FINANCIAL REPORTING
GUIDE 2

ACCOUNTING FOR BLACK ECONOMIC EMPOWERMENT (BEE) TRANSACTIONS

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GUIDE ON ACCOUNTING FOR BLACK ECONOMIC EMPOWERMENT (BEE) TRANSACTIONS

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THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
P O BOX 59875, KENGRAY, 2100

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PREFACE

This guide has been issued by The South African Institute of Chartered Accountants’ (SAICA’s) Accounting Practices Committee (APC). IFRS 2 - Share-based Payment applies to the accounting for Black Economic Empowerment (BEE) transactions where the value of cash and other assets received is less than the fair value of equity instruments granted to the BEE partner, i.e. for the BEE equity credentials.

While IFRS 2 addresses the broad principle that equity instruments issued at a discount are within the scope of IFRS 2, it does not address issues specific to BEE transactions. This guide seeks to address certain of these issues:

- Should the difference between the fair value of the equity instruments granted and the fair value of the cash and other assets received, i.e. the BEE equity credentials, be recognised as an intangible asset or as an expense?

- Where BEE equity credentials are obtained as part of the net assets acquired in a business combination, how should the BEE equity credentials acquired be accounted for?

- Assuming that BEE equity credentials do not meet the criteria for recognition as an intangible asset, how should vesting conditions be interpreted in the context of a BEE transaction?

Although accounting guides do not have the authority of IFRS or IFRS for SMEs, in the event of significant deviation from the guidance given, and should the member’s actions be questioned, the member may be required to demonstrate that such deviation was justified.

Every effort has been made to ensure that the advice given in this guide is correct. Nevertheless, that advice is given purely as guidance to members of SAICA to assist them with particular problems relating to the subject matter of the guide, and SAICA will have no responsibility to any person for any claim of any nature whatsoever that may arise out of, or relate to, the contents of this guide.
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Paragraph .16 of the International Financial Reporting Standard (IFRS) on Presentation of Financial Statements requires an entity whose financial statements comply with IFRSs to make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRSs. Paragraph .7 states that assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users.

References
(a) Framework for the Preparation and Presentation of Financial Statements;
(b) IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors;
(c) IAS 34 – Interim Financial Reporting;
(d) IAS 38 – Intangible Assets;
(e) IFRS 1 – First-time Adoption of International Financial Reporting Standards;
(f) IFRS 2 – Share-based Payment; and
(g) IFRS 3 – Business Combinations.

Background
1. Following the withdrawal of Statements of Generally Accepted Accounting Practice (GAAP) for years beginning on/after 1 December 2012, the Accounting Practice Committee (APC) has issued the relevant AC 500 – series of Statement of Generally Accepted Accounting Practice (GAAP) as a Financial Reporting Guide (FRG). This Financial Reporting Guide 2 replaces AC 503 – Accounting for Black Economic Empowerment (BEE) Transactions, issued initially by the Accounting Practices Board (APB) in 2006 and revised in 2009 and 2010. The only changes made from AC 503 to this Guide of the same name are to delete references to Statements of GAAP, replacing the wording of “Interpretation” with “Guide” and deleting the effective date and transition sections.

2. Paragraph 13A of IFRS 2 clarifies that the standard applies to transactions in which goods or services are received as consideration for equity instruments¹ of the entity or for the entity incurring a liability to transfer cash or other assets for amounts that are based on the price (or value) of the entity’s shares or other equity instruments of the entity, even when the entity cannot specifically identify some or all of the goods or services received.

3. In the context of empowerment of black people² through meaningful participation in the South African economy, entities may issue equity instruments to black people or entities controlled by black people at a discount to fair value. The goods or services received

¹ These include equity instruments of the entity, the entity’s parent, and other entities in the same group as the entity.
² As defined in terms of the Broad-Based Black Economic Empowerment Act No. 53 of 2003.
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received from the black people or entities controlled by them in return for the equity instruments may or may not be specifically identifiable.

4. IFRS 2, therefore, applies to the accounting for BEE transactions where the fair value of cash and other assets received is less than the fair value of equity instruments granted to the BEE partner, i.e. to the BEE equity credentials.

5. While IFRS 2 addresses the broad principle that equity instruments issued at a discount are within the scope of IFRS 2, it does not address issues specific to BEE transactions. This Guide seeks to address certain of these issues.

Scope

6. BEE credentials may be obtained in various ways, such as:
   (a) equity ownership;
   (b) management control;
   (c) compliance with the Employment Equity Act;
   (d) contribution to skills development;
   (e) preferential procurement; and
   (f) enterprise development.

