

How do management determine the appropriate measurement basis where IFRS allow an accounting policy choice?


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DECLARATION

I declare that this research report is my own, unaided work. It is being submitted for the Degree of Masters of Accounting at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination at any other University.



(Signature of candidate)

27 day of October 2017 in Johannesburg

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Abstract

The IASB is the independent standard-setting body of the IFRS Foundation which set accounting standards. A number of IFRS standards permit entities to make accounting policy choices with regards to the measurement basis of assets and liabilities. Limited guidance is provided in IFRS standards on what considerations should be made when choosing a measurement basis. Principal users of financial statements place a high degree of reliance on amounts provided within the financial statements to make economic decisions. Given the wide use and reliance on financial statements it is critical that the reported amounts are determined appropriately. This research considers whether there is consistency in practice when choosing a measurement basis. This is done by considering to what extent measurement choices are influenced by the nature of the reporting entity (industry) and the manner of consumption. The results show some consistency in the measurement basis chosen under some IFRS standards for entities in the same industry, however it is difficult to conclude that the industry impacts the measurement basis chosen. The results did not indicate that the manner of consumption impacts the measurement basis. Further research will be helpful on this topic. The underlying reasons will assist management of other entities to make informed decisions when making accounting policy choices and provide useful information to principal users of financial statements.

Abbreviations used and definition of terms

Abbreviations

FASB – Financial Accounting Standards Board

FVTOCI – Fair value through profit or loss

FVTPL – Fair value through profit or loss

IAS – International Accounting Standards

IASB – International Accounting Standards Board

IFRS – International Financial Reporting Standards

JSE – Johannesburg Stock Exchange

SOC – State owned company

US – United States

Definitions

Fair value - The price which would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IASB 2011).

Relevant financial information – Information capable of making a difference in the decisions made by users (IASB 2010).

Faithful representation – To be useful, financial information must not only represent relevant phenomena but it must also faithfully represent the phenomena that it claims to represent. To be a perfectly faithful representation, a depiction would have three characteristics: It would be complete and neutral (IASB 2010).

1. Chapter 1: Introduction

The IASB is the independent standard-setting body of the IFRS Foundation. The IASB's mission is:

"To develop IFRS Standards that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy (Foundation 2016)".

Certain IFRS standards permit entities to make accounting policy choices with regards to the measurement basis of assets and liabilities. These include, for example, the subsequent measurement of property, plant and equipment and investment property being either at cost or revaluation amount/fair value in terms of IAS 16 *Property, plant and equipment* and IAS 40 *Investment property* (IASB 2003; IASB 2003). IFRS standards, however, do not provide guidance on how entities should go about making a decision on which measurement basis to apply.

The objective of financial reporting is to provide financial information which is useful to existing and potential investors, lenders and other creditors in making decisions about the reporting entity (IASB 2010). The amounts on the statement of financial position and statement of profit or loss and other comprehensive income are relied upon by many existing and potential investors, lenders and other creditors for making economic decisions (principal users of financial statements) (IASB 2010). This includes performing financial ratios widely used in making economic decisions, for example, in determining whether an entity is liquid and solvent and whether bank covenants have been breached or not. Although existing and potential investors, lenders and other creditors are expected to make certain adjustments to the amounts reported in the financial statements when calculating financial ratios, the reported amounts remain the major starting point for many economic decisions.

Given the wide use and reliance which existing and potential investors, lenders and other creditors place on the financial statements, it is critical that the reported amounts

are determined appropriately. This will ensure that the objective of financial statements is met, as economic decisions made will be based on relevant information and provide faithful representation.

1.1. Statement of the problem

The conceptual framework is used by the IASB as a framework for developing IFRS standards as it provides concepts which underlie the preparation and presentation of financial statements (IASB 2010). Both IFRS standards and the conceptual framework provide limited guidance on measurement. Where IFRS standards permit different measurement bases, entities end up having to rely on historic precedent and experience when choosing a measurement basis (IASB 2010; Barth 2013). This raises the question of whether different measurement bases can provide relevant information and provide faithful representation.

The measurement of financial statement items is considered at two stages throughout the life of a financial statement item. Firstly, at initial recognition and, secondly, throughout the life of the item. As such, IFRS standards provide different measurement bases for initial recognition and subsequent measurement.

Usually financial statement items are required to be measured initially either at fair value or cost, depending on whether they are financial items (i.e. investment in shares or loans) or non-financial items (i.e. inventory or property, plant and equipment). The initial measurement of a financial statement item is generally based on the current transaction price. In many cases, the current transaction price will equal fair value (IASB 2011). Fair value is defined in IFRS 13 *Fair value measurement* 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 (IASB 2011)".

The initial measurement of non-financial items is at cost. There are two definitions of cost from three IFRS standards:

- *IAS 2 Inventories* - “The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition (IASB 2003)”.
- *IAS 16 /IAS 40* - “Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg *IFRS 2 Share-based Payment* (IASB 2003; IASB 2003)”.

Based on the definitions above, it is clear that cost could include an accumulation of costs other than the purchase price, depending on the circumstances applicable to a particular transaction. As a result, cost may not necessarily equal the current transaction price or the fair value of a financial statement item. In most cases, cost will equal fair value on initial measurement (Barth 2014). The research focuses on subsequent measurement as the research question is mainly applicable for subsequent measurement.

Generally financial items are subsequently required to be measured at either fair value or amortised cost (IASB 2003). Fair value requires financial items to be revalued on a regular basis, while amortised cost requires the initial fair value of a financial asset to be amortised over the remaining life of the financial item. Generally non-financial items are subsequently required to be measured either at cost less depreciation and impairment or revalued amount less depreciation and impairment (IASB 2003; IASB 2003). The revalued amount measurement alternative is a variation of fair value as this requires a non-financial item to be fair valued and then depreciated and impaired (if applicable), based on the new fair value, over the remaining life of the non-financial item.

The debate on which measurement basis is appropriate for financial reporting, between cost and fair value, has been ongoing for a number of years and this topic remains controversial to date. Proponents of the historical cost measurement regard stewardship to be of utmost importance to financial reporting as this results in accountability (Dichev 2008; Whittington 2008; Barth 2014). Proponents of the fair value measurement, on the other hand, are of the view that relevance is of utmost importance and fair value achieves this by making use of current market prices. (Ravenscroft and Williams 2009; Laux and Leuz 2009; Georgiou and Lisa 2011; Chea 2011; Barth 2014).

