



Reporting back on proactive monitoring of financial statements in 2019

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Introduction

This report (the “**2019 report**”) provides an overview of the proactive monitoring activities (the “**review process**”) undertaken by the JSE during 2019. The objective of the JSE’s process of reviewing Annual Financial Statements (“**AFS**”) and interim results (“**interims**”) is both to ensure the integrity of financial information and to contribute towards the production of quality financial reporting of entities listed on our market. The review process leads to healthy debate which we believe is important for the credibility of our markets.

The target audience for this report is entities whose securities have a primary listing on the JSE. The 2019 report sets out important findings identified during the year, which we request issuers to consider. It also highlights focus areas that issuers should be aware of for 2020.

We provide details of the review process for new issuers (and directors) to understand the review process. Finally, this report provides statistical findings that highlight the regulatory value of the review process.

Confirmation by audit committees

The JSE specifically requests every issuer’s audit committee to consider the findings contained in this 2019 report and ensure that the issuer takes appropriate action.

In order to assist and ensure that the audit committee is able to give the review findings the necessary consideration, the JSE has taken steps to both reduce the volume of information and improve the ease of use thereof. This section of the report sets out clearly what information must be considered by the audit committee and under what circumstances. Annexure 3 contains a quick checklist of that information.

This 2019 report must be considered by the audit committee. The two JSE reports listed below are incorporated by reference and must also be considered:

- “Final Findings of our Thematic review for compliance with IFRS 9 and 15”, issued on 6 November 2019 (“**IFRS 9/15 Thematic Report 2019**”); and
- “Activities of the Financial reporting Investigation Panel in 2019”, issued on 22 October 2019 (“**the Activities of the FRIP in 2019**”).

Copies of these (and other JSE reports on the review process) are available on the JSE website under the ‘Reports’ heading (“**the JSE website**”) at <https://www.jse.co.za/current-companies/issuer-regulation/accounting-matters>.

Audit committees should also consider our previous reports issued from 2011 to 2018 (“**our PM reports**”), if the issuer:

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

For ease of use, in October 2019 we consolidated our annual PM reports into one report entitled “Combined findings of the JSE Proactive Monitoring of financial statements”:

Reviews done 2011 to 2018" ("the Combined Findings Report"). This report is also available on our website.

Due to the recurring nature of various matters, the JSE also requests that certain specific sections of the Combined Findings Report be considered again. Those sections are discussed under the "Statement of cashflows" and "Common disclosure omissions" headings of this report, and are summarised in Annexure 3.

Detailed findings

The 2019 focus areas

Adoption of new standards

The JSE performed a thematic review for the adoption of the IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. The 'IFRS 9/15 Thematic Report 2019' details our findings in this area.

The report is available on the JSE website and, for the purposes of audit committees' consideration, is an integral part of this report.

Disclosure of judgements and estimates

The disclosure requirements of IAS 1 *Presentation of Financial Statements* applicable to judgements (paragraph 122-124) and estimates (paragraph 125-133) were identified as a focus area in both our 2017 and 2018 reports. In our 2018 report we identified six instances of non-compliance with IAS 1.122, mainly relating to judgements around group accounting. Our number of findings for the past year 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.

The following question should be asked regarding the application or non-application of a specific IFRS: “Is it clear to the reader why we have reached this decision?”

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.

Matters where action was required

This section does not discuss all the cases dealt with in 2019. Instead, we focus on specific aspects from the material cases.

Current liabilities

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*.

Capital raising - accounting for a resultant embedded derivative

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).

Statement of cashflows ("SCF")

Paragraph 10 of IAS 7 *Statement of Cash Flows*, states that the SCF shall report cash flows classified by operating, investing and financing activities. Whilst the incorrect application of these three definitions does not affect the net movement in cash, as previously communicated, the JSE continues to regard material misallocations between the categories in a serious light.

Our findings have detected instances of non-compliance that have been explained in previous reports. In order to prevent the ongoing misapplication of IAS 7, issuers are requested to include the Statement of Cashflow cases on pages 21 to 29 of the 'Combined Findings Report' at their audit committee meeting.

