rate was appropriate for land element, being a non-depreciable asset; IAS 12.51B. The deferred tax liability recognised on the revaluation gain for the building however should have been calculated with reference to how the carrying amount was to be recovered, which was through use. Consequently, the deferred tax liability on buildings should have been calculated using a higher tax rate (28% vs the effective CGT rate applicable at that time of 18.67%).

Matter 5 (2017/ 8 /9/20 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). Whilst still featuring as one of the top common issues in the 2018 and 2020 reviews, its severity was reduced to in third and second spot (respectively) of the total number of findings in those year.

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).

In the 2020 there were also instances of insufficient disclosures to support the recognition of deferred tax assets (IAS 12.82).

Matter 6 (2016)

An issuer 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 7 (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 8 (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 9 (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 10 (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 11 (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 12 (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 13 (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.

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 a '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 y*ear, 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: Extent of disaggregated revenue (2022 common finding)
Four equity issuers did not disaggregate revenue into sufficient categories to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors (IFRS 15.114).

Geographical considerations (per IFRS 15.B89(b)) in determining disaggregation categories was again a common weakness. This was often linked to the fact that:

- detailed revenue information provided in the investor presentation was not brought through to the AFS as would be expected by IFRS 15.B88(a); and
- segmental information (per IFRS 8) was incorrectly assumed to be the only factor to consider (IFRS 15. B88(b)). Such an approach ignores the fact that consideration must also be given to IFRS 15. B88(a), (c) and B89 to achieve the objectives of IFRS 15.114. Whilst segmental information is a useful starting point, it is not the end point.

The Russian invasion of the Ukraine and the impact of ongoing covid-19 restrictions in China highlight that Europe and Asia are not one homogenous market. Revenue should have been provided on a disaggregated basis between (at least) Western and Eastern Europe and Russia, Mongolia and China. That is because of the different economic factors in those regions (IFRS 15. B87 and B89(b)). These events also highlighted that the process applied to determining the appropriate levels of disaggregation is dynamic. Circumstances can change from year to year and even from year end to the interim reporting date.

Two reoccurring findings from 2021 in terms of disaggregation were:

- Giving insufficient weight to sales channels (IFRS 15.B89(g)). In this instance, the sales channels were ‘low-to-no contact‘ verse ‘full contact’ with customers; and
- Incorrectly justifying non-compliance on the basis of the unavailability of information i.e. that issuers had not created accounting systems to capture that information.

Paragraph 115 of IFRS 15 states that: “An entity shall disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with paragraph 114) and revenue information that is disclosed for each reportable segment.” Illustrative example 41 of IFRS 15 provides guidance in this regard.

One issuer provided the required disaggregation of revenue by geographic region in their revenue note. The segmental report on the other hand only disclosed the issuer’s revenue in terms of its’ segment. The segments were based on the nature of various operations undertaken by the issuer. There was insufficient information to enable a user to understand which of Group’s four different operations/ segments derived revenue from which of geographic regions. In the absence of such information, users are unable to ascertain the level of revenue concentration risk of each operation (by means of that segment) to a particular geographic region.

Matter 2: Extent of disaggregated revenue (2021 focus area)
Several issuers did not disaggregate their revenue in sufficient categories so as to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors (IFRS 15.114).
Some issuers appear to have read IFRS 15.B88(b) to mean that information need only be given if it is reviewed by the chief operating decision maker (per IFRS 8.7). Our response to such argument is that whilst segmental information is a useful starting point for the consideration of disaggregation of revenue, it is not the end point. The objectives of IFRS 15.114 must still be achieved, and consideration must also be given to IFRS 15. B88(a), (c) and B89.

Arguments that the contracts are all the same (IFRS 15. B89(d) and (e)) and therefore disaggregation is not warranted ignores the impact that other factors, such as the type of product, had for example on the total amount of revenue. Giving insufficient weight to sales channels (for example online platforms, wholesale sales or exports) and geographical considerations (in the context of both regions within South Africa and international markets) was also a common weakness. We found instances where issuers gave detailed revenue information on product categories in their investor presentation but did not bring this level of detail into their results, as would be expected when reading IFRS 15.B88(a).

In one instance an issuer had provided information on revenue growth per sales channel in the commentary accompanying their results. Through our engagement they acknowledged that the disclosures per sales channel were required under IFRS. However, they did not yet have the systems in place to accurately capture such information. We were able to close off on our review through accepting their commitment (which they subsequently fulfilled) to provide some limited information in their AFS (which were due for imminent publication) and to ensure full compliance in their next interims.

Matter 3: Presentation of revenue (2022 common finding; 2020 focus area)
Unlike its predecessor (IAS 18 *Revenue*), IFRS 15 only deals with revenue arising from contracts with customers. This does not however mean that there are no other types of revenue or that such items are presented as 'other income' as opposed to revenue.

Revenue arises in the course an entity's ordinary activities (IFRS 15: Appendix A). Therefore, where an entity is an investment holding company (which is often the case in the context of the separate AFS), dividends received and interest income are typically 'ordinary activities' for that entity and must be presented as revenue (paragraph 82(a) of IAS 1 *Presentation of Financial Statements*).

Matter 4: Disaggregation of revenue (2020 focus area adoption of new standards)
Our 2019 Thematic Report highlights the need to provide detailed disaggregated revenue disclosures. We continued to find instances of insufficient disaggregation of revenue (see IFRS 15.114-115 read together with paragraphs B87-B89).

The purpose of such disclosures is to provide categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. The disaggregation process is not restricted to and does not stop with an IFRS 8 *Operating Segments* assessment. Furthermore, providing information to investors in analysts' presentations is a clear indication of a category for disaggregation. The same level of detail is also required in the interims as is presented in the AFS (paragraph 34.16A(l) of IAS 34 *Interim Financial Reporting*).

Matter 5: Revenue recognition: accounting policies (2020 focus area adoption of new standards)

We identified the following omissions in accounting policies:

- a description of the treatment of ‘trade-ins’, discounts and other customer incentives (paragraphs 66-69 and 126); and
- an explanation of the types of transactions giving rise to commission revenue and the payment terms for such revenue (IFRS 15.119(b) read with paragraph (b) thereof)

When measuring the progress of revenue recognition, either using the input or output method, we found the required disclosures of IFRS 15.124 to be:

- absent;
- provided in such a generic manner that their usefulness was limited; or
- lacking the required justification as to why that method provides a faithful depiction of the transfer of the goods/ services.

Matter 6: Revenue recognition: significant judgments and assumptions (2020 focus area adoption of new standards)

IFRS 15 contains detailed and specific requirements for the disclosure of managements’ judgements and assumptions. We found those disclosures to be insufficient in the following instances:

- an explanation as to why the entity recognised both of its revenue streams (being the sale of goods and the separate delivery of a service) at a point in time when seemingly this should not have been the case (paragraph 119(a));
- whether revenue was recognised either at a point in time or over time (paragraph 123(a));
- an explanation as to why all of the service revenue was recognised on a point in time bases, when ordinarily such revenue would be recognised over time (paragraph 123(a));
- why certain performance obligations were highly interdependent, as opposed to being separate performance obligations (paragraph 119). The issuer was entitled to a commission for performing the following obligations:
  (1) Obtaining the customer signature/referral for an insurance product; and
  (2) The ongoing collection of the subscription fee for the insurance product referred to in item (1).

  Although items (1) and (2) are potentially distinct from each other, for this issuer they were highly interrelated. This was because the collections in the micro credit industry (in which the issuer operated) were extremely specialised and very dependent on the branch network, branch level collections strategies and the customer relationship developed at point of sale. As a result, it would be very difficult for a third party to collect the subscription fees successfully over the life of the insurance product;
- a generic (or non-entity specific manner) description of the assessment of the transaction price and the timing of satisfaction of the performance obligations (paragraphs 123-124; 126(b) and B18);
- details of the methods, inputs and assumptions used for determining the transaction price, including estimation of variable consideration (such as rebates and discounts) (paragraph 126). In the instance identified, the issuer had only disclosed the following:

  “*Revenue is recognised net of rebates and discounts provided to the customers*”

  The omitted entity-specific inputs and methodology applied in estimating the variable consideration used for determining the transaction price, related to the fact that:

(1) The discounts and rebates were based on either the volume or value of product purchased within a particular rebate/discount cycle; and
(2) The key account managers responsible for that customer performed assessments of the most likely outcome for those contracts for which the variable consideration may fall.