The US equivalent of the IASB is the FASB. The FASB does not generally allow accounting policy choices on measurement, but in 2002 the FASB agreed with the IASB, in a memorandum of understanding known as the Norwalk Agreement, that they would work together towards convergence of global accounting standards (FASB and IASB 2002). The aim of this convergence is to increase global comparability in financial reporting.

“The convergence project will require both Boards to use their best efforts to propose changes to U.S. and international accounting standards that reflect common solutions to certain specifically identified differences (FASB and IASB 2002)”.

The convergence project included the following projects which impact measurement:

- Introducing the fair value option for financial instruments in US GAAP
- The FASB requiring investment properties to be measured at fair value and
- Alignment of principles used in determining fair value, which resulted in the IASB issuing IFRS 13 (FASB and IASB 2012).

Both standard setters (the IASB and the FASB) have been criticised for being biased in favour of fair value accounting. The main reason for the criticism is that fair value accounting is seen as not providing reliable information (Dichev 2008; Whittington

2008; Ravenscroft and Williams 2009; Laux and Leuz 2009; Georgiou and Lisa 2011; Chea 2011; Barth 2014).

Despite the identified controversy, fair value accounting is applied to measure many assets and liabilities on the statement of financial position by many entities today, as this is one of the recognised measurement bases for entities applying IFRS. None of the IFRS standards which permit accounting policy choices on measurement provides guidance for preparers of financial statements to consider when choosing a measurement basis. The measurement basis used affects amounts in the statement of profit or loss and other comprehensive income as the fair value movements on the assets and liabilities will be recognised in either profit or loss or other comprehensive income depending on the relevant IFRS standard requirements.

Refer to Appendix 1 for a list of currently effective IFRS standards which contain an accounting policy choice for the measurement basis to be applied.

1.2. Purpose and significance of the study

The purpose of this research is to examine the extent to which measurement options for the same classes of assets and liabilities are applied differently across and within different industries.

The results of this research will also contribute to assisting preparers of financial statements to make informed decisions when making accounting policy choices relating to the measurement bases of assets and liabilities.

1.3. Research question

Is there consistency in the measurement choices made by management where IFRS allow an accounting policy choice between either cost or fair value/revaluation amount²?

Sub questions

- 1) To what extent are measurement choices influenced by the industry in which a company operates?
- 2) To what extent are these measurement choices influenced by the manner of use (i.e. consumption of economic benefits) of the assets?

1.4. Limitations

The research can only be performed on entities which have assets subject to an accounting policy choice between cost and / or fair value/revaluation amount in accordance with relevant IFRS.

The extent of disclosure provided on accounting policy choices made differs from one entity to the other as IFRS do not provide standard disclosure required for accounting policy choices. The accounting policy choices may have been made some time ago, so some information relevant to the research may not be available on record. Current management may simply be following the measurement basis chosen by their predecessors.

The researcher used a non-probability sampling method, which does not allow the results to be extrapolated over the entire population. This is sufficiently mitigated by covering a significant portion of the JSE-listed companies in terms of market

² For purposes of simplicity “fair value” has been used to refer to “revalued amount” being the fair value on the revaluation date less subsequent depreciation and impairment.

capitalisation, as well as the largest SOCs. In addition the use of descriptive statistics limits the conclusions that can be obtained from the data.

2. Chapter 2: Background

2.1. Literature review

There are a number of IFRS standards which permit measurement accounting policy choices. Some of the reasons provided by the IASB for permitting these choices are included in the basis for conclusions of a few IFRS standards. These reasons include:

- Simplifying the application of accounting standards (IASB 2003)
- It results in relevant and reliable information (IASB 2003) and
- In IFRS 3 *Business combinations*, it was simply because the board's decision on a measurement basis was split. In addition, the board believed that the benefits of the other improvements outweighed the disadvantage of including a measurement accounting policy (IASB 2004).

The only guidance provided to management and preparers of financial statements when choosing a measurement is the overarching principle that the same accounting policy should be applied consistently to similar transactions (IASB 2003).

It is important to note that measurement accounting policy choices should be made on initial recognition and once an accounting choice is made, there are very limited circumstances which allow for a change in the measurement bases. This requirement was inserted by the IASB as a mechanism to avoid predetermined accounting outcomes based on the performance of a particular asset (IASB 2003).

In its conceptual framework, the IASB states that the objective of financial statements is to provide information which is useful to existing and potential investors, lenders and other creditors for making economic decisions (IASB 2010). The objective of financial

statements directly links with the fundamental qualitative characteristics of financial statements in the conceptual framework, which identifies information mostly expected to be useful to users of financial statements. These characteristics are relevance and faithful representation. Relevant information is information which would make a difference to the decisions which users of financial statements make. Faithful representation requires financial statements to represent faithfully what they claim. Both these fundamental qualitative characteristics need to be met in order for financial content to provide useful information (IASB 2010).

Although reliability is not one of the fundamental qualitative characteristics, it is included in faithful representation (IASB 2010). Reliability was previously included as one of the fundamental qualitative characteristics in the previous version of the conceptual framework and it was described as follows:

"Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent (IASB 2010)".

The IASB have provided the following reason for removing reliability, which clearly explains that the intended meaning is still applicable even today.

"Because attempts to explain what reliability was intended to mean in this context have proved unsuccessful, the Board sought a different term that would more clearly convey the intended meaning. The term faithful representation, the faithful depiction in financial reports of economic phenomena, was the result of that search. That term encompasses the main characteristics that the previous frameworks included as aspects of reliability (IASB 2010)"

Based on this definition of the purpose of financial statements, the measurement basis chosen by entities should meet the objective of being relevant and faithfully representing an entity's activities.

The IASB makes use of the conceptual framework to provide guiding principles when developing new IFRS standards (IASB 2010). The conceptual framework, including

the fundamental characteristics, however, only provides general guidelines with no specific guidelines for entities when choosing a measurement basis. In order to address this, the IASB has issued an exposure draft in 2015 on the new conceptual framework which includes specific guidelines relating to measurement (IASB 2015). Even though the new conceptual framework has not been issued yet by the IASB, the principles contained in it, as well as the basis for conclusions, provide valuable information about the IASB's thinking on the objectives of the existing conceptual framework and whether they believe those objectives are being achieved or not.

