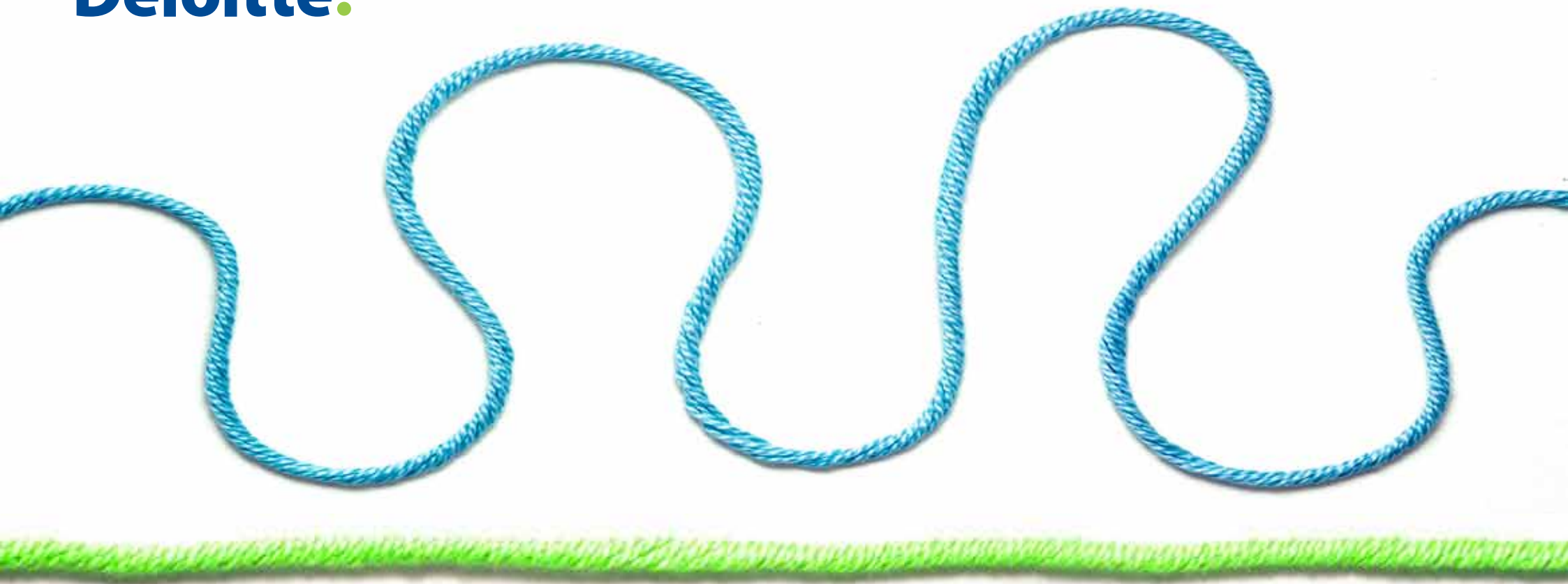


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Technically Speaking

The road ahead



Welcome

Dear Colleagues

Welcome to our tenth edition of Technically Speaking!

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

Kind Regards

N. RANCHOD

Nita Ranchod
Business Unit Leader
Accounting & Auditing

This edition includes articles on the following topics:

Proposed amendments to the South African Labour Broking Laws

This could have a far reaching impact on entities which employ workers under short-term contracts through labour brokers.

New consolidation standards issued

All entities that report under IFRS need to consider the impact of these standards for the preparation and presentation of consolidated financial statements.

Fair value measurement

All entities that report under IFRS will need to consider the measurement and disclosure requirements of IFRS 13 where items in the financial statements are measured at fair value.

To audit or not to audit

Under the new Companies Act, not all entities are required to have audits, however consideration should be given as to whether to have financial statements reviewed instead.

The IFRS Service Line

Accounting & Auditing and Capital Markets have put together a team to assist with the implementation of new IFRS Standards.

Shared Services

Insights into auditing a Shared Services Centre.

