15 July 2022

For attention:

The FRSC Committee

CC: Minister of Finance

The Honourable Enoch Godongwana

Via Email

AN ANALYSIS OF THE FINANCIAL REPORTING STANDARDS COUNCIL (FRSC): POLITICAL NATURE AND POTENTIAL TO POWERFULLY SUPPORT GOVERNMENT'S ABILITY TO ATTRACT FDI, INCREASE GDP AND REDUCE UNEMPLOYMENT

Introduction

1. The Department of Trade, Industry and Competition (the DTIC) is responsible for administering the Companies Act, No 71, of 2008. The Act entitles the Minister to appoint a Financial Reporting Standards Council (FRSC).
2. The FRSC is an important element within the financial reporting supply chain and plays a role in ensuring the production of quality financial statements which is relied on by entrepreneurs, investors, lenders and tax authorities.
3. Financial statements that are reliable, relevant, and comparable enhances the ability of the country to attract Foreign Direct Investment (FDI) and has the potential to increase Gross Domestic Product (GDP).

t: + 27 12 643 1800 /2/4 | **f:** +27 86 508 2923 | **e:** saiba@saiba.org.za | **w:** www.saiba.org.za
p: PO Box 7905, Centurion, 0046 | **a:** The Workspace, Cnr Pinaster Avenue and 18th Street, The Club Shopping Centre, Second Floor, Hazelwood, Pretoria, 0081
The Workspace 44 Melrose Boulevard, Block G, 2nd Floor, Birnam, Johannesburg, 2196 | Namibia: Regus Office Building, 3rd Floor, Maerua Mall, Windhoek, 10005
Philippines: FINEX Office, Unit 1901, 19/F, 139 Corporate Center Valero Street, Salcedo Village, Makati City

4. However, it is our submission that the basis on which financial statements are prepared are subject to political influence and lobbying from nations and large corporates that compete with South Africa for FDI.
5. We believe that the FRSC, can provide significant support to the Ministries of Finance, and Trade, Industry and Competition to achieve the goal of increasing FDI and GDP.
6. We therefore submit a proposal to secure a sustainable funding model which will enable the DTIC to provide enhanced support to the South African public and private companies by prescribing a basis of accounting that is derived from a clear national mandate, namely increased economic growth, reduced unemployment, and asset valuations that reflect South African circumstances.
7. An appropriately funded FRSC can align South Africa to the international standards, influence the development of standards and, in the interest of radical economic transformation, *provide carve outs to international standards.*
8. Our proposal is unique in that it introduces the concept of carve outs to international standards, similar to India and China. This is also used extensively by the US, which largely uses "modified cash basis of accounting" or "American GAAP", in a political manner and to the advantage of American Corporates.
9. To paraphrase the words of President Rhamaphosa, if we want to be a winning nation, and take our rightful position amongst other leading nations, we must not hamper our economic development by blindly adhering to standards that our international partners themselves do not do.

Our proposal demonstrates how respected countries like the United States, China, India and some African States apply a nuanced approach to applying international financial reporting standards, greatly benefiting their economies.

Background

10. It is universally accepted that financial statements play an important part in the economic wellbeing of nations.
11. Based on the information presented in financial statements economic actors, including directors, shareholders, lenders, investors, tax authorities, economic policy makers, government officials and politicians make decisions and take actions with the intent to achieve desired outcomes.

