DISCLOSURE OF ACCOUNTING POLICY FOR ACCOUNTING FOR BLACK ECONOMIC EMPOWERMENT (BEE) TRANSACTIONS

Introduction
IFRIC 8(AC 441) – Scope of IFRS 2, was issued in January 2006 and clarifies that IFRS 2(AC 139) – Share-based Payment, applies to transactions in which goods or services are received as consideration for equity instruments 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 where the entity cannot specifically identify some or all of the goods or services received.

AC 503 – Accounting for Black Economic Empowerment (BEE) Transactions, expands on IFRIC 8(AC 441) and was issued by the Accounting Practices Board in April 2006. AC 503 addresses specific issues relating to the application of IFRS 2(AC 139) to BEE transactions.

However, IFRIC 8(AC 441) and AC 503 are only effective for annual periods beginning on or after 1 May 2006, and therefore the concern remains that the existing manner in which BEE transactions are accounted for may not be comparable because of the different accounting policies that may be followed until IFRIC 8(AC 441) and AC 503 are effective.

1 These include equity instruments of the entity, the entity’s parent, and other entities in the same group as the entity.
Background to the uncertainty of the accounting treatment for BEE transactions

.04 Equity instruments (including shares and share options) are commonly issued for cash, or other financial assets, or in business combinations. The accounting treatment for the receipt of financial assets is within the scope of IAS 39(AC 133) – *Financial Instruments: Recognition and Measurement*, and business combinations are within the scope of IFRS 3(AC 140) – *Business Combinations*.

.05 However, in many BEE transactions, no cash is received, or the fair value of cash and other assets received is less than the fair value of the equity instruments issued. This raises the question as to whether the difference is indicative that the entity issuing the equity instrument has received goods and services that should be accounted for in terms of IFRS 2(AC 139).

.06 If the difference between the fair value of the cash and other assets received by an entity and the fair value of the equity instruments issued in a BEE transaction is within the scope of IFRS 2(AC 139), IFRS 2(AC 139) requires the entity to recognise the difference (representing the goods or services received or acquired) in a share-based payment transaction when it obtains the goods or when the services are received, with a corresponding increase in equity.

.07 If not accounted for in terms of IFRS 2(AC 139), the accounting treatment of the difference between the fair value of the cash and other assets received and the fair value of the equity instruments would depend on the classification of the equity instruments.

.08 Where the equity instruments are classified as financial liabilities, they should be recognised and measured in accordance with IAS 39(AC 133). IAS 39(AC 133) does not consider matters relating to vesting and therefore the difference, in its entirety, will be recognised immediately.

.09 Where the equity instruments are classified as equity, International Financial Reporting Standards (IFRS) and Statements of Generally Accepted Accounting Practice (GAAP) do not specifically address their recognition and measurement. IAS 32(AC 125) – *Financial Instruments*: 

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Presentation, merely states that equity instruments are recognised as a residual interest in the assets of an entity after deducting all of its liabilities, and does not specifically address the recognition of equity instruments, except as part of a compound instrument. This may result in the equity instruments being recognised at a nominal amount.

Conclusion

It should be noted that, in selecting an accounting policy for accounting for BEE transactions, the requirements of IAS 8(AC 103) – Accounting Policies, Changes in Accounting Estimates and Errors, and IAS 1(AC 101) – Presentation of Financial Statements should be applied for annual periods beginning on or after 1 January 2005, unless adopted earlier, and that AC 101 should be applied for annual periods beginning prior to 1 January 2005. Refer to the Appendix which contains the appropriate accounting references.

In addition, because of the significance of BEE transactions, entities entering into BEE transactions should disclose their accounting policy for BEE transactions in their financial statements.

Entities that have not applied IFRIC 8(AC 441) and AC 503 in determining their accounting policy for BEE transactions in their financial statements are also reminded of the requirement to disclose that fact and the known or reasonably estimable information relevant to assessing the possible impact that its application will have on the entity’s financial statements in the period of initial application. This is a requirement of paragraph 30 of IAS 8(AC 103).

