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Review of practical implementation issues of International Financial Reporting Standards

Case study of South Africa*

Note by the UNCTAD secretariat**

Executive summary

In concluding its twenty-third session, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) agreed to conduct additional studies and reviews of practical implementation issues of International Financial Reporting Standards (IFRS) with a view to developing guidance on good practices on IFRS implementation. Accordingly, country case studies of Pakistan, South Africa and Turkey were prepared.

This report presents findings of the case study conducted of South Africa. Listed companies in South Africa were required to comply with IFRS for financial periods commencing on or after 1 January 2005. In this case study, the South African financial reporting system and the South African experience of the implementation of IFRS are discussed.

The main objective of this case study is to draw lessons learned from the South African experience in converging local standards with IFRS, and to discuss the findings with member States, with a view to facilitating sharing of experience among countries that are either implementing IFRS or that intend to do so in the future.

* This document was prepared and edited by the UNCTAD secretariat with substantive inputs from the South African Institute of Chartered Accountants (SAICA).
** This document was submitted on the above-mentioned date as a result of processing delays.

Contents

I. Introduction

1. South Africa is regarded as the economic powerhouse of Africa, with a gross domestic product (GDP) of four times that of its southern African neighbours and comprising around 25 per cent of the entire continent's GDP.[1] This positive picture of the South African economy is confirmed in the Chairman and CEO Statement of the Johannesburg Stock Exchange (JSE):

> "The South African economy continues its strong performance, and translates into increased interest in the market from local and international investors, and trading volumes reach record levels…The building blocks for this success have been put in place by Government, and we must applaud its efforts in creating an environment in which the economy can thrive. A continued commitment to produce macroeconomic policies builds confidence in South Africa as an investment destination, and boosts the image of the country as a whole. The JSE plays its role in providing an efficient, well-regulated exchange that makes the investment process as simple, low cost and transparent as possible, but the underlying investment decision is dependent upon perceptions of the future performance of South Africa as a whole."[2]

2. The Minister of Finance, Trevor A Manual, in summarizing the Government's efforts in the budget speech of 2007, said:

> "As our young nation enters its 13th year, we have much to be proud of. We are building a society founded on principles of equality, non-racialism and non-sexism. We have built institutions of democracy, creating an open society founded on a rule of law. After stabilizing the economy and the public finance, we have created the conditions for rapid economic growth, job creation and the broadening of opportunities."[3]

3. The South African Institute of Chartered Accountants (SAICA), the JSE and the Accounting Practices Board (APB) of South Africa have recognized the need to be part of a global economy with respect to financial reporting.[4] Local accounting standards in South Africa have been harmonized with international accounting standards since 1993.[5] In February 2004, a decision was taken by APB to issue the text of International Financial Reporting Standards (IFRS) as South African Statements of Generally Accepted Accounting Practice (GAAP) without any amendments.[6] The reasons for the ongoing harmonizing and the issuing of the text of IFRS as South African Statements of GAAP were:

(a) "For South African companies to attract foreign investment;

(b) To provide credibility to the financial statements of South African companies in the global market; and

(c) To do away with the need for dual listed entities to prepare financial statements in accordance with more than one set of accounting standards."[7]

1 Available from http://www.southafrica.info/doing_ business/ economy/ econoverview.htm (accessed 25 June 2007).
2 JSE: Chairman and CEO Statement. Available from http://www.jse.co.za/chairmanceo.jsp (accessed 25 June 2007).
3 South African Government (2007). Budget Speech 2007 by Minister of Finance, Trevor A Manual, MP. 21 February 2007. Available from http://www.info.gov.za/speeches/2007/07022115261001.htm.
4 The Accounting Practices Board was established in 1973, the year in which the current Companies Act was enacted.
5 SAICA (2004). Preface to Statements of Generally Accepted Accounting Practice. August 2004; SAICA (2006). Circular 03/06 – Evaluation of Compliance with Statements of Generally Accepted Accounting Practice. March 2006.
6 *Ibid.*
7 Ludolph S (2006). Why IFRS? Accounting SA, April: 19. Sue Ludolph is the SAICA Project Director – Accounting.

4. The main purpose of this case study is to set out South Africa's experience in the implementation of IFRS.[8] The case study starts in chapter II by providing a brief overview of the current financial reporting system in South Africa, including the development of the system and proposed reforms. The transition to IFRS in South Africa is integrated into this discussion. Thereafter, the South African experience in converting South African standards into IFRS is discussed, with a focus on issues of a more general nature (chapter III), and specific technical and application issues are presented in chapter IV.

II. The South African financial reporting system

5. The legal framework for corporate reporting in South Africa is governed by the 1973 Companies Act, No. 61. However, the standard-setting process (discussed below) is developed in South Africa outside the scope of the Companies Act.

A. Companies Act

6. The 1973 Companies Act requires that the financial statements of companies be in conformity with generally accepted accounting practice.[9] The concept of Statements of GAAP was introduced into the Companies Act with the introduction of paragraph 5 into Schedule 4in 1992.[10] It stated that if the directors of a company believe that there are reasons for departing from any of the accounting concepts in the Statements of GAAP approved by APB in preparing the company's financial statements in respect of any accounting period, they may do so, but particulars of the departure, the effects and the reasons for it shall be given.

7. Legal opinion was obtained by SAICA in September 1999 to interpret the effect of these provisions of the Companies Act.[11] The opinion merely confirmed that, to meet the requirements of the Companies Act, the financial statements should be prepared and presented in accordance with generally accepted accounting practice. However, the required disclosure needed to be provided if the financial statements materially departed from Statements of GAAP. Only additional disclosure was required. No true and fair view override, similar to IAS 1 (presentation of financial statements), was created by the Companies Act.