Exposure draft: Conceptual framework for financial reporting

It is important to note that the existing conceptual framework was not developed by the IASB but was developed by its predecessor body, the International Accounting Standards Committee in 1989. Although the guidance on the objective of financial reporting and the qualitative characteristics of financial statements was revised by the IASB in 2010, this was a result of a joint project with the FASB, so it is the first time that the IASB is having a complete look at the conceptual framework (IASB 2015).

The exposure draft has been issued after much public consultation which indicated that this project should be a priority to the IASB. One of the major reasons for the IASB to issue a new conceptual framework was to ensure that it provided guidelines on important matters which are not currently covered in the existing conceptual framework. One of the areas which lacked guidance is measurement requirements as members of the public consider this to be a serious gap in the existing conceptual framework. In addition, the new conceptual framework clarifies the following, relating to measurement:

- “(iii) That a high level of measurement uncertainty can make financial information less relevant;
and
- (iv) That important decisions on, for example, recognition and measurement, are driven by considering the nature of the resulting information about both financial performance and financial position (IASB 2015)”.

As part of the consultation process, the IASB considered introducing a single measurement basis for all assets, liabilities, income and expenses. The benefits of using a single measurement basis include increased comparability of financial statements and reducing the complexity of financial statements. Many of the respondents, however, felt that a single measurement basis would be inappropriate as this would result in information which is not relevant (IASB 2015).

The exposure draft identifies two broad categories of measurements as being, historical cost and current value. These are described as follows:

"Measures based on historical cost provide monetary information about assets, liabilities, income and expenses using information derived from the transaction or event that created them. The historical cost measures of assets or liabilities do not reflect changes in prices.

Measures based on current value provide monetary information about assets, liabilities, income and expenses using information that is updated to reflect conditions at the measurement date. Because of the updating, current values capture any positive or negative changes, since the previous measurement date, in estimates of cash flows and other factors included in those current values (IASB 2015)".

Historical cost

The exposure draft provides the following main advantages and disadvantages of using a historical cost (IASB 2015):

Advantages	Disadvantages
Provides predictive value which can be used for estimating future cash flows.	May lack comparability as similar assets acquired at different times may be recorded at different values.
May have confirmatory values by providing feedback on past estimates.	Estimates required for determining consumption which result in subjectivity.
Simpler to understand and obtain.	May be difficult to obtain if there is no observable transaction price.

Current value

The exposure draft provides the following main advantages and disadvantages of using current value (IASB 2015):

Advantages	Disadvantages
Provides predictive value by reflecting future expectations.	Depending on what the item is used for, current value may not be useful (i.e. if item is not sold or transferred).
May have confirmatory values by providing feedback on past estimates.	
Enhances comparability between entities and within an entity as it is based on independent market participants.	If their current value is not observable, this results in subjectivity when determining the current value.
Simpler to understand and obtain when there is an observable price.	
Current value on specialised items is likely to produce similar measures from an entity's perspective, as well the market participant's perspective.	

The introduction to the measurement section of the exposure draft states that:

"Consideration of the objective of financial reporting, the qualitative characteristics of useful financial information and the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities and items of income and expense (IASB 2015)".

The above statement provides some reasons to justify selecting a specific measurement basis. The exposure draft states that a chosen measurement basis

should provide useful information to the users of financial statements. It further states that for information to be useful, it must be relevant and faithfully represent what it claims to represent. Another objective of measurement is that the chosen measurement basis should provide information which is comparable, verifiable, timely and understandable for the users of financial statements. Lastly, the exposure draft acknowledges that cost constrains the selection of a measurement basis (IASB 2015). In addition to the objectives stated above, the exposure draft provides specific factors to consider when selecting a measurement basis. These factors include:

- **Relevance.**

Chapter 2 of the exposure draft describes information being of relevance when it can make a difference in the decisions made by users. It further states that when financial information has predictive value, confirmatory value or both, this means that it can make a difference in decision making.

Chapter 2 of the exposure draft states that when determining whether a measurement basis provides useful information, entities should consider how items will contribute to the future cash flows of the entity as well as the specific characteristics of that item. One factor which impacts relevance is the level of uncertainty which needs to be considered in determining amounts. A certain degree of uncertainty is expected in the financial statements as the IASB allows estimates to be used, however, the exposures draft states that the degree of uncertainty should not be so high that it renders a measurement basis irrelevant.

- **Faithful representation.**

“A faithful representation provides information about the substance of an economic phenomenon instead of merely providing information about its legal (IASB 2015)”.

The exposure draft states that a perfect faithful representation is that it is free from error. This does not require measurements to be 100% accurate, however, where estimates have been used, additional disclosures should be

provided in the financial statements to explain the estimation process to the users of financial statements.

- Enhancing qualitative characteristics.

The exposure draft states that the qualitative characteristics of comparability, verifiability and understandability have an impact on measurement and should be enhanced when choosing a measurement basis.

"Comparability implies using measurement bases that are the same between periods and between entities. Verifiability implies using measurement bases that result in measures that can be independently corroborated. Understandability depends partly on the number of different measurement bases used and on whether they change over time. In general, if the number of measurement bases used in a set of financial statements increases, the resulting information becomes more complex (and, hence, less understandable) (IASB 2015)".

The IASB states that the relative importance of each of the above factors will be dependent on specific facts and circumstances, so the IASB has not prescribed the relative weightings of the above factors to the preparers of financial statements (IASB 2015).

Accountability

Accountability suggest that accounting performs a stewardship function as it makes management accountable to the owners of the business, the shareholders. In 2006 the IASB and the FASB proposed that stewardship not be included as one of the primary objectives of financial reporting. This proposal was not well received as a number of interested parties raised strong negative views. The major concern from the interested parties seemed to be that stewardship has always been part of the living law of accounting, so it should remain as the core objective of accounting (Murphy, O'Connell et al. 2013).

Although the IASB and the FASB welcomed the concerns raised by the interested parties, they still went ahead with the proposals and the revised conceptual framework

was issued in 2010. Although stewardship was not included as a primary objective of financial reporting, the IASB indicated that stewardship is certainly an important part of financial reporting. Despite the word “stewardship” being excluded from the conceptual framework because it would be difficult to translate into other languages, the IASB acknowledges stewardship in the objective of financial reporting defined as follows:

“... users make resource allocation decisions as well as decisions as to whether management has made efficient and effective use of the resources provided (IASB 2010)”.

The exposure draft on the conceptual framework makes stewardship more prominent than the existing conceptual framework as it discusses stewardship as part of the objective of financial reporting. This proposal was added after many respondents raised concern that stewardship lacked prominence in the existing conceptual framework (IASB 2015).

