Report on proactive monitoring of financial statements in 2022

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JSE

Table of Contents

Introduction

The body of this report (the “2022 report”) discusses the findings of the proactive monitoring activities (the “review process”) undertaken by the JSE during the period October 2021 to September 2022. 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 with securities listed on our market. This aligns with one of the general principles of the JSE Listings Requirements (”the Listings Requirements”) namely to enhance investor confidence in our market. The healthy debate that often surrounds a review process is in of itself important for the credibility of our markets.

The aim of this report is to highlight matters and provide details around our expectations for financial reporting to help prevent the misapplication of IFRS. The target audience for this report is entities whose securities have a primary listing on the JSE. Secondary listed issuers may also find benefit therein. The 2022 report sets out important findings identified during the year to date, which we request issuers to consider. It also highlights an emerging focus area for the 2023 review process.

This report also provides statistical findings that highlight the regulatory value of the review process. We provide details of the review process for new issuers (and directors) for their understanding (see annexure 1). Annexure 2 includes feedback on the activities of the FRIP for the case concluded by the JSE in 2022. Annexure 3 includes an easy-to-use list of documents for audit committee’s consideration.

Consideration by audit committees

The JSE acknowledges the important role that audit committees play in ensuring the integrity of financial reporting. As our reports on the review process are intended to highlight areas of potential concern in the preparation of financial statements, the JSE specifically requests every issuer’s audit committee to consider this 2022 report together with certain other information previously published by the JSE. Annexure 3 contains a checklist of the information that the audit committee must consider, together with appropriate links to website references where that information may be found.

We ask that audit committees ensure that issuers take appropriate action to respond to the information detailed in annexure 3 when preparing both their interim and AFS.

In order to ease the administration burden for issuers, effective November 2021, we no longer require that a confirmation be included in the annual compliance certificate submitted to the JSE. Instead, to the extent necessary, the JSE may write to an issuer and ask that they explain how their audit committee has complied with the request set out above.

Detailed findings

2022 focus area: The 'geography of the income statement'

The 'shock events' of covid 19 and the July 2021 riots caused us to focus on the way issuers present their profit/loss on the face of the statement of comprehensive income ("income statement"). Such presentation typically has knock on implications to management commentary which accompanies such results. Inappropriate messaging can be misleading to investors.

Whilst the 'shock events' brought this matter to our attention, in many instances issuers had not changed their approach to the 'geography' of their income statement. In other words, the problems we identified pre-dated these 'shock events'. This serves as a reminder that, given the approach to our reviews, new matters may arise on the same set of AFS if reviewed in a subsequent year, given that a new lens may be applied.

We engaged with 11 different issuers on this topic.

<u>The use of subtotals</u>

Most of our engagements with issuers under this focus area centred around the use, or more specifically the naming, of sub totals in the income statement. After such engagements, issuers either agreed to remove or rename subtotals that were labelled as 'operating profit' yet excluded items such as:

- depreciation, amortisation and impairments (of property plant and equipment, intangible assets and goodwill);
- fair value adjustments on biological assets (which were the issuers business);
- lease exit/ modification gains (on property plant and equipment used in the business);
- legal settlement costs (relating to a trademark dispute);
- profit on sale of an owner occupied building;
- restructuring costs; and
- share based payment expenses.

As our 2021 report (issued November 2021) provides IFRS references around this topic we do not repeat all the detail here. In summary, paragraph 1 of IAS 1 *Presentation of Financial Statements* requires an entity to faithfully present the effects of transactions, other events and conditions. The International Accounting Standards Board ("IASB") noted (in IAS 1.BC56) that an entity should ensure the amount disclosed in any operating subtotal is representative of activities that would normally be considered to be 'operating'. Their view is that it would be inappropriate to exclude items from such a subtotal on the basis that:

- it is industry practice; or
- they occur irregularly or infrequently; or
- the amount is unusual; or
- do not involve cash flows (for example depreciation/ amortisation).

Furthermore, by analogy, paragraph 6 of IAS 7 *Statement of Cashflows* defines 'operating activities' as 'the principal revenue-producing activities of the entity'.

