SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS

FINANCIAL SERVICES

Quarterly Brief

DECEMBER 2021

REGULATED INDUSTRIES

Timing of release of the JSE's report on proactive monitoring of financial statements (Advocacy)

A SAICA submission was made to the JSE on the timing of the release of the proactive monitoring report of financial statements. The submission was a collaborative effort between the SAICA Banking, Insurance and Medical Schemes project groups. The proactive monitoring report was usually issued in February of each year, creating practical timing issues for issuers, auditors, and audit committees for entities with a 31 December to 31 March year-end.

The JSE specifically requests the audit committee of every issuer to consider the findings contained in the proactive monitoring report when preparing their interim and annual financial statements. In order to ensure the findings are carefully considered, the submission requested for the JSE to consider publishing the report in November each year in order to give both issuers and auditors sufficient time to comprehensively address any areas highlighted in the report.

The JSE has responded favourably to the submission and agreed to amend the date for issuing their annual report from February to November of each year. The latest report for 2021 was issued on the 9th of November and is available on the JSE website.

The JSE has also made changes to their internal proactive monitoring process to ease the administrative burden on issuers. They will no longer request for a confirmation in the annual compliance certificate that an audit committee has considered the information in annexure 3 of the of the report and took appropriate action as highlighted in the JSE findings, instead where necessary issuers may be asked to explain how they complied.

IFRS 17

The SAICA IFRS 17 working group continued its work in 2021 and will continue as long as there are implementation challenges in the industry. Several issues have been deliberated on including reinsurance commission, treatment of cash back products, treatment of premium delays, bad debts and premium variance, disclosure in terms of IAS 8.30, fixed fee service contracts, Covid provisions, I-E tax specifically chargeable to the policyholder.

These are only a few of the topics discussed which demonstrates the necessity of such a forum as insurers continue to prepare to implement IFRS 17 when it becomes effective. The standard is effective for annual reporting periods beginning on or after 1 January 2023 with earlier application permitted as long as IFRS 9 is also applied.

Regulators such as the Prudential Authority as well as the Council for Medical Schemes (CMS) have conducted surveys for the respective industries to determine the readiness for implementation. For the insurance industry, the larger insurers are well into their implementation programmes, while the smaller insurers have lagged. The SAICA IPG, at its November meeting, agreed to consider if a forum of small insurers can be set up to provide support on IFRS 17 implementation and focus on their unique challenges.

The CMS conducted its survey in late 2020 and published the results in circular 6 of 2021. 58% of respondents indicated that have not yet decided which accounting model they would be applying while 91.7% of the respondents indicated that they will not early adopt IFRS 17.

The SAICA Medical Schemes Project Group (MSPG) continues to deliberate on implementation challenges in the industry. IFRS 17 was the main topic in both the SAICA Insurance and Medical Schemes seminars (as noted under past events) in an effort to add to the dialogue on IFRS 17 implementation.

BANKING

Withdrawal of the temporary relief measures related to the liquidity coverage ratio

The PA issued Directive 1 of 2020, dated 31 March 2021, as a temporary relief measure in response to the negative impact of COVID-19. The Liquidity Coverage Ratio (LCR) was reduced from 100% to 80% as of 1 April 2020 in order to alleviate the adverse impact of COVID-19 on liquidity in the banking sector.

Directive 8 of 2021 was issued outlining the PA's decision to withdraw this relief measure as financial markets have normalised. The PA has concluded that banks currently have healthy liquidity as a result of increased deposits. The nation, and the world at large, has seemingly adapted to the 'new normal' in as much as the COVID-19 pandemic persists.

The revised minimum LCR will be 90% with effect from 1 January 2022 and will be back to 100% with effect from 1 April 2022.

Prudential Authority Climate Risk Survey Report 2021

The PA has published a Climate Risk Survey Report 2021. Banks, insurers, and financial market infrastructures were surveyed on their response to climate risk matters.

The PA conducted the survey because "the acute and chronic nature of climate-related financial risks and the potential impact of such risks on financial institutions necessitate further examination that falls within the supervisory and regulatory remit of the PA from a financial stability as well as a safety and soundness perspective." The survey provides the PA with insights that will allow it to respond and maintain financial stability considering climate-related financial risks.