7. This Guide considers only those BEE transactions where the entity grants equity instruments to black people (directly or indirectly) and the fair value of the cash and other assets received (or to be received), if any, is less than the fair value of the equity instruments granted.

8. The equity instruments may take many legal forms, such as:
   (a) ordinary shares;
   (b) deferred ordinary shares;
   (c) share options; and
   (d) convertible preference shares or debentures.

9. The difference between the fair value of the cash and other assets received and the fair value of the equity instruments granted may arise because of specific goods or services that the BEE partner provides to the entity, or because of the BEE equity credentials that the entity has received. This Guide applies only to BEE transactions where there is a difference that arises from the entity obtaining BEE equity credentials. It does not apply to transactions where the BEE partner is issued with equity instruments for transactions that are unrelated to the entity obtaining BEE equity credentials, because the requirements of IFRS 2 are adequate for such transactions.

10. Types of structures that are considered to be within the scope of this Guide include, but are not limited to, the following:
    (a) leveraged buyout structures where equity is issued to an empowerment partner and the issuer of the equity (or a related party) provides or guarantees the borrowings required to purchase the equity;
    (b) structures where equity is issued at a nominal amount by a new entity to all participants so that the entity can obtain BEE equity credentials;
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(c) transactions between shareholders of an entity that enable the entity to obtain BEE equity credentials;
(d) transactions that facilitate BEE through a special-purpose entity for obtaining BEE equity credentials; and
(e) business combinations between BEE businesses in order for at least one entity to obtain further BEE equity credentials.

Issues

11. **Issue 1**: Should the difference between the fair value of the equity instruments granted and the fair value of the cash and other assets received, i.e. the BEE equity credentials, be recognised as an intangible asset or as an expense?

12. **Issue 2**: Where BEE equity credentials are obtained as part of the net assets acquired in a business combination, how should the BEE equity credentials acquired be accounted for?

13. **Issue 3**: Assuming that BEE equity credentials do not meet the criteria for recognition as an intangible asset, how should vesting conditions be interpreted in the context of a BEE transaction?

Consensus

14. **Issue 1**: The difference between the fair value of the equity instruments granted and the fair value of the cash and other assets received, i.e. the BEE equity credentials, represents an intangible item that does not meet the definition of an intangible asset and, therefore, does not qualify for recognition as an intangible asset. The difference should be expensed.

15. Where the cost of the BEE equity credentials is directly attributable to the acquisition of another intangible asset, then such an intangible asset should be valued at its fair value and any additional BEE equity credential costs should be expensed.

16. **Issue 2**: Where BEE equity credentials are obtained as part of the net assets acquired in a business combination, the BEE equity credentials do not qualify for recognition as an intangible asset and shall, therefore, form part of goodwill.

17. Where the business combination element of the transaction is insignificant or contrived, this would indicate that the substance of the transaction is in fact two separate transactions – a BEE transaction and a business combination. These two transactions should be accounted for separately. The BEE transaction should be accounted for under IFRS 2, and the business combination should be accounted for under IFRS 3.

18. **Issue 3**: The entity should assess whether the terms of the BEE transaction include service conditions, performance conditions, or non-vesting conditions.

19. Where the BEE transaction includes service conditions, the fair value of the equity instruments shall be measured at grant date and the expense should be recognised over the vesting period, which is the period over which services are rendered to the entity. The service condition shall not be taken into account when estimating the fair value of the equity instrument. Where the BEE transaction includes no service
conditions, the fair value of the equity instruments shall be measured at grant date and the expense should be recognised immediately on grant date.

20. Performance conditions exist where the counterparty must complete a service period and a performance target must be met. A performance condition may be either a market performance condition or a non-market performance condition.

21. Non-market performance conditions exist when the BEE partner must complete a specified period of service, and meet a non-market performance target, such as an earnings target. Where such non-market performance conditions exist, these shall not be taken into account when estimating the fair value of the equity instruments at the grant date. Instead, the number of equity instruments included in the measurement of the transaction amount shall be adjusted so that the cumulative amount recognised for goods or services received (i.e. BEE equity credentials) as consideration for the equity instruments granted shall be based on the number of equity instruments that the BEE partner will become entitled to.

22. Market performance conditions exist when the BEE partner must complete a specified period of service, and meet a market performance target, such as a share price target. Where such conditions exist, the market performance target shall be taken into account when estimating the fair value of the equity instruments granted.

23. Where a non-vesting condition exists in a BEE transaction, it shall be taken into account when estimating the fair value of the equity instruments granted.

24. A post-vesting restriction on the transfer of the equity instruments is a non-vesting condition, and must be taken into account in determining the fair value of equity instruments granted to the extent that the restriction would affect the price that a knowledgeable, willing market participant would pay for those equity instruments.

