Proactive monitoring of AFS by Johannesburg Stock Exchange

10 May 2021

Agenda

- Part I
  - The role of proactive monitoring
  - Navigation of our reports
  - *Tania Wimberley (JSE)*

- Part II – educational material
  - IFRS 13 Common findings report
  - IAS 1 –Judgements and estimation uncertainty
  - *Sonja Carshagen (JSE)*

- Part III – forward looking
  - Impact of Covid-19
  - *Tania Wimberley (JSE) & Ahmed Mohammadali Haji (UJ)*

Part I

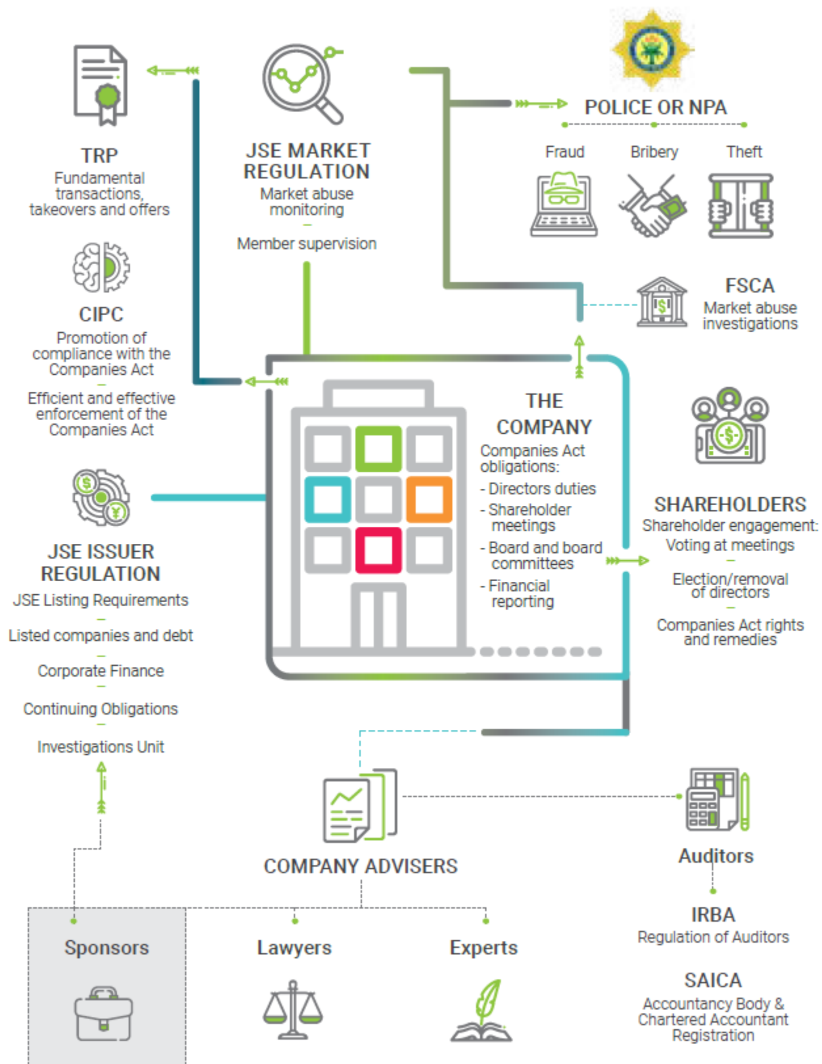
The JSE Regulatory Landscape

- The Issuer Regulation Guide

