

- 44.5. The recording of the fair value gain as part of revenue distorts key measures of financial performance. For example, the year on year revenue growth, 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.

Signed at

on

2021

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**PROFESSOR W MAROUN Phd**



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## Curriculum vitae: Warren Maroun

### Qualifications summary

Professional memberships	South African Institute of Chartered Accountants (SAICA) Chartered Institute of Management Accountants (CIMA)
Highest qualification	PhD (King's College London)
Other qualifications	Bachelor of Accountancy (Wits) – Cum Laude Honours (Taxation) (Wits) – Cum Laude Masters (Accountancy) (Wits) – Cum Laude
Select awards	SAICA examinations – top 10 placement CIMA – top 10 placement (internationally) Wits – most distinguished graduate in human sciences

### Research summary

Research areas	Assurance; corporate governance; corporate social responsibility; financial accounting; integrated and sustainability reporting
ORCID	<a href="https://orcid.org/0000-0001-7448-1220">https://orcid.org/0000-0001-7448-1220</a>
Google Scholar <sup>1</sup> :	Citations = 2 254; H-index = 28
NRF <sup>2</sup> Rating	Y1 Rating (effective 2016)
Research Gate	Research impact score in top 20%

### Work experience

<b>2010 – Current</b> University of the Witwatersrand	<b>Professor (2015-Current)</b> <b>Associate professor (2012-2015)</b> <b>Senior lecturer (2010-2012)</b>
<b>2018-Current</b> University of Exeter	<u>Areas of expertise</u> Auditing, financial accounting, integrated reporting and research
<b>2010 – 2018</b> PricewaterhouseCoopers	<b>Visiting audit manager</b>  <u>Summary of clients</u> Impala Refining Services (2010-2018) First Uranium Corporation (2010-2011) PwC Technical (2010-2013) Associate (2007-2010)

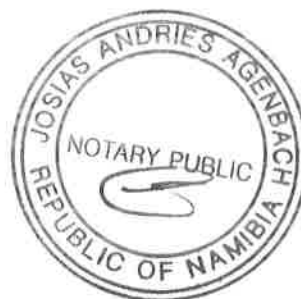
### Summary of research activity

I have published over 70 full-length academic papers, three full-length books and five book chapters dealing with different aspects of accounting, assurance, corporate reporting and sustainability. A summary of outputs is provided below.

Research marked with an asterisk is either classified as world-leading for the purpose of the Research Excellence Framework where co-authors are based in the United Kingdom or published in the leading international journals according to the Australian Dean's List (A\* rating).

<sup>1</sup> As at 17 March 2021

<sup>2</sup> The National Research Foundation (NRF) is responsible for the review of research quality in South Africa. Per the NRF website, the institution's mandate is to 'promote and support research through funding, human resource development and the provision of the necessary research facilities in order to facilitate the creation of knowledge, innovation and development in all fields of science and technology, including indigenous knowledge...'



*RB*

#### Select academic publications

- \*Atkins, J. & Maroun, W. 2020. The Naturalist's Journals of Gilbert White: exploring the roots of accounting for biodiversity and extinction accounting. *Accounting, Auditing & Accountability Journal*, 33 (8), 1835-1870.
- Atkins, J. & Maroun, W. 2015. Integrated reporting in South Africa in 2012: perspectives from South African institutional investors. *Meditari Accountancy Research*, 23 (2), 197-221.
- \*Atkins, J. & Maroun, W. 2018. Integrated extinction accounting and accountability: building an ark. *Accounting, Auditing & Accountability Journal*, 31 (3), 750-786.
- \*Cerbone, D. & Maroun, W. 2020. Materiality in an integrated reporting setting: Insights using an institutional logics framework. *The British Accounting Review*, 52 (3), 10876.
- De Villiers, C., Pei-Chi, K. H. & Maroun, W. 2017. Developing a conceptual model of influences around integrated reporting, new insights and directions for future research. *Meditari Accountancy Research*, 25 (4), 450-460.
- Harber, M. & Maroun, W. 2020. Mandatory audit firm rotation: a critical composition of practitioner views from an emerging economy. *Managerial Auditing Journal*, 35 (7), 861-896.
- Maroun, W. 2014. Reportable irregularities and audit quality: Insights from South Africa. *Accounting Forum*, 39 (1), 19-33.
- \*Maroun, W. 2017. Assuring the integrated report: Insights and recommendations from auditors and preparers. *The British Accounting Review*, 49 (3), 329-346.
- \*Maroun, W. 2018c. Modifying assurance practices to meet the needs of integrated reporting: The case for "interpretive assurance". *Accounting, Auditing & Accountability Journal*, 31 (2), 400-427.
- Maroun, W. 2019a. Does external assurance contribute to higher quality integrated reports? *Journal of Accounting and Public Policy*, 38 (4), 106670.
- \*Maroun, W. 2019b. Exploring the rationale for integrated report assurance. *Accounting, Auditing & Accountability Journal*, 32 (6), 1826-1854.
- Maroun, W. 2020. A Conceptual Model for Understanding Corporate Social Responsibility Assurance Practice. *Journal of Business Ethics*, 161, 187-209.
- \*Maroun, W. & Atkins, J. 2014a. Section 45 of the Auditing Profession Act: Blowing the whistle for audit quality? *British Accounting Review*, 46 (3), 248-263.
- \*Maroun, W. & Atkins, J. 2014b. Whistle-blowing by external auditors in South Africa: Enclosure, efficient bodies and disciplinary power. *Accounting, Auditing & Accountability Journal*, 27 (5), 834-862.
- Maroun, W. & Prinsloo, A. 2020. Drivers of combined assurance in a sustainable development context: Evidence from integrated reports. *Business Strategy and the Environment*, 29 (8), 3702-3719.
- van Zijl, W. & Maroun, W. 2017. Discipline and punish: Exploring the application of IFRS 10 and IFRS 12. *Critical Perspectives on Accounting*, 44, 42-58.



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THE FINANCIAL SERVICES TRIBUNAL

**FA5**

REF: JSE1/2021

In the matter of:

**TRUSTCO GROUP HOLDINGS LIMITED**

Applicant

and

**JSE LIMITED**

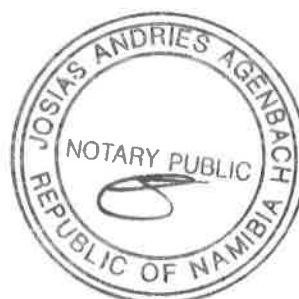
Respondent

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**EXPERT REPORT OF TAPIWA NJIKIZANA**

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- 1 I am employed as a director at W Consulting.
- 2 W Consulting is a global independent financial reporting and corporate finance advisory firm. As JSE accredited IFRS Advisors, it assists companies in researching emerging financial reporting issues and with the formulation of accounting opinions on complex accounting matters.
- 3 My abbreviated curriculum vitae is attached hereto marked as "A".
- 4 I:
  - 4.1 have advised Trustco in relation to the accounting treatment of accounting entries forming the basis of the Decision and the application for reconsideration;



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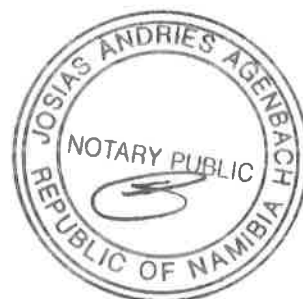
- 4.2 have assisted Trustco and its legal representatives in the preparation of its application for reconsideration; and
- 4.3 confirm that the manner in which Trustco has treated the accounting entries - (as explained in the application for reconsideration) is in my view correct and accords with IFRS.
- 5 I have now been requested to review and comment on the expert report of Professor Maroun. I deal *ad seriatim* with Prof. Maroun's report below. Where I have highlighted or underlined quoted parts of a particular IFRS, I do so for emphasis purposes.

**AD PARAGRAPHS 6 TO 12: GENERAL COMMENTS ON APPROACH AND THE SUBSTANCE OVER FORM ARGUMENT**

- 6 Prof. Maroun's statements, generically applied, are not contentious. What is however important is how these concepts are applied to the specific facts and circumstances under discussion.
- 7 The concept of "substance over form" is part of the concepts of financial reporting discussed in the Conceptual Framework for Financial Reporting ("CFW"). The status and purpose of the CFW are however significant:

**"STATUS AND PURPOSE OF THE CONCEPTUAL FRAMEWORK**

**SP1.1** *The Conceptual Framework for Financial Reporting (Conceptual Framework) describes the objective of, and the concepts for, general*



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*purpose financial reporting. 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**;...*

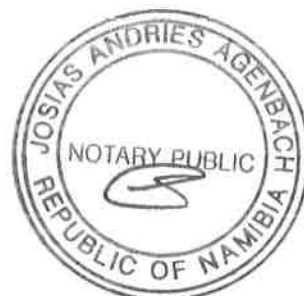
8 The concept of "substance over form" (together with the other concepts set out in the CFW) is consequently "baked into" all the standards developed by the International Accounting Standards Board ("IASB"). It is not a concept which should be considered as residing outside the individual standards and therefore has to be applied over and above the specific requirements of the standards, or worse still, be applied instead of the specific requirements of the standards.

9 To make this clear, the CFW states explicitly that:

***"SP1.2 The Conceptual Framework is not a Standard. Nothing in the Conceptual Framework overrides any Standard or any requirement in a Standard."***

10 The IASB may, notwithstanding its objective as set out in SP1.1(a), itself depart from aspects of the CFW in developing a standard. It is for this reason that the CFW does not replace or supersede a standard because the IASB reserves for itself the right to deviate from certain of its aspects as it deems appropriate. See in this regard, the following passage of the CFW:

***"SP1.3 To meet the objective of general purpose financial reporting, the Board may sometimes specify requirements that depart from aspects of the Conceptual Framework. If the Board does so, it will explain the departure in the Basis for Conclusions on that Standard."***

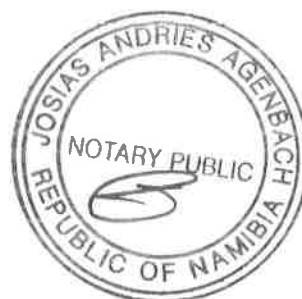


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- 11 In short, where a standard deals with a particular matter, an argument that the standard is incorrect, incomplete, or lacks a "substance over form" perspective would be baseless. If a preparer considers the requirements of a standard as well as the facts and circumstances to which that standard should be applied, it can be concluded that this includes the consideration of all concepts of the CFW as deemed appropriate by the IASB, including the "substance over form".
- 12 The standards cited by Prof. Maroun to illustrate that "substance over form is an important consideration" in the application of IFRS in fact confirm my views about the relationship between the CFW and the standards as explained above, being that the concept of "substance over form" is in fact baked into the standards. By way of example, IAS 16, paragraph 25 cited by Prof. Maroun states:

" 25 An entity determines whether an exchange transaction has **commercial substance** by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction **has commercial substance** if:

- (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and



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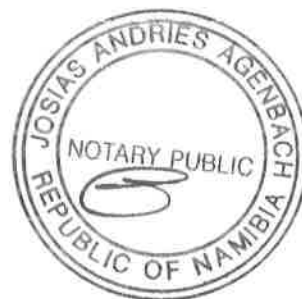
- (c) *the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.*

*For the purpose of determining whether an exchange transaction **has commercial substance**, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations."*

- 13 It is clear from the paragraph cited that the IASB explicitly dealt with the concept of "substance over form" describing it as a consideration of the "commercial substance" of a transaction. The standard explains exactly what is meant by "commercial substance" and provides the tests to be applied in order to reach a determination thereof. The preparer is not required to seek any guidance or to seek for further requirements outside of the standard in order to have properly considered the concept of "substance over form".
- 14 The view of the IASB is that the application of IFRS would result in a fair presentation of financial statements, this is confirmed by this extract from IAS 1 [I have added in bold my emphasis, however the entire paragraph itself is in bold in the original text denoting that it is a key principle of the standard]:

***"Fair presentation and compliance with IFRSs***

- 15 *Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the **faithful representation** of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the*



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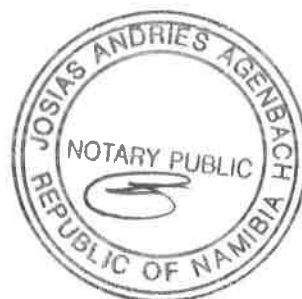


*Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.*"

- 15 There is therefore a built-in presumption within IFRS that by applying the requirements of the standards, an entity will achieve a fair representation, meaning that the financial statements will faithfully represent the financial effects of transactions. Put differently, where an entity has referred to no information other than the requirements set out in the IFRS applicable to it, it shall be able to present financial statements that fairly represent its affairs.
- 16 Finally, the IASB has made for an exception to this presumption in circumstances where management (or in the case of the JSE, a regulator, taking on the role of management with respect to the proper application of IFRS) may deviate from the requirements of an IFRS, stating in IAS 1 [bold added for emphasis, however the entire paragraph itself is in bold in the original text denoting that it is a key principle of a standard]:

*"19 In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure."*

- 17 In considering whether such circumstances exist, management is to have regard to the following requirements of IAS 1:

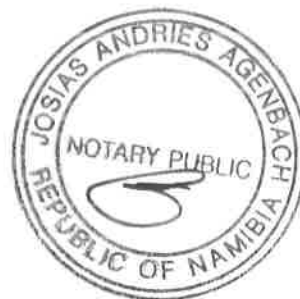


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**"24** For the purpose of paragraphs 19–23, an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events and conditions that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to influence economic decisions made by users of financial statements. **When assessing whether complying with a specific requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, management considers:**

- (a) why the objective of financial statements is not achieved in the particular circumstances; and
- (b) how the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework."

18 In my view, and based on the above, the transactions to which Trustco has applied specific requirements of IFRS, where such exist, result in a fair presentation of its financial position and the faithful representation of the transactions on the basis of the presumption set out in IAS 1, paragraph 15. The application of IAS 1, paragraph 19 would be pursuant to an assessment by Trustco management that complying with IFRS would result in the presentation of misleading information. That is not their assessment.



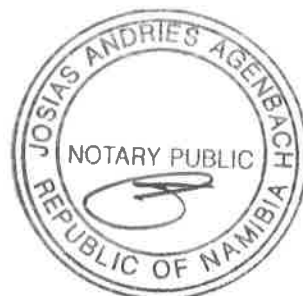
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- 19 Where the JSE and Prof. Maroun are of the view that the application of specific requirements of IFRS do not result in a fair representation, on the basis of "substance over form" for instance, it is for them to demonstrate how they have arrived at this assessment in terms of IAS 1, paragraph 24 with regard to all the facts and circumstances they consider relevant to that assessment.
- 20 I have noted that neither the JSE nor Prof. Maroun express the view that compliance with aspects of IFRS in so far as the matters under consideration are concerned would result in the presentation of misleading information. Instead, they hold the view that Trustco has misapplied IFRS which is an entirely different matter.
- 21 In my view, the effect of the JSE decision is to instruct Trustco not to comply with IFRS in order to achieve what the JSE considers to be a fair presentation of its financial statements. It however does so under the mistaken conclusion, in my view, that Trustco has misapplied IFRS.

## THE LOANS

### AD PARAGRAPHS 14 TO 16

- 22 Trustco's application for reconsideration sets the basis for why IFRS 3 is not applicable to the Huso acquisition.
- 23 Prof. Maroun does not address how it is that IFRS 3, and the specific paragraphs therein referred to by him, are assessed as being applicable given the explicit exclusion of common control business combinations from the scope of IFRS 3.



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- 24 This is not a small detail to be overlooked in developing an accounting policy for the transaction(s) in question, especially since the context is the application of judgment to consider different potential sources of accounting guidance and to evaluate why and how each of those sources are appropriate or not. The absence of any supporting reasoning in Prof. Maroun's report in this regard is a significant deficiency which significantly constrains one's ability to engage critically with the conclusions reached or, I would argue, to place reliance thereupon.
- 25 Notwithstanding this deficiency, I will nevertheless address the matters that are raised as if an argument had been made in support of their relevance or applicability to the specific facts and circumstances of the referral matter.
- 26 Prof. Maroun asserts broadly that "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". This assertion has the potential to mislead in terms of the specific requirements of IFRS 3.
- 27 In this regard, IFRS 3 paragraph 45 states:

***"Measurement period***

- 45** *If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the*



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*measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date **to reflect new information obtained about facts and circumstances that existed as of the acquisition date** and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities **if new information is obtained about facts and circumstances that existed as of the acquisition date** and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date."*

28 Whilst referring to the above paragraph 45 in his report, Prof. Maroun does not indicate to what aspect(s) of the referred matters it was intended that the above should be applied and how. What is provided is a broad assertion that "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" which by itself sheds no light on the accounting to be applied in these specific circumstances and glosses over important nuances of the requirements of the paragraph.

29 I can only infer, based on the nature of the matters under dispute in the referrals, that his reference to paragraph 45 of IFRS 3 is to do with the recognition of a liability at the acquisition date of Huso by Trustco relating to the Quinton van Rooyen ("QvR") loan (loan 1). Proceeding from this assumption, the application



of paragraph 45 is subsequent to the compilation of a provisional balance sheet as at the acquisition date of the acquiree by the acquiror.

- 30 In order to properly understand its purpose and application of paragraph 45 of IFRS 3 in the accounting for a business combination, one should have regard to the requirements for the compilation of the acquisition date balance sheet as set out in the paragraphs of IFRS preceding paragraph 45 for which I have provided the relevant excerpts below:

***"Recognition principle***

- 10 ***As of the acquisition date***, the acquirer shall recognise, separately from goodwill, **the identifiable assets acquired, the liabilities assumed** and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.