In accordance with IAS 34(AC 127) – Interim Financial Reporting, paragraph 16(c), interim financial reports should contain an explanation of BEE transactions that are significant to an understanding of the changes in financial position and performance of the entity since the last annual reporting date as well as the BEE transactions’ effects on the assets, liabilities, equity, net income and cash flows of the entity. Refer to the Appendix which contains the appropriate accounting references.

Johannesburg
May 2006

I Sehoole
Executive President
APPENDIX – ACCOUNTING REFERENCES

Requirements effective for annual periods beginning on or after 1 January 2005

.01 IAS 8(AC 103) – Accounting Policies, Changes in Accounting Estimates and Errors, and IAS 1(AC 101) – Presentation of Financial Statements, apply to annual periods beginning on or after 1 January 2005, although earlier application is encouraged. IAS 8(AC 103) paragraphs 10 to 12 provide certain guidance in the selection of accounting policies.

.02 “10 In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and
(b) reliable, in that the financial statements:
   (i) represent faithfully the financial position, financial performance and cash flows of the entity;
   (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
   (iii) are neutral, ie free from bias;
   (iv) are prudent; and
   (v) are complete in all material respects.

11. In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in Standards and Interpretations dealing with similar and related issues; and
(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

12. In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.”
IAS 1(AC 101), paragraph 8 states that a complete set of financial statements includes “... a summary of significant accounting policies”. Paragraph 103 states that “the notes shall:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with paragraphs 108-115”.

Paragraph 112 states that “an accounting policy may be significant because of the nature of the entity’s operations even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by IFRSs, but is selected and applied in accordance with IAS 8.”

Paragraph 30 of IAS 8(AC 103) requires that:

“When an entity has not applied a new Standard or Interpretation that has been issued but is not yet effective, the entity shall disclose:

(a) this fact; and
(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Standard or Interpretation will have on the entity's financial statements in the period of initial application”.

**Requirements effective for annual periods beginning prior to 1 January 2005**

AC 101 – Presentation of Financial Statements, (revised October 1998) contains similar requirements with respect to the selection and disclosure of accounting policies. “Management should select and apply an enterprise’s accounting policies so that the financial statements comply with all the requirements of each applicable Statement of Generally Accepted Accounting Practice and each applicable approved interpretation. Where there is no specific requirement, management should develop policies to ensure that the financial statements provide information that is:

(a) relevant to the decision-making needs of users, and
(b) reliable in that they:
   (i) present fairly the results and financial position of the enterprise,
   (ii) reflect the economic substance of events and transactions and not merely the legal form,
   (iii) are neutral, that is free from bias,
   (iv) are prudent, and
   (v) are complete in all material respects.

In the absence of a specific Statement of Generally Accepted Accounting Practice and an approved interpretation, management uses its judgement in developing an accounting policy that provides the most useful information to users of the enterprise’s financial statements. In making this judgement, management considers:

(a) the requirements and guidance in Statements of Generally Accepted Accounting Practice with similar and related issues,
(b) the definitions, recognition and measurement criteria for assets, liabilities, income and expenses set out in the statement on the framework for the preparation and presentation of financial statements,
(c) pronouncements of the International Accounting Standards Committee, and
(d) pronouncements of other standard setting bodies and accepted industry practices to the extent, but only to the extent, that these are consistent with (a), (b) and (c) of this paragraph.”

.07 Paragraph 92 states that “the notes to the financial statements of an enterprise should:

(a) present information on the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and events”.

.08 Paragraph 102 states that “an accounting policy may be significant even if amounts shown for current and prior periods are not material. It is also appropriate to disclose an accounting policy for each policy not covered by existing Statements of Generally Accepted Accounting Practice, but selected and applied in accordance with paragraph .21.”
Interim financial reports

IAS 34(AC 127) – Interim Financial Reporting, states that:

“15. A user of an entity’s interim financial report will also have access to the most recent annual financial report of that entity. It is unnecessary, therefore, for the notes to an interim financial report to provide relatively insignificant updates to the information that was already reported in the notes in the most recent annual report. At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the last annual reporting date is more useful.

16. An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an understanding of the current interim period: ...

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence …”

“25. While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity’s financial position and performance during the interim period.”