8. The result is that the current Companies Act does not require companies to comply with South African Statements of GAAP. Thus, no statutory enforcement procedures for Statements of GAAP have been created by the Companies Act.

B. The standard-setting process in South Africa

9. Standard-setting in South Africa follows a two-level process. While APB approves and issues accounting standards, the Accounting Practices Committee (APC) serves as an advisory body to APB.

10. The objective of APC in this regard is firstly to propose to APB the issuing in South Africa of the international Statements of GAAP (AC 100 series) and Interpretations of Statements of GAAP (AC 400 series).[12] A second objective of APC is to develop South African pronouncements of Statements of GAAP and Interpretation (AC 500 series) in instances where issues are relevant to the South

[8] Except for different documents referred to in this report, the South African experience is obtained from discussions with representatives of companies such as Telkom, Sasol, the JSE and Standard Bank, and the auditors, Deloitte.
[9] South Africa (1973). Companies Act No. 61 of 1973, section 283(6). Pretoria: Government Printer.
[10] SAICA (2005). Circular 8/99 – Compliance with Section 286(3) and Paragraph 5 of Schedule 4 to the Companies Act, 61 of 1973 and Statements of Generally Accepted Accounting Practice. June 1999.
[11] *Ibid.*
[12] SAICA (2004). Preface to Statement of Generally Accepted Accounting Practice. August 2004.

African context only. The AC 500 series developed by APC also undergoes a process of exposure and review of comments before being recommended to APB.

11. An exposure draft of a proposed IFRS, issued by the International Accounting Standards Board (IASB), is issued for comment by APC at the same time and for a period similar to IASB in South Africa.[13] Comments received on the South African version of the exposure draft are considered by APC in its process of drafting the comment letter submitted by SAICA to IASB. Once IASB issues an IFRS, APC reviews the IFRS to ensure that it is not in conflict with any South African legislation before recommending to APB that it is issued as a South African Statement of GAAP.

12. Since 1993, as stated above (see paragraph 3), South Africa has been harmonizing its Statements of GAAP with international standards, although the South African versions of the international standards have been issued as South African Statements of GAAP (AC 100 series) and Interpretation of Statements of GAAP (AC 400 series) after a due process. As a result, South African Statements of GAAP have been, in most respects, similar to IFRS. Minor differences have arisen as a result of different effective dates, and in some instances options permitted in IFRS have been removed from South African Statements of GAAP and additional disclosure requirements have been included.[14]

13. In February 2004, APB decided to issue the text of IFRS as South African Statements of GAAP without any amendments (see paragraph 3 above). From then on, each South African Statement of GAAP would be identical to each IFRS. However, transitional differences, such as implementation dates, could still exist, since a South African due process is still followed. To indicate the similarity between each IFRS and its corresponding South African Statement of GAAP, a dual numbering system is used to refer to both the IFRS number and the relevant Statement of GAAP number in the South African Statements of GAAP.[15]

14. If an entity applies South African Statements of GAAP, it cannot claim compliance with IFRS because of the transitional differences that still exist.

15. In respect to the public sector, Statements of Generally Recognized Accounting Practice (GRAP) are issued by APB in South Africa.[16] A key priority of APB is to develop a core set of standards of GRAP by 2009. These Statements of GRAP are drawn preliminary from the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants' International Public Sector Accounting Standards Board (IPSASB).

C. JSE Limited

16. The Johannesburg Stock Exchange (JSE) was originally established as the Johannesburg Stock Exchange in 1887. The name changed to JSE Securities Exchange South Africa on 8 November 2000, when it became a national exchange and expanded to other financial products. In 2005, JSE revised its corporate identity and changed its name to JSE Limited.[17]

17. JSE is among the 20 largest stock exchanges in the world and provides capital to large listed entities, with its Alternative Exchange offering access for small businesses, and its Social Responsibility Index supporting businesses that invest in socially, economically, and environmentally sustainable development. At the week ended

[13] *Ibid.*
[14] SAICA (2006). Circular 03/06 – Evaluation of Compliance with Statements of Generally Accepted Accounting Practice. March 2006.
[15] *Ibid.*
[16] Statements of GRAP are available at www.asb.co.za.
[17] JSE (2007). Our history. Available from http://www.jse.co.za/our_history.jsp (accessed 23 April 2007).

22 June 2007, the JSE Market Capitalization was 5, 814 billion Rand, an increase of 40.9 per cent from the corresponding week in 2006.[18]

18. Currently, just over 50 companies with dual listings are registered on JSE, of which more than half are primarily listed in South Africa.[19] This demonstrates that most of these companies originated in South Africa. However, some companies with dual listings, such as SABMiller and BHP Billiton, have been created through international mergers and takeovers. Only five of these companies are listed on the New York Stock Exchange and will benefit if the United States GAAP reconciliation is abolished.

19. As of October 2000 JSE required listed companies to prepare their annual financial statements in accordance with the national law applicable to listed companies (the Companies Act) and to apply either South African Statements of GAAP or International Accounting Standards.[20] The reason for allowing the choice was to assist companies with dual listings on overseas stock exchanges and overseas companies listed on JSE.

20. Further revised listing requirements called for listed companies to comply with IFRS for financial periods commencing on or after 1 January 2005.[21] In the light of the above, APC took a decision to issue the text of IFRS in South Africa without any amendments in February 2004.[22]

D. Developed practice

21. Although the Companies Act does not explicitly require companies to apply South African Standards of GAAP, such a practice has developed in South Africa. This practice is also confirmed by the audit practice in South Africa, which does not recognize generally accepted accounting practice as a financial reporting framework for audit assurance purposes.[23]

22. To confirm this practice, and taking into account the JSE requirements discussed above, SAICA issued a circular in 2006 stating that:[24]

(a) Companies listed on JSE must prepare financial statements in terms of IFRS, and unlisted companies are permitted to do so.