***Recognition conditions***

- 11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Conceptual Framework for the Financial Reporting ***at the acquisition date***. For example, costs the acquirer expects **but is not obliged** to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees **are not liabilities at the acquisition date**. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. **Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other IFRSs.**



*RB*

- 12 *In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination transaction **rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs 51–53** to determine which assets acquired or liabilities assumed are part of the exchange for the acquiree and which, if any, are the result of separate transactions **to be accounted for in accordance with their nature and the applicable IFRSs.***

***Classifying or designating identifiable assets acquired and liabilities assumed in a business combination***

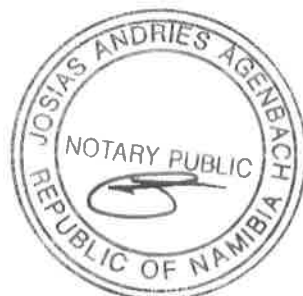
- 15 ***At the acquisition date**, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other IFRSs subsequently. The acquirer shall make those classifications or designations **on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions** as they exist **at the acquisition date.***
- 31 None of the above requirements nor the requirements of paragraph 45 have been addressed with respect to their application to the specific facts and circumstances of the referral matter by Prof. Maroun, having cited paragraph 45 in his report. It is therefore not possible to determine if, or how, the cited paragraph and the related paragraphs were applied in arriving at Prof. Maroun's determination of the appropriate accounting.
- 32 Despite referring to IFRS 3, paragraph 51, there is no indication in his report as to the application of the requirements of that paragraph with respect to facts and



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circumstances of the Huso transaction. It is therefore not possible to determine if, or how, the quoted paragraph was applied in arriving at Prof. Maroun's determination of the appropriate accounting.

- 33 As such, I am of the view that the broad assertion by Prof. Maroun that "all information which is known up to the date the financial statements are prepared must be considered" is made out of any context relating to its application to the referral matter, and is therefore misleading in the manner in which it is presented.
- 34 The accurate position, in my view, is that for purposes of compiling the acquisition date balance sheet (which is a primary purpose of the procedures of IFRS 3), the facts and circumstances as **at acquisition date** determine what is to be recognised. The determination of what those facts were at acquisition will include the assessment of any new information of relevance to those facts which sheds light on those facts as they existed at acquisition date. The period over which new information should be considered for this purpose extends up to a maximum of 12 months after the date of acquisition, or may be earlier if management has determined that it has assessed all relevant matters and is able to finalise the business combination accounting. This is referred to as the measurement period.
- 35 During the measurement period as the acquirer's management gathers and considers **it is required to differentiate** between information that comes to its attention which provides further details about facts that existed at acquisition date and information that relates to **events that have occurred subsequent** to the acquisition date.



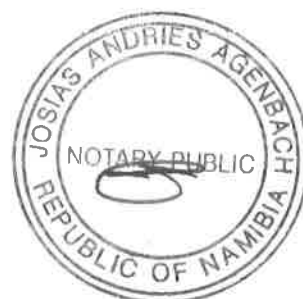
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36 In broad terms, one could therefore assert as Prof. Maroun has done, that all that information is to be "considered". A lay person may interpret that to mean that all information is relevant and should therefore be incorporated into the accounting giving rise to an adjustment to the initial accounting or assessments made at acquisition date. That would be an erroneous understanding of the requirements of IFRS 3. This idea that some events that adjust and other events do not adjust the accounting adopted at an earlier point in time, such as at acquisition date or a reporting date is well articulated in IAS 10, and the IASB confirms this in BC 399 of IFRS 3 which reads:

**"BC399** *The boards concluded that adjustments during the measurement period following a business combination **are more analogous to adjusting events after the end of the reporting period (IAS 10 Events after the Reporting Period)** than to changes in estimates. The effects of events that occur after the end of an accounting period but before the financial statements for the period are authorised for issue and provide evidence of a condition that existed at the date of the financial statements are reflected in financial statements as of that date. Similarly, the effects of information that first becomes available during the measurement period and provides evidence of conditions or circumstances that existed at the acquisition date should be reflected in the accounting as of that date."*

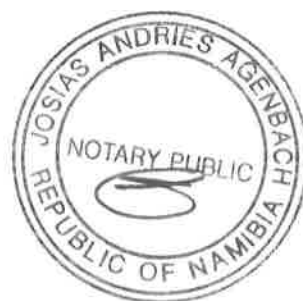
37 Whilst Trustco has not applied IFRS 3 to this transaction (on the basis that common control transactions are explicitly excluded from the scope of IFRS 3)



RB

and has therefore applied its own accounting policy (informed by FRS 6) as required by IAS 8, if its accounting is tested against the requirements of IFRS 3 with respect to the recognition of assets and liabilities at acquisition date, Trustco would have met every single IFRS 3 requirement. This includes assessing whether the Huso loan forgiveness soon after acquisition date could be considered as being "part of the business combination", which by direct reference to IFRS 3.51-53 and B50-62, could not be considered to be a part of the business combination. The detailed arguments in this regard have been provided in Trustco's prior submissions to the JSE and as part of the application for reconsideration, and are accordingly not repeated herein.

- 38 In addition to the fact that the conditions that would need to be present in order for the loan waiver to be considered a part of the business combination, the fact is that the majority of the tests applied in IFRS 3.51-53 and B50-62 relate to an assessment of "relative advantage" in the trade-offs that occur between an acquirer and the acquiree, and/or the respective shareholders thereof, which in the circumstances of a common control business combination necessarily results in a circular reference due to the controlling shareholder of the acquirer and the acquiree being the same party (by definition).
- 39 In my view these circumstances where logical requirements applicable to "normal" business combinations fail to be applicable to business combinations under common control are an example of one reason why the IASB determined it to be appropriate to exclude such business combinations from the scope of IFRS 3.

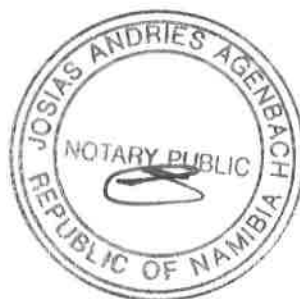


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- 40 Prof. Maroun has referred to a number of IFRS 3 paragraphs in his report. He has not, however, taken the reader through the application of those paragraphs to specific facts and circumstances of the referral matter. Without this, one is left with a generalised argument which may be appealing to a lay person as it does not drag one into the detail of IFRS or the specific transaction details which are complex.
- 41 This generalised approach is given credence by extensive referencing to the CFW which provides a discussion of accounting concepts in broad terms and makes use of reassuring terms such as "substance over form" which gives the lay person a sense that there is some inherent "common sense" to be applied. The fact is that the specific transaction details matter, the specifics of the circumstances matter, and the demonstration of how the specific and applicable elements of the standards have been applied to those facts and circumstances is what matters. Such an approach may be referred to pejoratively as "legalistic" but such a view is belied by the position of the IASB itself that standards contain within themselves all the necessary requirements to capture, amongst others, the economic substance of what is being accounted for.

AD PARAGRAPHS 17 TO 20

- 42 I take no issue with the quotes from IFRS in so far as they are for the purposes of providing information about what the standards require.



RB

43 I do however note that Prof. Maroun does not explain how he has made use of the standards he has quoted in arriving at this accounting treatment. Particularly he has not offered any explanation of how he has considered and applied IAS 8.10-12.

AD PARAGRAPH 21

44 When an entity develops an accounting policy in the absence of an IFRS standard per IAS 8, paragraph 10, the policy developed, irrespective of whether reliance was placed on any of the sources listed in IAS 8 paragraphs 11 or 12, becomes its own accounting policy and part of "its IFRS", irrespective of the source. It is however no longer directly tied to the sources of guidance from whence it may have been derived. This is confirmed in IAS 8 paragraph 21 which states:

*"21 In the absence of an IFRS that specifically applies to a transaction, other event or condition, management may, **in accordance with paragraph 12, apply an accounting policy from the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy."***

45 My understanding and instructions are that the Trustco Group first developed and applied its accounting policy for common control business combinations (including the application of FRS6) some years prior to the Huso transaction. This occurred at a time when FRS 6 was effective and was in fact the most recent



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pronouncement from the standard setter. Trustco, having established the accounting policy, duly applied it to the Huso transaction, notwithstanding that the standard from which the policy had been derived was no longer effective at that date. This position is in compliance with the requirements of IAS 8 as Trustco could elect, at its own discretion, to update the policy or not per IAS 8 paragraph 21 quoted above.

- 46 Prof. Maroun's view that Trustco should only have applied a standard that was operative at the date of the financial statements is therefore not consistent with the requirements of IAS 8 paragraph 21, nor is it consistent with IAS 8 paragraph 12 which simply refers to a "most recent pronouncement", which does not imply either recent (as the most recent pronouncement may be many years old but remain the most recent) nor is there a requirement for it to be operative.
- 47 Prof. Maroun further opines that FRS 6 should not have been relied upon as it did not deal expressly with the forgiveness of shareholder loans, in respect of which I note the following:
- 47.1 Trustco did not apply FRS 6 to the loan forgiveness as it was not assessed to be part of the Huso acquisition on the basis that the acquisition. The basis for that view has been articulated by Trustco in its submissions to the JSE and as part of this appeal process. In short; the acquisition was approved subsequent to a shareholder approval process (in terms of which neither **QvR** nor his associates could participate as a related party per JSE Listing Requirement rules and furthermore, I am instructed and understand



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that, the documentation relating to the transaction was approved by the JSE), the purchase agreement did not in any way contemplate or require the loan forgiveness as part of its rationale as evidenced by the circular issued as part of the approval process. I am further instructed that, the loan forgiveness was not discussed between any parties to the Huso transaction either prior or subsequent to the acquisition until such time as QvR made the offer to forgive the loan and the Trustco board accepted the offer.

47.2 Prof. Maroun's criticism that FRS 6 does not deal expressly with shareholder loan forgiveness is telling. It should be noted that IFRS 3 does not deal with this matter either, yet he does not see fault in considering it relevant in the determination of the appropriate accounting. He does not offer an explanation for this contradiction.

47.3 In fact, the only standard which deals with the extinguishment of a financial liability is IFRS 9, which is how the shareholder loan (loan 1) was classified by Trustco on the acquisition balance sheet of Huso.

47.4 IFRS 9 is the standard which Trustco applied to the loan extinguishment which was made subsequent to the acquisition date and was neither contemplated nor required explicitly or implicitly at the Huso acquisition date and therefore its subsequent waiver could not be assessed as new information relating to facts or circumstances existing at the acquisition date.



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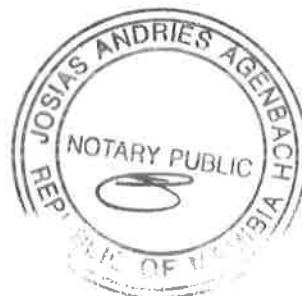
AD PARAGRAPH 22

48 The statement by Prof. Maroun, which is tied to CFW 2.12 and 2.18, on my reading cannot be said to be derived from a reading of those paragraphs of the CFW, which I quote below:

***"Faithful representation***

2.12 *Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon (see paragraphs 4.59–4.62).*

2.18 *Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate."*



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AD PARAGRAPH 23

- 49 I have already dealt with the generalised assertion by Prof. Maroun that "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" when I commented on his views with respect to IFRS 3.
- 50 I demonstrated why such a broad statement is in fact misleading when considered in context as it fails to get to the actual purpose of considering the information, the purpose being that some of that information will cause there to be adjustments to amounts recognised but only if it is information about facts and circumstances that existed at contract date (or acquisition date in the case of a business combination), or will not have any effects on amounts recognised if it is simply information about new events which have occurred subsequently.
- 51 With respect to CFW 4.62, I find it necessary that it should be quoted in full so as to understand its possible usefulness. It reads:

***"4.62 A group or series of contracts may achieve or be designed to achieve an overall commercial effect. To report the substance of such contracts, it may be necessary to treat rights and obligations arising from that group or series of contracts as a single unit of account. For example, if the rights or obligations in one contract merely nullify all the rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that the two contracts create no rights or obligations. Conversely, if a single contract creates two or more sets of rights or obligations that could have been created through two or***



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*more separate contracts, an entity may need to account for each set as if it arose from separate contracts in order to faithfully represent the rights and obligations (see paragraphs 4.48–4.55)."*

52 The broad statement by Prof. Maroun belies the very nuanced considerations of this paragraph. In the first instance, one has to determine that a group or series of contracts has been designed to achieve an overall commercial effect. Thereafter, even where one has determined that there was a design to achieve an overall commercial effect, one may or may not find it necessary to treat such a group or series of contracts as a single unit of account.

53 If one is relying on this paragraph to make an argument for assessing a group or series of contracts as a single unit of account then it is my expectation that such an assessment should be included in the report including a description of the contracts which are to be grouped, the basis for grouping them, and what the overall effect of doing so is and why that outcome is appropriate. This would necessarily involve an assessment of the "overall commercial effect" that is being observed. None of that is offered in Prof. Maroun's report when citing this paragraph, it is therefore not possible to understand how and if it has affected his conclusions.

AD PARAGRAPH 27

54 If one assumes these broad statements made refer to the waiver of loan 1 by QvR, then there is an IFRS which applies to that matter which is IFRS 9. Whether the change to the terms of a financial instrument is a modification or an



extinguishment of a financial liability, IFRS 9 would be the applicable standard and Prof. Maroun has pointed to the appropriate paragraphs in paragraph 26 of his report.

55 I have already demonstrated in great detail that it is undisputed that where an IFRS exists that applies to a transaction, it shall be applied. Nothing in the CFW may be invoked to override the IFRS with a single exception. That exception (which I have previously discussed in above) is in terms of IAS 1 paragraph 19, which requires management to conclude that **compliance** with an IFRS would result in the presentation of information that is misleading. Management would be required to make the necessary assessment in terms of IAS 1, paragraph 24, to substantiate that assessment. Trustco has made no such assessment and Prof. Maroun has similarly not made that argument in his report.

56 Prof. Maroun makes a further broad statement that "[t]he 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)". It is unclear why this is "the same" since the preceding sentence refers to a change in terms of a financial liability and has nothing to do with what has preceded it in his report. Nevertheless, the assertion that "the close relationship between the parties can affect the economic rationale for entering into the transaction (see IAS 24)" is made without any further discussion regarding how the economic rationale for entering into this specific transaction was affected by this observation and how that should affect the accounting. Presumably, the observation is in furtherance of a broader argument around



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"substance over form", which, as I have demonstrated earlier, is a concept that is baked into individual standards and is not something to be considered over and above the explicit requirements of an IFRS.

- 57 The assertion that somehow the fact that the transacting party is a related party to the reporting entity should have a material bearing on the appropriate accounting to be applied, is likely a compelling one to a lay person. In order to address this point, I do so by quoting directly from IAS 24 with respect to paragraphs that deal with key definitions and its purpose:

***"Definitions***

- 9 The following terms are used in this Standard with the meanings specified:

**A related party** is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').

(a) **A person** or a close member of that person's family **is related to a reporting entity if that person:**

(i) **has control or joint control of the reporting entity;**...

***Purpose of related party disclosures***

- 5 **Related party relationships are a normal feature of commerce and business.** For example, entities frequently carry on parts of their activities through subsidiaries, joint ventures and associates. In those circumstances, the entity has the ability to affect the financial and operating policies of the investee through the presence of control, joint control or significant influence.



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6 ***A related party relationship could have an effect on the profit or loss and financial position of an entity. Related parties may enter into transactions that unrelated parties would not. For example, an entity that sells goods to its parent at cost might not sell on those terms to another customer. Also, transactions between related parties may not be made at the same amounts as between unrelated parties.***

8 ***For these reasons, knowledge of an entity's transactions, outstanding balances, including commitments, and relationships with related parties may affect assessments of its operations by users of financial statements, including assessments of the risks and opportunities facing the entity."***

58 The response of the IASB, as reflected by the standards it has issued, as regards the relevance of the transacting party being a related party (which includes a controlling shareholder) to the reporting entity to how a transaction ought to be recognised and measured has been to bring such transactions to the attention of users of the financial statements by way of the disclosures required by IAS 24.

59 It is also noteworthy that the IASB has observed that transactions with related parties, such as transactions between a controlling shareholder such as QvR and a reporting entity such as Trustco "are a normal feature of commerce and business". The view of the IASB, as expressed by its decision to develop IAS 24 as a response to capturing peculiarities associated with related party transactions, is to draw the attention to these transactions by way of enhanced disclosure to which Trustco did adhere to (in other words, the best medicine to keep everyone honest in such circumstances is "sunlight", which is a disclosure



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standard.). I believe this response by the IASB to be instructive and of pertinence to the assessment of the appropriate accounting to the referral matters generally but referral matter 1 in particular. ". T

60 All of the accounting standards issued by the IASB with one notable exception, IFRS 3, do not create any explicit or implicit IFRS requirements that apply on the basis that the transacting party is a related party including transactions with a controlling shareholder. This is notwithstanding repeated references in the CFW that contributions or distributions from "holders of equity" (all holders of equity and not restricted to controlling shareholders) should not affect income or expenses.

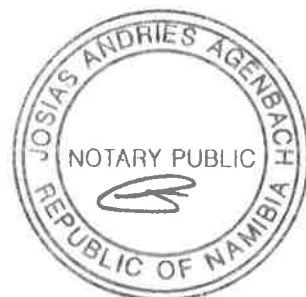
61 It is common knowledge, and practice, that related parties, including shareholders, will not always transact with an entity in their capacity as equity holders for each transaction undertaken. They may transact as lenders, customers, suppliers, lessors etc. The transaction described in IAS 24.6 in terms of which an entity may sell goods to its parent "at cost" may at face value be open to an argument of that being an "in-substance dividend" for the margin lost by the reporting entity. In such circumstances what IAS 24 requires is:

***"23 Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated."***

62 The effect of the above is that if indeed an entity were to supply its parent with goods "at cost" and thereby forego its margin in favour of the shareholder the



- 65 To be clear, the contract in question (loan 1) was classified as a financial liability as required by IAS 32 paragraph 15 by considering its contractual terms and the definition of a financial liability as at date of acquisition. Trustco applied its accounting policy for common control business combinations which require it to adopt the carrying amount (measurement) applied by the predecessor company (Huso).
- 66 The facts (as explained in Trustco's application for reconsideration) are as follows:
- 66.1 Huso had recognised the loan (loan 1) as a financial liability as of the date of acquisition.
- 66.2 The classification was based on the fact that it had a contractual obligation to deliver cash to the lender which it could not avoid, thereby meeting the definition requirements of a financial liability in terms of IAS 32.15.
- 66.3 There was no agreement which created any expectation of waiver at or after the acquisition date between QvR and Huso. It was therefore a financial liability in terms of its substance which conformed with its legal form.
- 66.4 The acquisition of Huso, albeit ultimately a transaction between entities under common control, was not a transaction that could have been initiated and concluded on terms only suited to the controlling shareholder, because



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QvR and his associates as a related party per JSE Listing Requirements could not participate in the shareholder vote to approve the transaction alongside other Trustco shareholders. I am instructed and understand that the documentation to the transaction was also approved by the JSE before it was distributed to Trustco shareholders for voting on the transaction. It was therefore, factually and in substance, a transaction concluded on terms acceptable between himself and Trustco minority shareholders. This context confirms the substance of the loan arrangement and the acquisition agreement overall, which conform with the contracts related to the transactions.

