60 The JSE concluded that whilst the loan had initially been recognised as a liability (paragraph 56 above) on waiver, the full carrying amount should be transferred directly to equity both in order to ensure that no profit or loss was recognised from transaction with a shareholder and in line with the analogous guidance of IFRIC 19.

61 The substance of the waiver of the loan in 2020 is considered to be an action of a shareholder (as opposed to a creditor), confirming that the subsequent waiver is akin to an equity contribution which should be treated as such. The waiver does not result in the recognition of a gain in profit and loss and should not be recognised as such.

Referral 1: economic benefit of the waivers to both initial and subsequent loans

62 The similarity of the quantum of earnings (EBITDAASA) targets specified in the earn out clauses (EBITDAASA per the amended share purchase agreement) and the quantum of the loan amounts waived is noteworthy and is illustrated below:

March 2019 AFS (N$'000)		Sept 2019 interims (N$'000)	
Resource segment Profit before tax	490 339	Resource segment Profit before tax	943 854
Add back impact of waiver gain	(545 601)	Add back impact of waiver gain	(1 000 000)
Resulting Loss before tax	(55 202)	Resulting Loss before tax	(56 146)
EBITDAASA target per HUSO share purchase agreement (tranche 1&2)	500 000	EBITDAASA target per HUSO share purchase agreement (tranche 3-5)	808 100

63 The resources segment of Trustco would not have made the profits necessary to trigger the EBITDASA targets without the 'benefit' of the loan waivers; in fact, the resources segment of Trustco would

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there is no benefit to a lender, acting in their capacity as a lender, in waiving a loan in anticipation of an uncertain future IPO. A lender does not benefit from an IPO. A shareholder on the other hand does. This supports the JSE's finding the substance of the subsequent loan was in fact an equity contribution.

57.2 The waiver leads to the resources segment of Trustco making a profit (without which it would have made a loss) which leads to the EBITDASA targets being triggered and Trustco shares being issued to QvR. This result of the waiver was pre-determined by the terms of the subsequent loan.

57.3 The recognition of a gain on the waiver of the subsequent loan results in a profit in the profit and loss account when the subsequent loan did not have any cashflow effect on Trustco when it was advanced.

58 The JSE concludes that QvR's waiver of the subsequent loan was, in substance, made by him as shareholder (not lender). Consequently, there can be no income (gain on waiver) recognised in profit and loss as the transaction is a contribution by the holder of equity claims (Conceptual Framework definition 4.68).

59 Whilst the IFRS arguments above are sufficient justification in accounting for the waiver as an equity transaction, the JSE also considered the guidance provided by *IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments*. Although the transaction is technically out of the scope of IFRIC 19, the JSE considered that it was appropriate to consider the IFRIC 19 requirements by analogy. This was particularly as the reasons for the scope exclusion did not appear to be applicable to this transaction. The carrying amount of the loan absent the waiver (which was at the discretion of QvR and not Trustco) and the fair value of the shares could be determined.

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waive the subsequent loan, this suggests that QvR intended to waive the subsequent loan as he had with the initial loan.

55.6 There was no apparent commercial reason (for QvR in his capacity as a lender) to waive the subsequent loan, and Trustco did not present any commercial reason for QvR waiving the loan.

55.7 The subsequent loan was always designed to cause a benefit in Trustco's resources sector, which is where the contingent share obligation for the benefit of QvR was located.

56 Whilst the JSE believes that the subsequent loan should always have been treated and reported as an equity contribution, the contractual terms of the loan prior to the waiver mean that the recognition as a liability at March 2019 cannot be considered a clear violation of IFRS.

57 However, the waiver, a mere 9 months into a 5 year term of the loan, and without there being any commercial reason for QvR effecting the waiver, demonstrates that in substance it is additional financing provided in the form of an equity contribution from the controlling shareholder. When analysing why QvR's would possibly forgive / waive repayment of the subsequent loan, the JSE noted the following:

57.1 Trustco has not adequately demonstrated the commercial rationale for why QvR (in his capacity as lender) would forgo the receipt of capital and interest payments related to a 5 year loan a mere 9 months after the loan had been initiated without some form of compensation. Trustco suggested (in its 9 September 2020 letter) that the waiver relieved the Company of a debt burden which would have facilitated a potential initial public offering (**"IPO"**) in the future. But this is a matter that would only arise in future if, and when, an IPO was considered. There is as yet no indication of an IPO. Furthermore,

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54 The JSE applied similar reasons advanced in paragraphs 39.1; 39.3; 39.4; and 40 above with respect to economic substance over legal form in its assessment of the subsequent loan.

55 The JSE considered several factors that suggest that the substance of the subsequent loan by QvR was of an equity contribution rather than advancing a debt / liability instrument to Trustco. These include the following:

55.1 The fact that QvR appears to have been acting as a shareholder (as opposed to a lender) when waiving the subsequent loan.

55.2 The fact that the waiver of the subsequent loan led to in the issue of Trustco shares to QvR as a result of triggering the EBITDAASA earn-out clause.

55.3 The reference to the right to waive the subsequent loan in the SENS announcement of 8 October 2018 and how any waiver was to be recognised by the Trustco Group. The ability to relieve a counterparty of the obligation to repay a loan is a common right in any debt agreement and the explicit inclusion of this right is unusual. In the JSE's view, this suggests that the future waiver was predetermined.

55.4 The SENS announcement was specific as to how any 'waiver benefit' would be required to be passed down to operating segments of the Trustco Group. In the JSE's view, this also suggests that the future waiver was predetermined.

55.5 The timing of the subsequent loan. The market was informed about the subsequent loan approximately one month after the Huso acquisition was effected. The initial loan from QvR was waived by 30 September 2018. Considering the explicit inclusion of a right to

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the classification of the initial loan as a financial liability there cannot therefore be a gain (on an equity transition) as has been reflected in Trustco's 2019 AFS.

51 This is supported by the fact that the 'gain on waiver' does not meet the definition of income (per the definition in the Conceptual Framework) as it has been provided by the holder of an equity claim (QvR/majority shareholder). This principle is further embedded when considering (by analogy) IAS 32.33 which states "no gain or loss shall be recognised in profit or loss" on any dealings by a company in its own instruments.

52 In summary, the JSE viewed the BCUCC and subsequent waiver of the initial loan to be inextricably linked. This requires these two transactions to be accounted for as one transaction so as to reflect their economic substance. This differs from the view applied by Trustco, which has considered only the legal form of each transaction and accounted for each transaction separately. The JSE does not believe that the accounting treatment by Trustco results in these transactions being fairly presented.

53 In this regard, the JSE notes that IAS 1.15 explains that:

53.1 financial statements must fairly present (amongst others) the financial position and performance of an entity; and

53.2 fair presentation requires faithful representation of the effects of transactions and other events in accordance with the definitions and recognition criteria for "income" as set out in the Conceptual Framework for financial reporting, and the gain does not meet the definition of "income".

Referral 1: subsequent loan from QvR to Trustco

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48 The JSE concluded that the substance of the initial loan has always been equity and should be treated as such when accounting for the BCUCC. This would result in the inclusion of the additional shares issued in relation to the 'forgiveness of the loan' as part of the initial equity consideration given to acquire control.

49 Using figures derived from Trustco's 2019 AFS the JSE expects Trustco to have recorded the following journal entries in the Group AFS:

<u>4 September 2019 – Acquisition date</u> (N$ '000)

Dr	Net liabilities acquired *	240 410	
Dr	Common control reserve (equity)	3 197 685	
Cr	Shares issued/ to be issued		2 957 275

<u>26 September – waiver date</u> (N$ '000)

Dr	Shareholders loan	545 601	
Cr	Common control reserve (equity)		545 601

 # quantitative values are illustrative only and have not accounted for any taxation consequences

** for simplicity of illustration purposes, this balance has not been adjusted for the required reclassification of shareholder loan from liability to equity*

50 The general principle in IFRS is that equity instruments are never measured or remeasured (Conceptual Framework 6.89). On the basis that the JSE does not accept that there is substance to

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conclusion that there is no economic rationale for why QvR would unilaterally waive the initial loan without also receiving some form of compensation. The waiver also benefits minority shareholders of Trustco.

46 Trustco has argued (in its letter of 9 October 2020) that the initial loan was not part of the interests sold to Trustco (only QvR's right to equity instruments was sold to Trustco). The JSE has not (as asserted by Trustco in its letter of 9 September 2020) failed to take this into consideration. The JSE understood that QvR retained his rights to the initial loan (i.e. these rights were not sold to Trustco). It is these rights that gave QvR the ability to waive the initial loan. As discussed in paragraph 45 above, the JSE believes that it is unlikely that QvR would have waived the initial loan without also receiving some form of compensation for having done so. Trustco have asserted (Trustco letter 9 October 2020) that QvR was not subject to any 'side agreements' that would link the business combination and the subsequent waiver of the initial loan. The JSE concluded that the existence (or non-existence) of legal agreements of this nature is not relevant nor necessary in the assessment of economic substance of the transaction. Trustco's approach is premised on the legal form and not the substance of the transaction – a view that the JSE does not accept. The JSE believes that the BCUCC and the subsequent waiver of the initial loan are economically linked.

47 Before a transaction is accounted for under IFRS 9 the underlying instrument needs to be classified (by applying IAS 32 Financial Instruments: Presentation) as either a financial liability (with scope of IFRS 9) or an equity instrument. In this instance, the JSE concluded that the loan should be viewed in substance as being an equity instrument—this was its initial classification by Huso and QvR, and this is what Trustco had told the market it was in anticipation of the Huso transaction. The subsequent measurement requirements of IFRS 9 are therefore not applicable.

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loss allowed the resources segment of Trustco to recognise profits for the 2019 year (absent the gain the resources segment would have recognised a loss before tax). This triggered a portion of the EBITDASA earn-out mechanism which (in turn) lead to Trustco shares being issued to QvR under the contingent provisions of the Huso share purchase agreement.

44.2 Who initiated the transaction (IFRS 3.B50(b)). QvR is a central counterparty to the transaction (previous 100% shareholder of Huso/ controlling shareholder of Trustco; and provider of finance which he waived).

44.3 The timing of the transaction (IFRS 3.B50(c)). The loan was waived a mere 26 days after the Huso transaction was effected. No facts have been presented by Trustco to explain why the waiver took place then. Given that QvR is Trustco's CEO, Trustco ought to have provided this explanation.

45 At the time that the loan was waived, the lender/QvR/controlling shareholder owned 55% of Trustco. The existence of a significant minority interest in Trustco implies that there is economic substance to the forgiveness of the loan, as it is not likely to be done without some form of compensation. In other words, it is unlikely that QvR would have relieved Huso and thereby effectively Trustco, to the benefit of its minority shareholders of a debt obligation, without receiving some form of compensation. It seems clear that the compensation received in exchange for waiving the loan was additional Trustco shares issued in terms of the earn-out clause to the Huso acquisition. Trustco have asserted (in their letter of 9 September 2020) that the obvious 'grounds' for the initial loan to be reclassified from equity to a liability was in light of the pending transaction with Trustco so as to protect the rights of the lending shareholder relative to other shareholders. The JSE understands this 'protection' to be with reference to minority shareholders of Trustco. This adds to the JSE's

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providing guidance to determine what should or should not be part of the Huso acquisition, and this in turn goes to what the economic substance of the transaction is.

42 In the JSE's view, application of guidance in IFRS 3.B50 is appropriate in these circumstances. It is appropriate to consider the requirements of similar IFRS standards, including IFRS 3 before defaulting to UK GAAP (FRS6). This is because IAS 8.11 requires an entity (when developing an accounting policy) to consider (in descending order):

42.1 the requirements of IFRS's dealing with similar and related issues (IAS 8.11(a));

42.2 the Conceptual Framework (IAS 8.11(b); and

42.3 pronouncements of other standard-setting bodies (IAS 8.12).

43 The JSE also considered that:

43.1 UKGAAP FRS6 was withdrawn, effective 1 January 2015; and

43.2 Whilst FRS6 identified (amongst others) the transactions that would qualify for merger accounting, the standard provided no specific guidance on what is or is not considered to be part of the BCUCC. The JSE was not able to identify, and Trustco has not articulated, how the accounting would or would not have been different if FRS 6 had been (or had not been) applied.

44 In its consideration of IFRS 3.B50 the JSE noted the following:

44.1 The reasons for the transaction (IFRS 3.B50(a)). Whilst waiving the loan in his capacity as lender, QvR benefited in his capacity as shareholder to Trustco. There was no benefit to QvR in his capacity as a lender when waiving the loan. The gain recognised in profit and

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39.4 The JSE also considered the definition of income in terms of paragraph 4.68 of the Conceptual Framework, which excludes contributions from holders of equity claims from income contributions. The following facts gave rise to the JSE's conclusion that the waiver of the loan was, in substance, the action of a party acting as a shareholder and not a lender, namely that QvR is:

39.4.1 the controlling shareholder of Trustco;

39.4.2 the lender of finance to Huso; and

39.4.3 the recipient of additional Trustco shares issued when the EBITDAASA earnings-based earn out clauses of the Huso acquisition were triggered (which were directly impacted by the recognition of a gain on loan waiver)

40 As noted above, the requirement to consider the economic substance of transactions is a requirement of IFRS and was considered by the JSE in its Decision. In the JSE's view, reliance on, and reference to, the Conceptual Framework is appropriate considering the purpose of the Conceptual Framework to "*...assist all parties to understand and interpret the* (IFRS) *Standards*" (SP1.1(c), 2018). Accordingly, the JSE considered the Conceptual Framework as an interpretive aid to IFRS and existing IFRS guidance.

41 The JSE did not question the treatment of the transaction as a business combination under common control ("**BCUCC**"). The JSE accepts that BCUCC are scoped out of IFRS 3, and the JSE did not apply acquisition accounting (as set out in IFRS 3) or IFRS 3 as a whole. The JSE does not disagree with the Trustco's development of an accounting policy for the common control transaction (i.e. application of a merger-based policy in which no goodwill is recognised). Rather, the JSE's concern was in regard to what is, or is not, included in the scope of that acquisition. The JSE considered IFRS 3.B50 as

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the initial loan—to which QvR is a common counterparty) are inextricably linked and should be considered as one transaction from an accounting perspective.

39 In considering the appropriate accounting treatment that Trustco applied to the waiver of shareholder loans, the JSE considered whether recognition of a gain on waiver (in profit and loss) appropriately reflects the substance of the transactions. The requirement to consider the substance of a transaction (and not merely its legal form) is a cornerstone of IFRS and is present throughout IFRS literature. The JSE noted:

39.1 The requirement in IAS 32.15 to consider the substance of contractual arrangements (and not only the definition of a financial liability/ equity instrument) when classifying an instrument as either financial liability or equity.

39.2 The requirement in IAS 8.10(b)(ii) to develop an accounting policy that produces reliable information which identifies the economic substance of transactions and not merely the legal form. The JSE does not believe that the policy developed for the Huso acquisition (which disregards the consequences of the loan waiver) produces reliable information identifying the economic substance of the transactions.

39.3 Paragraphs 2.12 and 4.59 of the IFRS Conceptual Framework for Financial Reporting (2018) (**"the Conceptual Framework"**) which require financial statements to report the substance of the rights and obligations created by contracts. These may, in certain instances, differ from their legal form. In certain cases, a contract (or a group of contracts) may require further analysis to identify the substance of the rights and obligations inferred by those contracts.

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significant detrimental effect on the net asset value of Huso which was acquired by Trustco. If a genuine change to the terms of the loan had been made then that should have been communicated to the market, not least because QvR was the seller of Huso and the majority shareholder and CEO of Trustco.

37.7 The close proximity (26 days) of the Huso transaction (which was effective on 4 September 2018) and the alleged waiver of the loan (being 30 September 2018) is unusual. This is all the more unusual because the loan had apparently recently been reclassified as a liability loan but was now being waived. This raises questions about why the loan was reclassified in the first place. This concern is heightened by the large increase in the loan immediately before it was waived.

37.8 There was no apparent commercial reason for the loan to be waived by QvR, and Trustco did not present any commercial reason for QvR waiving the loan.