- https://www.jse.co.za/regulation/companies-issuer-regulation

- Announcements regarding the Listings Requirements February 2021

The JSE Regulatory Landscape



JSE

Part II

Fair value

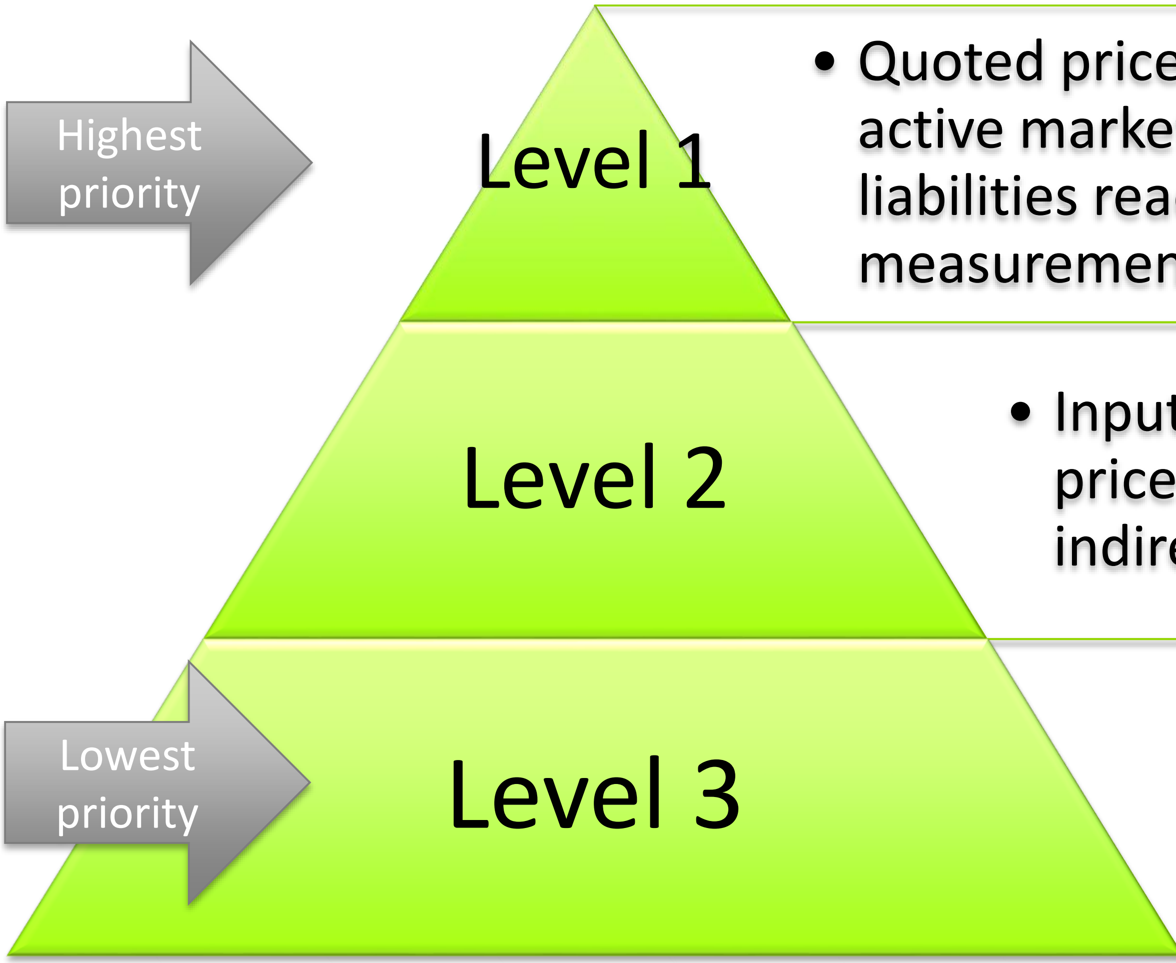
IFRS 13

Fair Value findings

- 25 Findings on fair value matters, predominantly disclosure
  - IFRS 3.91: three
  - IFRS 3.93: twenty-two

- Roughly 1/3 of findings related to investment property disclosures
  - Consequently, the JSE issued:
    - ‘Investment property: Common findings report’
    - 3 November 2020