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Breaking the Broker

Article by:
Chris Kotze
 Associate Director
 Tax & Legal

The proposed amendments to Labour Broking Laws in South Africa

Background

In 2009, the African National Congress included in its election manifesto a need for the following:

“In order to avoid exploitation of workers as well as to protect the employment relationship, introduce laws to regulate contract work, subcontracting and out-sourcing, address the problem of labour broking and prohibit certain abusive practices.”

In answer to the election manifesto the Department of Labour published amendment Bills to the Labour Relations Act, Basic Conditions of Employment Act and Employment Equity Act, as well as a new Employment Services Bill.

The Bills were published on Friday, 17 December 2010, with the comment period closing on 17 February 2011.

Labour Broking under current legislation

Labour Broking is currently regulated under Section 198 of the Labour Relations Act. The crux of the provision is that the broker and not the client to whom such resources are provided, remains the factual employer of the resources for employment law purposes. This forms the backbone of labour broking. Simply put, the client does not employ and thus cannot be held liable for termination of employment. The unfair dismissal risk remains in essence that of the broker. For retaining this risk the broker earns a return by providing the services of the resources to the client.

Organised labour has argued that this form of employment can result in potentially unfair exploitation of people. Companies use brokered staff to avoid proper dismissal procedures and paying minimum benefits.

Labour Brokers on the other hand, argue that it has played a major role in job creation. It benefits both the employer and labour resources. Companies often need people to work for a short period of time and cannot be expected to employ these people. This form of employment relationship creates job opportunities where there would otherwise be none.

Labour Broking under new proposed amendments and the Employment Services Bill

The proposed changes and new Employment Services Bill intends to address labour broking as follows:

- Both the Labour Relations Act Amendment Bill and the new Employment Services Bill propose to repeal Section 198 of the Labour Relations Act and no provisions regulating labour broking are proposed in replacement of Section 198
- An employer will be defined as “Any person, institution, organisation, or organ of state who employs or provides work to an employee or any other person and directly supervises, remunerates or tacitly or expressly undertakes to remunerate or reward such employee for services rendered”
- An employee will be defined as “Any person employed by or working for an employer, who receives or is entitled to receive any remuneration, reward or benefit and works under the direction or supervision of an employer”
- One of the proposed amendments in the Labour Relations Act aims to stop the repeated contracting for short-term periods, instead the onus will be on employers to justify the use of short-term contracts, in place of contracting employees permanently.

Breaking the Broker

The proposed amendments and new Employment Services Bill do not contain provisions placing an outright ban on labour broking. Such a provision would probably have been considered unconstitutional. In fact a recent Namibian Constitutional Court case (Africa Personnel Service) on the outright banning of labour broking has confirmed the unconstitutionality of such provisions.

However, considered carefully, the repeal of Section 198 of the Labour Relations Act as read with the new proposed definitions of employer and employee, makes it impossible for a labour broker to be the sole employer of workers it places with a client. The client will inherit the mantle of employer and with it the potential liability of an unfair termination claim when the purpose or operational reason for the resource comes to an end.

Clients may therefore question whether to continue to pay a premium for resources provided through a labour broker now that some of the potential advantages have been removed.



Desired Outcome

In the past, labour broking has led to some potentially unfair practices which have given rise to the planned amendments. However it is estimated that labour brokered resources make up 6,8% of total employment in South Africa and 23.2% of the country's temporary workforce. Many of these employees are provided as resources through reputable companies ensuring compliance with fair labour practice and entitlements above the minimum requirements.

It remains questionable whether the proposed amendments will encourage clients of labour brokers to employ workers directly in future. The amendments may be considered as yet another barrier to employment in circumstances where flexibility is an operational requirement. As such the question must be asked whether proper regulation of sections of the industry as opposed to an outright ban may not bring us closer to the desired outcome for all concerned.