Due to the fact that stewardship remains embedded in the conceptual framework, it is important that financial statements have the authority to allow the existing and potential investors, lenders and other creditors to use financial statements for this purpose.

Neoliberalism

Neoliberalism, on the other hand, suggests that accounting is an information metaphor which changes due to political and social paradigms which began as far back as World War II (Ravenscroft and Williams 2009). According to Ravenscroft and Williams (2009), neoliberalism is replacing accountability which has been the root of accounting for much of the past century. This may explained by the view that the standard setters are moving towards fair value accounting and the data used for measuring fair value may not always be reliable (Ravenscroft and Williams 2009). Whittington (2008), who states that the use of fair value results in a trade-off between relevance and reliability, substantiates this.

According to Ravenscroft and Williams (2009) accountability cannot be the primary purpose of accounting as it is an ancillary function to stewardship. Murphy, O'Connell et al. (2013) in their research on stewardship and neoliberalism evidences that both of these date back to ancient times. They suggest that more research should be performed in order to determine the nature of the overlap and interaction between neoliberalism and accountability (Murphy, O'Connell et al. 2013). The existing research, although not specific to the overlap and interaction between neoliberalism and accounting, seems to suggest that the two are mutually exclusive.

The premise that determining fair value requires predictions of the future as described Ravenscroft and Williams (2009) is in line with the current definition of fair value which defines it as an exit price (IASB 2011). Although fair value may be seen to provide the economic substance as opposed to historical cost, this ends up being an entity-specific value due to the number of assumptions which go into determine the fair value (Penman 2007). Ball (2006) raises a concern that this could result in investors being worse off by making economic decisions based on unreliable information.

In 1971, the Accounting American Association, issued a statement stating

"Accounting's function is transformed from accountability to providing data for the following decisions:

- a) Predictions of future events or states (or probability distributions of them).*
- b) Predictions of alternative courses of action.*
- c) Predictions of outcomes or payoffs that will occur given the future event and the future action (AmericanAccountingAssociation 1971)".*

The statement by the Accounting American Association seems to substantiate Ravenscroft and Williams (2009) view that fair value provides more relevant information. Penman (2007), on the other hand, implies that there are circumstances when historical cost provides more relevant information, for example, when buying inventory to convert it and sell it, it would not be relevant to carry the inventory at fair value as this will result in managers being evaluated on changes in inventory fair value.

The articles referred to above provide relevant arguments about the reliability of fair value, however, the arguments are centred on a single measurement basis being used by a company (i.e. either cost or fair value accounting be applied to all assets and liabilities of a company). On the other hand Penman (2007) for example, indicates that fair value may not be relevant when measuring inventory if managers are evaluated on changes in inventory fair value.

The circumstances under which fair value accounting can provide both relevant and reliable information (although not for all assets and liabilities) should be explored and, in the researcher's view, the starting point lies in the business model concept, as in Barth (2007).

"Fair value is not a panacea, and other measurement bases also have desirable characteristics.....Relating specifically to fair value as a measurement basis, research can provide more evidence on the extent to which fair value meets the criteria specified in the Framework (Barth 2007)".

The business model concept is further explored below.

Business model

The business model refers to how an entity conducts its business activities. The IASB considered providing guidance on how financial statements could be more relevant and specific guidance on the business model was provided by the IASB. Mixed comments were received from the respondents, with some believing that such guidance is required while others believed it was not necessary because when an entity applies objective measures, the entity's business model will be taken into account by implication (IASB 2015).

Although the IASB decided not to provide general guidance on the impact of the business model on financial reporting in the conceptual framework exposure draft, it acknowledges that the way in which an entity conducts its business may affect

measurement. An example provided by the IASB is that when an entity is not involved in selling or transferring its assets and liabilities, fair value measurement may not be relevant (IASB 2015).

IFRS 9 *Financial instruments* explicitly uses the concept of business model. The measurements of financial assets are based on the business model applicable to an entity (IASB 2010). The application of the business model indicates that the IASB has identified that the same financial assets may require different measurements, depending on an entity's business model.

This may further be evidenced by the IASB allowing an accounting policy choice in certain standards, for example, IAS 28 *Investments in associates* requires entities to account for investment in associates or a joint venture using the equity method in the consolidated financial statements. IAS 28 contains a measurement exemption to account for these investments at fair value through profit or loss when these investments are held, directly or indirectly, by an entity which is a venture capital organisation, or a mutual fund, unit trust and similar entities, including investment-linked insurance funds (IASB 2003).

The availability of an accounting policy choice raises questions of whether it is possible for both the equity method and fair value accounting to provide relevant information and faithful representation. Is it possible that the only reason why either cost or fair value may be used depends on an entity's business model, although this is not explicit? Leisenring, Linsmeier et al. (2013) question whether the business model is the same as management intent and this should be further explored when considering whether a business model should influence the decisions made with regards to the measurement basis being used. This concern was also raised as part of Mr Leisenring's dissenting opinion to IFRS 9 (IASB 2010).

3. Chapter 3: Methodology

3.1. *Research methodology*

The purpose of this research is to refine the current understanding of why different entities apply different measurement bases to the same assets and liabilities (Barth 2007; Penman 2007).

The research is exploratory in nature and seeks to gather measurement information on a broad range of companies at a point in time (companies with yearends falling within the same calendar year). The research does not seek to find explanations from preparers of financial statements and auditors as to why a particular measurement choice was made, but only to compare and contrast companies facing the same measurement choices.

This chapter sets out the research methodology and develops the research design applied in achieving the research objective. The research considers whether the industry in which an entity operates and the manner of use of an asset influences the decision made when choosing a measurement basis, where IFRS allows an accounting policy choice. The two considerations identified are based on information expected to be obtained in financial statements without additional substantiation by preparers of financial statements or auditors. This is undertaken by applying a qualitative research method in the form of content analysis and descriptive statistics in order to identify patterns and themes (Leedy and Ormond 2010).

3.2. *Research design*

The research design follows a structured process in collecting data relating to the measurement basis of assets and liabilities. The research design consists of the following steps which are described in more detail below:

- Performing a literature review of why different measurement bases exist and the argument for and against the available measurement bases (section 2)
- Selecting a sample of companies (section 3.2.1)
- Extracting information relating to measurement basis of assets and liabilities where IFRS allows an accounting policy choice (section 3.2.2)
- Presentation of results (section 3.2.3) and
- Evaluation of results (section 3.2.4).