37.9 Trustco did not produce the agreement embodying the initial loan, nor did it produce the amendment to the initial loan that reclassified it as a financial liability. Trustco should have been able to produce the information because Huso is its subsidiary and the counter party to the initial loan. Whilst both the initial loan and amendment thereto pre-dated the acquisition of Huso by Trustco, Huso is a subsidiary of the Trustco Group and is expected to maintain accurate and complete accounting records (supported by appropriate underlying financial information to support those accounting records).

38 These factors raise doubt as to whether the initial loan was in substance ever a financial liability as Trustco suggests. It indicates that the two legal transactions (the Huso acquisition and the waiver of

4 September 2018 (being the related party loans balances at the acquisition date per the Trustco interim results at 30 September 2018 and note 33 of Trustco's March 2019 AFS).

37.3 Trustco's 2019 AFS state that QvR waived a loan of N$ 546m. Trustco asserted (in its 20 April 2020 letter) that the initial loan was waived on 30 September 2018 (i.e. same date as the interim reporting period end).

37.4 Furthermore, the amounts advanced by QvR in the period between 4 September 2018 and 30 September 2018 (26 days) were significant:

37.4.1 Loan balance at 4 September 2018: N$ 401.4m;

37.4.2 Loan balance 29 September 2018 (i.e. day before waiver) N$ 546m;

There was accordingly an increase in the loan of N$ 144.2m. This is more than the movement between any other period mentioned in 37.2 above. It also occurred in 26 days.

37.5 The market had been informed of the transaction in terms of which Trustco would acquire Huso on terms where the loan was an equity loan which meant that Huso did not have the liability to repay the loan. This meant the Huso was effectively worth an additional N$ 546m (being the amount of the loan that was eventually forgiven) or N$ 295.8m in terms of the 2017 circular.

37.6 Trustco alleges that the terms of the loan were amended sometime by at least December 2017 (to require repayment and therefore implying classification as a financial liability), but no announcement of the change in terms was made to the market. No announcement was made even though the amendment to the terms of loan had a

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34 After an independent assessment of the FRIP Report, Trustco's financial statements, and correspondence exchanged between the parties to date, the JSE agreed with the FRIP Report's conclusions and recommendations.

35 Accordingly, and for the purposes of the JSE's obligation to furnish reasons for the Decision in terms of section 229 of the Financial Sector Regulation Act 9 of 2017, the JSE incorporates into these reasons the contents of the FRIP Report.

36 The JSE also considered Trustco's responses to the FRIP Report's conclusions and recommendations (attached as "G"), as well as the extensive correspondence itemised above that the parties exchanged prior to the FRIP Report and prior to the Decision.

Referral 1: initial loan from QvR to Trustco

37 The loan was originally classified an equity 'loan' both in the annual financial statements of Huso and by Trustco in the proforma financial statements which reflected the effects of the Huso transaction (meaning there was no contractual obligation for Huso to repay any capital amount to QvR (IAS 32.16(a)). It was communicated by Trustco in two circulars: one dated 11 September 2015 and another dated 11 May 2017. The JSE noted:

37.1 The original Huso transaction was approved on 5 October 2015, the amended transaction was approved on 13 June 2017, but the transaction could not be effected until a mining license was issued. The effective date of the acquisition was 4 September 2018.

37.2 The loan was N$ 269.6m at 31 March 2015 (per the 2015 circular), N$ 295.8m at 30 September 2016 (per the 2017 circular) and appears to be N$ 401.4m at

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paragraph 22 above, the JSE decided to dismiss Trustco's objection. The JSE communicated its decision on Trustco's objection to Trustco in a letter dated 11 November 2020 (attached as "I").

30 In its letter dated 11 November 2020, the JSE made slight amendments to the corrective action set out in the Decision. The JSE explained the reasons for the amendments as follows:

> "The Amended Corrective Action removes reference to FRIP referral 3, requires a restatement, as opposed to a re-issue, and no longer requires the Company to publish a SENS. The JSE will publish a SENS simultaneously with the dispatch of this letter to you, informing the market of its decision pursuant to the Company's Objection, and of the Amended Corrective Action. The SENS will also provide the market with information on the restatement that JSE has decided must be implemented in the Amended Corrective Action. A copy of the SENS that will be published simultaneously with the dispatch of this letter to you is attached hereto as annexure 'B'."

31 On 11 December 2020, Trustco's attorneys noted Trustco's intention to apply to the Financial Services Tribunal for a reconsideration of the Decision and requested reasons for the Decision.

Reasons for the Decision

32 The Decision was based on the JSE's consideration of the facts that Trustco had provided to the JSE in the correspondence and the oral presentation, the conclusions and recommendations in the FRIP Report, and Trustco's responses to the FRIP Report.

33 The FRIP is an expert advisory body. Given the FRIP's expertise, the JSE acted reasonably and rationally in considering, and attaching weight to, the FRIP's conclusions and recommendations.

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4. Reversing the N$1bn gain previously recognised in profit and loss and accounting for this as a transaction with an equity participant i.e. recognising the credit directly in equity (referral 1).

The restatement (in both the AFS and interims) must be identified as prior period errors and you must explain that they are made on instruction by the JSE following a proactive monitoring review of Trustco's AFS which also involved a referral to the Financial Reporting Investigations Panel.

Publish a SENS announcement containing the information set out in A and B above as soon as possible but by no later than close of business on Tuesday 20 October 2020."

26 The JSE communicated the Decision to Trustco in a letter dated 16 October 2020 (attached as "A").

27 In letters dated 20 October 2020 (two letters were sent on 20 October 2020), 21 October 2020, 27 October 2020, and 2 November 2020, Trustco objected to the Decision in terms of paragraph 1.4 of the Listing Requirements (copies of these letters are attached as "H").

28 Trustco objected to all aspects of the Decision. Nonetheless, in its audited interim results for the 12 months ended 31 March 2020, published on SENS on 2 November 2020, Trustco effected a restatement in respect of a prior period error to sales of unserviced land. This was the issue dealt with in paragraph A3 of the Decision (and referred to as Referral 3 in the FRIP Report). Trustco's restatement in this regard makes this aspect of the Decision moot.

29 After considering Trustco's submissions in its objection letters and an oral presentation to the JSE on 30 September 2020 and 2 October 2020 which was later recorded in writing, as set out in

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24.2 Trustco's unaudited interim results for the six-month period ended 31 September 2019 do not comply with IFRS in that Trustco recognised a N$1 billion gain in profit and loss with respect to the waiver by QvR of the subsequent loan.

25 Based on those findings, the JSE ordered Trustco to take the following corrective action which corrective action is necessary and appropriate to ensure that Trustco's financial information comply with IFRS.

"The JSE therefore instructs Trustco to:

A. Re-issue the Group AFS for the year ended 31 March 2019 making the following corrections:

1. Reversing the N$545.6m gain previously recognised in profit and loss and recognising this 'credit amount' to reduce the common control reserve initially recognised in equity as a result of the Huso acquisition (referral 1);

2. Reversing the reclassification of the Elisenheim properties (incorrectly reclassified to investment properties) and consequently reversing the N$693m gain (presented as revenue of N$984m and cost of sales of N$91m) from profit and loss (referral 2); and

3. Reversing revenue recognised on the sale of all unserviced land (for property developments) where bulk services have not yet been installed on such unserviced land (referral 3).

B. Re-issue the interim results for the 6 months ended 31 September 2019 making the following corrections:

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arguments presented in oral representations in writing. Trustco did so in its letter of 9 October 2020. Both the 9 September 2020 and 9 October 2020 letter (and their accompanying appendices) were shared (by the FRIP chairperson) with the review committee of the FRIP. The review committee of the FRIP considered these and advised the JSE that they were unanimous in their view that there is no additional information or IFRS arguments or facts that did, or could, change the FRIP's views and position as set out in in the FRIP report.

23 It is evident from this timeline that the JSE gave Trustco ample opportunities to make representations. It is similarly evident that the JSE gave due consideration to Trustco's response to the FRIP report dated 9 September 2020 and subsequent IFRS arguments and information provided by Trustco in its letter of 9 October 2020 prior to the JSE making the Decision.

24 The JSE decided that Trustco has not complied with IFRS in the following respects:

24.1 Trustco's 2019 AFS do not comply with IFRS in that Trustco:

24.1.1 recognised a N$545.6 million gain in profit and loss with respect to the waiver by QvR of the initial loan (Referral 1 in the FRIP Report);

24.1.2 reclassified certain properties in the Elisenheim development from inventory to investment property and thereby recognising a N$693 million gain (presented as revenue of N$984 million and cost of sales of N$91 million) in profit and loss (Referral 2 in the FRIP Report); and

24.1.3 recognised revenue on the sale of unserviced land at the time that the purchaser signs the purchase agreement (Referral 3 in the FRIP Report).

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addition to the extensive correspondence listed in paragraph 11, the following correspondence was exchanged:

21.1 JSE letter dated 7 July 2020;

21.2 JSE letter dated 7 August 2020;

21.3 Trustco letter (signed by QvR) dated 18 August 2020;

21.4 JSE letter dated 20 August 2020;

21.5 Trustco response dated 20 August 2020;

21.6 JSE letter dated 24 August 2020;

21.7 JSE letter dated 26 August 2020;

21.8 two Trustco responses (both dated 9 September 2020);

21.9 JSE letter dated 23 September 2020;

21.10 JSE letter dated 29 September 2020;

21.11 Trustco response dated 9 October 2020; and

21.12 JSE letter dated 14 October 2020.

22 Trustco also requested an opportunity to make oral representations to the JSE. For this purpose, meetings were held on 30 September 2020 and 2 October 2020 between representatives from the JSE, the FRIP chairperson, representatives of Trustco and its IFRs advisor (W Consulting). Subsequent to the oral representations, the JSE asked Trustco to commit any additional information and

JOSIAS ANDRIES AGENBACH
NOTARY PUBLIC
REPUBLIC OF NAMIBIA

Email: John.Bell@bakermckenzie.com
Wian.Steyn@bakermckenzie.com
Ref: J Bell/W Steyn/LS/50274781

TO: **FINANCIAL SERVICES TRIBUNAL**
Kasteel Office Park
Orange Building (2nd Floor)
546 Jochemus Street
Erasmuskloof
Pretoria
0048
Tel: 012 741 4300
Email: Applications@fstribunal.co.za

AND TO: **WEBBER WENTZEL**
Attorneys for the Respondent
90 Rivonia Road
Sandton, Johannesburg
2196
Tel: +27 (0) 73 229 2280
Email: Michael.Straeuli@webberwentzel.com
Prathik.Mohanlall@webberwentzel.com
Dominic.Harris@webberwentzel.com
Naseeha.Bham@webberwentzel.com
Ref: M Straeuli/P Mohanlall/D Harris/3043858

JOSIAS ANDRIES AGENBACH
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ANNEXURE X-2

GROUNDS FOR APPLICATION FOR RECONSIDERATION IN TERMS OF SECTION 230 OF THE FINANCIAL SECTOR REGULATION ACT, 2017

INTRODUCTION

1 Trustco Group Holdings Limited (the applicant in this matter) ("**Trustco**") is a Namibian company listed on the JSE Limited ("**JSE**") and the Namibian Stock Exchange.

2 The JSE is the respondent in this matter.

3 Trustco hereby sets out the grounds on which it relies in support of this application for reconsideration in terms of section 230 of the Financial Sector Regulation Act, 2017 ("**Act**").

BACKGROUND

4 On 5 December 2019, the JSE informed Trustco that it had been selected for review under the JSE's proactive monitoring review process. The Trustco financials subject to the review were the:

4.1 group annual financial statements for the year ending 31 March 2019 ("**the Group AFS**");[1] and

4.2 interim results for the six months ending 31 August 2018.

[1] https://www.tgh.na/wp-content/uploads/2019/07/TGH-ANNUAL-FINANCIAL-STATEMENTS-JUNE-2019-Final-1.pdf

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5 The JSE raised five concerns in respect of the Group AFS and the interim results for the six months ending 31 August 2018. Having identified these concerns, the JSE called for an explanation from Trustco.

6 Between February and July 2020, Trustco corresponded extensively with the JSE in a bid to address the concerns raised. In so doing, Trustco engaged with the two independent audit firms, one South African and one Namibian, that had signed the Group AFS. These audit firms confirm that, in issuing unqualified / unmodified audit reports, they had engaged with specialist advisors to ensure full and proper compliance with the International Financial Reporting Standards ("**IFRS**").

7 The correspondence referred to above is attached hereto as "**A1**" to "**A8**".

8 After considering Trustco's responses to the five concerns initially raised, the JSE notified Trustco that it had referred just three of the initial concerns to the Financial Reporting Investigations Panel ("**FRIP**"). The three issues referred to the FRIP concern:

8.1 Trustco's financial treatment of loans advanced by Dr Quinton van Rooyen ("**Dr van Rooyen**") – the CEO and majority shareholder of Trustco – to:

8.1.1 an entity called Huso Investments (Pty) Ltd ("**Huso Investments**"); and

8.1.2 to Trustco in respect of the Related Party Loan Agreement (as defined below) – a loan agreement for an amount of up to NAD

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1 billion to deleverage Trustco's balance sheet and support the Resources Segment ("**Related Party Loan**"),

("**the Loan Issue**");

8.2 Trustco's reclassification of property that forms part of the Elisenheim property development ("**the Property Issue**"); and

8.3 Trustco's decision to recognise revenue on a sale of land as at the sale agreement signature date ("**the Revenue Recognition Issue**").

9 On 7 August 2020, the JSE wrote to Trustco, informing it that it had received a report from the FRIP ("**the FRIP Report**"). The letter summarised the FRIP investigation findings which, in sum, disagreed with the Trustco's accounting treatment in respect of each of the three issues referred to it. The JSE's letter is attached hereto as **"A9"**.

10 Trustco requested the JSE's referral to the FRIP as well as the FRIP Report. Both were provided to Trustco on 26 August 2020, copies of which are attached respectively as "**B**", "**B1**" and "**B2**".

11 On 9 September 2020, Trustco responded to the JSE's letter disputing, with full and detailed motivation, the FRIP's IFRS interpretation and application. Trustco also sought an opportunity to present its motivations and explanations at a meeting with the FRIP. A copy of this letter is attached as "**C**".

12 Trustco's request was granted and, on 2 October 2020, its representatives met with the JSE and the Chairperson of the FRIP. Having heard Trustco's accounting treatment motivation and explanations, the FRIP Chairperson

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requested that the additional explanations be submitted to her in writing, together with further information that was required by the FRIP.

13 Trustco duly complied with each of the FRIP Chairperson's requests.

14 On 16 October 2020, Trustco received the JSE's initial decision (attached as "**D**"), in which it was decided that Trustco's accounting treatment was incorrect and prescribing various corrective action that Trustco must take. Trustco objected to the determination on 20 October 2020, which objection is attached as "**E1**".

15 After receipt of Trustco's objection, the JSE issued an amended decision on 11 November 2020 (attached as "**E2**") in which it:

15.1 found that the Group AFS were not compliant with IFRS because they:

15.1.1 classified a loan by Dr van Rooyen to Huso Investments as a financial liability, the waiver of which was recognised as a gain in profit and loss; and

15.1.2 reclassified certain properties in the Elisenheim development from inventory to investment property, which resulted in a gain in profit and loss;

15.2 required Trustco to restate the Group AFS by:

15.2.1 reversing the gain in respect of the Huso Investments loan and instead recognising the amount directly in equity; and

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15.2.2 reversing the Elisenheim property reclassification and the resultant gain in profit and loss;

15.3 found that the interim results for the year ending 30 September 2019 were not compliant with IFRS because they classified the Related Party Loan by Dr van Rooyen as a financial liability, the waiver of which was recognised as a gain in profit and loss;

15.4 required Trustco to restate the interim results for the year ending 30 September 2019 by reversing the gain in respect of the Related Party Loan and instead recognising the amount directly in equity; and

15.5 required that the restatement of the Group AFS and interim results for the six month period ending 30 September 2019 be effected in accordance with paragraphs 42 and 49 of IAS 8.