12. National authorities should therefore have a strong interest in the quality of the financial reporting supply chain that causes financial statements to be prepared.
13. However, a bigger concern should be whether the actors working within this chain, share or support either directly or indirectly, and by way of compulsion or self-interest, the most beneficial outcome for the people of South Africa.
14. The financial reporting supply chain refers to the "…people and processes involved in the preparation, approval, audit, analysis and use of financial reports. All links in the chain need to be of high quality and closely connected to supply high quality financial reporting"[1]. Furthermore, the preparation of financial reports is a process of measurement, recognition, presentation and disclosure of an entity's assets, liabilities, equity, income and expense.
15. This process is informed by a set of standards as determined by the International Accounting Standards Board (IASB) a structure organised under an independent foundation, the International Financial Reporting Standards (IFRS) Foundation. The IFRS Foundation is a non-profit corporation created under the laws of the State of Delaware, United States of America, on the 8 March 2001. This registration is somewhat ironic as the United States of America does not follow IFRS but has developed their own financial reporting standards to benefit their local economy.
16. It is clear from the above that the achievement of our national objectives is subject to, and influenced by, the characteristics, beliefs, assumptions, and actions of the various actors operating in the financial reporting supply chain, and unelected persons that form the international standard setting authorities.
17. This proposal accepts the following statement as true: "but the notion of IFRS being shaped by a multilateral political dynamic is one with important implications for the development and growth of the standards"[2] and seeks therefore to empower the Minister to steer South Africa's involvement in shaping IFRS.
18. In order to provide context to our proposal we consider:
    - the context within which the FRSC was created,
    - the relative flexibility awarded to the Minister in prescribing IFRS, and which we believe ought to have been used more often to assist South African Corporates derive the benefits as enjoyed by Indian, Chinese and US Corporates,
    - the nature of accounting as a social science,
    - the political influences in the standards setting process,
    - the selective way countries such as India, China, and the USA have approached IFRS.

[1] https://www.ifac.org/system/files/publications/files/financial-reporting-supply.pdf
[2] https://www.degruyter.com/document/doi/10.1515/ael-2013-0004/html

The purpose of our proposal is to illustrate the political nature of the standard setting process, and how the outcome of this process can benefit or harm a national economy. We conclude with a proposal to set a political agenda for the FRSC and a funding model that will ensure appropriate outcomes for economic development and growth

A contextual perspective on the FRSC and the authority granted to the Minister of DTIC

19. The South African Financial Reporting Standards Council (FRSC) was established in terms of Chapter 8 Part D Section 203 and 204 of the Companies Act, No 71 of 2008. The main purpose of the FRSC, as required by Section 29(4), *is to provide consultative support to the Minister prior to the Minister issuing regulations prescribing financial reporting standards.*
20. It is our view that the Minister is not obligated to prescribe financial reporting standards but may do so (Section 29(4)).
21. Section 29 of the Act requires that if a company provides financial statements to any person those statements must:
    - satisfy financial reporting standards as to form and content, *if such standards have been prescribed by the Minister*.
    - present fairly the state of affairs and business of the company and explain the transactions and financial position of the business of the company.
    - show the company's assets, liabilities, equity, income and expenses.
    - in addition, financial statements prepared by a company must not be false or misleading, or incomplete materially.
22. In the absence of financial reporting standards, for example if the relevant Minister does not prescribe any standards, a company's financial statements must still provide fair presentation, disclose required information, and not be misleading or incomplete. It is generally accepted that the Courts have presented companies and their directors with case law as to the meaning of fair presentation. This provides a framework within which to prepare financial statements in the absence of any specifically prescribed standards.

23. *In our view financial reporting standards, although important, are not a primary condition within which financial statements are prepared*. In our view, all provisions of the Companies Act, 2008, including those related to financial reporting standards are subject to the purpose statements of the Act as presented in Section 7 i.e., to promote compliance to the Bill of Rights as provided for in the Constitution of the Republic.
24. We believe therefore that the Minister may consider issuing financial reporting standards if those standards would result in some benefit to the South African economy and reflects the social construct best suited to our economic and social development.
25. *We do not believe that the Minister is required to indiscriminately adopt, and issue International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) as those standards may not necessarily create employment or economic growth once adopted in South Africa.*
26. This distinction is well known and very common within the standard setting community and are contrasted as: adoption vs convergence.[3]
27. South Africa has not been afforded an opportunity to fully consider these distinct approaches and to choose the one that best suits its economic development. This is a historical issue with roots in our colonial British past.
28. The US/Euro-centric[4] standard setter, the IASB favours adoption, meaning a country fully implements the standards as set by the IASB (ironically with the exclusion of the US). Competing interest in countries such as India and China favour convergence. Convergence allows for the harmonisation of IFRS with local conditions, freeing local jurisdictions from standards that might harm their local economies.
29. Considering that the mission of the DTIC is to "…promote structural transformation that establishes a dynamic industrial and globally competitive economy, and provide a predictable, competitive, equitable and socially responsible environment, conducive to investment, trade and enterprise development, and broaden participation in the economy to strengthen economic development, and continually improve the skills and capabilities of the DTIC to effectively deliver on its mandate and respond to the needs of South Africa's economic citizens", any standards that the Minister may choose to prescribe should therefore be supportive of the mission of the DTIC, which presumably is an embodiment of South Africa's national interest.

