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Technically Speaking
Painting a picture

Accounting and Auditing - External

Contents

Welcome

Dear Colleagues

Welcome to the second edition of Technically Speaking for 2012!

This winter edition includes articles on the following topics:

Business Rescue

Business rescue is a new concept which has been introduced by the Companies Act of 2008. It provides companies in financial distress with options to avoid having to liquidate when the company experiences financial distress.

New Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (ASB) has issued several standards of Generally Recognised Accounting Practice (GRAP) which become effective for periods beginning on or after 1 April 2013. This article provides an overview of these new standards.

Offsetting: Amendments to IAS 32 Financial Instruments: Presentation

The International Accounting Standards Board (IASB) has issued amendments to IAS 32 relating to offsetting of financial assets and liabilities. This article explores the implications of these amendments.

Withdrawal of South Africa Statements of Generally Accepted Accounting Practice

With effect from 1 December 2012, South African Statements of Generally Accepted Accounting Practice (SA GAAP) have been withdrawn. Entities currently reporting under SA GAAP will need to transition to another financial reporting framework.

Whose Expense is it Anyway?

The introduction of the new Dividends Tax on 1 April 2012 has changed the way in which companies should account for taxes on dividends to shareholders.

The Protection of Personal Information Bill

This article explores how management should start thinking about the impact of the Protection of Personal Information Bill.

We look forward to your comments on this publication. Please feel free to contact our editor Amy Escott if you have any questions or suggestions for future issues.

Kind Regards

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Business Rescue

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Chapter 6 of the Companies Act No. 71 of 2008 (the Act) introduces business rescue to the South African business environment. Business rescue is often referred to as South Africa's equivalent to the United States Chapter 11 bankruptcy provisions. South African companies which are financially distressed or trading under insolvent circumstances now have the opportunity to reorganise and restructure its affairs in relation to its creditors, employees and shareholders.

The purpose of business rescue is to maximise the likelihood of the company continuing in existence on a solvent basis. The key will therefore be the successful development and implementation of a business rescue plan. This plan should aim to restructure the company's affairs, business, property, debt, and other liabilities and equity, and stand to be approved by creditors and other affected parties. In the event that such a plan cannot be successfully implemented or achieve the required approval by the creditors, the plan should result in better returns for the company's creditors and shareholders than would have been the case from an immediate liquidation of the company.

With the introduction of any new concept, there are always questions that arise. Some of the more frequently asked questions are discussed below.

1. What is business rescue?

Business rescue ("BR") is defined as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:

a) Temporary supervision of the company and management of its affairs, business, and property. Management and directors are able to continue with their duties subject to the authority of a BR practitioner

b) Temporary moratorium on the rights of claimants against the company or in respect of property. Payments to creditors are suspended until the BR proceedings have ended or settlement terms have been agreed to in an approved BR plan. Development and implementation of a plan to rescue to company by restructuring its affairs, business, property, debt and other liabilities, and equity.

2. Who can apply for business rescue?

The board of directors of the company may resolve (which has no effect until it has been filed with the Commission) that the company voluntarily begins BR proceedings if the board has reasonable ground to believe that the company is financially distressed and that there appears to be a reasonable prospect of rescuing the company. No resolution may be adopted if liquidation proceedings have been initiated by or against the company. If the board has not already adopted a BR resolution, an affected person (see below) may apply to the court to begin BR proceedings.

3. In terms of the Act, when should a company apply for business rescue?

When the company is financially distressed and there is a reasonable prospect of rescuing the company.

4. When is a company financially distressed?

When, at any particular time it appears to be reasonably unlikely that:

a) The company will be able to pay all of its debts as it becomes due and payable within the immediately ensuing six months, or
b) The company will become insolvent within the immediately ensuing six months.

5. Is a company or its directors obliged to apply for business rescue?

No, the Act provides that the board of directors may pass a resolution as opposed to instructing the board to do so. The obligation on directors to comply with the provisions of Chapter 6 should be read with their obligation to act responsibly and their potential personal liability if found not to.