- 66.5 In the sale and purchase agreement, as well as information presented to shareholders for approval, the loan was never indicated as being subject to a waiver, or even a possible waiver.
- 67 Subsequent to the acquisition date, the loan was waived by agreement with QvR. The waiver required the discretion of the shareholder to occur. It is clear, applying the requirements of IAS 10 (or the requirements of IFRS 3 in this specific regard), that the application of a discretion by QvR approximately 30 days after the acquisition could not be considered information that provides clarity about facts and circumstances at acquisition date. The waiver was an event which objectively occurred on an entirely discretionary basis subsequent to the acquisition date. This is therefore in no way a "measurement period" adjusting event and no argument has been presented by the JSE's expert to contradict this.



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68 As a consequence, the waiver is treated as the extinguishment of a financial liability for no consideration, occurring after the acquisition of Huso, with the carrying amount to be extinguished being recognised in profit or loss as required by IFRS 9. IFRS 9 does not exclude from its scope loans due to or from related parties so it is therefore the applicable standard to be applied.

AD PARAGRAPH 29

69 The issue of classification as it pertains to IAS 32 to which Prof. Maroun refers is limited to the narrow matter of “puttable” instruments. The shareholder loan (loan 1) is not a puttable instrument as defined in terms of IAS 32 16A-D. The entire section of IAS 32 from paragraph 16A to 16F deals exclusively with the classification of puttable instruments. The peculiarity regarding the classification, and possible reclassification of such instruments between financial liabilities and equity is that its classification is not only dependent on its contractual terms, but also its ranking relative to other instruments of the entity. It may so happen that after it is initially classified as equity or as a liability, another instrument is issued or redeemed which causes its ranking to be altered and consequently its classification to be amended. Even so, such reclassification only occurs as of the date of the change in facts and is not adjusted retrospectively.

70 In all other instances, the classification of a financial instrument, which by definition is represented by a contract, is based solely on its own terms and conditions and is not affected by the terms and conditions of other instruments,



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unlike the puttable instruments discussed above. As such, being contracts, such instruments are not reclassified when the terms of the contract are amended. Instead they are considered as either derecognised in full or in part in accordance with the requirements of IFRS 9 not IAS 32. In the case of loan 1, there is in fact no amendment of the contract other than its termination resulting in its extinguishment. There is no momentary or intermediate phase where the loan becomes some other instrument, such as equity, before being extinguished. No other standard apart from IFRS 9 is applicable for this circumstance as it is a financial liability solely with the scope of that standard. No argument has been presented to contradict this.

- 71 Finally the contention that somehow the changes or developments (which aren't detailed as to what they are but which I have assumed could only relate to the waiver) are disregarded is false. The accounting applied by Trustco has been to recognise that a waiver of the loan has occurred and as a consequence to recognise its extinguishment in terms of IFRS 9 accordingly.

AD PARAGRAPH 30

- 72 Prof. Maroun appears to be working with incorrect information.
- 73 The factual position (per Trustco's application for reconsideration) is the Huso loan, loan 1, was due and payable to QvR per the agreed terms between himself and Huso and that Huso had no discretion whatsoever with respect to its repayment. Huso was, in other words, contractually obliged to repay the loan in



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accordance with its terms until such time as the shareholder may exercise a discretion to waive that obligation. These facts have not been disputed or addressed to my knowledge and instructions.

74 With respect to Prof. Maroun's assertion regarding the significance of whether a party is related or not to the issuer with respect to the application of AG25 of IAS 32, I make the following points:

74.1 AG25 does not offer any information as to the status of the preference shareholder (as related or otherwise to the issuer) in the scenario presented. Therefore, the assertion by Prof. Maroun that AG25 is based on an arms' length transaction (which as a factual matter can occur between related parties) and does not involve a related party is not supported by the text of AG25 explicitly or implicitly on the basis of any surrounding context to AG25.

74.2 More importantly, and consistent with the rest of the IAS 32, the framing of the classification of financial instruments is always with reference to the contract and its terms and never addresses the identity or status of the instrument holder as a related or unrelated party. Related parties are simply not a consideration, the contractual terms and their substance are what remain relevant. We have addressed above what the IASB's approach to related party transactions is as set out in IAS 24, which places an emphasis on enhanced disclosures and not a change in the application of the



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requirements of standards to deal with transactions between related parties.

## RECLASSIFICATION OF PROPERTY

### AD PARAGRAPHS 32 TO 34

- 75 I note that in summarising the requirements of IAS 40 paragraph 57 Prof. Maroun states that the standard requires "...**clear** evidence of a change in use....". The language of IAS 40 paragraph 57 however reads as follows:

#### ***"Transfers***

**57** *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 meets, or ceases to meet, the definition of investment property and **there is evidence of the change in use.**"*

- 76 The word "clear" does not come from the standard. What is peculiar is that this error in stating the requirements of the standard was also made by the JSE and the FRIP.
- 77 This repeated error appears to have factored into how the JSE, FRIP and now Prof. Maroun, have applied the requirements of IAS 40 in so far as assessing the **weight** of evidence they believe is required to support a reclassification of the land from inventory to investment property. If so, the threshold applied by Prof. Maroun is inappropriate and not in compliance with the requirements of the standards. This point, on the importance of the language used and its impact on the appropriate application of IFRS may seem "legalistic" to a lay person, it is



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not. There are examples across IFRS where qualifiers such as "clear", "substantial", "possible", "remote", "probable" are applied with respect to some aspect of consideration in manner that directly affects the accounting required and is used with intent and not flippantly. Within IAS 40 itself there is deliberate use of the qualifier "clear", for example see IAS 40 paragraph 48 and 58 for example with both refer to "clear evidence" when referencing a particular aspect of relevance to the issue being discussed in those passages.

- 78 Prof. Maroun states that "...profit or loss is entirely different to revenue...revenue arises from the sale of goods or services and has nothing to do with fair value gains."
- 79 It should however be noted that revenue is an aggregation of certain types of transactions whereas profit or loss is a sub-total presented in the Statement of Comprehensive Income which, being a sub-total, comprises many items of income and expense including revenue. There can therefore not be any confusion that profit or loss is unlike any other individual item reported under IFRS as it is a sub-total of many items. This is not a contentious matter nor one on which any matter under consideration swings.
- 80 Although I do not take issue with the statement that "revenue arises from the sale of goods or services...", the statement is not complete. I, in this regard, refer to an extract from IAS 1 paragraph 82 which address items that shall be presented in the statement of profit or loss:



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***"Information to be presented in the profit or loss section or the statement of profit or loss***

**82** *In addition to items required by other IFRSs, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period:*

*(a) revenue, presenting separately interest revenue calculated using the effective interest method;"*

81 It is evident therefore that "revenue" is not limited to amounts arising from the sale of goods or services but may at least include interest income in the manner described in IAS 1 paragraph 82. I point this out to draw attention, once again, to the use of broad and generalised assertions which may be comfortable for the lay person to engage with but which run the significant risk of oversimplification of issues that aren't necessary as simple as we would like them to be, or as they are presented to be.

AD PARAGRAPH 35

82 I agree with the assertion that the cessation of development, distinct from a delay in development, would justify the decision to reclassification of inventory to investment property.

83 In my opinion, Trustco has not only provided proof of a change in intention by management with respect to the land in question, but has also provided sufficient and appropriate evidence to show that there has indeed been a change in use.



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- 84 In many instances the only way to definitively discern the difference between a cessation and mere delay in development is to consider the outcome with the use of hindsight many years from the date of the change in use.
- 85 Hindsight and time are luxuries not available under IFRS as the assessment must be made at the date at which a change is said to have occurred based on the evidence at hand at that date. The evidence of a change of use cannot, therefore, be expected to rise to the level of "clear evidence" or be definitive. In fact it would in my opinion be impossible to provide "clear evidence" at the date of change in use to discern between a delay and a cessation in development.
- 86 In the moment a delay and a cessation are indistinguishable at face value. What is important in weighing evidence is to firstly understand the nature of evidence that could be provided given the nature of the matter being considered, and then secondly with due regard to inherent limitations of the evidence that could be provided assess the quality and strength of it.
- 87 If for example the circumstance had been a commencement of development and not a cessation the evidence may have been expected to include evidence of physical activity, recruitment of workers, contracting with suppliers etc. On the contrary a cessation of development, especially where development was still at a very early stage, would not be expected to be supported by the same wide variety of types of evidence. Work in process, if any, may stop, planned work may stop, workers assigned may be reassigned to other tasks or may only be



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retrenched following a protracted labour process, etc. To expect the same type, extent, and strength of evidence for each and every circumstance is not rational.

AD PARAGRAPH 36

88 I agree that a board resolution only establishes management intent and on its own would be insufficient to cause the land to be reclassified. It would be necessary for management to act on that resolution to give it practical effect.

89 In my opinion Trustco's management acted on the resolution by the board to cease development and undertook all the necessary **actions** required to do so in an orderly manner. Those actions included instructions to internal and external parties to cease activities that were underway, and those that were being planned, to prepare the land for development and sale as inventory. These actions put Trustco in the desired position where the land is now held for long term capital appreciation and as such recognise it as investment property and not inventory for sale in the ordinary course of business.

AD PARAGRAPH 38

90 The wording used by Prof. Maroun is not accurate. The exact quote from the relevant IAS 40 paragraph reads as follows:

*"8 The following are examples of investment property:*

*(e) property that is being constructed or developed for future use as investment property."*



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91 It is unclear how this particular paragraph has been applied by Prof. Maroun in arriving at his accounting conclusions but it is uncontentious when considered in its correct form.

AD PARAGRAPH 39

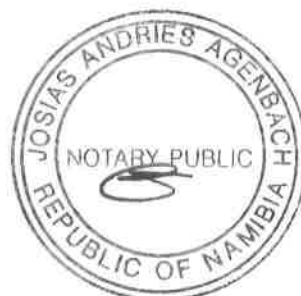
92 I agree that the evidence of a change of use must have substance.

93 I do however wish to highlight that Prof. Maroun's examples as cited in paragraph 39.1 of his report do not apply to the facts and circumstances of the matter under referral.

94 I differ from Prof. Maroun in that I do not view this as a **period** of discontinuation, the decision of Trustco was to cease development. There are no plans to develop this land for sale at any time. The land will be held for long term capital appreciation in a manner consistent with other parcels of land held for a similar purpose. The fact that at some point in the past it was under development is not a factor in management's current actions and intentions with respect to the purpose for which it is now being held.

AD PARAGRAPH 40

95 No basis has been provided for this view other than, presumably, the reference to paragraph 33 of Prof. Maroun's report which I have addressed above.



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- 96 In effect, from the perspective of the JSE expert, no further discussion is required beyond his definition of what constitutes revenue in order to determine the appropriate accounting. I disagree with this approach.

AD PARAGRAPH 41

- 97 The explanation of what this means in lay terms is incorrect. The paragraph which he references, deals with the matter of **in which** of the primary statements ("primary statements" refers collectively to the; statement of financial position, statement of changes in equity, and the statement of cash flows) and/or a sub-total therein the effects of the transfer should be presented. It in no way deals with the matter of **how** the effects of the reclassification are to be presented.
- 98 For example, IAS 40 paragraph 62 which deals with the reclassification of property previously classified as property plant and equipment and reads, in part as follows:

*"Up to the date when an **owner-occupied property** becomes an investment property carried at fair value, an entity depreciates the property (or the right of- use asset) and recognises any impairment losses that have occurred. The entity **treats** any difference at that date between the carrying amount of the property in accordance with IAS 16 or IFRS 16 and its fair value **in the same way as a revaluation in accordance with IAS 16. In other words:***

- (a) *any resulting decrease in the carrying amount of the property **is recognised in profit or loss**. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is*



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recognised in other comprehensive income and reduces the revaluation surplus within equity.

- (b) any resulting increase in the carrying amount is treated as follows:
- (i) to the extent that the increase reverses a previous impairment loss for that property, the increase is recognised in profit or loss. The amount recognised in profit or loss does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised.
  - (ii) any remaining part of the increase is recognised in other comprehensive income and increases the revaluation surplus within equity. On subsequent disposal of the investment property, the revaluation surplus included in equity may be transferred to retained earnings. The transfer from revaluation surplus to retained earnings is not made through profit or loss."

99 From the above, it is clear that references to profit or loss, or other comprehensive income are made with reference to which primary statement and as part of which sub-total in within the primary statement the effect of the transaction shall be included and not **how** it shall be presented within those statements.

100 **How** a transaction is to be presented in the financial statements is dealt with within the standards which apply to it. In instances where no presentation requirements are specified within the applicable standards, directly or by way of a cross reference, the preparer will look to the requirements of IAS 1 to determine how the transaction should be presented in the financial statements.



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AD PARAGRAPHS 42 TO 44

- 101 The language applied in IAS 40 paragraph 64 uses similar language as that of paragraph 62 in that it refers the accounting "treatment" to be in terms of another standard.
- 102 This idea of cross referencing an accounting requirement to another standard is common across IFRS and is used by the IASB to avoid unnecessarily repeating detailed requirements already contained elsewhere in other standards.
- 103 In the case of paragraph 62, it refers to IAS 16 explicitly and for paragraph 64 the cross reference to the **treatment is implied in the reference to** "sales of inventories" which matter is addressed by two standards, IFRS 15 with respect to revenue, and IAS 2 with respect to "cost of sales". There are no other standards beside these 2 that deal with the sale of inventories under IFRS.
- 104 This cross reference, to IFRS 15 and IAS 2, and the analogy to the sale of inventories is made by the IASB **notwithstanding** that, factually, there has been no sales of inventory. It is probably pertinent to emphasise this point by referring to IFRS 15 by its full title "*Revenue from Contracts with Customers*". Prof. Maroun, the JSE, and the FRIP have all provided extensive arguments as to why **any application of any aspects** of IFRS 15 or IAS 2 when dealing with this transfer are "counter intuitive" and/or are "not in the scope" of these standards based on the undisputed fact that there is no sale to any party let alone a third party. It is evident that in so far that this is the basis of their argument with



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Trustco's treatment of the reclassification, that quarrel is with the IASB and not with Trustco's application of the requirements of IAS 40.

105 Following the logic of Prof. Maroun as set out in paragraph's 43.1 - 43.2 of his report, the conclusion is that there **could never be any circumstances** in terms of which such a transfer of inventory to investment property could be treated "in a manner consistent with a sale of inventories" as required by IAS 40 paragraph 64. This must render that paragraph, on his understanding, as being completely illogical, unimplementable, and therefore irrelevant. If this is the case, that outcome cannot be placed at Trustco's door to account for. Others may argue that some paragraphs of an IFRS matter more than others, but the fact is that all paragraphs apply equally and at the same time when applicable, unless presented as options. There are no paragraphs in the standards issued by the IASB that may be ignored when applicable, with due consideration to materiality.

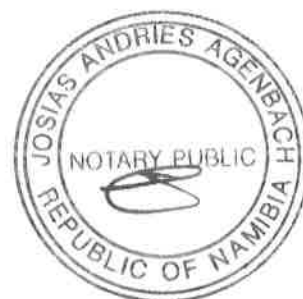
106 Prof. Maroun makes reference to IAS 40 paragraph 75(f), read with IAS 1 paragraph 85. Below is the full text:

***"Disclosure***

***Fair value model and cost model***

**75** *An entity shall disclose:*

- (f) the amounts recognised in profit or loss for:*
  - (i) rental income from investment property;*
  - (ii) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period;*



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- (iii) *direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period; and*
- (iv) *the cumulative change in fair value recognised in profit or loss on a sale of investment property from a pool of assets in which the cost model is used into a pool in which the fair value model is used (see paragraph 32C)."*

107 On my reading, none of the items listed in paragraph 75(f) are applicable to the matters under referral.

108 IAS 1 paragraph 85 states as follows:

***"Information to be presented in the other comprehensive income section***

**85** *An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income when such presentation is relevant [Refer: Conceptual Framework paragraphs 2.6-2.11] to an understanding of the entity's financial performance."*

109 The purpose of this paragraph is to require a disaggregation of items for the purpose of improving the understandability of the entity's financial performance. In the event that this was in fact applicable to the referral matter, it would require that a disaggregation of the revenue amount be presented to (for example) separate the revenue arising in the normal course of business and the revenue arising from the reclassification in terms of IAS 40 paragraph 64. This paragraph would not change that a component of what is present under the disaggregation of revenue would relate to the reclassification.



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110 I have no issue with the discussions set out in paragraphs 44.1 to 44.5 of Prof. Maroun's report in the generic sense and as it would apply in a transaction accounted for in terms of IFRS 15 from start to finish. The difficulty is that the argument fails to address the reality that the application of IFRS 15, and IAS 2, is by analogy to a sale of inventory, not because it is a sale of inventory. The issue is not whether or not a sale occurred, it is agreed that none has occurred.

111 The failure to address this reality defines the basis of my disagreement with the accounting opinion of the Prof. Maroun on this referral matter.

#### **CONCLUDING REMARKS**

112 As a concluding remark, whilst it is tempting to simplify IFRS so as to align with one's own sense of what is correct and broad accounting principles which are discussed in the CFW, the reality is that IFRS is complex.