Matter 7 (2020)
The JSE disagreed with the 'point' at which the issuer recognises revenue attributable to the sale of unserviced land. This matter was the subject of a FRIP referral, see annexure 1.

Matter 8: Triggered by poor trade receivables disclosures (2019)
The disclosure around trade receivables was an additional trigger leading the JSE to question a revenue recognition matter. 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 9 (2019)
[The following matter was assessed under IAS 18 - which has subsequently been superseded by IFRS 15. IAS 18 related matters has been retained as they may still have relevance under IFRS 15.]

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 had 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 10 (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 applied, hence the full revenue number was recognised, and was later subject to impairment provisioning.

Matter 11 (2017 common disclosure omissions)

The omission of interest and dividends received as 'revenue' in the Company AFS (per IAS 18.7 or IAS 1.82(a)) was the area of the third most number of deficiencies identified through the review process in 2017.

Matter 12 (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 13 (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 (2020 common disclosure omissions)

The third greatest number of deficiencies identified through the review process in 2020 related to insufficient disclosure of all related party transactions and balances as is required by paragraph 18 of IAS 24 *Related Party Disclosures*.

Matter 2 (2012)
We identified the following deficiencies in related party disclosures as per IAS 24:

- 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 3 (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 FRIP and is discussed in Annexure 1.

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 depleted 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 Earnings per share for dual class share structures (2023)
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.

Matter 2 (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 3 (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 4 (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 5 (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 (2021)
Paragraphs 18 and 19 of the SAICA Headline Earnings Circular 1/2019 (and its replacement 1/2021; "**the Circular**") explain that the Circular creates detailed rules for all items to ensure consistency. Deviations from the rules are not permitted, even if an entity believes that the distribution between trading and platform remeasurements is inappropriate for their specific business.

Paragraph 14(vii) of the Circular states that, "Included re-measurements are the re-measurements identified in the table in paragraph .21 (Section C) of this circular and are to be included in headline earnings because: they are financial instrument adjustments arising from the application of IFRS 9 (whether as the result of revaluation, impairment or amortisation), except for all reclassified gains and losses for a hedge of a net investment in a foreign operation".

Our findings detected two instances where items were erroneously excluded from headline earnings. The first related to fair value revaluations of derivative financial instruments and the second impairments of loan receivables.

For the impairment of loans case, the issuer explained that the loan was made to an associate. The loan was viewed as being akin to the investment in the associate. They therefore followed the treatment applicable to impairments on equity accounted investments in associates and excluded the impairment from headline earnings.

We reminded the issuer that:

- the Circular is rules-based as opposed to being principle-based;
- in terms of paragraph 19 of the Circular, deviations from the rules are not permitted as that would mean that the Circular does not achieve its objective as described in paragraph 18; and therefore
- the treatment that should have been applied for the impairment of loans receivable is clear.

Matter 2 (2020)

Equity issuers are required to disclose headline earnings per share. In one instance, an issuer erroneously added back the impairment loss incurred on a related party loan in their calculation of headline losses for the period. This led to a 17% understatement of their loss per share. As the related party loan was a financial asset accounted for per IFRS 9, the impairment loss did not qualify as a 'remeasurement item' to be added back per the SAICA HEPS circular.

Matter 3 (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 a financial instrument loan.

What was further noteworthy from this matter was the way the error impacted the results. The error led to an understatement of 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 4 (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 5 (2017)
The starting point of HEPS is 'earnings' as determined by IAS 33. The SAICA Circular on Headline Earnings explains which items are excluded from "earnings" as reported under IFRS. In addressing items accounted for under IAS 39 *Financial Instruments: Recognition and Measurement* [now IFRS 9], 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 6 (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 7 (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 8 (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 9 (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 10 (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 11 (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 12 (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 (2022 common finding)
The misapplication of the disclosure requirements IAS 34 was identified for 8 issuers.

We found a reoccurrence of the following topics, flagged in our previous reports:

- a lack of disaggregation of revenue on the same level as is presented in the AFS (IAS 34.16A(l)); and
- presentation of a 3-line SCF (2014 IFRIC agenda decision).

Other topics included the omission of the following required disclosures:

- capital commitments (IAS 34.15B(e);
- related party transactions (IAS 34.15B(j)); and
- fair value disclosures for financial instruments (IAS 34.16A(j).

There were instances where it was not clear that fair value calculations had been performed (for assets carried at fair value) or, in the face of obvious impairment indicators, that a rigorous impairment calculation was undertaken. IAS 34.28 requires that (absent an accounting policy change) the same accounting policies must be applied in the interims as are applied in the AFS.

One issuer did not include the same headings and subtotals for the income statement in their interims as was included in their AFS (IAS 34.10).

Matter 2 (2021 focus area)
In this matter, investment properties were the most significant assets for the issuer. In their 2020 interims (issued in the midst of the covid-19 pandemic) the issuer stated that:

> "Investment properties were last revalued at (the previous financial year end). Caution needs to be exercised by the user of this announcement, bearing in mind that the valuations were performed without the covid-19 impact".

IAS 1.18 states that:

> "An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policy used or by notes or explanatory material."

The objective of an interim report is to provide timely and reliable financial information aimed at improving the ability of investors to understand the Group's financial condition. IAS 34.28 determines that an entity applies the same accounting policies in its interims as are applied in its AFS. The issuer's accounting policy is to subsequently measure investment property at fair value (Paragraph 33 of IAS 40 *Investment Property*). Consequently, fair value measurement must be applied in the interims.

The issuer initially asserted that there was no reliable information available with which to prepare valuations at the interim reporting date. IAS 34.41 notes that the preparation of interim results will generally require a greater use of estimation than for AFS.

Heightened uncertainty about the future does not justify the non-application of IFRS to determine the fair value at the interim date. This was confirmed by the IASB in their document 'Applying IFRS standards in 2020-impact of covid-19' which highlights that an increase in uncertainty is not a reason to "freeze" estimates.

Estimates must be made based on assumptions that reflect expectations of market participants of business performance and the existing trading environment at the reporting date (B14 of IFRS 13 *Fair Value Measurement*).

IFRS 13.9 defines fair value as the price that would be received to sell an asset at the measurement date. In the South African context in which the issuer operated, a buyer would not pay the same price for an asset at (say) 31 March 2020 as they would six months later. Fair value is a price obtained in the principal market under current market conditions, regardless of whether the price is directly observable (IFRS 13.24). Market conditions are not always perfect. In instances of widespread disruptions to markets (such as the covid-19 pandemic) reliance is placed on unobservable inputs applied in a valuation technique. Unobservable inputs can be developed using the best information available about the assumptions that market participants would use when pricing the asset.

IFRS 13.B23 describes the expected present value technique as a possible valuation approach. In so doing it describes as a starting point the use of a set of cash flows that represents the probability-weighted average of all possible future cash flows. It later caveats this (IFRS 13.B28) by noting that it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. IFRS 9.B5.5.41 and B5.5.42 (applied by analogy) also explain that estimates are neither a worst-case scenario nor an estimate of a best-case scenario but rather an estimation that reflects a range of possible outcomes. A similar requirement for estimates of future cash flows is drawn in IFRS 17.B37, noting that the objective of estimating future cash flows is to consider the full range of possible outcomes. A caveat is again provided in B39 of IFGRS 17 in that, in practice, explicit scenarios may be unnecessary if the resulting estimate is consistent with the measurement objective of considering all reasonable and supportable information available.

On further enquiry it transpired that the issuer was indeed able to estimate the fair value. We found that the issuer had not complied with IFRS as they had not remeasured their investment properties to fair value at the interim date.

If the issuers original assertion regarding the inability to make an estimate was correct (which was not the case) their results would still have been lacking in compliance with IFRS from a disclosure perspective.

