Frequently asked questions

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Monthly Newsletter

The technical department receives many requests for technical assistance during the year. This month's Tip summarises some of the frequently asked questions.

What guidance can be used in order to determine whether a Close Corporation needs to be audited?

A Close Corporation is treated as a private company in determining the need for an audit or independent review. Once an auditor/independent reviewer is appointed, the accounting officer role falls away.

What should be considered in the classification of a financial instrument as either a financial liability or an equity instrument?

The instrument must satisfy the "critical feature test" of a financial liability. The critical feature test is whether the contractual terms of a financial instrument establishes a contractual obligation of the issuer to deliver cash or another financial asset to the holder.
Where an issuer will settle a financial instrument using its own equity instruments, this will **not meet the critical feature test**, as there is no contractual obligation to deliver cash or another financial asset.
An exception to the critical feature test is where the financial instrument will be settled by issuing a **variable number** of the issuer's instruments that equals an **agreed value**. This should be classified as a financial liability even though it fails the critical feature test.
Therefore, a contract to pay a **specified amount** (rather than a specified equity interest) is a **financial liability** and not an equity instrument. A contract that will be settled by the entity delivering a **fixed number of its own equity instruments** is an equity instrument.

A provision has been recognised for a legal matter that has not yet been settled. Would this provision be adjusted once the court case has been settled?

The settlement of a court case after the reporting period, but before the financial statements are authorised for issue, confirms that the entity had a present obligation at the end of the reporting period, and would require adjustment to any previously recognised provision related to this court case.

Are shareholders' loans classified as current or non-current?

As per IAS 1, an entity shall classify an asset as current when it expects to realise the asset, or intend to sell or consume it, in its normal operating cycle; it holds the asset primarily for the purpose of trading; it expects to realise the asset within twelve months after the reporting period; or the asset is cash or a cash equivalent (unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period).

The asset may only be classified as non-current if none of the above are met. In the case of a shareholder's loan, the borrower does not have the right to defer payment for more than 12 months, thus the asset cannot be classified as non-current.

Must interest free loans be discounted?

The only way a loan can remain interest free and not be discounted is if the loan has a demand feature which is immediately exercisable. IFRS 13 states that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount would be required to be paid.

Does section 90(2) of the Companies Act apply to a voluntary audit?

Section 90(2) only applies to an audit that is required in terms of the Companies Act, most often identified as a statutory audit. If a company's Memorandum of Incorporation (MOI) requires an audit, the company has scoped themselves into sections 90-93 of the Act and the same requirements would therefore also apply.

What is the difference between proportionate consolidation and the accounting for a joint operation in terms of IFRS 11?

In terms of IFRS 11, a joint operator shall recognise in relation to its interest in a joint operation its assets including its share of any assets held jointly; its liabilities including its share of any liabilities held jointly; its revenue from the sale of its share of the output; its share of the revenue from the sale of the output; and its expenses including its share of any expenses held jointly.

Proportionate consolidation is a method of including items of income, expense, assets and liabilities in proportion to the firm's percentage of participation in the venture.

The rights and obligations as specified in the contractual arrangement that an entity has with respect to the assets, liabilities, revenues and expenses might differ from the ownership interest in the joint operation. IFRS 11 requires the recognition of assets, liabilities, revenue and expenses according to the entity's shares in those items as determined and specified in the contractual arrangement, rather than basing it on the ownership interests.

When can goodwill be recognised?

The recognition of goodwill is prescribed in IFRS 3 *Business Combinations*. It states that goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

Goodwill is thus only recognised as a result of a business combination. Internally generated goodwill may not be recognised.

Can the useful life of a fully written-off asset that is still being used be amended?

Yes, the residual value and useful life of an asset shall be reviewed at least at each financial year-end and if expectations differ from previous estimates, then the changes shall be accounted for as a change in accounting estimate and be adjusted prospectively.