Article by:
Cara Botha
Manager
Accounting & Auditing

New Consolidation Standards Issued

On 12 May 2011 the International Accounting Standards Board (IASB) completed the first phase of its consolidation project, which brings with it a revised definition of control, more rigorous guidance on the concept of control and enhanced disclosures. In addition, amendments have been made to the accounting for joint ventures, which include the elimination of proportionate consolidation accounting.

The first phase of the consolidation project concluded with the publication of the following five new or amended standards:

- IFRS 10 Consolidated Financial Statements
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosures of Involvement with Other Entities
- IAS 27 Separate Financial Statements (revised 2011)
- IAS 28 Investments in Associates and Joint Ventures (revised 2011).

All new and amended standards are effective for annual periods beginning on or after 1 January 2013, with early application permitted as long as all five standards are adopted at the same time. An entity is required to apply all new standards and amendments to existing standards retrospectively. This means that companies will need to begin accumulating information in 2011 in order to meet the requirements for retrospective application.

IFRS 10 Consolidated Financial Statements

The main objective of the IASB in publishing IFRS 10 was to create a single consolidation model that would offer robust guidance for making consolidation decisions, particularly in areas where it has proved difficult to assess control in the past (where less than the majority voting rights are held in an investee). Prior to the 2011 revision, control was defined as the power to govern the financial and operating policies of an entity so as to obtain benefits. SIC 12 Consolidation - Special Purpose Entities, which interpreted the requirements of IAS 27 in the context of special purpose entities, placed greater emphasis on risks and rewards. This perceived conflict has caused significant divergence in the application of the concept of control.

A new definition of control

The decision by the IASB to make control the basis for consolidation forms the cornerstone of IFRS 10. This makes an investor's exposure to risks and rewards serve only as an indicator of control rather than the determining factor. An investor will conclude that it controls an investee when:

- it is exposed, or has rights to variable returns from its involvement with the investee, and
- has the ability to affect those returns through its power over the investee. An investor has power over an investee when it has existing rights that give it the current ability to direct the relevant activities that significantly affect the investee's returns.

The IASB decided to amend the definition of control because even though power is often obtained by governing the strategic operating and financing policies of an investee, this is only one of the ways in which power can be achieved. IFRS 10 prescribes that the current ability to direct the activities of an investee will in all cases arise from rights. These rights include voting rights, potential voting rights, rights within other arrangements, or a combination of these.

Assessing control

In the absence of any additional arrangements that may alter decision making, control is still assessed with reference to the majority of the voting rights.

An investor's voting rights relative to the size and dispersion of the holdings by other holders will likely cause the biggest impact on reporting entities. The existence of control under these circumstances is known as de facto control. De facto control exists if the balance of holdings in an entity with other shareholders is dispersed and the other shareholders have not organised their interests in such a way that they commonly exercise more votes than the significant minority shareholder.

The intention of the IASB by including guidance on de facto control was not that an investor owning a low percentage of voting rights be required to consolidate an investee, nor that the shareholder with the largest proportion of voting rights will always control the investee. If after all available evidence has been considered, it is still unclear whether an investor has power, it should not consolidate the investee. It is likely however that as a consequence of this amendment, companies will be required to consolidate entities that were previously concluded to not be subsidiaries.

This makes an investor's exposure to risks and rewards serve only as an indicator of control rather than the determining factor.



In the following example it would be concluded that de facto control exists:

An investor holds 47 percent of the voting rights of an investee, with the next two largest holdings of voting rights being 10 per cent and 4 per cent. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders have any arrangements to consult with each other or make collective decisions. In this case, it could be concluded that the investor has de facto control over the investee and should be consolidated.

IFRS 12 Disclosure of Involvement with Other Entities

IFRS 12 prescribes significant disclosures for reporting entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. The minimum disclosures required to meet the objectives as laid out in IFRS 12 are extensive and significant effort will be required on the part of reporting entities to accumulate the information required.