IAS 1.7 states that applying a requirement is only impracticable when the entity cannot apply it after making every reasonable effort to do so. The JSE would expect an issuer to apply (at least) the following when considering expected future cash flows (whether for fair value or impairments):

1) Assess feasible future scenarios (for example the end of covid restrictions by a specific date; continuation of current wave ‘structure’; or worsening of the existing situation);
2) Determine the cash flows that relate to each scenario (i.e. return to normal; continuation of outcomes; effect of a worsening); and
3) Apply probabilities to each of the scenarios.

It is almost impossible to envisage a scenario where the high impracticable threshold of IAS 1.131 is triggered in each of the above three steps. We expect that an issuer is likely, at the very least, to be able to apply steps 1 and 2. Management is likely to be considering this type of information in its budgeting process. Should step 3 be problematic, applying IAS 1.17 with IAS 1.131 would compel the issuer to provide all available information that they considered to conclude that it was impracticable to complete the determination of an estimate. The

issuer is required to disclose the information in steps 1 and 2 together with an explanation of the reasonable efforts that they made, including explaining what prevented them from completing the estimation exercise.

The above required disclosures provide valuable information. Not only do they assist investors in building their own models, but they provide insight into the state of the issuers financial reporting procedures. In terms of paragraph 3.84(g)(ii) of the Requirements, the audit committee must ensure that an issuer has appropriate financial reporting procedures in place. In a listed environment it would be extremely rare for a scenario to arise where an issuer cannot, through reasonable efforts, build models to determine expected future cashflows.

Matter 3: Disaggregated revenue in interims *(2021 focus area)*
We remind issuers that the same level of disaggregated revenue detail is required in the interims as is presented in the AFS (IAS 34.16A(l)).

Despite our communication of this potential pitfall, we found several issuers where the information was erroneously omitted in the interims. We do not believe that the application of this aspect of IAS 34 requires a high level of judgement or that it is a complex area of IFRS. We can therefore only conclude that issuers are not considering the messages in our various proactive monitoring reports when preparing their interims. This points to a potential weakness in financial reporting processes which can be easily addressed.

Matter 4 (2017/ 8-common disclosure omissions)
The issue of a three-line statement of cash flows (see statement of cash flow section above) featured as a common disclosure issue for both 2017 (fifth most common) and 2018 (third most common).

Matter 5 (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 6 (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 7 (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 8 (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 9 (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: Disclosure omissions (2022 common finding)
We continue to identify the omission of all or some of the minimum obligations of paragraphs 130 to 134 of IAS 36. In 2022, five issuers had findings under this topic.

There were several instances where there were significant changes in the assumptions used in the impairment calculation compared to the previous year. An explanation should have been provided for such changes (IAS 36.134(d)(ii) or .134(e)(ii)).

In one matter, we questioned why the same discount rate was used for different cash generating units ("CGU's"). It appeared that the nature of the business for the CGU's, and their associated risk, were dissimilar. The issuer provided a detailed explanation and calculation of the different factors affecting each of these CGU's (which coincidently resulted in the same discount rate been applied). We would not have raised this question had the AFS included detailed information on the inputs specific to each unique CGU (per IAS 36.134(d)(ii))

Matter 2 (2021 focus area)
The common finding table was included for the first time in our report issued in February 2018. Poor application of the disclosure obligations of IAS 36 *Impairment of Assets* has featured as a common item since then, and this year is no different.

Our findings continue to reveal the omission of all or some of the minimum obligations of paragraphs 130 to 134 of IAS 36. In 2021 this occurred for 14 issuers. We gave impairments

heightened consideration in the covid-19 environment and shifted our line of questioning in certain areas. We specifically looked for:

a) explanations for significant changes in assumptions (IAS 36.134(d)(ii) or .134(e)(ii)); and
b) disclosures where a reasonably possible change in a key assumption might lead to an impairment (IAS 36.134(f)).

In order to understand (b) above, we asked some issuers to provide us with the amount of the available 'headroom' in their impairment calculations. Those enquiries revealed that certain issuers had very little available 'headroom' and that a very small change in assumptions could lead to an impairment. In such an instance, the entity must provide disclosures quantifying the 'headroom', the value assigned to each key assumption and the amount by which such a key assumption must change for there to be an impairment in terms of IAS 36.134(f).

Matter 3 (2020)
An issuer fully impaired an associate through profit and loss in its interims. Our review identified that the issuer should have recognised this impairment in their preceding AFS.

Paragraph 8 of IAS 36 *Impairment of Assets* states that an entity shall at the end of each reporting period assess whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

Matter 4 (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 5 (2017/ 8 /9 /20 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 to 2019 reviews and the fourth most common omission in the 2020 reviews.

Matter 6 (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 7 (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 8 (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 9 (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 10 (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 11 (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 12 (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: Partial write offs (2023)

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.

Matter 2: Classification of 'loan' to associate (2022)

What began as an enquiry into the impairment assessment of a 'loan' to an associate led us to question the appropriateness of classifying and subsequently measuring this 'loan' at amortised cost. The 'loan' had several features which caused us to question how the business model test of receiving contractual cashflows that were solely principal and interest (the so called SPPI test) were met (paragraph 4.1.2 of IFRS 9 *Financial Instruments*): The specifics of the case were as follows:

- Whilst the loan was interest bearing, interest would only be paid as and when profits and cash resources were available via dividend distributions from underlying subsidiaries;
- The loan agreement stated that no scheduled repayments (of either interest or capital) were to be specified; and (amongst other factors);
- Any loan repayment (whether capital or interest) was subject to the unanimous approval by the Board of the associate.

Given these features, the issuer had no automatic (or contractual) right to receive payment of any and all accrued interest or the capital outstanding without the Board first approving this.

The issuer subsequently amended their AFS to classify funds advanced to the associate as an equity investment in that associate. This was subsequently measured at fair value through profit and loss. The revised classification of the loan affected the risk disclosures provided. When the loan was measured at amortised cost, credit risk disclosures were identified as being appropriate. Given the revised classification, market risk disclosures were required (IFRS 7.40-42).

The incorrect classification of a loan to an associate had the knock-on effect of the disclosures provided under IFRS 7.32. The issuer incorrectly providing credit risk disclosure when they should have proved market risk disclosures.

Matter 3 (2021)
Paragraph 11(c)(i) of IAS 32 *Financial Instruments: Presentation* defines a financial asset as existing where there are contractual rights to receive cash or exchange financial asset from another entity.

We queried the nature of a significant increase in an 'other income' line item in the statement of profit or loss of an issuer's interim report. The issuer explained that it had an agreement whereby it was entitled to recover (from a third party) certain costs it had incurred. The issuer accounted for this agreement by recognising:

- their right to the reimbursements within 'other income'; and
- including the corresponding (equal amount of) costs incurred as an expense within the 'operating expenses' line item.

The issuer subsequently acknowledged the recognition of items in the income statement was incorrect. The arrangement should have only affected the statement of financial position. Whilst the error had no impact on net profit (due to the recognition of the expense which matched the income) the affected line items within the statement of profit or loss were materially misstated.

Matter 4: Financial assets held at fair value through profit or loss (2020)
In its interims an issuer disclosed the ECL rate that it applied to a material financial asset. Given that the financial asset also existed in the AFS preceding the interims, we would have expected to see disclosure of management's inputs, assumptions and estimation techniques for that ECL rate in its AFS (IFRS 7.35G). The AFS provided no such disclosure.

Upon enquiry, the issuer initially responded that the ECL rate was the amount their external auditors reported to management, as the potential error in the valuation of this financial asset in the AFS. At the time, management concluded that this error was not quantitatively material and therefore no adjustment was recognised. The JSE found the issuer's conclusion on materiality to be unconvincing and thus pursued the matter further. It transpired that the:

- Issuer incorrectly used the term 'ECL' to describe a downward fair value adjustment to this financial asset. The asset was subsequently measured at fair value through profit and loss as opposed to at amortised cost; and
- Downward fair value adjustment should already have been processed in the AFS.

As a reminder on bullet point one:

- IFRS 9.5.2.1 allows for a qualifying financial asset to be subsequently measured at fair value through profit and loss; but
- IFRS 9.5.2.2 requires an ECL impairment assessment to be performed on financial assets that are subsequently measured at amortised cost.