The findings below under the headings: 'revenue recognition' and 'financial assets-trade receivable' emphasise the importance of the SCF and users of the AFS being able to 'follow the cash'.

- Case 1:
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.
- Case 2:
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.

- Case 3:
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%.
- Case 4:
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%.

Property Plant and Equipment (“PPE”)

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 ‘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 year*, 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.

Revenue Recognition

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 has 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 unilaterally affect changes to the asset, thus they did not have the significant risks and rewards of ownership (IAS 18.14).

Financial assets –trade receivables

The disclosure around trade receivables was an additional trigger leading the JSE to question the revenue recognition matter discussed above. 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.

Effective boards should be challenging issuers in scenarios where the ‘story’ across different parts of the AFS does not reflect the same message. Disclosure obligations are not trivial: questions on disclosure can unravel into material measurement matters.

Venture capital exemption in terms of IAS 28

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 Financial Reporting Investigation Panel (“**FRIP**”) and is discussed in detail under the heading Case 1 of Annexure 2.

Headline earnings

The SAICA Headline Earnings Circular has very explicit rules for each type of re-measurement. An issuer incorrectly added back the impairment reversal on an IAS 39 loan.

What was further noteworthy from this matter was the manner in which the error impacted the results. The error led to an understatement of headline earnings per share (“**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. Taking into account 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.

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

BEE transactions

An issuer incorrectly accounted for its BEE scheme. This matter was referred to the FRIP and is included as Case 3 of Annexure 2.

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.

- Case 1: Fair value measurement:

An issuer did not correctly apply IFRS 13 *Fair Value Measurement* 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:

- i. 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.
- ii. 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.

- Case 2: Loans to subsidiaries:

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) take into account expected business activities, divorced from the contractual arrangement. Furthermore, the disclosure obligations of any subsequent impairment loss are different under the two routes.

Common disclosure omissions

Apart from the concerns regarding the disclosures of judgements (which have already been discussed in the 'feedback on the 2019 focus areas' section of this report) we highlight the disclosure areas most commonly found to be wanting in the AFS. The table below ranks the matters per different instances that issuers results were found to be deficient for this specific topic.

| Ranking | |
|---------|--|
| 1 | IAS 12 <i>Income Tax</i> , paragraph 81(c) and 84 Insufficiently detailed tax rate reconciliations |
| 2 | IAS 36 <i>Impairment of Assets</i> , paragraphs 130-134 Insufficient information regarding impairment calculations |
| 3 | IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> , paragraph 49 Correction of errors not reflected as such in a transparent manner |
| 4 | IFRS 13 <i>Fair Value Measurement</i> , paragraph 93 Lack of details regarding entity specific unobservable inputs used in valuation models |
| 5 | IAS 1 <i>Presentation of Financial Statements</i> , paragraphs 31, 117, 119 Accounting policies not entity specific or focussed on significant policies |
| 6 | IFRS 3 <i>Business Combinations</i> , paragraph B64(e) Factors in support of goodwill recognised in the current period not described in an entity-specific manner |
| 7 | IFRS 7 <i>Financial Instruments: Disclosures</i> , paragraph 39(c) Incomprehensive liquidity risk disclosures |

Past findings

To assist with a full understanding of the above topics, issuers are requested to include extracts from the 'Combined Findings Report' at audit committee meetings as follows: Income taxes (pages 30 to 32); Impairments (pages 41 to 43); and Transparency when reporting errors (pages 20 to 21).

Generic wording

In many of the above common errors we have found that, in response to our questions, issuers believe that they are addressing the IFRS requirement and refer us to wording within the AFS. That information is often generic and lacks the required depth of entity specific information.

Generic wording typically:

- can be read with any other set of AFS and still make sense;
- is a cut and paste from illustrative examples of AFS; and/or
- is merely brought forward from previous years AFS.

By way of example, 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.

Generic IFRS 7.39 (c) liquidity risk disclosures include the following narrative before a maturity analysis table:

“The group will utilise undrawn facilities and cash on hand to meet its short-term funding requirements.”

