REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2015

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INTRODUCTION

The integrity of financial information is a critical element of a well-functioning market. The objective of the JSE's process of reviewing Annual Financial Statements (**"AFS"**) is to contribute towards the production of quality financial reporting of entities listed on its market. This report provides an overview of the proactive monitoring activities (the "**review process**") undertaken by the JSE during 2015.

This report is intended to be of interest to all market participants, including listed entities (**"Issuers"**), investors, auditors, other regulators and the general public. In addition to providing statistics on our findings, it sets out the important points which came to our attention during the year with a view to assisting Issuers. We have also highlighted specific focus areas that Issuers should be aware of for 2016.

In the last quarter on 2015 we applied the review process to the debt market. The AFS of 10 debt issuers were selected for review. Feedback on that process will only be provided in 2017, once more reviews have been completed. This report therefore gives feedback solely on our reviews of equity Issuers.

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

REVIEW PROCESS

Annexure 1 contains a high-level overview of the review process. The information set out therein remains unchanged from that contained in our report issued in February 2015 other than to highlight that our reviews during the 2015 calendar year covered AFS for the years ending between 28 February 2014 and 30 June 2015.

We made no amendments to the review process itself, which we believe is running efficiently. The one change that was however made was to expand the scope of the information we reviewed, and specifically to review the interim results for Issuers simultaneously with their AFS.

RESULTS

Statistics – what we did

From January to December 2015, 64 AFS and interim results were reviewed and by January 2016, 1 of the cases was still pending finalisation. We wrote query letters to 52 of the Issuers, of which 3 cases (2014-2, 2013-1, 2012-3, 2011-2) resulted in a further referral to the FRIP for advice.

	2011	2012	2013	2014	2015
Letters of query	40	68	59	67	52
Cases closed immediately	16	14	19	18	12
Number of AFS reviewed	**56**	**82**	**78**	**85**	**64**
Cases b/f from previous year		11	15	9	10
Total cases reviewed during period	*56*	*93*	*93*	*94*	*74*
Cases still pending	(11)	(15)	(9)	(10)	(1)
Cases completed during period	45	78	84	84	73

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

Our objective is to cover every Issuer at least once within a 5-year cycle. 2015 marks the end of the first cycle, and a final 11 AFS for this first cycle were reviewed in January 2016 and are therefore excluded from these statistics. We have indicated that we may select Issuers more than once. Within this cycle we reviewed the AFS of 329 Issuers, and performed a further 36 repeat reviews.

Statistics – what we found

Seven cases resulted in restatements of the AFS and public announcements. In consultation with the Issuers, these announcements were made as soon as possible. For a further 6 cases the misstatement was such that we agreed with the Issuer that it could be corrected within the next published results. For a further 17 cases, whilst fortuitously there was no material misstatement, adjustments needed to be made within the next published results to avoid potential investor prejudice. The remaining 25 cases revolved around the smaller disclosure issues that the Issuer will clarify or correct in the future.

	2011	2012	2013	2014	2015
AFS needed restatement and public announcement made	2	7	3	6	7
Non-compliance such that we agreed to a correction within the next published results	2	2	8	5	6
Non-compliance not material this year, but must be corrected in the next results in order to avoid potential investor prejudice	10	10	7	12	17
Subtotal of forced corrections	**14**	**19**	**18**	**23**	**30**
Smaller disclosure issues that will be corrected in the future	15	28	33	36	25
Subtotal of cases with corrections	**29**	**47**	**51**	**59**	**55**
AFS in respect of which no issues were identified, or only potential areas of improvement were identified	16	31	33	25	17[1]
Total cases closed	**45**	**78**	**84**	**84**	**72**

In 2015, material infringements were identified in 9.7% of the closed cases (2014-7.1%, 2013-3.6%, 2012-9%, 2011-4.4%). The cases where corrections were required in future reporting periods was at 31.9% (2014-20.2%, 2013-17.8%, 2012-15.4%, 2011-26.7%) bringing the total number of forced corrections to 41.6% of the closed cases (2014-27.4%, 2013-21.4%, 2012-24.4%, 2011-31.1%).

As in the past, in assessing the potential impact of matters, consideration was given to the number of different issues as well as whether the impact was an IFRS disclosure matter and/or affected the measurement of items within the AFS. For the current period 60% of the 55 cases that needed correction dealt with IFRS disclosures matters (2014-61%, 2013-55%, 2012-68%, 2011-66%), with the remaining 40% impacting both IFRS disclosure and measurement (2014-39%, 2013-45%, 2012-32%, 2011-34%). These figures are calculated based on the year of completion of the review and not the period covered by the AFS and can therefore be distorted when matters carried forward from one year to the next contain measurement issues. If the analysis is done based on the year of initial review, then 63% of the cases closed in 2015 dealt with disclosure matters (2014-64%, 2013-59%,2012-61%, 2011-66%).

