Report Back on Proactive Monitoring of Financial Statements in 2013

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JOHANNESBURG STOCK EXCHANGE

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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 undertaken by the JSE during 2013.

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. By presenting the points in an uncomplicated manner we also hope that this will help demystify International Financial Reporting Standards (**"IFRS"**) for the public.

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 Issuer.

We were once again pleased with the positive approach adopted by the majority of the Issuers who have been subject to our review process. We encourage Issuers to provide detailed, considered IFRS arguments, in their responses to us. Such an approach aids with the speedy resolution of matters.

REVIEW PROCESS

What we do

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 2013 other than to highlight that our reviews during the 2013 calendar year covered AFS for the years ending between 28 February 2012 and 31 March 2013.

We have also implemented certain amendments to the review process which are discussed below.

Involvement of the audit committee

An important change to our process is that we now address all of our correspondence to the Chairman of the Audit Committee. Previously our initial letter was addressed to the company secretary with the request that, in terms of good corporate governance, it be brought to the attention of the chairman of the audit committee.

We believe that our revised approach is correct as in terms section 94(7)(g) of the Companies Act 2008, the Audit Committee is responsible to receive and deal with any concerns or complaints relating to the AFS. Furthermore in terms of the King Report, in fulfilling its obligations set out in Principle 3.4 of the King Code and overseeing integrated reporting, the audit committee should:

> "consider any evidence that comes to its attention that brings into question any previously published financial information, including complaints about this information. Where necessary, the audit committee should take steps to recommend that the company publicly correct the previously published information if it is materially incorrect".

It is also worth noting that in the UK, for AFS from November 2013, it is expected that the audit committee of a company listed in that jurisdiction must report any interaction that the company had with the IFRS regulator in that jurisdiction. This is due to changes to the UK Corporate Governance Code which requires audit committees to disclosure significant issues that the audit committee considered in relation to the AFS and how they were addressed.

Working for a speedy resolution

Timely completion of reviews is an imperative for the JSE in order to ensure that there is a fully informed market. It's also in the interest of Issuers to receive certainty on the outcome of their review. Delays are sometimes unavoidable in order to ensure that all parties are provided with sufficient time to give the matters due consideration. Nevertheless, the JSE introduced various procedural changes which successfully reduced the time taken to close the average review. The mean time taken to close reviews in the first half of 2013 was reduced to 45 calendar days from 95 calendar days in the comparable 2012 year.

RESULTS

Statistics –what we did

From January to December 2013, 78 AFS were reviewed. We wrote query letters to 59 of the Issuers, of which 1 case (2012-3, 2011-2) resulted in a further referral to the FRIP for advice. By January 2014, 9 of the cases were still pending finalisation.

	2011	2012	2013
Letters of query	40	68	59
Cases closed immediately	16	14	19
Number of AFS reviewed	**56**	**82**	**78**
Cases b/f from previous year		11	15
Total cases reviewed during period	*56*	*93*	*93*
Cases still pending	(11)	(15)	(9)
Cases completed during period	45	78	84

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

Whilst our objective is to cover every Issuer at least once within a 5 year cycle, we have indicated that we may select Issuers more than once. To date therefore, we have reviewed the AFS of 216 Issuers, with 10 repeat reviews.

Statistics – what we found

Three cases resulted in restatements of the AFS and public announcements. In consultation with the Issuers, these restatements were made as soon as possible. For a further 8 cases the misstatement was such that we agreed with the Issuer that it could be corrected within the next published results. For a further 7 cases, whilst fortuitously there was no material misstatement, adjustments needed to be made in future to avoid potential investor prejudice. The remaining 33 cases revolved around the smaller disclosure issues that will be clarified or corrected in the future by the Issuer.

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

* this includes the 19 cases that were closed off immediately

In 2013, material infringements were identified in 3.6% of the closed cases (2012-9%, 2011-4.4%). The cases where corrections were required in future reporting periods was at 17.8% (2012-15.4%, 2011-26.7%) bringing the total number of forced corrections down to 21.4% of the closed cases (2012-24.4%, 2011-31.1%). This declining trend is an encouraging indication that our proactive monitoring process in the regularly changing financial reporting environment is having the desired effect of improving the quality of financial reporting.

In assessing the potential impact of the matter, 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 55% of the 51 cases that needed correction dealt with IFRS disclosures matters (2012-68%, 2011-66%), with the remaining 45% impacting both IFRS disclosure and measurement (2012-32% ,2011-34%). The apparent increase in problems with measurement is due to the fact that many of the 2012 cases which were finalised in 2013 contained measurement issues. If the analysis is done based on the year of initial review, then 64% of the 2013 cases dealt with disclosure matters (2012-62%, 2011-66%).

