Regulatory Update

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Aims

» develop a more cohesive understanding of accounting and reporting of non-financial items in accordance with IFRS Accounting Standards

» enhance capacity to make/audit/regulate the judgements in applying IFRS Accounting Standards to non-financial items

Overview

» Presentation of financial statements, including statement of cash flows

» Non-financial assets

» Non-financial liabilities

» Business combinations

» Disclosure

Overview: recent regulatory issues

IFRS annual financial statement topics	FRC 23/24 and 22/23	JSE 23 and 22	ESMA 24 and 23
Impairment of assets	1 (ie most prevalent issue) / 1	6	*
Cash flow statements	2 / 3	3	
Financial instruments	3 / 5	2 / 1	*
Revenue	4 / 6	3	*
Presentation of financial statements	5 / 9 +thematics (see below)	1	
Judgements and estimates	7 / 2 +thematic		
Income taxes	7 / 6+thematic	5	
Fair value measurement	9 / 10+thematic	3 / 4	*
Climate-related	9 +thematic		*
FRC and JSE **thematic reviews** and ESMA other issues	Offsetting Judgements & Estimates Discount rates IFRSs 3 & 17 and IAS 33	Cash flow information and disclosures of liquidity and going concern	IASs 24, 28 & 38 IFRSs 3, 8, 10 & 16

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Presentation of financial statements, including statement of cash flows

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Financial statement presentation
Regulatory observation

» *"Matter 1: Presentation of financial statements (2021 focus area)*

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

  » paragraph 117 - providing **accounting policies** (here our findings related to unusual transactions and unusual accounting treatments);

  » paragraphs 17(c) and 31 - providing **additional disclosures** when compliance with the specific requirements in IFRS are insufficient to enable a full understanding (our cases dealt specifically with unusual and complex transactions);

  » paragraph 25 - detailed disclosure to support the **going concern** assumption; and

  » paragraph 113 - **consistency** of presentation between various notes. "

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p7 (**emphasis** added)

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Key sources of estimation uncertainty (IAS 1.125-129)

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Key sources of estimation uncertainty (IAS 1.125-129) Regulatory observation

"Matter 2 (2014)

» There was an **increase in the instances of non-compliance** with requirements of 125 of IAS 1 which requires disclosure of the sources of estimation uncertainties. Examples included

  » valuation of assets and liabilities;

  » calculations for impairments of various assets; and

  » calculations for provisions of bad debts. "

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p19 (**emphasis** added)

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Disclosures about key sources of estimation uncertainty (paragraphs 125-129, 131 and 133 of IAS 1)

» Disclose in a way that helps users understand assumptions/key sources of estimation uncertainty about management's most difficult, subjective or complex judgements that have significant risk of resulting in material adjustment to carrying amounts within the year ahead.

» Typical disclosures:

  » nature of assumption

  » sensitivity analysis on reasonably possible changes (including reasons for the sensitivity)

  » expected resolution

  » changes to past assumptions, if unresolved.

» When impracticable to disclose extent and possible effects of an assumption, disclose nature and carrying amount of the item and that it reasonably possible that on the basis of existing knowledge that outcomes could be materially different from that assumed (paragraph 131)

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Disclosures about key sources of estimation uncertainty Example 1: regulatory commentary fair value of investment property

"Determining fair value has always been a **subjective** matter. It requires issuers to make assumptions about the future and can lead to the incorporation of significant levels of estimation uncertainty into valuation models. **IAS 1.125** requires disclosure of these uncertainties. Our observations of these disclosures are that issuers often include generic (or '**boiler plate**') statements without providing **entity specific** (or useful) information relevant to their particular situation. The consequences of uncertainties following the **covid-19** pandemic are expected to elevate both the level of subjectivity and the importance of these (and other) disclosures."

Source: derived from JSE, *Investment property: Common findings report* (November 2020)

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Disclosures about key sources of estimation uncertainty Example 2: regulatory commentary

» In 2020 an issuer **expected changes in production capacity to have a significant impact** on the recoverable amount of an impairment calculation, yet the issuer provided **no IAS 1.125-129 disclosures**.

Source: JSE, *Reporting Back On Proactive Monitoring Of Financial Statements In 2021*

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Disclosures about key sources of estimation uncertainty
Example 3: regulatory commentary

» We would expect a company to disclose relevant information about estimates and assumptions carrying significant risk of material adjustment in the following year, as required by **IAS 1.125**, **where the company's net assets exceed its market capitalisation, indicating a possible impairment, but no loss has been recognised.**

Source: UK FRC's *Thematic Review Impairment of non-financial assets (October 2019)* p26

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Disclosures about key sources of estimation uncertainty
Example 4: regulatory commentary Covid 19 effects

"The main issues identified were:

- We noted a high number of instances where disclosures around **sensitivities** or ranges of possible outcomes were **incomplete or missing** altogether. We expect accounts to include disclosures in this area."
- Sensitivities for the discount rates used in **value-in use** calculations were only provided for certain key input values, with the commentary stating that there was a risk that those values may increase, thus **implying that the values for which sensitivities were provided do not necessarily express the extent of reasonably possible changes.**
- Companies explained the effect of Covid-19 on **inventory** provisioning, but **it was not clear why certain sensitivity ranges were chosen and what were the key assumptions** on which the sensitivities were based.

Derived from UK FRC's *Covid-19 Thematic Review: Review of financial reporting effects of Covid-19* (07/2020) 14

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Disclosures about key sources of estimation uncertainty
Example 5: regulatory commentary

Because management is likely to be considering relevant information in its budgeting process, the JSE believes that it "is **almost impossible to envisage a scenario where the high impracticable threshold** of IAS 1.131 is triggered" on the basis of its expectation that "an issuer would apply (at least) the following steps when considering expected future cash flows (whether for fair value or impairments):

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

Should step 3 be problematic, applying IAS 1.17 with IAS 1.131 would compel the issuer to provide all available information that they considered to conclude that it was impracticable to complete the determination of an estimate. The issuer is required to disclose the information in steps 1 and 2 together with an explanation of the reasonable efforts that they made, including explaining what prevented them from completing the estimation exercise."

IAS1.17(c) requires **additional disclosures** when compliance with explicit IFRS disclosures is insufficient to enable users to understand the effects of transactions/events/conditions on financial position/performance.

Source: JSE, *Reporting Back On Proactive Monitoring Of Financial Statements In 2021*

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Disclosures about key sources of estimation uncertainty
Example 6: regulatory commentary—better disclosure

Key sources of estimation uncertainty *… A regulatory change of this nature is unprecedented and its impact on customer behaviour will not be known until some years after implementation. As the implementation takes effect and customer behaviour becomes known, this could result in further impairments (or reversals of the existing impairment charge) of assets in the Retail segment. Refer to note 12 for an analysis of the sensitivity of the impairment to a range of reasonably possible changes in assumptions. …*

[Note 12] *For the Retail CGU, the following reasonably possible changes in assumptions upon which the recoverable amount was estimated, would lead to the following changes in the net present value of the Retail CGU:*

Change in assumption	*Decrease in the value in use of Retail CGU £m*
Decrease in forecast operating cash flows by 20%	*109.0*
Increase in discount rate by 1%	*43.5*
Decrease in long term growth rate by 1%	*26.9*

William Hill Annual Report and Accounts 2018

This identifies the assumptions whose change in value may lead to material adjustment.