Inputs that determine the FV hierarchy

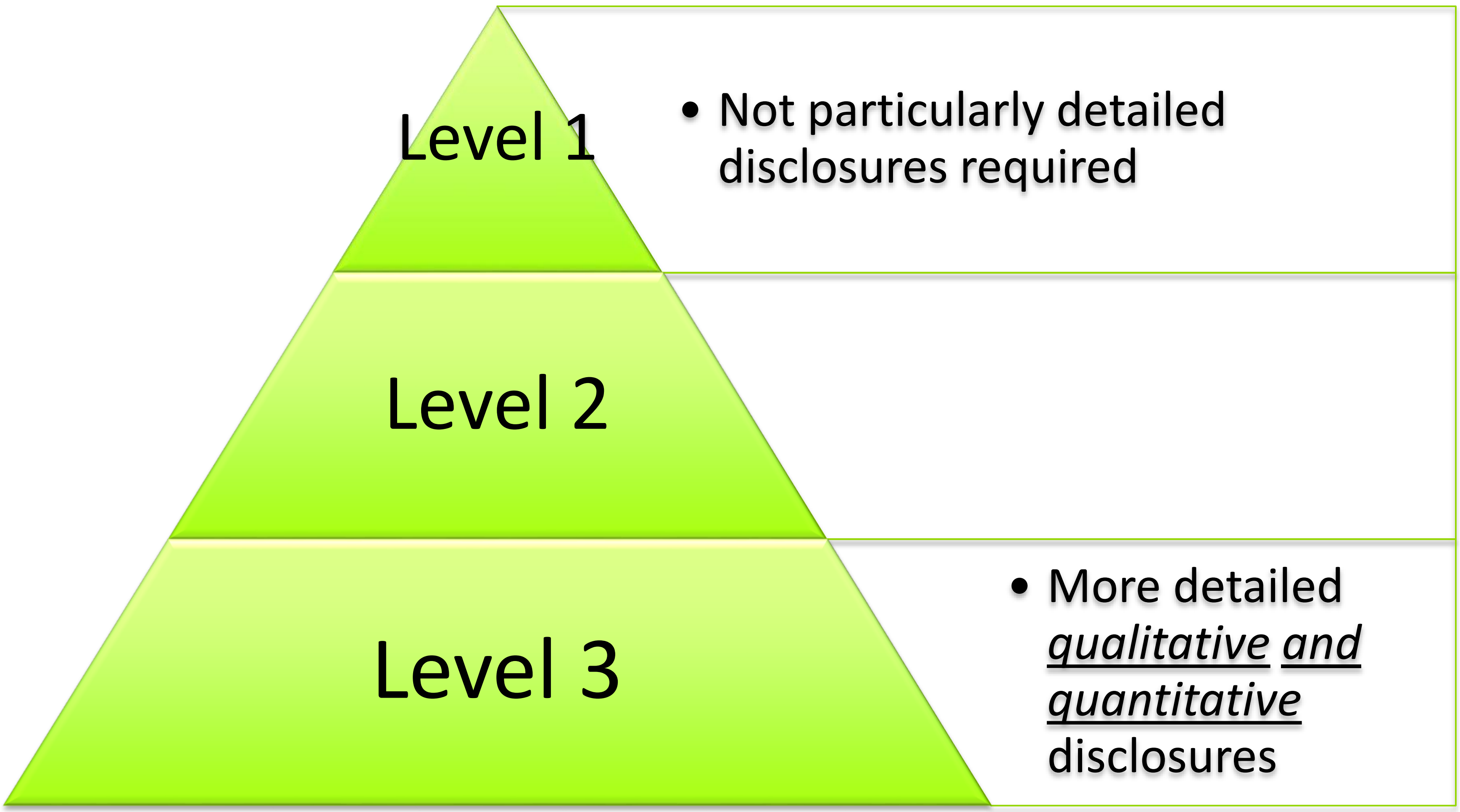


- Quoted prices (unadjusted) in active market for identical assets/ liabilities readily accessible at measurement date
- Inputs other than quoted prices that are directly/ indirectly observable
- Unobservable inputs

Level of the FV hierarchy drives disclosure

"Sunlight is said to be the best of disinfectants"

Level of the FV hierarchy drives disclosure



IFRS 13 disclosure

All levels

- Valuation techniques
- Level in FV hierarchy
- Transfers between levels

Add for Levels 2 & 3

- Describe the valuation technique
- Describe valuation inputs

Add for Level 3

- Quantitative info: significant unobservable inputs
- Reconciliation
- Sensitivity disclosures

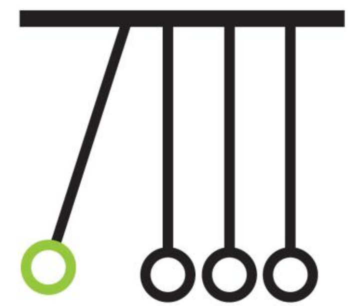
IFRS 13 disclosure

- Some issuers have maintained:
  - FV was derived by an independent valuer
  - FV 'must therefore be correct'
  - AFS do not need to include all of the quantitative disclosures of IFRS 13.

However

- The extent of IFRS 13 disclosure is <u>NOT</u> driven by whether valuation was internal vs external
- IFRS 13 disclosures <u>is driven</u> by FV hierarchy
  - FV hierarchy, in turn, is driven whether significant inputs are quoted/ observable/ unobservable.