113 The complexity in part comes from the requirements of IFRS itself and in terms of what it expects a reporter to do in order to comply, and it is also complex in the sense that it is a framework driven in large part by the exercise of judgement. This extract from the CFW, which is included as an insight into the reality of the application of IFRS in practice from the perspective of the IASB, is a good way to summarise the genesis of at least some of the matters that are now before the Tribunal as referrals:



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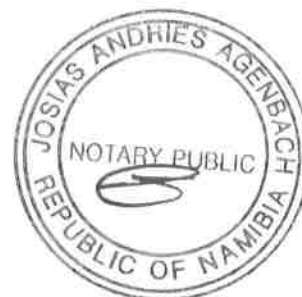
***"1.11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The Conceptual Framework establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the Conceptual Framework's vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept and implement new ways of analysing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness."***

114 Lastly, it bears mentioning that Prof. Maroun does not appear to reach any independent conclusions in his report on any one of the matters under referral.

DATED at Sandton on this the 8<sup>TH</sup> day of **APRIL 2021**



**TAPIWA NJIKIZANA**



## Curriculum Vitae: Tapiwa H Njikizana

### Qualifications Summary

<b>Professional Memberships</b>	<ul style="list-style-type: none"> <li>▪ South African Institute of Chartered Accountants</li> <li>▪ Institute of Chartered Accountants of Zimbabwe</li> <li>▪ Institute of Directors of Southern Africa</li> </ul>
<b>Other professional designations/positions held</b>	<ul style="list-style-type: none"> <li>▪ JSE Accredited IFRS Adviser – current (6 years)</li> <li>▪ Former member, JSE <b>GAAP Monitoring Panel</b> (now known as the Financial Reporting Investigations Panel, FRIP) – 3 years</li> <li>▪ Former member of SAICA's <b>Accounting Practices Committee</b> – 9 years</li> </ul>
<b>Experience</b>	<ul style="list-style-type: none"> <li>▪ Director of Wconsulting, a financial reporting advisory firm - current (13 years)</li> <li>▪ IFRS Technical Partner at SizweNtsaluba (now SNG Grant Thornton) – 8 years</li> <li>▪ Former IFRS technical manager in audit divisions of E&amp;Y and Andersen (UK and Republic of Ireland) – 3 years</li> </ul>
<b>Other pertinent experience</b>	<ul style="list-style-type: none"> <li>▪ Director of Lewis Group Limited and member of the audit committee (1 year)</li> <li>▪ Former director of Mercantile Bank Holdings Limited and Chairman of audit committee (12 years)</li> <li>▪ Former director of Iliad Africa Limited, and member of the audit committee (5 years)</li> <li>▪ Co-Author "<i>Wiley IFRS 2014: Interpretation and Application of International Financial Reporting Standards</i>"</li> </ul>
<b>Select Awards</b>	<ul style="list-style-type: none"> <li>▪ CA Board exams placed top ten</li> <li>▪ "<i>Top Consulting Professional</i>" Sanlam South African Professional Services Awards, 2018</li> <li>▪ "<i>Male Entrepreneur of the Year</i>" Zimbabwe Diaspora Achievers (South Africa), 2018</li> </ul>

### Summary of Experience

I have been advising companies and auditors on the appropriate application of IFRS for the past 19 years. My focus area is to provide IFRS related advice to JSE listed entities across many different Industries and sectors which has included the following (to mention a few): banking, agriculture, automotive, financial services, manufacturing, mining, property, tourism. Outside of the listed company environment I have provided IFRS related advisory services to the largest state owned companies in South Africa.

My firm has been retained over the past 6 years by over a dozen auditing firms to provide them with specialist IFRS support in the conduct of their auditing engagements. I have also provided support to regulators who are performing IFRS compliance oversight over listed companies in their environment (Saudi Arabia stock exchange).

I have been a non-executive director of several JSE listed companies over the past 13 years and have applied my expertise in the role of a board and audit committee member and therefore have a thorough understanding of the broader landscape within which





financial statements and the application of IFRS interacts with key stakeholders that have an interest in those matters.

I have conducted numerous IFRS training events, inhouse to many of the companies to whom I offer advice, as well as in public forums. Over the past 13 years I have delivered IFRS training in public events in over 12 different countries at the invitation of national accounting bodies. I have delivered IFRS related training on behalf of SAICA since 2010 to date and my firm has been the single largest provider of IFRS providers to SAICA, including its members now resident in the United Kingdom and Australia.

In 2014 I co-authored, together with my colleagues at Wconsulting, a book "*Wiley IFRS 2014: Interpretation and Application of International Financial Reporting Standards*". I am also co-author of another financial reporting book "*Applying IFRS for SMEs*" which was published in 2010 and remains in circulation to date.



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REPORT OF THE REVIEW COMMITTEE

REFERRAL: TRUSTCO GROUP HOLDINGS LIMITED ("TRUSTCO")

FINANCIAL REPORTING PERIOD: FINANCIAL YEAR ENDED 31 MARCH 2019

**1. Introduction**

- 1.1. Three separate matters relating to Trustco's 2019 audited group financial statements for the financial year ended 31 March 2019 were referred to the FRIP on 3 July 2020.
- 1.2. A five person Review Committee was convened from members of the FRIP.
- 1.3. Trustco is listed on both the JSE and the Namibian Stock Exchanges.
- 1.4. The JSE's proactive monitoring process identified the issues that have been referred to the FRIP.
- 1.5. Quinton van Rooyen ("QvR") is the controlling shareholder of Trustco as well as the Chief Executive Officer.
- 1.6. The company had joint auditors for the 2019 financial statements – BDO Namibia and Moore Stephens Inc. W Consulting act as IFRS Consultants for Trustco.
- 1.7. The JSE requested the FRIP's opinion as to the Company's compliance with International Financial Reporting Standards ("IFRS"), in respect of three separate matters, namely:
  - 1.7.1. Substance of initial and subsequent loans from QvR to Trustco (Referral 1).
  - 1.7.2. Appropriateness of reclassifying inventory to investment property and presenting the fair value gain as revenue/cost of sales (Referral 2).
  - 1.7.3. Appropriateness of the point at which revenue on land sales is recognised (Referral 3).
- 1.8. The following documents were considered as part of the referral:
  - 1.8.1. JSE Referral letter dated 3 July 2020.
  - 1.8.2. The Trustco 2019 Financial Statements.
  - 1.8.3. Two related SENS announcement relating to the QvR Loans (Referral 1) dated:
    - 1.8.3.1. 8 October 2018
    - 1.8.3.2. 14 October 2019
  - 1.8.4. Letters from the JSE to Trustco dated:
    - 1.8.4.1. 5 December 2019
    - 1.8.4.2. 17 March 2020
    - 1.8.4.3. 15 May 2020
  - 1.8.5. Trustco responses to the JSE dated:
    - 1.8.5.1. 5 February 2020
    - 1.8.5.2. 5 March 2020
    - 1.8.5.3. 20 April 2020
    - 1.8.5.4. 12 June 2020
  - 1.8.6. Copy of Deed of Sale agreement - Elsenheim Property Development Company (Referral 3).
  - 1.8.7. IFRS Opinion from W. Consulting referring to the accounting treatment of a transfer of Inventory to Investment Property dated 7 March 2019 (Referral 2).
  - 1.8.8. Various other SENS announcements and Shareholder Circulars available on the website of Trustco.



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**2. Background Information – General**

- 2.1. The 2019 Trustco financial statements contain unqualified audit opinions from both Moore Stephens MWM Inc and BDO (Namibia).
- 2.2. The Group concluded a restructuring with its international lender group on 28 June 2019, which provided more certainty to the cash flow forecasts used in the Board's assessment that the Group will remain a going concern for the foreseeable future.
- 2.3. QvR is the sole shareholder of a company called Next Investments (Pty) Ltd ("Next"), which has a management contract with Trustco in terms of which a management fee based on turnover, headline earnings and earnings is paid quarterly by Trustco to Next.
- 2.4. The deputy CEO, Q Z van Rooyen "QZvR" is remunerated by Next.

**REFERRAL 1 – SUBSTANCE OF INITIAL AND SUBSEQUENT LOANS FROM QVR TO TRUSTCO**

**3. Background Information – Referral 1**

- 3.1. Two loans were made by QvR to Trustco.
  - 3.1.1. The initial loan was made by QvR to a company (Huso) which he controlled at the time of making the loan but then subsequently sold to Trustco.
  - 3.1.2. QvR is the controlling shareholder of Trustco, the holder (beneficiary) of the loan accounts and the previous 100% shareholder of Huso.
  - 3.1.3. QvR has an investment vehicle known as Next, which is the vehicle which was nominated by QvR as the recipient of the shares to be issued as consideration for the Huso acquisition.
  - 3.1.4. The loan made by QvR to Huso was initially classified as an equity instrument in the Huso financial statements, but by the date that Trustco acquired control of Huso (4 September 2018), the loan had been reclassified to a financial liability, ostensibly on the basis that the terms of the loan were amended by the lender.
  - 3.1.5. The acquisition of Huso by Trustco was a common control transaction as QvR controlled both Trustco and Huso. The acquisition was accounted for in terms of Trustco's previously applied policy for common control transactions, which was based on UK GAAP FRS 6 (now withdrawn).
  - 3.1.6. The purchase consideration for Huso contains an earn out mechanism by which contingently issuable Trustco shares may be issued to QvR/Next. This aspect of the consideration was recognised on the basis prescribed in IFRS 3 in the absence of UK GAAP FRS6 guidance in respect of contingent consideration.
  - 3.1.7. Trustco acquired control of Huso on 4 September 2018. On 30 September 2018 (26 days later) QvR (the lender) forgave the loan, resulting in a significant gain (N\$546 million) being recognised by Trustco in its 2019 financial statements. Recognition of the gain converted what would otherwise have been a loss making resources segment to a profit, and also triggered the Huso acquisition earn-out mechanism which resulted in the issue of additional Trustco shares to QvR.
  - 3.1.8. The impact of the transaction is that the common control transaction gave rise to a N\$3,2 billion reduction to equity (recognised directly in 'other reserves') and a gain of N\$546 recognised in profit as a result of the waiver of the loan.



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- 3.1.9. QvR advanced a second loan of up to N\$1 billion to Trustco in FY 2019. The funds required to grant the loan were raised by QvR selling an appropriate number of Trustco Shares. The 8 October 2018 SENS announcement stipulated that QvR had the right to forgive the loan at any time.
- 3.1.10. The N\$1 billion subsequent loan arose as a result of QvR/Next funding the purchase consideration of an additional interest in a company called Meya together with the settlement of contingent consideration related to the initial investment in Meya. As QvR/Next settled directly with the seller, there are no cash flow implications to TrustCo. (The transaction was treated as an equity transaction with non-controlling interest as Trustco already controlled Meya.)
- 3.1.11. In a SENS announcement dated 14 October 2019 it was announced that the loan was subsequently forgiven, resulting in a N\$1 billion gain that will be recognised in the 2020 financial statements.
- 3.1.12. The earnings targets that trigger the contingent share issue are referred to as follows:
  - 3.1.12.1. Circular relating to Huso acquisition includes in the definition section EBITDAASA as ..... "for Huso and its subsidiaries"
  - 3.1.12.2. SENS of 4 July 2019 "should resources achieve .....EBITDAASA"
  - 3.1.12.3. SENS of 12 February 2020 "upon reaching EBITDAASA targets"
  - 3.1.12.4. The Trustco financial statements in note 19.1, Shares for Vendors, and note 33, Common Control Transaction, refers to the Resources Segment earnings as the basis for the contingent consideration.

The distinction between the Huso group and the resources segment may not be relevant in respect of the first loan, where it was structured to be part of the Huso group. The second loan, however, was never part of the Huso group. It was raised to fund growth throughout the group but primarily in the Resources segment. The wording in the SENS of 12 February 2020 simply refers to the targets without specifying the entity to which it relates.

- 3.2. The JSE has queried the appropriateness of IFRS relating to 4 separate issues relating to the loans, namely:
  - 3.2.1. Classifying the initial loan by QvR to Trustco as a financial liability
  - 3.2.2. Recognising the N\$ 545.6m gain loan waiver in profit and loss in 2019
  - 3.2.3. Classifying the subsequent loan from QvR to Trustco as a financial liability
  - 3.2.4. Recognising a N\$ 1 billion gain on loan waiver in profit and loss subsequent to 2019.

#### 4. IFRS Conclusion by the Review Committee – Referral 1

- 4.1. The acquisition of Huso by Trustco was treated as a common control transaction, for which there is no current IFRS. As both entities are controlled by QvR, the review committee concurred that this was a common control transaction. The committee notes that in the absence of an IFRS that specifically applies to a transaction, management must use its judgement to develop a policy that reflects the economic substance of the transaction and not merely the legal form (IAS 8 para 10(b)(ii)).
- 4.2. The challenge in the application of IFRS to the shareholder loans is in correctly identifying the substance of the transactions, and specifically what relates to the acquisition of Huso and should be included as part of the initial accounting for the business combination, and what is a separate transaction. While common control transactions are scoped out of IFRS 3, the



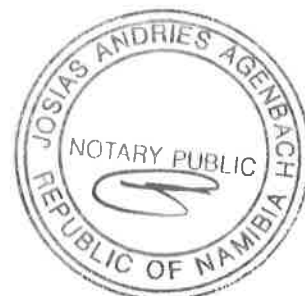
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guidance as to what forms part of the business combination is helpful. IFRS 3.B50, B54-5 provides guidance as to what is considered part of the business combination, and what should be excluded. Defining what should form part of the business combination is considered necessary in order to establish what was out of scope in IFRS 3.

- 4.3. The discussion below deals separately with the initial and subsequent loans as there are differences in the way in which the loans originated.

*Classifying the initial loan by QvR to Trustco as a financial liability*

- 4.4. At the time of the common control transaction, the loan was classified as a financial liability, which would suggest that in normal circumstances, the loan would continue to be classified as a financial liability. However in this case, the loan was initially classified by Huso as an equity loan (and communicated in shareholder announcements as such) and then subsequently reclassified to a financial liability prior to the date on which Trustco gained control. There do not appear to be any grounds for the reclassification as a liability other than the apparent change in the terms of the agreement by the 'lender'.
- 4.5. Despite having initially publicly communicated the equity nature of the contribution, there does not appear to be any subsequent communication in a SENS of the reclassification of the amount to a liability. While this committee does not directly concern itself with the correct application of the JSE listing requirements, the fact that there are specific requirements to communicate a significant change of that nature and that was not done, raises a concern about whether there was in fact any substance to the reclassification.
- 4.6. As the provider of the 'loan' finance and the owner of the Huso shares prior to the sale to Trustco were the same, this raises the possibility that the two transactions may be inextricably linked in which case they should be considered as one transaction. In this case, the forgiveness of the loan by QvR was done in close proximity (26 days) to the date on which control of Huso was transferred to Trustco.
- 4.7. While QvR owned 100% of Huso, the classification of the instrument as debt or equity was of minimal consequence. Once Huso was transferred to Trustco, QvR's interest was reduced to +/- 55%. The introduction of a significant minority interest implies that there is economic substance to the forgiveness of a loan, and that is not likely to be done without some form of compensation.
- 4.8. The compensation that QvR received in exchange for forgiving the loan was the additional shares issued in terms of the earn-out clause of the business combination. The gain recognised on forgiving the loan resulted in the additional equity issue requirements of the earn-out clause being triggered. The subcommittee noted that the earnout clause was part of the sale of Huso by its shareholder to Trustco. In considering whether QvR was acting in the capacity of a shareholder or a creditor when the loan was waived, the subcommittee could not establish any benefit that would flow to a creditor by such a waiver. The benefit, in the form of additional shares, would only accrue to the shareholder of Huso.
- 4.9. In the opinion of the committee, the substance of the so called loan waiver forms part of the transfer of control of Huso to Trustco and therefore should form part of the initial accounting for the business combination.
- 4.10. This would result in the inclusion of the additional shares issued in relation to the 'forgiveness of the loan' being included as part of the initial equity consideration given to acquire control.



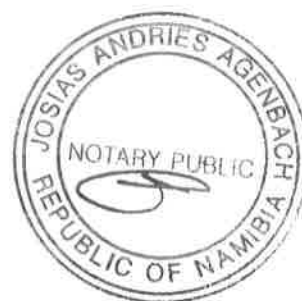
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*Recognising the N\$545,6m loan waiver in profit and loss in 2019*

- 4.11. On the basis that the committee believes that the substance of the loan waiver is an integral part of the equity consideration for the business combination as opposed to being a separate transaction, neither the loan nor the profit from the waiver of a loan would be recognised subsequent to the business combination. The impact of this is that the so-called gain on the loan waiver would form part of the common control transaction in the Trustco group statement of changes in equity. This would result in correctly reflecting the substance of the loan waiver as being an action of the shareholder as opposed to an action of a lender.

*Classifying the subsequent loan from QvR to Trustco as a financial liability*

- 4.12. The subsequent loan of N\$1 million has been structured to meet the definition of a financial liability on initial recognition and to have the potential to boost the earnings of the resources segment. The unusual facts that raise questions on whether recognition as a financial liability is in fact correct include:
- 4.12.1. Timing – the SENS announcement relating to the subsequent loan was issued on 8 October 2018, barely a month after the acquisition of Huso. This raises the question on whether the treatment of the initial loan provides a precedent for the treatment of similar loans.
- 4.12.2. Waiver announcement – in the SENS announcement relating to the related party loan (SENS 8 October 2018), it was specifically stated that the grantor had the right to waive the loan and where the impact of any waiver should be recognised. As the waiver right always applies, this could suggest that the intention had always been to waive the loan. In addition, the specific reference to how the impact of a waiver of the loan should be recognised suggests a motivation other than that of only a lender.
- 4.12.3. Linkage - The SENS highlights that in terms of the loan agreement, the impact of any waiver or conversion was required to be recognised in the operating segment to which the financing had been 'on lend'. As the financing had been provided primarily for the Resources segment, any gain on waiver of the loan would be recognised in that segment. As discussed above, the contingent equity consideration for the HUSO transaction was linked to meeting earnings targets in the Resources segment and result in the issue of Trustco shares to QvR/Next i.e. the lender. (It should be noted that the shareholder circulars related to the Huso transaction referred to meeting earnings targets of the Huso group, whereas the SENS announcement of 4 July 2019 related to the issue of the shares refers to meeting targets of the Resources group.)
- 4.13. While the legal structure of the subsequent loan made by QvR to Trustco appears to meet the definition of a financial liability as Trustco has an obligation to settle the loan unless the grantor waives that requirement, the specific circumstances require more careful consideration of the substance of the financing provided by the controlling shareholder.
- 4.14. Given Trustco's attribution of the loan to the resources segment, and the apparent change in the entity to which the performance criteria relate, recognition of profit from the loan waiver would create sufficient profits for the balance of the contingent consideration from the Huso transaction to be earned by QvR i.e. the party who waived the loan.
- 4.15. While QvR has received consideration for the loan waiver in the form of additional equity consideration for Huso, this is structured to be as a result of meeting an earnings target as opposed to an equity for debt/equity swap.