The PA has established the Prudential Authority Climate Think Tank (PACTT), which is a dedicated climate risk-focused unit. Its objective is to promote, develop and coordinate the PA's regulatory and supervisory response to climate risks. These developments indicate that response to climate change is a priority for the PA.

MEDICAL SCHEMES

Prescribed statement of cash flows for medical schemes

The Council for Medical Schemes (CMS) published Circular 52 of 2021: Statement of Cash Flows which highlights requirements relating to the statement of cash flows for medical schemes. There are two main requirements which the CMS outlined:

- **Medical schemes are required to report cash flows from operating activities using the direct method in their Statement of Cash Flows in their financial statements of the year ended 31 December 2021 onwards; and**
- **to report on investment income received on scheme investments as investing cash flows, and not as operating cash flows, in their Statement of Cash Flows in their financial statements of the year ended 31 December 2021 onwards.**

CMS indicated that it introduced the direct method in its 2011 annual statutory returns which schemes did not follow but continued to report on their cash flows using the previous indirect method. It also highlighted IAS 7 paragraph 33 which states that there is no consensus on the classification of interest paid and interest and dividends received for entities other than financial institutions.

The SAICA MSPG discussed this Circular at the October meeting and decided to review it and consider making a submission to the CMS on the requirements outlined as well as possibly requesting a deferral of the effective date. The letter is available on the SAICA website for perusal.

Medical Schemes Accounting Guide

The 2021 updated Medical Schemes Accounting Guide has been published and is available on the website. The guide has been prepared by the SAICA MSPG in consultation with the CMS. The objective is to provide guidance to the industry on the accounting requirements applicable to medical schemes and auditors of medical schemes. We welcome suggestions on what members would like us to include in the guide and urge schemes to consider their own unique circumstances in terms of COVID-19 disclosures and the impact it has had in the reporting period.

CMS 2020/21 Industry Report

The CMS released its 2021 industry report, which details the impact of the COVID-19 pandemic on the medical schemes industry. It is a 107-page report with detailed analysis of various aspects of the industry.

The industry solvency ratio improved from 35.62% in 2019 to 44.55% in 2020 which exceeds the minimum required ratio of 25.00% according to Regulation 29. This improvement in 2020 was due to the higher net surpluses incurred.

The net healthcare result for all medical schemes combined reflected a surplus of R19.93 billion in 2020 which was an increase from R1.03 billion in 2019 because of the lower utilisation of benefits during the pandemic.

COVID-19 claims received during 2020 were R10.10 billion. Schemes provided various financial relief measures to their members during the pandemic, which the CMS allowed, such as utilising personal medical savings accounts to offset contributions, the relaxation of credit policies, contribution holidays and lower future contribution increases. The report notes that there was an overall decline in the amounts paid toward specialists, hospitals, general practitioners, dentists, and dental specialists, which is attributed to lockdowns and cancellation of elective procedures and services during 2020 due to the pandemic.

The complete CMS report can be downloaded here: https://www.medicalschemes.co.za/industryreport2020/

Submission on draft Conduct Standard – Conditions Prescribed in respect of Pension Fund Benefit Administrators (Advocacy)

The Financial Sector Conduct Authority (FSCA) issued this draft conduct standard intended to replace Board Notice 24 of 2002, published in Government Notice No. 10505 of Government Gazette 23153 of 1 March 2002. This board notice was issued in line with section 13B(1) of the Pension Funds Act, which allows the FSCA to prescribe conditions for benefit administrators.

SAICA made a submission on the draft standard in September. One of the main areas of concern, among other questions and concerns raised, relates to section 36 of the standard where a benefit administrator will be required to maintain a minimum capital of R 3 000 000. The requirement to maintain this level of capital may be unfair for small and medium sized benefit administrators who are SMMEs with limited turnover. Some might even be forced to cease operations. The submission proposes consideration of a measurement metric based on the size of fund, staff compliment, revenue generated annually etc.

SAICA will review the next draft of the standard to determine if the comments raised were taken into consideration by the FSCA.