The company has elsewhere disclosed the 'base case' values for discount rate and long term growth rate in the information about its VIU calculation.

This confirms that management has considered reasonably possible changes, consistent with a significant risk of material adjustment.

In some instances, a company may also need to explain how a material adjustment arises from reasonably possible changes in several assumptions in combination.

Source: UK FRC, *Thematic Review Impairment of non-financial assets* (October 2019) p27

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Most significant judgements unrelated to estimation uncertainty (IAS 1.121-124)

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Most significant judgements unrelated to estimation uncertainty (IAS 1.121-124)
Regulatory observation

"Matter 1 (2021 focus area)

» Matters covered under IAS 1.122 included (inter alia):

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

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p20 and 21 (**emphasis** added)

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Most significant judgements unrelated to estimation uncertainty (IAS 1.121-124) (1)
Regulatory observation

"Matter 4 (2018 focus area)
There were six instances where the disclosures of judgements made by management in applying their accounting policies were **not in line with paragraph 122 IAS 1**. These included:

- » the trigger point to determine **when revenue should be recognised**;
- » whether an acquisition was a **business combination or an asset acquisition**;
- » why an entity was regarded as an **associate despite a 51% shareholding**;
- » the **move to equity accounting** for associates previously accounted for at fair value through profit and loss; and
- » **accounting for common control transactions** and put options involving non-controlling interests\shareholders.

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p22 (**emphasis** added)

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Most significant judgements unrelated to estimation uncertainty (IAS 1.121-124) (2)
Regulatory observation

"We again emphasise that the factual nature of the information supporting the judgement does not negate the need to provide disclosures under IAS 1.122. **The focus should be on how management applies that information against its accounting policies** to achieve compliance with IFRS.

- » Transparent and **fact specific discussion of judgements** and estimates applied to financial reporting is necessary to enable users to have a full understanding of the impact that these significant matters have to the AFS."

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p22 (**emphasis** added)

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Correcting prior period errors

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Reporting prior period errors
Regulatory observation

"Matter 1 (2019 common disclosure omission)

» The third greatest number of deficiencies identified through the review process in 2019 was not reflecting the correction of errors in a **transparent manner**. "

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p24 (**emphasis** added)

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Reporting prior period errors
Regulatory observation

"*Matter 4 (2016):* Our 2015 report contained a section entitled 'correction of errors'. We had further instances where **issuers were not transparent** in their disclosure regarding the correction of material prior period errors (IAS 8). In these instances, we encountered one or a combination of the following problem areas:

- » the item was **labelled as merely being a 'restatement'** or 'representation' and **not identified as being an error**;
- » the disclosures required in terms of IAS 8.49 were provided;
- » whilst the impact of the error was disclosed in terms of paragraph 49(b) of IAS 8, **the item was not labelled as being an error**;
- » a material error was **incorrectly referenced as being a change in accounting policy**; and
- » the issuer **failed to explain and highlight the fact that there was a material error**. …

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p24 (**emphasis** added)

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Regulatory mini-case study 1
Materiality judgement regarding prior period error (1)

- » **An issuer determined** that a **percentage of net asset value was an appropriate benchmark for their materiality** for the following reasons:
  - » the business was in a growth/recovery stage;
  - » the earnings were volatile;
  - » users do not rely on the profit/loss of the entity
  - » users are more concerned with the progress being made towards the entities stated strategy than the actual level of profit/loss; and
  - » **it's auditor also considered this to be the most appropriate benchmark.**

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (28 October 2022), p25-p26 (**emphasis** added)

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Regulatory mini-case study 1
Materiality judgement regarding prior period error (2)

- The issuer decided not to adjust for an identified error in the prior year annual financial statements as, **from a quantitative perspective, it was below the materiality threshold.** They also took into account the following **qualitative perspectives**:
  - the matter revolved around a **complex accounting matter**;
  - there was **no evidence of any intention to misstate** the AFS; and
  - the error **did not arise from fraud or a break down in controls**.

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (28 October 2022), p25-p26 (**emphasis** added)

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Regulatory mini-case study 1
Materiality judgement regarding prior period error (3)
What do you think?

- Consequently, in year it discovered the error, the issuer corrected the cumulative error prospectively, ie it did not restate the prior period results.
- Prospective correction resulted in:
  - 65% of the adjustment made in the current period's profit or loss related to the results of previous years; and
  - profit before taxation for the current year being misstated by 38%.
- The issuer did not disclose the above facts in its current year AFS.

Does the issuer's accounting for the correction of the error likely contravene IFRS Accounting Standards? Choose one of: 1) Yes; or 2) No.

Source: Combined findings of the JSE proactive monitoring of financial statements (28 October 2022), p25-p26 (**emphasis** added)

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Regulatory mini-case study 2
assessing the materiality of a FVM overstatement
What do you think?

- An entity, in error, overstated the fair value of a financial asset classified FVOCI. Consequently, its 2022 financial statements overstates:
  - **Asset:** financial asset classified FVOCI
  - **Income:** fair value change presented in other comprehensive income (OCI)
- The error substantially exceeds the quantified materiality threshold determined with reference to profit for 2022.
- **Management argue that OCI is not relevant** to the materiality assessment because they assert that investors focus only on the profit component of comprehensive income.
- **Is the error material?** Choose one of: 1) Yes; or 2) No.

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Regulatory mini-case study 3
FVOCI defined benefit pension mini-case study
What do you think?

- A company, in error, **double-counted** a pension prepayment. Consequently, its 2022 financial statements **overstates:**
  - **Asset:** pension asset
  - **Income:** change in pension actuarial assumptions income presented in other comprehensive income **(OCI) overstated**
- The error substantially exceeds the quantified materiality threshold determined with reference to profit for 2022. However, the company argued that error was not material because investors only focus on the profit component of performance.
- **Is the error material?**—choose one of: 1) Yes; or 2) No.

*Adapted from: UK FRC Corporate Reporting Review Annual Report 2015, pages 14 & 15 (**emphasis** added)*

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Regulatory mini-case study 4: Kraft Heinz (2018)

"As previously disclosed on February 21, 2019, we received a **subpoena from the SEC** in October 2018 related to our procurement area, specifically the accounting policies, procedures, and internal controls related to our procurement function, including, but not limited to, agreements, side agreements, and changes or modifications to agreements with our suppliers. Following the receipt of this subpoena, we, together with external counsel and forensic accountants, and subsequently, under the oversight of the Audit Committee of our Board of Directors (the "Audit Committee"), conducted an internal investigation into the procurement area and related matters. As a result of the findings from this internal investigation, which was completed prior to the filing of our Annual Report on Form 10-K for the year ended December 29, 2018 on June 7, 2019 and which identified that multiple employees in the procurement area **engaged in misconduct**, we corrected prior period misstatements that generally increased the total cost of products sold in prior financial periods.

Extract from Kraft Heinz 2018 Form 10K Annual Report (**emphasis** added)

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Regulatory mini-case study 4: Kraft Heinz (2018)
What do you think?

"These misstatements principally related to the **incorrect timing** of when certain cost and rebate elements associated with supplier contracts and related arrangements were initially recognized.