6. Who are the affected persons?

Any shareholder, creditor, or employee not represented by a registered trade union, as well as a registered trade union representing employees of the company. Therefore, an employee represented by a registered trade union is not an affected person, but rather the trade union is. Also, it should be noted that the stakeholder is not required to be a significant stakeholder.

7. What is the effect of business rescue on legal proceedings and protection of property interests?

Subject to certain exceptions, no legal proceeding may be commenced or proceeded with, and no person may exercise any right in relation to property lawfully possessed by the company (i.e. the company may not be evicted from the premises it is lawfully occupying) during the BR proceedings. This also means that if a bank has security over the company's owner-occupied building, the company may only sell the property with the consent of the bank and then first settle the bank from the proceeds of the sale. On the counter side, the bank can only exercise its right over the building once the BR proceedings have ended or in terms of the approved BR plan.

8. What is the effect of business rescue on post-commencement finance?

During BR proceedings, a company may obtain financing which may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered. Such lender's claim will have preference in the order in which it has been incurred over all unsecured claims against the company (secured creditors rights remain and will not be affected unless agreed to).

The order of payment of unsecured claims is as follows:

a) BR practitioner's remuneration
b) All employment related costs due but not paid during the BR proceedings
c) All funding obtained post BR proceedings
d) All unsecured creditors.

9. What is the effect of business rescue on employees?

During BR proceedings, employees of the company hired immediately before the beginning of the BR proceedings continue to be so employed on the same terms and conditions except to the extent that:

a) Changes occur in the ordinary course of business, i.e. employees resign or their contracts end;

b) The employees and company agree to different terms and conditions (in accordance with the Labour Relations Act).

Any retrenchment contemplated in the BR plan is subject to the Labour Relations Act and other employment related legislation.

10. What is the effect of business rescue on contracts?

During BR proceedings, the practitioner may suspend any obligation of the company that arises under an agreement to which the company was a party at the commencement of the BR proceedings and would otherwise become due during those proceedings. For example, payments to creditors can be suspended until the BR plan has been approved or BR proceedings have ended.

Any party to an agreement that has been suspended or cancelled by the practitioner may only assert a claim against the company for damages.

A practical consequence is that creditors would require cash on delivery for any further products and services. If the cash is not available creditors would most likely not continue supplying the company with the resultant impact on the companies trading ability, etc.

11. What is the effect of business rescue on shareholders and directors?

During BR proceedings, an alteration in the **classification or status** of any securities issued, is invalid except to the extent:

a) That the court otherwise directs or

b) Contemplated in an approved BR plan.

During BR proceedings, each director:

a) Must continue to exercise the functions of directors, subject to the authority of the BR practitioner

b) Has a duty to exercise management function as instructed or directed by a BR practitioner

c) Remains bound by requirements of Section 75 (personal financial interest).

A BR practitioner can apply to the court to remove a director on the grounds that the director has:

a) Failed to comply with Chapter 6 or

b) Impeded the BR practitioner in the performance of their powers and functions, management of the company or development/implementation of the BR plan.

12. What is the business rescue practitioner supposed to do?

The BR practitioner:

a) Has full management control

b) May delegate a power or function to a board/management member

c) May remove a member of management or appoint a person as management

d) Develop a BR plan for consideration by affected persons

e) Implement the BR plan once adopted by affected persons

f) Inform the regulatory authorities that the company has been placed under BR proceedings.

13. What should be included in a business rescue plan?

After consultation with all creditors, other affected persons and management, a BR practitioner must prepare a BR plan to be published within 25 business days after appointment.

Such a BR plan must contain all the information which affected persons may need in order to reach a decision regarding its adoption, and should as a minimum contain the following:

Background	Proposals	Assumptions and conditions
• List of assets and security holders • List of creditors indicating status (secured, unsecured) and which proved a claim • Probable dividend in the event of liquidation • List of holders of securities • Agreement concerning BR practitioner's remuneration statement on whether informal proposals were made by creditors	• Nature and duration of any moratorium provided for • Extent of debt released/converted to equity • Ongoing role and treatment of contracts • Property available to pay claims • Order of preference from proceeds of the property sale • Benefits of the BR plan over liquidation • Effect the BR plan will have on holders of securities (shares)	• Conditions for the BR plan to come into operation and be fully implemented • Effect on employee numbers and terms and conditions of employment • Circumstance in which the BR plan will end • Projected balance sheet • Projected income statement for three years

14. Who can approve or stop a business rescue plan?

Where the rights of shareholders are not proposed to alter (e.g. no introduction of new shareholders such as in the event of a debt to equity swap where debt providers become equity holders), then at least 75% of all creditors voting interest as well as at least 50% of independent creditors' voting interest (i.e. inter-group companies excluded) is required to approve the BR plan.