In one matter, 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 liquidity risk disclosures were therefore found to be insufficient.

After reading the disclosure in the AFS, will an independent person have a full understanding of the entity specific circumstances, without needing to ask or look for a further explanation?

Information available elsewhere

On challenging issuers on the usefulness of generic or omitted information, we were often referred to other publically 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).

Meaningful Impairment disclosures

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.

Fair value measurement- competitive harm

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).

The findings in numbers

The purpose of this section is two-fold. Firstly, it enables issuers to understand the process that is followed by the JSE. Secondly, it highlights the fact that, both in South Africa and internationally, a clean auditors' report is no guarantee that the AFS will not subsequently be subject to regulatory challenge and correction where these are found to contain material misstatements. The reason for this is best understood in light of the types of matters that we have found (as discussed in the detailed findings section) as well as the concept of materiality. In the bulk of the cases where we have requested action, we have done so to ensure that there is no future investor prejudice for matters which fortuitously may not have been material in the results that we reviewed.

Review process

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

Ignoring cases brought forward from the previous year, the 2019 calendar year reviews (on both equity and debt issuers) covered AFS for years ending between 31 December 2017 and 28 February 2019.

Statistics

What we did

Between January and December 2019 new reviews we performed on 60 equity issuers' AFS and interim results and 11 debt issuers' AFS. We wrote letters of enquiry to 64 of the issuers, with 7 cases closed immediately without any questions asked. By January 2020 fourteen of the equity cases and three of the debt cases were still pending.

| | Equity | Debt¹ | Total |
|------------------------------------|---------------|-------------------------|--------------|
| Letters of query | 54 | 10 | 64 |
| Cases closed immediately | 6 | 1 | 7 |
| Number of new AFS reviews | 60 | 11 | 71 |
| Cases b/f from previous year | 14 | 3 | 17 |
| Total cases reviewed during period | 74 | 14 | 88 |
| Cases still pending | (14) | (3) | (17) |
| Cases completed during period | 60 | 11 | 71 |

¹ Other hybrid instruments are also reviewed and are included in this category

What we found

Six cases resulted in the restatement of AFS and public announcements being made. In consultation with the respective issuers, these announcements were made as soon as possible. For 6 cases the non-compliance was material from an IFRS perspective, but often, due to the presence of other mitigating factors, not necessarily price sensitive. As such we agreed that the matters would be corrected in the issuers' next results announcement. For a further 22 cases, whilst fortuitously there was no material misstatement for the period reviewed, amendments needed to be made within the next published results to avoid potential investor prejudice. The remaining 21 cases involved smaller disclosure issues that the issuer agreed to clarify or correct in the future.

In 2019 material infringements were identified in 10% of the closed cases (2018-7%) for equity issuers and none for debt issuers (2018-17%). The number of cases where corrections were required in future reporting periods was at 45% (2018-39.5%) for equity issuers and 9.1% for debt issuers (2018-8.3%).

| | 2019 Equity | 2019 Debt | 2019 Total | 2018 Equity | 2018 Debt |
|---|----------------|--------------|---------------|----------------|--------------|
| AFS needed restatement and public announcement made ² | 6 | - | 6 | 3 | 2 |
| Non-compliance was such that we agreed to a correction within the next published results | 6 | - | 6 | 8 | - |
| Non-compliance not material this year, but must be corrected in the future in order to avoid potential investor prejudice | 21 | 1 | 22 | 9 | 1 |
| Smaller disclosure issues that will be corrected in the future | 13 | 8 | 21 | 15 | 7 |
| AFS in respect of which it was concluded that there were no issues | 14 | 2 | 16 | 8 | 2 |
| Total cases closed | 60 | 11 | 71 | 43 | 12 |

In assessing the potential impact of matters for the current period, the number of cases impacting measurement was at 32% (2018-40%) for equity issuers and at 11% (2018-30%) for debt issuers. The remaining 68% and 89% (for equity and debt issuers respectively) therefore related to disclosure issues. The data continues to reveal that disclosure matters remain a key area of non-compliance.