16 On 11 December 2020, Trustco requested reasons for the JSE's decision (attached as "**F**"). The JSE's reasons in terms of section 229 of the Act were received on 11 January 2021 (attached without its lengthy annexures as "**G1**" and "**G2**").

17 The Revenue Recognition Issue was rectified by Trustco. Accordingly, the Revenue Recognition issue is not detailed herein as Trustco's reconsideration application concerns only the JSE's decisions in respect of the Loan Issue and the Property Issue.

THE LOAN ISSUE

18 As set out above, the Loan Issue is divided into two parts:

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18.1 a loan of NAD 546 million made up as follows: (i) a loan of NAD 204 million to Huso Investments; (ii) a loan of NAD 121 million to Trustco Resources (Pty) Ltd ("**Trustco Resources**"); (iii) a loan of NAD 42 million to Morse Investments (Pty) Ltd ("**Morse**") (subsidiary of Huso Investments); and a loan of NAD 179 million to Northern Namibia Development Company (Pty) Ltd ("**NNDC**") (subsidiary of Huso Investments); and

18.2 a loan to Trustco in respect of the Related Party Loan.

The Huso Investments Loan

19 Dr van Rooyen is the majority shareholder of Trustco. Dr van Rooyen was also the sole shareholder of Huso Investments. In order to fund Huso Investments' operations, Dr van Rooyen advanced NAD 546 million to Trustco Resources and Huso Investments and its subsidiaries over a period of time ("**the Huso Loan**"). While Dr van Rooyen was the sole shareholder of Huso Investments, the two loans to Huso Investments (NAD 204 million) and NNDC (NAD 179 million) were structured so that their repayment was entirely within the discretion of Huso Investments and NNDC. Given the repayment terms, the loans were recorded as equity loans by Dr van Rooyen in the books of Huso Investments and NNDC.

20 During 2015, Trustco engaged in a transaction to acquire Huso Investments through its subsidiary Trustco Resources ("**the Huso Transaction**"). The terms of the Huso Transaction were recorded in a sale of shares agreement (which excluded any loans) which is attached hereto as "**H2**" ("**the Huso Share Purchase Agreement**").

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21 On 11 September 2015, Trustco issued a circular to its shareholders to approve the Huso Transaction (**"the First Circular"**). A copy of the First Circular is attached hereto as "**H1**". The First Circular records the structure of the Huso Transaction in the following terms:

21.1 Trustco, through Trustco Resources, would acquire the entire shareholding in Huso Investments from Dr van Rooyen;

21.2 the effective date of the Huso Transaction was 30 September 2015;

21.3 the agreement was be subject to certain conditions precedent, in particular, that:

21.3.1 Morse and NNDC (subsidiaries of Huso Investments), hold all licences required for its operations, including a diamond cutting and polishing license;

21.3.2 a mining license is issued to NNDC; and

21.3.3 Morse receives Export Processing Zone status;

21.4 the purchase consideration in respect of the Huso Transaction was NAD 3,621,149,000, payable to Dr van Rooyen by an issue of no more than 772.1 million Trustco shares at a price of NAD 4.69 per share;

21.5 the purchase consideration was to be settled by means of:

21.5.1 an initial amount of NAD 672 million by the issue of 143.3 million Trustco shares at an issue price of NAD 4.69 per share;

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21.5.2 the balance of the purchase consideration, amounting to NAD 2,949,149,000, by the issue of no more than 628,800,000 shares at a price of NAD 4.69 per share, over a nine year period and determined:

21.5.2.1 with reference to Huso Investments and Morse achieving certain annual EBITDAASA targets in each respective year; and

21.5.2.2 an additional payment in the form of a maximum of 461.5 million Trustco shares at an issue price of NAD 4.69 per share if, at any time during the nine year period following the closing date, the Mineral Resource (as defined) is in excess of 1.5 million carats.

22 The shareholders of Trustco approved the Huso Transaction and voted in favour of it at a meeting held on 5 October 2015. Importantly, as the Huso Transaction constituted a 'related party transaction' under the JSE Listing Requirements, Dr van Rooyen did not vote in respect of it. A SENS announcement confirming the Huso Transaction approval is attached hereto as "**H3**".

23 At this point, two important considerations should be borne in mind:

23.1 as the name of the Huso Share Purchase Agreement suggests, only Dr van Rooyen's shareholding was acquired by Trustco. The Huso Loan was not affected by the Huso Transaction. Accordingly, the initial accounting treatment of the Huso Loan, as an equity loan, was not altered; and

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23.2 as the SENS announcement makes plain, the Huso Transaction was effective only upon fulfilment of the conditions precedent, which then remained unfulfilled.

24 Due to a delay in obtaining the requisite mining licences, and thus fulfilment of the Huso Transaction suspensive conditions, a change in the structure of the Huso Transaction was proposed through an addendum to the Share Purchase Agreement (attached as "**H4**"). In order to affect the change, a second circular was issued to Trustco's shareholders ("**the Second Circular**"). A copy of the Second Circular is attached hereto marked "**H5**". It details, *inter alia*, that:

24.1 Morse obtained export processing zone status in December 2015;

24.2 as at the Last Practicable Date the transaction was still subject to NNDC obtaining a mining license. This was believed to be imminent and, once obtained, control of Huso Investments, NNDC and Morse would transfer to Trustco Resources; and

24.3 the purchase consideration would be completely determined by specific financial performance targets (i.e. EBITDAASA) rather than a portion of the consideration being settled upon the Mineral Resource exceeding the Initial Resource Estimate by 1.5 million carats.

25 The addendum to the Share Purchase Agreement was approved by Trustco's shareholders on 13 June 2017. Again, as a 'related party transaction' under the JSE Listing Requirements, Dr van Rooyen did not vote in respect of the addendum approval. A SENS announcement confirming shareholder approval of the addendum is attached as "**H6**".

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26 During March 2018, the terms of the Huso Loan were changed by a resolution of directors of Huso Investments and NNDC (attached as "**H7.1**" and "**H7.2**" respectively). Notably, repayment was no longer at the discretion of Huso Investments, but was due within the following twelve month period. As a result of this change, the accounting treatment of the Huso Loan changed in the books of Huso Investments from equity to a liability.

27 The Huso Transaction subsequently became effective and the shares of Huso Investments acquired by Trustco Resources and, in turn, Trustco. The transaction was accordingly reflected in the preparation of Trustco's Group AFS. In so doing, Trustco merely recorded the Huso Loan as it had been reflected in the books and records of Huso Investments as at the acquisition date: a financial liability.

28 On 30 September 2018, Dr van Rooyen elected to waive repayment of the Huso Loan, made up, at that date, by the NNDC loan of NAD 174 million and the Morse loan of NAD 42 million thereby relieving NNDC and Morse of their financial liability on their books. Upon forgiveness of the these loans, the liabilities of these two companies (and Trustco in turn) were reduced by NAD 216 million. It is reiterated that Dr van Rooyen's decision to waive the loan was not contemplated by any party to the Huso Transaction either prior to or after the acquisition. Indeed, the first time that it was considered by the Board was when Dr van Rooyen offered the waiver in September 2018.

Trustco's accounting treatment of the Huso Transaction

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29 IFRS 3 does not apply to the Huso Transaction. This as it falls within the 'combination of business or business under common control' exclusion created by paragraph 2(c) read with B1 of IFRS 3.

30 Given the inapplicability of IFRS 3, there is no IFRS standard to apply to the common control business combination. Accordingly, in the absence of an applicable accounting standard, Trustco was required to formulate its own accounting policy. IAS 8 provides guidelines for accounting policy formulation by "...prescrib[ing] the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors."

31 Of particular relevance are paragraphs 10 to 12 of IAS 8.[2] In sum, they prescribe a three tiered approach that requires:

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[2] *10 In the absence of an IFRS 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 statement
(i) represents faithfully the financial position, financial performance and cash flows of the entity
(ii) reflect the economic substance of transactions, other events and condition and not merely the legal form
(iii) are neutral, i.e. 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 in IFRS dealing with similar and related issues; and
(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework for Financial Reporting (Conceptual 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

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31.1 first, a consideration of accounting standards that are similar in substance to the nature and circumstance of the transaction in question;

31.2 second, where there is no similar accounting standard, consideration of the Conceptual Framework; and

31.3 finally, if the Conceptual Framework does not give appropriate guidance, consideration of the treatment of other Accounting Standard setters of similar transactions.

32 It is notable that IAS 8 does not oblige a company to follow or adopt a particular standard, but merely guides the judgment of its management in making a decision. By its very nature, the selection of accounting policy in terms of IAS 8.10 – 8.12 differs in every company as the decision is affected by the subjective judgment of its particular management.

33 This particular area of business combinations under common control is a well-known example of differing accounting policies adopted across entities. The International Accounting Standards Board ("**IASB**") has commented on the widely known and accepted consequence as follows:[3]

> *"As a result of this gap in IFRS Standards, companies report similar business combinations in different ways… This diversity in practice makes it difficult for investors to understand the effects of such transactions on companies that*

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[3] https://www.ifrs.org/news-and-events/2020/11/iasb-consults-on-possible-new-accounting-requirements-for-mergers-and-acquisitions-within-a-group/; https://cdn.ifrs.org/-/media/project/business-combinations-under-common-control/factsheet-dp-bcucc-nov-2020.pdf

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undertake them and to compare companies that undertake similar transactions."

34 The IASB commenced the process of developing an accounting standard to address common control transaction from as far back as December 2007, but to date it has not managed to bring that process to finality.

35 In formulating its own policy in accordance with IAS 8, Trustco:

35.1 initially looked to IFRS 3 to determine whether, despite the explicit scope exclusion for common control business combinations, there might be aspects thereof that could be used in formulating a new policy. The requirement of IAS 8 in this regard is to consider the applicability of standards dealing with similar or related issues, IFRS 3 states explicitly and without exception to certain parts thereof, that common control business combinations should not be accounted for in terms of the accounting policies set out therein. The very basis of the IFRS 3 scope exclusion for common control business combinations is that common control business combinations are in fact not similar to other business combinations that are within the scope of IFRS 3. As such, in the judgment of Trustco management, IFRS 3 is not a standard that deals with similar issues or related issues and for this reason it did not inform the policy ultimately developed;

35.2 then looked at the Accounting Framework but found no relevant guidance with respect to a complex transaction such as a business combination, let alone a common control business combination; and

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35.3 thereafter considered other sources of guidance from other standard setters. Having considered numerous sources, Trustco eventually found guidance in the UK FRS 6 (since repealed and replaced). This standard, dealing with amalgamations, was found by Trustco management to be the most apt in the circumstances and so formed the basis of Truscto's policy development.

36 Having identified an applicable standard set by a recognised body, Trustco, together with its auditors and IFRS advisors, developed what management deemed to be an appropriate policy to deal with this peculiar and novel transaction.

37 Notably, the Trustco Group had previously developed an accounting policy for common control transactions when FSR6 was the most recent pronouncement from the standard setter in question. This in relation to a prior transaction that occurred some time prior to the Huso Transaction. Given the commonality between that transaction and certain elements of the Huso Transaction, the board considered the self-same accounting policy to be appropriate in the circumstances.

38 The Group AFS set out in detail the accounting policy developed by Truscto's management to account for common control transactions and how it was formulated.

39 Applying the policy, the Huso Transaction was then accounted for in Trustco's records at the time of the transaction as follows:

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TGH - Company		
Loan account - Trustco Business Developments PL	DR	2,957,275,448.91
Share capital	CR	(672,077,000.00)
Shares for vendors	CR	(2,285,198,448.91)
Being issue of shares for the Huso Transaction		

Trustco Business Developments PL		
Loan account - Trustco Group Holdings Ltd	CR	(2,957,275,448.91)
Loan account - Trustco Resources PL	DR	2,957,275,448.91
Being loan on the purchase of Huso Group		

Trustco Resources PL		
Investment in subsidiary	DR	2,957,275,448.91
Loan account - Trustco Business Developments PL	CR	(2,957,275,448.91)
Being investment in Huso Group		

Consolidation Entry		
Share capital	DR	100.00
Equity loan	DR	-
Retained income	CR	(240,409,232.97)
Investment in subsidiary	CR	(2,957,275,448.91)
Common control Reserve	DR	3,197,684,581.88
Being eliminating of investment in Huso		

Share capital	DR	200.00
Retained income	DR	203,975,749.00
Deferred taxation	DR	100,465,716.00
Investment in subsidiary	CR	(304,441,665.00)
Being eliminating of investment in NNDC & Morse		

40 Once the Huso Loan was waived, Trustco looked to IFRS 9 in determining how best to account for it. Paragraphs 3.3.1 and 3.3.3 of IFRS 9 provide that:

> *"3.3.1 An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—i.e. when the obligation specified in the contract is discharged or cancelled or expires."*

> *"3.3.3 The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid including any non-cash assets*

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transferred or liabilities assumed, shall be recognised in profit and loss."

41 Trustco applied IFRS 9 to the letter and, in so doing, reflected the waiver of the Huso Loan as a net gain in profit and loss.

The flaw in the JSE's treatment of the Huso Transaction

42 From the JSE's reasons, it is apparent that it considers the Huso Loan reclassification by Huso Investments and Dr van Rooyen's subsequent waiver as part and parcel of the Huso Transaction. The JSE considers that the Huso Loan was never a financial liability but an equity loan never to be repaid. This view is premised on the following factors:

42.1 the common interest that Dr van Rooyen has as acting as both a shareholder and lender;

42.2 the timing of the reclassification and waiver;

42.3 no communication of the reclassification having been communicated to the market; and

42.4 the JSE's view that Dr van Rooyen would not have waived the loan without receiving some sort of compensation in the form of Trustco shares.

43 The JSE's agenda forms the basis of its incorrect treatment of each aspect of the issue. The JSE's misplaced view fails to distinguish the loan transactions (i.e. the reclassification and waiver) from the acquisition of Huso Investment's shares.

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The correct position, it is submitted, is to treat the Huso Loan reclassification, waiver, and acquisition transaction as separate and distinct transactions. Cognisance should in this regard be taken of the following:

43.1 the Huso Loan reclassification occurred prior to the acquisition of Huso Investments by Trustco. Therefore, its classification and reclassification prior to the date of acquisition by Trustco is of no accounting relevance to the reporting of Trustco as it did not then form part of the Trustco group. The objective of reporting a business combination is to determine an acquisition balance sheet (statement of financial position) showing the net asset (assets and liabilities) acquired by the acquirer, based on the facts and circumstances at the acquisition date (which, in this case, was 4 September 2018). As at the acquisition date, the Huso Loan was a financial liability in the accounting records of Huso Investments, as it had a non-discretionary obligation to repay to Dr van Rooyen. Given the fact of this liability in the books of Huso Investments, it was recorded as a financial liability of the Group AFS;

43.2 the Huso Transaction, as demonstrated by the Huso Share Purchase Agreement and the First and Second Circulars, never included a transfer of Dr van Rooyen's interest in the Huso Loan (irrespective of its classification) to Trustco. The accounting treatment applied by the JSE ignores the Huso Loan retention fact and effectively requires the Huso Loan to be recognised as a transfer of Dr van Rooyen's loan asset to Trustco;

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43.3 a business combination transaction occurs on the date on which the acquirer obtains control of the company. In this instance, the business combination preceded the date of Dr van Rooyen's waiver; and

43.4 using hindsight – which is specifically prohibited by IFRS 9 – the JSE links the Huso Transaction and the loan waiver which occurred 26 days later. IFRS 9 requires the classification of financial instruments to be determined at the date on which the entity becomes a party to the contractual provisions thereof. As at the date of the Huso Transaction, Huso Investments recognised the Huso Loan as a financial liability. Rightly classified, Trustco accounted for it in the same manner.

Conclusion in respect of the Huso Transaction

44 Properly applying the relevant accounting standards, as Trustco has, the rise in profit and loss was not as a result of the Huso Transaction, but in consequence of the separate and distinct Huso Loan waiver which occurred thereafter.