One of the most common discussion points was the exclusion of depreciation, amortisation and impairments from operating profit. Assets are used in entities operations to produce revenue and generate profits. The depreciation, amortisation, impairment, scrapping and disposal of assets thereof represent costs associated with the use thereof and are thus part of operating activities. Impairment losses are similar in nature to an accelerated depreciation or amortisation charge, representing the deterioration of the carrying amount of the asset that is no longer available to support future cash flows generated from the asset. In responding to our letters of enquiry, certain issuers did not disagree that such items were operational in nature but were focussing on the fact that their occurrence was infrequent.

Consistency in the treatment of associates

We identified instances where there was an inconsistency in the presentation of:

a) the income from associates/joint ventures;
b) profit on sale of shares in associates/ joint ventures; and
c) impairments of investment in associates/joint ventures.

Item (a) was presented outside of a subtotal called 'profit from operations' whilst items (b) and (c) were included within the subtotal. We challenged this inconsistency. All income streams linked to associates should be within the same section of the income statement i.e. either all part of operations or not.

Presentation by nature versus by function

This matter is discussed extensively in the 2021 report, and there are no new noteworthy discussion points to highlight arising from this topic.

Material cases

Annually we provide feedback on the key aspect of cases where the IFRS impact of the misstatement to AFS and/ or interims was material. Material cases are the first two categories listed in our table of findings on page 14. There was only one such case for the current period of 2022 (2021-8), relating to the statement of cashflows, which is detailed below.

In order to enrich our feedback to the market, we have also included a discussion on a case dealing with how an asset was measured. The impact of the matter was fortuitously not material in the specific year of our review.

Statement of Cash Flows ("SCF")

Paragraph 43 of IAS 7 *Statement of Cash Flows* states that: "Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements…"

We had an instance where a repayment was made in the form of gold bullion (i.e. a non-cash item) against a borrowing originally advanced in cash. This repayment was incorrectly classified by the issuer as a cash outflow under financing activities. The issuer acknowledged that the repayment using gold bullion should have been accounted for as a non-cash movement in its cash flow workings, thus leading to a misstatement of both the reported cash flows from operating and financing activities in the SCF.

<u>Classification of 'loan' to an associate</u>

What began as an enquiry into the impairment assessment of a 'loan' to an associate led us to question the appropriateness of classifying and subsequently measuring this 'loan' at amortised cost. The 'loan' had several features which caused us to question how the business model test of receiving contractual cashflows that were solely principal and interest (the so called SPPI test) were met (paragraph 4.1.2 of IFRS 9 *Financial Instruments*): The specifics of the case were as follows:

- Whilst the loan was interest bearing, interest would only be paid as and when profits and cash resources were available via dividend distributions from underlying subsidiaries;
- The loan agreement stated that no scheduled repayments (of either interest or capital) were to be specified; and (amongst other factors);
- Any loan repayment (whether capital or interest) was subject to the unanimous approval by the Board of the associate.

Given these features, the issuer had no automatic (or contractual) right to receive payment of any and all accrued interest or the capital outstanding without the Board first approving this.

The issuer subsequently amended their AFS to classify funds advanced to the associate as an equity investment in that associate. This was subsequently measured at fair value through profit and loss. The revised classification of the loan affected the risk disclosures provided. When the loan was measured at amortised cost, credit risk disclosures were identified as being appropriate. Given the revised classification, market risk disclosures were required (IFRS 7.40-42).

Common findings

This section discusses common disclosure problems identified in our reviews, grouped by IFRS standard. We identified instances of insufficient disclosure for both equity and debt issuers for IAS 12, IFRS 7 and IFRS 13, whilst the remaining topics only impacted equity issuers.

We ranked the topics by prevalence in terms of the number of entities where the deficiencies occurred. The results are as follows:

Ranking	Topic	Percentage of population affected
1	IFRS 7 *Financial Instruments: Disclosures*	20%
2	IAS 34 *Interim Financial Reporting*	21.6% *
3	IFRS 15 *Revenue from Contracts with Customers*	19% *
4	IFRS 13 *Fair Value Measurement*	14%
5	IAS 12 *Income Tax*	14%
]6	IAS 36 *Impairment of Assets*	13.5% *

* population is limited to (37) completed cases for the equity issuers.