(b) Unlisted companies that choose not to follow IFRS must prepare financial statements in terms of South African Statements of GAAP. Where there is a departure from such statements, the departure, its particulars, the reason for the departure and its effect on the financial statements must be disclosed.

(c) If unlisted companies choose to adopt IFRS by way of an explicit and unreserved statement of compliance with IFRS, IFRS 1 must be applied in the preparation of their first set of IFRS financial statements. Unlisted companies that comply with Statements of GAAP are not permitted to use the IFRS 1 (AC 138) [25] option.

23. This circular issued by SAICA does not create any regulating authority on unlisted companies. It is foreseen that corporate law reform will legislate this practice

18 JSE (2007). Weekly Statistics: Week ended 22 June 2007.
19 JSE (2007). Dual Listed Company Information. Available from: http://www.jse.co.za/dual_listrd.jsp (accessed 25 June 2006).
20 Section 8.62(b) of the then JSE Listing Requirements.
21 Section 8.3 of the JSE limited Listing Requirements.
22 SAICA (2006). Circular 03/06 – Evaluation of Compliance with Statements of Generally Accepted Accounting Practice, March 2006.
23 Public Accountants and Auditors Board (PAAB) (2005). South African Auditing Practice Statement (SAAPS 2) – Financial reporting frameworks and audit opinions, July 2005.
24 SAICA (2006). Circular 03/06 – Evaluation of Compliance with Statements of Generally Accepted Accounting Practice, March 2006.
25 SAICA (2006). IFRS 1 (AC 138) – First-time Adoption of International Financial Reporting Standards, the South African equivalent to IFRS 1.

in South Africa. Further, no relief is currently available for small and medium-sized enterprises (SMEs) in South Africa.

E. Corporate Law Amendment Act

24. The Corporate Law Amendment Act, 2006, was issued on 17 April 2007 as the first official document in the process of the reform of the Companies Act, but at the time of writing (July 2007) does not have an effective date. It has been seen as the first phase of the reform process. The second phase entails a complete review of the Companies Act.[26]

25. The Corporate Law Amendment Act provides for differential accounting in South Africa by identifying two types of companies: a widely held company and a limited interest company. The Amendment Act specifically declares that financial reporting standards for widely held companies shall be in accordance with IFRS.[27] A company will be classified as widely held if its articles provide for unrestricted transfer of its shares, if it is permitted by its articles (or by special resolution) to offer shares to the public, or if it is a subsidiary of a widely held company.

26. Once the Corporate Law Amendment Act is effective, relief will be granted to limited interest companies in that they will not have to comply with the stringent requirements of IFRS or South African Statements of GAAP. However, the financial reporting standards for limited interest companies still need to be developed. As an interim measure, limited interest companies are required to prepare their financial statements in terms of accounting policies adopted, which must comply with the framework for the preparation and presentation of financial statements (AC 000 in the South African context, which is identical to IASB's conceptual framework).[28] In anticipation of this relief for limited interest companies, APC will recommend to APB an early adoption of IASB's ED 222 (IFRS for SMEs) as a transitional measure.[29]

27. A further initiative of the Corporate Law Amendment Act is the establishment of a statutory Financial Reporting Standards Council (FRSC), which will take over the function of APB as the non-statutory standard setter in South Africa. Until the FRSC is established, APB will continue its function as the South African standard-setting body. The objective of the FRSC will be to establish financial reporting standards that promote sound and consistent accounting practices.[30] The functions of the FRSC will be to:

(a) Establish financial reporting standards for widely held companies in accordance with IFRS; and

(b) Develop separate reporting standards for SMEs in South Africa.[31]

F. Enforcement

28. Currently, the Companies Act does not create any procedures for the enforcement of financial reporting in South Africa.

29. As an interim phase, in 2002 JSE, in partnership with SAICA, established the GAAP Monitoring Panel (GMP) (see paragraphs 6 and 10 above) in response to the need to create an oversight body that would enhance compliance with accounting

[26] SAICA (2007). Summary of the main features of the Corporate Laws Amendment Bill. Johannesburg: SAICA.
[27] Section 440S(2) of the Corporate Law Amendment Act, 2006.
[28] Section 56(3) of the Fourth Schedule of the Corporate Law Amendment Act, 2006.
[29] SAICA issued ED 225 – Financial Reporting for Small And Medium-Sized Entities (SMEs) – Proposed Process in May 2007 to invite the South African accounting practice to comment on the process leading to the early adoption of the IFRS for SMEs in South Africa.
[30] Section 440P(1) of the Corporate Law Amendment Act, 2006.
[31] Section 440S(1) of the Corporate Law Amendment Act, 2006.

standards.[32] The results of investigations by GMP are reported to JSE, which takes action against any company guilty of non-compliance. (This is discussed further in chapter III below.)