² The 2018 figures include one very old case involving an equity issuer from 2014 which was finally concluded during this period.

International comparison

Our counterpart enforcers in Europe (through the European Securities Markets Authority (“ESMA”)) publish an annual activity report. For information purposes, below is an extract from the ESMA reports with comparisons to our current and previous findings.

A direct comparison of the South African data against international trends is difficult due to the different reporting and cut off periods. Furthermore, regulators have varying powers to require correction action. The 2018 ESMA activity report (issued in March 2019) is the latest available information, which from a period perspective, is best compared to the data contained in our 2018 report.

| | South Africa | | | ESMA ³ | ESMA ⁴ |
|--|--------------|----------|----------|-------------------|-------------------|
| Coverage | | | | | |
| Period when reviews were undertaken | 2019 | 2018 | 2017 | 2018 | 2017 |
| Date of regulator's report | Feb 2020 | Feb 2019 | Feb 2018 | March 2019 | April 2018 |
| Reviews closed at reporting date ⁵ | 71 | 55 | 79 | 885 | 1005 |
| Examination rate (Percentage coverage of population) ⁶ | 17% | 14% | 21% | 15% | 17% |
| Actions | | | | | |
| Material infringement (Requested re-issuance or immediate public announcement) | 8.5% | 9.1% | 2.5% | 7.2% | 8.3% |
| Corrections required in future financial statements | 39.4% | 32.7% | 31.6% | 26.2% | 24.3% |
| Action rate (Total number of instances where action was taken) | 47.9% | 41.8% | 34.1% | 33.4% | 32.6% |

The 2018 ESMA activity report indicates that of the 885 ex-post examinations undertaken by the 28 European enforcers during the calendar year to December 2018, 7.2% of those identified material infringements (requiring public announcements or reissuing of AFS). For a further 26.2%, whilst classified as material, the enforcers accepted a correction in the next AFS. Although the material infringement action rate for the JSE was only 2 percentage points higher (at 9.1% compared to 7.2%) the overall action rate was substantially higher (at 41.8% compared to 33.4%).

Due to both high-profile cases and the technical nature of several cases in 2018, together with the revised approached (as discussed in last years' report), the JSE's examination rate for 2018 was significantly lower than in previous years. This rate was out of line with both

³ Information extracted from the ESMA report entitled “Enforcement and Regulatory Activities of Accounting Enforcers in 2018”

⁴ Information extracted from the ESMA report entitled “Enforcement and Regulatory Activities of Accounting Enforcers in 2017”

⁵ Only the ex-post examinations of financial reports have been considered. European regulators perform ex-ante examinations, which allow them to obtain a higher coverage rate. Given the nature of these reviews there is no re-publication and therefore no action rate to be used for comparative purposes.

⁶ The total South African population is calculated excluding issuers that are both debt and equity issuers as well as replica special purpose vehicles (“SPVs”). A replica SPV is one where the arranger creates an exact replica legal entity for each new debt issuance.

the JSE's own target coverage rate and historical international trends. The JSE expanded its resources for the review process during the calendar year, enabling it to increase the examination rate to the 17% set out above. With the targeted reviews covered in the thematic review process (not discussed in this report) the JSE actually achieved an examination rate of 22%.

On reflection, the increasing technical nature of reviews that the JSE encountered in 2018 do not appear to be unique. The ESMA activity reports reflect a declining examination rate from 19% in 2016 to the level of 15% in 2018. The 2018 ESMA activity report explains that this was due to a combination of two factors. Firstly, there was a shift in the focus of regulators to also review non-financial information and alternative performance measures. Secondly, that the financial statement reviews dealt with more complex and resource intensive matters.

Looking forward - the 2020 review cycle

New IFRS standards

In 2020 there will be a consolidation of the learnings from IFRS 9 and 15, together with consideration of the application of IFRS 16.

Previous findings

Issuers should continue to pay careful attention to how all of the JSE's past findings could impact their results. If problems are highlighted in the AFS for matters that were set out in this (and previous) proactive monitoring reports, audit committees will be asked to explain how they fulfilled their obligation to consider this report and to ensure that appropriate action was taken.