45 The reclassification of the Huso Loan was effected by Huso Investments before the Huso Transaction became effective. In the records of Huso Investments, the Huso Loan was classified as a financial liability and thus properly recorded as such in Trustco's accounts after the Huso Transaction.

46 The JSE's awkward application of aspects of IFRS 3, in circumstances where that standard is specifically excluded, gives rise to its strained conclusion. It is particularly strained as, rather than take issue with the application of IAS 8 by Trustco, the JSE instead takes issue with the result. It then attempts to impose a

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certain and definite criteria where IAS 8 provides for the flexible process informed by managerial discretion. If that was the intention of the accounting standards, a definite standard would be present in IFRS. There is not and so Trustco's application of IAS 8 cannot be faulted.

The Meya Acquisition and the Related Party Loan

47 On 23 August 2016, Trustco announced the acquisition by Trustco Resources of a 51% shareholding interest in Meya Mining (Mauritius) ("**Meya**") from Germinate Sierra Leone Limited ("**Germinate**") ("**Meya Acquisition**").

48 The purchase price in respect of the Meya Acquisition was:

48.1 USD 1 million plus a USD 500,000 exclusivity fee; and

48.2 USD 25 million cash payment should the work program yield results by proving a minimum resource statement of 3 million carats or a resource of USD 1 billion ("**Hurdle Payment**").

49 Trustco Resources also had the option to increase its shareholding in Meya to 60% for a cash consideration of USD 20 million ("**Option Payment**").

50 On 8 October 2018, Trustco concluded a loan agreement ("**the Related Party Loan Agreement**") with Van Rooyen through the investment vehicle, Next Investments (Pty) Ltd ("**Next**") (together "**the Lender**"). A copy of the Related Party Loan Agreement is attached as "**I1**".

51 In terms of the Related Party Loan Agreement:

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51.1 the Lender would provide a loan facility of a maximum amount of up to NAD 1 billion ("**the Related Party Loan**") - the actual amount to be advanced would depend on Trustco's growth capital requirements;

51.2 the Related Party Loan would be unsecured and sub-ordinated;

51.3 the Related Party Loan would be advanced as and when it becomes available;

51.4 interest would accrue on the Related Party Loan and charged monthly in arrears;

51.5 the Related Party Loan is repayable on 31 March 2024;

51.6 the Lender was afforded a conversion option right in lieu of capital payments. This entailed the conversion of capital into Trustco shares at specific option dates at a specific conversion price ("**Conversion Option**"); and

51.7 the Lender has the right and may elect to postpone or write-off any portion of the Related Party Loan.

52 On 14 December 2018, Trustco issued a circular to its shareholders regarding:

52.1 the Related Party Loan Agreement, which was recorded as "a related party transaction"; and

52.2 the Conversion Option as a potential mechanism for the redemption of the Related Party Loan,

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("**the Related Party Loan Circular**").

53 Salient aspects of the Related Party Loan Circular are the following:

53.1 the Lender shall raise the requisite funding via the disposal of a portion of its Trustco shares if Shareholders elect to approve the Loan Transaction (paragraph 2.1.1);

53.2 the Loan is earmarked to be deployed for the growth through the Trustco of companies but primarily in the resources segment to continue development of the Meya Project (paragraph 2.2);

53.3 the recorded rationale of the transaction (paragraph 2.3) that:

> *"The sale of a portion of the Lender's equity and entering into a subsequent Loan Agreement with the Lender will not have the immediate effect of further dilution for existing shareholders in Trustco. Shareholders will only be diluted if the Lender elects to exercise its Conversion Option.*
>
> *The sale of a portion of the lender's equity in Trustco Shares will improve liquidity and the free float of the Trustco Shares in the market."*

54 The Related Party Loan Circular was issued and a general meeting of shareholders was called in compliance with section 10 of the JSE Listing Requirements. On 22 January 2019, the shareholders approved the Related Party Loan and Conversion Option detailed in the Related Party Loan Agreement. The minutes of the Trustco General Meeting in this regard is

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attached as "**I2**". Again, it is important to note that Dr van Rooyen and his associates did not vote on the Related Party Loan Circular.

55 Between 15 February 2019 and 5 March 2019, Dr van Rooyen sold a number of his Trustco shares in the market.

56 On 28 March 2019, Trustco decided to increase its shareholding in Meya but, instead of making payment in cash as contemplated by the Option Payment, it was decided that Germinate would take up Trustco shares *in lieu* of the cash payment. The Trustco board approved the Hurdle Payment, the Option Payment (albeit through the taking up of Trustco shares) and the acquisition of a further 5% shareholding in Meya.

57 Instead of Trustco issuing shares to Germinate, on 29 March 2019, Dr van Rooyen sold 30,208,33 of his Trustco shares to Germinate at a price of ZAR 9.60 per share, thereby in effect settling Trustco Resources' payment obligation to Germinate ("**Revised Payment Mechanism**"). This Revised Payment Mechanism constituted a drawdown under the Related Party Loan in that Trustco owed Dr van Rooyen the value of the placement.

58 On 2 April 2019, Trustco issued a SENS announcement (attached as "**I3**") confirming the above securities transfers and further confirmed that:

58.1 the final share placements took place on 29 March 2019 whereby the "related party loan program" was concluded;

58.2 the related party loan program is oversubscribed by NAD 269,641,529.45, which oversubscribed portion will be provided as a loan

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on normal commercial terms and used in the ordinary course of business for the benefit of the Group; and

58.3 the related party loan program which is subject to a convertible option will be limited to NAD 1 billion.

59 On 14 October 2019, a SENS announcement (attached as "**I4**") confirmed that the Lender had elected to write off the Related Party Loan of an amount of up to NAD 1 billion.

Trustco's accounting treatment of the Related Party Loan waiver

60 As it was a term of the Related Party Loan Agreement that the Loan was repayable, albeit with provisions for repayment waiver, the Related Party Loan was recognised as a financial liability. This accounting treatment accords with IAS 32 and the JSE does not take issue with it.

61 IFRS 9 provides that the carrying amount of a liability, which is to be derecognised following its waiver, must be recognised in profit and loss as a gain. After the Related Party Loan was waived by Dr van Rooyen, Trustco followed the exact requirements of IFRS and reflected a gain to profit and loss.

The flaw in the JSE's treatment of the Related Party Loan

62 The essence of the JSE's concern with the Related Party Loan is that a transaction with a shareholder should not give rise to profit and loss. This assertion is not supported by any accounting standard, but is purportedly based on the provisions of the Conceptual Framework.

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63 The Conceptual Framework does not amount to an accounting standard, nor does it override applicable accounting standards. Paragraph SP1.2 is unequivocal in this regard:

> *"The Conceptual Framework is not a Standard. Nothing in the Conceptual Framework overrides any Standard or any requirement in that Standard."*

64 It is only when IFRS does not have an appropriate standard, as in the case of the Huso Loan above, that guidance can be taken, if appropriate, from the Conceptual Framework.[4] Contrary to this founding principle, the JSE inexplicably seeks to elevate the framework over a specific and pointed accounting standard.

65 While the FRIP Report confirms that the Related Party Loan is a financial liability; that its recognition as such is not "conclusively incorrect" and that waiver in the ordinary course is uncontentious, it seemingly takes issue only because the waiver was made by Dr van Rooyen. It asserts that, in the circumstance, the waiver should be viewed as that of a shareholder and not a lender. This contorted approach permits its interpretation of the Related Party Loan as an equity contribution. The JSE's attempted justification cites the following factors:

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[4] Paragraph SP1.1 stipulates that:
"The purpose of the Conceptual Framework is to:
(a) assist the International Accounting Standards Board (Board) to develop IFRS Standards (Standards) that are based on consistent concepts;
(b) assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy; and
(c) assist all parties to understand and interpret the Standards."

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65.1 that Dr van Rooyen always had the right to waive the Related Party Loan and how the waiver should be recognised gives rise to the inference that the waiver was predetermined;

65.2 linkage - in that the terms of the loan agreement stipulates that the impact of the waiver or conversion was to be recognised in the operating segment to which the financing has been on-lent. Insofar as the financing was provided to the resources segment this linked to the contingent equity (EBITDAASA) consideration for the Huso Transaction if certain earnings targets were met; and

65.3 the fact that there appears to be no commercial reason for the waiver from a lender's perspective.

66 However, having accepted the correctness of the Related Party Loan recordal as a financial liability, the subsequent attempt to force it into the box of an equity contribution is an obvious contrivance.

67 The JSE's insistence, without any substantiation, that the Related Party Loan waiver amounts to a debt/equity swap is premised on the notion of it "being common" for a majority shareholder to convert debt to equity if a company is over-indebted. With respect, this approach is wholly inappropriate and misplaced as it seeks to attach significant weight to assumptions and common notions than to the case specific facts. Contrary to the JSE's contentions in paragraph 65 above:

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67.1 the Huso Transaction became effective on 4 September 2018 after fulfilment of the suspensive conditions relating to mining licenses. Trustco had no control over the issue of the licences and the Huso Transaction had been approved more than three years earlier;

67.2 if the waiver was predetermined, there needn't have been a contractual provision in the Related Party Loan providing for it;

67.3 regarding linkage, Trustco's Integrated Report for the period ending 31 March 2019 made clear the purpose of the Related Party Loan and why it was being directed at that particular segment. In this regard, the JSE:

67.3.1 honed in on the particular settlement mechanisms without looking at it at the time when the Related Party Loan Agreement was concluded or considering how, if at all, any other alternatives for settling the Related Party Loan weighed on its determination;

67.3.2 interpretation can only be sustainable if it conclusively determines that the Resources Segment strategy was predestined, if not predetermined to fail commercially, and that it would rely perpetually on loan waivers to achieve the EBITDAASA targets. There are no facts which would support such a conclusion particularly mindful that Trustco has a 9 year earn-out period ending 2027, without relying on any continuous loan waiver requirements or assumptions.

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68 The extent of the JSE's strain in forcing an interpretation suitable to it is evinced by its concession that the Related Party Loan transaction falls outside of IFRIC 19 but then, without explanation, asserting that IFRIC 19 should guide Trustco's accounting treatment. As Trustco informed the JSE in a 9 September 2020 letter:

68.1 all 3 of the stated scope exclusions in respect of IFRIC 19 apply; and

68.2 it is incongruous that the JSE categorises Dr van Rooyen as a shareholder in order to arrive at its various conclusions. However, in this instance, and when its suits the JSE, this position is simply abandoned without any explanation.

69 In addition, there is no indication of whether or not the FRIP considered IAS 32. Trustco's interpretation of the IFRIC view is that no special or additional accounting applies to a transaction merely because it is entered into with a party under common control, unless there is a specific exclusion for such a transaction, such as with IFRS 3. Opposite to this, it appears that the JSE incorrectly concluded that IFRS 3 which specifically excludes common control transactions (IFRS 3) is applied by analogy, and the application of IAS 32 to the Dr van Rooyen loans is altered when the standard itself does not make provision for a special application to shareholder loans.

Conclusion in respect of the Related Party Loan

70 In order to arrive at its conclusion, the JSE has disregarded the specific facts of this case, drawn assumptions unrelated to the facts, relied on inapplicable accounting standards and viewed the Related Party Loan accounting treatment

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date post implementation rather than as at the appropriate accounting date: at the time of conclusion.

71 To the contrary, Trustco has applied the letter of the accounting standards that are expressly applicable in respect of the Related Party Loan. At best, the JSE's interpretation of the accounting treatment differs from Trustco's. That difference of interpretation does not amount to non-compliance with IFRS, as the JSE and FRIP have concluded.

THE PROPERTY ISSUE

72 This issue concerns 1,186,2387 hectares of land acquired for development as residential property. The proper accounting treatment of such land is that:

72.1 if the land is held for purposes of sale in the ordinary course of business, then it constitutes inventory. In accordance with IAS 2, the property is held at cost and any proceeds from a sale will be recognised as revenue;

72.2 if the land is held for use by the company, then it is reflected on the balance sheet as property, plant and equipment in accordance with IAS 16; and

72.3 if the land is held to earn rentals, for capital appreciation or both, then in terms of IAS 40 (*Investment Property*) it is held and reflected as investment property.

73 Land acquired for development purposes, was held as inventory in accordance with IAS 2. A portion of the land was developed for residential purposes. However, in 2018 Trustco experienced a slow-down in demand and the majority

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of the land stood vacant and undeveloped. Reflecting on this wasted use of the land, the directors of Trustco resolved during March 2019 (attached hereto are extracts from the relevant board minutes of Trustco and Legal Shield Holdings (Pty) Ltd (attached as "**J**") to effectively:

73.1 retain 3,563,603 hectares, which would no longer be held for purposes of development and sale in the ordinary course of business;

73.2 cease all works in relation to the development of the identified portion of the property for the purposes of a sale in the ordinary course of business; and

73.3 the identified portion of land will be held as a long term investment for capital appreciation.

74 Pursuant to the resolution of the board, the property has been held for investment purposes. There have been no continued efforts to develop the land or in any way deal with it in a manner other than holding it in the hope that its value appreciates. There have not been, and it is not expected that there will be, any sales of the land to customers or that the land wil be treated or dealt with in a manner other than for investment purposes.

Accounting treatment of the Property Issue

75 Given the board's decision to change the purpose of the land, it looked to IAS 40 to reclassify the land for accounting purposes. IAS 40.57 stipulates that:

"An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use. A change in use occurs when the property

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meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use. Examples of evidence of a change in use include:

(a) commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;

(b) commencement of development with a view to sale, for a transfer from investment property to inventories;

(c) end of owner-occupation, for a transfer from owner-occupied property to investment property; and

(d) inception of an operating lease to another party, for a transfer from inventories to investment property".

76 The examples in IAS 40.57 are not exhaustive. The critical factor influencing the appropriate accounting treatment and valuation is the intention for which the property is held. IAS 40 then prescribes that land held at cost and then reclassified as investment property must be valued at fair value.

77 The objective factors that evince Trustco's change in intention include:

77.1 cessation of all development activity related;

77.2 decommissioning of the development plans; and

77.3 cessation of associated activities such as planning, contracting and obtaining regulatory approval.

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78 Given the outward manifestation of the board's decision, Trustco was and remains of the view that the jurisdictional requirements of IAS 40 were met and the reclassification justified as a result. IAS 40 makes clear that the assessment of the facts and circumstances pertaining to a change of use may require the application of judgment by management of the company, who are best placed to understand all of the available information. This is not considered or overcome by the JSE.

79 In exercising its discretion, the Trustco management considered other persuasive sources of accounting guidance. It found that a publication by one of the most reputable global accounting firms, KPMG, contained an example whose described facts and circumstances were almost identical to those faced by Trustco. KPMG concluded that the scenario presented could be considered to satisfy the requirements of a change in use from inventory to investment property in the case of a decommissioned planned development.

80 It should be emphasised that Trustco management developed its view on the appropriate accounting by considering the facts and circumstances pertaining to Trustco and that the relevance of the cited KPMG example was that it did not give Trustco's management any cause to believe that it had erred in developing its views.

81 Having determined that the reclassification was permitted in the specific circumstances and arrived at a fair value, the Trustco management applied the direct provisions of IAS 40.63, which stipulates that:

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"For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss."

82 The presentation of the gain resulting from the transfer of the land from inventory to investment property at fair value is, guided by IAS 40.64 which states:

"The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories."

83 Plainly, the requirements of paragraph 64 is that in all other respects ,except for matters of measurement and recognition which are dealt with under paragraph 63, the term "treatment" as used in the manner in which it is used in paragraph 64 is consistently used across multiple IFRS standards as referring the accounting policy to be applied to a transaction.

84 On this basis, its meaning is that the transfer of inventory to investment property shall be accounted for, in terms of its presentation, in the same manner as for a sale of inventory in terms of IAS 1 (*Presentation of financial Statements*) paragraph 82, and the carrying amount of the inventories sold as cost of sales under paragraph 103.

The flaw in the JSE's treatment of the Property Issue

85 The JSE raises two concerns in respect of the Property Issue:

85.1 the reclassification of the Elisenheim property from inventory to an investment ("**the Reclassification Issue**"); and

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85.2 the manner in which Trustco presented the resulting gain on a gross basis as revenue and deemed cost of sales (**"the Presentation Issue"**).