[1] this includes the 12 cases that were closed off immediately

The increase in forced corrections in 2015 is contrary to declining trend from 2011 to 2013. the reason for this is two-fold. Firstly, we undertook a more risk based selection approach in 2014 and 2015, as we neared the end of our first cycle. The second reason is due to the implementation of certain new Standards (effective for all Issuers during the review period). Our detailed findings revealed that problems with IFRS 12 and IFRS 13 accounted for 14% of the number of matters identified and were present in 46% of our forced restatement cases. Fortuitously, only a few of these cases revealed problems with the recognition and measurement principles of IFRS. Nevertheless, the omission of material disclosures is inappropriate.

The trends reveal that disclosure matters remain the key area of non-compliance. Under the umbrella of disclosure matters, we refer not just to a lack of disclosure, but also excessive or confusing disclosure. We discourage Issuers from including immaterial disclosures into the AFS in an attempt to avoid enquiries from ourselves and we have taken a more aggressive approach in the past 2 years in insisting that Issuers 'de-clutter' their AFS.

International comparison

Our counterpart enforcers in Europe (through the European Securities Markets Authority (**"ESMA"**)) publish an annual activity report and we have included an extract therefrom for information purposes. A direct comparison of the data is however difficult due to the different reporting and cut off periods. The 2014 activity report (issued in March 2014) is the latest available information. The report does indicate that they have changed the manner in which they report, making 2014 information not fully comparable with the 2010-2013 time series.

The 2014 report indicates that of the 1533 reviews undertaken by the 30 European enforcers during the calendar year to December 2014, 8.7% of those reviews identified material infringements, requiring public announcements or reissuing of AFS. For a further 12.7%, whilst classified as material, the enforcers accepted a correction in the next AFS. Whilst we saw a similar percentage of material infringements in the 2014 period of review, our total forced corrections were higher.

The latest ESMA report also indicates that they will only report on the manner in which European issuers have applied the new IFRS requirements of IFRS 10 to 12 in 2016.

	South Africa	South Africa	South Africa	ESMA[2]	ESMA[3]
Coverage					
Period of review	2013	2014	2015	2013	2014
Reporting date	Feb 2014	Feb 2015	Feb 2016	May 2014	Mar 2015
Reviews closed at reporting date	84	84	72	1 900	1 533
Percentage coverage of population	25%	25%	25%	25%	24%
Findings					
Material infringement, requested re-issuance or immediate public announcements	3.6%	7.1%	9.7%	8.9%	8.7%
Corrections required in future financial statements	17.8%	20.2%	31.9%	17.1%	12.7%
Total forced corrections	21.4%	27.4%	41.6%	26%	21.4%

[2] Information extracted from the ESMA report entitled "Activity report on IFRS enforcement in the Europe in 2013"

[3] Information extracted from the ESMA report entitled "ESMA Report on Enforcement and Regulatory Activities of Accounting Enforcers in 2014"

DETAILED FINDINGS

The objective of providing the information set out in this section is to advise Issuers of the potential pitfalls and to highlight areas for enhancement. In order to be concise, this report does not deal with all non-compliance matters. Certain matters identified during 2015 were discussed in previous reports and are not repeated here. Issuers reading this report for the first time should therefore refer to our previous four years' reports in order to obtain an understanding of all the matters that the JSE have raised, with a continuing view to avoiding similar mistakes.

Our review process could have identified one or several matters for a specific Issuer. The percentages discussed in this section of the report relate to the total number of matters identified and not to the number of Issuers or AFS.

Overview

The following areas continue to be problematic, accounting for 58% of the number of matters identified:

- Instances where we were faced with sloppy drafting;
- Presentation of Financial Statements (IAS 1)[4] and specifically problems with accounting policies and lack of disclosure regarding significant judgements;
- Statement of Cash Flows (IAS 7);
- Income Taxes (IAS 12);
- Financial instruments: Presentation, Recognition and measurement (IAS 32 and IAS 39);
- Interim Financial Reporting (IAS 34) (in our 2015 report we identified this as a new focus area); and
- Impairment of Assets (IAS 36) [4].

A further 14% of the number of issues identified came from the following new standards (which were applicable for years ending on or after 31 January 2014):

- Disclosure of Interests in Other Entities (IFRS 12); and
- Fair Value Measurements (IFRS 13).