3.2.1. Sampling *method*

The sampling method applied is a quota-based non-probability method which allows for appropriate coverage of the population sampled. The population consists of companies listed on the JSE during the 2014 calendar year and major SOCs over the same period. The majority of financial statements for the 2014 calendar year were issued in 2015. Although the data may appear outdated as it is 2 years old, information disclosed in the 2014 financial statements is still largely relevant for the following reasons:

- The IASB issued 4 standards (IFRS 10 *Consolidated financial statements*, IFRS 11 *Joint arrangements*, IFRS 12 *Disclosure of Interests in Other Entities* and IFRS 13 *Fair Value Measurement*) and revised 2 standards (IAS 27 *Separate Financial Statements* and IAS 28) coming into effect on or after 1 January 2013. Information relating to these standards is included in the data collected and the IASB has not issued any new standards.
- The accounting policies of companies are mostly expected to remain the same as IAS 8 *Accounting policies, changes in accounting estimates and errors* only requires changes in accounting policies if it is required by IFRS standards (i.e. new

IFRS standards issued) or if it results in reliable and more relevant information being provided to the users of financial statements (IASB 2003).

The only exception to the above is the amendment to IAS 27 which was issued on 12 August 2014 with an effective date of 1 January 2016 (IASB 2014). The amendment allows companies to account for investments in subsidiaries, associates and joint ventures using either cost, equity accounting or fair value in accordance with IAS 39 *Financial instruments: recognition and measurement*. Due to the equity accounting measurement option not included in the effective version of the standard applicable in 2014, this is not reflected in the data collected (IASB 2011).

The sample size is limited to the top 100 companies listed on the JSE, based on market capitalisation, as well as the top ten SOCs as contained in the EY survey of integrated reporting (EY 2014). The purpose of the EY survey is to encourage excellence in the quality of integrated reporting (EY 2014). An integrated report provides a comprehensive report to all stakeholders of a company and includes the financial statements. As the EY survey ranks the integrated report of the companies in order of the highest quality to the lowest, management of these companies are expected to have applied their minds when determining the measurement basis of assets and liabilities in their financial statements. Although subjectivity may have been applied in ranking these companies, this has been applied by independent panelists using a consistent criterion, therefore avoiding bias by the researcher.

The 100 listed companies represent 94 percent of the total market capitalisation of all companies listed on the JSE as at 31 December 2014. The sampling size based on coverage is in line with the sampling method used in other accounting research (Barac and Moloi 2010; DeVilliers and Middelberg 2013). Due to the significant market capitalisation covered by the top 100 companies, the sample size is considered

appropriate. Refer to table 1 in Appendix 2 for a list of JSE listed companies selected in the sample.

The 10 SOC's represent 48 percent of the total major public interest entities as at 31 December 2014. Refer to table 2 Appendix 2 for a list of SOC selected in the sample.

3.2.2. Information extraction

The primary source of data is the financial statements of the sample of JSE-listed companies and SOC's as set out in section 3.2.1. The financial statements of the companies in the sample are publicly available and can be downloaded on the companies' official websites. All the financial statements of these companies are audited, therefore the information extracted can be relied upon as being valid.

Once the financial statements have been downloaded, the key information required is the measurement basis applied for assets and liabilities which IFRS allow accounting policy choice. The expectation was that this information would be provided in the accounting policies section of the financial statements. However, this information was obtained from either the accounting policies and/or notes to the annual financial statements, with some inconsistencies noted not only between companies but also within the same company in some instances. This made the information extraction process time-consuming as the information was not disclosed in a standard format.

There were various companies that included an accounting policy that indicated a measurement basis chosen, however the specific item was not contained within the statement of financial positions of the company, which indicates that the accounting policy is not relevant. In some instances the accounting policies were not specific to a company in that it provided both measurement bases allowed by IFRS, however there was no indication of the chosen measurement basis in the annual financial statements.

3.2.3. Results

The results of the information extracted are presented in aggregate, based on the EY adjudication process which ranks the top 100 listed companies and the SOCs' into the categories provided in table 1 below. The presentation of the results has been done using histograms to provide a visual presentation of the results. The x-axis provides the number of companies, while the y-axis shows the measurement basis used as well as the EY ranking.

The results are also presented based on the industry which the companies listed on the JSE represent, again using a histogram. The x-axis provides the number of companies, while the y-axis shows the measurement basis used as well as the industry. A list of the JSE industries has been provided in table 2 below.

Table 1: EY ranking

Ranking	Top 100 companies listed on the JSE	State owned companies
Excellent	35 companies (which includes the top ten)	3 companies
Good	29 companies	0
Average	20 companies	3 companies
Progress to be made	16 companies	4 companies
Total	100	10

Table 2: List of JSE Industries

Industry
Oil & Gas
Basic materials
Industrials
Consumer goods
Health care
Consumer services
Telecommunication
Utilities
Financials
Technology

3.2.4. Evaluation of results

The information extracted has been analysed to determine whether there any themes and patterns in the accounting policy choice made on measurement. This included the following steps:

- Obtained the measurement bases used for different assets and liabilities, from the accounting policies and notes to the financial statements for the sample of companies set out in section 3.2.1. The data collected from the financial statements was summarised per company, in Microsoft Office Excel, for each accounting standard which contains an accounting policy choice for measurement with separate columns indicating the EY ranking, industry and the type of asset or liability.
- Interrogated the data by performing correspondence analysis, which is a statistical tool used to determine whether there is a relationship between two or more depend variable and other independent factors (Yellend 2010). Correspondence analysis is applied to exploratory research therefore it can be applied to this research. In order to perform the correspondence analysis, the

data was arranged in a contingency table with the rows indicating the measurement bases applied and individual columns indicating the number of companies applying that measurement bases per industry.

The qualitative data was converted into quantitative data to allow the data to be analysed using correspondence analysis. This was done by allocating a numerical value to identify the accounting policy choice made for each applicable accounting standard (e.g “0” to indicate cost, “0” to indicate fair value and “2 to indicate both cost and fair value).

XLSTAT in Microsoft Office Excel was used to perform the correspondence analysis when testing the relationship between the data. The option to replace missing data by 0 was selected which indicated that a specific measurement bases was not applicable in an industry. Due to the results of the correspondence analysis not providing meaningful information, descriptive statistics was used instead (refer to section 4.1 below).

