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Dear Sir/Madam

GUIDANCE LETTER: APPLICATION OF IFRS FOR ANTECEDENT INTEREST ON LINKED UNITS

The JSE wishes to bring to your attention a recent matter arising from its pro-active monitoring activities dealing with the treatment of antecedent interest payable by property entities with linked units. This matter was also referred to the Financial Reporting Investigation Panel (“**FRIP**”) for their advice.

Fact pattern

In this specific instance a property entity (“**the issuer**”) with a debenture linked to an ordinary share (“**linked unit**”) issued new linked units between two debenture distribution dates.

The issuer:

- (i) Determined the amount of interest attributable to the newly issued linked units from the last distribution date to the issue date (“**antecedent interest**”) and accounted for this as income;
- (ii) Did not correctly apply their own accounting policy to measure the debenture at fair value plus transaction costs at initial recognition; and
- (iii) Thereafter incorrectly fair valued the debenture, instead of measuring it applying amortised cost using the effective interest rate method.

Application of IFRS

The treatment of antecedent interest in terms of the above fact pattern is not in accordance with International Financial Reporting Standards (“**IFRS**”). It is neither revenue in terms of *IAS 8 – Revenue* standard nor income in terms of the *Framework*. The FRIP advised that this antecedent interest forms part of the cash inflow on the issue of the linked units and should be recognised as part of the

debenture liability's initial carrying amount using the effective interest rate method (*IAS 18.30 and IAS 39.09*).

IAS 39.43 states that when a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Thus the fair value of the debenture liability as determined initially should include the antecedent interest portion, since it is a component of the debenture portion's future contractual cash flows.

Furthermore the debenture liability is then amortised using the effective interest rate in accordance with *IAS 39 - Financial Instruments: Recognition and Measurement* for every separate issue of debentures (linked units).

Conclusion

The JSE urges issuers to pay careful attention to their accounting treatment for both antecedent interest and the measurement of debentures. Whilst we understand that the linked unit structures are in the process of being collapsed, we wish to highlight these principles to ensure that issuers do not take the same approach as it relates to dividends that they may believe accrue on the shares issued in place of the linked unit structures.

Yours faithfully



**A F VISSER: GENERAL MANAGER
ISSUER REGULATION**

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