Judgements

We draw attention to the content of 2018 IRBA Public inspections Report. Page 14 of that report highlights the audit regulators' dissatisfaction with the application of professional scepticism by auditors in the area of judgement. The IRBA findings revealed significant deficiencies in this regard. These types of findings have been identified as a common thread in corporate failures and are prevalent in other financial markets across the world. In terms of paragraph 22.15(h) of the JSE Listings Requirements, audit committees receive copies not only of the audit firms' inspection findings performed by IRBA, but also the individual engagement review on their specific AFS.

This report includes various instances involving the exercise of judgement in applying IFRS. We understand the discomfort faced by management and directors alike when matters are found wanting where the auditors gave explicit confirmation that they were comfortable.

Nevertheless, the board of directors are ultimately responsible for the AFS and not the auditors. In line with the international approach, and to assist with better financial reporting, the JSE believes that it should continue to probe judgemental areas, to ensure that these matters are correctly disclosed and that board has the necessary justification for application. The JSE is very mindful of directors' responsibility and recognise that most boards fulfil their duties with the utmost care and skill.

Negative findings may well be identified in the subsequent review of an issuers audit file in the area of judgement. Audit committees could find that they have placed undue reliance on the auditor to sufficiently challenge the judgements applied by management.

Materiality

The consideration of materiality is a cornerstone of IFRS. Our 2017 report included the following:

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) ("The Materiality PS") 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 Materiality PS makes reference, in certain instances, to specific IFRS paragraphs which are mandatory. Nevertheless, paragraph 3 of the Materiality PS states that the document (as a whole) provides non-mandatory guidance and its application is not a pre-requisite to be able to state compliance with IFRS.

Whilst application of the Materiality PS is not mandatory, the JSE is of the view that the Materiality PS is a useful reference point as:

- it is a concise reference point for key materiality requirements of IFRS; and
- applying the Materiality PS provides a solid foundation for materiality discussions.

Where a review process evolves into a discussion on materiality, the JSE may ask issuers to frame their responses in the context of understanding how the decisions made for the specific matter under review fit within the issuers materiality framework. That framework, which could be developed either in line with the Materiality PS or on an alternative basis, should be robust enough to demonstrate that treatment in question is appropriate under IFRS from a materiality perspective.

Annexure 1 - review process

Details of the review process

A high-level overview of the review process was detailed in the 2018 report (and previous reports). That content is not repeated here. It is recommended that individuals that are unfamiliar with the review process should refer back to the 2018 report for a full understanding thereof.

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

Amendments to the review process

Annually we reconsider our review process to ensure that it remains aligned with international trends and attuned to local market developments. No such amendments were made in the past year.

Year to year findings

Given that the:

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

it is possible that a subsequent review of the same issuer may lead to different questions being asked, even where matters are treated on an identical basis from one year to the next.

Annexure 2 – activities of the FRIP in 2019

To provide the market with timely feedback, the JSE issued the 'Activities of the FRIP in 2019' report on 22 October 2019. That report provided information on four FRIP cases under the following headings:

- Case 1: Venture capital exemption in terms of IAS 28;
- Case 2: Property investment – consolidation;
- Case 3: Consolidation of an empowerment trust; and
- Case 4: Disclosure of non-IFRS performance measures as part of segmental reporting.

The content of that report is not repeated here, but is incorporated by reference. The report is available on the JSE website and is an integral part of this report.

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

For ease of reference, this annexure contains the details of the information that must be considered by all audit committees in fulfilling their responsibilities

1. This, the 2019 report;
2. The IFRS 9/15 Thematic Report 2019;
3. The Activities of the FRIP in 2019;
4. The following extracts from the Combined Findings Report:
 - a. Transparency when reporting errors (pages 20 to 21);
 - b. Statement of cashflow (pages 21 to 29);
 - c. Income taxes (pages 30 to 32); and
 - d. Impairments (pages 41 to 43).

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

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