Quantitative unobservable inputs: IFRS 13.93(d)



JSE observations to qualitative data

- Often too aggregated to be useful

- Objective of the quantitative disclosures is
  - NOT to enable users to replicate the entity's pricing models, but
  - RATHER to provide enough information for users to assess whether the entity's views about individual inputs differ from their own

    (IFRS 13.BC192).

Disclosure of significant unobservable inputs
- Disclosure in the AFS reviewed

Property company

- Investment property is their single largest asset

The valuations were performed using the discounted cash flow and income-capitalisation methodology. These methods are based on open-market values with consideration given to the future earnings potential and applying an appropriate discount rate to the property. The Group's discount rate range applied for valuations performed on the discounted cash flow method ranged between 13.1% and 17.3% and for valuations performed on the income-capitalisation methodology, the capitalisation rate applied ranged between 8.3% and 12.0%. Other significant inputs used in the valuations were vacancy rates based on current and expected future market conditions; terminal value taking into account rental, maintenance projections and vacancy expectations; as well as additional bulk where applicable. Factors taken into account in arriving at the discount rates are geographical position, grading of building and the tenant grading.

Significant unobservable inputs – Subsequent AFS

At the reporting date, the key assumptions and unobservable inputs used in determining fair value were in the following ranges for the Group's portfolio of properties:

Expected market rental growth	**4% - 6%**	4% - 6%
Expected expense growth	**6% - 8%**	6% - 8%
Vacancy rate	**0 - 12 months**	0 - 12 months
Rent-free periods	**0 - 12 months**	0 - 6 months
Grouping 1		
Number of buildings	**15**	15
Discount rate	**14% - 16.5%**	14% - 16.25%
Market capitalisation rate	**9.75% - 12%**	9.75% - 12%
Grouping 2		
Number of buildings	**3**	3
Discount rate	**14.50% - 15%**	14.50% - 15%
Market capitalisation rate	**10% - 11%**	10% - 11%
Grouping 3		
Number of buildings	**3**	4
Discount rate	**14.75% - 15.25%**	14.75% - 15.25%
Market capitalisation rate	**10.25% - 10.75%**	10.25% - 10.75%

Disclosure of significant unobservable inputs - Another example of good disclosure

JSE

At the reporting date, the key assumptions used by the group in determining fair value were in the following ranges for the group's portfolio of properties:

Unobservable inputs across sectors (%, unless otherwise stated)		
Expected market rental growth	**3.00-6.00**	3.00-6.00
Expected expense growth	**6.50 -8.00**	6.50-8.00
Occupancy rate	**94.60**	95.68
Vacancy periods	**0-12 months**	0-12 months
Rent-free periods	**0-6 months**	0-6 months
Sector 1		
Discount rate	**10.00-17.00**	10.00-17.00
Exit capitalisation rate	**7.75-12.25**	7.50-13.25
Bulk rate	**R2 000-R4 725 p/m²**	R2 000-R4 725 p/m²
Sector 2		
Discount rate	**12.00-17.00**	11.75-17.00
Exit capitalisation rate	**7.00-13. 00**	7.25-12.00
Bulk rate	**R330-R4 000 p/m²**	R330-R4 000 p/m²
Sector 3		
Discount rate	**13.00-16.00**	13.00-16.00
Exit capitalisation rate	**8.00-12.00**	8.00-11.50
Bulk rate	**R400-R 1 850 p/m²**	R60-R1 900 p/m²
Sector 4		
Discount rate	**14.00-14.50**	14.00-14.50
Exit capitalisation rate	**9.50-10.50**	9.50-10.50
Sector 5		
Core yield	**N/A**	6.25-7.50
Discount rate	**7.00-9.00**	6.25-7.50
Exit capitalisation rate	**6.50-7.25**	n/a
Bulk rate	**R398-R403 p/m²**	n/a

Illustrating that not all inputs were the same/ significant in all sectors

Disclosure of significant unobservable inputs
- Further example of good disclosure

Property name	Fair value R'000	Expected net operating income R'000	Growth rate %	Vacancy factor %		Capitalisation rate %
INVESTMENT PROPERTY						
Secured by Agency Facilities X						
Each property in the portfolio is listed	157 400	14 564	2.00	6.50	1.50	9.25
	117 785	10 505	2.00	6.50	1.50	9.25
	143 900	13 308	2.00	6.00	1.50	9.25
	211 650	19 979	2.00	4.50	1.50	9.50
	268 680	22 660	2.00	6.00	1.50	8.75
	230 212	19 099	2.00	4.00	1.50	8.25
Total	2 360 727	214 738	1.98	5.12	1.50	9.26