[3] https://www.accountingtoday.com/news/ifrs-convergence-or-adoption
[4] https://www.researchgate.net/publication/260319540_The_Extent_of_Membership_Representation_and_Non-Representation_on_the_IASB

30. Further to the role of the FRSC in guiding the relevant Minister, the Companies Act, 2008 appoints the Companies and Intellectual Properties Commission (CIPC) according to Chapter 8 of the Act, to support the functioning of the FRSC.
31. The CIPC is required to promote the reliability of financial statements by monitoring compliance to financial reporting standards and making recommendations to the FRSC for amendments to financial reporting standards, to secure better reliability and compliance.
32. The CIPC is also mandated to implement education and information measures to develop public awareness of the provisions of the Act, and to advance the purpose of the Act and conduct research relating to the Commission's mandate.
33. *It is our view that the Minister is entitled to appoint the FRSC with a mandate to align, influence, and carve-out financial reporting standards within the parameters of*:
    - enhancing South Africa's economic growth, reducing poverty and unemployment,
    - attracting FDI,
    - enhancing the ability of public and private companies to increase their balance sheet value, with the aim of positively impacting GDP.

We therefore propose the establishment of either a specialist committee as envisioned in Section 191 of the Companies Act, 2008 or alternatively a Ministerial Advisory Committee to advise the Minister and the Commissioner of the CIPC, on the terms of reference for the FRSC, including the funding model in line with a national mandate to promote economic growth and employment.

SAIBA nominates the following persons to be appointed to the Section 191 specialist committee or the Ministerial Advisory Committee:

- Mr. Nicolaas van Wyk, CEO, SAIBA,
- Prof. Rajen Pillay, CEO, Garuda Capital.
- Dr. Pali Lehohla, Previous Statistician General, South Africa,
- Jenitha John, Global Chairman of the Board of the IIA,
- Prof. Vishnu Padaychee an Oxford Economist, and previous SA Reserve Bank Director and Deputy Chairman of Ithala (DFI).

Accounting as a Social Science

34. Accounting, and the underlying process of determining IFRS, contrary to popular belief, is not classified as a natural science such as biology, chemistry or physics. Accounting is a social science influenced by subjective concepts of reality.
35. It is man-made and hence subject to failure, abuse, lobbying, influence, personal preferences, and cultural differences of powerful role players, not all of whom have South Africa's national interest at heart.
36. Researchers have described accounting as a "…social science and not a collection of abstract mathematical manipulations" and subject to "…very considerable methodological problems which have bedevilled social sciences generally and the parallel problems of professional property-in-knowledge, boundary-guarding and closed-mindedness which are unfortunately part of the social science scene."
37. Accounting has been described as a "social-construct" meaning there should be many ways of doing accounting, an act of explaining business realities to multiple stakeholders of socio-economies… however, the current trend is to use Fair Value Accounting which is considered to be useful …for investors…" but other stakeholders may regard other forms of accounting as more suited to their particular circumstances.
38. Accounting treatments may therefore favour certain stakeholders to the detriment of others.
39. According to these researchers "many aspects of our life may have been undemocratically administrated without being noticed, because the fair value accounting is presumed to be fair, while it is not."
40. Within obvious limitations, it stands to reason that the relevant Minister, the CIPC, the FRSC and the Specialist Committee may join forces to develop an engagement framework and political mandate to engage with the IASB on a manner that supports economic growth and employment within the South African, and African landscape.