International comparison

Whilst our counterpart enforcers in Europe (through the European Securities Markets Authority (**"ESMA"**)) have not yet released their 2013 findings, their 2012 activity report provides a useful comparison. The report indicates that of the 2 250 reviews undertaken by the 29 European enforcers during the calendar year to December 2012, 8.6% of those reviews identified material infringements, requiring public announcements or reissuing of AFS. For a further 13.3%, whilst classified as material, the enforcers accepted a correction in the next AFS.

A direct comparison of the data is difficult as the JSE reports in February every year, with pending cases being carried forward to the next period. ESMA on the other hand only produces its report in the last quarter of the following year, when all their reviews for the previous calendar year are completed. Nevertheless our findings are broadly in line with these international trends.

	South Africa	**South Africa**	**ESMA#**
Coverage			
Period of review	2012	2013	2012
Reporting date	Feb 2013	Feb 2014	July 2013
Reviews closed at reporting date	78	84	2 250
Percentage coverage of population	23%	25%	37%
Findings			
Material infringement, requested re-issuance or immediate public announcements	9%	3.6%	8.6%
Corrections required in future financial statements	15.4%	17.8%	13.3%
Total forced corrections	24.4%	21.4%	21.9%

Information extracted from the ESMA report entitled “Activity report on IFRS enforcement in the Europe in 2012”

It is interesting to note that ESMA reported a declining trend in the total forced corrections, as the figure reflected in their 2011 activity report was 30%. The South African experience is similar, as in our 2011 report we indicated that the total forced corrections at 31%.

DETAILED FINDINGS

In the past we have discussed all of the closed cases where a correction was required. The matters identified in last year's report were in many instances similar to those discussed in the prior year. The same trend emerged in 2013, although we were pleased to find that the number of occurrences within many of the standards discussed in our previous reports is reducing. More specifically, our monitoring activities reveal a reduction in problems found in the area of Income Tax (IAS 12) and Financial Instruments Disclosure (IFRS 7).

We have decided not to repeat information that was already communicated. Instead Issuers should refer to our previous two 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.

In this report we have decided to focus on the following key areas:

- Instances where we were again faced with sloppy drafting;
- Presentation of Financial Statements (IAS 1);
- Statement of Cash Flows (IAS 7);
- Earnings per Share (IAS 33) and the Headline Earnings circular;
- Impairment of Assets (IAS 36);
- Share-based Payments (IFRS 2); and
- Segmental Reporting (IFRS 8).

The above list accounted for two thirds of the number of issues we identified and also includes the standards that caused the most material errors.

The Property, Plant and Equipment (IAS 16) and Revenue (IAS 18) standards are also covered as they are not discussed in our previous reports.

Once again the objective of providing the information set out in this section is to advise Issuers of the potential pitfalls and to highlight where the quality could be enhanced. We hope that our amended focus on a reduced number of key issues will be more beneficial to Issuers.

General

Issuers are reminded that 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.

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.

These errors led to unnecessary confusion, and all Issuers are reminded to ensure that they have the necessary processes and procedures in place in order to prevent these types of problems from occurring.

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

Presentation of Financial Statements

IAS 1 contains the overall requirements for the presentation of financial statements. There were various cases where some of the matters covered by this Standard were not adequately addressed. These are discussed below.

Accounting policies

In our previous years' reports we highlighted our concerns with a "boiler plate" approach to accounting policies. Three categories of accounting policy problems were identified: accounting policies that were unnecessary, too generic, or absent. We highlighted our concern with the confusion that is created by these practices. The objective of accounting policies is to inform users so that they can understand the financial statements.

Given that our concerns over accounting policies persisted during 2012 in our report to the market last year we gave a detailed list of the 25 areas where we found problems with accounting policies. We did so with the objective that Issuers should pay more careful attention to the accounting policy section of the AFS and we looked forward to a marked improvement in this regard in 2013.

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.*

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. 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.

The asterisk indicates that this problem area was also highlighted in the previous year's report. Therefore it remains a concern that nearly half of the problem areas have been explicitly pointed out to Issuers. Once again 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. We therefore remind Issuers of the content of paragraphs 117 to 121 of IAS1– *Presentation of Financial Statements* which discusses the presentation of accounting policies.

Significant judgements and assumptions

The next significant problem area with IAS 1 had to do with the requirements of Paragraph 122 and 125 of IAS 1 which requires:

- disclosure of the significant judgments that management makes in the process of applying the entity's accounting policies; and
- sources of estimation uncertainties.