25. Restrictions on transfer or other restrictions that exist during the vesting period shall not be taken into account when estimating the grant date fair value of the equity instruments granted because those transfer restrictions stem from the existence of vesting conditions.
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Illustrative Examples

These examples accompany, but are not part of this Guide.

These examples of the application of the scope of the Guide and its consensus are not an exhaustive list, as other fact patterns are possible.

Illustrative Examples of the application of the scope

Exclusion of goods or services that are unrelated to obtaining BEE equity credentials (paragraphs 6 to 10 of the Guide)

Example 1

Facts
IE1 A BEE partner is paid commission, through the issue of equity instruments, on the basis of profits from contracts that it is instrumental in obtaining on behalf of the entity. The fair value of the service received by the entity is equal to the fair value of the equity instruments. Is the payment of commission within the scope of this Guide?

Conclusion
IE2 The recognition of the commission and equity instruments issued is not within the scope of this Guide because there is no BEE equity credential element in the transaction.

IE3 The payment of this commission is, however, clearly within the scope of IFRS 2.

Example 2

Facts
IE4 An entity issues equity instruments to a BEE partner for the purpose of acquiring a building. The fair value of the building acquired is lower than the fair value of the equity instruments given up. Is this transaction within the scope of this Guide?

Conclusion
IE5 IFRS 2 applies to transactions in which goods or services are received. IFRS 2, therefore, clearly applies to the building element, as this is identifiable through its fair value. Assuming that there are no other clearly identifiable goods or services, the difference between the fair value of the building and the fair value of the equity instruments is attributable to BEE equity credentials and is, therefore, within the scope of this Guide.
Example of partial capitalisation of BEE equity credentials as part of the acquisition of another intangible asset (paragraph 15 of the Guide)

Example 3

**Facts**
IE6 Company A enters into a BEE transaction with a black-owned company, Company B, in which it sells 25% of its ordinary share capital to Company B at a 20% discount to the fair value of the shares. In return, Company B has contractually agreed to buy a specific minimum number of tyres exclusively from A over the next seven years to meet its production requirements. Assume that the right to future revenue arising from the supply contract meets the definition of an intangible asset in terms of IAS 38.

**Conclusion**
IE7 In terms of the facts, Company A has issued shares in order to secure future revenue through the supply of tyres to Company B over the next seven years. The supply contract is considered to be ‘goods’ received, in the form of intangible assets, in terms of IFRS 2 paragraph 7. IFRS 2 requires that “the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless the fair value cannot be estimated reliably.”

IE8 IFRS 2, therefore, clearly applies to the intangible asset arising from the supply contract. Assuming that there are no other clearly identifiable goods or services, the difference between the fair value of the intangible asset arising from the supply contract and the fair value of the equity instruments is attributable to BEE equity credentials. Also, assuming that the supply contract and the BEE equity credentials are directly linked, the difference should be capitalised to the intangible asset in accordance with paragraph 15 of this Guide only to the extent of the fair value of the supply contract. Any excess over the fair value of the supply contract should be expensed in terms of this Guide.

Examples of application of the consensus in relation to vesting conditions (paragraphs 18 to 25 of the Guide)

Example 4

**Facts**
IE9 In order to obtain BEE equity credentials, Company A introduces a BEE share incentive scheme for its black directors. In terms of the scheme, Company A grants share options to these black directors in return for which the black directors are required to remain in the company’s employ for three years. The number of options that the black directors will be entitled to depends on profit growth at the end of the three years. Therefore, the actual number of options to be delivered to the black directors will not be finalised until the end of year three. Over what period should the expense related to these options be recognised?
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Conclusion
IE10 In terms of IFRS 2 paragraph 15, the services received in relation to a share-based payment arrangement, to which payment the counterparty does not become entitled to immediately, should be recognised as an expense over the vesting period. Performance conditions require the counterparty to complete a specified period of service and to meet specified performance targets (such as a specified increase in the entity’s profit over a specified period of time).

IE11 Because the black directors are required to be in the employment of the company for a service period in order to be entitled to a certain number of options, and are required to meet a specified profit target, the grant has a non-market performance condition. The expense should be recognised over the three-year service period. As the vesting condition is a non-market performance condition, it shall not be taken into account when estimating the fair value of the equity instruments at the measurement date. Instead, the number of equity instruments included in the measurement of the transaction amount shall be adjusted so that the cumulative amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that the black directors will become entitled to.