IFRS 11 Joint Arrangements

IFRS 11 was published to supersede IAS 31 Interests in Joint Ventures (IAS 31) and SIC 13 Jointly Controlled Entities - Non-Monetary Contributions by Venturers. Joint arrangements may be classified as either joint operations or joint ventures:

- Joint ventures are joint arrangements whereby the parties that have joint control of the arrangement have rights to the **net assets** of the arrangement (similar to the existing concept of a jointly controlled entity).
- Joint operations are defined as direct interests whereby parties have contractual rights to **individual assets or contractual obligations** in respect of individual liabilities (similar to jointly controlled assets and jointly controlled operations). For example, in a South African partnership, the partners are generally liable for the individual liabilities incurred by the partnership. This would result in classification as a joint operation.

Classification as a joint venture or joint operation is based on the parties' rights and obligations under the arrangement, with the existence of a separate legal vehicle no longer being the key factor. This amendment could result in joint ventures being classified differently under IFRS 11 compared to IAS 31.

IFRS 11 removes the option to proportionately consolidate joint ventures. All joint ventures are equity accounted in terms of the requirements of IAS 28 Investments in Associates. The accounting for joint operations is consistent with the current treatment of jointly controlled operations and jointly controlled assets.

Transition and Effective Date

All five new or amended standards are effective for periods beginning on or after 1 January 2013 and are required to be applied retrospectively.

IFRS 11 removes the option to proportionately consolidate joint ventures.



Fair Value Measurement



Article by:
Amy Escott
Manager
Accounting & Auditing

During May 2011, the International Accounting Standards Board (IASB) issued International Financial Reporting Standard IFRS 13: Fair Value Measurement (IFRS 13). The aim is to provide consistent guidance as to how fair value should be determined when preparing and presenting financial statements in accordance with IFRS. Prior to the issue of IFRS 13, guidance on determining fair value was scattered throughout the different Standards and did not necessarily result in fair value being determined in a consistent manner.

IFRS 13 does not provide guidance on when items are required to be measured at fair value. That guidance remains in the individual Standards. IFRS 13 also does not apply to measurements that have some similarities to fair value but are not fair value such as net realisable value in IAS 2 Inventories or value in use in IAS 36 Impairment of Assets.



The following table illustrates some of the areas where fair value measurement is either required or optional in IFRS:

Standard	Item / Transaction to be Measured at Fair Value	Mandatory or Optional Fair Value Measurement
IFRS 3 Business Combinations	All identified assets and liabilities in a business combination	Mandatory
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	Non-current assets held for sale are measured at the lower of fair value less costs to sell and carrying amount	Mandatory
IAS 16 Property, Plant and Equipment	Items of property, plant and equipment	Optional
IAS 19 Employee Benefits	Plan assets held to fund a defined benefit plan	Mandatory
IAS 27 Consolidated and Separate Financial Statements	Investments in subsidiaries	Optional
IAS 38 Intangible Assets	Intangible assets	Optional provided an active market exists
IAS 39 Financial Instruments	Financial instruments at fair value through profit or loss and available for sale financial instruments	Mandatory
IAS 40 Investment Property	Investment property	Optional
IAS 41 Agriculture	Biological assets and agricultural produce	Mandatory (unless for biological assets market prices are unavailable or alternative fair value estimates are unreliable)

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is considered to be a market based measurement rather than an entity based measurement, and as such takes into account characteristics of the asset or liability if market participants would take those characteristics into account. Fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability or in the absence of a principal market in the most advantageous market for the asset or liability.

Non-Financial Assets

Fair value of non-financial assets considers the asset in its highest and best use. Highest and best use is determined from the perspective of the market participants even if the entity has a different intended use for the asset. An entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

Liabilities and an Entity's Own Equity Instruments

Fair value measurement for liabilities (both financial and non-financial liabilities) or an entity's own equity instruments assumes that these instruments are transferred to a market participant at the measurement date. It assumes that:

- The liability would continue and the market participant would be required to fulfil the obligation, or
- The entity's own equity instrument would remain outstanding.

The fair value of a liability reflects the effect of non-performance risk which is the risk that the entity will not fulfil an obligation.