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

There were several instances of insufficient disclosure including:

- consideration of agent vs principle in the context of revenue recognition;
- recognition of revenue in the context of services delivered over time;
- use of the capital gains tax rate to determine deferred tax on an intangible asset;
- determining whether an acquisition was regarded as a business combination or the acquisition of an asset;
- valuation of assets and liabilities;
- the appropriateness of the going concern assumption; and
- determining whether a contribution from a minority shareholder was equity or a liability.

Other comprehensive income ("OCI")

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.

Current/ non- current distinction

Liabilities where the Issuer does not have an unconditional right to defer settlement for at least twelve months must be classified as current liabilities.

Statement of cash flows

We must again stress that 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. Our engagement with the investment community has confirmed this fact on several occasions.

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.

There were two other 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. In another instance dividends received were reflected as part of revenue, yet these were shown as investing activities in the statement of cash flows as opposed to operating activities. We remind Issuers that Paragraph 14 of IAS 7 is clear that cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Investing activities on the other hand represent expenditure made for resources that are intended to generate future income and cash flows (or proceeds from the disposal of such asset).

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.

Property, Plant and Equipment

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 which 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

Revenue forms the backbone of the earnings of an entity. It is therefore critical that Issuers pay careful attention to the disclosure of revenue and their revenue accounting policy.

We encountered an Issuer that did not include the actual method adopted to determine the stage of completion of transactions involving the rendering of services. This caused us to not only question the lack of compliance with the disclosure requirements of paragraph 35(a) of IAS 18, but also whether in fact the measurement of revenue was correct. Paragraph 122 of IAS 1 also states that there must be disclosure of the judgements management has made in applying the entities accounting policies, when such judgement is required. It is therefore insufficient for an entity to state that the sale of goods is recognised when the significant risks and rewards of ownership have been transferred without providing the details of when it believes that this occurs specifically where judgement is involved or where it is not clear when this occurs.

We found instances were Issuers did not provide disclosure of each significant category of revenue and other instances where the accounting policy created the false impression that a specific category (for example dividends) was significant when this was not the case.

There were also some cases where we engaged in lengthy debate with Issuers as to whether or not 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.

Earnings and Headline Earnings per Share

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 (for example convertible loans) excluded from the diluted earnings per share calculation due to their antidilutive effect for the period under review.

We also encountered an instance of the incorrect application of paragraph 24 of IAS 33 as it related 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.

Various problems were also 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.

The Headline Earnings Circular 3/2012 as issued by SAICA ("**Headline Earnings Circular**") is clear on the treatment of the above items and errors of this nature are unnecessary and remain concerning.

Impairment of assets

Compliance with the disclosure requirements of IAS 36 continued to be found wanting in several instances. Insufficient application of all of the disclosure requirements of IAS 36 could point to a more fundamental problem of incorrect measurement and the overstatement of assets and thus we continued to tackle Issuers for their lack of disclosure in this regard. 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.

Share based payments

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.

Once again we also 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.

In September 2013, the JSE issued a detailed guidance letter entitled "Application of IFRS 2 to share incentive schemes containing cash settled option" and Issuers are referred to that letter (a copy of which is attached to this report as Annexure 2) for a more detailed understanding of the specifics of that case.

Segmental reporting

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.

LOOKING FORWARD TO THE 2014 REVIEW CYCLE

We see the introduction of major accounting developments in 2014. IFRS 10, 11, 12 and 13 are all applicable for Issuers with year ends commencing on or after 1 January 2013. Therefore, in addition to paying careful attention to how the JSE's past findings (as set out above) could impact their results, Issuers should pay careful attention to these new standards. Letters to Issuers in this next review cycle are likely to contain probing questions regarding the application of these standards.

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 2013.

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.

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 21 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 and 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 2013 calendar year covered AFS for the years ending between 28 February 2012 and 31 March 2013.

ANNEXURE 2 – JSE GUIDANCE LETTER

10 September 2013

APPLICATION OF IFRS 2 TO SHARE INCENTIVE SCHEMES CONTAINING A CASH SETTLEMENT OPTION

The JSE wishes to bring to your attention a recent matter arising from its pro-active monitoring activities dealing with the treatment of cash settled options. The matter was also referred to the Financial Reporting Investigation Panel ("**FRIP**") for their advice.

Fact pattern

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.

Application of IFRS 2

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 judgment that should be disclosed in terms of IAS 1.

<u>Conclusion</u>

The JSE urges Issuers to pay careful attention to their accounting treatment for share incentive shares where the scheme allows for cash settlement and this option is being utilised.