Example 5

Facts
IE12 Company B grants share options to a BEE consortium. The BEE consortium does not need to provide any further identifiable service or deliver goods, although it is locked into the BEE transaction for a period of five years. The number of share options that the BEE consortium will be entitled to depends on the profit growth over the next five years. Therefore, the actual number of share options to be delivered will not be finalised until after year five. Over what period should the expense related to these options be recognised? What are the implications of the profit target and the post-vesting transfer on the valuation of the expense?

Conclusion
IE13 The BEE consortium is not required to complete a specified period of service. Therefore, there are no service or performance vesting conditions attached to the grant, and the expense should be recognised in profit and loss on grant date. The profit target and the post-vesting transfer restrictions are non-vesting conditions, which should be taken into account when estimating the fair value of the equity instrument, and should not be included as an adjustment to the number of options the BEE consortium is expected to be entitled to.
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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of the Guide.

BC1 This Basis for Conclusions summarises the considerations of the Accounting Practices Committee (APC) in reaching its consensus as technical advisory body, at the time, to the Accounting Practices Board (APB). Individual APC members gave greater weight to some factors than to others.

Issue 1

BC2 The South African government has issued various BEE documents, including the Broad-Based Black Economic Empowerment Act, Act No. 53 of 2003. This Act empowers the Minister of Trade and Industry to issue codes of good practice, which currently are not legally binding, with the purpose of achieving meaningful participation by black people in the South African economy. These codes will be applied in determining both foreign and local entities’ BEE credentials that are necessary for the granting of tenders, licences and other concessions by government in South Africa.

BC3 In a BEE transaction, the entity, therefore, issues equity instruments in order to obtain a certain number of points that contribute to the entity’s overall BEE scorecard and the entity’s ability to tender for business.

BC4 Entities that do not have favourable BEE credentials are finding it difficult to operate effectively as a result of tender criteria that require, amongst other things, minimum participation of black people. Entities, therefore, enter into BEE transactions with the intention of either preventing loss of future revenue or increasing opportunities to obtain future revenues.

BC5 Because an entity relies on the market and government (its customers) to decide whether a BEE transaction increases or maintains the entity’s ability to operate and tender for business, it is difficult to determine whether the entity has actually received goods or services, as contemplated by accounting frameworks, as a result of concluding the BEE transaction.

BC6 In addition, the issue of equity instruments is merely one element that contributes to the determination of the entity’s BEE scorecard, as mentioned in paragraph 6 of this Guide, and, therefore, the issue of equity instruments has no direct relationship to the value the entity’s customers will place on the issue of the equity instruments or the amount of business the entity will obtain from its customers.

BC7 The nature of BEE equity credentials may, therefore, be likened to internally generated intangible assets, where in terms of paragraph 51 of IAS 38:

“It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

(a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and
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(b) determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 52–67 to all internally generated intangible assets.”

BC8 Definition of intangible asset: Paragraph 8 of IAS 38 defines an intangible asset as “an identifiable non-monetary asset without physical substance”.

BC9 An intangible asset is identifiable in terms of paragraph 12 of IAS 38 “when it:

(a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability; regardless of whether the entity intends to do so; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.”

BC10 An asset is defined as “a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.”

(paragraph 8 of IAS 38)

BC11 The BEE equity credentials that may be created in a BEE transaction are a non-monetary item without physical substance.

BC12 Identifiable: The BEE equity credentials are not separable as they are linked to the business as a whole and the BEE partner to whom the equity instruments have been granted. The BEE equity credentials are, therefore, not capable of being sold, transferred, licensed, rented or exchanged separately from the business.

BC13 The BEE equity credentials may arise from contractual rights where the BEE transaction includes a contract between the entity and the BEE partner. Where this is the case, the BEE equity credentials could be considered identifiable.

BC14 Control: IAS 38 paragraph 13 states that “An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.”

BC15 Furthermore, IAS 38 paragraph 16 states that “An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control,
the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (e.g., portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.”

BC16 Therefore, in terms of IAS 38, control over an intangible asset may be evidenced in two ways:

(a) as legal rights that are enforceable by law; or
(b) as exchange transactions for the same or similar non-contractual customer relationships.

BC17 In BEE transactions, a contract is usually entered into with a BEE partner. The contract between the entity and the BEE partner may include a contractual lock-in period or a clause that only allows the transfer of such equity instruments to another BEE partner. However, the contract does not provide the entity with legal rights that give it the power to obtain the future economic benefits arising from the BEE transaction, nor the ability to restrict the access of others to those benefits.

BC18 In the absence of a specific contract between the entity and a counterparty, for example a sales or supply agreement with a customer which provides the entity with legal rights that give it the power to obtain the future economic benefits arising from the BEE transaction and the ability to restrict the access of others to those benefits and which is concluded on the basis of the BEE transaction and at the time that the BEE transaction is concluded, the contract between the entity and the BEE partner does not establish control over future economic benefits.