- Descriptive statistics involves identifying trends based on observations from data collected (Leedy and Ormond 2010). Descriptive statistics can be applied to exploratory research and is generally applied to quantitative data. As the data collected has been converted into quantitative data it can be applied to this research.
- The quantitative data was used to create pivot tables in Microsoft Office Excel. This allows the data to be summarised to allow relevant information to be extracted from it. Histograms were then created, again using Microsoft Office Excel, from the pivot tables to provide a visual display of the results. Observations were then made by the researcher based on the results obtained by identifying themes and patterns.

4. Chapter 4: Results

Chapter 4 sets out the results of the methodology which was used based on the methods and assumptions described in Chapter 3. The results presented in this chapter relate to the companies listed in Appendix 1 and exclude 2 companies listed on the JSE whose financial statements could not be obtained on the entity's official website. Refer to Appendix 3 for the results tables on each IFRS standards. The results are evaluated in Chapter 5 and the conclusion is provided in Chapter 6.

4.1. Correspondence analysis

Correspondence analysis was performed on the data collected. Refer to tables 4, 5 and 6 in Appendix 3 for the contingency tables used for IFRS 3, IAS 16 and IAS 27 respectively in order to be able to perform correspondence analysis. The results of the correspondence analysis are provided in table 3 below.

Table 3: Test of independence between the rows and the columns

	IFRS 3	IAS 16	IAS 27
Chi-square (Observed value)	8.918	28.063	10.7795
Chi-square (Critical value)	23.685	18.307	28.8693
DF	14	10	18
p-value	0.836	0.002	0.90348
alpha	0.05	0.05	0.05

The hypothesis, in the results, is that there is a link between the rows and the columns of a table while the null hypothesis, in the results, is that the rows and the columns of a table are independent. As the computed p-value for IFRS 3 and IAS 27 is greater than the significance level $\alpha=0.05$, one cannot reject the null hypothesis. These results show that there is no association between the measurement bases used and the industry in which a company operates in. Based on this no further interpretation is required as no relationship can be identified.

For IAS 16, the computed p-value is lower than the significance level $\alpha=0.05$, one should reject the null hypothesis, and accept the alternative hypothesis that there is a

relationship between the measurement basis and the industry. Once the hypothesis has been accepted, the next step is to consider the quality of the analysis which indicates whether reliance can be placed on the results. The quality of the analysis can be evaluated by consulting the table of the eigenvalues or the corresponding scree plot. The eigenvalues from the IAS 16 results is shown below.

Table: Eigenvalues and percentages of inertia

	F1
Eigenvalue	0.25984
Inertia (%)	100
Cumulative %	100

The results calculated the total Inertia as 0.26. Inertia measures the variance of the individual profiles around the average profile and represents the deviation from independence. A larger inertia indicates that there are larger differences. The eigenvalue is calculated in relation to inertia. A number of dimensions are created by identifying those axes for which the distance between the profiles and axes is minimized while simultaneously maximizing the amount of explained inertia (Epidemiol 2013).

The results for IAS 16 indicates that only one dimension (indicated by F1 in the table above) was created and 100% of the inertia is explained by this. This indicates that the quality of the analysis is very high and the correlation identified between the measurement bases chosen and the industry is 100% dependent on the industry.

The descriptive results (refer to section 4.2.2 below) show that the companies applying cost represent all the industries, so there is an overlap between industries that apply cost and those that apply both cost or fair value. This overlap is not reflected in the results of the correspondence analysis. Due to the results of the correspondence analysis not providing meaningful information either because the results had a significance level alpha that is greater than 0.05 and not further interpretation could be

done on the data or only one dimension was created, descriptive statistics was used instead

4.2. Descriptive analysis

4.2.1. IFRS 3: Business combinations

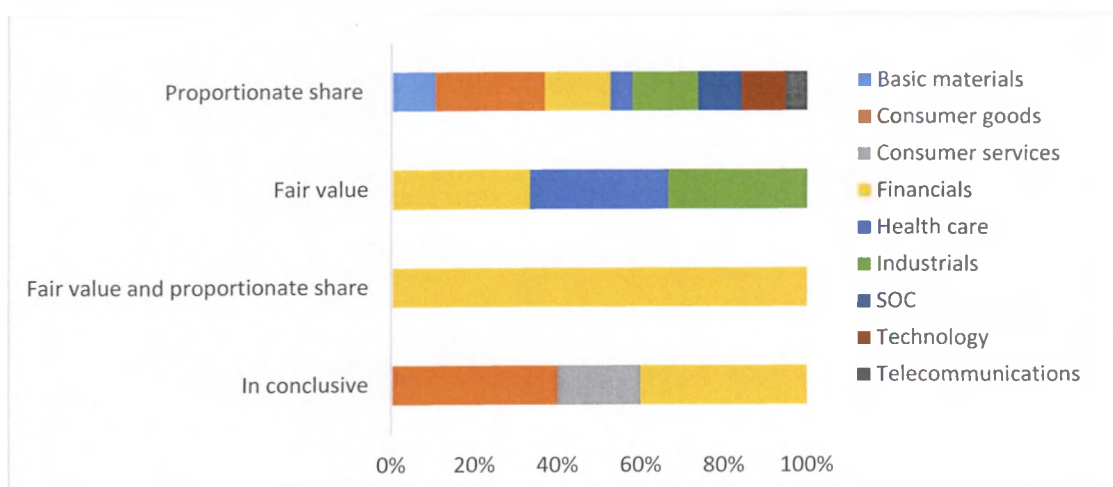
28 companies had business combinations in the 2014 financial year, two of these are SOCs (7%) and 26 are companies listed on the JSE (93%). From the 26 companies listed on the JSE, five (18%) of them did not have accounting policies which explicitly stated whether the non-controlling interest was accounted for at fair value or proportionate share of net assets. The results show that 19 companies (68%) account for their non-controlling interest at proportionate share of net assets, three companies (11%) at fair value and one company (4%) at both fair value and proportionate share of net assets.

Refer to table 7 in Appendix 3 for the number of companies accounting for non-controlling interest at fair value and/or proportionate share taking into account the EY ranking.

Industry analysis

From the 28 companies that had business combinations in the 2014 financial year, the 26 companies listed on the JSE represent eight industry groups. The remaining two companies are SOCs. Figure 4.1 shows the percentage of companies, which account for non-controlling interest at fair value and proportionate share based on industry. All companies in the basic materials and telecommunications industries as well as the SOCs apply the proportionate share measurement basis.