The 'percentage of the population affected' means that, for 1 in every 5 completed reviews, we found a deficiency in the issuers' IFRS 7 disclosures.

Given the reoccurrence of many of these findings we have kept the description of the matters to a high level. We assume that both management and audit committees of issuers will review our previous findings (as set out in our Combined Findings Report) if they do not have a full understanding of the topics. There are a select number of topics that we have flagged for audit committees to specifically consider and detail those in annexure 3.

Financial instrument disclosures

We reached agreement with 10 issuers that their disclosures under IFRS 7 across a variety of topics were insufficient. These are discussed below under four separate headings.

Common findings – liquidity risk

Our most common finding was the in the area of over aggregating the time bands used in the liquidity risk analysis (IFRS 7. B11). This topic is also discussed in our 2021 thematic report (from page 23 onwards) which sets out good and poor examples which demonstrate our concern. Disclosure of appropriate time bands enables users to evaluate the extent of the Company's liquidity risks more clearly.

The second most common theme was the quantum used in liquidity risk disclosures (IFRS 7.39). The maturity analysis must be presented on an undiscounted basis i.e. the actual contract amounts rather than the discounted carrying amounts used in the primary AFS (IFRS 7.B11D.

Credit risk rating grades
We challenged an issuer on their credit risk disclosures for credit risk rating grades. Both were special purpose entities, in which the receivables book was their most significant asset class.

Appendix A to IFRS 7 defines credit risk rating as the "rating of credit risk based on the risk of a default occurring on the financial instrument". IFRS 7.35M requires (amongst others) entities to disclose, by credit risk rating grades, the gross carrying amount of financial assets and their exposure to credit risk. This information is to be provided separately for financial instruments for which the loss allowance account is measured at an amount equal to:

a) the 12-month expected credit loss (IFRS 7.35M(a)); and
b) lifetime expected credit losses (IFRS 7.35M(b)).

Paragraph B8I to IFRS 7 explains that the number of credit risk rating grades used to disclose the information in accordance with paragraph 35M shall be consistent with the number that the entity reports to key management personnel for credit risk management purposes. The grades for which this information is required to be disclosed may therefore differ from (or be in addition to) the generic stage 1; stage 2; stage 3 'buckets' identified by IFRS 9.

In one matter, we challenged the detail disclosed in a credit risk matrix that provided quantitative information of receivables across 11 internally assigned credit risk rating grades. The issuer provided no detail to explain what each of the 11 grades represented - they were simply identified as 'grade 1' to grade 11'. We questioned the issuer on whether the disclosure enabled users to assess the entity's credit risk exposure and understand its significant credit risk concentrations (IFRS 7.35M). Qualitative information (in addition to the quantitative disclosures) is necessary to understand the context of the internal rating grades used to present this information. Without such information users were unable to assess the effect of credit risk on the amount, timing and uncertainty of future cash flows (IFRS 7.35B).

Class of financial instruments

IFRS 7.6 explains that disclosures are required by class of financial instruments and that those classes shall be appropriate groups of financial instruments that takes into account the characteristics of those financial instruments.

In one matter, it appeared that a particular customer grouping could affect the credit worthiness and characteristics of those advances. As such, the groupings could be a relevant factor to consider in determining whether there were additional credit risk rating grades or classes of financial instruments than those disclosed in the notes. Engagement with the issuer revealed that specific terms and conditions may be attached to an advance made to private sector customer but not to an advance made to a public sector customer.

We questioned whether the advances book should have been segregated to reflect more classes and thus more granular disclosure of credit risk should be presented to satisfy the requirements of IFRS 7.35H (the ECL allowance reconciliation). In its subsequent reporting period, the issuer split its advances book (and the related disclosures) to distinguish 'private sector clients' and 'public sector clients'.

Other

An issuer had pledged certain assets against a loan but had omitted the required disclosures per IFRS 7.14. Information that should have been disclosed included the carrying amount of financial assets pledged as collateral (IFRS 7.14(a)) and the terms and conditions relating to the pledge (IFRS 7.14(b)).