BC19 In addition, exchange transactions do not exist for BEE equity credentials because BEE equity credentials are linked to the business as a whole and the BEE partner to whom the equity instruments have been granted. Therefore, BEE equity credentials are not capable of being exchanged separately from the business.

BC20 This means that, in a BEE transaction, the BEE equity credentials are not controlled by the entity because the entity is not able to demonstrate that the entity has the power to obtain the future economic benefits flowing from the underlying resource either through legal rights or through exchange transactions.

BC21 **Future economic benefits:** Paragraph 17 of IAS 38 states that “the future economic benefits flowing from an intangible asset may include revenue from the sale of products, services, cost savings, or other benefits resulting from the use of the asset by the entity”. As mentioned previously, all organs of state and public entities must take an entity’s BEE status into account when determining awards of business contracts. Entities may, therefore, enter into BEE transactions with the aim of either preventing loss of future revenue or increasing opportunities to obtain
future revenue. The protection or enhancement of future revenues represents an
economic benefit as envisaged by IAS 38.

BC22 Conclusion on definition of intangible asset: Paragraphs 8 and 9 of IFRS 2
require that “when the goods or services received or acquired in a share-based
payment transaction do not qualify for recognition as assets, they shall be
recognised as expenses”.

BC23 BEE equity credentials do not meet the definition of an intangible asset because
they do not meet all of the following criteria that are required by IAS 38:

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable non-monetary resource without physical substance</td>
<td>Yes</td>
</tr>
<tr>
<td>Controlled by an entity as a result of past events</td>
<td>No (however, refer to BC25)</td>
</tr>
<tr>
<td>From which future economic benefits are expected to flow</td>
<td>Yes, maybe</td>
</tr>
</tbody>
</table>

BC24 Therefore, the BEE equity credentials are expensed in profit or loss, except under the circumstances referred to in paragraph BC25 of this Guide.

BC25 It is considered extremely rare that the expenditure incurred to create or obtain BEE equity credentials may be capitalised as an asset. Only two situations are envisaged where BEE equity credentials may be capitalised as an asset:

(a) where the BEE equity credentials are created or obtained in a business combination as discussed in Issue 2; or

(b) where the cost of the BEE equity credentials is directly attributable to the acquisition of another intangible asset. In this situation the cost may be capitalised to the cost of the other intangible asset in accordance with paragraph 27(b) of IAS 38. (Refer to Illustrative Example 3.)

BC26 Further discussions: The APC also had further discussions with respect to the recognition of BEE equity credentials as intangible assets. These discussions are detailed below in paragraphs BC27 to BC36 of this Guide.

BC27 In terms of IAS 38, an item shall only be recognised as an intangible asset if an entity is able to demonstrate that:

(a) the item meets the above definition of an intangible asset;

(b) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(c) the cost of the asset can be measured reliably.

BC28 While the APC agreed that the definition of intangible asset is not met, the APC had certain further discussions regarding criteria (b) and (c) above.

BC29 In applying the recognition criteria, the APC discussed whether the creation of BEE equity credentials through a BEE transaction is a separate acquisition or whether it is expenditure relating to internally generated goodwill. The APC concluded that
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the creation of BEE equity credentials is not a separate acquisition, but rather part of the development of the entity (i.e. internally generated). An entity ordinarily enters into a BEE transaction because of the requirement prescribed by government that it distribute equity instruments of the entity among black people.

BC30 IAS 38 paragraphs 48 to 50 state that:

“Internally generated goodwill shall not be recognised as an asset.

In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.”

BC31 BEE equity credentials are measured with reference to the fair value of the equity instruments granted in terms of IFRS 2 because it is not possible to estimate reliably the fair value of the BEE equity credentials received. In other words, the total BEE transaction can be measured with reference to the equity instruments granted by the entity, but the amount that relates specifically to obtaining or creating BEE equity credentials cannot be reliably measured.

BC32 A number of factors indicate that the BEE equity credentials cannot be reliably measured and that the fair value of the equity instruments issued does not necessarily equal the fair value of the BEE equity credentials. For example:

(a) The entity relies on the market and government (its customers) to decide whether the BEE transaction increases or maintains the entity’s ability to operate and tender for business.

(b) The percentage of equity instruments granted to a BEE partner is often driven by the minimum BEE equity ownership that is encouraged by government in the various industry charters. This implies that, if an entity with a smaller equity value enters into a BEE transaction and grants a certain percentage of its equity to the BEE partner, the value of the BEE equity credentials is less than it would be for an entity with a larger equity value. However, this is not necessarily the economic reality. The benefit that the entity receives does not necessarily increase proportionately as its equity value increases. Therefore, while the entity may gain value from the BEE transaction, this asset value is not capable of being reliably measured.