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- 4.16. The fact that this loan is granted by the controlling shareholder who stands to benefit from the issue of equity shares if the loan were waived, strongly suggests that recognising a financial liability with a subsequent gain when it was waived does not faithfully represent the transaction. As in the original loan, no benefit accruing to the creditor was considered present in making such a waiver. The benefit accrued purely to QvR in the capacity of a shareholder being the vendor of Huso with the associated earn-out provisions.
- 4.17. The group is overindebted. In those circumstances, it is not uncommon for the majority shareholder to convert existing loans to equity or to make a further equity contribution to the company. The introduction of additional equity will never give rise to a gain or loss, and as this appears to be the substance of the N\$1 million contribution from QvR, this should be faithfully represented by recognising the amount appropriately as equity.
- 4.18. There are a number of similarities with the initial loan which the committee believes to be in substance an equity settled part of the business combination and therefore the precedent of treating that loan as an equity consideration suggests that a similar treatment for the subsequent loan is appropriate.
- 4.19. While the committee believes that the substance of the 'loan' may always have been that of an equity contribution, the contractual terms prior to the waiver do suggest that at the 2019 reporting date, recognition as a liability was not conclusively incorrect.
- 4.20. The committee does however believe that when the waiver occurs, this clarifies that the additional financing provided is in the form of an equity contribution from the controlling shareholder and that there cannot be a gain on settlement of a liability.
- 4.21. While the transaction is technically out of the scope of IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*, the committee believes that the guidance in that interpretation is helpful in considering the correct treatment. In particular, the committee notes that as the carrying amount of the loan absent the waiver (which was at the discretion of the lender and not Trustco) and the fair value of the shares could be determined, the reason for the scope exemption can be overcome and IFRIC 19 can be used by analogy.
- 4.22. The suggested treatment is therefore that the loan could initially be recognised as a liability. On waiver, the full carrying amount would be transferred directly to equity. When the company issued the additional shares on 12 February 2020, they would be accounted for by transferring the balance of Shares for Vendors to share capital. All these entries should be made through the statement of changes in equity, not in the statement of comprehensive income.

*Recognising a N\$ 1 billion gain on loan waiver in profit and loss subsequent to 2019*

- 4.23. In the opinion of the committee, no gain can be recognised in relation to the waiver of the loan. This is based on the conclusion reached above that the substance is that of a debt to equity conversion or alternately that the substance of the additional financing provided to the group in substance was always equity financing relating to the acquisition of Huso.
- 4.24. The recognition of a gain from the waiver of a loan provided by the majority equity holder would provide misleading information and would not faithfully represent the substance of the transaction. In addition, the definition of income (Conceptual Framework para 4.25(a)) specifically excludes amounts relating to contributions from equity participants – which is the substance in this instance. Furthermore, to do this in a way that results in the recognition of a gain that triggers an earn-out clause giving rise to the issue of additional equity shares to the



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controlling shareholder (as opposed to QvR acting as a creditor) suggests that the structure has been contrived to increase QvR's equity shareholding.

**5. Recommendation by the Review Committee – Referral 1**

*Initial loan*

- 5.1 The recommendation of the review committee is that the accounting for the initial loan should be considered to be a prior period error and not an adjustment to provisional initial accounting. This will result in the reversal of the gain recognised at the time of the loan waiver and an adjustment to the common control amount recognised in equity.

*Subsequent loan*

- 5.2 As the committee believes that while there are indications that the substance of the loan was always that of an equity contribution, classification as a liability in 2019 is not conclusively incorrect.
- 5.3 The waiver of the loan in 2020 is considered to be the action of a shareholder in the capacity of a shareholder as opposed to a creditor. This confirms that the nature of the subsequent loan is akin to an equity contribution and should be treated as such.
- 5.4 The subsequent waiver of the loan will therefore not result in the recognition of any gain in the 2020 financial statements.

**6. Consensus – Referral 1 IFRS Conclusion by the Review Committee – Referral 1**

- 6.1 The review committee unanimously support the conclusion reached with respect to referral 1.



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**REFERRAL 2 – APPROPRIATENESS OF RECLASSIFYING INVENTORY TO INVESTMENT PROPERTY AND PRESENTING THE FAIR VALUE GAIN AS REVENUE/COST OF SALES**

- 7. Background Information – Referral 2**
- 7.1. Trustco reclassified certain properties in its Elisenheim development from inventory to Investment Property.
- 7.2. The argument provided by the issuer for the reclassification of the properties is that given the decline in demand, it is not anticipated that the properties will be sold in the foreseeable future and where the land has a currently undetermined future use, the land is regarded as held for capital appreciation and therefore meets the definition of investment property. (For context, the company has 251 properties classified as inventory and is currently selling at three erven per month i.e. has stock for 7 years at the current rate of demand. 1 911 erven have been classified as investment property on the basis that they would only be sold in 8 or more years' time.)
- 7.3. As a result of the reclassification, the property was measured at fair value with the fair value of the property being recognised as sales revenue and the cost of the property as cost of sales, resulting in the overall impact of the recognition of the fair value gain in profit and loss. (The reclassification gave rise to 'sales revenue' of N\$984 million and 'cost of sales' of N\$291 million, being 66% (984/1479) and 58% (291/500) of the total amounts recognised.)
- 7.4. IAS 40 *Investment Property*'s amendment in respect of transfers of Investment Property is effective for financial years beginning on or after 1 January 2018 and is therefore relevant to the financial period under consideration in this review. In terms of those amendments, in order to recognise a transfer to or from investment property, there needs to be evidence of the change in use. Paragraph 57 of IAS 40 as amended states that "In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use."
- 7.5. Trustco has treated the transfer of the property from inventory to investment property as a sale of the property i.e. by recognising the fair value as sales revenue and the carrying amount as cost of sales as opposed to recognising the fair value adjustment as a gain on transfer. The impact on profit is the same but the presentation differs.
- 7.6. The presentation decision is of added relevance given that the remuneration of the group managing director (QvR) is paid to a company (Next Investments) in which QvR is the sole shareholder, in the form of a management fee that is partly linked to turnover. (Page 16 of the Annual Financial Statements.)
- 7.7. The JSE has queried:
- 7.7.1 Trustco's assertion that there is sufficient evidence of a change in use as required by paragraph 57 of IAS 40 to reclassify the property from inventory to investment property and
- 7.7.2 The manner in which Trustco has presented the resulting 'gain' on a gross basis as revenue and deemed cost of sales.



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## 8. IFRS Conclusion by the Review Committee – Referral 2

### *Appropriateness of the reclassification of the properties from investment property to inventory*

- 8.1. In order to reclassify property from inventory to investment property, the properties involved must satisfy the definition of investment property and there must also be evidence of a change in use. The test for transfer therefore requires more stringent requirements than the initial classification as investment property, which would be based only on the intended use of the asset. The key issue here is whether there is “evidence of the change in use”.
- 8.2. Paragraph 57 of IAS 40 states that “In isolation, a change in management’s intentions for the use of a property does not provide evidence of a change in use.” The paragraph includes the “inception of an operating lease to another party” as appropriate evidence for the transfer of a property from inventory to investment property, but does make it clear that the examples provided to illustrate are not exhaustive.
- 8.3. The factors that the issuer considered as providing evidence that there is a change in use are essentially that it has ceased development of the provision of bulk services on the properties and that the planning for the development has been decommissioned. (Trustco response 20 April 2020 pg 18). In assessing the relevance of this response, it is worth noting that the development of the properties only commences once sufficient properties within a particular area have been sold.
- 8.4. The properties concerned were vacant prior to reclassification and continue to be vacant. There is no clear evidence that there has been a change in use. The more plausible interpretation is that economic reasons have resulted in the suspension of plans for further development, which is not evidence of a change in use.
- 8.5. It appears that the development activities conducted by Trustco are generally limited to installing/providing bulk services once a sufficient number of erven in a phase are subject to a contract of sale. This further supports the view that the suspension of development activities could be linked to a decline in the number of sales as opposed to a clear case of “evidence of the change in use”.
- 8.6. The definition of investment property specifically excludes those properties that are held for sale in the ordinary course of business i.e. those that are classified as inventory. The definition of inventory does not include a time limit in which the asset is expected to be sold. It is based on the business model or purpose for which the asset is held. This supports the view that the properties could continue to be recognised as inventory i.e. measured at the lower of cost and net realisable value.
- 8.7. Despite repeated interactions the only evidence provided by Trustco to support the “change in intention” is a board resolution and the fact that the properties are not likely to be sold in the foreseeable future. The review committee considered that IAS 1 would have required the necessary disclosures of such judgements to support the change in use of the asset.
- 8.8. The review committee is not convinced that a board resolution is sufficient evidence to indicate a change in use and therefore believes that the properties should continue to be recognised as inventory.

### *Presentation of the resulting gain on loss on reclassification*

- 8.9. Despite the fact that the review committee does not believe that it is appropriate to reclassify the property, it has considered the appropriate presentation of the resulting gain that would arise were it appropriate to reclassify the property.



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- 8.10. The current treatment has included the fair value of the transferred property as revenue on the basis that the transfer is treated as a sale of the property at fair value. As revenue arises from a contract with a customer, recognition as revenue is not appropriate as this transaction does not involve any interaction with a customer.
- 8.11. In addition, paragraph 63 of IAS 40, Investment Property, requires that on reclassification from inventories to investment property, "any difference shall be recognised in profit or loss", which indicates recognition of the difference as a single amount.

**9. Recommendation by the Review Committee – Referral 2**

- 9.1 The recommendation of the review committee is that the reclassification of the property should be treated as an error. In the case of material omissions IAS 8 would require that the 2019 financial statements should be restated to reverse the impact of the reclassification as investment properties and retain the properties as inventories.
- 9.2 The company should be advised that were there sufficient evidence of a change in use, it would have been required to restate the presentation in order to remove the amounts from revenue and cost of sales and to recognise the fair value adjustment as a single amount.

**10. Consensus – Referral 2**

- 10.1 The review committee unanimously support the conclusion reached with respect to referral 2.



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**REFERRAL 3 – APPROPRIATENESS OF THE POINT AT WHICH REVENUE ON LAND SALES IS RECOGNISED**

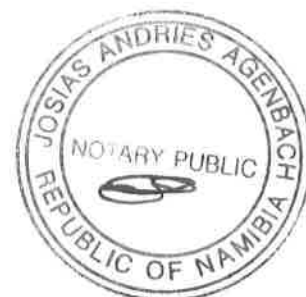
**11. Background Information – Referral 3**

- 11.1. Trustco assert that the sale of land and the subsequent installation of bulk services are two distinct performance obligations.
- 11.2. On the basis that it is a separate performance obligation, Trustco recognises sales revenue relating to the land component on the date on which a purchase contract is signed with a purchaser. (The company's policy for recognising revenue for land sales when the contract was signed applied both in terms of its application of IFRS 15 and IAS 18. There was no restatement as a result of the adoption of IFRS 15).
- 11.3. Clause 3 of the sale agreement details that Trustco is entitled to a non-refundable deposit and the balance of the purchase price on registration of transfer. However, clause 4 of the sale agreement details that a customer is only eligible to take possession of a property upon completion of the bulk services and the issue of an engineering completion certificate. The purchaser is not entitled to resell or alienate the property prior to the installation of bulk services or without taking legal transfer.
- 11.4. Trustco has the right to install the bulk services i.e. the customer cannot use an alternate service provider without the approval of Trustco.
- 11.5. It appears that the customer has no influence over when the bulk services will be provided as the seller has the sole discretion to provide services when there is sufficient demand in an area.
- 11.6. A dwelling is required to be erected and completed within two years of registration of the transfer. The customer contract specifies that if the dwelling is not completed within the specified period, this will give Trustco the right to treat the transaction as a failed sale, a repurchase option and the imposition of a penalty. The nature of Trustco's rights when a dwelling is not complete are significantly more than the protective rights generally provided to a homeowners association to pressurise owners to complete building for aesthetic reasons.
- 11.7. Trustco routinely 'repurchases' properties that they have previously treated as being 'sold' to purchasers. This is a frequent occurrence (e.g. 44% of the properties sold in phases 4 & 5 were repurchased by the group) and is on a significant upward trend (70 erven in 2017, 105 in 2018, 263 in 2019).
- 11.8. The JSE has questioned
  - 11.8.1. the number of distinct performance obligations that exist in the sale of property and
  - 11.8.2. the 'point' at which revenue on unserviced land is recognised.

**12. IFRS Conclusion by the Review Committee – Referral 3**

*The number of distinct performance obligations that exist in the sale of property*

- 12.1. In order to be a separate performance obligation, the goods or services promised in terms of the contract must be distinct. In order to be distinct, the customer must be capable of benefitting from the goods or services either on its own or together with resources that are readily available and the promise to supply the goods or services must be separately identifiable.
- 12.2. The key issue in this example is determining the extent to which the sale of land is distinct from the provision of bulk goods and services.



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Ref.: JSE1/2021

In the matter between:

**TRUSTCO GROUP HOLDINGS LIMITED**

Applicant

and

**JSE LIMITED**

Respondent

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**JSE'S HEADS OF ARGUMENT**

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**INTRODUCTION AND THE FACTS**

1. Dr van Rooyen is the CEO and majority shareholder of Trustco Group Holdings ("**Trustco**"). He was also the sole shareholder of Huso Investments (Pty) Ltd ("**Huso**").
2. Between 2015 and 2018, Dr van Rooyen advanced loans totalling approximately N\$546 million to Huso and its subsidiaries, which we refer to as "**the first loan**".<sup>1</sup>
3. In 2018, Trustco acquired all the issued shares of Huso.
4. In Huso's financial statements, the first loan was initially classified as equity. By the time Trustco acquired Huso, though, the first loan had been reclassified as a liability<sup>2</sup> and this was not disclosed to the Trustco shareholders.

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<sup>1</sup> JSE's reasons; record part A p 351, para 37.3.

<sup>2</sup> JSE's reasons; record part A p 350, para 37.



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5. The sale of shares agreement for the purchase of the Huso shares included an EBITDA-based earn-out mechanism in favour of Dr van Rooyen (or his investment vehicle, Next Investments (Pty) Ltd)<sup>3</sup>, in terms of which Trustco shares were to be allotted if profit thresholds were met.
6. 26 days after Trustco acquired the Huso shares, Dr van Rooyen forgave the first Huso loan and released Huso from all of its obligations in relation to the first loan.<sup>4</sup>
7. Consequent on the first loan being forgiven Trustco then recognised a substantial gain of N\$546 million in its 2019 annual financial statements.<sup>5</sup>
8. The conversion of the first loan from equity to liability and its subsequent forgiveness converted what was otherwise a loss-making resources segment to a profit, which also triggered the earn-out mechanism in Dr van Rooyen's favour.
9. Despite several opportunities, neither Dr van Rooyen nor Trustco has offered a commercial rationale for forgiving the first loan.<sup>6</sup> Their failure persists in Trustco's heads of argument.
10. In 2019, Dr van Rooyen advanced a second loan of up to N\$1 billion to Trustco ("**the second loan**").<sup>7</sup> After only 8 months Dr van Rooyen forgave this loan too, resulting in a N\$1 billion gain recognised by Trustco in its September 2019

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<sup>3</sup> JSE's further reasons; record part B p 4, para 9.

<sup>4</sup> JSE's reasons; record part A p 235, para 2.1.7.

<sup>5</sup> JSE's reasons; record part A p 235, para 2.1.7.

<sup>6</sup> JSE's reasons; record part A p 352, para 37.8.

<sup>7</sup> FRIP report; record part A p 254, para 3.1.9.



interim results and September 2020 financial statements.<sup>8</sup> Here too, neither Dr van Rooyen nor Trustco has offered a commercial rationale for forgiving the second loan. But as with the first loan, this forgiveness triggered the earn out provisions in terms of the Huso sale of shares agreement and Dr van Rooyen, or his investment vehicle, benefited handsomely from the allocation of Trustco shares.

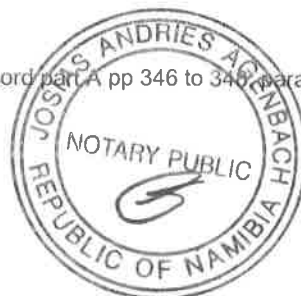
11. On a separate issue, Trustco owns properties in its development in Elisenheim, Windhoek. Trustco reclassified properties in the development from inventory to investment property.<sup>9</sup> It justified the reclassification on the basis that a decline in demand meant that it did not anticipate selling the properties for the foreseeable future.<sup>10</sup> Trustco reported the fair value of the properties as a rise in sales revenue which increased its profitability.
12. In October 2020, the JSE decided that Trustco Group Holdings' 2019 annual financial statements and 2019 interim results did not comply with IFRS in three ways:<sup>11</sup>
  - 12.1 the first relates to loans that Dr van Rooyen, Trustco's majority shareholder, advanced to Huso and related entities. In its heads of argument, Trustco calls this **"the loan issue"**;

<sup>8</sup> FRIP report; record part A p 254, para 3.1.11.

<sup>9</sup> FRIP report; record part A p 259, para 7.1.

<sup>10</sup> FRIP report; record part A p 259, para 7.1.

<sup>11</sup> JSE's decision; record part A p 9, para 9. See also JSE's reasons; record part A pp 346 to 349, paras 24 to 25.