Property name	Fair value R'000	Facility		Valuation
Non-current assets held-for-sale				
Property name	62 374	Agency Facilities	Y	Valued at contractual selling price less cost to sell
	20 795	Agency Facilities		Valued at contractual selling price less cost to sell
	63 050	Agency Facilities		Valued at contractual selling price less cost to sell
Total	146 219			

Property portfolio disclosures

- Property companies disclose detailed property portfolio information (s13 JSE Listings Requirements)
- s13 disclosures do not mitigate IFRS 13 disclosures:
  - Property portfolio info not always audited
  - Information outside of AFS
  - Valuations per s13 not necessarily in line with IFRS 13

Biological assets

- IAS 41 (Agriculture)
  - Requires FV measurement for biological assets + agricultural produce
- IFRS 13
  - How measure FV
  - Disclosure requirements

- Biological assets + agricultural produce often classified as level 3 FV
  - Detailed level 3 disclosures therefore required

Competitive harm

- Some issuers are reluctant to provide required disclosure for commercial reasons
  - i.e. could cause comparative harm

- JSE does not consider this a defendable position under IFRS
  - IASB considered this matter when deliberating IFRS 8
  - Board concluded:
    - Competitive harm exemption inappropriate, leads to broad non-compliance with IFRS
    - Most competitors already have information about entity

Investment in subsidiaries

- Listco (Company AFS) carry inv in subsidiaries at FV
- Identified as a KAM by auditor

Key audit matter	How the matter was addressed in our audit
Valuation of the investment in subsidiaries This key audit matter relates to our audit of the separate financial statements. Refer to accounting policy 1.3, significant judgements and sources of estimation uncertainty note 1.22 and note 9	
At each year-end, the company estimates the fair value of its investments in subsidiaries. The total value of the company's investment in subsidiaries is R1,4 billion, as disclosed in note 9. The valuation is subject to inherent uncertainty and significant judgement is applied in deriving the assumptions used in the valuation model. In determining the estimated fair values of the investments in subsidiaries, the company uses a discounted earnings model or net asset value if the net asset value approximates fair value. The valuation model used is sensitive to the projected business plans as well as the risk- adjusted discount rates used This matter is a key audit matter due to the significant judgements applied in the determination of the fair values of investments in subsidiaries.	

Investment in subsidiaries

Significant portion of Company's
Total assets / Total equity

	Level 1 R million	Level 2 R million	Level 3 R million	Total R million
Investment in subsidiaries	–	–	1,426	1,426
Investment in employee share trusts	–	634	–	634
Non-current asset held for sale	–	257	–	257
	–	**891**	**1,426**	**2,317**
Investments at fair value				
Unlisted shares	–	–	43	43
Unlisted empowerment private equity fund	–	–	90	90
Listed shares	466	–	–	466
Unlisted money market funds	2,554	–	–	2,554
	3,020	**–**	**133**	**3,153**
	3,020	**891**	**1,559**	**5,470**

Investment in subsidiaries

Sensitivity analysis for investments at fair value

Material subsidiary companies are valued using the discounted cash flow method and net asset value is used as a proxy for the valuation of less material subsidiaries.

Sensitivity discl

A sensitivity analysis performed on the investment in subsidiaries indicates that an increase of 10% in the discount rate will result in a maximum movement of 12% or R133 million impact on profit or loss (2018: 36% or R559 million) in the calculated fair value.

If the market interest rate associated with the unlisted money market investments changes by 1% the impact on fair value as well as the profit or loss would be R13 million for the Group and R3 million for the company.

The unlisted empowerment private equity fund consists of cash and unlisted ordinary shares. The unlisted ordinary shares are shown at fair value which is calculated by reference to expected future cash flows, discounted by an applicable risk-adjusted discount rate for similar equity securities. A 2.5% difference in earnings before interest, tax, depreciation and amortisation (EBITDA) would impact the profit or loss by R1 million (2018: R3 million).

Further information relating to investments and securities is contained in note 15 of the financial statements.

- How reasonable is a 10% change in the discount rate?