We **do not believe** that the misstatements are quantitatively material to any period presented in our prior financial statements."

In your judgement are the commercial income errors in Kraft Heinz's 2018 annual financial statements (including comparative information) material?—choose one of: 1) Yes; or 2) No.

Extract from Kraft Heinz 2018 Form 10K Annual Report (**emphasis** added)

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Regulatory mini-case study 5
Tesco commercial 'income' debacle timeline

- **02/05/2014** Tesco 2014 Annual Report: The Audit Committee notes that commercial income was an area of focus for the external auditors based on their assessment of gross risks. "It is the Committee's view that whilst commercial income is a significant income for the Group and involves an element of judgement, management operates an appropriate control environment which minimises risks in this area. As a result, the Committee does not consider that this is a significant issue for disclosure in its report."
- **29/08/2014** Tesco published the August Statement, which updated the market on Tesco plc's expected trading profit for H1 2014/2015 and expected trading profits for the full year 2014/2015.
- **22/09/2014** Tesco published a trading update (September Statement) in which it "identified an overstatement of its expected profit for the half year, principally due to the accelerated recognition of commercial income and delayed accrual of costs."
- **22/12/2014** UK Financial Reporting Council (FRC) announces its investigation in relation to the preparation, approval and audit of Tesco's financial statements for the financial years ended 02/2012, 02/2013 and 02/2014 and their conduct in relation to the matters reported in its interim results for the 26 weeks ended 23/08/2014.
- **27/02/2015** Warren Buffet writes in his annual letter to shareholders "An attentive investor, I'm embarrassed to report, would have sold Tesco shares earlier. I made a big mistake with this investment by dawdling. … Our after-tax loss from this investment was $444 million, about 1/5 of 1% of Berkshire's net worth."

Regulatory mini-case study 5
Tesco commercial 'income' debacle timeline (continued)

- **29/05/2015** UK FRC announces that in 2015/2016 it will focus on the reporting and the audits of businesses where complex supplier arrangements are prevalent.
- **15/12/2015** UK FRC announces "Boards need to assess materiality through the "right lens" and not use materiality assessments to conceal errors or achieve a particular presentation."
- **26/01/2016** the UK Grocery Code Adjudicator finds that Tesco "knowingly delayed paying money to suppliers in order to improve its own financial position". In particular, "Payments to maintain the margin target were requested from suppliers by Tesco regardless of whether the planned growth had been achieved and regardless of whether Tesco had delivered on its own JBP commitments."
- **09/09/2016** UK Serious Fraud Office (SFO) charges three individuals, Carl Rogberg, Christopher Bush and John Scouler, with Fraud by Abuse of Position and False Accounting.
- **31/10/2016** Bentham Europe Limited reports that "over 125 institutional funds have filed a claim for damages against Tesco PLC (Tesco) for well in excess of £100 million over alleged breaches of the Financial Services & Markets Act in relation to over-statement of earnings."
- **28/03/2017** UK SFO confirms that it has reached an agreement with Tesco which, if approved by the Crown Court, will result in a Deferred Prosecution Agreement becoming effective and will result in Tesco paying a £128,992,500 fine and the SFO's full costs.

Regulatory mini-case study 5
Tesco commercial 'income' debacle timeline (continued)

» **28/03/2017** UK Financial Conduct Authority (FCA) requires Tesco pay restitution to specified stakeholders because "[d]uring the period from the [29] August [2014] Statement to the [22] September [2014] Statement, purchasers of Relevant Securities paid more than they should have done, as a result of the August Statement."

» **28/03/2017** BBC Business Editor Simon Jack reporting on the UK CFO's Tesco DPA "As I said at the time of the Rolls-Royce agreement, when it comes to ethics versus jobs and money, jobs and money usually come out on top."

» **28/03/2017** UK Financial Conduct Authority (FCA) announces that Tesco agrees that they committed market abuse by giving a false or misleading impression about the value of publicly traded Tesco shares and bonds. Tesco have agreed to pay compensation to investors who purchased Tesco shares and bonds on or after the 29/08/2014 and who still held those securities when the statement was corrected on 22/09/2014.

» **05/06/2017** UK FRC announces that it is closing its investigation into the conduct of PwC regarding Tesco's accounts because it has "concluded there is not a realistic prospect that a Tribunal would make an Adverse Finding against PwC…"

» **03/08/2017** BBC reports that "Three former Tesco executives have denied fraud charges in relation to a £326m accounting scandal… A trial is due to start in September."

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Regulatory mini-case study 5
assessing materiality of a deliberate overstatement of profit

» Tesco plc, in error, overstates 'income' from complex arrangements with its suppliers. The financial effects are:
  » profit for 2014: overstated by £53 million
  » profit for years before 2014: overstated by £155 million.
  » 2014 and 2013 statements of financial position: overstated by £208 million and £155 million respectively.

» Quantified materiality thresholds determined by PwC (Tesco plc's then external auditors) with reference to profit are:
  » 2015 (period in which the error is discovered): £50 million
  » 2014: £150 million.

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Regulatory mini-case study 5 assessing materiality of a deliberate overstatement of profit What do you think?

- Matters surrounding the issue are the subject of an investigation by the country's serious fraud office and an industry body to which it is subject (2015 annual financial statements).
  - should fines be levied as a result, these could be material
  - (update September 2016) former Managing Director, former Financial Director and former Commercial Director charged with fraud
- One of the world's foremost investors (Warren Buffet's Berkshire Hathaway Inc) sells shares in Tesco, sighting lost faith in management.
- Tesco appoints new management and 'their' first annual accounts (2015) includes:
  - £4,292 million PPE impairment charges
  - £323 million charge for change in estimate for inventory impairment
- **Is the error in Tesco's 2014 annual financial statements a material prior period error?** Choose one of: 1) Yes; or 2) No.

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Examples—fair value measurement What do you think?

Adapted from Appendix A to Agenda Paper 11A Review of IAS 8 - Distinction between changes in accounting policies and changes in accounting estimates, May 2015 IASB meeting.

If not the correction of a prior period error, are each of the the following: 1) changes of accounting policies; or 2) changes in accounting estimates?

Issue	IAS 8 and
Issue A. Change in the option pricing model for share options from Black and Scholes to Monte Carlo.	IFRS 2
Issue B. Change in the assessment of own credit risk for measurement of financial liabilities at fair value; eg from using a credit default swap curve to using the spread of the most recent debt issuance.	IFRS 13
Issue C. A change of credit value adjustment (CVA) calculation to determine the probability of default.	IFRS 13
Issue D. A change in the valuation technique to measure fair value, eg from a market approach to an income approach (Level 3).	IFRS 13

Fair value measurement **principle**: estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). (IFRS 13.2)

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Statement of cash flows (IAS 7)

Reporting prior period errors
Regulatory observation

"Matter 7 (2019)

» An **issuer presented cashflow items and non-cash flow adjustments interchangeably on the face, incorrectly applying a combination of the 'direct' and 'indirect' methods** described in IAS 7.18. Consequently, there was no distinction between actual cash flows and adjustments made in respect of non-cash flow items. The error was compounded by poor note disclosure hampering an understanding of the true operational cashflows."