[4] although there were still a large number of matters falling into this standard, there was a marked reduction in the number of problems identified compared to 2014

Furthermore, a new problem area (compared to 2014) which warrants discussion is Non-current Assets Held for Sale and Discontinued Operations (IFRS 5).

Whilst not discussed in this report, we wish to highlight the fact that in 2015 we saw a slight increase in the number of problems with the following specific standards compared to 2014:

- Related Party Transactions (IAS 24); and
- Share-based Payments (IFRS 2).

Issuers are referred to our previous reports to familiarise themselves with the types of matters identified with those standards.

General

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

Matters identified relating to poor presentation in the AFS (including confusing terminology), which could have been avoided, remains at around 16%. We are concerned that we continue to find these types of errors, as it points to a potential disregard of one of the core principles of the Requirements. Such errors also raise concern regarding underlying financial knowledge and structures. One such example is the use of the word "negative goodwill". 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.

Presentation of Financial Statements

IAS 1 contains the overall requirements for the presentation of financial statements. We highlight some of the key concerns identified with this Standard below.

Accounting policies

Problems with accounting policies accounted for 6.5% of the matters identified (2014-9%). Whilst it is pleasing to see this number decrease, it would seem to us that these matters are avoidable.

The objective of accounting policies is to inform users for them to understand the financial statements. 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. We therefore expect to see entity specific *significant* accounting policies.

We identified numerous instances of the inclusion of generic accounting policies. We raised several concerns with revenue policies and uncovered instances where the incorrect accounting policies were disclosed.

Issuers also omitted accounting policies for the following unusual or non-recurring transactions:

- Reverse acquisitions;
- Accounting for recharge arrangements on share based payments;
- A non-routine loan linked to treasury shares; and
- Unusual capital structures.

The above list is not exhaustive, and we ask Issuers to review our previous reports as they highlight the types of problems we continue to identify.

Significant judgments and assumptions

During our review process we often engaged with Issuers regarding the judgements they had made in applying their accounting policies. In certain cases, those judgements lacked substance and the accounting needed to be revised. In other instances, we concluded that more disclosure in the AFS of these key issues was necessary.

Whilst there was a decrease in the instances of non-compliance with requirements of paragraph 122 and 125 of IAS 1, regrettably this area still accounted for 4% of the matters we identified. Disclosure in this regard is necessary to ensure an understanding of how the entity has applied its accounting policies. The focus is on matters that entail difficult, subjective or complex judgments and will often be necessary for *unusual* transactions and items.

Although we are unlikely to witness any positive effects until 2017, we hope that the new audit report will help Issuers focus on these matters.

Separate disclosure

Paragraph 97 of IAS 1 states that when an item or expense is material an entity must disclose the amount and nature of the item separately. Materiality is not just a qualitative assessment, as the circumstances that led to the recognition of that line item may be significant.

Correction of errors

IAS 8 explains the manner in which to correct material prior period errors and what disclosure to provide. There was one instance where the Issuer did not clearly identify the fact that they were correcting a material error. Not only was their presentation confusing, but also their lack of transparency runs contrary to the general principles of the Requirements. We are concerned with this type of approach to financial reporting and insisted that the Issuers made an immediate announcement highlighting this issue.

Statement of cash flows

Information about the cash flows of an entity is important to enable investors to evaluate the ability of that entity to generate cash flows and to understand the timing and certainty thereof. The types of errors that we identified are discussed below.

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

- Fair value movements;
- Deferred consideration payable for a business combination;
- Share based payment expenses; and
- Imputed interest.

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

The classification of items within the statement of cash flows is equally important for users and the consequence of any such errors is amplified when, in its interim report, an Issuer provides only the headings in a condensed statement of cash flows. There were instances of misclassifications, with Issuers incorrectly reflecting amounts between the three categories of activities within the statement of cash flows. Examples of this include:

- The purchase of additional shares in an existing subsidiary incorrectly being reflected as an investing instead of financing activities;
- The payment of the contingent consideration for an acquisition incorrectly being reflected as an operating instead of financing activities; and

- Cash held by a subsidiary on acquisition being incorrectly reflected as a financing activity, as opposed to being deducted from the purchase consideration and thus being shown as an investing activity.

Taxation

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.

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.

Interim financial reporting

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.

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

The related party disclosure of paragraph 15B(j) of IAS 34 was the other area of concern. From a review of the subsequent AFS it was clear that there was significant related party information on which the market should have been updated at the interim stage.