30. The Corporate Law Amendment Act also creates initiatives for the monitoring and enforcement of financial reporting standards. For monitoring purposes the act proposes that a suitably qualified officer may be appointed to monitor the financial reports and accounting practices of certain widely held companies in order to detect non-compliance with financial reporting standards that may prejudice users.[33]

31. To enhance enforcement, the Corporate Law Amendment Act proposes that a Financial Reporting Investigation Panel (FRIP) be created to replace GMP. The objective of FRIP will be to contribute to the reliability of financial reports by investigating alleged non-compliance with financial reporting standards and recommending measures for rectification or restitution.[34] Any person, whether or not a shareholder, who has reason to believe that the financial report of a widely held company has failed to comply with a financial reporting standard may refer the matter to FRIP for investigation. FRIP will have much wider powers than GMP. Once FRIP is established and fully operational, it is the intention of SAICA and JSE to dissolve GMP.[35]

III. Implementation issues of a general nature

32. The major implementation issues of a general nature encountered in South Africa with the transition to IFRS are discussed in this chapter. Although both SAICA and JSE were instrumental in publicizing the decision to implement IFRS in South Africa (SAICA and JSE communicated the nature of the IFRS implementation decision through press releases and circulars), they were not involved in developing the strategy to implement IFRS. Each company had to adopt its own strategy as is explained below.

A. Transition to IFRS

33. As stated earlier, JSE required that all listed companies comply with IFRS for financial periods commencing on or after 1 January 2005. Two groups of listed companies existed in South Africa in 2005: those that had already adopted IFRS before 2005 by voluntarily electing to convert, and those that had converted in 2005. Some of the companies in the first group had adopted IFRS before 2005 as they were dual listed on other security exchanges and IFRS was more internationally recognized.

34. Many companies in South Africa, especially in the banking industry, saw the implementation of IFRS as a two-step process. Firstly, under South African Statements of GAAP, the principles of IAS 39 (financial instruments: recognition and measurement) were adopted in 2001/2002.[36] Secondly, the full adoption of IFRS occurred in 2005. IFRS 3 (business combinations) and the consequent amendments to IAS 36 (impairment to assets) and IAS 38 (intangible assets) were applicable under SA Statements of GAAP from 2004.[37] This could create the impression that transition to IFRS in South Africa during 2005 was not a burdensome process. However, two surveys conducted by Ernst and Young in South Africa demonstrated that South

[32] SAICA (2006). GAAP Monitoring Panel has taken a closer look at 30 listed companies. Press release, 29 November 2006.
[33] Section 440V of the Corporate Law Amendment Act, 2006.
[34] Section 440W of the Corporate Law Amendment Act, 2006.
[35] SAICA (2007). Summary of the main features of the Corporate Law Amendment Bill. Johannesburg: SAICA.
[36] AC 133, the South African equivalent of IAS 39, was applicable for financial years starting from 1 January 2001.
[37] IFRS 3 (AC 140) – Business Combinations was applicable to all business combinations with an agreement date on or after 31 March 2004.

Africa's transition to IFRS in 2005 was still a significant and costly exercise for most companies.

35. Ernst and Young carried out a survey of 46 JSE-listed companies in the first quarter of 2005 to investigate the IFRS implementation status of companies in South Africa.[38] The survey indicated that 96 per cent of the companies surveyed were not on track for reporting IFRS 2005 interim results and that only 33 per cent were on track with the overall progress of the IFRS 2005 implementation. This clearly indicates that many South African companies underestimated the transition to IFRS.

36. In 2006, Ernst and Young conducted a follow-up survey to assess the implications and impact of the IFRS transition both for first-time adopters (IFRS Conversion) and previous adopters (the effect of the improvements project).[39] The survey highlighted the challenges South African companies faced with the adoption of IFRS, which included greater complexity than anticipated, high costs in some cases, poor understanding of the reasoning behind the transition, and potential confusion about company performance information.[40]

37. The survey indicated that almost two thirds of the respondents surveyed made use of a steering committee for their IFRS projects and held regular meetings to assess progress and discuss issues. Nearly all of the companies implemented IFRS in-house, but over 80 per cent indicated that they were assisted by their external auditors and/or other external consultants (including other auditing firms). What mostly occurred was that the external consultants presented their findings, and the companies' auditors were involved in verifying the choices made and policies implemented by the companies. Consistency and control procedures were created through such a review process.

38. The transition to IFRS also placed a burden on company staff. Training of staff was deemed necessary and, in response to the survey, approximately a third of the companies indicated that they had had to employ staff on a permanent basis to take responsibility for compliance with accounting standards and disclosure requirements. Some respondents had employed staff from the inception of the IFRS project, while others were still looking for additional staff to assist with the accounting function. In practice, because South Africa was one of the first countries to harmonize its accounting standards with IFRS, its experience is sought after and globalization is draining experience and skills from South Africa. This has occurred particularly in relation to the implementation of the financial instrument standards (IAS 32 and 39).

39. At present, 5,942 of the 26,222 SAICA members (26.6 percent) who hold the South African chartered accountant designation are based outside South Africa.[41] To date, SAICA has focused its attention on the education and training of chartered accountants. SAICA has also identified the need to better assess the supply of and demand for accounting and financial expertise at all levels in South Africa. To understand the nature and extent of the current shortage in financial management, accounting and auditing skills, and nature and extent of the retention of trainee accountants, SAICA launched two research projects during June 2007.[42] These projects are a first step toward resolving the skills shortage in the accounting field in South Africa.

40. The 2006 survey also indicated enormous cost and time constraints for certain companies in the adoption of IFRS. One third of the respondents had taken more than

[38] Ernst and Young (2005). IFRS readiness amongst South African companies – a survey. April 2005.
[39] Ernst and Young (2006). Transition to IFRS – the final analysis results. No date.
[40] Ernst and Young (2006). Facing the challenges of IFRS adoption. 27 July 2006.
[41] SAICA (2007). CA(SA) qualification results reflect blossoming transformation in accountancy profession. Press release, 22 June 2007.
[42] SAICA (2007). Request for proposal: research into the financial management, accounting and auditing skills shortage, and request for proposal: research into the attrition and retention of trainee accountants.

a year to implement the changes, while only a small group (16 per cent) had taken less than six months. More than half the respondents indicated that the IFRS implementation had cost them more than R1 million and more than 10 per cent believed that the cost had exceeded R5 million.