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p30 (**emphasis** added)

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Statement of cash flows (IAS 7)
Regulatory mini-case study 1
What do you think?

» Issuer extinguished a loan by physically transferring to the lender gold bullion.

» **Which part of Issuer's cash flow statement is affected by the transfer of gold bullion in settlement of the loan?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on Issuer's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 2
What do you think?

» **Which part of consolidated cash flow statement is affected by the cash outflow in exchange for the acquisition of treasury shares?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on the group's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 3
What do you think?

» Entity B is wholly-owned by Entity A.

» Entity B pays $100 million cash to buy 100% of Entity C when Entity C's only asset is shares in Entity A.

» **Which part of consolidated cash flow statement is affected by the cash outflow in exchange for the acquisition of treasury shares?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on the group's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 4
What do you think?

» **Which part of consolidated cash flow statement is affected by the cash outflow in exchange for extinguishing the non-controlling interest of a partly-owned subsidiary?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on the group's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 5
What do you think?

» **Which part of consolidated cash flow statement is affected by dividends paid to the non-controlling interest of a partly-owned subsidiary?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on the group's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 6
What do you think?

» **Which part of consolidated cash flow statement is affected by cash paid to increase from 60% to 75% the parent's holding of a partly-owned subsidiary?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on the group's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 7
What do you think?

» **Which part of cash flow statement is affected by the cash outflow in settlement of a cash-settled share-based payment?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) Note disclosure only (non-cash transactions); or 5) It depends on the group's accounting policy.

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Statement of cash flows (IAS 7)
Regulatory mini-case study 8
What do you think?

» On the last day of its 2024 financial year, Manufacturer commenced a lease (as lessee) for a new factory. At year-end 2023 RoU asset and lease liability = \$2 billion. No payments are made in 2024.

» **Which part of lessee's cash flow statement for 2024 is affected by the lease?** Choose one of: 1) Operating; 2) Investing; 3) Financing; 4) note disclosure only (non-cash transactions); or 5) It depends on the Lessee's accounting policy.

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Non-financial assets

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Property, plant and equipment (IAS 16)

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Property, plant and equipment (IAS 16)
Regulatory observation

- *"Matter 3 (2014)*
- **Care should be taken when reclassifying property from 'investment property' to 'owner occupied'** to ensure that it is correctly measured under the new IFRS that is applicable. More specifically **'owner occupied property' is subject to depreciation.**
- The decision to classify property as 'owner occupied' or 'investment property' is an area that requires the exercise of significant judgement. **A detailed explanation of the exercise of this judgement to the issuer's specific facts and circumstances must therefore be included in the AFS.** It is also confusing to assign labels to 'owner-occupied property' that imply that they are 'investment property' and vice versa and issuers should avoid such practices."

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p71 (**emphasis** added)

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Property, plant and equipment (IAS 16)
Regulatory mini-case study 1
What do you think?

- **Group** consists of Parent and its subsidiaries (Subsidiary A and Subsidiary B).
- **Subsidiary A** uses the fair value model to account for its investment property, that it **leases to Subsidiary B**.
- **How must Group account for the property that Subsidiary A leases to Subsidiary B?** Choose one of: 1) Fair value model; 2) Cost model; 3) revaluation model; or 4) It depends (specify on what it depend...).

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Property, plant and equipment (IAS 16)
Regulatory mini-case study 2
What do you think?

» Entity **does not depreciate** its owner-occupied building because it is of the view that residual value is > or = to its carrying amount (revalued amount).

» The Entity's view is on the basis of current trends, based on historical information and third party valuations received, the values of the assets are increasing at a rate higher than inflation.

» **Is Entity's practice of not depreciating its owner-occupied building consistent with IFRS Accounting Standards?** Choose one of: 1) Yes; or 2) No.

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Example—depreciation principle
What do you think?

Depreciation **principle**—reflect the pattern in which the depreciable item's service potential is consumed by the entity (IAS 16).

Is the following change: 1) a change of accounting policy; 2) a change in accounting estimate; 3) correction of a prior period error; or 4) it depends (specify on what it depends)?

Issue	IAS 8 and
A change in the depreciation method from straight-line to the units-of-production method.	IAS 16

Adapted from Appendix A to Agenda Paper 11A Review of IAS 8 - Distinction between changes in accounting policies and changes in accounting estimates, May 2015 IASB meeting.

In **02/2021** the IASB issued *Definition of Accounting Estimates (Amendments to IAS 8)* to help entities distinguish changes in accounting estimates from changes in accounting policies (effective date = annual periods beginning on or after 01/01/2023).

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Impairment of assets (IAS 36)

Impairment of assets (IAS 36)
Regulatory challenge

» "**Impairment method**

» We asked for clarification when:

- » It was unclear how **goodwill** had been **allocated to CGUs**, or the methodology appears to have **changed from prior years**;
- » It was not clear how cashflows relating to a significant e-commerce business had been **allocated to CGUs**
- » The allocation of assets to CGUs appeared **inconsistent with segmental information**
- » **Liabilities had been deducted** from the carrying amounts of CGUs."

Source: FRC, *Annual Review of Corporate Reporting*, September 2024, p14 (**emphasis** added)

Impairment of assets (IAS 36)
Regulatory challenge: key inputs and assumptions (1)

- “We questioned companies when:
  - assumptions appeared to be **inconsistent** with those used elsewhere in annual reports, such as viability statements
  - it was unclear how uncertainties related to **climate change** had been reflected in the assumptions used
  - it appeared that cashflows used to estimated ViU included those arising from the **enhancement of assets**
  - **…**

Source: FRC, *Annual Review of Corporate Reporting*, September 2024, p14 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory challenge: key inputs and assumptions (2)

- “We questioned companies when:
  - …
  - budgeted or forecast cash flows used to estimate ViU appeared **to extend beyond five years without explanation**, or included cash flows that had occurred before the date of testing
  - **sensitivity disclosures** that appeared to be required by IAS 36 or IAS 1 had not been given
  - it was not clear whether the disclosed post tax discount rate had been applied to **pre- or post- tax cash flows** when estimating ViU

Source: FRC, *Annual Review of Corporate Reporting*, September 2024, p14 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory observations: Companies should ensure that … (1)

- “they provide adequate disclosures about the **key inputs and assumptions** used in their impairment testing, including justifying the use of financial budgets/forecasts for periods longer than five years [IAS 36.134; IAS 1.125]
  - the **effect of tax is consistently reflected in the discount rates and projected cash flows** used in VIU calculations [IAS 36.51], and the forecasts used for VIU calculations reflect the asset in its current condition [IAS 36.44]
  - impairment reviews and related disclosures **appropriately reflect information elsewhere in the report and accounts** about events or circumstances that are indicators of potential impairment, as well as information about the company’s business operations and principal risks
  - they **explain the sensitivity** of recoverable amounts to reasonably possible changes in assumptions where required [IAS 36.134(f); IAS 1.129] …

Source: FRC, *Annual Review of Corporate Reporting*, September 2024, p15 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory observations: Companies should ensure that … (2)

- …
- Further guidance is available in our previous **thematic reviews on impairment of non-financial assets** and **discount rates**.”