In the event that the rights of shareholders are proposed to alter, the same approval as above is required as well as a simple majority of the voting rights of these shareholders.

Deloitte has a dedicated team responsible for business rescue and encourages directors and creditors to proactively engage with our advisors on the matter. For more information or assistance with business rescue please contact:

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New Generally Recognised Accounting Practice Standards

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Standards of Generally Recognised Accounting Practice (GRAP) are accounting standards issued by the Accounting Standards Board (ASB) in terms of Section 89 of the Public Finance Management Act (PFMA). These standards are required to be applied by public entities, constitutional institutions, municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality, parliament and the provincial legislatures. Due process is followed by the ASB in setting these standards and once they have been approved by the Minister of Finance, the standards are regarded as effective and must be applied by the entities from the standard's effective date.

GRAP Standards are largely based on International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). However, as IFRS standards are set for profit-orientated entities as opposed to service-orientated entities which are found in the public sector, the ASB has issued several standards which provide guidance on accounting for public sector specific issues.

Five new standards will be applicable to those entities applying GRAP for periods beginning on or after 1 April 2013.

GRAP 21 Impairment of Non-Cash Generating Assets

Public sector entities are required to fulfil their mandate as determined by the relevant legislation/regulation for that entity. This often involves supplying goods or services for which either nothing or a nominal price is charged. The assets used to provide such services are regarded as non-cash generating assets as the entity is required to generate a public service rather than a commercial (cash flow) return.

Similarly to IAS 36 Impairment of Assets (IAS 36), if there is an impairment indicator, then an impairment test is performed to assess whether the asset is impaired. The recoverable service amount of the asset is compared to the carrying amount of the asset and if the carrying amount exceeds the recoverable service amount, the carrying amount is written down to the recoverable service amount.

The calculation of the recoverable service amount cannot be done using the future expected cash flows from the assets as there may be little or no future cash flow streams. GRAP 21 therefore provides three methods which can be used to determine the recoverable service amount:

- Depreciated replacement cost where the cost to replace the asset is determined and then depreciated so that it is the same age as the asset being assessed for impairment
- Restoration cost where the cost to restore the asset to its full working condition is determined
- Service units where the estimated number of service units expected to be obtained from the asset is determined and then the cost of the asset to produce this number of service units is calculated.

GRAP 21 does not specify which method must be used for which assets as judgement will be required in deciding which method is the most appropriate for the asset under consideration.

GRAP 23 Revenue from Non-Exchange Transactions

GRAP differentiates between revenue from exchange transactions and revenue from non-exchange transactions. Revenue from exchange transactions is similar to revenue as defined in IAS 18 Revenue (IAS 18) and is a transaction in which parties give approximately equal value in the transaction, for example the sale of goods. Revenue from non-exchange transactions occur when one party receives value without giving something in return in the transaction, for example taxes and fines levied and grants received from central government.

Public sector entities frequently receive revenue in non-exchange transactions. GRAP 23 requires that when such revenue is received, that the following assessments are made:

- Asset recognition: any asset which is received as part of the non-exchange transaction should only be recognised once the definition of an asset is satisfied
- Conditions: the non-exchange revenue may contain conditions which are attached to it. For example a grant may be received from central government for construction of a road. The condition attached to the grant would be that the grant can only be used to construct the road.

Until all conditions attached to the grant are satisfied, the revenue is deferred. Once the entity has fulfilled the conditions, then revenue can be recognised.