There may not be an active market for the transfer of these instruments. When there is no active market for the liability or equity instrument, fair value is determined as follows:

- Using the quoted price in an active market for the identical instrument held by another entity as an asset
- If such a quoted price is not available, using other observable inputs such as quoted prices for similar liabilities, equity instruments or similar assets where the instrument is held as an asset by another entity
- If unobservable inputs are not available, using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

The fair value of a liability reflects the risk that the entity will not fulfil an obligation. This includes an entity's own credit risk.

For example, assume that both Entity X and Entity Y each enter into a contractual obligation to pay Entity Z R500 in five years time. Entity X and entity Y have different credit ratings and so borrow money at different interest rates. Entity X and Entity Y receive the present value of the R500 today discounted at the applicable interest rate to each entity. The effect of the different interest rates (and thus credit risk) on the fair value of the liability is as follows:

	Entity X	Entity Y
Credit Rating	AA	BBB
Borrowing Rate	6%	12%
Payment Due in Five Years Time	R500	R500
Fair Value of Obligation (present value of R500 discounted at the appropriate interest rate)	R374	R284

Valuation Techniques

Valuation techniques should be used that are appropriate to the circumstances and for which sufficient data is available. Maximum possible use of observable inputs should be used. Valuation techniques should be applied consistently, however, should a change in valuation technique be appropriate, the change is accounted for as a change in accounting estimate.

There are three valuation techniques which are allowed by IFRS 13:

- **Market approach:** prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities is used
- **Cost approach:** fair value is determined by reference to the amount which would be required to replace the service capacity of an asset
- **Income approach:** valuation techniques are used to convert future amounts (for example cash flows or income and expenses) to a single present (discounted amount).

Inputs to the valuation techniques are categorised into three levels (the fair value hierarchy), similar to those in IFRS 7 Financial Instruments: Disclosure (IFRS 7):

Level 1: quoted unadjusted prices in active markets for identical assets or liabilities.

Level 2: inputs other than quoted prices included in Level 1 that are observable for an asset or liability either directly or indirectly.

Level 3: unobservable inputs for assets or liabilities.

Disclosure

IFRS 13 includes disclosure requirements for those items which are measured at fair value, including the fair value at measurement date, valuation techniques used and details of the fair value hierarchy which are similar to the disclosure requirements set out in IFRS 7.

Transition and Effective Date

IFRS 13 is effective for financial periods beginning on or after 1 January 2013. Prospective application is required.





Article by:
Werner van Niekerk
 Senior Manager
 Accounting & Auditing

To Audit or Not to Audit

The Companies Act No. 71 of 2008 (as amended) (“the Act”) is effective from 1 May 2011.

In terms of the Act not all companies will require an audit of its annual financial statements. These companies will require an independent review, except in circumstances noted below.

It should also be noted that all subsidiaries of listed companies are required to amend the Memorandum of Incorporation of the company to require an audit in terms of section 10 of the Johannesburg Stock Exchange Listings Requirements. Until this amendment is made, an audit of the financial statements of these subsidiaries is still required.

Regulation 28 of the Act stipulates that the following companies are required to have their financial statements audited:

- Public companies
- State-owned companies
- Any company other than a public and state-owned company that falls within any of the following categories in any particular financial year:
 - Any profit or non-profit company if, in the ordinary course of its primary activities, holds assets in a fiduciary capacity for persons who are not related to the company, and the aggregate value of such assets held at any time during the financial year exceeds R5 million

- Any non-profit company, if it was incorporated directly or indirectly by the state, an organ of state, a state-owned company, an international entity, a foreign state entity or a foreign company; or primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direct or indirect initiation or direction of an organ of the state, a state-owned company, an international entity, or a foreign state entity, or for a purpose ancillary to any such function
- Any other company whose public interest score in that financial year is 350 or more
- Any other company whose public interest score in that financial year is at least 100, if its annual financial statements for that year were internally compiled
- Any other company which stipulates within its Memorandum of Incorporation that its annual financial statements must be audited.