86 Regarding the Reclassification Issue, the JSE disputes that the threshold of IAS 40 has been met. Instead, the JSE considers the cessation of development as a simple delay or postponement of the initial intended use. By necessary implication, it appears that the JSE has neglected consideration of the pertinent objective factors described in paragraph 77 above.

87 The JSE also criticised the "KPMG example" stating, as a matter of principle, that the JSE does not consider literature issued by any organisation other than the IASB to be authoritative IFRS. However, contrary to this, in paragraph 66 of its reasons, the JSE quotes conclusions from IAS 40.BC27, on which its contentions are premised. However, the IASB states that "This Basis for Conclusions accompanies, but is not part of, IAS 40."

88 Furthermore, paragraph 9 of IAS 8 applies to the sources of IFRS requirements:

> *"IFRSs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of IFRSs. Guidance that is an integral part of the IFRSs is mandatory. Guidance that is not an integral part of the IFRSs does not contain requirements for financial statements."*

89 The JSE therefore appears to dismiss literature from a reputable accounting firm as non-authoritative, yet relies on extracts from the Basis of Conclusion. As set out above, the Basis of Conclusion does not form part of IAS 40 and, in terms of IAS 8, cannot contain requirements for financial statements.

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90 The JSE concludes, with respect to the "KPMG example" that without knowing all of the facts and circumstances surrounding the example it cannot determine if the example is relevant. However, Trustco's response is that of the facts and circumstances provided in the example, substantially all are present in Trustco's own circumstances and therefore in the absence of any other information, it appears reasonable to consider the example informative, no more and no less than that.

91 The JSE in essence attacks the accounting on two fronts, i.e. the intent and the weight of the evidence to support a change in use.

91.1 On the intent, the JSE has not provided any substantiating or viable argument which would allow for the notion that Trustco's intent is not what it purports to be. Indeed, the JSE cannot in the absence of any evidence seek to substitute what it views as Trustco's intent with that which has clearly been demonstrated by the board resolution and the conduct which followed.

91.2 On the weight of evidence, the JSE's position is pinned to one primary argument - that there has not been an express cancellation of the development and the correspondence they refer to speaks of a postponement as opposed to a cancellation. It is not clear on what wording of IAS 40 the JSE relies in order to substantiate this argument. It would be wholly inappropriate to keep the property as inventory when there is clearly no intention to sell same in the ordinary course, one point on which Trustco is unequivocal. This coupled with the fact that the JSE has assumed some discretion to determine the weight that must be

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attached to each piece of evidence is simply arbitrary and indicative of the JSE simply dismissing evidence which runs contrary to its views.

92 The JSE simply cannot, based on its reasoning and with reference to IAS 40 and its jurisdictional requirements, contend that Trustco's recognition of the property (which happens to be supported by the KPMG publication) amounts to non-compliance with IFRS. It is not for the JSE to determine how much evidence it deems appropriate to justify a change in the recognition and to simply out of hand dismiss the objective evidence Trustco provided in support of its accounting treatment. It should be noted that to date Trustco and its two independent auditors with their respective JSE accredited IFRS Advisors have found the evidence of a change in use to be sufficient to support the accounting adopted.

93 In regard to the Presentation Issue, two factors are notable:

93.1 first, the JSE (and the FRIP) conceded that "the impact on profit in respect of how Trustco treated the transaction as opposed to recognising the fair value adjustment as a gain on transfer is the same but the presentation differs"; and

93.2 second, the only apparent reason why the JSE takes issue with this particular accounting treatment is the fact that Next derives a management fee linked to Trustco's revenue.

94 In relation to the Next management fee, Trustco fails to see what is untoward or irregular about this particular arrangement. Indeed, it is also not addressed by the JSE's reasons.

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95 Despite the FRIP's concession in 93.1 above, the JSE maintains that "recognition as revenue is not appropriate as this transaction does not involve any interaction with a customer". It does not point to any IFRS standard, or any other recognised standard at all in support of its view. Indeed, a reading of IAS 40.64 – which deals with a transfer from inventory to investment – shows that it was not envisaged that customer interaction is necessary. The JSE's issue with the outcome of application of the standard is not a gripe that ought to be directed at Trustco, but at the standard itself.

96 The JSE then questions whether or not paragraphs 60 to 65 of IAS 40 refer to the recognition and measurement issues related to the transfers. This presents two difficulties for the JSE:

96.1 first, if this was accepted (which the JSE does not), it would mean that IAS 40 does not prescribe specific requirements with respect to the presentation of the effects of the transfer in the income statement; or

96.2 second, if this was not accepted (the position adopted by the JSE), why does the JSE permit itself to infer that the word "difference" in paragraph 63 ought to be read as a presentation requirement.

97 With respect, the JSE cannot have it both ways. If the JSE insists that paragraphs 60 to 65 apply to presentation, it must accept Trustco's reliance on "treatment" in paragraph 64. The result is that the presentation of a revenue and cost of sales amount in accordance with IFRS 15, inferred by IAS 40. The JSE's contention, that because the text of paragraph 63 is emboldened it is to be elevated over the others, is ludicrous and renders paragraph 64 redundant.

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Conclusion in respect of the Property Issue

98 The JSE has brazenly ignored the real fact of a number of objective and independent factors that evince a clear intention to shift the property from inventory to an investment. Its neglect for so doing evinces a single outcome devoid of reference to the facts which actually underpin the accounting.

99 In addition, the JSE can find no counter to Trustco's application of paragraph 64 of IAS 40, at least not one that is reasonable, rational or otherwise even remotely supported by the proper application of IFRS.

CONCLUSION

100 In relation to its conclusions in respect of both the Loan Issue and the Property Issue:

100.1 the FRIP Report on which the JSE relies is premised on a large degree of conjecture;

100.2 no regard is had to the factual matrix and basis underpinning the particular accounting treatment that Trustco applied;

100.3 the FRIP has not been able to demonstrate with any degree of substantiation why Trustco's accounting treatment does not align and accord with IFRS; and

100.4 the reasons furnished by the JSE do not support a conclusion that Trustco's accounting treatment amounted to non-compliance with IFRS.

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101 Trustco's treatment of the Loan Issue and the Property Issue was done after lengthy consultation with and advice from JSE accredited auditors and IFRS consultants who considered the underlying facts of each transaction.

102 On this basis, it is submitted that the JSE ought not to have accepted the conclusions and recommendations of the FRIP as set out in the FRIP Report. Relying on the FRIP Report in making its decision, the JSE erred. Instead it should have concluded that the Group AFS and the interim results for the year ending 30 September 2019 conform with IFRS and JSE accounting standards and that no restatements or any corrective measures have to be undertaken in respect thereof.

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THE FINANCIAL SERVICES TRIBUNAL

REF: JSE1/2021

In the matter of:

TRUSTCO GROUP HOLDINGS LIMITED Applicant

and

JSE LIMITED Respondent

JSE'S FURTHER REASONS

INTRODUCTION

1. On 11 January 2021, the JSE provided Trustco with the reasons for its decision of 11 November 2020, in which it:

1.1 found that the Group AFS for March 2019 were not compliant with IFRS because they:

1.1.1 classified a loan (the initial loan) by Dr van Rooyen to Huso Investments as a financial liability, the waiver of which was recognised as a gain in profit and loss; and

1.1.2 reclassified certain properties in the Elisenheim development from inventory to investment property, which resulted in a gain in profit and loss;

1.2 required Trustco to restate the March 2019 Group AFS by:

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1.2.1 reversing the gain in respect of the Huso Investments loan and instead recognising the amount directly in equity; and

1.2.2 reversing the Elisenheim property reclassification and the resultant gain in profit and loss;

1.3 found that the interim results for the year ending 30 September 2019 were not compliant with IFRS because the waiver of a subsequent Related Party Loan by Dr van Rooyen was treated as a gain in profit and loss;

1.4 required Trustco to restate the interim results for the year ending 30 September 2019 by reversing the gain in respect of the subsequent Related Party Loan and instead recognising the amount directly in equity; and

1.5 required that the restatement of the Group AFS and interim results for the six month period ending 30 September 2019 be effected in accordance with paragraphs 42 and 49 of IAS 8.

2. Trustco has since brought an application for reconsideration of the JSE's decision (**"Trustco's application"**). In Trustco's application, it adopts a narrow and overly legalistic approach in its criticism of the JSE's reasons for its decision. This is consistent with the manner in which Trustco has approached the matter to date, and the manner that it asserts that the loan transactions, which are the subject of these proceedings, ought to be considered and treated from an accounting perspective. What Trustco has overlooked is that the issues at stake are accounting matters and must be viewed through an accountants lens and not a lawyers lense.

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3. Trustco has also raised certain allegations and/or arguments which are not dealt with in the JSE's initial reasons. The JSE now deals with the further allegations or arguments. The JSE does not re-traverse issues dealt with in it is reasons. It also does not, in this document seek to address each and every issue raised by Trustco in its application where these have already been dealt with. In the circumstances, to the extent that any arguments raised by Trustco in its application are inconsistent with the JSE's initial reasons and further reasons, the JSE denies same.

SUMMARY OF THE APPROACH OF THE JSE IN MAKING ITS DECISION AND ITS FINDINGS

4. Trustco's approach in the application is to focus on the form of the relevant transactions and decisions that underly the matter. It carefully dissects each transaction into its component steps, and then justifies its accounting treatment with reference to these individual components, while criticising the JSE for adopting the broader approach that it did. What Trustco ignores is that IFRS requires financial statements to be a faithful representation of the underlying economic substance and events.

5. This means that financial statements must consider the economic substance and financial reality of the underlying transactions, and not merely their legal form.

Waiver of loans

6. Having regard for the provisions of IFRS and, in particular, the substance over form requirement, the accounting by Trustco for waivers of loans to

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Trustco by the controlling shareholder as gains in profit or loss is not in compliance with IFRS.

7. IFRS requires the evaluation of all information known up to the date the financial statements are prepared. The accounting is not limited to only the facts known as at the date of acquisition.

8. The fact that the loans are granted by the controlling shareholder; are waived within roughly a year after the combination and have the potential to result in additional shares being issued to the controlling shareholder must be taken into consideration when evaluating their substance and the underlying economic reality.

9. This is also the position taken by the Financial Reporting Investigations Panel ("**FRIP**") which concludes that the waiver of the initial loan is, in substance, an integral part of the business combination and the receipt of additional shares in terms of an "earn-out" provision in the contract for the business combination.

10. The classification of loans is dealt with by IAS32 which, again, specifically requires an assessment of their substance.

11. Even if the amount received or assumed by Trustco is <u>legally</u> a loan, an assessment must still be made to determine the <u>substance</u> for the classification as a liability or otherwise. All information which is known up to the date the financial statements are finalised must be considered. The accounting is not limited to only the information known at the time a contract was concluded or the loans were received/assumed. This is not the

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application of 'hindsight' as referred to by Trustco, but an obligation under the IFRS applicable to these loans.

12. The economic substance and financial reality of the waivers of loans owing by Trustco to the controlling shareholder was an equity contribution and not a profit. This takes into consideration the most extraordinary circumstances asserted by Trustco that the lender (Dr Quinton Van Rooyen ("**QvR**")) has waived, without any consideration, the vast amount of N$1.546 billion for the benefit of Trustco which is not wholly-owned by QvR.

13. Even if the loans and the waivers were distinctly separate transactions, there was no obligation to waive and the loans, and the waivers occurred at different times, the assessment remains unchanged. None of these factors, either separately or together, precludes the recognition of the loan and waiver for accounting purposes as an equity contribution.

Reclassification of inventory

14. The accounting by Trustco in relation to the reclassification of properties held as inventory to investment property was not in compliance with IFRS.

15. In terms of IAS 40, a change of intention is not, by itself, sufficient to justify the reclassification. The key issue is whether or not there has been a change in use from an asset held for sale in the ordinary course of business (inventory under IAS 2) to an asset held for capital appreciation and/or to earn rentals (investment property per IAS 40).

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16. There is insufficient evidence to support Trustco's reported intention to change the use of the properties and justify its decision to reclassify the properties from inventory to investment property.

17. If inventory is reclassified as investment property, IFRS requires the property to be measured at its fair value. Any difference between its carrying value (as inventory) and its fair value is accounted for as a fair value gain.

18. Trustco accounted for the gain by increasing revenue and cost of sales (the net amount being the fair value gain). Even if the reclassification was justified this accounting was contrary to IFRS as the gain was not revenue in terms of IFRS. Similarly, there cannot be a "cost of sale" because inventory was never sold. The asset has only been reclassified.

THE RELEVANT STANDARDS

19. The JSE has together with with these submissions submitted the expert opinion of Professor W Maroun which sets out the relevant accounting standards and how they must be applied by accountants and auditors.

REFERRAL 1: FORGIVENESS OF LOANS

20. The JSE's analysis of the accounting for the first and second loans is guided primarily by IFRS 3, IAS 32, IAS 8 and the Conceptual Framework ("**CF**").

Accounting for the first loan

21. The JSE's conclusions concerning the first loan rely on the application of IFRS 3, by analogy, to the accounting for a business combination under

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common control. This is based on the application of IAS 8 to develop an accounting policy for business combinations involving entities under common control in the absence of a specific standard dealing with this type of transaction.

22. The JSE's decision concluded that the QvR was compensated for the forgiven loan by receiving additional shares in terms of an earn-out clause which was impacted by the recognition of the gain accounted for in profit and loss on the waiver of the loan.

23. The JSE's decision is based on the guidance provided by IFRS 3 (paragraphs 50-51 and B50) for determining what is part of the business combination. The result is that any gain or loss arising on the waiver of the loan is accounted for as part of the business combination and affects equity. The waiver of the loan cannot be recorded as a gain in the statement of comprehensive income.

24. Trustco contends that IFRS 3 is inoperative because the standard expressly excludes business combinations involving entities under common control (Trustco letter of 9 October 2020, paragraph 1.2.2). Even if this were not the case, Trustco maintains that the waiver of the loans took place after the business combination was completed. In Trustco's view, the guidance provided by IFRS 3 (paragraphs 50-51 and B50) for determining what is part of the business combination refers exclusively to transactions which occur before the business combination, or which were agreed to during the negotiations for the business combination (Trustco letter of 9 October 2020, paragraph 1.2.2). Trustco suggests, by inference, that the waiver of the loan

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is separate from the business combination (Trustco letter of 9 October 2020, paragraph 1.2.3).

25. Trustco has, accordingly, decided to account for the waiver of the loan by derecognising the liabilities recorded in its financial statements with a corresponding gain in profit or loss. This accounting is, so Trustco alleges, per the guidance provided by IFRS 9 (Trustco letter of 9 October 2020, paragraph 2.2.5).

26. The issue is whether or not Trustco's accounting for the waiver of the shareholder loan is appropriate and represents the economic substance. In other words, should the waiver of the loan be accounted for as part of equity or as a gain in profit or loss? The applicability of IFRS 3 is considered first. Thereafter, how the forgiveness of the loan should be accounted for without reference to IFRS 3 is dealt with.

27. Concerning Trustco's argument that IFRS 3 is inapplicable because it expressly excludes common control transactions (see IFRS 3.2c), the following is noted:

27.1 Trustco relied on UK GAAP (FRS6) to develop its accounting policy for business combinations involving entities under common control. IAS 8 refers to the use of standards set by other accounting bodies when existing IFRS do not deal with a transaction (IAS 8.12). FRS 6 was withdrawn for reporting periods commencing on or after 1 January 2015 and was, therefore, not operative at the relevant time.

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27.2 FRS 6 dealt with certain, but not all, elements of the business combination that are relevant in this instance. Practically, IFRS 3 is required to address those aspects of the accounting which are not covered by FRS6. It seems clear that not withstanding its protestations that IFRS 3 does not apply it has informed Trustco's accounting for the business combination. For example, it has identified an acquirer and acquiree and recognised the acquirees' identifiable assets and liabilities in the consolidated financial statements (see, IFRS 3.1). As a result, it is difficult for Trustco to argue that IFRS 3 is completely inapplicable.