Figure 4.1: Percentage of companies accounting for non-controlling interest at fair value and proportionate share, based on industry



4.2.2. IAS 16: Property, plant and equipment

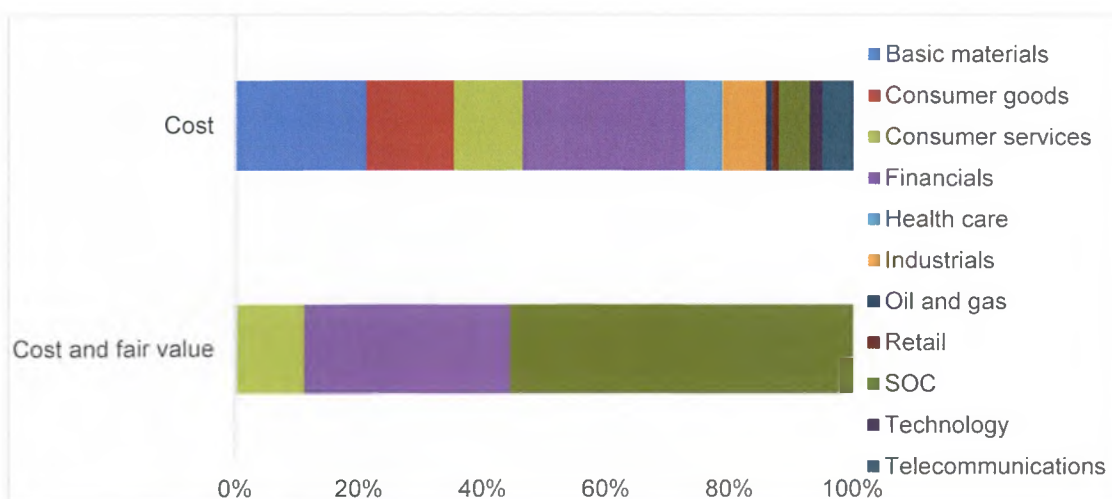
All 108 companies had property, plant and equipment in the 2014 financial year. The results show that 99 companies (92%) account for property, plant and equipment at cost. Five of these companies (5%) are SOCs and 94 are companies listed on the JSE (87%). Nine companies (8%) account for property, plant and equipment at both fair value and cost, five of these companies (5%) are SOCs and four are companies listed on the JSE (4%). There are no companies that accounts for all their property, plant and equipment at fair value.

Industry analysis

From the 108 companies which had property, plant and equipment in the 2014 financial year, the 98 companies listed on the JSE represented ten industry groups with the remaining ten companies being SOCs. Figure 4.2 shows the percentage of companies which account for property, plant and equipment at fair value and cost based on industry. All companies in the different industries account for property, plant and equipment at cost, with the exception of companies in the consumer services industry, financial industry and SOCs, which apply both fair value and cost.

Refer to table 8 in Appendix 3 for the number of companies accounting for property, plant and equipment at cost and/or fair value taking into account the EY ranking.

Figure 4.2: Percentage of companies accounting for property, plant and equipment at fair value and cost, based on industry



4.2.3. IAS 20: Government grant

Two companies had non-monetary government grants in the 2014 financial year. 1 of the companies is a SOC (50%) and the other company is listed on the JSE (50%). The SOC accounted for the non-monetary government grant at a nominal amount, while the company listed on the JSE accounted for the non-monetary government grant at an amount that equals the cost at the time of the grant being received.

The industry analysis indicates that the company listed on the JSE forms part of the basic materials industry.

4.2.4. IAS 27: Separate financial statements

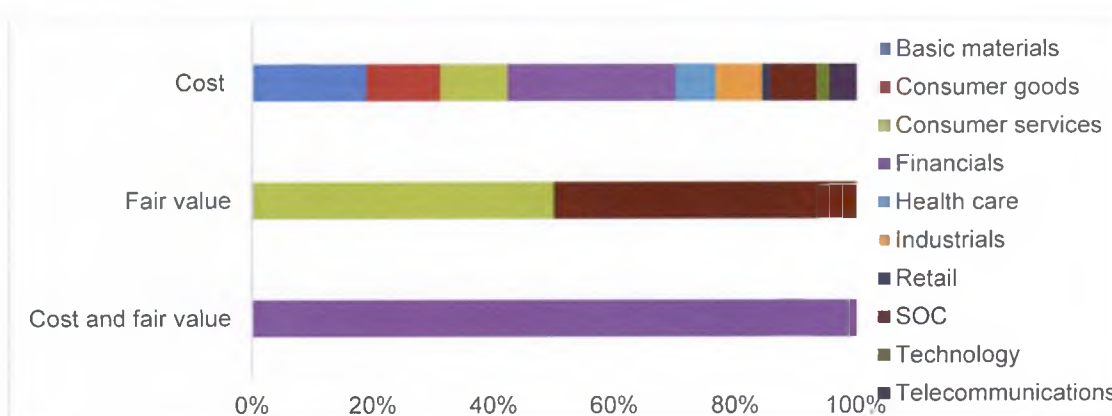
93 companies had investments in subsidiaries, joint ventures and/or associates in the 2014 financial year. Eight of these companies are SOCs (9%) and 85 are companies listed on the JSE (91%). The results show that two companies (2%) account for investments in subsidiaries, joint ventures and/or associates at fair value, 90 companies (97%) at cost and one company (1%) at both fair value and cost.

Refer to table 9 in Appendix 3 for the number of companies accounting for investments in subsidiaries, associates and joint ventures at cost and/or fair value in separate financial statements taking into account the EY ranking.

Industry analysis

From the 93 companies had investments in subsidiaries, joint ventures and/or associates in the 2014 financial year, the 93 companies listed on the JSE represent 9 industry groups, with the remaining 8 companies being SOCs. Figure 4.3 shows the percentage of companies which account for property, plant and equipment at fair value and cost based on industry. These companies in the different industries account for investments in subsidiaries, joint ventures and/or associates at cost, with the exception of one company (4%) in the financial industry that apply both fair value and cost (this represents 4% of the companies in the financial industry). In addition, one company representing 1% of the companies in the consumer services industry and one SOC apply only fair value, this represents 13% of the SOCs.