41. In the survey, most of the respondents (66 per cent) indicated that the IFRS changes had resulted in more meaningful information being provided to shareholders. However, they also indicated that the adoption of IFRS brought with it increased intricacies and complexities.

42. Interestingly, the survey pointed to a mixed impact on the bottom-line profit being reported. Almost 66 per cent of the respondents indicated an adverse effect, while approximately one third reported a positive effect.

43. One of the most significant findings of the survey concerned the impact on the recording and maintenance of financial information. Information and communication technology (ICT) systems were reported to be unable to supply information in all instances and workarounds were reported to be required to achieve compliance with IFRS, which suggests that more ICT system changes will be seen in the future. Concerns were expressed mostly in the following areas:

(a) Maintenance of information relating to property, plant and equipment, such as updating of the fixed asset register and recording and updating of the residual values and useful lives: In the transition to IFRS in 2005, the improvements to IAS 16 (property, plant and equipment) were seen as the most burdensome task. Many companies applied the deemed cost approach in IFRS 1 to eliminate retrospective adjustments. However, uncertainty about the level of application of the component approach to depreciation remained a challenge.

(b) Financial-instrument valuation and recording, including risk-management disclosures, complying with de-recognition principles and splitting financial instruments: Currently, under IFRS 7 (financial instruments: disclosure), companies trading in different countries with different functional currencies experience difficulty in completing sensitivity analyses.

(c) Processes around doubtful debt provisions and accounting for employee and management/executive compensation: The South African experiences surrounding doubtful debt provisions are discussed in greater detail below.

B. Local technical committee

44. With the adoption of IFRS, the question could be raised whether a local technical committee, such as the South African APC, is indeed still needed. The South African experience confirms a positive need for such a committee.

45. The first need for such a committee is to achieve the involvement of the local accounting community in the due process of standard setting by IASB and the International Financial Reporting Interpretations Committee (IFRIC) through commenting on exposure drafts and discussion papers. Firstly, APC is regarded as being representative of the South African corporate world in that members of the committee represent commerce and industry, users, auditors, JSE and academics. Further, by creating a separate technical subcommittee for each new exposure draft or discussion paper, APC invites the local accounting community and industry experts to be involved in its comment process should this be necessary.

46. The second need for such a committee is the role it plays in education. APC assumes the role of educating the local accounting community on new developments in the accounting field. Road shows (sometimes involving IASB staff) and other opportunities for discussion are held when the need is identified. SAICA, through its

continued education process, also provides training seminars to its members on pre-identified topics.

47. The last, and maybe the most important, need for a committee such as APC is that such a committee should consider the correct treatment of accounting issues for which there is currently insufficient guidance in IFRS, including also instances where diversity in practice is detected. Such issues to be discussed and resolved by APC are obtained through the following role players:

(a) The APC members themselves;

(b) Other SAICA committees;

(c) Industry committees;

(d) The technical partners' forum;

(e) JSE;

(f) The top 40 CFO forum; and

(g) Members of SAICA.

C. Local issues and diversity in practice

48. The experience in South Africa is that diversity exists in practice. However, one of the main advantages of converting to IFRS is that, through this conversion, many of these divergent practices have been eliminated. By adopting IFRS, companies have had to evaluate their existing accounting policies and procedures. The involvement of external consultants and the review process of the internal auditors have created a move toward consistency in implementation. Consistency has been strengthened by industry experts coming together and resolving related issues. In this regard, the technical partners' forum plays a vital role in resolving issues and creating consistency. Each of these technical partners also has the support of their international technical desk.

49. Local issues and diversity in practice that cannot be resolved through the above structures are channeled to APC. The task of APC is then to determine the appropriate means of resolving these issues. The first question APC asks is whether the issues are widespread and significantly divergent to send a request to IFRIC. Issues such as operating leases and Black Economic Empowerment (BEE) transactions (discussed further in chapter IV below) are examples of South African requests that have been referred to IFRIC.

50. If the decision is made not to refer an issue to IFRIC for a number of valid reasons (e.g. the issue is considered to be only a local one), the alternatives are to release a local standard, a circular or a guide, or to use other communication methods of announcing how the issue has been resolved. APC recommends the issuing of such South African pronouncements to the appropriate authoritative body.

51. Where appropriate, a local standard (one of the AC 500 series of Statements of GAAP) is issued by APB to interpret specific accounting aspects, transactions or other issues that occur only in the South African context, where such aspects, transactions or other issues are not specifically or clearly addressed in IFRS.[43] The AC 500 series has the same authority as the AC 100 series of Statements of GAAP, and must be adhered to by South African companies even if they prepare the financial statements in accordance with IFRS.[44] A company which claimed compliance with IFRS and which also complied with the AC 500 series would not be in contravention of IFRS, as these

[43] SAICA (2005). Circular 8/05 – Status of Professional Announcements. August 2005.
[44] JSE (2005). Compliance with the AC 500 Series of Standards. JSE's Listing Division's letter, 12 May 2003.

local standards are merely local interpretations of IFRS. These companies would not need to also claim compliance with South African Statements of GAAP, and in fact would not be able to as they would have applied IFRS 1 (which is not part of South African Statements of GAAP).