Matter 5: 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 6 (2018)

A revenue matter 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 7 (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* *subordinate to all other classes of instruments* (must) *have* *identical features*"….and that *"the* *formula or method used* *to calculate the repurchase or redemption price…* (must be) *the* *same for all instruments in that class"* (emphasis added).

The issuer subsequently agreed that their classification was incorrect.

Matter 8 (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 9 (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, <u>see also</u> IFRS 13 and <u>paragraph AG76</u>)….*(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. [A similar principle is contained in IFRS 9.B5.1.2A].

Matter 10 (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 11 (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 12 (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 13 (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 14 (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 15 (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 16 (2014)
We also identified problems with the subsequent measurement of financial liabilities, specifically debentures. Loans and receivables are to be measured at amortised cost using the effective interest rate method. One issuer incorrectly amortised their premium on a debenture instrument on a straight-line basis. They also neglected to include in the debenture premium an amount for an ‘antecedent’ interest payment and reported this as revenue. This matter is discussed in more detail in annexure 1 as it was the subject of a FRIP case and a guidance letter.

Matter 17 (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 18 (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 19 (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 20 (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 21 (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 22: 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 23 (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: Liquidity risk disclosures (2023 thematic review)

We considered issuer's liquidity risk disclosures against, amongst others, the following aspects of IFRS 7, paragraphs 31, 33, 39 and B11 and well as IAS 1.30A which 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.

Matter 2: Expected credit loss allowances (2023 thematic review)

We considered issuer's liquidity risk disclosures against, amongst others, the following aspects of IFRS 7, paragraphs 31, 35B, 35D, 35F, 35G and 35I. For credit risk exposure and credit risk rating grades, we unpacked the paragraphs 35M and B81 of IFRS 7.

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.

By now issuers should be familiar with the fact that IFRS 7 (and IFRS 9) are not limited to the financial sector only. 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 findings are group under the following themes:

- Default events and write-offs;
- Reason for the ECL allowance;
- Analysis of ECL rate;

- Credit risk rating grades;
- Reconciliations; and
- Collateral.

In line with the format style of other thematic report, our 2023 report includes examples of good and bad disclosures for the 6 themes listed above. Readers are requested to revie the content of pages 12 to 18 of the 2023 report for the details.

Matter 3: Liquidity risk (2022 common finding)
Our most common finding was the in the area of over aggregating the time bands used in the liquidity risk analysis (IFRS 7. B11). This topic is also discussed in our 2021 thematic report (from page 23 onwards) which sets out good and poor examples which demonstrate our concern. Disclosure of appropriate time bands enables users to evaluate the extent of the Company's liquidity risks more clearly.

The second most common theme was the quantum used in liquidity risk disclosures (IFRS 7.39). The maturity analysis must be presented on an undiscounted basis i.e. the actual contract amounts rather than the discounted carrying amounts used in the primary AFS (IFRS 7.B11D.

Matter 4: Credit risk rating grades (2022 common finding)
We challenged an issuer on their credit risk disclosures for credit risk rating grades. Both were special purpose entities, in which the receivables book was their most significant asset class.

Appendix A to IFRS 7 defines credit risk rating as the "rating of credit risk based on the risk of a default occurring on the financial instrument". IFRS 7.35M requires (amongst others) entities to disclose, by credit risk rating grades, the gross carrying amount of financial assets and their exposure to credit risk. This information is to be provided separately for financial instruments for which the loss allowance account is measured at an amount equal to:

a) the 12-month expected credit loss (IFRS 7.35M(a)); and
b) lifetime expected credit losses (IFRS 7.35M(b)).

Paragraph B8I to IFRS 7 explains 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. The grades for which this information is required to be disclosed may therefore differ from (or be in addition to) the generic stage 1; stage 2; stage 3 'buckets' identified by IFRS 9.

In one matter, we challenged the detail disclosed in a credit risk matrix that provided quantitative information of receivables across 11 internally assigned credit risk rating grades. The issuer provided no detail to explain what each of the 11 grades represented - they were simply identified as 'grade 1' to grade 11'. We questioned the issuer on whether the disclosure enabled users to assess the entity's credit risk exposure and understand its significant credit risk concentrations (IFRS 7.35M). Qualitative information (in addition to the quantitative disclosures) is necessary to understand the context of the internal rating grades used to present this information. Without such information users were unable to assess the effect of credit risk on the amount, timing and uncertainty of future cash flows (IFRS 7.35B).

Matter 5: Class of financial assets (2022)
IFRS 7.6 explains that disclosures are required by class of financial instruments and that those classes shall be appropriate groups of financial instruments that takes into account the characteristics of those financial instruments.

In one matter, it appeared that a particular customer grouping could affect the credit worthiness and characteristics of those advances. As such, the groupings could be a relevant factor to consider in determining whether there were additional credit risk rating grades or classes of financial instruments than those disclosed in the notes. Engagement with the issuer revealed that specific terms and conditions may be attached to an advance made to private sector customer but not to an advance made to a public sector customer.

We questioned whether the advances book should have been segregated to reflect more classes and thus more granular disclosure of credit risk should be presented to satisfy the requirements of IFRS 7.35H (the ECL allowance reconciliation). In its subsequent reporting period, the issuer split its advances book (and the related disclosures) to distinguish 'private sector clients' and 'public sector clients'.

Matter 6: Collateral (2022)
An issuer had pledged certain assets against a loan but had omitted the required disclosures per IFRS 7.14. Information that should have been disclosed included the carrying amount of financial assets pledged as collateral (IFRS 7.14(a)) and the terms and conditions relating to the pledge (IFRS 7.14(b)).

Matter 7: Expected credit losses (2021 focus area)
We reached agreement with several issuers that their disclosures under IFRS 7 across a range of topics were insufficient.

The biggest area of weak disclosure related to expected credit loss ("**ECL**") calculations in terms of the omission of:

- ECL assessments being carried out on 'other receivables';
- disclosing *entity specific* inputs and assumptions;
- details that demonstrated how forward looking information had been incorporated into calculations; and
- information that explained how changes in the gross carrying amount of receivables contributed to changes in the ECL.

Matter 8: Credit risk and expected credit loss disclosures (2020 focus area)
We noted many similar findings to those contained in our 2019 Thematic Report regarding credit risk disclosures of IFRS 7 *Financial Instruments: Disclosures*. Our findings were most often characterized by insufficiently detailed or entity specific disclosures being provided that would assist users in understanding the extent of an entity's credit risk, the effect on the amount, timing and uncertainty of future cash flows or how this has changed from prior periods (paragraph 35B). The disclosure of methods, assumptions and inputs (including the use of macroeconomic information) as well how forward looking information has been incorporated into the Group's ECL assessments, should be provided in an entity specific manner (paragraph 35G).

In one case an issuer assumed a remote credit risk for certain transactions in which it acted as a facilitator. It offered lenders an indemnification of the borrowers' obligations arising under the transactions. The issuer considered the risk of a claim to be remote, given that the borrower had provided collateral greater than the value of the scrip lent. They only disclosed the following information in their AFS:

> *"Within the Securities Lending business there is an off-balance sheet exposure relating to bond and equity collateral receivables with a maximum exposure to credit risk of R4,216,290,701"*

Disclosures for 'off-balance sheet' credit risk exposure needs to be in sufficient detail to enable an understanding of why such exposure exists (paragraph35B(c)) and their disclosure fell short in this regard.

IFRS 7.35I requires disclosure of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the ECL allowance. The relative value/ relationship between the ECL provision and gross carrying amount of an asset class is not static in all instances. We asked a number of issuers to disclose more information detailing the reasons why the significant increase/decrease in their ECL allowance was 'out of sync' with the underlying gross carrying amount in a particular period. Such disclosure is emphasised by IFRS 7.35H which asks for details of and an explanation of the changes in the ECL loss account.

Whilst disclosure of a provision matrix is no longer a specific requirement of IFRS 7, we found that many issuers who had applied the simplified impairment methodology made use of (and continued to disclose) a provision matrix in their ECL assessment. We found such information to be most helpful in providing insight into credit risk concentrations (paragraphs 35M and 35N). We must however caution issuers to carefully consider the extent to which such information is aggregated - both in terms of the bands (i.e. types of customers) as well as the 'buckets' (time periods) for which the balances are disclosed as being outstanding for. We queried the usefulness of information when a large proportion of the gross carrying amount was disclosed in a single band (say outstanding for 90 days +) without explaining what proportion was outstanding for (say) 90 days versus 180+ days and what default rates were applied to the different bands.