The historical approach to IFRS in South Africa

41. Due to its colonialist past, South Africa was an early adopter of IFRS standards as issued by the IASB (in its earlier format), dating back to the Companies Act, 1973.

42. From 1993 until the establishment of the FRSC, IFRS remained virtually unchanged whilst promoting the perceived benefits of international standards and fair value accounting. Parallel to this process, the Johannesburg Stock Exchange (JSE) formed a monitoring panel to report any non-compliance of listed companies to the JSE.

43. Within this context the drafters of the Companies Act, 2008 were influenced to establish a new concept of "legal backing" for financial reporting standards. The effect was that the Companies Regulations, 2011 references IFRS and applies the standards to different types of companies based on a public interest score. During this transition the power to determine and influence standards shifted to the FRSC. However, the FRSC continued to follow a similar legacy path in its engagements with the IASB. The FRSC was not explicitly mandated to act in the national interest of South Africa and in any event did not receive adequate funding to perform this role.

44. As a result of the early adoption of IFRS as promoted, South African authorities have never fully considered the political nature of the standard setting process and has instead opted to trust technocrats with managing national policy.

45. The IASB is a well-known and recognised authority with regards to financial reporting standards, despite the fact that it is not created by any national government.

46. IFRS is applied, to a varied degree, within multiple jurisdictions. A motivating factor for the wide acceptance of IFRS includes the perceived contribution to Foreign Direct Investment (FDI) and Gross Domestic Product (GDP)[5]. Ostensibly the robustness of the financial reporting supply chain (including the adoption of IFRS) and other factors such as GDP, GDP per capita, inflation, infrastructure, openness to trade, human capital development, and global interest rates, combine to determine the level of FDI.

47. However, not all countries have adopted IFRS in full. Accepting the benefits of IFRS does not mean a country should blatantly adopt IFRS fully and unchanged. It seems to us that a nuanced and convergent approach to IFRS will better protect our independence whilst more likely being able to increase FDI and GDP.

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[5] https://iiardpub.org/get/JAFM/VOL.%203%20NO.%202%202017/The%20impact%20of%20International.pdf

Perceived international adoption of IFRS

48. According to the IFRS foundation[6] there is overwhelming support for the adoption of a single set of high quality, global accounting standards. However, there is a big difference between a perceived adoption and actual implementation.
49. Our proposal illustrates the care that should be taken to not accept IFRS at face value. The emerging powers of India and China may indicate their support for adoption but in reality, only converge to IFRS, whilst allowing carve-outs from IFRS should it be in their national interest to do so, whereas the USA follows their own unique approach.

The political nature of the standard setting process

50. Despite the seemingly unanimous support for IFRS a closer look reveals the political nature of the standard setting process. The fact that the process of determining and prescribing IFRS can be characterised as political, reveals the important role of the FRSC in protecting the interest of South Africa amongst a number of competing nations.
51. A more balanced approach to the standard setting process in South Africa should therefore be to consider the technical nature of the process, but more importantly the political aspect, and potential positive contribution to FDI and GDP.
52. From a technical perspective it has been shown that the adoption of IFRS does have a positive effect on FDI in African countries as it reduces "information asymmetries between foreign investors and local investors. Hence, it is expected to lower the investment risks perceived by foreign investors to Africa…Many African countries had to make the transition from protectionism to market liberalisation in the 1990s. This was done with the encouragement of foreign direct investment campaigners such as the World Bank, which has particularly encouraged emerging markets to engage in reforms that would among other benefits, make them attractive to foreign direct investments as a means of stimulating their economies. This involved opening up the market to competition and improved efficiency". [7]

[6] https://www.ifrs.org/use-around-the-world/why-global-accounting-standards/

[7] https://www.researchgate.net/publication/323943862_The_impact_of_International_Financial_Reporting_Standar