52. The guides issued by SAICA are not regarded as having the same status as Statements of GAAP.[45] Members or associates that are responsible for preparing financial statements and that do not comply with a guide could be called upon by SAICA to explain why they did not do so. Most of the guides are issued to resolve industry-specific issues.

53. Circulars issued by SAICA communicate relevant issues to members, but never interpret issues. Where communication is provided on accounting issues, circulars have the same status as the accounting guides referred to above.[46]

54. The more significant of these pronouncements are discussed under specific issues in chapter IV below.

D. Monitoring and enforcement

55. The formation of GMP has also contributed to consistency in accounting application in South Africa. On the advice of GMP, the Listing Division of JSE has issued guidance to listed companies in respect of the correct accounting treatment of certain transactions or events identified by GMP. This includes the following:

(a) Insurance companies should not include smoothing adjustments relating to long-term investment returns in their income statements.[47]

(b) Concerning the correct presentation in the income statement, it is inappropriate to end the income statement with the line item “headline earnings” or with any figure other than net income attributable to ordinary shareholders (the previous format of the income statement).[48]

(c) A statement that “certain comparative figures have been restated to comply with current year classification” should be supported by full disclosure on a line-by-line basis of all reclassifications.[49]

(d) Companies should review their accounting treatment of their share trusts to ensure that they comply with consolidation principles.[50]

(e) Compliance with IFRS also includes compliance with the AC 500 standards.[51]

56. Currently, 28 companies have been referred to GMP for review. Nine of these have required a review of the total financial statements, and 18 have required reviews of specific policies or line items in the interim or annual financial statements.[52] The results of the recommendations and actions taken by JSE are presented in table 1.

[45] SAICA (2005). Circular 8/05 – Status of Professional Announcements. August 2005.
[46] *Ibid.*
[47] JSE (2003). Long-term investment return adjustment to income statement. JSE’s Listing Division’s letter, 21 February 2003.
[48] JSE (2003). Income statement presentation. JSE’s Listing Division’s letter, 12 May 2003.
[49] JSE (2003). Listing Division of the JSE. Restatement of comparative financial information. JSE’s Listing Division’s letters, 22 October 2003 and 29 December 2003.
[50] JSE (2004). Consolidation of share incentive scheme trusts. JSE’s Listing Division’s letter, 16 February 2004.
[51] JSE (2005). JSE. Compliance with the AC 500 series of standards. JSE’s Listing Division’s letter, 24 January 2005.
[52] SAICA (2007). Summary of matters. Available from http://www.saica.co.za/documents/summary_of_matters. (accessed 23 April 2007).

Table 1. Decisions on cases referred to the GAAP Monitoring Panel

Recommendations or actions	Number
Annual financial statements withdrawn and re-issued	3
Companies suspended (other JSE problems also present)	2
Accounting policy changed for future financial reports/other companies also adopting the policy advised to comply in the future/draft publication of the results changed before final publication of the results	7
Revised results announcement made	9
Reference to issues identified by GMP made in next interim results and full disclosure made in annual report	2
Correct headline earnings per share re-published on Security Exchange News Service and in annual report before distribution	1
Results revised before distribution to shareholders	2
No action required	1
Pending	1
Total	**28**

Source: SAICA (2007). *Summary of matters.* Available from http://www.saica.co.za/documents/summary.

57. The South African history of a lack of legal enforcement of financial reporting standards has created the opportunity for different interpretations and applications in practice, sometimes even for accounting manipulation. The lesson learned is that if South Africa truly wants to be a player in the global market, monitoring and enforcement must be a cornerstone of the financial reporting system. IASB is not responsible for monitoring and enforcement of IFRS. These tasks are the responsibility of national regulators. South African regulators are committed to carrying rigorous monitoring and enforcement. In this respect, efforts so far have proved to be successful in ensuring compliance. Professor Harvey Wainer, chairman of GMP, stresses the urgency and seriousness with which GMP views its task as advisor to JSE in the achievement of this compliance.[53]

E. Involvement of local firms

58. The technical partners' forum in South Africa plays an important role in identifying different practices and applications of financial reporting standards. This technical partners' forum represents a network of technical partners in South Africa. This could be seen as a first step in the process of creating consistency in the application of financial reporting standards in South Africa. Through their international networks, these partners also obtain knowledge of international practices to resolve identified issues. In the sustainability of consistent global reporting practices, this networking is seen to be crucial.

[53] SIACA (2006). GAAP Monitoring Panel has taken a closer look at 30 listed companies. Press release, 29 November 2006; only 28 of the 30 companies have been actioned.

59. Local auditing firms are also required to refer accounting issues to their international desks in order to create consistency in practice. The downside, however, is increased cost and increased turn-around time, which has frustrated auditors and clients in practice.

IV. Technical and application issues

60. The major technical and application issues encountered in the transition to IFRS in South Africa are highlighted in this chapter. These issues have been identified through a review of the formal process of APC and discussions with industry leaders.

A. Impairment of debtors' book

61. Processes to create provisions for doubtful debts were identified as an implementation issue in the second Ernst and Young survey (discussed above). The issue started in the banking industry with the adoption of the South African version of the original IAS 39 in 2001/2002.[54] At that stage, the South African Reserve Bank (the regulator of South African banks) required banks to calculate the impairment on loans and receivables on the basis of a provision matrix. This matrix did not explicitly consider a discounted cash-flow model based on expected cash flows, as required by the original IAS 39. The practical question raised at that stage was whether any adjustments to the expected cash-flow model should be made to the opening balance of retained earnings. SAICA's response was that the transitional provisions provided for an adjustment to the opening balance of retained earnings if the provisioning matrix did not explicitly consider the amount or timing of underlying cash flows.[55]

62. This clearly demonstrates that the adoption of IFRS for financial statement purposes is a move away from any requirements prescribed by a local regulatory body.