Matter 9: Liquidity risk disclosures (2020 focus area)

As it relates to the liquidity risk contractual maturity analysis (IFRS 7.39(a)), we identified the following deficiencies:

- insufficient disaggregation of the last column (often presented as 'one to five years') into narrower, more relevant periods (covid-19 has heightened the importance of presenting meaningful, narrow bands);
- omission of interest cash flows; and
- the erroneously inclusion of non-financial liabilities.

We find that many issuers concentrate on the credit risk (and related disclosures) associated with trade receivables only. Whilst trade receivables are often the most significant asset class, we remind issuers that they should evaluate credit risk across all classes of financial assets that are subject to credit risk. They should provide disclosures for all material assets.

Disclosure is still required if, after assessing credit risk for a material asset, the issuer concludes that no/an immaterial ECL provision is required. In such a situation, issuers should state this fact and provide the reasons supporting such an assessment (i.e. the inputs used in making this determination) (see paragraphs 35B, 35F and 35G of IFRS 7).

In one instance, an issuer in the property sector had raised the appropriate ECL provision against tenant trade receivables (in respect of monthly rental receipts) but had overlooked raising a similar provision against utility and rate recovery debtors. This class of financial assets was due from the same group of tenants and therefore subject to similar risk characteristics.

Amounts due from related parties (or inter-group receivables) was a common asset class for which ECL disclosures were found lacking in sufficient detail (or boiler plate). For receivables that are payable on demand, the disclosure in the company AFS should include an assessment of the liquid assets (including restrictions thereon) of the underlying subsidiary's (IFRS 7: 35G). The fact that a receivable is owing by a subsidiary (or related) company does not negate the need to both perform a credit risk assessment and provide disclosure thereof

Matter 10 (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 11 (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 12: 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 is material to the AFS (IFRS 7:40).

Matter 13 (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 14 (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 15 (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 16: 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 17 (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 18 (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 19 (2011)
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 requirement of IFRS 7:
- 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: Owner occupied property (2021)
An issuer included a revaluation (increase) on property, plant and equipment as a gain in the consolidated profit or loss. We questioned why the gain was not presented in other comprehensive income (paragraph 39 of IAS 16 *Property, Plant and Equipment)*.

Upon further enquiry it was found that:
- the property held by a subsidiary was classified as an investment property for that entity and was measured at fair value under IAS 40 *Investment Property*;
- the property was leased to a fellow subsidiary;
- from a group perspective the property was not leased to a party outside of the group and thus was required to be accounted for as owner occupied property plant and equipment at a group level;
- the groups' accounting policy was to measure owner occupied properties on the cost model; and
- the issuer had omitted to reverse the fair value gain when consolidating the affected subsidiary.

Matter 2 (2020)
An issuer incorrectly reclassified property from inventory to investment property and was incorrect to recognise a fair value gain in profit in loss due to the transfer. This gain was also incorrectly presented as two separate transactions being 'deemed revenue' and an associated 'cost of sales'. This matter was referred to the FRIP and is discussed in Annexure 1.

Matter 3 (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.

BEE transactions

Matter 1 (2021)
In vendor-financed transactions, the company issuing the shares also provides the necessary financing to the BEE party to subscribe for those shares. This financing is 'repaid' through dividend receipts on the underlying shares. In most 'vanilla-type' transactions of this nature:

- the identifiable consideration received (or to be received) by the company is less than the fair value of the shares issued to the BEE party; and
- the 'discount' indicates that other consideration has been (or will be) received by the entity.

This triggers an equity-settled share-based payment expense under paragraph 13A of IFRS 2 *Share-based Payments* (and Financial Reporting Pronouncement 2: Accounting for BEE transactions under IFRS) whereby the substance of transaction (rather than its legal form) is recorded. The shares (whilst legally issued) are accounted for as an option. They are only reflected in the AFS as 'issued shares' once the underlying financing has been repaid (often through dividend receipts on the underlying shares).

We considered an instance where an issuer had embarked on a BEE transaction where they did not directly advance the funds to purchase the shares. Instead, the issuer guaranteed the BEE party's loan obligation to a third-party financial institution. The issuer accounted for the transaction at inception by recognising:

- a share-based payment transaction under IFRS 2.13A (representing the 'in substance option' profile of the equity instruments issued to the BEE party); and
- the nominal value of the shares (legally) issued to the BEE party as a normal share-issue transaction. Their argument was this was necessary as the entity had received cash from a party external to the Group (the financial institution).

In subsequent years, the BEE party defaulted on its loan repayments to the financial institution. The financial institution called on the underlying guarantee and the issuer had to

repay the outstanding balance of the BEE party's loan. The issuer recognised the ensuing loan obligations (now triggered as the guarantees were called) against equity, arguing that this was effectively 'undoing' a previous equity transaction.

The JSE found that the accounting treatment applied by the issuer when initially accounting for the transaction was not appropriate under IFRS. At the time that the BEE transaction was concluded, the issuer had presented both:

a) An issue of shares to the BEE party; and
b) A credit to equity (equity-settled share-based payment transaction) representing the issue of an option to the BEE party over the same shares it had already reflected as having 'issued' under (a) above.

This meant that the BEE party was represented as both the owner of the issuer's shares and the holder of an option over those same shares.

The issuers' justification for (b) above was that the benefit for the BEE party was similar to that of an option. The BEE party bore no (effective) obligation to the financial institution to repay loan. They could 'walk away' with no liability to the financial institution for the subscription price of the shares or the related interest on the loan.

Whilst the legal and accounting situation may have been different, only one relationship (i.e. economic event) representing the BEE transaction should have been reflected in the AFS.

The JSE found that, by issuing the guarantee to the financial institution, the issuer bore the legal obligation (for the liability) from day 1. When receiving the cash for the 'shares issued', the issuer should have recognised the liability to the financial institution rather than recognising an additional 'credit leg' in equity. This is supported by IAS 32.19(b) which explains that a contractual obligation which is conditional upon a counterparty (i.e. financial institution) exercising its right to redeem the instrument is a financial liability (to the issuer). This is because the issuer does not have the unconditional right to avoid delivering cash under the arrangement.

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

Matter 3 (2018)
Annexure 1 provides details of a case considered by the FRIP regarding a BEE trust.

Matter 4 (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 5 (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. [Note SIC 12 was repealed by IFRS 10].

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 FRIP case in 2013 on IFRS 2, 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)
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)
We had a matter involving the 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 (2021)
Our inquiry led us to question the accounting treatment applied to certain unconsolidated structured entities of an issuer.

Paragraph 17 of IFRS 10 *Consolidated Financial Statements* states that an investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

It emerged that the issuer's initial assessment of control over these structured entities was incorrect. They concluded that they should have previously consolidated the structured entities as they had:

- power over the structured entities and the ability to use that power to affect their returns from these structured entities; and
- exposure to variable returns as a result of financial guarantees they provided to the lender of those structured entities.

In the context of structured entities, the provision of financial guarantees may often lead to an issuer having to consolidate that entity.

Matter 2 (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 3 (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 4 (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 5 (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 6 (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 7 (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 8 (2015)

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

Matter 9: 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 10 (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 11 (2012)
A large part of the 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 12 (2012)
Other problem areas included the:

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

Matter 13 (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 14 (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; 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: Material income and expenses in the segment report (2023 emerging issue)
This item discussed as matter 2 below (being an emerging issue in 2022) continued to unfold during the course of the year. 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.

> Question 1: Is disclosure required only if the Chief Operating Decision Maker separately review an item?

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.

Question 2: What are the IAS 1.97 disclosures?

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 referred the matter to the IFRS Interpretations Committee of the IASB. (Please note that the IFRIC decision on this matter was finalised in 2024 and is dealt with the 2024 report).

Matter 2: Material income and expenses in the segment report (2022 emerging issue)

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, *or* are otherwise regularly provided to the chief operating decision maker ("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."