The incorrect classification of a loan to an associate (see the discussion above on page 6) had the knock-on effect of the disclosures provided under IFRS 7.32. The issuer incorrectly providing credit risk disclosure when they should have proved market risk disclosures.

Interim financial reporting

The misapplication of the disclosure requirements IAS 34 was identified for 8 issuers.

We found a reoccurrence of the following topics, flagged in our previous reports:

- a lack of disaggregation of revenue on the same level as is presented in the AFS (IAS 34.16A(l)); and
- presentation of a 3-line SCF (2014 IFRIC agenda decision).

Other topics included the omission of the following required disclosures:

- capital commitments (IAS 34.15B(e);
- related party transactions (IAS 34.15B(j)); and
- fair value disclosures for financial instruments (IAS 34.16A(j).

There were instances where it was not clear that fair value calculations had been performed (for assets carried at fair value) or, in the face of obvious impairment indicators, that a rigorous impairment calculation was undertaken. IAS 34.28 requires that (absent an accounting policy change) the same accounting policies must be applied in the interims as are applied in the AFS.

One issuer did not include the same headings and subtotals for the income statement in their interims as was included in their AFS (IAS 34.10).

Revenue

Four equity issuers did not disaggregate revenue into sufficient categories to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors (IFRS 15.114).

Geographical considerations (per IFRS 15.B89(b)) in determining disaggregation categories was again a common weakness. This was often linked to the fact that:

- detailed revenue information provided in the investor presentation was not brought through to the AFS as would be expected by IFRS 15.B88(a); and
- segmental information (per IFRS 8) was incorrectly assumed to be the only factor to consider (IFRS 15. B88(b)). Such an approach ignores the fact that consideration must also be given to IFRS 15. B88(a), (c) and B89 to achieve the objectives of IFRS 15.114. Whilst segmental information is a useful starting point, it is not the end point.

The Russian invasion of the Ukraine and the impact of ongoing covid-19 restrictions in China highlight that Europe and Asia are not one homogenous market. Revenue should have been provided on a disaggregated basis between (at least) Western and Eastern Europe and Russia, Mongolia and China. That is because of the different economic factors in those regions (IFRS

15. B87 and B89(b)). These events also highlighted that the process applied to determining the appropriate levels of disaggregation is dynamic. Circumstances can change from year to year and even from year end to the interim reporting date.

Two reoccurring findings from 2021 in terms of disaggregation were:

- Giving insufficient weight to sales channels (IFRS 15.B89(g)). In this instance, the sales channels were 'low-to-no contact' verse 'full contact' with customers; and
- Incorrectly justifying non-compliance on the basis of the unavailability of information i.e. that issuers had not created accounting systems to capture that information.

Paragraph 115 of IFRS 15 states that: "An entity shall disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with paragraph 114) and revenue information that is disclosed for each reportable segment." Illustrative example 41 of IFRS 15 provides guidance in this regard.

One issuer provided the required disaggregation of revenue by geographic region in their revenue note. The segmental report on the other hand only disclosed the issuer's revenue in terms of its' segment. The segments were based on the nature of various operations undertaken by the issuer. There was insufficient information to enable a user to understand which of Group's four different operations/ segments derived revenue from which of geographic regions. In the absence of such information, users are unable to ascertain the level of revenue concentration risk of each operation (by means of that segment) to a particular geographic region.

A further two equity issuers did not reflect dividend income as revenue in the separate company AFS of their holding company.

Fair value measurement disclosures

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.

Taxation

We found shortcomings in the tax rate reconciliations (per IAS 12*)* for 6 issuers. These were concentrated in the requirements of paragraphs 81(c) and 84 in terms of:

- not separately disclosing items that were material to the tax position (i.e. over aggregation of items); and
- using vague labels.

Deferred tax

A seventh matter involving IAS 12 related to deferred tax. Paragraph 61A of IAS 12 states that: "Current tax and deferred tax that relates to items that are recognised, in the same or a different period:

a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).
b) directly in equity, shall be recognised directly in equity (see paragraph 62A).

In other words, the tax effects effectively 'follow' the original item when being recognised in OCI or directly in equity.