(c) The benefits an entity receives are dependent on the extent to which other entities and its competitors are ‘empowered’.

(d) There may be other elements embodied in the discount given to the BEE partner that cannot be specifically identified, such as social responsibility.
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(e) Where the BEE transaction requires that the BEE partner be employed for a specified period, the BEE transaction comprises two elements:

(i) services; and

(ii) BEE equity credentials.

Because of the nature of both of these elements, IFRS 2 requires them to be measured with reference to the fair value of the equity instruments granted; therefore, it would not be possible for an entity to split out and reliably measure the fair value of each element.

BC33 The BEE equity credentials created in a BEE transaction can, therefore, be likened to internally generated goodwill because the expenditure incurred through the issue of equity instruments merely contributes to the internally generated goodwill of the entity and cannot be distinguished from the cost of maintaining or enhancing the entity’s internally generated goodwill.

BC34 Further, paragraphs 63 and 64 of IAS 38, which relate to internally generated assets, state that:

“Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.

Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.”

BC35 Expenditure incurred on BEE equity credentials is in substance similar to the items mentioned in the above paragraphs because the BEE equity credentials cannot be distinguished from the cost of developing the business as a whole.

BC36 Expenditure incurred on BEE equity credentials is also similar in nature to expenditure on items such as advertising and promotional expenditure, which are described in paragraph 69 of IAS 38 and which are required to be expensed.

Issue 2

BC37 Paragraph 68 of IAS 38 requires that “expenditure on an intangible item shall be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria …; or

(b) the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see IFRS 3).

BC38 As discussed in Issue 1, the BEE equity credentials acquired represent an intangible item, which should not be recognised as an intangible asset. Therefore, where the BEE equity credentials are acquired as part of a business combination, this intangible item shall form part of the amount attributed to goodwill at the acquisition date.
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BC39 Paragraph 35 of the Framework for the Preparation and Presentation of Financial Statements also states that:

“If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an entity may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the entity continues to enjoy the future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).”

BC40 Where the business combination element of the transaction is insignificant or contrived, this would indicate that the substance of the transaction is in fact two separate transactions, a BEE transaction and a business combination. These two transactions should be accounted for separately, and the BEE transaction should be accounted for under IFRS 2.

Issue 3

BC41 Paragraph 15 of IFRS 2 as amended states that:

“If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the vesting period. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity.” (emphasis added)

BC42 Paragraphs 19 to 21A of IFRS 2 as amended further state that:

“A grant of equity instruments might be conditional upon satisfying specified vesting conditions. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity’s employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity’s share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, eg. the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21. (emphasis added)
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To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21. (emphasis added)

Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied.” (emphasis added)

“Similarly, an entity shall take into account all non-vesting conditions when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with non-vesting conditions, the entity shall recognise the goods and services received from the counterparty that satisfies all vesting conditions that are not market conditions, (eg services received from an employee who remains in service for the specified period of service) irrespective of whether those non-vesting conditions are satisfied.”

Appendix A to IFRS 2 as amended defines vesting conditions as “the conditions that determine whether the entity receives the services that entitle the counterparty to receive cash or other assets or equity instruments of the entity, under a share-based payment arrangement. Vesting conditions are either service conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as specified increase in the entity’s profit over a specified period of time). A performance condition might include a market condition.”

Discussion by the APC following the amendments to IFRS 2 – Vesting Conditions and Cancellations issued by the IASB in January 2008

As a result of the amendments to the definition of vesting conditions in IFRS 2 as amended, the APC reconsidered Issue 3 and identified the areas outlined below for revision.

The definitions of vesting conditions and performance conditions have been amended. Vesting conditions are either service conditions or performance conditions. The definition of service conditions has not been amended. The definition of performance conditions has been amended to state that there must be a performance target, whether market or non-market, and a service condition. Under the previous version of IFRS 2, the performance condition was not necessarily linked to a service condition.

Paragraph 19 of IFRS 2 as amended states that a non-market performance condition shall not be considered for the purposes of determining the fair value of the equity
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instruments granted, but that the number of equity instruments included in the measurement of the transaction amount shall be adjusted so that the cumulative amount recognised for goods or services received (i.e. BEE equity credentials) as a consideration for the equity instruments granted shall be based on the number of equity instruments that the counterparty to a BEE transaction eventually becomes entitled to.