Retirement reform

The Minister of Finance, Mr Enoch Godongwana, gave the 2021 Medium Term Budget Policy Statement Speech in parliament on the 11th of November. He provided an update on retirement reform stating that the National Treasury is proposing measures to boost household savings by increasing preservation before retirement and to increase flexibility through partial access to retirement funds through a "two-pot" system. This system means that individuals would be able to access contributions to the one pot, while contributions to the other pot would be saved until retirement.

The minister stated that National Treasury would soon publish a discussion document on this proposal before further announcements are made in the 2022 budget.

Retirement Reform is a process that has been ongoing for many years which National Treasury has acknowledged would still take some time to complete. The main objective of this process is for government to introduce policies that encourage employees to save and sufficiently provide for retirement to ensure they retire comfortably as well as encourage employers to provide retirement savings plans to their employees as part of the employment contract, among other objectives.

Amendments to Regulation 28

There are other developments taking shape in the retirement fund space. One such development is the amendments to Regulation 28 of the Pension Funds Act which aims to encourage pension fund investment in infrastructure. National Treasury published the first draft amendments in February 2021. The second draft was published in October, updated for comments received on the first draft. One of the updates is the introduction of a new restriction on retirement funds from investing in crypto assets. The restriction is in line with the Intergovernmental Fintech Working Group (IFWG) policy proposal of not allowing collective investment schemes and pension funds to have exposure to crypto assets.

INVESTMENT MANAGEMENT

Accounting treatment of cash held in 's104 accounts' (Advocacy)

The SAICA Investment Management Project Group (IMPG) made a submission to the FSCA after debating the appropriate accounting treatment of cash held by Collective Investment Scheme Managers (managers) in 's104' bank accounts. These are bank accounts owned and operated by managers to comply with the requirements of s104 of the Collective Investment Schemes Control Act 45 of 2002. The IMPG noted an inconsistency in the industry as some managers have deemed the bank accounts to be an asset, therefore recognising the cash on their Statement of Financial Position with a corresponding and equivalent liability to the relevant investor, while others have interpreted the legislation to imply that these accounts do not meet the definition of an asset and thus do not recognise the cash in their Statement of Financial Position.

The requirements of section 104 have been incorporated in the COFI bill which is currently with National Treasury and will soon be taken through the parliamentary process. The IMPG noted that s40(1)(b) of the proposed COFI Bill states that **"A financial institution must— ...In its accounting records and financial statements, clearly indicate the trust property as being property belonging to a specified person for, or on whose behalf, the financial institution is acting".** The IMPG is of the understanding that the cash in these accounts meets the definition of 'Trust Property' in terms of the Financial Institutions (Protection of Funds) Act 28 of 2001.

The IMPG thus made a submission to the FSCA with the following requests and suggestions:

- For the FSCA to issue a directive requiring these bank accounts to be accounted for outside of the financial statements of managers and thus eliminate the inconsistency in accounting treatment which currently exists.
- That the FSCA provide an indication of how these bank accounts will be expected to be "indicated" in the financial statements of managers upon promulgation of the COFI Bill.
- Suggestion that these amounts should be treated as 'off-balance sheet' and only separately disclosed in the notes to the financial statements of the relevant manager.
- Propose that the report in s40(1)(c) of the COFI Bill should be aligned with s19(3) of the FAIS Act if it is the intention for the report to be issued to resemble a s19(3) Factual Findings report.

SAICA expects a positive response from the FSCA in this regard as it is of the view that these requests and suggestions would foster the needed consistency in reporting.

Past events (Recordings)

- **2021 IFRS 17 event**

(https://livestream.com/saica/ifrs17a1)
On the 25th of May SAICA held an IFRS 17 event presented by Darrel Scott (former IASB member) and Esther Pieterse (Director, KPMG). The session provided an overview of the standard and outlined the objectives and requirements of IFRS 17. Darrel and Esther also discussed the implementation journey so far, highlighting various challenges that have been noted in South Africa. Recording of the event is available to watch.