Part II

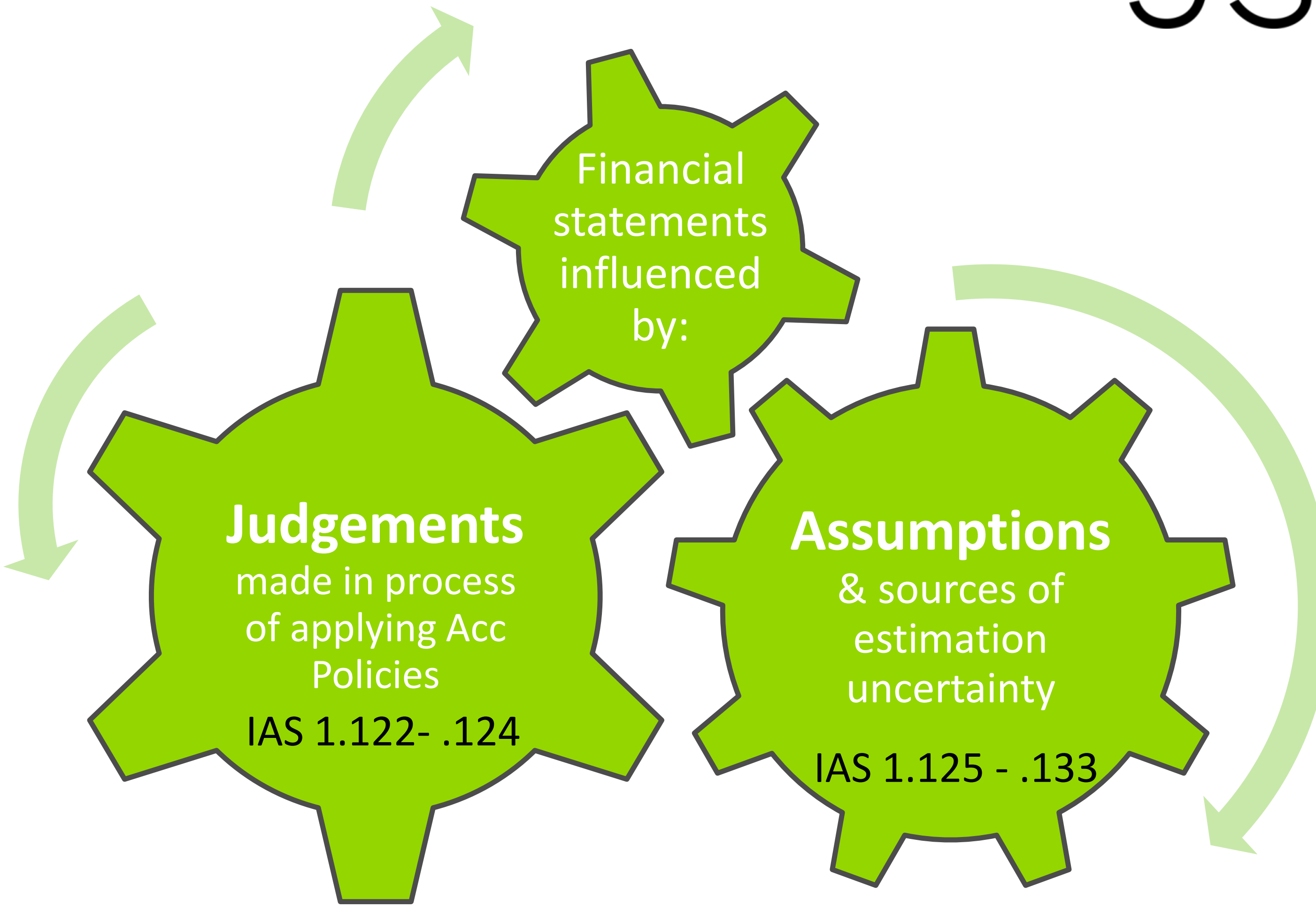
Judgement and estimation uncertainty

IAS 1

Matters related to judgement and estimates

- Consistent trend to previous PM reports
  - Boilerplate out of IFRS standards
  - Not specific to the entity

  - Ask yourself:
    - Why are we making this decision/ disclosure?
    - Is our reasoning clear to the reader?