Any company that does not fall into any of the above mentioned categories will be required to have their financial statements independently reviewed, except for a private company where every person that is a holder of, or has a beneficial interest in, any securities issued by the company is also a director of the company. In this case, an independent review will not be required.

What is an independent review?

The Act requires an independent review to be performed in accordance with the International Standard on Review Engagements 2400 – Engagements to Review Financial Statements (“ISRE 2400”). A review in accordance with ISRE 2400 consists primarily of making inquiries of management and others within the entity involved in financial and accounting matters and applying analytical procedures. The review may also include any other procedures that are considered necessary in the circumstances of the engagement to obtain sufficient appropriate evidence to support the conclusion on the financial statements as a whole. These procedures, if any, will be determined by the review practitioner based on professional judgement.

The procedures performed during a review are therefore substantially less than the procedures that would be performed under an audit in terms of the International Standards on Auditing. This means that a significantly higher risk exists that any material misstatements that exist in the financial statements may not be revealed by the review, even though the review is properly performed in accordance with ISRE 2400.

Whereas an audit provides reasonable assurance on the financial statements, a review in terms of ISRE 2400 provides only limited (negative) assurance. The review practitioner will report on the financial statements in the following form: “Based on our review, nothing has come to our attention that causes us to believe that the financial statements are not presented fairly, in all material effects, in accordance with the applicable financial reporting framework.”



A review in accordance with ISRE 2400 consists primarily of making inquiries of management and others within the entity involved in financial and accounting matters and applying analytical procedures.

Why audit if this is not required by the Act?

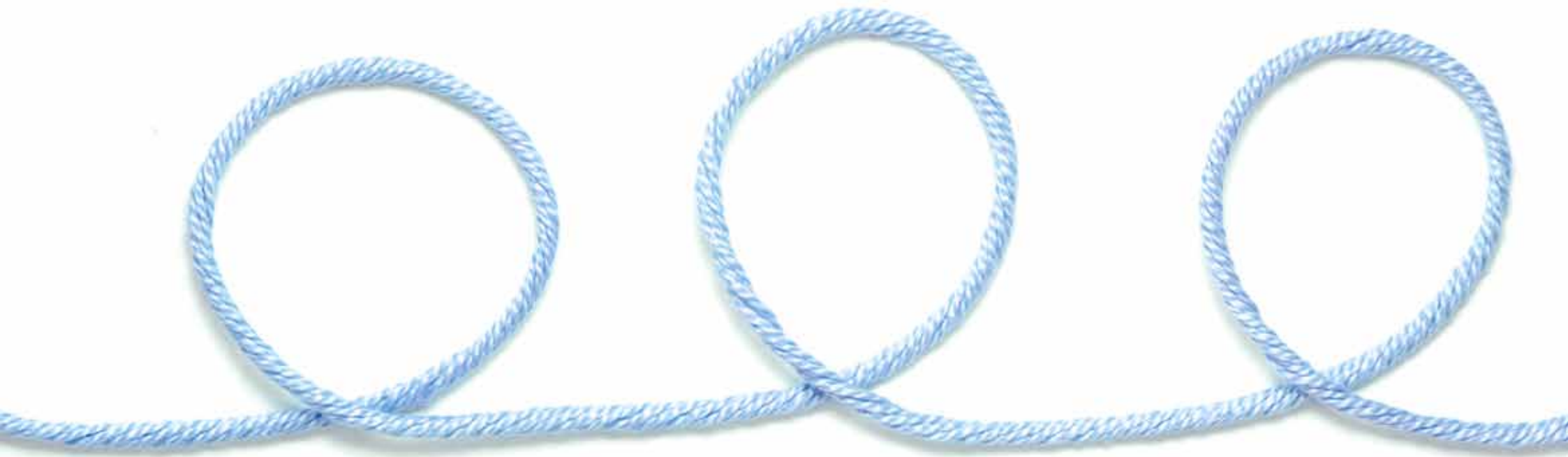
It is also important to note that even though the Act may not require the company's financial statements to be audited, those companies may still need to present audited financial statements because it may be required by, amongst others:

- Shareholders and/or other stakeholders
- Potential investors
- Regulators
- Lenders, where the company applies for credit or where it is party to an existing credit agreement.