53. *However, partial adoption of IFRS is likely to provide a higher FDI and GDP than full adoption*, "IFRS adoption and other variables such GDPPC, ROL are significant and positively influences FDI inflows. Secondly, non fully-IFRS adopted countries experience higher inflows of FDI than the fully-IFRS adopted countries... Countries that have good regulatory policies and safe and secure business environments need not necessarily fully adopt IFRS as the result showed that countries that have adopted by means of modification or partially, experience higher FDI inflows than those with full adoption". [8]

54. Similar research performed in India provides ample examples how Tata Steel, described as the "unique temple of modern India" has been able to influence the standard setting process in India so as to benefit the company and Indian economic development. [9] [10] Tata Steel is one of India's largest firms, and "…has a history of leadership in guiding corporate regulation, including accounting standards, within India by lobbing…Indian standard setters to create an IFRS exception in Indian(ed) GAAP for specific situations".

55. Of special interest to South Africa, as part of the BRICS nations should be China's approach to IFRS "adoption" whilst ensuring that their national interest is protected and enhanced.[11] Chinese standard setters are "…careful to tailor IFRS to its needs, excepting certain provisions when crafting its domestic IFRS-based standards, and in one particular case, working with the IASB to modify IFRS itself to meet Chinese interests", this cautious and politically motivated approach is believed by some to have protected the Chinese economy during the 2008 – 2009 financial crises.

56. The Chinese authorities feel so strongly about the approach that they issue exceptions or allow alternative treatments despite the fact that other international standard setters may prohibit such treatment under their jurisdiction, for example a "…compelling example of China's reluctance on fair-value accounting is found in its decision to permit the historic-cost-based pooling-of-interests method for business combinations (in addition to the fair-value-based purchase method) despite the prohibition of this method by both the FASB and the IASB".

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ds_IFRS_Adoption_on_Foreign_Direct_Investments_FDI_Evidence_from_Africa_and_Implications_for_Managers_of_Education

[8]https://www.researchgate.net/publication/338230495_The_Effect_of_International_Financial_Reporting_Standards_on_the_Association_between_Foreign_Direct_Investment_and_Economic_Growth_Evidence_from_Selected_Countries_in_Africa

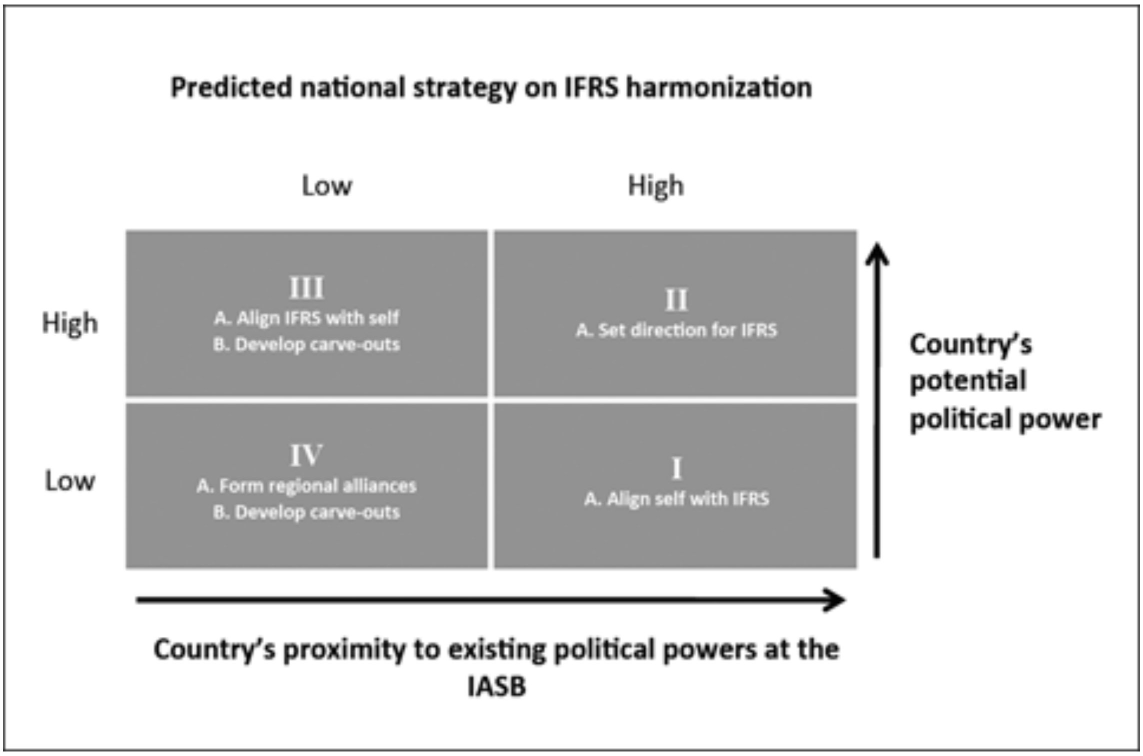
[9] https://www.degruyter.com/document/doi/10.1515/ael-2013-0004/html