SAICA: Educational material # 3: Issued: April 2020

‘Application of IFRS in light of Covid uncertainty’ series

Judgements in applying accounting policies

Does the proposed disclosure about judgement applied in process of applying accounting policies:

- Identify alternatives management considered i.e. (a) vs (b)
- Explain why the choice was difficult/ judgemental
- Provide entity specific explanations as to why (b) was chosen over (a)

Assumptions & sources of estimation uncertainty

Do the disclosures about assumptions made about the future and other estimation uncertainty:

- Identify the assumptions
- Prioritise quantifiable disclosures as much as possible
- Explain sensitivity
- Identify most likely view (or apply probability-based outcome)

Judgement and estimation uncertainty
Good disclosure – impact of Covid to AFS

The assessment of COVID-19 as part of accounting judgements and sources of estimation uncertainty

Management has considered all the possible financial effects the virus could have on the measurement, presentation and disclosure in the annual financial statements. Key areas are considered in the table below:

COVID-19 Consideration	Assessment	Potential impact
Subsequent events >	COVID-19 was assessed as being a condition that existed in the Group's markets as at Y/ end date Recognised assets and liabilities at reporting date are therefore presented, measured and disclosed after taking into account the effect or impact of material adjusting subsequent events as these provide further information about the COVID-19 condition which existed at Y/ end date	High
Financial asset impairment (expected credit losses) >	The Group has based the measurement of expected credit losses ("ECL") on an unbiased, probability-weighted amount that is determined by evaluating a range of possible outcomes and reflecting time value of money. IFRS 9 requires ECL provisions to be measured in a way that incorporates information available at the reporting date about past events, current conditions and forecasts of future economic conditions. All of these were used in calculating the ECL on financial assets. The total ECL provision increased by R626 million as a result of incorporating the impacts of COVID-19 into the model.	High
Non-financial asset impairment >	Goodwill is tested for impairment annually and whenever there are indicators of impairment. In determining the recoverable amount of the cash generating unit ("CGU") the Group considered several sources of estimation uncertainty and made certain assumptions or judgements about the future. Management also considered various scenario analysis with respect to the impact of COVID-19 on the cash flow projections, given the evidence available at the time of finalising the annual financial statements.	Low

Judgement and estimation uncertainty
Good disclosure – impact of Covid to AFS

The assessment of COVID-19 as part of accounting judgements and sources of estimation uncertainty

Management has considered all the possible financial effects the virus could have on the measurement, presentation and disclosure in the annual financial statements. Key areas are considered in the table below:

COVID-19 Consideration	Assessment	Potential impact
Inventories >	There was a low impact of COVID-19 on inventories due to limited disruptions in operations as Co X was an essential service. There was no indication of losses suffered due to damage, contamination or write-off due to slow moving inventory.	Low
Revenue >	There was no significant impact of COVID-19 on revenue as the industry was declared as an essential service in South Africa. The Group's fixed revenue has however been impacted by COVID-19 post the reporting date.	Medium

Judgement and estimation uncertainty
Good disclosure – impact of Covid to AFS

COVID-19 impact on contract assets

Impairment losses were calculated using the simplified approach, with historical losses used as an input to parameterise the expected loss percentage. The methodology considers expected losses over the average remaining life, with the historical calibration period selected to consider expert judgement on the portfolio's performance going forward.

The Group has based the measurement of expected credit losses ("ECL") on an unbiased, probability-weighted amount that is determined by evaluating a range of possible outcomes and reflecting the time value of money.

Management included an overlay to consider the expected impact of the current COVID-19 stress. The methodology for this overlay was aligned to the approach used for trade receivables, which used the 2008 crisis for calibration purposes.

The Group has adjusted the loss rates used to calculate the ECL on contract assets. Based on this approach, the ECL has increased by R207 million.

Management has analysed the impact of COVID-19 on contract assets, assuming a 2% and 5% increase on the COVID-19 overlay. The results of the analysis have been summarised as follows:

Sensitivity discl

	Current rate incl COVID-19	2% Increase on COVID-19 stress	5% Increase on COVID-19 stress
Expected loss rate	4.24% to 23.60%	4.40% to 23.76%	4.67% to 24%

By applying the 2% and 5% increase on the COVID-19 overlay, the Company's and Group's existing contract asset ECL would increase by R4.6 million and R12 million respectively, which is not material to the Group.

Concluding comments

- Does it communicate information users need?
- Is it specific to the entity/ an asset group/ a key operation?
- Avoid 'disclosure for the sake of disclosure'

Consider the objectives of the proposed disclosure

Part III

Impact of Covid-19

JSE letters

- Reflecting the impact of covid-19 on Financial results (May 2020)
- Effective Communication with Investors (Sep 2020)
- https://www.jse.co.za/issuer-regulation-covid-19