27.3 Like IFRS 3, FRS 6 does not deal expressly with the forgiveness of shareholder loans. The JSE analogised to IFRS 3 to determine what was considered part of the business combination. If pronouncements by other standard-setting bodies are used to develop an accounting policy for the waiver of the shareholder loans, IAS 8 is clear that the accounting policy cannot conflict with the CW and the IFRSs dealing with similar transactions (IAS 8.12).

28. The JSE's position is that IFRS 3 is applicable by analogy, and that the waiver of the loan should be recorded in reserves (equity) as part of the business combination accounting. In applying IAS 8 and analogising to standards dealing with similar transactions it must be noted that the only standard (per IFRS) dealing with a transaction similar to a business combination involving entities under common control is IFRS 3. As a result,

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the JSE's decision to rely on IFRS 3 to inform its views on the accounting for the waiver of the shareholder loan is not unreasonable.

29. The JSE's conclusion that the waiver is part of the consideration for the business combination is supported by the following:

29.1 Trustco argues that the loan waivers are not included in the business combination negotiations and, because they arose after the business combination, cannot be included as part of the business combination accounting. This position does not address the fact that the IFRS requires (in certain cases) contracts concluded at or near the same time to be evaluated collectively and for facts and circumstances, even if not stated explicitly in the contracts, to be considered in aggregate when determining an appropriate accounting policy (see, for example, CW, paragraph 4.62; IFRS 15.17; IFRS 16.B2).

29.2 The application of the provisions in IFRS 3 (paragraphs 50-51 and B50) to which Trustco objects (Trustco letter of 9 October 2020, paragraph 1.2.2) convey an important principle: that a transaction must be concluded as part of the exchange for the acquiree to be taken into consideration when accounting for the business combination. That a transaction may only be completed or effected after the contract for a business combination is signed does not mean that it should automatically be excluded when determining the transaction price for the combination or the net assets assumed. On the contrary, there are cases where transactions and events are only finalised at a later

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date but still form an integral part of the business combination accounting (see, for example, IFRS 3.39).

29.3 The waiver was initiated by QvR and results in a gain of N$596 million on the first loan (and N$1 billion on the second loan) to Trustco implying a corresponding loss to QvR of a substantial amount. It is unlikely that QvR would incur these losses without adequate compensation. The JSE concluded that this compensation takes the forms of the shares issued by Trustco under the contingent share provisions of the business combination agreement. The decision relies on the evaluation of the business combination, contingent share issue, and waiver of the loan concurrently even though the transactions are not housed in the same agreements. This is consistent with the guidance provided by the CW and other IFRS (see, for example, IFRS 15 and IFRS 16) on considering contracts in aggregate to give effect to the underlying substance.

29.4 In support of the JSE's decision, the recorded gain on the waiver of the loan contributed to the issue of a greater number of shares to QvR by virtue of the earn-out clause[1]. The fact that the number of shares issued was not determined exclusively by the gain resulting from the waiver, or that the terms of the relevant agreements did not explicitly

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[1] Trustco has not argued that the earn-out clause itself should be excluded from the determination of the purchase consideration for the common control transaction despite the fact that this treatment is informed by IFRS 3 which Trustco maintains is inapplicable (see paragraphs 2.7.2-2.7.3).

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refer to the issue of shares as compensation for waiving a loan does not affect the outcome. It is the economic substance that is relevant.

29.5 To account for the economic substance and financial reality of transactions, and not just the legal form, it is unnecessary for the parties to have known or to have reasonably foreseen that a loan waiver would occur and trigger the earn-out clauses. The hurdle for accounting purposes is much lower than what is required to satisfy a legal test which may require an element of deceit. This is because IFRS is concerned with accounting for the economics of transactions only (see CW, paragraphs 2.12 and 2.18).

29.6 The waiver of the first loan occurred on 30 September 2018, shortly after Trustco acquired shares in and assumed direct control over Huso. From an accounting perspective, the economics suggests that the waiver was concluded as an integral part of the business combination, notwithstanding the fact that the waiver was only finalised after the business combination (see Trustco, 9 October 2020, paragraph 1.2.2.1). The decision to release Trustco from its obligation to repay the loans provides confirmatory information about the economic value of the right to waive the loan which existed from the outset. In this way, the actual waiver provides additional information about facts and circumstances existing at the acquisition date. Because the waiver occurred at or within 12 months of the business combination, it should be included in the determination of the amounts used to complete the initial accounting for the business combination

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(see IFRS 3.45). As explained by IFRS 3, the emergence of new information is more likely to provide information about facts and circumstances existing at the acquisition date when it emerges shortly after the acquisition date (see IFRS 2.47). In this case, the loan is waived only 26 days after the business combination.

29.7 The above approach is consistent with the key principles of accounting for the economic substance of transactions and not only their legal form. Provisions in separate contracts can be considered as a single unit of account to understand and present the underlying economics of transactions. Similarly, all information available up to the point that the financial statements are finalised is considered rather than only the facts and circumstances prevailing at the date a contract is concluded (CW, paragraph 4.62; IAS 10).

29.8 Finally, Trustco asserts that the CW should not be considered when evaluating the appropriateness of accounting for the waiver because it is not authoritative (see, for example, Trustco letter of April 2020, paragraph f(ii)). For the reasons explained in above the argument cannot be accepted.

30. Next, the accounting for the waiver of the shareholder's loan according to Trustco's view that the waiver took place after, and independently of, the business combination, is considered. The following provisions of the IFRS are noted in addition to what is summarised above:

30.1 A financial liability is a contractual obligation "to deliver cash or another financial asset to another entity; or to exchange financial assets or

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financial liabilities with another entity under conditions that are potentially unfavourable to the entity" (IAS 32.11).

30.2 "The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument" (IAS 32.15, emphasis added).

30.3 A financial liability is derecognised when it is extinguished. The difference between the carrying amount of the financial liability and the consideration paid (including non-cash assets transferred and liabilities assumed) is recognised in profit or loss (IFRS 9 3.3.1 and 3.3.3).

31. Trustco maintains that the shareholder loan is a financial liability falling exclusively within the scope of IAS 32 and IFRS 9 (Trustco letter of 9 October 2020, paragraphs 2.2.1 and 2.2.5). Trustco also asserts that loan contracts are classified as a financial liability at initial recognition and the classification is "not subject to revision based on events which may arise subsequently" (Trustco, letter of 9 October 2020, paragraph 2.2.2). The classification is also unaffected by the fact that the loans are between related parties (Trustco, letter of 9 October 2020, paragraph 2.2.1). Both positions are inconsistent with the need to account for the economic substance of transactions under IFRS:

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31.1 If there have been changes to the terms of a financial liability or equity instrument which have a material effect on the amount, timing and certainty of the cash flows inherent in an asset or liability, this reflects a change in the underlying economics which ought to be accounted for to provide a faithful representation. The same applies when a transaction is concluded with a related party because the close relationship between the parties can affect the economic rationale for entering into the transaction (see IAS 24).

31.2 There are examples in IFRS dealing with the accounting implications of contract modifications (see, for example, IFRS 15, paragraphs 18-20), changes in the intended use of assets (see, for example, IAS 40.57) and re-assessments of liabilities after initial recognition (see, for example, IFRS 163.9-46).

31.3 IAS 32 provides only limited guidance on the re-classification of financial liabilities (see IAS 32.16E-F). If this guidance does not apply to Trustco's shareholder loan, IAS 8 must be used to develop an appropriate accounting policy (see paragraph 2). Disregarding changes or developments which materially alter the underlying economics of a financial instrument is inconsistent with the requirements of IAS 1, IAS 32 and the CW to account for the substance of transactions.

31.4 It should also be noted that the initial loan was first classified as an equity instrument and then re-classified as a financial liability by Trustco.

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32. Taking the relationship between the parties, the nature of the loan, the decision to waive the loan and the timing of the waiver into consideration, the economic substance points to the waiver being an equity contribution and not a gain arising on the derecognition of a financial liability. The nature of the initial loan *before* being waived is considered first.

32.1 Based on Trustco's representation, at 31 March 2015, the loan accrued no interest and was unsecured (Trustco letter of 5 February 2020 paragraph 1(i)). In substance, the only return to QvR arises indirectly from the deployment of funds in the Huso and/or Trustco business and resulting distributions and capital appreciation similar to a direct equity investment.

32.2 As at 31 March 2015, the loan was to be re-paid at the option of the borrower (letter of 5 February 2020, paragraph 1(i)). A loan is typically characterised by a schedule of fixed or determinable payments. That the borrower can determine when and to what extent payments are made is economically similar to a company's discretion concerning the payment of dividends on equity instruments.

32.3 By September 2018, the loan was re-classified as a financial liability but the basis for the re-classification is not explicated.

32.4 Per the audited interim results for March 2019[2] ("**2019 Interims**"), the waiver of the first loan of N$546 million is recognised in profit and loss

[2] These results provide details on the 12 months ended 31 March 2019 and information pertaining to the next financial year.

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(2019 Interims, Note 16). Finance costs paid to related parties total NS9.9 million (2019 Interims, Note 20). At the time of the business combination, the first loan balance was N$401 million (Trustco letter of 5 February 2020, page 6). Assuming no other movements on the loan and that the disclosed related party finance costs are only for the first loan, the interest charge is approximately 2% for the 7 months to the year ended 31 March 2019[3]. This is well below current market rates on risk-free financing[4]. There are also no indications of repayment terms or security for the first loan.

32.5 The amount, timing and certainty of the cash flows inherent in the loan are, therefore, not the same as for a loan originated with an unrelated third party. In the absence of a market-related interest rate, clear repayment schedule and security, the loan does not have the economic characteristics of a liability. This is because the lender, QvR, does not receive a fixed or determinable repayment of capital and risk-adjusted compensation for the use of borrowed funds (see IFRS 9. 4.1.2).

32.6 The loan resembles equity more closely than a financial liability. This means that IFRS 9 is not applied[5]. Per IAS 32, "redemptions or

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[3] The business combination is completed on 4 September 2018. The year end is 31 March 2019. The period is 7 months. The rate for the 7 months is the equivalent of 3.6% pa effective.

[4] South African government bond yields range between 9% and 11% based terms (between 10 and 20 years). The two-year return on RSA Retail Savings Bonds is 6%. The prime lending rate at the date of the current report is 7%.

[5] IFRS 9 only deals with the extinguishment and derecognition of financial liabilities. Equity instruments are accounted for under IAS 32.

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refinancing of equity instruments are recognised as changes in equity" (IAS 32.36).

33. Even if the first loan is regarded as a financial liability, the economic substance suggests that the liability is settled by an equity contribution in the form of a waiver:

33.1 An agreement providing for the waiver of a loan without any consideration or compensation (see, for example, Trustco, 9 October 2020, paragraph 2.1.3) is extraordinary, more so when the waiver is for hundreds of millions and the beneficiary of the waiver is not wholly-owned by the lender. Waiving contractual rights to the repayment of the loans without any compensation places QvR in the same position as making an equity contribution to Trustco. In both cases, QvR is exposed to a full loss of the initial investment without a fixed or determinable return.

33.2 The right to waive the loan means that there is a possibility that the amount and timing of any loan repayments will be varied to accommodate the financial position, financial performance or other circumstances of the borrower precisely because QvR is also a controlling shareholder.

33.3 The right to waive the loan would be established when the loan is originated. This alters the risk-reward profile or configuration of the loan's future cash flows because an unrelated borrower would not surrender any right to repayment of capital and interest for no

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consideration[6]. The probability of a concession (including a waiver) and its timing does not need to be certain. The fact that a waiver was contemplated by the parties and could have impacted the amount and timing of any repayments is sufficient because QvR, as the controlling shareholder, has the practical ability to waive the loan. That QvR exercised his rights to waive the loan reaffirms that the waiver provisions have substance.

34. That the waiver of the loans is a part of equity and does not give rise to a gain in profit or loss is supported by the CW:

34.1 For Trustco to classify the loan as a liability, it must have an obligation to transfer economic resources to the counterparty (CW, paragraph 4.27). The repayment of the loan was prior to its amendment conditional on Trustco's future actions (CW, paragraph 4.32) because the loan is paid at the company's discretion. This means that the company has a practical ability to avoid the outflow of economic resources and that there is no obligation until it makes that election (CW, paragraph 4.32).

34.2 The obligation must also arise because of a past event (CW, paragraph 4.42). QvR has granted the loan but prior to its amendment, until Trustco elects to repay the loan, there is no resulting past event

[6] For example, IAS 24 notes that 'related parties may enter into transactions which un-related parties would not (IAS 24, paragraph 6) and that the profit and loss and financial position of an entity can be affected by related parties (IAS 24, paragraph 7).

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(CW, paragraph 4.43). Similarly, until the election is made, repayment of the loan could not have been enforced (CW, paragraph 4.46).

34.3 Even if Trustco did not have the unconditional right to defer payment, the circumstances surrounding the waiver must be considered. Ordinarily, a lender expects a repayment of capital and interest. A waiver is inconsistent with the economic reality of a loan, especially as there is no collateral to apply against unpaid amounts. From Trustco's perspective, any obligation resulting from the loan does not, in substance, result in a transfer of economic resources to a counterparty. This is a key part of the definition of a "liability" in the CW which is not met (CW, paragraph 4.37).

34.4 It follows that, when the loan is waived, the transaction cannot yield a gain in Trustco's consolidated statement of profit or loss. According to the CW (paragraph 4.2) an income results from "*increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims*". Because the loans are, in substance, equity instruments there has not been a decrease in liabilities with the result that no gain is recorded in profit or loss. On the contrary, the waiver is, in substance, part of QvR's equity contribution to Trustco (CW, paragraph 4.68).

35. In response to the contention that that the borrower may not have been in a financial position to repay the loans at the time of the combination, and that this undermines the argument that the loans are a financial liability, Trustco referred to IAS 32.AG25 dealing with redeemable preference shares. IAS

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32.AG35 states that the inability of the borrower to satisfy the redemption of preference shares does not negate the existence of a contractual obligation to deliver cash and, hence, the fact that preference shares give rise to a financial liability (Trustco letter of 5 February 2020).

36. IAS32.AG25, however, is inapplicable to the loan between Trustco and QVR because:

36.1 AG25 deals with a situation where the redemption of the shares is mandatory or at the option of the holder. The issuer's subsequent inability to satisfy the redemption does not extinguish the contractual obligation to deliver cash which was established when the instrument was initially recognised. In the case of the shareholder loans, the decision to repay the loans vests with the borrower. This means that the borrower has a contractual right to avoid the transfer of cash (see IAS 32.17). This right appears to be unconditional (IAS 32.19) and means that the loan to Trustco does not meet the definition of a financial liability.

36.2 IAS32 AG25 is based on an arms-length transaction, rather than one which involves a related party, and does not contemplate the forgiveness of amounts due for no consideration.

37. In summary, the waiver of the first loan is, in substance, an equity contribution. The liability is derecognised with a corresponding adjustment

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to equity (see, for example, IAS 36 IE 29). No gain or loss is recognised per IAS 32.36 on an equity transaction[7].

Accounting for the second loan

38. The second loan has been classified as a financial liability, but the appropriateness of the classification is incorrect:

38.1 If the loan was originated with a fixed or determinable payment schedule and a market-related return for the use of funds, the fact that it was issued with an explicit waiver notice suggests that the waiver has economic substance. This position is affirmed by the fact that the loan is actually forgiven (on 14 October 2019) barely a year after the SENS announcement on QvR's right to waive the loan (on 8 October 2018).

38.2 Like the first loan, the waiver of the second loan is recorded as a gain in the statement of profit and loss. This is relevant for the earn-out clauses in the business combination and can affect the number of shares issued to QvR per the earn-out clauses. Consequently, the argument that the waiver of the first loan is closely linked to the issue of equity instruments applies to the second loan, albeit that waiver of the second loan takes place more than 12 months after the business combination.

[7] The transaction is outside the scope of IFRIC 19, dealing with the settlement of liabilities by issuing equity instruments (see IFRIC 19, paragraph 3). Nevertheless, its application would result in the same accounting treatment because the fair value of the loan and the waiver are the same.