[10] https://www.hbs.edu/faculty/Pages/item.aspx?num=39443

[11] https://www.degruyter.com/document/doi/10.1515/ael-2013-0004/html

A model to represent South Africa’s interest at the IASB

57. Combining the experience of India, China and the USA, a model[12] has been developed for emerging countries on how to represent their interest at the IASB. The model is reflected in figure 1 below:



58. The model classifies a nations ability to influence the development of IFRS using a scale consisting of potential political power, and proximity to the historical European powers that controlled the IASB.
59. Based on historical developments, South Africa followed the example of New Zealand and Australia and aligned itself with IFRS. These countries, as per this model are tier 1 nations with close proximity to European nations but with low political power.
60. Europe, and the United States of America, are grouped into tier 2 with high political power and high proximity to existing powers.
61. China is grouped into tier 3 with high political power but low in its proximity to existing powers at the IASB.
62. India is a tier 4 nation due to it being classified as representing low political power and low proximity to the existing IASB powers.

[12] https://www.degruyter.com/document/doi/10.1515/ael-2013-0004/html

63. This model can be used to understand South Africa's current position in respect of other nations and their ability to shape the development of IFRS in their favour. The model demonstrates that South Africa should attempt to move from tier 1 to tier 3, alongside China given its current close proximity to the historical powers but should exert its own influence to benefit its own economy.
64. A political mandate granted to the FRSC coupled with strong funding will allow South Africa to leverage its existing position of being aligned to IFRS but strengthen this position with carve-outs of IFRS that negatively affect sectors of our economy that is of national interest.

Secretariat Function

65. SAIBA hereby volunteers to perform the secretariat function for the FRSC. This will include providing an office venue for administration, meeting arrangements and the taking of minutes and any other ad hoc secretariat functions as required.

The model as proposed by us requires significant funding and we are confident that the proposed Section 191 specialist committee or alternatively the Ministerial Advisory Committee, and the nominees will be able to present a solution, under the guidance of the CIPC Commissioner and after an extensive consultation process with all role players within the financial reporting supply chain, to the Ministries of Finance and, Trade, Industry and Competition.

The process of consultation will include:

- Technical experts from accounting firms and Universities,
- Relevant bourses such as the JSE, financial analysts, and lenders,
- Standard setters from India and China.

The aim is to build a national consensus around a convergence approach to international standards with the aim of delivering increased FDI and improved GDP.

From the national consensus a funding model will be proposed by the Specialist or Advisory Committee to ensure the independence of the FRSC, adequate support from technical experts, and sustainable support from the public and corporate sector.