In FY2020, the effects of a deferred tax liability on the fair value movement of a cash flow hedging instrument were correctly recognised in other comprehensive income ("OCI"). In FY2021 there was a significant change in the fair value of cash flow hedge such that the deferred tax liability moved to a deferred tax asset. To account for the related deferred tax movement in the FY 2021 the issuer:

a) reversed the original deferred tax (liability) directly via equity; and
b) recognised an additional deferred tax (asset) via OCI for the remaining fair value movement.

After engaging with them, this issuer acknowledged that the full deferred tax movement (i.e. including item (a)) should have been recorded in OCI. The effect of this error was an overstatement in the other comprehensive loss for the year.

Impairments of assets

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)).

In one matter, we questioned why the same discount rate was used for different cash generating units ("CGU's"). It appeared that the nature of the business for the CGU's, and their associated risk, were dissimilar. The issuer provided a detailed explanation and calculation of the different factors affecting each of these CGU's (which coincidently resulted in the same discount rate been applied). We would not have raised this question had the AFS included detailed information on the inputs specific to each unique CGU (per IAS 36.134(d)(ii)).

Emerging issue – looking to the 2023 review cycle

Material income and expenses in the segmental report

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."

Paragraph 97 of IAS 1 states that: "When items of income or expense are material, an entity shall disclose their nature and amount separately."

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.

Upon inquiry, issuers have 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.

We disagree with such an approach on the basis that paragraph 23 of IFRS 8 does not require the expense items to be regularly provided to the CODM to qualify for per-segment disclosure. This is due to the '*or*' requirement of paragraph 23. In other words, if a material income/expense item is included in a profit measure set out in the segmental disclosures, then that material income/expense item must be individually disclosed on a per segment basis, irrespective of whether or not they are regularly provided to the CODM.

We note that in several instances the disclosures reveal that the material expense items are not incurred proportionally to the size of the segments. The 'non-proportional' nature is, in our view, relevant to users.

The findings in numbers

The purpose of this section is to enable issuers to understand the process that is followed by the JSE. It also highlights the fact that a clean auditor's report is no guarantee that the AFS will be free from regulatory challenge and correction where these are found to contain material misstatements.

The reason for this is best understood considering 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 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 applied in our detailed reviews 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 issuer from one year to the next (if this were to be done) may therefore identify different matters.

Our completed reviews covered AFS for years ending between 30 June 2020 to 30 September 2021.

Statistics

What we did

Between October 2020 and September 2021, we performed new detailed reviews on 34 equity issuers (which included both their AFS and interim results) and the AFS of 10 debt issuers.

	Equity	**Debt** [1]	**Total**
Letters of query	26	7	33
Cases closed immediately	8	3	11
Number of new AFS reviews	**34**	**10**	**44**
Cases b/f from previous year	9	4	13
Total cases reviewed during period	43	14	57
Cases still pending	(6)	(1)	(7)
Cases completed during period	37	13	50

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

We wrote letters of enquiry to 33 of the issuers, with 11 cases being closed immediately without any questions asked. By October 2022 six of the equity cases and one of the debt cases were still pending.

What we found

For one case, the non-compliance was material from an IFRS perspective. But due to the presence of other mitigating factors, we agreed that the matter would be corrected in the issuers' next results announcement.

For a further 14 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. Twenty-one cases involved smaller disclosure matters that issuers agreed to correct or clarify in the future.

Therefore, the number of cases where corrections were required in future reporting periods was at 32% (12 cases) for equity issuers (2021-52%; 2020-58%,) and 23% (3 cases) for debt issuers (2021-10%; 2020-12.5%).

	2022 Equity	**2022 Debt**	**2022 Total**	**2021 Equity**	**2021 Debt**
AFS needed restatement and public announcement made	-	-	-	2	-
Non-compliance was such that we agreed to a correction within the next published results	1	-	1	6	-
Non-compliance not material this year, but must be corrected in the future in order to avoid potential investor prejudice	11	3	14	19	1
Smaller disclosure issues that will be corrected in the future	15	6	21	20	4
AFS in respect of which it was concluded that there were no issues	10	4	14	5	5
Total cases closed	**37**	**13**	**50**	**52**	**10**

In assessing the potential impact of matters, the number of cases with findings impacting measurement was at 7.4% (2021-14.9%) for equity issuers and 22% (2021-nil) for debt issuers. The data continues to reveal that disclosure matters remain a key area of non-compliance.