- **2021 Insurance Seminar**

(https://livestream.com/saica/events/9823786)
This event was held in September 2021 and the recording is available upon request from SAICA Seminars and Events.
The seminar included a panel discussion on IFRS 17 discussing the general readiness and practical implementation challenges within the insurance industry. The panel included Esther Pieterse (KPMG), Gert van den Berg (Sanlam), Charlton le Grange (Santam) and Linel de Beer (Outsurance). Other topics included finance and regulatory trends; Ethics; Regulatory update by the PA; and the importance of Data Governance as the first building block in building insurers of the future, all presented by experts in the respective topics.

- **2021 Medical Schemes Seminar**

(https://livestream.com/saica/events/9869169) The seminar had four sessions covering learnings from the COVID response as a precursor to the National Health Insurance including its potential impact; Ethics and schemes board governance; sustainability of medical schemes; and IFRS 17 considerations for medical schemes. The recording is available upon request from SAICA Seminars and Events.

Valuations

SAICA is a member of the International Valuation Standards Council (IVSC)

The IVSC is the independent global standard setter for the valuation profession. It exists to set the International Valuation Standards (IVS) in order to promote global consistency in the valuation profession. The IVS serve as the key guide for valuation professionals globally to ensure consistency, transparency and confidence in valuations.

SAICA supports this vision for the valuation profession and has become one of more than 170 member organisations to represent SAICA members, provide them with access to the standards and opportunity to participate in the activities of the IVSC.

IVS comprises five 'General Standards' and eight 'Asset-specific Standards'. The General Standards set requirements for the conduct of all valuation assignments including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting.

The Asset Standards include requirements related to specific types of asset valuation, including background information on the characteristics of each asset type that influence value and additional asset-specific requirements regarding common valuation approaches and methods used. The assets standards cover:

- Businesses and Business Interests (IVS 200)
- Intangible Assets (IVS 210)
- Non-Financial Instruments (IVS 220)
- Inventory (230)
- Plant and Equipment (IVS 300)
- Real Property Interests (IVS 400)
- Development Property (IVS 410)
- Financial Instruments (IVS 500)

Watch: IVSC Standards Review Board shares updates on IVS

Members can read more information and access the IVS on the SAICA website here: https://www.saica.org.za/resources/61849

Activities of the SAICA Working Groups

The various SAICA industry project groups have established specialist sub-working groups to tackle specific issues and topics. One of such working groups is the Model Matters Working Group (MMWG) established under the SAICA Banking Project Group. The MMWG has existed since when IFRS 9 was being introduced and the industry needed a forum to deliberate on potential implementation issues and challenges. Banks needed to expend significant effort in developing appropriate provisioning models. The group has recently been busy deliberating on the modelling challenges related to COVID-19 relief offered by banks.

The MMWG recently concluded on three topics which include updates to the macroeconomic outlook, scenario and scenario-weightings; model, assumptions and data framework for adjusting Expected Credit Loss models to cater for post-COVID business-as-usual; and IFRS 9 ECL components and the release of COVID-19 overlays.

Another group under the Banking Project Group is the Basel Task Group which brings together industry auditors, the Prudential Authority and the IRBA to discuss and collaborate on matters related to assurance of regulatory returns submitted to the Prudential Authority. The group is currently reviewing and updating Regulation 46 AUP reports and procedures for ISRS 4400(revised). This project will be concluded soon in line with IRBA timelines. A similar project is currently in progress to update the Section 15 Auditor's

Report for retirement funds in line with ISRS 4400 (revised). A task group under the SAICA Retirement Funds Project Group is collaborating with the IRBA and the FSCA on this project.

SAICA members are welcome to participate in these working groups. **See contact details at the bottom of the newsletter.**

What's on the agenda of the SAICA technical project groups going into 2022?

Insurance Project Group (IPG)

IFRS 17 will be effective for years ended on or after 1 January 2023 and will continue to be on the agenda of the IPG and its sub-working groups. The focus will continue to be on practical implementation challenges in the industry. The group will focus on small to medium insurers to ensure their unique challenges with IFRS 17 are taken into consideration. Current and deferred tax implications will also be a focus. The IFRS 17 working group will continue to meet and discuss challenges arising, including considerations for cell captives.