BC47 Market performance conditions exist when the BEE partner in a share-based arrangement must complete a specified period of service and meet a market performance target, such as a share price target. Where such conditions exist, these shall be taken into account when estimating the fair value of the equity instruments granted.

BC48 Other conditions are defined as being non-vesting conditions. The accounting for non-vesting conditions was not specified in the previous version of IFRS 2. Under the amended IFRS 2, non-vesting conditions are considered when determining the fair value of the equity instruments granted.

BC49 Non-market performance conditions, such as hurdle rates based on earnings or headline earnings, create a vesting period in BEE transactions only if the BEE partner is required to perform a specific period of service. In both versions of IFRS 2, Paragraph 19 of IFRS 2 requires that non-market performance conditions shall adjust the measurement of the transaction such that the expense is based on the number of equity instruments that the BEE partner eventually becomes entitled to.

BC50 Paragraph 15 of IFRS 2 of both versions requires the expense, which is recognised for BEE equity credentials, to be recognised as the related services are rendered.

BC51 If no services are required to be rendered by the BEE partner, an expense shall be recognised immediately.

BC52 This effectively results in recognition of the expense during the vesting period, but on a basis that reflects when the goods and services, i.e. BEE equity credentials, are received.

BC53 Paragraph 21 of IFRS 2 requires market conditions, such as hurdle rates based on the fair value of the underlying equity instruments, to be taken into account in determining the fair value of equity instruments at grant date.

BC54 Transfer and other restrictions are currently common within BEE transactions. Paragraphs B2 and B3 of Appendix B to IFRS 2 provide the following guidance on restrictions that may be incorporated into an issue of shares:

“For shares granted to employees, the fair value of the shares shall be measured at the market price of the entity’s shares (or an estimated market price, if the entity’s shares are not publicly traded), adjusted to take into account the terms and conditions upon which the shares were granted (except for vesting conditions that are excluded from the measurement of fair value in accordance with paragraphs 19–21).

For example, if the employee is not entitled to receive dividends during the vesting period, this factor shall be taken into account when estimating the fair value of the shares granted. Similarly, if the shares are subject to restrictions on transfer after
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vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares. Restrictions on transfer or other restrictions that exist during the vesting period shall not be taken into account when estimating the grant date fair value of the shares granted, because those restrictions stem from the existence of vesting conditions, which are accounted for in accordance with paragraphs 19–21.” (emphasis added)

In its initial discussions in 2006, the APC considered several scenarios in determining the appropriate accounting treatment. These scenarios, as well as the re-deliberations that arose as a result of the amendments to IFRS 2 issued by the IASB in January 2008, are dealt with in paragraphs BC56 to BC71 of this Guide.

**BC55** Shares to all employees plus service condition: The APC initially considered a basic scenario where an entity grants share options to all employees. By issuing the share options to all employees, the entity will still obtain BEE equity credentials for the portion issued to black employees. In return, the employees need to remain in the entity’s employment for three years as a service condition.

**BC57** The APC concluded that the entity would recognise an expense over the period of the service condition in accordance with IFRS 2. The expense would be adjusted to take account of the share options that the counterparty actually becomes entitled to. (This adjustment is commonly referred to as “truing up”.) If any restrictions exist that prevent the employees from selling the shares or share options for a period of, for example, five years after the vesting date, these restrictions would be recognised in the fair value of the share options at grant date.

**BC58** The amendments to IFRS 2 have not impacted on this conclusion.

**BC59** BEE equity credentials with no service or performance condition, with post-vesting transfer restriction: The APC then considered a scenario in which an entity grants share options only to black people, both employees and non-employees, to obtain BEE equity credentials. The BEE partners become entitled to the share options immediately; therefore, if the employees leave the next day they are still entitled to exercise their share options. In order to secure the entity’s BEE equity credentials, the black people may not sell their share options or shares for a period of seven years from grant date. No economic hurdles (performance conditions) need to be met.

**BC60** In its initial discussions in 2006, the APC concluded that there was neither a service condition nor a performance condition in this scenario. The fair value of the equity share options should, therefore, be expensed immediately. The seven-year restriction on sale of the share options or shares represents a post-vesting transfer restriction and is, therefore, taken into account in the fair value of the share options at grant date.

**BC61** In terms of the amendments to IFRS 2 regarding vesting conditions (issued in January 2008), the restriction on transfer shall be treated as a non-vesting condition,
which is taken into account when estimating the fair value of the equity instruments granted. This is consistent with the treatment before the amendment to IFRS 2.

BC62 **BEE equity credentials plus service condition:** The APC then considered a more complex scenario. An entity grants share options to black employees only to obtain BEE equity credentials. In addition, the black employees need to work for a period of four years before they become entitled to the share options. If they cease to be employed by the entity before the end of four years, the share options lapse.