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39. As is the case with the first loan, even if the second loan has been correctly classified as a financial liability, the substance of the waiver is that the liability is equity-settled. The points raised above apply equally to the second loan and are discussed briefly:

39.1 The waiver of a loan without any consideration or compensation is exceptional and economically closer to a capital contribution by QvR than a gain enjoyed by Trustco.

39.2 The right to waive the loan alters the configuration of its expected future cash flows, such that they resemble equity rather than a repayment of capital and a market-related return to QvR. As before, when the loan is forgiven, this position is confirmed.

39.3 In keeping with the principle of economic substance over form, it is unnecessary for the parties to have known that the loan would be waived from the outset or to have referred explicitly to the waiver in any contract.

39.4 The loan is concluded with the controlling shareholder rather than on arms-length terms. The economic substance points to QvR acting as an equity participant on waiver of the loan, rather than as a lender. That the arrangements between the parties do not state explicitly the capacity in which QvR was acting, or refer to any equity settlement, is a legal matter which does not alter the underlying economic substance of the matter.

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40. In summary, the waiver of the second is, in substance, an equity transaction. The liability is derecognised with a corresponding adjustment to equity (see, for example, IAS 36 IE 29). No gain or loss is recognised per IAS 32 (paragraph 36) on an equity transaction[8].

Summary of the JSE's view on Referral 1

41. The waiver of the two loans is, in economic substance, part of QvR's equity contribution to Trustco. As a result, under IFRS no gain is recognised in profit or loss when the loans are waived. The waivers are accounted for directly in equity. This conclusion is supported from three perspectives:

41.1 The timing of the loans being waived relative to the business combination, and their close link to the number of shares which are issued or issuable to QvR-shareholder, means that these transactions should be understood as a single unit of account. The result is that the waivers are accounted for in equity and not in profit or loss.

41.2 For both loans, the amount, timing and certainty of the loans' cash flow profiles are affected by the off-market terms and the fact that the loans have also been granted by QvR, the controlling shareholder. The cash flow profiles resemble an equity contribution rather than a repayment of borrowed amounts with compensation for the time value of money. As a result, when the loans are forgiven, the waivers are treated as an

[8] The transaction is outside the scope of IFRIC 19, dealing with the settlement of liabilities by issuing equity instruments (see IFRIC 19.3). Nevertheless, its application would result in the same accounting treatment because the fair value of the loan and the waiver are the same.

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integral part of Trustco's equity. IAS 32 and the CW prohibit the recognition of gains and losses on the issue or cancellation of equity.

41.3 Even if the two loans are financial liabilities, the waiver should be seen as an equity contribution which settles the liabilities. In substance, a lender would not ordinarily forgo the right to unpaid capital and interest for no consideration[9]. The fact that QvR is also the controlling shareholder means that, by releasing Trustco from its obligations, it is adding to the group's financial resources and allowing the funds which would have been used to service the liabilities to be redeployed. In the same way as an equity participant, the "lender" is compensated by improved financial performance and the associated benefits of capital appreciation and dividends on his existing shareholdings. In support of this view, Trustco would be in the same position if the shareholder had advanced the funds as a direct equity contribution and these funds were then used to repay a third-party debt of the same amount.

41.4 The positions above hold irrespective of the appropriateness of using IFRS 3 to account for business combinations under common control.

REFERRAL 2: RE-CLASSIFICATION OF INVESTMENT PROPERTY

42. The JSE's analysis of this issue firstly considers the appropriateness of accounting for a transfer from inventory to investment property. Although

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[9] Even in the event of liquidation, the lender would hope for a portion of the unpaid amounts to be recovered.

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the JSE concludes that this is not appropriate, it in any event then considers the accounting for the transfer.

The appropriateness of a transfer from inventory to investment property

43. To support a transfer from inventory to investment property, there must be evidence of a change in use. Management's intention to hold inventory as investment property is, by itself, insufficient (IAS 40.57).

44. IAS 40 does not provide extensive guidance on differentiating between a change in intention and a change in use, but it includes some examples such as "commencement of development with a view to sale" to support a transfer from investment property to inventory (IAS 40.57(b)). Conversely, the cessation of development with a view to holding an asset for capital appreciation would justify the decision to re-classify inventory as an investment property.

45. The following is noted:

45.1 Trustco's response to the JSE (9 October 2020) includes correspondence from one of its agents stating that the development activities necessary for bringing the properties to a condition for sale to customers have been suspended; the construction staff have been retrenched and the "*equipment has been sold off etc*".

45.2 Correspondence from WCE Consulting Engineers confirms the "*postponement of progress meetings*" from 13 September 2018. "*Other than construction work required for the servicing of the*

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business erf for new commercial development, no substantial progress was recorded since November 2018".

45.3 a resolution by the Board of Directors confirms that the properties are not likely to be sold in the foreseeable future.

45.4 Trustco's correspondence with the JSE (see, for example, April 2020, Appendix C(i)) states expressly that the properties are held as investment property.

46. "*An entity must have taken observable actions*" to support a change in use (IAS 40.BC27). By itself, the resolution of the Board of Directors is insufficient to demonstrate a change in intention. This remains so even if the resolution is considered in conjunction with the other steps outlined above.

47. That the properties are "*vacant prior to reclassification and continue to be vacant*", that bulk services provided are subject to a contract of sale or that economic circumstances have resulted in development being discontinued, does not automatically rebut a change in use.

47.1 IAS 40 does not preclude a change in use being motivated by a change in economic circumstances. On the contrary, the change in the market in which Trustco operates suggests that the change in use has substance because there has been a change in the amount, timing and certainty of the economic benefits inherent in the asset.

47.2 Property held for an undetermined future use is an example of investment property (IAS 40.8b).

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47.3 The bulk services being supplied by Trustco would, presumably, have equal utility to Trustco holding the asset for capital appreciation or for rental to others. In addition, IAS 40 provides for properties being developed to be accounted for as investment property (IAS 40.8e).

48. The observations advanced by Trustco to evidence a change in use must have economic substance. For example:

48.1 The measures to discontinue development should be material and more than temporary. For instance, the retrenchment of staff and asset sales would lack economic substance if staff are re-appointed and assets are re-acquired shortly after the decision is taken to discontinue development.

48.2 The period of the discontinuation of activities should be longer than the delays or stoppages customarily encountered when developing the same or similar properties as inventory.

48.3 It should be unlikely that the plan to hold the properties for capital appreciation will be withdrawn or curtailed materially. Similarly, material sales of these properties to customers should be infrequent and immaterial.

48.4 In evaluating if the proposed change in use has economic substance, the following is noted:

48.4.1 It is difficult to distinguish between facts and circumstances, including the economic slowdown which resulted in a delay to the development activities required to prepare inventory for intended

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sale, rather than the discontinuation of development because of a change in the use of the property. This is especially true given that Trustco does not realise its inventory of properties within 12 months. It can take several years for inventory to be sold to customers.

48.4.2 The Directors' resolution states that all "land assets" will be treated as investment property unless they are identified as being held for sale or servicing with the intention to sell to customers. The investment property classification should apply to "all un-serviced and unsold land in the Elisenheim estate" currently accounted for as inventory. Only Phases 1-4 would be regarded as inventory (Director Resolution, March 2019, No 9.1). In contrast, correspondence from the consulting engineers dealing with work stoppages refers only to parts of Phase 4 and Phase 2 of the Elisenheim estate. It is also unclear if stoppages are only the result of technical or practical challenges encountered on site.

48.4.3 At the same meeting of the Directors, it is stated that "*the decision to defer the development of projects on future phases has necessitated the cancellation of previous property sales in these phases as the probability of these transactions from being concluded is reduced. These sales will be concluded in the future, but probably not in terms of existing sales contracts*" (Director Resolution, March 2019, No 9.1). The statement

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indicates that Trustco stands ready to sell the properties if a suitable buyer is found. This would support the properties continuing to be classified as inventory (i.e. assets held for sale in the ordinary course of business, IAS 2.6). The same may apply to properties classified as investment property especially given that these formed a material part of the organisation's inventory.

48.4.4 Moreover, the Directors' resolution refers to the 'deferment' of development projects rather than the discontinuation of development and holding for capital appreciation (Director Resolution, March 2019, No 9.1, line 167).

48.4.5 While staff have been retrenched and equipment sold, no provision for restructuring has been reported in the audited interim results as at 31 March 2020 or in the comparative year (March 2019 AFS). The exact number of staff affected by the decision, how plant and equipment are re-deployed and the steps taken to engage with the relevant stakeholders on the cessation of development are also not detailed.

49. In light of the information furnished by Trustco, there is insufficient information to support a transfer from inventory to investment property.

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Accounting for a transfer form inventory to investment property

50. Assuming that the transfer from investment property to inventory was regarded as appropriate, the accounting for the transfer must be considered.

50.1 "For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss" (IAS 40.63).

50.2 "The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories[10]" (IAS 40.64).

51. For the accounting to be "consistent with the treatment of the sale of inventories", the provisions of IAS 2 and IFRS 15 dealing with inventory and revenue from contracts with customers are considered:

51.1 Revenue is recognised as or when Trustco satisfies its performance obligations to its customers (IFRS 15.2). Performance obligations are successfully transferred when the customer obtains control of the underlying assets (IFRS 15.31-33). As the development of the property for sale has been discontinued and Trustco retains control

[10] IAS 40 (paragraphs 64) neither requires nor permits the recognition of revenue and cost of sale. The JSE contends that the paragraph clarifies why the accounting for a transfer to inventory is via profit or loss rather than other comprehensive income and equity, as is the case with a transfer concerning PPE.

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over the properties in question, no performance obligations have been satisfied and revenue cannot be recognised[11].

51.2 Inventories are only recognised as an expense when they are sold or impaired (IAS 2.34). The asset has not been derecognised because Trustco retains control over the assets. Only the classification of the assets has changed. As a result, no adjustment to profit or loss (in the form of cost of sales) is processed.

52. Investment property on the fair value model must be carried at its fair value (IAS 40.33). The difference between the carrying value of the properties (as inventory) and their fair value (as investment property) is accounted for in profit or loss (IAS 40.63).

53. The fair value adjustment on the re-classification is shown separately as fair value adjustment on investment property based on IAS 40.75f read with IAS 1.85. Recording the adjustment in revenue is inappropriate because:

53.1 Revenue is a measure of the effort expended by an organisation to satisfy performance obligations to customers by transferring promised goods and services to customers (IFRS 15.31). Trustco has not transferred the properties to customers. It retains control over the properties before and after the re-classification.

53.2 Revenue results in an inflow of a fixed or determinable amount of cash when the customer settles the amount due. Changes in the fair value

[11] Trustco (April 2020, Appendix C, 2(i)) acknowledges that the transaction is outside the scope of IFRS 15.

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of the property are different. They do not give rise to fixed or determinable amounts of cash.

53.3 The cash flows arising from a revenue transaction are presented as cash flows from operating activities in a cash flow statement. This is because revenue is, in substance, a measure of how cash flows are generated from an organisation's primary activity or purpose. Trustco is said to be holding the properties in question as investment property. This means that the properties are not expected to be sold in the ordinary course of the group's activities and have no impact on cash flows from operations.

53.4 Presenting revenue on the re-classification is counter-intuitive. Trustco has re-classified properties precisely because it does not expect them to be held for sale to customers.

53.5 Finally, the recording of the fair value gain as part of revenue distorts key measures of financial performance. For example, the gross profit percentages and margins will be altered. As fair value gains are, arguably, not a core part of Trustco's operating activities, they may affect users' determination of maintainable earnings.

Summary of the JSE's views on Referral 2

54. Management's intention, by itself, is insufficient to determine if there has been a change in the intended use of an asset. There must also be evidence of a change in use (IAS 40.57 and BC240). Trustco has not

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furnished sufficient evidence of a change in the expected use of certain properties from inventory to investment property.

55. A resolution of the Board of Directors (13 March 2019) refers to the development of properties to be deferred rather than discontinued. There accordingly remains a possibility that Trustco continues to stand ready to sell the properties. While Trustco has provided correspondence stating that work on some sites is halted, this does not seem to apply to all of the affected properties. The financial and non-financial impact of the decision to stop development could also not be determined. As a result, there is insufficient information to conclude if the change in use from investment property to inventory has substance.

56. Even if the alleged change in use does have substance, how it is presented is inappropriate.

56.1 The change in use should be accounted for as a fair value adjustment in profit or loss. Based on the amount and the non-recurring nature of the reclassification adjustment, presenting it as a separate line item in the statement of profit or loss is the only appropriate presentation. There is no basis under IFRS for accounting for the fair value adjustment in revenue and cost of sales (which should be entirely unaffected) as there is no sale that gives rise to the gain. The gain arises solely from an accounting construct requiring the asset to be fair valued when reclassified.

56.2 Presenting the adjustment as part of revenue creates the impression that goods and services have been transferred to a customer when

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this is clearly not the case. Treating the fair value adjustment as part of revenue also distorts the assessment of how the primary operating activities of the entity are realised in cash; the computation of the gross profit and margin percentages; and the determination of maintainable earnings.

CONCLUSION

57. In both its initial reasons and these further reasons, the JSE has demonstrated that:

57.1 in relation to referral 1, the forgiveness of the loans by QvR to Trustco are, in substance, part of the equity contributions by the controlling shareholder. As a result, a gain or loss should not be recognised on the waiver. The waiver of both loans should be accounted for as part of equity; and

57.2 in relation to referral 2, there is insufficient evidence to support Trustco's assertion that the change in use has substance. Even if does have substance, the gain on the change in use should be recorded in profit or loss and be presented separately from revenue because, in substance, there is no effect on revenue and costs of sales.

58. For the above reasons, the JSE maintains that its decision is correct and submits that Trustco's reconsideration should be dismissed.

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Dated at Johannesburg on 26 March 2021.

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FOR THE RESPONDENT:
JSE LIMITED
2 Gwen Ln, Sandown,
Sandton,
2196
C/O WEBBER WENTZEL
Respondent's attorneys
90 Rivonia Road, Sandton
Johannesburg, 2196
Johannesburg, 2107, South Africa
Tel:+27 11 530 5927
Email:
Michael.Straeuli@webberwentzel.com
Prathik.Mohanlall@webberwentzel.com
Ref: M Straeuli / P Mohanlall
3043585

To:

THE FINANCIAL SERVICES TRIBUNAL

And to:

BAKER MCKENZIE
Applicants attorneys
1 Commerce Square, 39 Rivonia Road
Sandhurst

JOSIAS ANDRIES AGENBACH
NOTARY PUBLIC
REPUBLIC OF NAMIBIA

TB

Sandton
2196
Tel: +27 (0) 83 464 2352
Fax: +27 (0) 11 784 2855
Email: John.Bell@bakermckenzie.com
Wian.Steyn@bakermckenzie.com
Ref: J Bell/WS

SERVICE BY EMAIL AS AGREED BETWEEN THE PARTIES

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NOTARY PUBLIC
REPUBLIC OF NAMIBIA

THE FINANCIAL SERVICES TRIBUNAL

REF: JSE1/2021

In the matter of:

TRUSTCO GROUP HOLDINGS LIMITED	Applicant
and	
JSE LIMITED	Respondent

EXPERT REPORT OF PROFESSOR W MAROUN

BACKGROUND

1. I have been requested to express an opinion on the correct approach that ought to be followed by a company when preparing financial statements in accordance with IFRS in relation to the maters identified below.

2. A copy of my abbreviated *Curriculum vitae* is attached and marked as "**A**".

3. I have considered the report prepared by the FRIP, the correspondence that was exchanged between the JSE and Trustco, and Trustco's reconsideration submissions.

INTRODUCTION

4. The opinion which I express in this report is expressed as a Chartered Accountant and not as a lawyer. This is an important distinction, because the

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accounting standards are used by accountants to prepare financial statements which faithfully represent the economic substance of a transaction, or group of transactions. The economic substance, as assessed by an accountant or auditor, may differ from the legal conclusions reached by a lawyer when interpreting a transaction, or group of transactions.