Coverage

Our report of 6 October 2022 entitled 'Limited scope thematic review: Cash flow information and disclosures of liquidity and going concern' (the "2022 Limited scope report") explains our revised approach to the review process. Limited scope reviews are now a permanent feature of our proactive monitoring activities. Our intention is to obtain a desired coverage ratio through performing a combination of detailed reviews and limited scope reviews.

This 2022 report provides feedback on our detailed reviews, but for the sake of completeness we include a table of the combined coverage.

	Equity	Debt [2]	Total 2022	Total 2021
Detailed reviews completed	37	13	50	62
Limited scope reviews completed	15	3	18	-
Reviews completed at reporting date	**52**	**16**	**68**	**62**
Examination rate (Percentage coverage of population)			21.2%	18.1%

[2] to avoid double counting , issuers that are both an equity and debt issuers are included in the numbers for equity issuers only

Annexure 1 – Understanding the review process

Why the review process

Our 2020 report includes a reminder that the JSE undertakes the review process because it was requested to do so by The Financial Services Conduct Authority (previously the Financial Services Board) in 2010. The integrity of financial information is a critical element of a well-functioning market. The objective of the review process is therefore to contribute towards the production of quality financial reporting of entities listed on the JSE.

Details of the review process

A high-level overview of the review process applied in our detailed reviews is included in the 2018 report (and previous reports). We do not repeat that content here. It is recommended that individuals that are unfamiliar with the detailed review process refer to page 21 of the 2018 report (which is available on our website) for a full understanding thereof.

We aim to be pragmatic in 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 thereof either on past, current or future accounting periods. Matters are often easily resolved through the provision of a satisfactory IFRS substantiated response.

Accounting topics examined and risk areas considered are likely to change from year to year. We identify these changes annually as we aim to ensure that the review process remains both attuned to local market developments and aligned to similar international processes.

Selection process amended in 2021

We have based our model largely on the guidelines that the European Securities and Market Authority sets out for the member states of the European Union. As a result to changes made to those guidelines, we made changes to our process which were implemented in 2021 and 2022.

In 2021, the JSE made a fundamental change to the selection process. Historically the random selection process was such that we treated all issuers equally, aiming to review every issuer's AFS at least once every 5 years. The JSE's revised approach considers the risk to investors in terms of market concentration. As part of the random selection process, we will select issuers (equity and debt) that have a larger market capitalisation and/or who are active in both the equity and interest rate markets more frequently. Furthermore, in order to remove the element of predictability, our review cycles have been amended from a 'once every 5 years' approach to the principle of 'once within a set window'. The selection period will be either a 3, 5, 8 or 10-year window, depending upon the size of the issuer. By way of example, an issuer within the top 40 index will now be selected at least once in the period 2021 to 2023 and then again once somewhere in the period 2024 to 2026.

Types of reviews amended in 2022

The 2022 Limited scope report explains the fact that we have introduced a limited scope review process to be performed annually in parallel to the established detailed reviews. It explains the nature of the limited scope review and includes a comparison between a limited scope and detailed review. We do not repeat that content here. It is recommended that individuals refer to page 2 of the 2022 Limited scope report (which is available on our website) for a full understanding thereof.

Process applied to ALT^{X} issuers

Our 2020 report includes an explanation of the revised approach that was introduced for issuers listed on the ALT^{X} market. Not only will they be reviewed on a less frequent basis but the process itself has been amended. Those involved in ALTX market are referred to page 23 of the 2020 report (which is available on our website) for an understanding of that process and our objectives.

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 by the issuer from one year to the next.

Annexure 2 – Activities of the FRIP

Whilst the JSE referred this case to the Financial Reporting Investigation Panel ("FRIP") during the course of 2021, it only concluded the matter in 2022. The details are therefore included in the report.

Introduction

In the correspondence and interactions with the issuers via the Issuer Regulation Department of the JSE ("IRD"), it has become apparent that there may be some confusion about the role of the FRIP.