63. The second issue with the impairment of the debtors' book arose with the revision of IAS 39, through which the "expected cash-flow model" was replaced by an "incurred-loss model". The critical question was how to apply the historical loss experience test in collective assessments. The banking sector started its discussions before the IAS 39 amendment to the "incurred-loss model" was implemented and through the banking association corresponded with IFRIC. The banking sector's concerns were incorporated in the "incurred-loss model" amendment, which resulted in the sector accepting the change to the "incurred-loss model".[56]

B. Operating leases

64. In respect of the straight-lining of operating leases, the South African practice differed from international practice. The South African practice was that operating lease agreements with inflation escalations should not be straight-lined. It was believed that inflation escalations were "another systematic basis" from which to spread the lease payments over the term of the lease. This issue was referred to IFRIC, but the body rejected the issue on the grounds that the standard is clear: IAS 17 (leases) refers to "another systematic basis" that is "more representative of the time pattern of the user's benefit". The time pattern of the user's benefit should only be affected by factors that impact on the physical usage of the asset, which does not include inflation.

[54] SAICA (2001). AC 133 – Financial Instruments: Recognition and Measurement. April 2001.
[55] SAICA (2003). Circular 6/03 – Implementation Guidance for AC 133 – Financial Instruments: Recognition and Measurement. November 2003.
[56] Information obtained from discussions held with the banking sector.

65. SAICA issued two circulars to announce the conversion of the South African practice to the international practice.[57] In spite of many negative reactions by preparers, this diverse practice has been amended in South Africa.

C. South African dividends tax

66. A dual tax system for companies was introduced by the South African Income Tax Act, 1993, comprising a normal tax levied on taxable income and a secondary tax on companies (STC). STC is a tax levied on dividends declared by South African companies and is based on the amount by which a declared dividend exceeds dividends previously received. Since this is a South African-specific issue, APB issued South African GAAP Standard AC 501 (secondary tax on companies) to clarify the accounting treatment of STC on the basis of the principles of IAS 12 (income taxes).[58]

67. The main question raised by AC 501 is whether STC should be included in the income-tax line in the income statement. The consensus reached was that STC is a tax on income since STC is a tax on companies and not a withholding tax. AC 501 links the recognition of the STC liability to the recognition of the liability for the dividend declared. The STC liability should be recognized when the liability for the dividend declared is recognized. AC 501 also adopted the principles of the creation of deferred assets in IAS 12. Deferred tax for an STC credit (instances where dividends received exceed dividends paid) may only be recognized to the extent that it is probable that the company would declare dividends in the future to use the STC credit.

68. This issue demonstrated that legislation could cover local issues not specifically covered by IFRS.

D. Black Economic Empowerment

69. Black Economic Empowerment (BEE) is a formal process followed in South Africa to uplift black South Africans.[59] The accounting issue in South Africa deals with the situation where entities issue equity instruments to black South Africans or entities controlled by black South Africans at a discount to fair value to achieve targets for the empowerment of black people. In terms of guidance in IFRIC 8 (scope of IFRS 2) it is clear that IFRS 2 (share-based payment) applies to such BEE transactions where the fair value of cash and other assets received from BEE partners is less than the fair value of equity instruments granted to the BEE partner, i.e. the BEE equity credential element.

70. APB issued AC 503 (accounting for BEE) transactions to clarify whether a BEE equity credential should be recognized as an intangible asset or as an expense.[60] The conclusion reached is that BEE equity credentials should be expensed, except where the cost of the BEE equity credentials is directly attributable to the acquisition of another intangible asset. The main reason for expensing the BEE equity credentials, based on the principles of IAS 38 (intangible assets), is that the BEE equity credentials are not controlled by the entity because the entity is not able to demonstrate that it has the power to obtain the future economic benefits flowing from the underlying resource, either through legal rights or exchange transactions.

71. This issue regarding BEE transactions, although South African-specific, was referred to IFRIC for clarity and IFRIC issued IFRIC 8 (scope of IFRS 2) in response.

[57] SAICA (2005). Circular 7/05 – Operation Leases; and SIACA 2006: Circular 12/06 – Operating Leases. August 2006.

[58] AC 501 was effective from financial years starting on 1 January 2004.

[59] The South African Government has issued various BEE documents, including the Broad Based Black Economic Empowerment Act, Act no. 53 of 2003. The act empowers the Minister of Trade and Industry to issue codes of good practice, which are applied to determine an entity's BEE credentials.

[60] Issued in 2006.

E. Divergence due to IFRIC rejecting items

72. Sometimes IFRIC rejects items submitted to it for consideration on the grounds that it considers the appropriate accounting treatment to be clear. However, the South African experience is that IFRIC's reasoning in such cases could identify divergence of practice in South Africa. SAICA's Circular 09/06, which relates to cash discounts, settlement discounts, other rebates and extended payment terms, contains examples where such divergence has been identified.[61]

(a) Cash discounts: IFRIC's view is that IAS 2 (inventory) provides adequate guidance. Cash discounts received should be deducted from the cost of the goods purchased. In contrast, many South African entities account for cash discounts received as "other income", thus creating divergence. Similarly, Circular 9/06 clarifies that cash discounts granted to customers should reduce the amount of revenue recognized on the date of sale.

(b) Settlement discounts: In rejecting the issue regarding settlement discounts, IFRIC agreed that settlement discounts allowed should be estimated at the time of sale and presented as a reduction in revenue. Settlement discounts received should similarly be deducted from the cost of inventory. The practice of many South African entities at the time was to account for settlement discounts allowed to customers as "operating expenses" and settlement discounts received as "other income".