Nicolaas van Wyk
CEO: SAIBA

About SAIBA

SAIBA is a Professional Accountancy Organisation (PAO) and Self-Regulatory Organisation for accountants, tax practitioners, financial managers, and financial directors with offices in South Africa and Namibia. We are associate members of the Pan African Federation of Accountants (PAFA) and full members of the International Association of Finance Executive Institutes (IAFEI). SAIBA is authorised to issue designations as registered with the South African Qualifications Authority (SAQA) and our designated members are recognised as accounting officers, independent reviewers, and independent accounting professionals. SAIBA was awarded the status of Recognised Controlling body (RCB) in terms of Section 240A(2) of the Tax Administration Act.

We were established in 1987 as a non-profit company in terms of the Companies Act, 2008, and are governed by a board elected by members.

SAIBA membership consists of more than 10 500 associates including >5000 designation holders. We issue four designations or certifications relevant to a variety of job functions within the finance department, as follows:

a) Junior Accountant: Business Accountant (SA) based on an NQF7 qualification,
b) Financial Manager: Certified Business Accountant (SA) based on an NQF8 qualification,
c) Financial Director: Certified Financial Officer (SA) based on an NQF9 qualification,
d) Accountants in Practice: Business Accountant in Practice (SA) based on an NQF7 qualification.

We are a level 2 BBBEE contributor with more than 60% black membership. We have signed MOUs with the Department of Social Development (DSD) to provide professional volunteer services to the NPO sector, and we have recognition agreements with several professional bodies including CIMA and SAIT.

We have the legal authority to verify and monitor the delivery of quality professional services by business accountants in terms of Section 60(4) of the Close Corporations Act, 1984 (accounting officers), Regulation 29(4) of the Companies Act, 2008 (independent review), Policy and Criteria for Recognising a Professional Body and Registering a Professional Designation for the Purposes of the National Qualifications Framework Act, Act 67 of 2008 (professional body), SAQA Register of SAIBA designations, List of Accredited Professional Bodies whose members are eligible to be licensed as business rescue practitioners, Recognised Controlling Body as referred to in s 240A of the Tax Administration Act, FIC Namibia (Accountable Institutions).

We protect the interest of the government, CIPC, SARS, SMEs, Corporates, and the public. We regulate the following services provided by designated business accountants:

Tax compliance, Preparation of financial statements, Compilation, Agreed-Upon Procedures, Accounting Officer Reports, Limited Assurance reports Assurance on non-financial information, Commissioner of Oaths, Business Rescue Practitioner Engagements, Tax Returns and Advice, Financial Intelligence Reports (Namibia). Business advisory services.

Our members are empowered in terms of the following laws, statutes, and supporting regulations to perform professional accounting work:
Tax Administration Act, 2011, Companies Act, 71 of 2008, Immigration Act, 13 of 2002, Justices of the Peace and Commissioners of Oaths Amendment Act, 1967, Sectional Titles Schemes Management Act, No. 8 of 2011 (Exemption from Chief Ombud), Trust Property Control Act, 57 of 1988 and the Trust deed, SA Schools Act 84 of 1996, Financial Advisory and Intermediary Services Act 37 of 2002 (Accounting Officer exemption), Non-profit Organisations Act 71 of 1997, National Credit Act 34 of 2005 (Application submitted), Co-operatives Act 14 of 2005, Fund-Raising Act 107 of 1978, Lotteries Act (No 57 of 1997), Broadcasting Act, Act No 4 of 1999, BEE Act 53 of 2003 (Affidavits for EME BBBEE Certificates), Construction Industry Development Board Act No. 38 of 2000, Immigration Act, No. 13 of 2002, Namibian Financial Intelligence Centre Act, No. 13, 2012, Tax Administration Laws Amendment Act 21 of 2012 (membership with SAIT), Close Corporations Act 69 of 1984.

SAIBA's objectives are to protect the public interest by adopting and enforcing standards of ethics, conduct, quality, and service engagement standards that seek to ensure the delivery of accountable and transparent professional service by SAIBA members.
We do this by offering executive education and continuous professional development (CPD) via our training platform SAIBA academy, technical news updates via accounting weekly and CFO talks, and enforcing ethical conduct thorough monitoring and disciplinary procedures.