Impairment of assets

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.

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.

Financial instruments: Presentation, recognition and measurement

The various problems identified within IAS 32 and IAS 39 are set out below and in Annexure 3.

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.

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.

Finally, the application of IFRS to interest free loans continues to be misapplied. The contract value of such a loan is not its fair value.

Interplay between the Financial Instruments and Business Combinations Standards

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. IFRS3: 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.

Disclosure of interests in other entities

IFRS 12 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'.

As it relates to unconsolidated structured entities, there was a lack of understanding to identify such entities and provide disclosures. Finally, there were instances where summarised financial information and other information required for material associates was omitted.

Fair value measurements

This was the third highest problem area in number of issues behind the 'General' and 'Presentation of Financial Statements' categories. Regrettably, unlike for IFRS 12, there was no visible reduction in problems for Issuer in their second year of implementation.

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.

Certain assets/ liabilities were incorrectly classified within the fair value hierarchy. These included:

- Investment property being classified as a level 2, when 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.

Finally, 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.

Non-current Assets Held for Sale and Discontinued Operations

We identified problems with the application of IFRS 5 for three separate Issuers. One case was referred to the FRIP and is explained in more detail in annexure 3. The key points from the other cases are as follows:

- Non-current assets that are accounted for in accordance with the fair value model in IAS 40- Investment Property are scoped out of the measurement provisions of IFRS 5; and

- 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.

LOOKING TOWARDS THE 2016 REVIEW CYCLE

Issuers should pay careful attention to how the JSE's past findings (as set out above and in our previous reports) could impact their results.

A strong focus will continue on standards that are relatively new, specifically IFRS 10 to 13. In this regard, given the apparent poor application of these new standards, the JSE also urges Issuers to pay careful attention to new developments in IFRS. The Annual Improvements to IFRSs Cycles 2010-2012 and 2011-2013 are effective 1 July 2014.

We remain committed to ensuring that Issuers declutter their AFS. In this regard we will look forward to seeing Issuers embracing the principles set out in the IASB Exposure Draft entitled *Application of Materiality to Financial Statements*.

The JSE is exploring ways to ensure that the content of this report, both in terms of the technical detailed finding and the need to declutter AFS, is given the necessary detailed consideration by Issuers.

ANNEXURE 1 - REVIEW PROCESS

This annexure provides a high level overview of the review process and the information set out below remains unchanged from that contained in our report issued in February 2015.

Selection process

We intend to review every Issuer's AFS at least once within a 5 year cycle and therefore our selection process was largely random. However, we aimed to ensure that we had a view of the entire market. Our selection process therefore was directed to proportional representation across all sectors and all markets. In this regard we also ensured that we covered Issuers of all sizes from the Top 40 to those with a very small market capitalisation. Naturally, as we have approached the end of this 5 year review cycle our ability to perform random selections of AFS has been reduced.

Risk based approach

The review process is not a detailed review of the AFS for compliance with every paragraph of IFRS. Detailed IFRS disclosure checklists are often standard armoury for an Issuer and their auditor and we do not intend to replicate this process. Instead, we follow a risk-based approach. Risk areas will change from year to year and from entity to entity and could include:

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

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

(iii) Matters that are peculiar to the specific circumstances of an entity in that specific year.

At all times our focus is on aspects that are potentially price sensitive or could impact investors understanding of the business.

Collaboration with the University of Johannesburg ("UJ")

A crucial part of this proactive monitoring process is the partnership that the JSE entered into with UJ. Whilst the initial review is based on the predetermined risk areas it is imperative to ensure that the reviewers have comprehensive IFRS knowledge. It is not just a case of ensuring compliance with a specific IFRS disclosure paragraph. Rather the reviewer needs to have a full understanding of all aspects of IFRS in order to understand the potential implications and impact on the AFS of a particular matter and as well as assessing the potential non-compliance within the objective of financial reporting . Each AFS has at least two reviewers working on it, with the final sign off being done by a senior member of the UJ academic staff. The volume of Issuers covered in a year means a large number of skilled staff is required to do the initial reviews. Through the partnership with UJ, the JSE effectively had access to 23 additional qualified personnel.

The following process is followed:

- The selected AFS are sent to the staff of UJ for the initial review;
- A detailed report is prepared for each set of AFS; and
- The handing over of the report marks the end of the involvement in the case by the UJ staff.

Communication with Issuers

The detailed UJ report forms the basis of a potential enquiry by the JSE. JSE staff members then engage with the Issuer, consider and debate the responses.