- 12.2 the second relates to the reclassification of the Elisenheim properties from inventory to investment property. In its heads of argument, Trustco calls this "**the property issue**"; and
- 12.3 the third related to Trustco's recognition of revenue on a sale of land as at the sale agreement signature date.
13. Trustco rectified the third issue. It objected to the JSE's decision on the first and second issues. The JSE dismissed Trustco's objection, and Trustco now applies for reconsideration.
14. This decision was part of the JSE's proactive monitoring process. The JSE sought guidance from the Financial Reporting Investigation Panel ("**FRIP**"). The JSE's decision aligns with the FRIP's report.<sup>12</sup> The JSE also afforded Trustco several opportunities to make representations on the JSE's concerns and findings, including an opportunity to comment on the FRIP's report<sup>13</sup> and opportunities to provide oral evidence to the JSE and the FRIP Chair.

## THE PROPER APPROACH TO THE MATTER

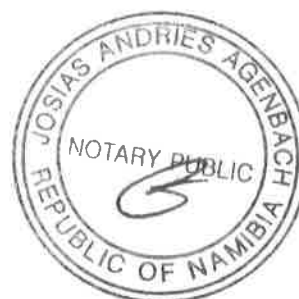
15. The JSE included in its further reasons an expert report of Professor Warren Maroun, a professor at the school of accountancy at Wits.<sup>14</sup> His report summarises his opinion on how Trustco should have prepared its financial statements in accordance with IFRS in respect of the loans and the properties.

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<sup>12</sup> FRIP report; record part A p 252.

<sup>13</sup> JSE's reasons; record part A pp 341 to 342, paras 11 to 13.

<sup>14</sup> Professor Maroun's report; record part B p 1.



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16. Professor Maroun makes an important point up-front: he expresses his views as a chartered accountant, not a lawyer.<sup>15</sup> We submit that is an important distinction. When companies apply IFRS and other reporting standards, they should do so through an accountancy lens, not a legal lens. This is especially important when considering the economic substance of a transaction over its form. Courts have already recognised a *"fundamental accounting principle is that economic substance should override legal form"*.<sup>16</sup>
17. Professor Maroun confirms that *"substance over form"* is an *"accounting concept which is specific to financial accounting"*.<sup>17</sup> It is not the same as the legal concept of a sham transaction. Rather, it 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"*.<sup>18</sup> The Conceptual Framework gives content to the substance-over-form approach to IFRS (see, in particular, paragraphs 2.6 to 2.19 of the Conceptual Framework).
18. Professor Maroun explains that IFRS requires financial statements to be a *"faithful representation of the underlying economic phenomena and events"*, which means that financial statements must consider the *"economic substance,*

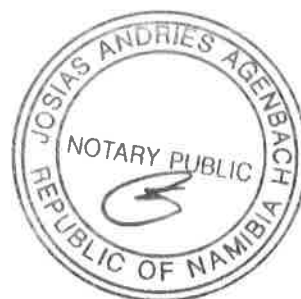
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<sup>15</sup> Professor Maroun's report; record part B p 2, para 4.

<sup>16</sup> *MEC for Economic Opportunities, WC v Auditor-General* 2021 (1) SA 455 (WCC) at para 151.

<sup>17</sup> Professor Maroun's report; record part B p 2, para 5.

<sup>18</sup> Professor Maroun's report; record part B p 2, para 7.



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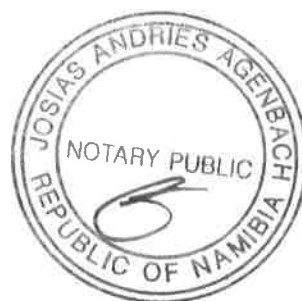
*and financial reality of the underlying transactions, and not merely their legal form".*<sup>19</sup>

19. Arguably most important for the facts of this case is the Conceptual Framework's recognition that 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"*.<sup>20</sup>
20. Though the Conceptual Framework does not override IFRS, it informs the proper interpretation and application of IFRS. In particular:
- 20.1 the Conceptual Framework informs the meaning of the substance-over-form approach that is adopted in IFRS;
- 20.2 if a specific IFRS does not deal with a transaction, IAS 8 requires consideration of the Conceptual Framework when developing an accounting policy; and
- 20.3 IAS 1 requires financial statements to achieve *"fair presentation"* and provide a *"faithful representation of the effects of transactions, other events and conditions"*.
21. The need to consider substance over form is a cornerstone of IFRS:

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<sup>19</sup> Professor Maroun's report; record part B p 2, para 8.

<sup>20</sup> Professor Maroun's report; record part B p 4, para 11.3.



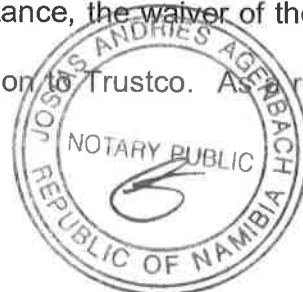
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- 21.1 IAS 32.15 requires consideration of the substance of contractual arrangements when classifying an instrument as either a financial liability or equity;
- 21.2 IAS 8.10(b)(ii) requires the development of an accounting policy that produces reliable information that identifies the economic substance of transactions and not merely their legal form; and
- 21.3 paragraphs 2.12 and 4.59 of the Conceptual Framework require financial statements to report the substance of the rights and obligations created by contracts.
22. A substance-over-form approach is important for another reason: the JSE's obligation to ensure that accurate information is released to the market. The JSE's decision here was the product of its proactive monitoring process, which gives shareholders and the investing public the benefits of a better-regulated market. The integrity of financial information is a critical element of a well-functioning market. Any omissions from published financial information, including omissions that result from the form of a transaction being used to disguise its substance, have a direct impact on the pricing information of a company and may influence the investment decisions of shareholders and the investing public.

## THE FIRST ISSUE: THE LOANS

### *Summary of the JSE's decision on the loans*

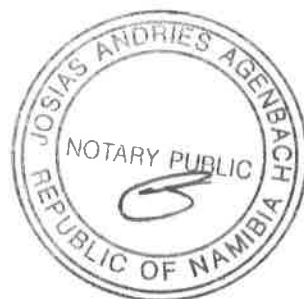
23. In the JSE's view, supported by the FRIP, in substance, the waiver of the two loans was part of Dr van Rooyen's equity contribution to Trustco. As a result,



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under IFRS, no gain is recognised in profit or loss when the loans are waived. The waivers are accounted for directly in equity. Three main facts support this conclusion:

- 23.1 the timing of the first loan being waived relative to the acquisition of the Huso shares, and the close link to the number of shares which are issued or issuable to Dr van Rooyen, means that these transactions should be understood as a single unit of account;
- 23.2 the cashflow profiles of both loans resemble an equity contribution by the controlling shareholder rather than a repayment of borrowed amounts with compensation for the time value of money; and
- 23.3 even if the two loans are financial liabilities, their waivers should properly be treated as equity contributions that settle liabilities. There is no commercially sensible reason why a lender would forgo the right to unpaid capital and interest for no consideration. In the same way as an equity participant, Dr van Rooyen was compensated by improved financial performance and the associated benefits of capital appreciation and dividends on his existing shareholdings and the receipt of a substantial number of Trustco shares under the earn out mechanism which would otherwise not have been due. Trustco would have been in the same position if Dr van Rooyen had advanced the funds as a direct equity contribution and those funds were then used to repay a third-party debt of the same amount.



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### *The first loan*

24. The first loan, between Dr van Rooyen and Huso, was originally classified as an equity loan in Huso's annual financial statements<sup>21</sup> and was communicated as an equity loan in two successive Trustco Circulars related to the Huso acquisition (2015 Circular and subsequent 2017 Circular). It was subsequently reclassified as a liability. Trustco did not, however, announce this change to the market.<sup>22</sup> According to Trustco's 2019 annual financial statements, Dr van Rooyen waived a loan of N\$546 million in September 2018, being 26 days after Trustco had acquired Huso.<sup>23</sup>
25. Trustco has, despite several opportunities, never offered a rational commercial reason for Dr van Rooyen's waiver of the first loan. Nor did Trustco produce the underlying agreement for the initial loan.
26. The JSE based its analysis of the accounting for the first loan on IFRS 3, IAS 32, IAS 8, and the Conceptual Framework.<sup>24</sup> The JSE concluded that Dr van Rooyen was compensated for the forgiven first loan through the earn-out mechanism, which was triggered by Trustco's recognition of a gain in profit.
27. IAS 8.10 requires companies 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. The JSE applied IFRS 3

<sup>21</sup> FRIP report; record part A p 253, para 3.1.

<sup>22</sup> JSE's reasons; record part A p 351, para 37.6.

<sup>23</sup> JSE's reasons; record part A p 351, para 37.3.

<sup>24</sup> JSE's further reasons; record part B p 6, para 20.



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by analogy to the accounting for a business combination under common control.<sup>25</sup> The JSE considered IFRS 3.B50 as providing guidance to determine what should (or should not) be part of the Huso acquisition which in turn goes to what the economic substance of the transaction is. For the reasons expressed in the JSE reasons document, the waiver cannot then be recorded as a gain in the income statement.<sup>26</sup>

28. Trustco is wrong that IFRS 3 is inapplicable.<sup>27</sup>

28.1 Trustco based its accounting policy for business combinations involving entities under common control based on UK GAAP (FRS 6). Trustco did so even though FRS 6 was withdrawn for reporting periods after January 2015.

28.2 On Trustco's own version, it must have considered at least some aspects of IFRS 3 in its accounting of the waiver. For example, Trustco identified an acquirer and acquiree and recognised the acquirees' identifiable assets and liabilities in the consolidated financial statements, which appears to be an application of FRS 3.1.

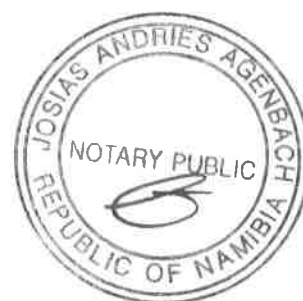
28.3 In any event, like IFRS 3, FRS 6 does not deal expressly with the forgiveness of shareholder loans. The JSE used IFRS 3 by analogy to

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<sup>25</sup> JSE's further reasons; record part B p 6, para 21.

<sup>26</sup> JSE's further reasons; record part B pp 3-5, paras 6-13.

<sup>27</sup> JSE's further reasons; record part B pp 8-9, para 27.



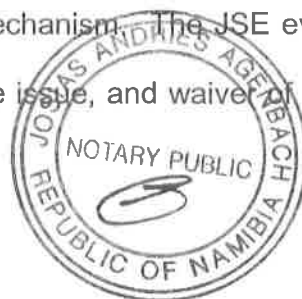
determine what was considered part of the business combination. IAS 8.12 makes it clear that an accounting policy cannot conflict with IFRS.

29. Five main factors supported the JSE's conclusion that the waiver of the first loan is part of the consideration for the business combination.

29.1 First, IFRS requires contracts concluded at or near the same time to be evaluated collectively (see, for example, paragraph 4.62 of the Conceptual Framework; IFRS 15.17; IFRS 16.B2). The first loan was waived 26 days after Trustco acquired Huso. This puts paid to Trustco's argument that the waiver of the first loan should not be included as part of the business combination accounting because it arose after the business combination.

29.2 Second, under IFRS 3, a transaction must be concluded as part of the exchange for the acquiree to be taken into consideration when accounting for the business combination. The fact that a transaction may be completed only after the contract for a business combination is signed does not necessarily mean that it should be automatically excluded when determining the transaction price for the combination or the net assets assumed. IFRS 3.39 shows that there are instances where transactions and events are finalised at a later date but still form an integral part of the business combination accounting.

29.3 Third, Trustco's accounting of the waiver of the first loan resulted in reported gains of N\$596 million to Trustco. Dr van Rooyen would not have incurred these losses without compensation. The most likely explanation is that he was compensated through the earn-out mechanism. The JSE evaluated the business combination, contingent share issue, and waiver of the loan



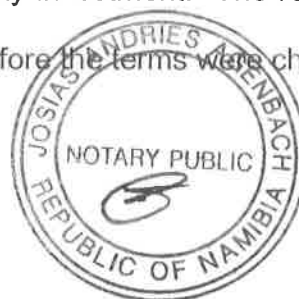
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concurrently even though the transactions are not housed in the same agreements. This is consistent with the guidance provided by the Conceptual Framework and other IFRS provisions (see, for example, IFRS 15 and IFRS 16) on considering contracts in the aggregate to give effect to their substance, not form.

29.4 Fourth, IFRS requires accounting for the economic substance and financial reality of transactions. For financial reporting standards, a showing of deceit or a sham transaction is not necessary to trigger a substance-over-form approach. IFRS is concerned with accounting for the economic reality of transactions (see, for example, paragraphs 2.12 and 2.18 of the Conceptual Framework).

29.5 Fifth, Dr van Rooyen waived the first loan at the end of September 2018, shortly after Trustco acquired Huso. The economic substance of the transaction suggests that the waiver was an integral part of the business combination despite the waiver occurring afterward. Because the waiver occurred within 12 months of the business combination, it should, under IFRS 3.45, be included in the determination of the amounts used to complete the initial accounting for the business combination.

30. With those considerations in mind, the JSE took as its starting point the nature of the first loan before it was waived. The loan accrued no interest and was unsecured. In substance, the only return to Dr van Rooyen arose indirectly from the deployment of funds in the Huso business and resulting distributions and capital appreciation. This resembles an equity investment. The repayment of the loan was initially at the option of Huso (before the terms were changed) and



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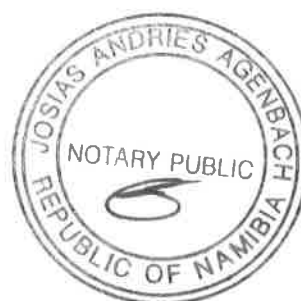


was communicated as such in the Trustco circulars. This closely resembles a company's discretion about payment of dividends on equity instruments. The terms of the loan were far from what would be expected on the open lending market.<sup>28</sup> In particular, in the absence of a market-related interest rate, clear repayment schedule and security, the loan does not have the economic characteristics of a liability; Dr van Rooyen did not receive a fixed or determinable repayment of capital and risk-adjusted compensation for the use of borrowed funds (see, in this regard, IFRS 9.4.1.2).

31. The economic substance of the transaction suggests that the waiver was an equity contribution. Waiving a loan without consideration is extraordinary, and even more so when the loan is for as substantial amounts as Dr van Rooyen's loans. In the end, waiving the loans placed Dr van Rooyen in the same position as if he made an equity contribution to Trustco: in both cases, Dr van Rooyen is exposed to a full loss of the initial investment without a determinable return.
32. The Conceptual Framework supports classifying the waiver of the loans as equity, as the JSE explained in its further reasons.<sup>29</sup>
33. Trustco points to IAS 32.AG35, which deals with redeemable preference shares. Under IAS 32.AG35, a borrower's inability to satisfy the redemption of preference shares does not undermine the reporting of preference shares as a liability. Trustco's reliance on IAS 32.AG35 is misplaced. IAS 32.AG35 deals with a situation where the redemption of the shares is mandatory or at the option of the

<sup>28</sup> JSE's further reasons; record part B pp 16-17, para 32.4.

<sup>29</sup> JSE's further reasons; record part B pp 19 to 20, para 34.



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- 12.3. The deed of sale contains the following aspects which suggest that the customer cannot benefit from the land without the provision of bulk services:
  - 12.3.1. The customer can only take possession on completion of the bulk services (as certified by an engineer)
  - 12.3.2. The customer may not sell or alienate the property prior to the transfer date (undefined), without Trustco's approval, which will only be granted once the customer has taken possession (defined.)
  - 12.3.3. Trustco retains the right of sole discretion to service the land and complete the bulk services in various phases depending on the demand for serviced properties and hence controls the date on which the necessary engineering certification required for transfer can be acquired.
  - 12.3.4. Trustco retains the right to cancel/repurchase/levy a penalty where a customer fails to erect a dwelling within 2 years.
- 12.4. There is limited information on who controls the bulk services once they have been developed. In order for these to be a separate performance obligation, a detailed IFRS 15 control analysis should be prepared to demonstrate when and how control of the bulk services is transferred to a customer. In the absence of that, it is not clear whether this is a separate performance obligation or a component of the cost of providing land sold to customers.
- 12.5. It is worth noting that in the analysis below relating to the date on which the sale of land should be recognised, the conclusion is reached that control of the land cannot be transferred prior to the provision of bulk services.
- 12.6. The identification of separate performance obligations requires judgment and a more detailed analysis than has been provided, particularly in respect of the provision of bulk services. As the view of the committee is that control of the land cannot occur prior to the completion of the bulk services, the relevance of determining whether they are separate performance obligations is diminished.

*The point on which sales revenue of land should be recognised*

- 12.7. The review committee has applied its mind to the appropriate date on which the sale of land should be recognised taking into consideration that the sale of land in the current period are for serviced land.
- 12.8. The current practice in terms of IFRS 15 by Trustco is to recognise revenue on the date that the purchaser signs the contract, which is consistent with the practice previously applied in terms of IAS 18.
- 12.9. There are a number of factors that indicate that the purchaser does not gain control of the land on the date on which the contract is signed. These include:
  - 12.9.1. Trustco's response indicates that the occupation of the land for the specific purposes of developing it as a dwelling is not permitted until the relevant certificates have been issued (which certificates can only be issued after completion of the bulk services.)
  - 12.9.2. The purchaser is unable to direct the use of the property until such time as he has taken possession of the property, which will only occur after the provision of bulk services.
  - 12.9.3. The purchaser cannot sell or alienate the property prior to the transfer date without the consent of Trustco prior to the date of possession, which occurs only after the provision of bulk services.