A company that is in its growth phase may also face the risk that even though an audit may not be required during the current financial year, its public interest score may increase to an amount greater than 350 during the next financial year, which will result in an audit being required during the next financial year. An audit in the next financial year will require increased effort and cost to obtain reasonable assurance relating to the opening balances and comparative information.

Conclusion

The audit requirements as introduced by the Act will be applicable for all financial year ends ending after 1 May 2011. It is critical for the management of every company to determine, as soon as possible, whether audited financial statements will be required for its next financial year.



The IFRS Service Line



With the intention of convergence in accounting standards between the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB), certain accounting standards are in the process of review and/or new issuance. In particular, a major overhaul of the accounting requirements relating to financial instruments is expected in the near future. The impact will be far-reaching, affecting financial institutions, corporates and the public sector.

In response to the expected changes, we have established a centralised International Financial Reporting Standards (IFRS) service line, with a focus on the practical implementation of the amended accounting standards. The primary objective of the centralised IFRS service line is to assist banks and corporates to implement the amended standards.

The team is able to assist clients through all phases of their IFRS implementation projects including:

- Structuring and managing their IFRS implementation projects
- Technical accounting elections, opinions and treatments
- Model design and build
- System configuration
- Process design and implementation.

We have built this capacity through pulling together these specialist functions under the single management team to ensure focused and consistent delivery to our clients.

Meet the team...



Catherine Stretton
Partner | Financial Services Team

Catherine Stretton Capital Markets

Catherine specialised in large-scale IFRS implementation projects in the United Kingdom and South Africa during the transition to IFRS. Catherine brings an understanding of how to transform the finance function to achieve IFRS compliance through large-scale projects.

Tel/Direct: +27 (0)11 209 6104
Mobile: +27 (0)84 444 7033
cstretton@deloitte.co.za



Pravin Burra
Director | Capital Markets

Pravin Burra Capital Markets

Pravin will apply his extensive credit modelling experience to the new requirements for expected loss impairment models. Pravin has been extensively involved in global discussions on the new Impairment Exposure Draft, and has contributed to the global Deloitte practice's comment letter on the proposals.

Tel/Direct: +27 (0)11 209 8118
Mobile: +27 (0) 82 336 1515
pburra@deloitte.co.za



Nita Ranchod
Partner | Audit & Assurance

Nita Ranchod Accounting & Auditing

Nita's technical team is on the cutting edge of unfolding developments at the IASB, and will ensure that our implementation projects are armed with the latest technical advice and insights.

Tel/Direct: +27 (0)11 806 5489
Mobile: +27 (0) 82 907 5999
nranchod@deloitte.co.za



Claudette van der Merwe
Associate Director
Actuarial & Quantitative Solutions

Claudette van der Merwe Capital Markets

Our Actuarial and Quantitative Solutions team will continue to provide specialist expertise on valuation and hedge accounting to our audit and non-audit clients. They have already updated their hedge accounting tool, DART, to reflect the new rules relating to hedge accounting that were issued in December 2010.

Tel/Direct: +27 (0)11 209 6365
Mobile: +27 (0)82 457 6891
cvandermerwe@deloitte.co.za

The pending replacement of IAS 39 Financial Instruments: Recognition and Measurement with IFRS 9 Financial Instruments is of particular interest to Deloitte and our clients. We are currently positioning ourselves, as a firm, to be first to market when the remaining phases of the new standard are issued in the second half of this year.

Should you have any questions relating to the new accounting standards, please contact the appropriate representative of the centralised IFRS Implementation team.



In closing

Note from the Editor

Dear Colleagues

I hope you have enjoyed reading this issue of Technically Speaking. This issue aims to equip you with the knowledge you need to cope with some of the many changes that are happening in the accounting and regulatory world.

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

Kind Regards

A handwritten signature in black ink that reads "Amy Escott".

Amy Escott



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