Source: FRC, *Annual Review of Corporate Reporting*, September 2024, p15 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory mini-case study 1
What do you think? (Q1)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **Must the Entity's treatment of inflation in the cash flows and the discount rate be consistent?** Choose one of: 1) Yes; or 2) No.

Source: FRC, *Annual Review of Corporate Reporting*, October 2023, p7

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Impairment of assets (IAS 36)
Regulatory mini-case study 1
What do you think? (Q2)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **Must the cash flows in the value in use calculation reflect the current condition of the assets, before any future enhancement expenditures?** Choose one of: 1) Yes; or 2) No.

Source: FRC, *Annual Review of Corporate Reporting*, October 2023, p7

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Impairment of assets (IAS 36)
Regulatory mini-case study 1
What do you think? (Q3)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **Must the cash flows in level 3 fair value calculation reflect the current condition of the assets, before any future enhancement expenditures?** Choose one of: 1) Yes; or 2) No.

Source: FRC, *Annual Review of Corporate Reporting*, October 2023, p7

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Impairment of assets (IAS 36)
Regulatory mini-case study 2
What do you think? (Q4)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **When calculating value in use, must a reporting entity use the same discount rate for all of its cash generating units?** Choose one of: 1) Yes; or 2) No.

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Impairment of assets (IAS 36)
Regulatory mini-case study 3
What do you think? (Q1)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **Must goodwill acquired in a business combination during the year be tested for impairment in that year (the year of the acquisition)?** Choose one of: 1) Yes; or 2) Not necessarily.

Source: FRC, *Annual Review of Corporate Reporting*, October 2023, p19

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Impairment of assets (IAS 36)
Regulatory mini-case study 3
What do you think? (Q2)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **Must an indefinite life intangible asset acquired in a business combination during the year be tested for impairment in that year (the year of the acquisition)?** Choose one of: 1) Yes; or 2) Not necessarily.

Source: FRC, *Annual Review of Corporate Reporting*, October 2023, p19

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Impairment of assets (IAS 36)
Regulatory mini-case study 3
What do you think? (Q3)

» **Regulatory observation = companies should ensure that their impairment testing methodology complies with IFRS.**

» **Must a <u>machine</u> acquired in a business combination during the year be tested for impairment in that year (the year of the acquisition)?** Choose one of: 1) Yes; or 2) Not necessarily.

Source: FRC, *Annual Review of Corporate Reporting*, October 2023, p19

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Impairment of assets (IAS 36)
Regulatory mini-case study 4
What do you think? (Q1)

» **Regulatory observation = when to perform IAS 36 impairment tests.**

» **Must <u>goodwill</u> be tested for impairment every year?** Choose one of: 1) Yes; or 2) Not necessarily.

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Impairment of assets (IAS 36)
Regulatory mini-case study 4
What do you think? (Q2)

» **Regulatory observation = when to perform IAS 36 impairment tests.**

» **Must indefinite life intangible assets be tested for impairment every year?** Choose one of: 1) Yes; or 2) Not necessarily.

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Impairment of assets (IAS 36)
Regulatory mini-case study 4
What do you think? (Q3)

» **Regulatory observation = when to perform IAS 36 impairment tests.**

» **Must machine be tested for impairment every year?** Choose one of: 1) Yes; or 2) Not necessarily.

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Impairment of assets (IAS 36)
Regulatory observations: impairment disclosures (1)

- *"Matter 5 (2017/ 8 /9 /20 common disclosure omissions)*
- **Insufficient information** regarding impairment calculations (paragraph 103-134 of IAS 36 *Impairment of Assets*) was the **second most common disclosure omission** identified in the 2017 to 2019 reviews and the fourth most common omission in the 2020 reviews."

Source: Comb*ined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p56 and 57 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory observations: impairment disclosures (2)

- *Matter 7 (2016)*
- The disclosure provided in terms of IAS 36 **should give the user a full understanding of the circumstances that led to impairments**.
- This information **provides justification that the impairments have been accounted for in the correct period**, i.e. that past impairments were not understated, and that future impairments are not currently envisaged.
- Importantly too, these disclosures are required for both the **recognition and reversal of impairment losses**."

Source: Comb*ined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p56 and 57 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory observations: impairment disclosures (3)

» *"Matter 1: Disclosure omissions (2022 common finding)*

» We continue to identify the **omission** of all or some of the minimum obligations of paragraphs 130 to 134 of IAS 36. In 2022, five issuers had findings under this topic.

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

Source: *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p55 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory observations: impairment disclosures (4)

» *"Matter 2 (2021 focus area)* …

» Our findings continue to reveal the omission of all or some of the minimum obligations of paragraphs 130 to 134 of IAS 36. In 2021 this occurred for 14 issuers. We gave impairments heightened consideration in the covid-19 environment and shifted our line of questioning in certain areas. We specifically looked for:

(a) explanations for significant changes in assumptions (IAS 36.134(d)(ii) or .134(e)(ii)); and

(b) disclosures where a reasonably possible change in a key assumption might lead to an impairment (IAS 36.134(f))."…

Source: *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p55 (**emphasis** added)

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Impairment of assets (IAS 36)
Regulatory observations: impairment disclosures (5)

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

Source: *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p55 (**emphasis** added)

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Mini-case study 5: CGU level disclosures about estimates used to measure the recoverable amount of CGUs containing goodwill or indefinite life intangible assets. What do you think?

In 2021 the JSE's IFRS compliance reviews revealed **14 issuers that omitted all or some of the disclosures** about the impairment of assets.

1. **Why would a regulator focus on the impairment of non-financial assets in their 2021 IFRS compliance reviews?**
2. **In the 2021 economic environment which disclosures about the impairment of non-financial assets would be particularly relevant?**

Source: JSE, *Reporting Back On Proactive Monitoring Of Financial Statements In 2021*

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Mini-case study 5 (continued): CGU level disclosures about estimates used to measure the recoverable amount of CGUs containing goodwill or indefinite life intangible assets. **What do you think?**

3. **Which disclosures are triggered when a reasonably possible change in a key assumption used in measuring a CGU's recoverable amount would cause the CGU's carrying amount to exceed its recoverable amount (ie headroom sensitivity)?**

» Clue:
  - » the JSE compliance review operation sought to detect non-compliance by asking some issuers to provide them with the amount of the available 'headroom' in their impairment calculations.
  - » Those enquiries revealed that **certain issuers had very little available 'headroom'** and that a very small change in assumptions could lead to an impairment.

Source: JSE, *Reporting Back On Proactive Monitoring Of Financial Statements In 2021*

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Mini-case study 6: presentation of impairment losses What do you think? (Q1)

» SOE1 included a component of the impairment loss in respect of non-current assets which was **attributed to be a result of Covid-19**, as an '**exceptional**' or similar item. **Is the presentation and disclosure of the loss attributed to Covid-19 by SOE1 appropriate?** Choose one of: 1) Yes; or 2) No.

Derived from UK FRC's *Covid-19 Thematic Review: Review of financial reporting effects of Covid-19* (07/2020)

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Mini-case study 6: presentation of impairment losses
What do you think? (Q2)

» SOE2 presented the entire impairment loss of non-current assets as '**exceptional**' but disclosed the element of that impairment loss it **considered caused by Covid-19** in the notes. **Is the presentation and disclosure of the loss attributed to Covid-19 by SOE2 appropriate?** Choose one of: 1) Yes; or 2) No.