Issuers generally disclose individually material income and expense line items by nature in the notes to their AFS, either in terms of paragraph 97 of IAS 1 and/or where another IFRS requires such disclosure (for example, paragraph 53 of IAS 19 *Employee Benefits*). In other cases, issuers disclose material non-cash income and expenses in the reconciliation between profit and cash generated from operations linked to the statement of cash flows.

The above sources identify individually material income/expense line items to which IFRS 8.23 is likely to apply. Specifically, where the above (disclosed) income/expense line items are included in the profit measure that is disclosed on per-segment basis, the items should be separately disclosed on a per segment basis in the segment report.

Upon inquiry, issuers have advanced the following arguments:

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

We disagree with such an approach on the basis that 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 they are regularly provided to the CODM.

Matter 3 (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 4 (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 operating 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 5(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: (2023 common findings)

New findings in 2023 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)).

Matter 2: Disclosure of inputs (2023 and 2022 common finding)

Our reviews found the IFRS 13 disclosures of several issuers to be insufficient. Reocurring problem areas included either the partial or entire omission of:

- significant unobservable inputs - 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)).

Granular details should be provided for the inputs used in the fair value calculations and over aggregation avoided.

Matter 3 (2021 focus area)

Our reviews found the IFRS 13 disclosures of several individual issuers (from a wide range of sectors) to be insufficient. Areas included either the partial or entire omissions of significant unobservable inputs (IFRS 13.93(d)) or the sensitivity analysis for changes in those inputs (IFRS 13.93(h)). There was also an over aggregation of disclosed inputs (IFRS 13.92(c)).

By way of example, in two separate cases we advised that more careful consideration should have been given to the obligations under IFRS 13.92(d) and explanations provided as to why:

- there was an inconsistent impact of covid-19 across different assets, with some assets increasing in value and others decreasing; and
- an increase in base revenue from a plant did not have a positive correlation to the average utilisation rate of that plant.

The incorrect assessment of materiality (also a previous focus area) also had a detrimental impact on the level of disclosures. We disagreed where an issuer had only focused on the size of asset in the context of the balance sheet, without due consideration applied to the possible income statement impact of fair value changes.

Matter 4 (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 5 (2017/ 8 /9/20 common disclosure omissions)

Lack of details regarding unobservable inputs used in valuation models (per IFRS 13.93) was a common disclosure omission identified in reviews from 2017 to 2020. In 2020 it was the most common omission -up from a ranking of fourth place in the three previous periods.

Matter 6 (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 7 (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 8 (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 9 (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 10 (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 11 (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 12 (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 13 (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.

Leases

Matter 1: Lessor accounting for covid-19 lease concessions (2021 focus area)
In its first set of interims published after the covid-19 outbreak, a property entity included the following, limited commentary, when referring to tenant relief measures: "Negotiations with tenants on covid-19 related arrears are ongoing". This limited disclosure triggered a series of enquiries which unravelled to expose a recognition error.

At their interim reporting date, no rent concessions had been granted by the issuer and no tenant contracts had been terminated. Given what the issuer regarded as significant uncertainty regarding the collectability of rent during the hard lockdown, rental income for this period was recognised only to the extent it was probable that it would be received. This resulted in a significant portion of 'unrecognised rental income' not being recorded in the 2020 interims. During our enquiry process the issuer explained that they intended to recognise at least 25% of this amount in their AFS as the probability of collection had

subsequently increased. Their view was that IFRS 16 *Leases* does not contain a collectability threshold for the recognition of lease income, and they therefore developed a new accounting policy based on IFRS 15 *Revenue from Contracts with Customers*.

We found that it was inappropriate for the issuer to look to the IAS 8.10 hierarchy in developing an accounting policy for this matter as:

- Paragraph 17(a) of IAS 1 *Presentation of Financial Statements* indicates that management uses the hierarchy (per IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) in the absence of an IFRS that specifically applies to an item;
- Paragraph 81 of IFRS 16 specifically deals with the revenue recognition of operating lease contracts;
- The impairment requirements of operating lease receivables fall within the scope of IFRS 9 *Financial Instruments* (IFRS paragraphs 2.1 and 5.5.1). IFRS 9 defines a credit loss as "the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e. all cash shortfalls)";
- The issuer previously applied established accounting policies for both recognising revenue and testing receivables for impairment. These policies aligned to the requirements of IFRS 16 and IFRS 9 and should not have been affected by the covid-19 pandemic;
- IAS 34.28 states that an entity shall apply the same accounting policies in its interims that are applied in its AFS; and
- It is inappropriate to depart from IFRS to achieve a particular presentation of an entity's financial performance (IAS 8.8).

The outcome was that the issuer restated their interims to recognise the previously unrecognised rental income and separately considered the collectability of the receivables under IFRS 9.

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.

Please refer to the 'Revenue' section above for common deficiencies as it relates to the presentation of revenue in the 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 so. 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)

[Note this matter was assessed in terms of IAS 18: Revenue which was subsequently replaced by IFRS 15].

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.

Revenue recognition for property sales (2020)

The JSE queried the 'point' at which the issuer recognises revenue attributable to the sale of unserviced land. The issuer's adopted accounting policy resulted in a sale (i.e. revenue) being recognised at the date the customer signs a contract of sale. The JSE found that the requirements to demonstrate transfer of control under IFRS 15 (paragraphs 31 to 45) were not met at the date of signature and that revenue was being recognised prematurely.

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)

[Note this matter was assessed in terms of IAS 39: Financial instruments recognition and measurement which was subsequently replaced by IFRS 9].

In respect of the same issue to which the revenue recognition matter of 2018 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)

[Note this matter was assessed in terms of IAS 39: Financial instruments recognition and measurement which was subsequently replaced by IFRS 9].

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.

Reclassifying inventory to investment property (2020)

The below is a high-level summary of this matter, which was the subject of a FRIP referral.

An issuer held undeveloped and vacant property assets in its property development portfolio. It had classified these assets as inventory as they are sold to customers after development activities and bulk services have been undertaken.

During the period under review the issuer transferred a portion of the undeveloped property erven from inventory (measured at cost) to investment property (subsequently measured at fair value). The issuer recognised a substantial fair value gain in profit and loss due to the transfer.

Paragraph 57 of IAS 40 *Investment Property* sets out the prerequisites for classifying items to investment property stating that a change in use occurs when:

- the property meets the definition of an investment property; and
- there is evidence of a change in use.

An amendment to IAS 40.57 (effective for periods ended on or after 1 January 2018) states that, "*in isolation a change in management's intentions for the use of a property does not provide evidence of a change in use*". IAS 40.BC27 further explains that: "*an entity must have taken observable actions to support such a change*" (emphasis added). The test for transfer therefore requires more stringent requirements than the initial classification as investment property.

The JSE concluded that the evidence of observable actions to support a change in use was insufficient to satisfy the requirements of IAS 40.57. Consequently, the JSE found the reclassification from inventory to investment property by the issuer (and the resulting gain recognised in profit and loss) to be inappropriate under IFRS.

Furthermore, the issuer had presented the abovementioned gain as two separate transactions being 'deemed revenue' and an associated 'cost of sales'.

The JSE also concluded that it was inappropriate to classify the transactions as 'revenue' and 'cost of sales'. IAS 40.63 states that "*any difference between the fair value….and its previous carrying amount shall be recognised in profit and loss*". The reference to 'difference' is a single amount. Furthermore, revenue arises in the course of an entity's ordinary activities (Appendix A to IFRS 15). In this instance, the reclassification was not in the ordinary course of the issuers' activities, it was an internal reclassification.

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 (2019)

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 8or 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.

Consolidation of an incentive trust (2020)

Whilst the JSE referred this case to the FRIP during the course of 2019, it only concluded the matter in 2020, after the publication of the 2019 report (issued in February 2020). The details are therefore included in the report.

An issuer (Company Y) acquired a company (Company B) in Y1. The sellers of Company B provided a profit warranty. The acquisition was effected by Company Y subscribing for new shares in Company B, followed by Company B repurchasing its shares from the existing shareholders. As a result, the sellers of Company B received cash and Company Y shares. An incentive trust ("the Trust") was created and it was agreed that the sellers of Company B would transfer (donate) cash and some of the shares it received in Company Y to the Trust for the purposes of incentivising employees of Company B, in order to ensure that the warranted profits will be met.