GRAP 24 Presentation of Budget Information

As public sector entities use taxpayer's money to fufil their mandate, the presentation of budget information is considered to be an important part of public sector financial statements. GRAP 24 therefore requires that the budget is presented in the financial statements in such a way that it can be compared to the actual amounts for the year. Any significant differences between the actual and budgeted amounts should be explained. If the situation arises where the final budget differs from the approved budget, then an explanation for these differences should also be provided.

GRAP 103 Heritage Assets

Public sector entities often hold assets which have a cultural, environmental, historical, natural, scientific, technological or artistic significance. Such assets are held for the benefit of future generations and it is unlikely that they will ever be sold. Examples of such assets include monuments, national parks and archaeological sites.

It is often difficult to place a monetary value on such assets. GRAP 103 requires that the assets are accounted for at cost (revaluation is permitted in some limited circumstances) but that the assets are not depreciated. Instead, heritage assets are assessed for impairment at each reporting date, or more often if there is an impairment indicator.

GRAP 104 Financial Instruments

Unlike IFRS where there are several standards which deal with the accounting for financial instruments, GRAP 104 is the only financial instruments standard issued by the ASB. It provides guidance on the recognition, measurement and disclosure of financial instruments. GRAP 104 does not provide guidance on hedge accounting. If a public sector entity wishes to apply hedge accounting, then it must comply with the requirements of IAS 39 Financial Instruments: Recognition and Measurement (IAS 39).

GRAP 104 has only three categories of financial instruments: loans and receivables, financial instruments at fair value through profit or loss, and financial instruments at cost. The recognition and measurement of these financial instruments is similar to the requirements under IAS 39.

These standards are effective for financial periods beginning on or after 1 April 2013. However, GRAP 103, GRAP 104 and GRAP 23 are required to be applied retrospectively. The ASB has issued specific directives with the transitional provisions for each of the new standards. The directives can be found on the ASB's website *www.asb.co.za.*

To Offset or Not? A review of how the new accounting guidance might impact banks

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As part of its phased approach to IFRS 9 Financial Instruments (IFRS 9), the International Accounting Standards Board (IASB) released amendments to the offsetting rules for financial instruments in the form of amendments to IAS 32 Financial Instruments: Presentation (IAS 32). The "new" rules were issued as an amendment to IAS 32 rather than as part of IFRS 9 because none of the actual rules within the main body of standard changed. The IASB instead added additional interpretational guidance at the back of the standard and as well as some additional disclosure requirements. The new guidance is effective for periods beginning on or after 1 January 2014.

The issue at hand is whether a bank could offset a financial asset and a financial liability and disclose these on a net basis in the financial statements. This grossing up of assets on the bank's statement of financial position might increase the capital requirement, the amount of liquid assets and regulatory reserves that a bank is required to hold. The requirement to hold these results is an opportunity cost for the bank and might very well reduce cash profits in the long term. The accounting treatment of financial instruments should, intuitively, not impact the regulatory treatment but it very often does.

The additional guidance makes it very difficult for banks to apply offsetting as it states that the legal right of set-off must not be contingent upon a future event and that there must be an intention to settle simultaneously. An entity must therefore have the right of set-off in all of the following circumstances:

- In the normal course of business
- In the event of default
- On insolvency or bankruptcy.

The above stands in contrast to the provisions of the Banks Act which has incorrectly been referred to by some corporates and banks to apply offset for accounting purposes in the past. The provisions of the Banks Act state that all of the following must be present before offset could apply:

- A legal right to set-off must exist
- The debit and credit balances should relate to the same entity
- Both the debit and the credit balances should be denominated in the same currency
- The debit and credit balances to should have identical maturities and
- The relevant debit and credit balances should be controlled on a net basis in its risk-management process.

Even if all of the above conditions are met by an entity it would be difficult to prove that it has the legal right of set-off given some of the case law rulings in South Africa. A bank would, for example, be unable to offset the financial assets and liabilities relating to cheque accounts of different branches within the same entity unless the bank "sweeps" those accounts on a predetermined contractual basis.