Derived from UK FRC's *Covid-19 Thematic Review: Review of financial reporting effects of Covid-19* (07/2020)

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Investments in associates accounted for using the equity method
What do you think?

» **Which IFRS Accounting Standard specifies impairment accounting for investments in associates accounted for using the equity method?** Choose one of:

1) IFRS 9 *Financial Instruments*;
2) IAS 36 *Impairment of Assets*; or
3) It depends on the entity's accounting policy.

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Impairment of assets (IAS 36)
Regulatory mini-case study 7: equity method impairment timing (1)
What do you think?

» In early January each year Entity tests all of its investments in associates for impairment.

» On 01/01/2024 it fully impairs an investment in Associate A and accounts for that impairment in its interim financial statements for the six-month period ended 30/06/2024 .

» **Should Entity likely have accounted for the impairment in its 31/12/2023 annual financial statements?** Choose one of: 1) Yes; 2) No; or 3) It depends (specify on what it depend...).

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Recoverable amount:
Contrasting inputs to DCF models when measuring value in use and fair value using a discounted cash flow model

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q1.1: What is the ViU measurement objective?

a) Present value (PV) of future net cash inflows the reporting entity expects to derive from using the asset and then disposing of it at the end of its useful life;
b) Undiscounted future net cash inflows the reporting entity expects to derive from using the asset and then disposing of it at the end of its useful life; or
c) Estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions; Existing and potential investors', lenders' and creditors' eyes.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q1.2: What is the fair value measurement objective?

a) Present value (PV) of future net cash inflows the reporting entity expects to derive from using the asset and then disposing of it at the end of its useful life;
b) Undiscounted future net cash inflows the reporting entity expects to derive from using the asset and then disposing of it at the end of its useful life; or
c) Estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions; Existing and potential investors', lenders' and creditors' eyes.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q2.1: Whose eyes must management look through when making the judgements in measuring an asset's (or CGU's) ViU?

a) Management's eyes;
b) Auditor's eyes;
c) Regulators' eyes;
d) General public's eyes;
e) The relevant market participants' eyes;
f) Competitors' eyes; or
g) Existing and potential investors', lenders' and creditors' eyes.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q2.2: Whose eyes must management look through when making the judgements in measuring an asset's (or CGU's) fair value?

a) Management's eyes;
b) Auditor's eyes;
c) Regulators' eyes;
d) General public's eyes;
e) The relevant market participants' eyes;
f) Competitors' eyes; or
g) Existing and potential investors', lenders' and creditors' eyes.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q3.1: What is the assumed use of the asset when measuring its ViU?

a) The current use to which the reporting entity puts the asset;
b) The use to which the entity intends to put the asset in the future, but is not doing so; or
c) The highest and best use to which the asset could be out.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q3.2: What is the assumed use of the asset when measuring its fair value?

a) The current use to which the reporting entity puts the asset;
b) The use to which the entity intends to put the asset in the future, but is not doing so; or
c) The highest and best use to which the asset could be out.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q4.1: Which valuation technique is used when measuring an asset's (or CGU's) ViU?

a) Discounted cash flows—management's expected most likely cash flows;
b) Discounted cash flows—management's expectations about possible variations in the amount or timing of those cash flows (multiple scenarios);
c) The valuation technique that the relevant market participants use, ie appropriate in the circumstances and for which sufficient data are available, maximising the use of relevant observable inputs and minimising the use of unobservable inputs; or
d) The valuation technique that management chooses to specify in the reporting entity's accounting policy.

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Recoverable amount: contrasting DCF model inputs when measuring value in use (ViU) and fair value (level 3)
What do you think?

Q4.2: Which valuation technique is used when measuring an asset's (or CGU's) level 3 fair value?

a) Discounted cash flows—management's expected most likely cash flows;
b) Discounted cash flows—management's expectations about possible variations in the amount or timing of those cash flows (multiple scenarios);
c) The valuation technique that the relevant market participants use, ie appropriate in the circumstances and for which sufficient data are available, maximising the use of relevant observable inputs and minimising the use of unobservable inputs; or
d) The valuation technique that management chooses to specify in the reporting entity's accounting policy.

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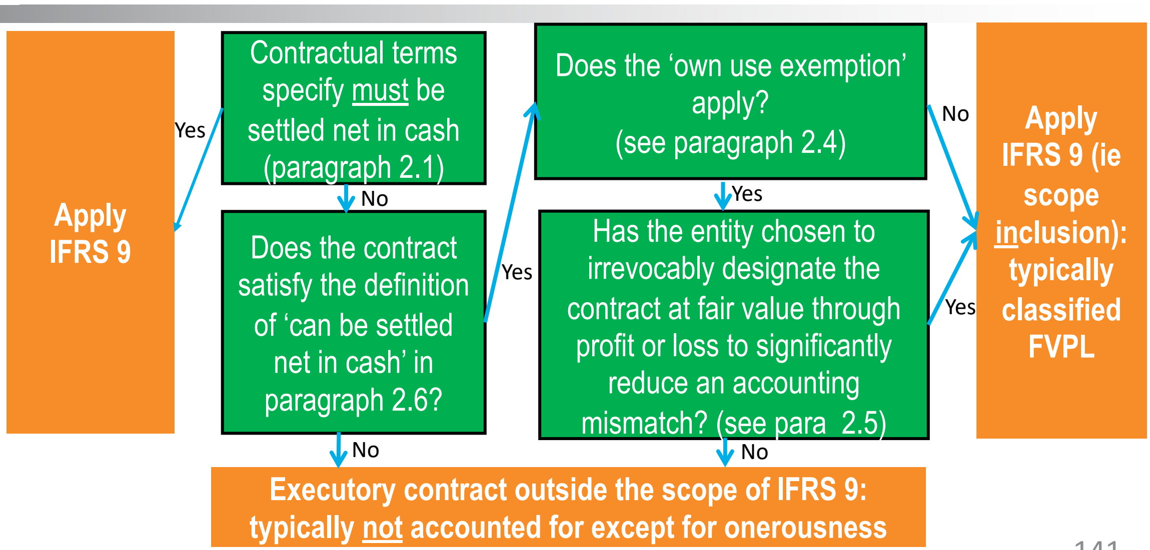
IFRS 9 scope inclusion: non-financial item contract asset subject to impairment testing used in generating the commodity specified in the contract (ie the 'underlying')



Reference: paragraphs 2.1 and 2.4 to 2.6 of IFRS 9

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Recoverable amount: contrasting value in use and fair value 'forward' contracts: asset subject to impairment testing used in generating the commodity specified in the contract (ie the 'underlying')

What do you think?

The contract is…	Value in Use	Fair Value
…in the scope of IFRS 9 (see decision tree on previous slide)	**Q1A: Is the price in the contract relevant to measuring ViU?** Choose one of: 1) Yes; or 2) No.	**Q1B: Is the price in the contract relevant to measuring fair value?** Choose one of: 1) Yes; or 2) No.

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Recoverable amount: contrasting value in use and fair value 'forward' contracts: asset subject to impairment testing used in generating the commodity specified in the contract (ie the 'underlying')

What do you think?