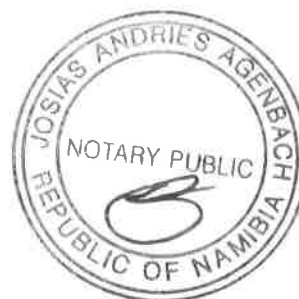
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- 12.9.4. The timing of the provision of bulk services is at the sole discretion of Trustco and therefore the purchaser has no influence over when he will be able to take possession of the land.
- 12.9.5. Trustco is only eligible to claim payment for land sales after the bulk services have been certified as having been completed.
- 12.10. Based on the many factors indicating that the purchaser does not acquire possible control of the land until at least the point at which the bulk services have been provided, the revenue from the sale of the land should not be recognised at the date that the contract is entered into.
- 12.11. The distinction between the date on which the bulk services have been provided and the date on which the necessary engineering certification has been received has not been specifically considered as it may be considered that the engineering certification is only confirmation that provision of the bulk services have been appropriately provided.
- 12.12. The review committee has noted the high level of repurchased properties with concern but notes that the proposed revised policy is likely to significantly reduce the level of repurchases.
- 12.13. An additional point that is worthy of consideration are the onerous penalties that are applicable if completion of the building does not occur within two years, which go considerably beyond the normal aesthetic protection rights afforded to home owner associations. As these include Trustco's right to reverse the sale, there is an argument that control of the property does not occur until such time as the building is completed. During the period that the so-called purchaser has the right to the transferred property, that would be in substance a lease.
- 12.14. The conclusion of the review committee is that in terms of the requirements of IFRS 15, the earliest point on which any revenue could have been recognised is on the satisfactory completion of the bulk services.
- 13. Recommendation by the Review Committee – Referral 3**
- 13.1. The review committee's recommendation is that Trustco is required to treat the application of IFRS 15 as an error. IAS 8 requires that material omissions be corrected retrospectively, which would require that Trustco change its revenue recognition policy in line with the requirements to only recognise revenue when the customer gains control of the land i.e. after the provision of bulk services.
- 13.2. The review committee further recommends that a proper analysis of the bulk services be performed in order to establish if, and when, the customer ever obtains control of this infrastructure.

**14. Consensus – Referral 3**

- 14.1 The review committee unanimously support the conclusion reached with respect to referral 3.

31 July 2020



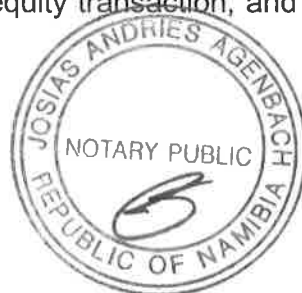
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*holder*. The issuer's subsequent inability to satisfy the redemption does not extinguish the contractual obligation to deliver cash that was established when the instrument was initially recognised.

34. Shareholder loans are different; 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. In the JSE's view, this means that the loans to Trustco were not liabilities. In any event, IAS 32.AG35 is based on an arm's length transaction, not loans between related parties. It also does not contemplate loan forgiveness for no consideration.

#### ***The second loan***

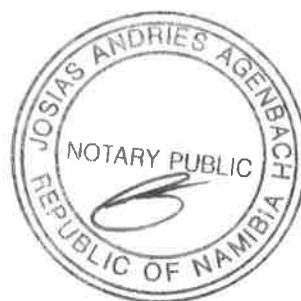
35. In the JSE's view, the second loan should always have been treated and reported as an equity contribution. It is only the contractual terms of the loan prior to the waiver which indicate that recognition as a liability at March 2019 cannot be considered a clear violation of IFRS. But the recognition as a liability, without considering the circumstances of the waiver, does not warrant the recognition of income. The waiver occurred only 8 months after the loan had been granted and was effected by Dr van Rooyen in his position as the controlling shareholder of Trustco. When this is brought into account the economic substance of the second loan, and its waiver, was in the JSE's view that of an equity contribution. The JSE concluded that the waiver of the second loan was, in substance, made by Dr van Rooyen as shareholder (not lender). Consequently, there should be no income (gain on waiver) recognised in profit and loss as the transaction is one which has the economic substance of an equity transaction, and the gain does



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not meet the definition of "income" per paragraph 4.68 of the Conceptual Framework).

36. Like the first loan, Trustco reported the waiver of the second loan as a gain in the statement of profit and loss. This triggered the earn-out mechanism to Dr van Rooyen's benefit.
37. And like the first loan, the JSE concluded that the substance of the transaction resembles equity. The waiver of a loan without any consideration or compensation is exceptional and economically closer to a capital contribution. This point is made clear when it is considered that the second loan was interest bearing and any waiver therefore forgoes an interest receipt on the part of Dr van Rooyen for no consideration. To this must be added the following two points:
- 37.1 the commercially unusual term in the second loan that provided that Dr van Rooyen was able to postpone or write off any portion of the capital amount. The ability to relieve a counterparty of the obligation to repay a loan exists without it having to be mentioned, and the explicit inclusion of this right is unusual; and
- 37.2 that Trustco was obliged to align the capital amount to subsidiaries to which it had on-lent the funds is clearly aimed at Dr van Rooyen's earn out in terms of the Huso acquisition.
38. It is, we submit, fairly clear that the subsequent waiver of the second loan was practically a forgone conclusion, or at the very least was something that was clearly contemplated when the loan agreement was concluded.



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39. Despite being given several opportunities to do so, Dr van Rooyen has never offered an economically rational explanation for waiving the second loan. The waiver of the second loan is, in substance, an equity transaction.

## THE SECOND ISSUE: THE PROPERTIES

### *Summary of the JSE's decision on the properties*

40. When considering whether there has been a change to the intended use of an asset, management's intention is, on its own, insufficient. There must also be evidence of a change in use (see, in this regard, IAS 40.57 and BC 240).
41. Trustco did not adduce sufficient evidence of a change in expected use of the properties to justify a change from inventory to investment property.
42. A resolution from Trustco's board of directors in March 2019 describes the development of the properties as being deferred, not discontinued. The resolution makes this clear where it states: *"These sales will be concluded in the future, but probably not in terms of the existing sales contracts"*.<sup>30</sup>
43. Even if Trustco did adduce evidence to justify the alleged change in use (which the JSE does not accept occurred), the change must be reported appropriately. The change should be accounted for as a fair value adjustment in profit or loss. There is no basis under IFRS for accounting for the adjustment in revenue as there has been no sale to another party. The transaction is simply an internal reclassification. The gain arises solely from an accounting construct requiring the asset to be fair valued when reclassified. Reporting the adjustment as

<sup>30</sup> Record part A p 609.



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revenue creates a false and misleading impression that goods had been transferred to customers.

***The appropriateness of a transfer from inventory to investment property***

44. IAS 40.57 makes clear that there must be evidence of a change in use to support a transfer from inventory to investment property. Management's intention alone is not enough.
45. Trustco did not adduce sufficient evidence of "*observable actions*" that show a change in use (as IAS 40.BC27 requires). The properties are undeveloped and vacant.<sup>31</sup> Trustco points to a resolution of its board of directors confirming that the properties are unlikely to be sold in the foreseeable future. But in the absence of evidence of "*observable actions*", the board resolution is not, on its own, sufficient.
46. Evidence of a change in use must have economic substance. For example, any period when activities are discontinued should be longer than delays or stoppages customarily encountered in similar projects.
47. The evidence that Trustco adduced was insufficient.
- 47.1 Trustco did not adequately distinguish between the economic slowdown that would have resulted in development delays as opposed to the discontinuing of the development because of a legitimate change in use of the property.

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<sup>31</sup> JSE's reasons; record part A p 365, para 68.1.



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47.2 The resolution of Trustco's board of directors records that "*sales will be concluded in the future, but probably not in terms of existing sales contracts*".<sup>32</sup> Alone, this statement suggests that Trustco is willing to sell the properties to a suitable buyer, which would support continuing to classify the properties as inventory (as assets held for sale in the ordinary course of business under IAS 2.6). The resolution also describes the "*defer[ment]*" of the development rather than its discontinuation.<sup>33</sup>

47.3 Trustco adduced no evidence about any restricting of its operations in respect of, for example, the retrenchment of employees and the redeployment of equipment which one would expect to see if the properties were truly treated as investment properties.

48. For these reasons, Trustco adduced insufficient evidence to support a transfer of the properties from inventory to investment property.

***The proper accounting of a transfer from inventory to investment property***

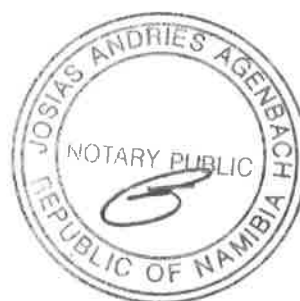
49. Even if Trustco could justify the transfer of properties from inventory to investment property, it still failed to properly account for the transfer.

50. It was inappropriate for Trustco to adjust its revenue as a result of the transfer to investment property. Under IFRS 15.31, 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. Trustco did not transfer

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<sup>32</sup> Record part A p 609.

<sup>33</sup> Record part A p 604.



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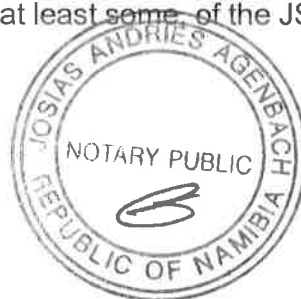


the properties to customers. It retains control over the properties before and after the re-classification.

51. In addition, revenue results in an inflow of a fixed or determinable amount of cash when the customer settles the amount due. Trustco claims to be holding the properties as investment property. That means, on Trustco's version, that it does not expect to sell the properties in the ordinary course of the group's activities, which, in turn, means that the transfer to investment property should have no impact on cash flow.
52. Trustco's argument is thus self-defeating: on the one hand, Trustco uses the transfer to investment property to adjust its revenue, but on the other Trustco has re-classified properties precisely because it does not expect them to be held for sale to customers. Trustco cannot have it both ways.

## CONCLUSION

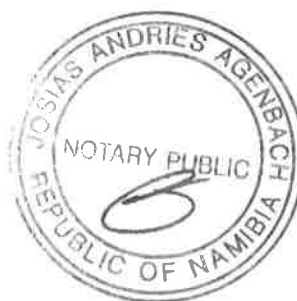
53. The JSE asks that the reconsideration application be dismissed.
54. Section 234(2) of the Financial Sector Regulation Act authorises the Tribunal, in "*exceptional circumstances*", to order that a party "*pay some or all of the costs reasonably and properly incurred by the other party in connection with the proceedings*".
55. We submit that Trustco's repeated failure to take the FRIP, the JSE, and the Tribunal into its confidence by fully explaining the economic rationale for Dr van Rooyen's waivers of the loans amounts to "*exceptional circumstances*" that warrant a costs order against Trustco for all, or at least some, of the JSE's costs.



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**IAN GREEN SC**  
**JASON MITCHELL**

Counsel for the JSE  
8 October 2021



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In the matter of:

**TRUSTCO GROUP HOLDINGS LIMITED**

Applicant

and

**JSE LIMITED**

Respondent

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**APPLICANT'S HEADS OF ARGUMENT**

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- 1 This is an application for reconsideration in terms of section 230 of the Financial Sector Regulation Act, 2017 ("**the Act**"). The decisions sought to be reconsidered were made by the respondent ("**the JSE**") of and concerning the financial treatment of certain transactions by the applicant ("**TrustCo**").
- 2 Of the five issues initially raised by the JSE,<sup>1</sup> three were referred to the JSE's Financial Reporting Investigations Panel ("**the FRIP**").<sup>2</sup> One of the issues referred to the FRIP – the Revenue Recognition Issue<sup>3</sup> – has since been resolved by the parties.<sup>4</sup>
- 3 Accordingly, the remaining issues relevant in this application resolve into two parts, namely:

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<sup>1</sup> Part A p 17, par 5

<sup>2</sup> Part A p 17, par 8

<sup>3</sup> Part A p 18, par 8.3

<sup>4</sup> Part A p 20, par 17



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- 3.1 the Loan Issue – concerning loans granted by TrustCo’s majority shareholder to TrustCo and Huso Investments respectively;<sup>5</sup> and
- 3.2 the Property Issue – concerning the reclassification of property owned by TrustCo, known as the Elisenheim development.<sup>6</sup>
- 4 Over the past year, there has been much correspondence between the parties in an attempt to reconcile their opposing understandings of the regulatory framework.<sup>7</sup> Despite this extensive engagement, the JSE remains discontent with the manner in which TrustCo reported the transactions in question.<sup>8</sup>
- 5 In October 2020, the JSE prescribed that TrustCo restate its accounting treatment of the transactions.<sup>9</sup> TrustCo’s objection to the initial decision<sup>10</sup> was given short shrift by the JSE as, on 11 November 2020, it issued an amended decision essentially reiterating the remedial steps prescribed previously.<sup>11</sup>
- 6 What is apparent from the JSE’s reasoning is that TrustCo has not actually breached any of the JSE’s rules, any accounting standards or indeed any regulatory framework at all. The JSE merely dislikes the result of TrustCo’s accounting treatment of these transactions, the unique aspects of which have no established or recognised accounting standard.
- 7 In developing an appropriate method of accounting for these transactions, TrustCo has engaged with accounting experts, audit firms and IFRS advisory

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<sup>5</sup> Part A p 17, par 8.1

<sup>6</sup> Part A p 18, par 8.2

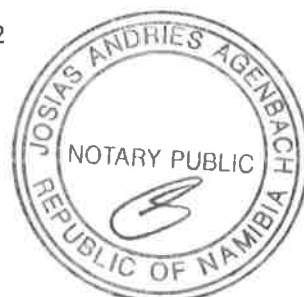
<sup>7</sup> See Part A p 18, par 9 to 14

<sup>8</sup> Part A p 19, par 15 and JSE Further Reasons Part B p 1, par 1.2

<sup>9</sup> Part A p 19, par 14 read with Annexure D

<sup>10</sup> Part A p 19, par 14 read with Annexure E1

<sup>11</sup> Part A p 19, par 14 read with Annexure E2



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experts. It has searched accounting policies and standards across the world so as to ensure that its accounting treatment of the transactions is fair and accords with international best practice.

- 8 The accounting treatment settled on and implemented by TrustCo accords with the highest accounting standards that exist in respect of transactions of this nature. Far from finding any material breach or irregularity with TrustCo's approach, the JSE merely asserts that it would have done it differently.
- 9 That the JSE may have approached the accounting from a different perspective is of no moment. The JSE is not permitted, in terms of its own rules, listing requirements or otherwise, to order that an entity amend its financial statements merely because the JSE would have prepared them differently. Without showing any actual irregularity in the method used by TrustCo in applying IFRS and developing an appropriate policy or classify certain transaction, the JSE's objections are misplaced.
- 10 TrustCo's accounting treatment of the transactions under the Loan Issue and the Property issue are considered in turn below.

## THE LOAN ISSUE

### The Huso Investments Loan

- 11 The structure of the Huso Loan and Huso Transaction is set out in detail in TrustCo's application.<sup>12</sup> In summary, the pertinent facts are these:

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<sup>12</sup> Part A p 21, par 19 to p 25, par 28



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11.1 Dr Quinton van Rooyen is the majority shareholder of TrustCo and was the sole shareholder of Huso Investments;<sup>13</sup>

11.2 Dr van Rooyen advanced NAD 546 million in loans ("**the Huso Loans**"), as follows:<sup>14</sup>

11.2.1 NAD 121 million to TrustCo Resources (a subsidiary of TrustCo);

11.2.2 NAD 204 million to Huso Investments;

11.2.3 NAD 42 million to Morse Investments (a subsidiary of Huso Investments); and

11.2.4 NAD 179 million to NNDC (a subsidiary of Huso Investments).

11.3 the loans of NAD 204 million to Huso Investments and NAD 179 million to NNDC were recorded as equity loans as their repayment was entirely within the discretion of Huso Investments and NNDC respectively;<sup>15</sup>

11.4 during 2015, TrustCo Resources concluded a Share Purchase Agreement to acquire Dr van Rooyen's shareholding in Huso Investments (excluding any loans) ("**the Huso Transaction**");<sup>16</sup>

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<sup>13</sup> Part A p 21, par 19

<sup>14</sup> Part A p 21, par 18.1

<sup>15</sup> Part A p 21, par 19

<sup>16</sup> Part A p 21, par 20 to par 22 read with Annexure H2



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- 11.5 the Huso Transaction was suspended until certain conditions precedent had been fulfilled, in particular that mining licences be obtained;<sup>17</sup>
- 11.6 due to the delay in obtaining the mining licences (and thus fulfilling the conditions precedent), the Huso Transaction was restructured by an addendum to the Share Purchase Agreement;<sup>18</sup>
- 11.7 in March 2018, the directors of Huso Investments and NNDC resolved to change the terms of the loans to become payable within the ensuing 12 months.<sup>19</sup> As a result, the loans were reclassified from equity to financial liabilities in Huso Investments' financial statements;<sup>20</sup>
- 11.8 after the Huso Transaction became effective, TrustCo Resources acquired Huso Investments;
- 11.9 as the ultimate holding company of Huso Investments, TrustCo had to account for the acquisition in its group consolidated financial statements post the acquisition. It did so by recording the Huso Loans as Huso Investments had: as financial liabilities;<sup>21</sup>
- 11.10 on 30 September 2018, Dr van Rooyen waived repayment of the portion of the Huso Loans then remaining, namely: NAD 174 million by the NNDC and NAD 42 million by Morse.<sup>22</sup>

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<sup>17</sup> Part A p 22, par 21.3

<sup>18</sup> Part A p 24, par 24 read with Annexure H4

<sup>19</sup> Part A p 25, par 26 read with Annexure H7.1 and H7.2 respectively

<sup>20</sup> Part A p 25, par 26

<sup>21</sup> Part A p 25, par 27

<sup>22</sup> Part A p 25, par 28



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- 12 The effect of the waiver by Dr van Rooyen is that NNDC and Morse were relieved of the respective repayment obligations owed by them. This gave rise to the reflected gain in profit and loss. This consequence operates up the group structure to Huso Investments (as shareholder of NNDC and Morse), on to TrustCo Resources (as shareholder of Huso Investments) and, in turn, to the group's parent: TrustCo.
- 13 As the Huso Transaction brought Huso Investments into the TrustCo group, it falls within the '*combination of business or businesses under common control*' exclusion created by paragraphs 2(c) and B1 of IFRS3.<sup>23</sup> IFRS3 does not apply as a result.<sup>24</sup>
- 14 TrustCo was unable to find an IFRS standard that applied directly.<sup>25</sup> Accordingly, TrustCo acted on advice from W Consulting who is Trustco's independent accredited JSE IFRS advisor. The transaction was audited by two independent audit firms: BDO (Namibia) and Moore Stephens MWM Inc in South Africa.<sup>26</sup> By issuing an unmodified audit report, they agreed with Trustco's IFRS application. Subsequently Trustco appointed new JSE accredited auditors (Nexia SAB&T) who were also required to independently audit the underlying facts of each transaction and like the other 2 (two) auditors, concluded that Trustco's IFRS was appropriate and correct.