BC63 The APC initially concluded that the entity would recognise an expense over the period of the service condition (four years), in accordance with IFRS 2. The expense would be adjusted to take account of the number of share options that the black employees eventually become entitled to, i.e. truing up. If any restrictions prevent the black employees from selling the shares for a period of, for example, five years after the vesting date, these restrictions would be recognised in the fair value of the share options at grant date.

BC64 The amendments to IFRS 2 have not impacted on this conclusion.

BC65 In reaching its conclusion, the APC considered the following arguments in favour of recognising the expense over the service period:

(a) If a black employee resigned one day after grant date, he/she would lose the share options. Therefore, being a black person is not a factor entitling the employee to keep the shares if the employee leaves before becoming entitled to those shares. It would be appropriate to conclude that the shares are earned over time and should be expensed over the period of the service.

(b) When an entity grants share options in a remuneration scheme, the entity normally distinguishes between employees who are entitled to share options and those who are not. Such share options would be expensed over the period of the service. Therefore, the grant of share options to employees within a particular community should not change the recognition of the expense. Such share options to black people should be recognised as an expense over the period of the service.

BC66 In reaching its conclusion, the APC also considered an argument against recognising the expense over the service period, but instead attributing the expense to the BEE equity credentials obtained because the share options were only granted to a particular community, i.e. black people. This would imply that the grant of the share options was rather for the purpose of obtaining BEE equity credentials than for receiving the service.

BC67 This argument was rejected because paragraph 15 of IFRS 2 requires a presumption that future services will be rendered in such circumstances.

BC68 **BEE equity credentials with no service condition, but including a non-market performance target:** This was the final scenario that the APC considered. In this scenario, an entity grants share options only to black employees. The employees do not need to complete any period of service to be entitled to the share options; however, the number of share options that vests is determined on the basis of the profit after tax in year five.
The following potential treatments for the BEE equity credentials were considered by the APC in 2006:

(a) Expense immediately because there is no service condition. The earnings hurdle represents a non-market performance condition and, therefore, the expense should be trued up for the number of share options that ultimately vests.

(b) Expense over the vesting period, together with truing up for share options that the black employees ultimately become entitled to. The earnings hurdle represents a vesting condition. This would, therefore, result in the spreading of the expense over the vesting period.

(c) The earnings hurdle represents a variable factor in the underlying valuation of the share option.

In its initial discussions in 2006, the APC agreed that (a) was the correct approach on the basis of the factors discussed in paragraphs BC41 to BC54 of this Guide.

Following the amendments to the definition of vesting conditions in IFRS 2 issued in January 2008, the APC reconsidered this conclusion. In the circumstances described in BC68, the employees do not complete a specified period of service. Therefore, the non-market performance target is neither a service nor a performance vesting condition. Instead, the non-market performance target is a non-vesting condition, which should be taken into account when measuring the fair value of the share options. As this is a non-vesting condition, no subsequent truing-up would occur.

The APC also considered restrictions that may apply in respect of BEE transactions. For example, the BEE partner may not be entitled to dividends during the vesting period. The APC concluded that this restriction affects the fair value of the equity instruments granted and should be taken into account in the determination of the fair value of the equity instruments on initial recognition of the equity-settled share-based payment.

A BEE employee who is required to provide services for a period of time may also be locked into the BEE transaction for a certain period. In this period the BEE employee may not sell his/her shares to another party, other than to another BEE party. Paragraph B3 of Appendix B to IFRS 2 states that: “Restrictions on transfer or other restrictions that exist during the vesting period shall not be taken into account when estimating the grant date fair value of the shares granted, because those restrictions stem from the existence of vesting conditions, which are accounted for in accordance with paragraphs 19–21.” A lock-in restriction does not represent a service condition within the scope of paragraphs 19 to 21 of IFRS 2. Therefore, this represents a non-market vesting condition to the extent that the lock-in period overlaps with the vesting period and a post-vesting transfer restriction to the extent that the lock-in period extends beyond the vesting period.
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Discussion by the APC following the amendments to IFRS 2 – Group Cash-Settled Share-based Payment Transactions issued by the IASB in June 2009

BC74 The amendments to IFRS 2 – Group Cash-Settled Share-based Payment Transactions, resulted in the withdrawal of IFRIC 8, which was effective for annual periods beginning on or after 1 May 2006. However, the guidance included in IFRIC 8 was incorporated into IFRS 2. As the guidance previously included in IFRIC 8 was not amended, the APC agreed to amend the references in AC 503, now this Guide to the revised IFRS 2. No further amendments to the guidance were required.