Aiming to be pragmatic, we have addressed our communication to Issuers in two separate sections. The first sets out matters of a potentially immaterial nature which could assist an Issuer in improving the quality of their financial reporting. The JSE did not require any further action or ask for any response on these matters but simply encouraged Issuers to take account of them with their next results. The second and more important section contains matters that could be price sensitive and therefore required further clarity. In our letter we note that some of these matters could be easily resolved if satisfactory responses are provided in the communication.

Collaboration with the South African Institute of Chartered Accountants ("SAICA")

In 2002 the JSE and SAICA formed the GAAP Monitoring Panel (**"GMP"**), an advisory body of accounting experts to assist the JSE to enforce compliance with IFRS. With the launch of the proactive monitoring process the GMP was renamed the Financial Reporting Investigation Panel (**"FRIP"**). The role of the FRIP under the new process continued as it did in the past. More specifically, the FRIP provides advice to the JSE on cases of possible non-compliance with financial reporting requirements.

The intention of the review process is that only certain cases may be referred to the FRIP. These would be cases where the JSE needed detailed technical advice, for example:

(i) Complex and technical matters; or

(ii) Where there is disagreement between the JSE and an Issuer on a specific matter.

Once referred to the FRIP, a case follows the FRIP process as set out in the FRIP Charter (a copy of which is available on the SAICA website). In summary, each case is considered by a review panel of 5 members selected from the 16 FRIP members (the list of names is also available on the SAICA website). Where a restatement is brought about after a FRIP investigation, reference is normally made in the restatement announcement to the FRIP.

AFS covered

The timing of reviews is impacted by two factors. Firstly, Issuers have 6 months after their year-end within which to distribute their AFS. Secondly, engagement with Issuers only commences once the initial review is performed by UJ and the detailed findings report is delivered to the JSE. Therefore, ignoring cases brought forward from the previous year, our reviews during the 2015 calendar year covered AFS for the years ending between 28 February 2014 and 30 June 2015.

ANNEXURE 2 – JSE LETTER

The 2015 review process did not lead to the issue any guidance letters for equity Issuers. Whilst we will only report on our activities for the debt market in 2016, a letter was issued on 15 October 2015 as it relates to compliance with IFRS. A partial extract of that letter is set out below

Pro active monitoring of Annual Financial Statements for Issuers of Debt Securities

As a pilot for this process the JSE has put a sample of AFS through its process. Approximately a third of the debt issuers are structured entities, and the JSE's pilot sample covered 20% of the effective population. Whilst some disclosure and classification questions will be raised, the JSE was pleased to note that 60% of the sample returned with a clean review. The question areas that were identified (whilst yet to be raised directly with the relevant parties) are highlighted below. The aim of doing this is encourage improvements in the levels of corporate reporting. We therefore ask that debt issuers consider their approach to these issues to ensure the necessary levels of compliance.

Areas for consideration by special purpose vehicles ("SPV's")

Disclosure requirements of IFRS 7 on credit risk disclosures

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 has been done very well in certain cases, in others the disclosure is bland and does 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.

ANNEXURE 3 – FRIP CASES IN 2015

Background

The JSE referred four matters to the FRIP for consideration in 2015. These matters emanated from the review process and other internal processes. Generally FRIP referrals relate to AFS of Issuers, however they could also cover other financial information, such as interim results or pre-listing statements.

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

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

In 2015, the accounting matters that were considered in the FRIP cases are set out below. This discussion is set out in terms of the matters discussed, and as certain cases involved more than one issue there are six separate headings.

It is important to note that in the first matter the FRIP recommended that the JSE issue guidance to the market on a specific matter. We believe that the inclusion of the details in this report is the appropriate place for such guidance.

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

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, *Presentation of Financial Statements*, 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 judgment is required and that disclosure should be provided on the assumptions and uncertainties considered in the exercise of such judgement.

Such disclosure on judgments 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 judgments, 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.

Accounting matters relating to linked units in a property entity

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 an 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.

Antecedent interest

This case also included a matter relating to accounting treatment of antecedent interest, as addressed by the FRIP in 2014. Guidance on the matter was also provided by the JSE in October 2014. Therefore, it is not elaborated upon any further in this report.

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

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, *Inventories* and not IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations.*

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

Determining the residual value of property in the application of the IAS 16, *Property, Plant and Equipment* revaluation model

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, *Fair Value Measurement*.

Accounting for the acquisition of a property in terms of IFRS 3, *Business Combinations*

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.

Treatment of recallable shares in the calculation of IAS 33, *Earnings per Share*

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 (ie 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.