As a reminder, in terms paragraph 8.65 of the Listings Requirements, the FRIP is an advisory body to the IRD. Its role is solely to act as an advisor to the IRD in relation to compliance by issuers with IFRS.

When the IRD has a matter that it considers necessary for the FRIP to consider, the correspondence is with the FRIP chair. For each case the FRIP chair forms a review committee consisting of 4 or 5 members (including the chair) to consider the matter, ensuring that none of those members have a conflict of interest with the issuer. While the names of FRIP members are published, membership of each review committee remain confidential, even from the IRD. All interactions with the review committee are done through the FRIP chair to ensure that such confidentiality is maintained.

For clarity, it is not the role of the FRIP to provide IFRS advice to issuers or to provide detailed feedback on the IFRS arguments put forward by the issuer to the JSE. The report issued by the review committee will express an opinion, and the IFRS reasons for that opinion, but will not necessarily provided a detailed rebuttal of each IFRS argument presented to the committee.

The review committee considers all the IFRS arguments put forward by an issuer. It is for this reason that the report issued by a review committee to the IRD identifies each of the documents that were considered by it in reaching its conclusion. Each document and each IFRS argument set out in the correspondence receives careful consideration.

The FRIP's conclusions are based on the:

- information that is published in the financial statements under consideration;
- review committee's understanding of the facts and circumstances as explained in the correspondence.

For clarity, it is not the role of the review committee to provide evidence in support of a conclusion. Rather its role is to consider the evidence presented to it and reach a conclusion on whether IFRS has been appropriately applied, given its understanding of the evidence presented. The onus is upon the issuer, who is provided with ample opportunity before a matter is referred to the FRIP, to provide explanations and evidence as to how they have complied with IFRS.

The review committee understands that judgment is required to be exercised in the preparation of financial statements. It therefore considers the information presented to it in the correspondence to determine whether it agrees that the conclusions reached are reasonable in the circumstances. Ultimately judgement and internal policies cannot override the requirements of IFRS.

It also implies that the information presented in the financial statements should meet the IFRS requirements without consideration of the additional information presented to the committee in the correspondence. That is because the users of the financial statements do not have access to additional information. The correspondence should assist the committee to understand how the issuer has exercised judgement in applying IFRS, but the extent of the judgments must be clear in the financial statements. Furthermore, in respect of the adequacy of disclosures, the assessment must be based on what is available to users of the financial statements.

Case 1

The Background

The issuer has debt instruments listed on the interest rate market operated by the JSE. A matter relating to fair value disclosures for equity instruments was identified as part of the JSE's proactive monitoring process.

The issuer holds equity investments that were categorised as Level 2 within IFRS 13's Fair Value hierarchy. The investments consist of direct equity investments and third-party managed private equity funds. Given the specialized nature of some of the investments, the FRIP was asked to consider whether classification as level 2 was appropriate.

The second issue that the FRIP was asked to consider was the adequacy of the disclosures for investments held as level 3.

IFRS Requirements

The requirements of IFRS 13 *Fair Value Measurement* relate to the unit of account in which the reporting entity has an ownership interest. This implies that where the ownership interest is in a fund, it is the fund itself rather than the underlying investments for which the disclosure hierarchy level should be determined.

IFRS 13's fair value hierarchy classifies investments into three levels, with level 1 having the highest level of external evidence supporting the valuation and level 3, the lowest level of observability. The classification within a level is based on the degree of observability of the lowest level of material input. To be classified as level 2, all significant inputs should be observable, either directly or indirectly where 'observable inputs' are defined as "inputs that are developed as market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability."

A market-corroborated input that might not be directly observable but is based on or supported by observable market data could be included as a level 2 input. If an adjustment made to a level 2 input which is itself unobservable and significant to the entire measurement, this will result in a level 3 classification for the entire fair value measurement.

IFRS 13's disclosure requirements specify that sufficient information is required to be disclosed to help the user assess the valuation techniques and inputs that have been used to develop the fair value measurement. There are additional specific disclosure requirements for fair value measurements with significant level 3 inputs. These disclosure requirements need to be considered alongside the disclosure objectives of IFRS 7 *Financial Instruments: Disclosures* which include the requirement to provide disclosures that enable users to evaluate the nature and extent of risks arising from the financial instruments.