Company Y accounted for the acquisition of Company B in Y1 in terms of IFRS 3. The Trust was not consolidated until the Y3 financial year, when Company Y concluded that it controlled the Trust, and consolidated it from the beginning of that year.

The recognition of 'pre acquisition' income

IFRS 10.B92 states that the financial statements of the parent and its subsidiaries (used in the preparation of the consolidated financial statements) should have the same reporting date. If this is not the case, then additional financial information should be prepared for the subsidiary, as of the same reporting date of the parent. Should this not be practicable, the difference in reporting dates should not be more than three months.

When the issuer consolidated the Trust it used the financial statements of the Trust for 23 months. It did so on the basis that these were the first financial statements prepared by the Trust. Donation income was recorded in those financial statements of the Trust for a period before the issuer took control thereof.

IFRS 10.B88 is clear that 'pre-acquisition' income and expenses of a subsidiary cannot be recognised in the consolidated financial statements. A subsidiary is consolidated only from its date of acquisition.

Therefore, if a subsidiary is acquired during a financial period, it is not appropriate to simply include all the income and expenses of that subsidiary from its financial statements:

- adjustments are required to exclude pre-acquisition income and expenses; and
- the reporting dates must be in line with IFRS 10.B92.

The recognition of donation income

The Trust appropriately recognised a donation received (both cash and shares) as income in its financial statements.

The cash and share donations made by the sellers were made for the purposes of ensuring that the profit warranties issued by the sellers would be met. Accordingly, the donations are related to the acquisition by Company Y and hence, to faithfully present the substance of the donations from a group perspective, the donations should be accounted for in this context.

Cash donation
From the perspective of the group (which is a single reporting entity) cash was paid to the sellers, of which an amount was paid back by the sellers in respect of the acquisition.

IFRS 3 *Business Combinations* does not address specifically how payments received from the sellers of a business should be treated. Paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, provides guidance on selecting an accounting treatment when an IFRS does not apply specifically to a transaction.

Given that IFRS 3 does not address specifically how payments received from the sellers of a business should be treated, and applying the requirements of IAS 8.11(a), consideration must be given as to whether any guidance or insights can be gleaned from another IFRS. IFRS 15, *Revenue from Contracts with Customers* addresses payments made to customers when determining the transaction price in the context of measuring the amount of revenue recognised from a contract with a customer. The similarity with the matter under consideration is that there is a transaction in which a payment is made to and received by the same party.

In terms of paragraph 70 of IFRS 15.70, "An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity".

Applying IFRS 15.70 by analogy to payments received from sellers of a business, would result in such payments being recognised as a reduction of the purchase price for the business, unless the payment received is in exchange for a distinct good or service that the entity transfers to the sellers. It was stated explicitly by Company Y that the donation was to ensure that the seller's profit warranty, issued in connection with the acquisition, would be achieved. There is no evidence that the cash donation received was in exchange for distinct goods or services that the group provided to the sellers.

The FRIP was of the view that the cash donation received was not in exchange for distinct goods or services that the group provided to the sellers. Accordingly, the cash donation was not related to a transaction independent of the acquisition. Applying the guidance in IFRS 15.70 in developing an accounting policy for the cash donation, Company Y should have accounted for the cash donation as a reduction of the cash purchase price for the acquisition. Even in the absence of referring to IFRS 15.70, the cash donation should have been treated as part of the acquisition. This is because the purpose of the donation was to incentivise the employees in order to achieve the profit targets in terms of the acquisition, which if not met would affect the amounts receivable by the sellers. The cash donation was not simply a fortuitous gain, even though Company Y may not have insisted upon the donation being made to the Trust and that the sellers made the donation of their own volition. The cash donation related to the acquisition and, in order to faithfully represent it and to reflect the economic reality of the transactions, the cash donation should have been treated as part of the acquisition. The FRIP concluded that the only way to do this was to treat the donation as a reduction of the cash purchase price for the acquisition. The cash donation should not have

been recognised as income, in any period, in the consolidated financial statements of the group.

Share donation
The above conclusion relating to the cash donation applies equally to the share donation received. In addition, the FRIP stated that the requirements of paragraph 33 of IAS 32 should have been applied, which prohibit the recognition of a gain or loss on the reacquisition of an entity's own shares.

Classification and disclosure of equity investments (2022)

The issuer has debt instruments listed on the interest rate market operated by the JSE. A matter relating to fair value disclosures for equity instruments was identified as part of the JSE's proactive monitoring process.

The issuer holds equity investments that were categorised as Level 2 within IFRS 13's Fair Value hierarchy. The investments consist of direct equity investments and third-party managed private equity funds. Given the specialized nature of some of the investments, the FRIP was asked to consider whether classification as level 2 was appropriate.

The second issue that the FRIP was asked to consider was the adequacy of the disclosures for investments held as level 3.

IFRS Requirements
The requirements of IFRS 13 *Fair Value Measurement* relate to the unit of account in which the reporting entity has an ownership interest. This implies that where the ownership interest is in a fund, it is the fund itself rather than the underlying investments for which the disclosure hierarchy level should be determined.

IFRS 13's fair value hierarchy classifies investments into three levels, with level 1 having the highest level of external evidence supporting the valuation and level 3, the lowest level of observability. The classification within a level is based on the degree of observability of the lowest level of material input. To be classified as level 2, all significant inputs should be observable, either directly or indirectly where 'observable inputs' are defined as "inputs that are developed as market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability."

A market-corroborated input that might not be directly observable but is based on or supported by observable market data could be included as a level 2 input. If an adjustment made to a level 2 input which is itself unobservable and significant to the entire measurement, this will result in a level 3 classification for the entire fair value measurement.

IFRS 13's disclosure requirements specify that sufficient information is required to be disclosed to help the user assess the valuation techniques and inputs that have been used to develop the fair value measurement. There are additional specific disclosure requirements for fair value measurements with significant level 3 inputs. These disclosure requirements

need to be considered alongside the disclosure objectives of IFRS 7 *Financial Instruments: Disclosures* which include the requirement to provide disclosures that enable users to evaluate the nature and extent of risks arising from the financial instruments.

Application of IFRS in this matter

Where investments are held in a fund, the unit of account that is relevant when determining the fair value hierarchy level is the investment in the fund and not the underlying investments. It may however be appropriate to consider the fair value of the underlying assets as a basis for determining the fair value of the fund.

Where the fair value of the fund is based on the determination of the net asset value ("NAV") of the underlying investments, determination of the appropriate level within the fair value hierarchy is therefore dependent on the extent to which the inputs into the determination of the fair value of the investments making up the NAV are determinable as well as the subjectivity and magnitude of any adjustments made to that input.

The issuer identified currency exchange rates and firm quotes corroborated with market data as observable direct and indirect inputs used. A 'marketability and other discount rate' factor was also disclosed as an input into the discounted cash flow model used to do the valuations. The FRIP noted that to be observable, there needs to be an actual transaction as opposed to a quote, and that where that transaction takes place at a date other than the reporting date, appropriate adjustments need to be made for the time difference as well as any other differences in contractual terms etc. that a market participant might take into consideration when assessing the market price of an asset.

Assuming that the unit of account is an investment in a fund, then the fair value of the investment in the fund would be measured applying IFRS 13 at the currency in which the fund is denominated. Should this currency differ from the functional currency of the investor, then the investment will be translated from the currency of the investment in the fund to the functional currency of the investor applying IAS 21 *The effects of changes in foreign exchange rates* and not as part of the fair value measurement.

The fair value measurement of a fund is often based on a NAV calculation. A NAV calculation would take into account the exchange rates between the currency of the fund instrument and the underlying currency of the investments held by the fund, if different. In the cases where there is a lack of exchangeability between the fund and the underlying currency of the investments held by the fund, consideration will need to be given to the inputs a market participant may apply where there are potential challenges to accessing the currency at a quoted exchange rate.