The IPG will engage the Prudential Authority to amend auditors' sign off and assurance provided on application forms insurers submit. Engagements with the PA will also continue regarding the proposed joint audit requirement for insurers. The group will continue to liaise with the Actuarial Society South Africa (ASSA) on matters of common interest such as tax and IFRS 17. Feedback from ASSA is a standing agenda item of the IPG.

Banking Project Group (BPG)

The BPG has a number of sub-working groups which are established to tackle specific topics/areas including auditing, accounting, and model matters. The group will continue working on audit reports together with the IRBA and the PA through the Basel Task Group as noted under activities of the SAICA working groups. The Model Matters will deliberate on modelling issues encountered due to the COVID-19 pandemic. Engagements with the PA will continue on regulatory reporting concerns including IFRS 9 reporting and financial conglomerates standards among others.

Retirement Funds Project Group (RFPG)

Top of the priority list for the RFPG is the revised Regulatory Reporting Requirements (RRR) which the FSCA is currently working on. A draft was expected in September for public comments, but the group will continue to engage the Authority until it is published. A number of members of the RFPG assisted the FSCA in compiling the draft prudential standard.

The RFPG has noted and deliberated on differences in asset manager instrument classifications and independent classifications vs asset manager classifications which may make its way back on the agenda going into 2022 in the group's endeavour to find a solution for the industry.

In 2021 the group decided to add discussion of fraud as a standing agenda item. Members discuss any fraud themes experienced by retirement fund administrators in an effort to share ideas and combat fraud. The group will continue to discuss this matter.

The group is engaging on and watch draft conduct standards which the FSCA is working on including Conditions Prescribed in respect of Pension Fund Benefit Administrators for which a submission was made.

Medical Schemes Project Group (MSPG)

IFRS 17 remains an area of concern for medical schemes as the industry continues to engage in order to understand what the impact of the standard will be. The MSPG will continue to engage the Council for Medical Schemes (CMS) on this matter, including the prescribed statement of cash flows for medical schemes outlined above.

Investment Management Project Group (IMPG)

The IMPG has several items on which it is engaging the FSCA which remain open at the end of 2021. The group will continue engagements on these matters in hope that they can be concluded in 2022. These include the audit requirements in respect of CIS managers under draft Board Notice relating to Fit and Proper Requirements which the FSCA is still working on through their Regulatory Framework Department, engagements with the SARB Financial Surveillance Department on the Quarterly Asset Allocation Reports. The SARB is currently considering the submission made (as mentioned in the previous newsletter) and are expected to revert soon; a Fund Accounting Framework which the FSCA is currently drafting and will be published as a conduct standard; including several other items.

These project groups are an essential element to SAICA's advocacy efforts. SAICA members and non-members who are in the respective industries are welcome to join these discussion groups and participate in the objectives of the different group, contact details are at the bottom of this newsletter.

IFRS FOUNDATION WORK PLAN PROJECTS TO WATCH

1. Business Combinations under Common Control
2. Cash Received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9)
3. Classification of Debt with Covenants as Current or Non-current (IAS 1)
4. Disclosure Initiative—Subsidiaries without Public Accountability: Disclosures
5. Disclosure Initiative—Targeted Standards-level Review of Disclosures
6. Dynamic Risk Management
7. Financial Instruments with Characteristics of Equity
8. Goodwill and Impairment
9. Demand Deposits with Restrictions on Use (IAS 7)
10. IFRS Taxonomy Update—Initial Application of IFRS 17 and IFRS 9—Comparative Information
11. Initial Application of IFRS 17 and IFRS 9—Comparative Information (Amendment to IFRS 17)
12. Pension Benefits that Depend on Asset Returns
13. Post-implementation Review of IFRS 9—Classification and Measurement

LET US KNOW WHAT YOU THINK!

How helpful did you find the content of this newsletter?

Click here & tell us more

Follow us!

SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS

Email us:

Kedibone Pilusa
Project Director: MIB Technical
KediboneP@saica.co.za

Thakhani Masindi
Project Manager: MIB Technical
ThakhaniM@saica.co.za