The contract is…	Value in Use	Fair Value
…out the scope of IFRS 9 (see decision tree on previous slide) and 'in the money'	Q2A: Is the price in the contract relevant to measuring ViU? Choose one of: 1) Yes; or 2) No.	Q2B: Is the price in the contract relevant to measuring fair value? Choose one of: 1) Yes; or 2) No.

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Recoverable amount: contrasting value in use and fair value 'forward' contracts: asset subject to impairment testing used in generating the commodity specified in the contract (ie the 'underlying')

What do you think?

The contract is…	Value in Use	Fair Value
…out the scope of IFRS 9 (see decision tree on previous slide) and 'out of the money'	Q3A: Is the price in the contract relevant to measuring ViU? Choose one of: 1) Yes; or 2) No.	Q3B: Is the price in the contract relevant to measuring fair value? Choose one of: 1) Yes; or 2) No.

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Non-current assets held for sale (IFRS 5)

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Non-current assets held for sale (IFRS 5)
Regulatory mini-case study 1
What do you think?

» **Must depreciation cease when an in continuing use depreciable item of property, plant and equipment becomes classified as a non-current asset held for sale?** Choose one of: 1) Yes; or 2) No.

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Non-current assets held for sale (IFRS 5)
Regulatory mini-case study 2
What do you think?

» **What measurement does IFRS Accounting Standards specify for investment property from when it becomes classified as a non-current asset held for sale?** Choose one of: 1) lower of carrying amount when reclassified from investment property and reporting-date fair value less cost to sell; 2) lower of carrying amount when reclassified from investment property and reporting-date fair value; 3) reporting-date fair value; 4) reporting-date fair value less costs to sell; or 5) it depends (specify on what it depends…).

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Non-current assets held for sale (IFRS 5)
Regulatory mini-case study 3
What do you think?

» **What measurement does IFRS Accounting Standards specify for investment property carried using fair value model (IAS 40) from when it becomes classified as a non-current asset held for sale?** Choose one of: 1) reporting-date fair value; 2) reporting-date fair value less costs to sell; or 3) it depends (specify on what it depends…).

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Inventories (IAS 2)

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Inventories (IAS 2)
Regulatory mini-case study 1
What do you think?

» Entity held undeveloped and vacant property assets in its property development portfolio (classified as inventory because they are sold to customers only after development activities and bulk services have been undertaken).

» 31/12/2024, Entity changed its intention to recover the carrying amount of the property assets through rental income, but took no further actions.

» **At 31 December 2024 which Standard specifies accounting for Entity's undeveloped and vacant property assets?** Choose one of: 1) IAS 2 *Inventories*; 2) IAS 16 *Property, Plant and Equipment*; 3) IAS 40 *Investment Property*; or 4) Non-current assets held for sale (IFRS 5).

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Examples—historical cost
What do you think?

If not the correction of a prior period error, is the following a: 1) change of accounting policy; or 2) change in accounting estimates?

Issue	IAS 8 and
A change in the cost formula used for inventories: from FIFO to weighted average cost.	IAS 2

Historical cost **artificial construct**: the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 *Share-based Payment* (IAS 16.6) + the conventions specified in IAS 16.11 to 16.28 + IFRIC etc.

Adapted from Appendix A to Agenda Paper 11A Review of IAS 8 - Distinction between changes in accounting policies and changes in accounting estimates, May 2015 IASB meeting.

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Non-financial liabilities

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Provisions and contingent liabilities (IAS 37)

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Provisions and contingent liabilities (IAS 37) Regulatory observations

» *“Matter 1 (2012)*

» *IAS 37 Provisions, Contingent Liabilities and Contingent Assets* sets out the specific and detailed disclosure requirements for provisions. In one instance this information **was omitted entirely**. What compounded our concern was that in that specific year there was a large reversal of impairments, which accounted for 25% of the issuer’s bottom line.”

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p58 (**emphasis** added)

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Business combinations and consolidations

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Business combinations and consolidations (IFRS 3 and IFRS 10)
Regulatory observation

» "*Matter 1 (2021)*

» Our inquiry led us to question the accounting treatment applied to certain **unconsolidated structured entities** of an issuer.

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

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p74 (**emphasis** added)

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Business combinations and consolidations (IFRS 3 and IFRS 10) Regulatory observation

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

» **power over the structured entities and the ability to use that power to affect their returns from these structured entities; and**

» **exposure to variable returns as a result of financial guarantees they provided to the lender of those structured entities.**

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

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p74 (**emphasis** added)

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Business combinations (IFRS 3) Regulatory mini-case study 1 What do you think?

» Entity measured the purchase consideration paid in a business combination using the '**contractual price**' of the shares issued to the vendors.

» **Is Entity's measurement of the consideration paid in the business combination likely compliant with IFRS 3?** Choose one of: 1) Yes; or 2) No.

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Business combinations (IFRS 3) and consolidations (IFRS 10)
Regulatory mini-case study 2
What do you think? (Q1)

- » 01/01/2024 Entity contracted to purchase of a business, including a clause that specifies the acquisition as having taken place on 01/01/2024 subject to regulatory approval for the acquisition being granted. There is reasonable doubt over whether regulatory approval will be granted.
- » 05/03/2024 Entity obtained the relevant regulatory approval.
- » **What is the acquisition date of the business combination?** Choose one of: 1) 01/01/2024; or 2) 05/03/2024.
- » **For which date must Entity consolidate the acquired business?** Choose one of: 1) 01/01/2024; or 2) 05/03/2024.

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Business combinations (IFRS 3) and consolidations (IFRS 10)
Regulatory mini-case study 2
What do you think? (Q2)

- » 01/01/2024 Entity contracted to purchase of a business, including a clause that specifies the acquisition as having taken place on 01/01/2024 subject to regulatory approval for the acquisition being granted. There is reasonable doubt over whether regulatory approval will be granted.
- » 05/03/2024 Entity obtained the relevant regulatory approval.
- » **For which date must Entity consolidate the acquired business?** Choose one of: 1) 01/01/2024; or 2) 05/03/2024.

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Business combinations (IFRS 3) and consolidations (IFRS 10)
Regulatory mini-case study 3
What do you think? (Q1)

» **What measurement does IFRS Accounting Standards specify for a contingent consideration liability for a business combination at initial recognition?** Choose one of: 1) cost; 2) transactions price; or 3) fair value.

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Business combinations (IFRS 3) and consolidations (IFRS 10)
Regulatory mini-case study 3
What do you think? (Q2)

» **What subsequent accounting does IFRS Accounting Standards specify for a contingent consideration liability for a business combination?** Choose one of: 1) amortised cost; 2) fair value through other comprehensive income; or 3) fair value through profit or loss.

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Business combinations (IFRS 3) and consolidations (IFRS 10)
Regulatory mini-case study 3
What do you think? (Q3)

» **In the subsequent accounting for such a contingent consideration liability is any amount presented in finance costs (for example, unwinding of the discount over time)?** Choose one of: 1) Yes; or 2) No.