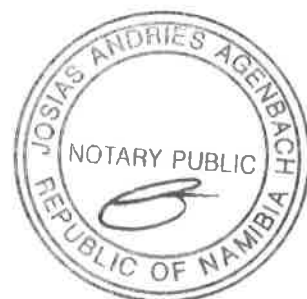
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<sup>23</sup> Part A p 25, par 29

<sup>24</sup> Part A p 659, par 23 and p 665, par 37

<sup>25</sup> Part A p 25, par 30

<sup>26</sup> Part A p 17, par 6



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15 TrustCo had previously been advised to formulate its own accounting policy in accordance with IAS8,<sup>27</sup> and, in particular, paragraphs 10 to 12 thereof.<sup>28</sup> These portions of IAS8 dictate that, in formulating an appropriate policy, TrustCo ought to:<sup>29</sup>

15.1 consider accounting standards similar in substance to the transaction in question;

15.2 if no similar accounting standard exists or could be found, consider the Conceptual Framework; and

15.3 if there is no appropriate guidance in the Conceptual Framework, consider how similar transactions are treated by other Accounting Standard setters.

16 As there are no similar standards<sup>30</sup> or any relevant guidance in the Accounting Conceptual Framework,<sup>31</sup> TrustCo had turned to an array of other accounting standard setters to see if any provided for the accounting treatment of business combination transactions.<sup>32</sup> The most apt standard was that provided for in the United Kingdom's FRS6, pertaining to amalgamations.<sup>33</sup>

17 Having identified that standard (which was applicable at the time), TrustCo worked closely with its auditors and IFRS advisors to develop an appropriate policy. The workings of TrustCo's policy, which were set out in full in the TrustCo

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<sup>27</sup> Part A p 25, par 30

<sup>28</sup> See Part A p 26, fn 2

<sup>29</sup> Part A p 26, par 31

<sup>30</sup> Part A p 28, par 35.1

<sup>31</sup> Part A p 28, par 35.2

<sup>32</sup> Part A p 28, par 35.3

<sup>33</sup> *ibid*



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Group AFS,<sup>34</sup> were applied in this instance and resulted in the Huso Transaction being accounted for as set out in paragraph 37 of the reconsideration application.<sup>35</sup>

18 Notably, it appears that the JSE does not take issue with this recognition of the Huso Transaction in and of itself.

19 In accounting for the loan waiver, TrustCo applied IFRS9 which required:

19.1 that TrustCo derecognise the financial liability as at the date it was extinguished; and

19.2 recognise in profit and loss the difference between the carrying amount of the financial liability and the consideration paid to settle it.

20 TrustCo did just that and so reflected a gain of NAD 546 million in profit and loss.

21 It was only at this point, having reflected a gain in profit and loss, that the JSE took issue with TrustCo's treatment of the Huso Transaction. In doing so, the JSE deemed the Huso Transaction and the loan waiver to be a single indivisible transaction. As a result, the JSE views the Huso Loan as having always been an equity loan and never a financial liability.

22 Plainly, this is a perversion of the true state of affairs. It is fanciful to disregard the express terms of the Huso Loans as well as the resolutions that amended their repayment terms.<sup>36</sup>

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<sup>34</sup> Part A p 29, par 36

<sup>35</sup> Part A p 29, par 37

<sup>36</sup> See Part A Annexures H7.1 (Huso Resolution) p 572 and H7.2 (NDC Resolution) p 574



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- 23 Initially the loan was recorded as an equity loan as its repayment was entirely in the recipients' discretion. When the respective entities resolved to change the loan repayment terms, it would be untenable from an accounting perspective for the loans to continue to be treated as equity as they had, in fact, become financial liabilities.
- 24 Far from the JSE's insistence that the transactions be treated as one, they are, properly construed, separate and distinct. As much is evidenced by the fact that the Huso Loans were reclassified on or about 31 March 2018,<sup>37</sup> before Huso Investments was acquired by TrustCo Resources in September 2018.<sup>38</sup>
- 25 The purpose of group combination accounting is to reflect the value of the entity acquired into the group. At the time of the acquisition, the Huso Loans were repayable and so were reflected as liabilities in the accounts of Huso Investments. Had the acquisition by TrustCo not occurred, the Huso Loans would have remained financial liabilities repayable to Dr van Rooyen.
- 26 The Huso Loans could thus not be accounted for by TrustCo in any manner other than as financial liabilities when Huso Investments was acquired into the TrustCo group.
- 27 After the Huso Transaction, Dr van Rooyen waived repayment of the Huso Loans. Having done so, the very nature of the loans changed. They were no longer repayable by Huso Investments and NNDC. This is an objective fact.

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<sup>37</sup> *ibid*

<sup>38</sup> Part A p 31, par 41.1



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- 28 Given that fact, what was the TrustCo group to do? It could not continue to report the loans as a financial liability as they were no longer repayable. In fact, to do so, as the JSE would have it, would have been misleading to the market at large and a direct contravention of the required treatment under IFRS.
- 29 All that TrustCo could do is what the relevant accounting standard required. That standard, IFRS9, requires that the financial liability be derecognised and reflected in profit and loss. This is precisely what TrustCo has done.
- 30 TrustCo's financial treatment of the Huso Loans accords precisely with the applicable accounting requirements. It properly and accurately reflects the actual financial position of the group and the consequences of the waiver. It provides a fair picture to investors, creditors and shareholders of TrustCo's financial affairs and future prospects.

#### The Related Party Loan

- 31 The facts and circumstance surrounding the Related Party Loan, and the Meya Acquisition which underpins it, are fully set out in TrustCo's application<sup>39</sup> and need not be restated here. At its essence:

31.1 Van Rooyen, through Next Investments concluded an agreement to loan up to NAD 1 billion to TrustCo ("**the Related Party Loan**");<sup>40</sup>

31.2 the purpose of the Related Party Loan was to fund the Meya acquisition;<sup>41</sup>

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<sup>39</sup> Part A p 33, par 45 to – 37, par 57

<sup>40</sup> Part A p 34, par 48 and 49

<sup>41</sup> Part A p 33, par 45 to 47 and p 35, par 51



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31.3 the Related Party Loan was approved by the shareholders of TrustCo,<sup>42</sup> excluding Dr van Rooyen as a related party;<sup>43</sup>

31.4 the shareholder approval was in accordance with the JSE listing requirements;<sup>44</sup>

31.5 in total, TrustCo acquired 56% of Meya, paid for as follows:

31.5.1 51% in cash;<sup>45</sup> and

31.5.2 5% in TrustCo shares.<sup>46</sup> These shares were not issued by TrustCo itself but belonged to Dr van Rooyen.<sup>47</sup> The shares of Dr van Rooyen constituted a drawdown under the Related Party Loan, as they were swapped for Meya shares;<sup>48</sup>

31.6 on 1 October 2019, repayment of the Related Party Loan was waived.<sup>49</sup>

32 As the Related Party Loan was repayable from the outset, it was accounted for as a financial liability.<sup>50</sup> The JSE does not take issue with this accounting treatment.<sup>51</sup>

33 As with the Huso Investments Loan above, in accounting for the loan waiver, TrustCo applied IFRS9 which required:

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<sup>42</sup> Part A p 36, par 52

<sup>43</sup> *ibid*

<sup>44</sup> *ibid*

<sup>45</sup> Part A p 33, par 45 and 46

<sup>46</sup> Part A p 36, par 54

<sup>47</sup> Part A p 36, par 55

<sup>48</sup> *ibid*

<sup>49</sup> Part A p 37, par 57

<sup>50</sup> Part A p 37, par 58

<sup>51</sup> *ibid*



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33.1 that TrustCo remove the financial liability as at the date it was extinguished; and

33.2 recognise in profit and loss the difference between the carrying amount of the financial liability and the consideration paid for it.

34 This is precisely what TrustCo did.<sup>52</sup>

35 Despite TrustCo's rigid adherence with the applicable accounting standards, the JSE takes issue with the result on the basis that the waiver of a shareholder loan should not give rise to profit and loss.<sup>53</sup> The JSE is unable to find support for its contention in any accounting standard,<sup>54</sup> and so relies exclusively on the Conceptual Framework.<sup>55</sup>

36 The JSE's reliance on the Conceptual Framework to oust the direct applicability of IFRS9 is misplaced. TrustCo's application quotes paragraph SP1.2 of the Conceptual Framework,<sup>56</sup> which provides:

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

37 This is the death knell of the JSE's contention. That the JSE has sought to squeeze a square peg into a round hole is evinced by the contortion that it

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<sup>52</sup> Part A p 37, par 59

<sup>53</sup> Part B p 19, par 34

<sup>54</sup> Part A p 38, par 60

<sup>55</sup> *ibid*

<sup>56</sup> Part A p 38, par 61



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employs in an attempt to classify the Related Party Loan as an equity transaction.<sup>57</sup>

- 38 TrustCo's accounting treatment of the Related Party Loan and its waiver again accords precisely with best accounting practice. It properly reflects the actual financial position of the group and the TrustCo financials thus accurately represent its true financial state of affairs to the market at large.

### THE PROPERTY ISSUE

- 39 The Elisenheim property consists of 1186,2387 hectares of land, on which TrustCo had intended to develop serviced stands for sale to the public.<sup>58</sup>

- 40 Given its intended development, in accordance with IAS2 TrustCo classified the Elisenheim property as 'inventory' and held it as its cost price.<sup>59</sup> TrustCo developed and sold a portion of the land, the proceeds of which were recorded as revenue,<sup>60</sup> as IAS2 directs.

- 41 When the property market slowed and TrustCo was unable to fully exploit this development opportunity, the board of directors resolved to:<sup>61</sup>

41.1 retain 356,3603 hectares as investment property: and

41.2 cease development of the remainder of the property.

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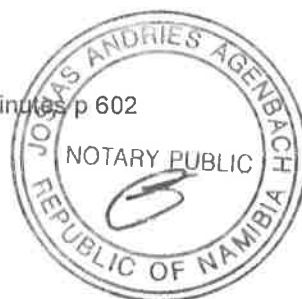
<sup>57</sup> Part B p 22, par 38 to 40

<sup>58</sup> Part A p 42, par 70

<sup>59</sup> Part A p 42, par 70.1 and p 43, par 71

<sup>60</sup> *ibid*

<sup>61</sup> Part A p 43, par 71 read with Annexure J - TrustCo Board Minutes p 602



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42 IAS40 prescribes the circumstances under which property can be reclassified as investment property.<sup>62</sup> At its essence, the reclassification is permitted when there is an actual change of use as well as evidence thereof (apart from management's intention).

43 TrustCo's intention to change the intended use of the Elisenheim property is evinced by the minutes of the meeting of directors held on 13 March 2019.<sup>63</sup> The directors recorded the following:<sup>64</sup>

*The current economic slowdown in the property market has forced the Group to reconsider its development timetable in order to optimally allocate resources and maximise its return on its investments. Based on this review a decision was taken to defer various development projects. Following from this decision to defer the various development projects, a guideline was established, that land assets would only be classified as inventory when it has been identified as "for sale" or if servicing with the intention to sell has commenced. All other land assets will be treated as Investment property and carried at fair value on the balance sheet. With this in mind, all un-serviced and unsold land in the Elisenheim estate which currently is classified as inventory will be reclassified to investment property, The only land still to be classified as inventory would be unsold erven in Phase 1, 2, 3 and 4 (unsold erven in phase 4 would be classified as Inventory due to the commencement of servicing with the intention to sell).*

44 In addition to TrustCo's stated intention, the objective factors that give credence to it include that Trustco:<sup>65</sup>

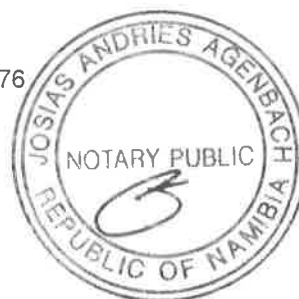
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<sup>62</sup> Part A p 44, par 72

<sup>63</sup> Part A Annexure J - TrustCo Board Minutes p 602

<sup>64</sup> Part A Annexure J - TrustCo Board Minutes p 602, ln 164 – 176

<sup>65</sup> Part A p 44, par 74



*B*



- 44.1 stopped development of the property and related activities;
  - 44.2 decommissioned further development plans; and
  - 44.3 ceased to obtain regulatory approval.
- 45 Indeed, in an email chain dated 29 September 2020, TrustCo's Finance Director confirmed that:<sup>66</sup>

*The development of phase 4 was suspended (decommissioned ) during September 2018 and to date no further development has taken place.*

*In terms of the MOA, additional bulk (water reservoirs, electricity, fly over bridge and waste water plant upgrades) must be installed before development of phases 5-21 can be initiated. This requirement makes development of the phases transferred from inventory to investment property impossible.*

and:<sup>67</sup>

*In other words the actions taken in the business are evidence that there has been a change in use, i.e. development activities have ceased, construction staff has been retrenched, equipment has been sold off, etc. Our actions with respect to the asset strongly indicate that we have changed the use of the asset.*

*We also would like to raise a question on fair presentation and whether the properties, as they currently are being managed and held, meet the definition of inventory? When the business model has been changed to effectively not treat this land as inventory and hold it for capital appreciation purposes, is it*

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<sup>66</sup> Part B p 594

<sup>67</sup> Part B p 612



*RB*

*correct to still disclose it as such. Is the best evidence of the change in use not our actual actions with respect to the properties?*

*We heard what you said about the asset being undeveloped land before and after our decision, but what has changed specifically is that previously there was a development timetable with resources dedicated to converting this undeveloped land to serviced stands within a reasonably short period of time whereas now it is held for an as yet undetermined use.*

46 The fact that TrustCo discerningly distinguished between the portions of property that 'were impossible' to reclassify as investment property is evidence not only of its *bona fides*, but also of its intention to reclassify only the portions of the property that had actually changed use. The portions of the property that had been developed and were continued to be held for sale by TrustCo did not form part of the reclassification.

47 In light of the change in use of the identified portion of the Elisenheim property, TrustCo was bound by IAS40 to reclassify the property now held for investment purposes. In the circumstances, IAS40.63 mandates that:<sup>68</sup>

*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.*

48 The TrustCo board resolved to do exactly as IAS 40.63 requires, by:<sup>69</sup>

48.1 derecognising the inventory value in cost of sales; and

48.2 recognising the fair value of the investment property in revenue.

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<sup>68</sup> Part A p 46, par 78

<sup>69</sup> Part A Annexure J - TrustCo Board Minutes p 604, In 178 to 181



A handwritten signature, likely of the notary, located to the right of the official seal.

- 49 Despite complying precisely with the relevant accounting standard, the JSE takes issue with both the reclassification itself ("**the Reclassification Issue**")<sup>70</sup> as well as the manner in which TrustCo presented the reclassification in its financials ("**the Presentation Issue**").<sup>71</sup>
- 50 Under the Reclassification Issue, the JSE contends that a mere postponement of a development does not meet the threshold of IAS40.<sup>72</sup> The JSE offers no evidence to prove that TrustCo has postponed development of Elisenheim. It also offers no evidence to counter the objective facts on which TrustCo relies to show the cessation of the development of Elisenheim.<sup>73</sup> To the contrary, the JSE relies on nothing but its own speculation.
- 51 In favouring speculation over objectivity, the JSE neglects:
- 51.1 a near identical situation (i.e. where a plant was recommissioned) where KPMG sanctioned such a reclassification;<sup>74</sup>
- 51.2 IAS40 which places prominence on the judgment of (TrustCo's) management as the party best placed to know the facts of the reclassification;<sup>75</sup> and
- 51.3 the fact that two independent auditors have found sufficient cause to warrant the reclassification.<sup>76</sup>

<sup>70</sup> Part B p 5, par 14 to 16 read with p 26, par 43

<sup>71</sup> Part B p 6, par 17 and 18 read with p 34, par 56

<sup>72</sup> Part B p 27, par 47 to 49

<sup>73</sup> Part A p 44, par 74

<sup>74</sup> Part A p 46, par 76 and 77

<sup>75</sup> Part A p 45, par 75

<sup>76</sup> Part A p 49, par 89



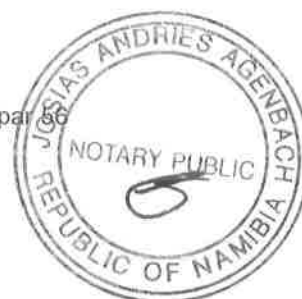
*RB*

- 52 Without anything more than speculation, there is no basis for the JSE to fault the reclassification. It does not point to the infringement of any accounting standard. It does not negate the conclusion of both of TrustCo's independent auditors. It does not offer any evidence to disrupt the conclusion that, in fact, there has been a change in use by TrustCo of the Elisenheim property.
- 53 As a result, the JSE's attempt to impugn the reclassification is divorced from the actual state of affairs, and must fail accordingly.
- 54 In respect of the Presentation Issue, although the JSE raises some concern with the management fee that Next may derive, the JSE's reasons do not deal with how or why this is an issue at all. It is accordingly not considered further here.
- 55 The only remaining consideration is the financial presentation of the transaction, as the JSE does not take issue with the result (i.e. of a gain in profit), as it quotes IAS 40.63 in its further reasons.<sup>77</sup>
- 56 The JSE's issue with the presentation is that, because the transaction does not involve a customer, there should be no revenue recognised nor a costs of sales, but rather only a net gain/loss.<sup>78</sup> The JSE endeavours to justify its position with reference to IFRS15, however, because the transfer from inventory to investment property falls within the scope of IAS40, IFRS15 is inapplicable. It is IAS 40 itself that requires the accounting treatment of a transfer from inventory to investment to be consistent with that for the sale of inventory.

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<sup>77</sup> Part A p 49, par 90 read with Part B p 32, par 52

<sup>78</sup> Part A p 50, par 92 read with Part B p 32, par 53 and p 33, par 56



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