IFRS 13 Fair Value which is effective for years beginning on or after 1 January 2013 introduces a limited exception for the offsetting of financial assets and liabilities. Financial assets and liabilities could be offset for the purpose of measuring the fair value of the net exposure in the following circumstances:

- It holds a group of financial assets and liabilities with offsetting market risks or counterparty credit risk
- It manages the group on the basis of net exposure to either risk.

This exemption is however only applicable on the measurement of the net exposure and it must be presented gross for disclosure purposes.

Banks that have previously applied offset would have to investigate whether financial instruments should be grossed-up. In some instances, it might be difficult and costly to comply with the standard due to information not being readily available and systems adjustments being required.

Whose expense is it anyway? Considering Dividends Tax from an accounting perspective

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In November 2011, the Accounting Practices Committee of SAICA issued Circular 3/2011 - *Impact of the Dividends Tax on deferred tax assets arising from unutilised STC credits.* This circular provides guidance on the following two issues:

- The impact that Dividends Tax has on deferred tax assets previously recognised in respect of Secondary Tax on Companies (STC) credits held
- The accounting treatment of any deferred tax re-measurement required as a consequence of considering the impact of Dividends Tax.

Dividends Tax, which became effective on 1 April 2012, does not constitute a tax levied on a company, but rather on the shareholders of a company that do not qualify for exemption in terms of the tax legislation. As a consequence of this, companies are no longer required to recognise a tax expense on the declaration of a dividend, and STC credits no longer serve to reduce a company's tax obligation, since the obligation to pay Dividends Tax is not that of the company. Companies are instead required to collect this tax on behalf of its shareholders and to make payment thereof directly to the South African Revenue Service (SARS). The journal entries below illustrate the accounting treatment of STC incurred prior to 1 April 2012, and Dividends Tax incurred after this date.

Illustrative example: A dividend of R100 000 is declared and paid to shareholders.

Prior to 1 April 2012		Prior to 1 April 2012	
Dr: Retained income	100 000	Dr: Retained income	100 000
Cr: Bank	100 000	Cr: SARS liability	10 000
		Cr: Bank	90 000
Dr: STC expense	10 000		
Cr: SARS liability	10 000		

Circular 3/2011 provides that deferred tax assets recognised in respect of STC credits held under the STC regime should cease to qualify for recognition as a deferred tax asset in terms of IAS 12 Income Taxes on the date on which Dividends Tax became effective, if not earlier. In terms of the new Dividends Tax legislation, STC credits held during the transitional period do not constitute an amount of income taxes recoverable by a company in future periods. On this basis, it was required that companies preparing financial statements determine the extent to which dividends were expected to be declared prior to 1 April 2012, and that any deferred tax asset previously recognised be re-measured to reflect only the STC credits expected to be utilised prior to this date. The Circular reiterates the principles of IAS 12, stating that the recoverability of a deferred tax asset is required to be assessed at the end of each reporting period and any adjustment to the deferred tax asset should be recognised in profit or loss and headline earnings.

Is the Protection of Personal Information Bill a necessary evil or anopportunity to add value?

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The Protection of Personal Information Bill (PPI) is a piece of legislation which not only provides a practical mechanism for South Africans to enforce their Constitutional right to privacy, but also brings South Africa in line with the data privacy laws of most first world countries. For these reasons alone it is a good piece of legislation.

As companies start to consider the process of achieving compliance with PPI, they usually think about how onerous the minimum requirements for compliance will be, how long they will take to become compliant and what the cost implications are likely to be. Some companies have chosen to take a 'wait and see' approach, however our experience has shown that those companies that see regulatory changes as an opportunity for increasing business value adopt a more positive, proactive approach and also spend considerably less time and money in achieving compliance over the long term. These companies are able to link compliance requirements to the entire value chain of the business so that each functional area buys into its importance, realises the value that can be delivered to the business and collectively bring about change to realise this value.

PPI is not exclusively an IT or legal or a process or a security issue, it's a combination of all of these. PPI affects most areas of a company's business, and aligning PPI compliance to this reality is key. It is important to begin compliance by creating the framework within which PPI will be managed within an organisation, and then building awareness amongst staff around both PPI and your entities PPI compliance framework. This will start to drive PPI issues into the framework, thereby facilitating a proactive, self-regulating model.