<u>Application of IFRS in this matter</u>

Where investments are held in a fund, the unit of account that is relevant when determining the fair value hierarchy level is the investment in the fund and not the underlying investments. It may however be appropriate to consider the fair value of the underlying assets as a basis for determining the fair value of the fund.

Where the fair value of the fund is based on the determination of the net asset value ("NAV") of the underlying investments, determination of the appropriate level within the fair value hierarchy is therefore dependent on the extent to which the inputs into the determination of the fair value of the investments making up the NAV are determinable as well as the subjectivity and magnitude of any adjustments made to that input.

The issuer identified currency exchange rates and firm quotes corroborated with market data as observable direct and indirect inputs used. A 'marketability and other discount rate' factor was also disclosed as an input into the discounted cash flow model used to do the valuations. The FRIP noted that to be observable, there needs to be an actual transaction as opposed to a quote, and that where that transaction takes place at a date other than the reporting date, appropriate adjustments need to be made for the time difference as well as any other differences in contractual terms etc. that a market participant might take into consideration when assessing the market price of an asset.

Assuming that the unit of account is an investment in a fund, then the fair value of the investment in the fund would be measured applying IFRS 13 at the currency in which the fund is denominated. Should this currency differ from the functional currency of the investor, then the investment will be translated from the currency of the investment in the fund to the functional currency of the investor applying IAS 21 *The effects of changes in foreign exchange rates* and not as part of the fair value measurement.

The fair value measurement of a fund is often based on a NAV calculation. A NAV calculation would take into account the exchange rates between the currency of the fund instrument and the underlying currency of the investments held by the fund, if different. In the cases where there is a lack of exchangeability between the fund and the underlying currency of the investments held by the fund, consideration will need to be given to the inputs a market participant may apply where there are potential challenges to accessing the currency at a quoted exchange rate.

The FRIP therefore questioned the extent to which a currency exchange rate presented separately was a significant input into the determination of fair values, but agreed that were it a significant input, it could be an observable input where the currency was exchangeable. If exchangeability was lacking, adjustments to the exchange rate may however be an unobservable input.

The FRIP noted that there are no bright lines of what is considered 'significant' when determining an adjustment made to a level 2 input to the determination of fair value, but the consensus of the review committee was that it is likely to be less than the 20% threshold that was applied by the issuer.

Another factor considered by the review committee in assessing the appropriate level within the fair value hierarchy was the specialized nature of the underlying assets within the fund. If trades in similar assets are infrequent, the market in which any trades take place are not public and the terms of the sale agreements are not publicly available, each of these factors would present challenges to demonstrating the observability of the fair value of the underlying investments making up the fund.

With respect to the application of the disclosure objectives and requirements of IFRS 7 and IFRS 13, to assess the nature and extent of the risks arising from the financial instruments, it is necessary to provide disclosure of the type of investments, the vehicle in which the investments are held and the currency in which the investment is denominated.

The FRIP also noted that without an understanding of the type of investments that were being valued, it was not possible to determine whether the valuation techniques and inputs used were suitable and whether all details had been provided on all significant inputs.

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

We consolidated our previous annual reports on the review process into one report entitled 'Combined findings of the JSE Proactive Monitoring of financial statements' ("the Combined Findings Report"). The report was updated from the one issued in October 2021 and was reissued on 28 October 2022.

For ease of reference, this annexure contains information that all audit committees must consider in fulfilling their responsibilities referred to on page 3 of this the 2022 report.

1. This, the 2022 report;
2. The Audit Committee Briefing Document on October 2022 Limited scope thematic review: Cash flow information and disclosures of liquidity and going concern;
3. Given our common findings, the following sections from the Combined Findings Report issued in October 2022;
    a. Income Tax (page 36 to 37-matters 3 and 5);
    b. Revenue (page 40-matters 1 and 2); and
    c. Interim Financial Reporting (page 49 to 52-matters 1 and 2).

Audit committees should 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.

The above documents can be accessed via the hyper-link reflected in green or downloaded from the JSE website https://www.jse.co.za/current-companies/issuer-regulation/accounting-matters.