5. For accounting purposes, an element of deceit (which may be required for a legal conclusion) is not necessary to conclude that the economic substance of a transaction is different to its form. Differentiating between economic substance and form would capture a transaction which is a simulation or sham, but it can also inform the accounting for entirely honest transactions. Consider, for example, a lease where IFRS requires the lessee to reflect an asset on its balance sheet which is not owned by the entity and may never be owned by the entity.

6. For the purpose of applying IFRS, "substance over form" is an accounting concept which is specific to financial accounting.

7. It is not a legal concept that is dictated by the assessment of whether a contract is a sham or not. "Substance over form" requires the underlying economics of a transaction to be considered, including how the facts and circumstances affect the amount, timing and certainty of the resulting cash flows and entity-specific values (see, for example, the Conceptual Framework for Financial Reporting ("**CFW**") which underpins the IFRS at paragraphs 2.6-2.19; IAS 16, para 25, IFRS 9, para 3.3.2 & IFRS 16 para B2).

8. IFRS requires financial statements to be a faithful representation of the underlying economic phenomena and events. This means that financial

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statements must consider the economic substance, and financial reality of the underlying transactions, and not merely their legal form.

9. When preparing financial statements an accountant must consider the following accounting standards, in the following order:

9.1. The IFRSs dealing specifically with the underlying transactions and the provisions of IAS 1 which require financial statements to provide a faithful representation of the substance of the transactions.

9.1. In the event that the IFRS does not cover a particular transaction, judgement must be used to develop an appropriate accounting policy. The accounting policy must, *inter alia*, represent faithfully the financial position, performance and cash flows of the entity and "reflect the economic substance of transactions, other events and conditions and not merely the legal form" (IAS 8, para 10b, emphasis added). In applying judgement to develop a suitable accounting policy, "management shall refer to, and consider the applicability of, the following sources in descending order: (a) the requirements in IFRSs dealing with similar and related issues; and (b) the definitions, recognition criteria measurement concepts for assets, liabilities, income and expenses in the [CFW]" (IAS 8, para 11).

10. The CFW states that financial reports must represent the underlying economic phenomena. To be a faithful representation, financial information must "*faithfully represent the substance of the phenomena that it purports to represent*". The substance and legal form may be the same in most cases, but where this is not the case, "*providing information only about the legal form would not faithfully represent the economic phenomenon*" (CFW, para 2.12).

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11. To give effect to faithfully presenting the economic phenomenon, the CFW states the following:

11.1. All terms of a contract are evaluated unless they have no substance and any arrangements, even if not stated explicitly, must be considered (CFW, para 4.60).

11.2. Rights which a holder has no *practical ability* to exercise have no substance (CFW, para 4,61). The same is true for obligations which are only enforceable under extreme circumstances or which are not genuine (IAS 32, para 25).

11.3. The rights and obligations arising from a group of contracts may need to be accounted for as a single unit of account, to give effect to their commercial reality. Conversely, the rights and obligations specified in a single contract may need to be considered separately (CFW, para 4.62).

11.4. "*When assets are acquired, or liabilities incurred, as a result of an event that is not a transaction on market terms, all relevant aspects of the transaction or other event need to be identified and considered. For example, it may be necessary to recognise other assets, other liabilities, contributions from holders of equity claims or distributions to holders of equity claims to faithfully represent the substance of the effect of the transaction or other event on the entity's financial position and any related effect on the entity's financial performance*" (CFW, para 6.82).

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12. The CFW is not itself an IFRS and does not override a requirement of the IFRS (CFW, SP1.2). It does, however, underpin the development of IFRS and inform how the standard-setter, which prepared IFRS, developed and interpreted the provisions of specific IFRSs (CFW, SP1.5). In addition, the use of the CFW to inform any analysis is supported by the following:

12.1. The CFW provides details on what is meant by "substance over form" which is referred to in certain of the individual IFRSs.

12.2. The CFW must be referred to when IAS 8 is used to develop an accounting policy, because a specific IFRS does not deal with a transaction (see IAS 8, para 10-11).

12.3. More generally, IAS 1 (which is part of IFRS) requires financial statements to achieve "*fair presentation*" and provide a "*faithful representation of the effects of transactions, other events and conditions*" (IAS 1, para 15).

13. Any analysis of the accounting for the forgiveness of the two loans (Referral 1) and the re-classification of property from inventory to investment property (Referral 2) must be guided by the provisions of the applicable IFRS and the CFW.

THE LOANS ISSUE

14. For the loans issue, Referral 1, the most relevant IFRS standards are IFRS 3 Business Combinations, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, IAS 32 Financial Instruments: Presentation and IAS1:

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Presentation of Financial Statements. (The suite of IFRS includes standards with the prefix IFRS and with the prefix IAS.)

15. IFRS 3 deals with the accounting for business combinations. *Inter alia* it requires the assets and liabilities of an acquiree to be identified, and for the consideration paid for the business combination to be determined (IFRS 3, para 10 & 37).

16. In applying IFRS 3, all information which is known up to the date the financial statements are prepared must be considered, and not only the information that is known as at the acquisition date. Accordingly, the accounting treatment is not limited to only the facts known as at the date of acquisition (IFRS 3, para 45 & 51).

17. IAS 32 deals with the classification of financial instruments as equity or liabilities, and the recognition and measurement of equity instruments. It states that "*the issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument*" (IAS 32, para 15, emphasis added).

18. In some cases, the IFRS may not cover a specific transaction or event. In these instances, IAS 8 requires management to apply judgement to develop an appropriate accounting policy, which is relevant and reliable (IAS 8, para 10). The accounting policy must be developed, *inter alia,* to ensure that the financial statements represent faithfully the financial position, performance and cash flows of the entity, and "*reflect the economic substance of*

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transactions, other events and conditions and not merely the legal form" (IAS 8, para 10b).

19. In applying its judgment to develop a suitable accounting policy, management must first refer to the IFRSs dealing with similar issues and the definitions and recognition of the elements[1] of the financial statements as set out in the CFW (IAS 8, para 11).

20. Management may also use the most recent pronouncements of other standard-setting bodies[2], accepted industry practices and other accounting literature, but only to the extent that these do not conflict with the first two sources (IAS 8, para 12).

21. Trustco relied on UK GAAP (FRS 6) to develop its accounting policy for business combinations involving entities under common control. IAS 8 refers to the use of standards set by other accounting bodies when existing IFRS do not deal with a transaction (IAS 8, para 12). In my opinion such standards must be operative (see IAS 8, para 12[3]) or at least ought to be operative, at the relevant date (i.e. when the financial statements are being prepared). FRS 6 was withdrawn for reporting periods commencing on or after 1 January 2015 and was, therefore, no longer operative at the relevant time, and in my opinion ought not to have been referred to, or relied upon, by Trustco in

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[1] These are the entity's assets, liabilities, incomes, expenses and equity.

[2] These standard setters must follow a similar conceptual framework to develop accounting standards (IAS 10, para 12).

[3] specifically, the requirement to refer to the "most recent" pronouncements of other standard-setters (IAS 8, para 12).

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developing its accounting policy. In any event, FRS 6 did not deal expressly with the forgiveness of shareholder loans.

22. To account for the economic substance and financial reality of transactions and not just the legal form, it is unnecessary for the parties to have known, or to have reasonably foreseen, that a loan waiver would occur and trigger the earn-out clauses. The hurdle for accounting purposes is much lower than what is required to satisfy a legal test where an element of deceit is involved. This is because IFRS is concerned with accounting for the economics of transactions only (see CFW 2.12 and 2.18).

23. Provisions in separate contracts can be considered as a single unit of account to understand and present the underlying economics of transactions. Similarly, all information available up to the point that the financial statements are finalised is considered rather than only the facts and circumstances prevailing at the date a contract is concluded (CFW, para 4.62; IAS 10; IFRS 3).

24. A financial liability is a contractual obligation "*to deliver cash or another financial asset to another entity; or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity*" (IAS 32, para 11).

25. "*The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with <u>the substance of the contractual arrangement</u> and the definitions of a financial liability, a financial asset and an equity instrument*" (IAS 32, para 15, emphasis added).

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26. A financial liability is derecognised when it is extinguished. The difference between the carrying amount of the financial liability, and the consideration paid (including non-cash assets transferred and liabilities assumed), is recognised in profit or loss (IFRS 9, para 3.3.1 & 3.3.3).

27. If there have been changes to the terms of a financial liability or equity instrument which have a material effect on the amount, timing and certainty of the cash flows inherent in an asset or liability, this reflects a change in the underlying economics which ought to be accounted for, to provide a faithful representation. The same applies when a transaction is concluded with a related party because the close relationship between the parties can affect the economic rationale for entering into the transaction (see IAS 24).

28. There are examples in IFRS dealing with the accounting implications of contract modifications (see, for example, IFRS 15, para 18-20), changes in the intended use of assets (see, for example, IAS 40, para 57) and re-assessments of liabilities after initial recognition (see, for example, IFRS 16, para 39-46).

29. IAS 32 provides only limited guidance on the re-classification of financial liabilities (see IAS 32 para 16E-F). If this guidance does not apply to a loan, IAS 8 must be used to develop an appropriate accounting policy. Disregarding changes or developments which materially alter the underlying economics of a financial instrument is inconsistent with the requirements of IAS 1, IAS 32 and the CFW to account for the substance of transactions.

30. In my opinion IAS32.AG25 is not applicable to the loan between Trustco and van Rooyen because:

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30.1. AG25 deals with a situation where the redemption of the shares is mandatory or at the option of the holder. The issuer's subsequent inability to satisfy the redemption does not extinguish the contractual obligation to deliver cash which was established when the instrument was initially recognised. In the case of the shareholder loans, the decision to repay the loans vested with the borrower. This means that the borrower had a contractual right to avoid the transfer of cash (see IAS 32, para 17). This right appears to be unconditional (IAS 32, para 19) and means that the loan to Trustco does not meet the definition of a financial liability.

30.2. IAS32 AG25 is based on an arms-length transaction, rather than one which involves a related party, and does not contemplate the forgiveness of amounts due, for no consideration.

31. At a fundamental level and in summary:

31.1. the accounting assessment under IFRS as to how the Van Rooyen loans to the subsidiary which existed at the date of acquisition by Trustco, and the subsequent waiver thereof, were to be accounted for in the Trustco group financial statements required a full conspectus of all the matters pertaining thereto, up to date of preparation of the financial statements;

31.2. that assessment requires reference to IFRS 3 read with IAS 32, IAS 1 IAS 8 and the CFW and required the consideration of the substance (in the accounting context, as dealt with above) and not merely the form, particularly having regard to the extraordinary waiver;

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31.3. the accounting assessment under IFRS as to how the subsequent Van Rooyen loans made to Trustco (and/or its subsidiaries) and their later waiver were to be accounted for in the Trustco group financial statements, also required a full conspectus of all the matters pertaining thereto, up to date of preparation of the financial statements – and the consideration of the substance, particularly having regard to the extraordinary waiver.

<u>THE RECLASSIFICATION OF PROPERTY ISSUE</u>

32. For the reclassification issue, referral 2, the most relevant standard is IAS 40 Investment Property.

33. IAS 40 requires investment property (as defined), which is valued on the fair value model, to be carried at fair value, with changes in fair value recognised in profit or loss[4] (IAS 40, para 33 & 35). In accounting, profit and loss is entirely different to revenue. Revenue arises from the sale of goods or services and has nothing to do with fair value gains.

34. Where there is a change in the use of an asset requiring a transfer to, or from, investment property, there must be clear evidence of a change in use. Management's intention is, by itself, insufficient (IAS 40, para 57).

35. IAS 40 does not provide extensive guidance on differentiating between a change in intention, and a change in use, but it includes some examples such

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[4] It is my understanding that Trustco uses the fair value model for investment property and that this is not in dispute.

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as "*commencement of development with a view to sale*" to support a transfer from investment property to inventory (IAS 40, para 57(b)). Conversely, the cessation of development, which is distinct from a delay in a development, with a view to holding an asset for capital appreciation would justify the decision to re-classify inventory as an investment property.

36. "*An entity must have taken observable actions*" to support a change in use (IAS 40, para BC27). By itself, a resolution of the Board of Directors is insufficient to demonstrate a change in use.

37. Land held for a currently undetermined future use is an example of investment property (IAS 40, para 8b).

38. IAS 40 provides for properties being developed to be accounted for as investment property (IAS 40, para 8e).

39. The evidence of a change in use must have substance. For example:

39.1. The measures to discontinue a development should be material, and be more than a temporary delay. For instance, the retrenchment of staff and asset sales would lack substance, if staff are to be re-appointed and assets are to be reacquired shortly after the decision is taken to discontinue development.

39.2. The period of the discontinuation of activities should be longer than the delays or stoppages customarily encountered when developing the same or similar properties as inventory. In property development the delays in completing the development may be several years and

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it would be incorrect to consider that there has been a discontinuation simply because it will take more than 12 months to sell a property.

39.3. It should be unlikely that the plan to hold the properties for capital appreciation will be withdrawn or curtailed materially. Similarly, material sales of these properties to customers should be infrequent and immaterial.

40. Assuming that a valid transfer from inventory to investment property takes place, with a resultant gain on the fair value adjustment, that is not be revenue and may not be reflected as revenue.

41. "*For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss*" (IAS 40, para 63). In lay terms, this means that there will be a line item in the income statement described, for example, as fair value gain on property/revaluation gain, and having no effect on revenue reflected.

42. "*The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories*[5]" (IAS 40, para 64).

43. For the accounting to be "*consistent with the treatment of the sale of inventories*" the provisions of IAS 2 Inventories (dealing with inventory) and

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[5] IAS 40 (para 64) neither requires nor permits the recognition of revenue and cost of sale. In my opinion, the paragraph clarifies why the accounting for a transfer to inventory is via profit or loss rather than other comprehensive income and equity, as is the case with a transfer concerning PPE.

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IFRS 15 Revenue from Contracts with Customers (dealing with revenue from contracts with customers) must be considered:

43.1. Revenue is recognised as or when or as the seller satisfies its performance obligations to its customers (IFRS 15, para 2). Performance obligations are successfully transferred when the customer obtains control of the underlying assets (IFRS 15, para 31-33). As the development of the property for sale has been discontinued and Trustco retains control over the properties in question, no performance obligations have been satisfied, and revenue cannot be recognised[6]. Indeed, there was no sale and, thus, the question of performance obligations did not even arise. It follows automatically that there was no Cost of sales that could be reflected, as there was no sale.

43.2. Inventories are only recognised as an expense when they are sold or impaired (IAS 2, para 34). The asset has not been derecognised because Trustco retains control over the assets. Only the classification of the assets has changed. As a result, no adjustment to profit or loss (in the form of cost of sales) can be processed.

44. The fair value adjustment on the re-classification must be shown separately as fair value adjustment on investment property based on IAS 40 (para 75f)

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[6] Trustco (April 2020, Appendix C, 2(i)) acknowledges that the transaction is outside the scope of IFRS 15.

JOSIAS ANDRIES AGENBACH
NOTARY PUBLIC
REPUBLIC OF NAMIBIA

read with IAS 1 (para 85). Recording the adjustment in revenue is contrary to IFRS because:

44.1. Revenue is a measure of the effort expended by an organisation to satisfy performance obligations to customers by transferring promised goods and services to customers (IFRS 15, para 31). Trustco has not transferred the properties to customers. It retains control over the properties before and after the re-classification.

44.2. Revenue results in an inflow of a fixed or determinable amount of cash when the customer settles the amount due. Changes in the fair value of the property are different. They do not give rise to fixed or determinable amounts of cash when the change in fair value occurs.

44.3. The cash flows arising from a revenue transaction are presented as cash flows from operating activities in a cash flow statement. This is because revenue is, in substance, a measure of how cash flows are generated from an organisation's primary activity or purpose. Trustco is said to be holding the properties in question as investment property. This means that the properties are not expected to be sold in the ordinary course of the group's activities and have no impact on cash flows from operations.

44.4. Presenting revenue on the re-classification is counter-intuitive. Trustco has re-classified properties precisely because it does not expect them to be held for sale to customers, and of course, there was no sale at all.

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