The FRIP therefore questioned the extent to which a currency exchange rate presented separately was a significant input into the determination of fair values, but agreed that were it a significant input, it could be an observable input where the currency was exchangeable. If exchangeability was lacking, adjustments to the exchange rate may however be an unobservable input.

The FRIP noted that there are no bright lines of what is considered 'significant' when determining an adjustment made to a level 2 input to the determination of fair value, but the consensus of the review committee was that it is likely to be less than the 20% threshold that was applied by the issuer.

Another factor considered by the review committee in assessing the appropriate level within the fair value hierarchy was the specialized nature of the underlying assets within the fund. If trades in similar assets are infrequent, the market in which any trades take place are not public and the terms of the sale agreements are not publicly available, each of these factors would present challenges to demonstrating the observability of the fair value of the underlying investments making up the fund.

With respect to the application of the disclosure objectives and requirements of IFRS 7 and IFRS 13, to assess the nature and extent of the risks arising from the financial instruments, it is necessary to provide disclosure of the type of investments, the vehicle in which the investments are held and the currency in which the investment is denominated.

The FRIP also noted that without an understanding of the type of investments that were being valued, it was not possible to determine whether the valuation techniques and inputs used were suitable and whether all details had been provided on all significant inputs.

Treatment of loans and the forgiveness thereof (2020)

The JSE questioned whether the substance of a series of related party transactions occurring between the issuer (Company P), its acquired subsidiary (Company S) and the issuers' majority shareholder (Shareholder M) were fairly presented in the AFS.

Initial loan
Company P had acquired Company S from Shareholder M in the period under review. Company P (in its Group AFS) accounted for the transaction as a business combination under common control. A large portion of the acquisition price for Company S payable to Shareholder M (who was the previous 100% shareholder of Company S) was contingent on future profits being earned by a specified reportable segment of the issuer.

Prior to the acquisition, Shareholder M had advanced a 'loan' to Company S. That loan was initially classified (in public documents) as an 'equity loan', i.e. Company S had no contractual obligation to repay any capital amounts to Shareholder M. In response to queries from the JSE, the issuer advised the JSE that the terms of the loan were amended prior to its acquisition of Company S. As a result, the loan was classified as a financial liability. The implication of a liability classification is that the subsidiary would be required to repay the capital amounts to Shareholder M, when Company P obtained control of Company S. Less than a month after the effective date of the acquisition the loan was waived by Shareholder M. The issuer recognised a substantial gain when derecognising the loan (then classified as a financial liability) in profit and loss. The gain contributed to profits being recognised in the specified reportable segment (absent the gain the segment would have recognised a loss before tax) which in turn triggered a portion of the contingent settlement being earned by Shareholder M. The result was that

contingently issuable shares were issued to the Shareholder M under the share purchase agreement in the year in question.

The JSE considered many factors in its assessment of the substance of the transactions. After referring the matter to the FRIP and considering the FRIP's advice, the JSE concluded that the business combination under common control (acquisition of Company S from Shareholder M) and the subsequent waiver of the loan (also by Shareholder M) were inextricably linked and should have been considered one transaction from an accounting perspective. Consequently, the 'loan' acquired by the issuer when it assumed control of Company S should not have been classified as a financial liability, and no 'gain on derecognition' should have been recognised in profit and loss.

The requirement to consider the substance of a transaction (and not merely its legal form) is a cornerstone of IFRS.

Paragraphs 2.12 and 4.59 of the IFRS Conceptual Framework for Financial Reporting (2018) ("the Conceptual Framework") require financial statements to report the substance of the rights and obligations created by contracts. These may, in certain instances, differ from their legal form. In certain cases, a contract (or a group of contracts) may require further analysis to identify the substance of the rights and obligations inferred by those contracts.

The JSE also considered the definition of income in terms of paragraph 4.68 of the Conceptual Framework, which excludes contributions from holders of equity claims from income .

In the JSE's view, reliance on, and reference to, the Conceptual Framework is appropriate considering the purpose of the Conceptual Framework to "*…assist all parties to understand and interpret the* (IFRS) *Standards*" (SP1.1(c), 2018). Accordingly, the JSE considered the Conceptual Framework as an interpretive aid to IFRS and existing IFRS guidance.

Before a transaction is accounted for under IFRS 9 the underlying instrument needs to be classified (by applying IAS 32 *Financial instruments: Presentation*) as either a financial liability (within the scope of IFRS 9) or an equity instrument. A requirement of IAS 32.15 is to consider the substance of contractual arrangements (not only the definition of a financial liability/ equity instrument) when classifying an instrument as either a financial liability or equity. The JSE concluded that the substance of the loan was always equity and it should have been treated as such when accounting for the business combination under common control.

The JSE did not question the treatment of the transaction as a business combination under common control ("BCUCC"). The JSE accepts that BCUCC are scoped out of IFRS 3, and the JSE did not propose the use of acquisition accounting (as set out in IFRS 3) or IFRS 3 as a whole. The JSE did not disagree with the development of an accounting policy for the common control transaction (i.e. application of a merger-based policy in which no goodwill is recognised). Rather, the concern was regarding what is, or is not, included in the scope of that business combination. Paragraph B50 of IFRS 3 *Business Combinations* was considered as providing guidance to determine what should or should not be part of the acquisition which, in turn, goes to what the economic substance of the transaction is.

Paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* identifies, in descending order, how an accounting policy should be developed. Therefore, even though IFRS 3, as a whole, is not applied to the BCUCC, the guidance in IFRS 3.B50 is appropriate (IAS 8.11(a)) when determining what forms part of the business combination.

The general principle in IFRS is that equity instruments are never measured or remeasured (Conceptual Framework 6.89). On the basis that the JSE does not accept that there is substance to the classification of the initial loan as a financial liability there cannot therefore be a gain (on an equity transition). This is supported by the fact that the 'gain on waiver' does not meet the definition of income (per the definition in the Conceptual Framework) as it has been provided by the holder of an equity claim. This principle is further embedded when considering (by analogy) IAS 32.33 which states 'no gain or loss shall be recognised in profit or loss' on any dealings by a company in its own instruments.

IAS 1.15 also explains that:

- financial statements must fairly present (amongst others) the financial position and performance of an entity; and
- fair presentation requires faithful representation of the effects of transactions and other events in accordance with the definitions and recognition criteria for 'income' as set out in the Conceptual Framework for financial reporting.

The BCUCC and the subsequent waiver of the loan were inextricable linked. This required the two transactions to be accounted for as one to reflect their economic substance. Reflecting the loan as a financial liability and recording a gain on the waiver thereof does not lead the transactions being fairly presented.

Further loan
In a subsequent transaction (after having waived the 'loan' to Company S discussed above), Shareholder M advanced a further loan to the issuer. Shareholder M waived the further loan in the subsequent period and the event was accounted for as a gain in P Group's profit and loss. The gain on waiver contributed to profits being recognised in the reportable segment, triggering contingently issuable shares being issued to shareholder M under the share purchase agreement.

Once again, the JSE considered many factors in its assessment of fair presentation of the above transactions. The JSE concluded that the waiver by Shareholder M was, in substance, made by M in his capacity as a shareholder - not lender. No income (gain on waiver) should therefore have been recognised in profit and loss as the transaction was a contribution by the holder of equity claims (Conceptual Framework definition 4.68).

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

The format of the documents referred to below are different to our annual reports, as they include examples of good and poor reporting. We have not included the content herein as they are good standalone documents and is difficult to integrate them into this report. Instead, wish to advise you that they:

- are available on the JSE website; and
- form an integral part of this report.

IFRS 7: Liquidity risk disclosure and excepted credit loss allowances (2023)

Our 2023 report issued in November 2023 contains a section regarding feedback on a limited scope review we performed on credit and liquidly risk matters for financial instruments. It is available on the JSE website through this link.

Cash flow information and disclosures of liquidity and going concern: Limited scope thematic review (2022)

In early October 2022 we concluded our first limited scope review and issued a report titled "Limited scope thematic review: Cash flow information and disclosures of liquidity and going concern". It is available on the JSE website through this link.

Investment property: Common findings report (2020)

In November 2020 we issued a report titled "Investment property: Common findings report". It is available on the JSE website through this link.

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. It is available on the JSE website through this link.

Availability of reports

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