(c) Other rebates: Many South African entities account for rebates received as "other income". However, IFRIC agreed that in terms of IAS 2 (inventory), those rebates that have been received as a reduction in the purchase price of inventories should be taken into account in the measurement of the cost of inventory. Rebates specifically related to selling expenses would not be deducted from the cost of inventory.

(d) Extended payment terms: There continues to be diversity in practice on the treatment of extended payment terms. This issue remains unresolved, as more than one standard deals with principles on deferred settlements, and different preparers interpret the requirements differently. IAS 2 (inventory) states that, when the arrangement effectively contains a financing element, that element must be recognized as interest over the period of the finance. IAS 18 makes a similar reference in respect of the recognition of revenue. The IFRIC reasons for rejecting an interpretation are that the accounting treatment for extended payment terms such as six-month's interest-free credit is clear: the time value of money should be reflected when it is material. The diversity has arisen with regard to the interpretation of extended credit (and therefore the necessity to present value the amounts in terms of IAS 39 (financial instruments: recognition and measurement)). Some auditors and users interpret extended credit as payment after the transaction date (i.e. that credit has been extended) and others have interpreted it as credit being extended for a period that is longer than normal for that industry. In addition, some preparers contend that when cash sales are concluded at the same selling price as those with extended payment terms, the sales revenue to be recognized must be the same.

F. Insurance industry: anomalies relating to treasury shares

73. Prior to the adoption of IFRS, the insurance industry applied a local standard, which had the effect of ring-fencing the results of insurance businesses.[62] Assets and liabilities relating to insurance business were disclosed separately from other business in the financial statements. The move to IFRS and also the application of IFRS 4 (insurance contracts) has resulted in assets being disclosed by their nature. For

[61] SAICA (2006). Circular 09/06 – Transactions giving rise to Adjustments to Revenue/Purchases. May 2006.
[62] AC 121 – Disclosure in the Financial Statements of Long-term Insurers was abolished during 2004.

instance, financial assets held to manage the insurance business are not disclosed separately from other assets.

74. The main result of the abolishment of the ring-fencing principle is the effect of treasury shares. Certain insurance divisions (subsidiaries) invest in equity shares of the entity (holding company). For instance, insurance operations offer products that are linked to equity performance, and, as a result, they often invest in shares of their holding companies.[63] These shares could also be bought for the purpose of linked investments (investments linked to the performance of a basket of shares) or to generate a direct return for policyholders. The main anomaly is that the value of these shares would be considered in the value of the insurance liability, but that the effect on the asset side is eliminated through the deduction of such shares as treasury shares from equity. The treasury shares are also deducted from the weighted number of shares in issue for the earnings per share calculation, which could potentially inflate the earnings per share number on an IFRS basis.

75. The issue of treasury shares was discussed with Sir David Tweedie, chairman of IASB, when he visited South Africa in November 2006. His response was that IASB had discussed the topic at various board meetings and had not been able to arrive at an acceptable solution without creating an exception for an industry.[64]

G. Fair value measurement considerations

76. Another concern raised by APB and the APC at their meeting with Sir David Tweedie was the application of fair value measurement applied to financial instruments in cases where there was no active market or where the market was illiquid.[65] The concern especially relates to instances where fair value measurement is based on management's estimates.

77. Tweedie's response was that an evaluation of the discussion paper on fair value measurement guidance was needed, which would contain a hierarchy for fair value measurement. This evaluation would be the process needed to resolve the fair value measurement concerns. The progress on this project is being closely monitored in South Africa.

H. Separate financial statements

78. In South Africa, holding companies were always required to prepare separate financial statements on the basis of the South African Statements of GAAP. While IFRS are not explicitly written for consolidated financial statements only, there is almost an implicit focus on the consolidated position rather than the separate financial statements.[66]

79. Some of the challenges facing preparers of financial statements stem from the uncertainty of applying the concept of substance over legal form. In respect of special purpose entities, the question is to what extent a "look-through" approach should be applied in the separate financial statements to reflect the economic substance rather than the legal form on the basis that the special purpose entity was effectively just a conduit or a warehousing vehicle. Similarly, in respect of transactions with other related parties, the question is to what extent the economic substance, and not merely the legal form, should be analysed and reflected, particularly where the transactions might not be on an arm's-length basis.

[63] SAICA (2006). Minutes of the meeting of the APC, 30 November 2006 (the meeting where the visit of Sir David Tweedie was documented).
[64] *Ibid.*
[65] *Ibid.*
[66] *Ibid.*

80. Sir David Tweedie's response in this regard was that IASB was aware of these issues and had been debating them, and that the preference at this stage was for the look-through approach to be applied.[67]

V. Conclusion

81. The adoption of IFRS has clearly increased South Africa's role as a global player in the accounting field and has strengthened uniformity in the application of IFRS in South Africa. Listed companies and the accounting practice have tackled the task of implementing IFRS diligently and have achieved great successes. Clearly, many teething problems have been resolved.

82. The adoption of IFRS has enhanced consistency of the application of IFRS and has further confirmed the need for a local technical body that will contribute to IASB's due process and resolve specific local issues and divergence in practice.

83. The country has witnessed a significant growth in the technical accounting departments of audit firms to cope with the increased technical demand. However, many accounting specialists trained in South Africa have left the country because of global demand for their skills.

84. The challenges facing South Africa are to create a process of legal backing for accounting standards by proper monitoring and enforcement structures and to implement a system of differential reporting.

[67] *Ibid.*