At an early stage in the compliance implementation, decide on a corporate ethics policy and define and communicate it, teaching the organisation to look out for problems. If and when a data privacy issue arises, react quickly and correctly to deal with it and close the loophole.

The PPI Bill can be the catalyst for companies to add value while achieving compliance. Companies should engage with their customers in the process and use it as an opportunity to build customer trust by highlighting the company's efforts to treat customer's personal information with respect and confidentiality. The opportunities to add value to your business are varied and are real, and should be woven into the compliance implementation plan.

Positive customer approvals for your company to process personal information are more likely to be obtained prior to promulgation of the law and prior to the market being flooded with requests from all those companies who leave compliance until the last minute. Valuable insights can be obtained from a company's existing customer database while engaging with customers to obtain their consent to the processing of their personal information. Customers will become aware of the fact that PPI will result in the protection of their personal information, something most people will appreciate, especially in those companies who have led the compliance wave instead of following it. Companies who lead the market in becoming PPI compliant will gain customer respect and loyalty.

Technology changes may be required to achieve PPI compliance, and this may signal the opportunity to effect technology changes or upgrades that have been considered for business reasons for a while.

Data analysis of personal information during PPI compliance can yield significant useful information around customers and markets. Compliance is also an opportunity to get employee or alumni data updated and remain up-to-date. Contracts will need adapting to privacy requirements, and this presents the opportunity to consolidate and improve the contracts typically used in your business. Most companies also spend significant money on archiving mountains of data, but have very little idea of what the archived data consists of, and as a result extract little to no value from it – PPI compliance will facilitate not only cost savings in this area, but will allow a view of data that allows its value to be tapped.

We recommend that companies do an analysis of their business to understand the changes needed to achieve PPI compliance. Following this analysis, plan a compliance plan and stitch the value add components into the plan. This will maximise both the success of the compliance project, and the level of buy-in from your business.
In summary, organisations can gain measurable business performance improvements by approaching the Protection of Personal Information Bill as a strategic opportunity rather than an onerous compliance cost. Realising this potential value from the Bill, however, requires a shift in organisational mindset.

Withdrawal of South African Statements of Generally Accepted Accounting Practice

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The Companies Act, 2008 (the Act) has established a new standard setting body known as the Financial Reporting Standards Council (FRSC). Furthermore, in order to reduce the burden of issuing each IFRS standard as SA GAAP, it has been decided that to withdraw SA GAAP for financial years beginning on or after 1 December 2012.

Entities which currently report under SA GAAP will need to transition to a different reporting framework. The Regulations to the Act permit companies to apply either IFRS or IFRS for Small and Medium-sized Entities (IFRS for SMEs) in specific circumstances. In addition, public sector entities applying SA GAAP may be required to transition to Generally Recognised Accounting Practice (GRAP) as issued by the Accounting Standards Board (ASB).

The ASB is still in the process of determining the appropriate reporting framework for each of the public sector entities. Once this process is finalised, the ASB will issue communication as to what reporting framework should be used by each public sector entity.

This transitional process will involve applying one of the following requirements, depending on which reporting framework is used:

Reporting Framework	Transitional Requirements
IFRS	IFRS 1: First Time Adoption of International Financial Reporting Standards
IFRS for SMEs	Section 35 of the IFRS for SMEs
GRAP	Appropriate Directive as Issued by the ASB

The transition to either IFRS or IFRS for SMEs should not cause a significant impact on an entity's financial statements.

Each reporting framework also has specific disclosure requirements which should be considered when preparing the first financial statements under that framework.

The following transitional provisions in IFRS and IFRS for SMEs may provide some benefit on transition:

- using fair value as deemed cost for property, plans and equipment
- re-set the foreign currency translation reserve to zero

In Closing – Note from the Editor

Dear Colleagues

I hope you have enjoyed reading this issue of Technically Speaking. I hope that this issue has helped paint a picture of the accounting and regulatory world.

Please continue to send your comments and suggestions that you may have to improve our future issues to technicallyspeaking@deloitte.co.za.

Kind Regards

Amy Escott

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