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Disclosure

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Related part disclosures (IAS 24)

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Related part disclosures (IAS 24)
Regulatory observations

- *"Matter 1 (2020 common disclosure omissions)*
- The **third greatest number of deficiencies** identified through the review process in 2020 related to insufficient disclosure of all related party transactions and balances as is required by paragraph 18 of IAS 24 Related Party Disclosures."
- *"Matter 2 (2012)*
- We identified the following deficiencies in related party disclosures as per IAS 24:
  - **omitted** disclosure of the **terms and conditions** of outstanding balances with related parties;
  - no disclosure of **the value of the transactions** with related parties; and
  - the omission of related party disclosures **in their entirely**, in circumstances where it was clear from a review of announcements made on SENS that these existed."

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p31 (**emphasis** added)

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Segment disclosures (IFRS 8)

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Segment disclosures (IFRS 8)
Regulatory observation

- "*Matter 4 (2012)*
- In one instance, there was a **complete omission** of the segmental report.
- In addition, certain disclosure requirements of IFRS 8 were poorly complied with. This was even more prevalent where the issuer had not identified any segments and therefore incorrectly disregarded the rest of the IFRS 8 requirements. **Problems included**:
  - the reconciliation not agreeing to total profit and loss;
  - a lack of geographical information; and
  - a lack of information regarding major customers."

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p81 (**emphasis** added)

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Segment disclosures (IFRS 8)
Regulatory observation

» *"Matter 3 (2013)*

» The **misidentification of the chief operating decision maker** was discussed in our prior reports and regrettably we continued to have problems in this area. As a reminder, in terms of IFRS 8, operating segments are identified as components of an entity whose results are regularly reviewed by the chief operating decision maker. It is also contradictory when management discusses in great detail a particular component of the business in the annual report or in other communication to investors, but does not then identify that component as an operating segment for segmental reporting purposes."

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p81 (**emphasis** added)

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Regulatory mini-case study
IFRS 8 segment income/expense disclosure (1)

» Paragraphs 23(f) and (i) of IFRS 8 Operating Segments, together with the preamble, state that:

- » "An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker, **or** are otherwise regularly provided to the chief operating decision maker ("CODM"), even if not included in that measure of segment profit or loss:
  - » material items of income and expense disclosed in accordance with paragraph 97 of IAS 1 *Presentation of Financial Statements* (as revised in 2007); and
  - » material non-cash items other than depreciation and amortisation."

Source: JSE, *JSE Report on Proactive Monitoring of Financial Statements in 2022* (**emphasis** added)

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Regulatory mini-case study
IFRS 8 segment income/expense disclosure (2)

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

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

Source: JSE, *JSE Report on Proactive Monitoring of Financial Statements in 2022* (**emphasis** added) 192

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Regulatory mini-case study
IFRS 8 segment income/expense disclosure (3)
What do you think?

» Upon inquiry, **issuers advanced the following arguments:**

  » their interpretation of the objective of segment report is to provide users with information on the same basis as reported internally to the CODM for decision-making purposes; and

  » the CODM does not consider the per-segment amounts of the individually material income and expenses for decision-making purpose.

» **Who do you agree with?** Choose one of: 1) the JSE: or 2) the issuers?

Source: JSE, *JSE Report on Proactive Monitoring of Financial Statements in 2022* (**emphasis** added) 193

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Fair value measurement (IFRS 13)

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Examples—fair value measurement applying the fair value measurement principle

» Fair value measurement **principle**: estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). (IFRS 13.2)

» **Judgements** include, has the registrant: (i) used an appropriate model? (ii) used appropriate model inputs? (iii) taken account of all factors market participants would consider in measuring fair value? (iv) applied the model properly (without material error)?

Regulatory example: FRC (UK) required AngloEastern Plantations plc to restate twice the fair value measurement of its oil palm plantations!

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Examples—fair value measurement hierarchy judging the boundaries of the artificial constructs

Boundary between **levels 1 & 2**—do transactions in the market in which the identical item trades (and that the entity can access at the measurement date) take place with sufficient frequency and volume to provide pricing information on an ongoing basis? (IFRS 13. A)

Regulatory example—JSE (following review of 2016 financial statements of debt issuers) observes:[1]

- **Debt issuers inappropriately classified their own debt instruments in Level 1 given the inactivity of trade in listed notes on the South African interest rate market.**
  - **Even when trade does occur, it is not usually of sufficient frequency and volume to satisfy a Level 1 classification.**

[1] JSE, *Reporting Back On Proactive Monitoring Of Financial Statements In 2016*

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Examples—fair value measurement hierarchy judging the boundaries of the artificial constructs

- Boundary between level 2 and level 3—significant unobservable inputs?

Example entity-specific policy—HSBC (2020) financial statements, p292:

- **"significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs**
- **'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used)"**

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Fair value measurement disclosures (IFRS 13) Regulatory mini-case study 1 What do you think?

» **At which level of the fair value measurement hierarchy are operational financial instruments (such as trade receivables and trade payables) likely classified?** Choose one of: 1) Level 1; or 2) Level 2; or 3) Level 3.

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Fair value measurement disclosures (IFRS 13) Regulatory mini-case study 2 What do you think?

» **At which level of the fair value measurement hierarchy are investment properties located in Skopje likely classified?** Choose one of: 1) Level 1; or 2) Level 2; or 3) Level 3.

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Fair value measurement disclosures (IFRS 13) Regulatory observation

» “*Matter 8 (2016)*

» **We questioned why an issuer had classified unlisted preference shares within the level 2 fair value hierarchy per IFRS 13.**

» It emerged that unlisted preference shares (some of which were regarded as being level 2 and some level 3 fair values) had been **categorised incorrectly as being ‘measured at fair value through profit and loss’ (in terms of IAS 39).**

» The corrected categorisation revealed that these instruments were a combination of ‘held to maturity’ and ‘loans and receivables’ assets. In both cases the correct measurement basis that **should have been applied to these preference shares was amortised cost.”**

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p83 and 84 (**emphasis** added)

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Fair value measurement disclosures (IFRS 13) Regulatory observation

» “*Matter 4 (2017/ 8 /9/20 common disclosure omissions)*

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

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p83 (**emphasis** added)

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Fair value measurement disclosures (IFRS 13)
Regulatory observation

» "*Matter 1: fair value measurement disclosures (2022 common finding)*

» Our reviews found the IFRS 13 disclosures of 7 individual issuers to be insufficient.

» Areas included either the **partial or entire omission of**:

  » **significant unobservable inputs** - both identifying them and (in the case of **level 3** fair values) **quantifying the amounts** (IFRS 13.93(d); and

  » the **sensitivity analysis** for changes in those inputs for **level 3** fair values (IFRS 13.93(h)).

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

Source: JSE, *Combined findings of the JSE proactive monitoring of financial statements* (27 October 2023), p82 (**emphasis** added)

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Appendix: Regulatory sources

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Recent regulatory updates

- ESMA, 27th, 28th and 29th Extracts from the EECS's Database of Enforcement
- FRC (UK), CRR Thematic Reviews
- FRC (UK), Annual Review of Corporate Reporting 2023/2024 (p33 and 48)
- FRC (UK), *Annual Review of Corporate Reporting 2022/2023*
- FRC (UK), CRR Thematic Review: *Reporting by the UK's Largest Private Companies (January 2024)*
- FRC (UK), CRR Thematic Review: *IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'*
- IFRIC agenda decisions
- JSE, *Combined findings of the JSE proactive monitoring of financial statements* (October 2023)

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Q&A session

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