Figure 4.3: Percentage of companies accounting for investments in subsidiaries, joint ventures and/or associates at fair value and cost, based on industry



4.2.5. IAS 28: Investments in associates

93 companies had investments in associates and/or joint ventures in the 2014 financial year. Five of these companies were SOCs (5%) and 88 of them were companies listed on the JSE (95%). The results show that 85 companies (91%) apply equity accounting,

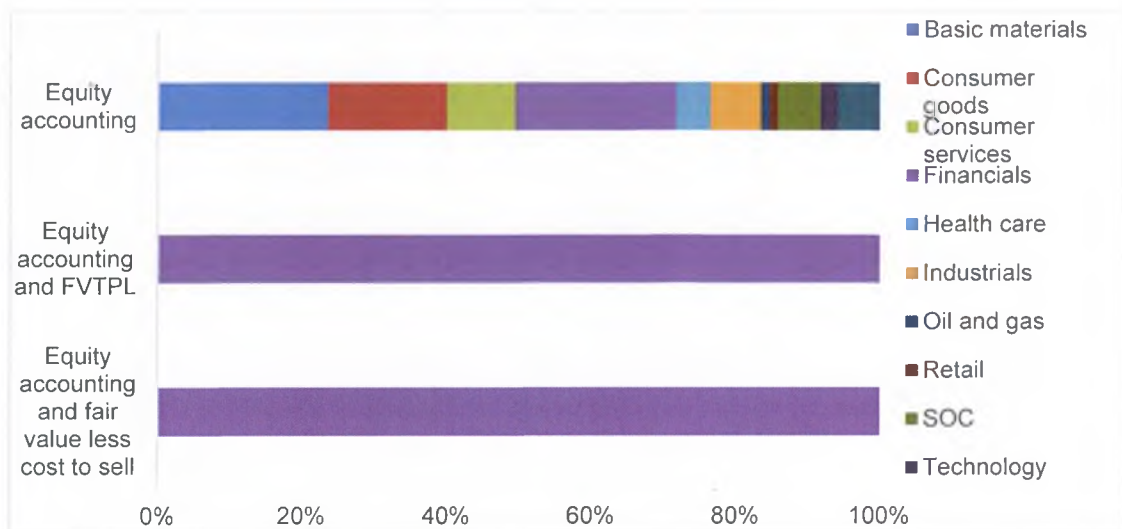
while seven companies (8%) apply both fair value and equity accounting and the remaining one company (1%) applies fair value less cost to sell as the investment is held for sale. There are no companies that account for investments in associates and/or joint ventures using fair value only.

Refer to table 10 in Appendix 3 for the number of companies accounting for investments in, associates and joint ventures using equity accounting and/or fair value through profit or loss in consolidated financial statements taking into account the EY ranking.

Industry analysis

From the 93 companies which had investments in associates and/or joint ventures in the 2014 financial year, the 88 companies listed on the JSE represented ten industry groups with the remaining five companies being SOCs. Figure 4.4 shows the percentage of companies with account for investments in associates and joint ventures at fair value and cost based on industry. Companies in different industries account for investments in associates and/or joint ventures using equity accounting, with the exception of the financial industry. From the financial industry, seven companies account for investments in associates and/or joint ventures by applying both equity accounting and fair value, this represents 26% of the companies in the financial industry. In addition, one company in the financial industry also applies only fair value less cost to sell, this represents 4% of the companies in the financial industry.

Figure 4.4: Percentage of companies accounting for investments in associates and joint ventures at fair value and equity accounting, based on industry



4.2.6. IAS 38: Intangible assets

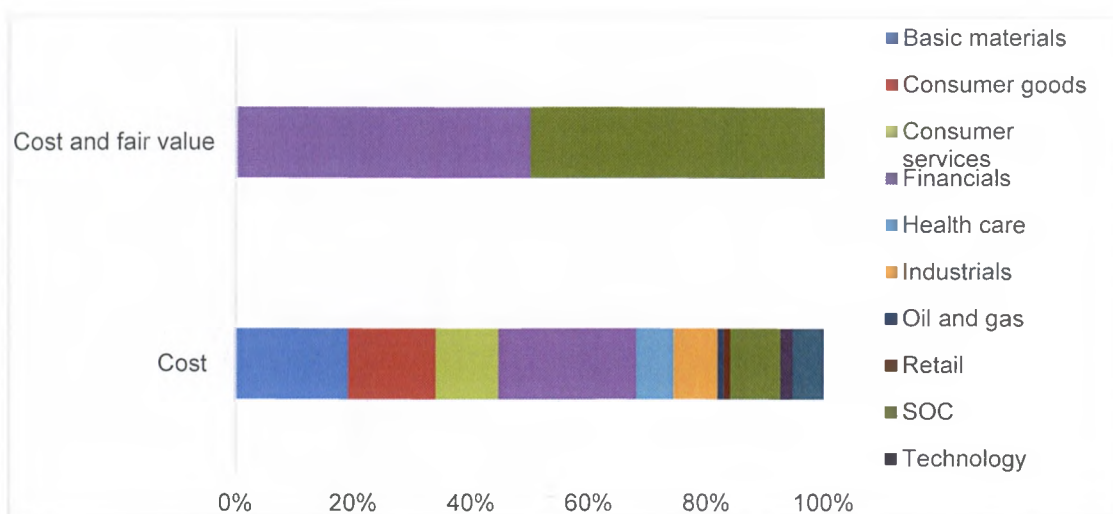
96 companies had intangible assets in the 2014 financial year. Nine of these companies are SOC's (9%) and 87 of them are companies listed on the JSE (91%). The results show that 94 companies (98%) account for intangible assets at cost and two companies (2%) use both fair value and cost. There are no companies which account for intangible assets using fair value only.

Refer to table 11 in Appendix 3 for number of companies accounting for intangible assets at cost and fair value taking into account the EY ranking.

Industry analysis

From the 96 companies which had intangible assets in the 2014 financial year, the 87 companies listed on the JSE represented ten industries with the remaining 9 companies being SOC's. Figure 4.5 shows the percentage of companies which account for intangible assets at fair value and at cost by industry. All companies in the different industries account for intangible assets at cost, except one company in the financial industry, this represents 4% of the companies in the financial industry and one SOC, representing 11% of SOC's which apply both cost and fair value.

Figure 4.5: Percentage of companies accounting for intangible assets at fair value and cost, based on industry



4.2.7. IAS 39: Financial instruments

All 108 companies had financial instruments in the 2014 financial year. The results have been provided in two categories to show companies which designated their financial instruments at FVTPL and those which had available for sale financial instruments.

IAS 39: Financial instruments (FVTPL)

The results show that 57 companies (53%) have financial instruments which are designated at FVTPL and the remaining 51 companies (47%) do not designate any of their financial instruments at FVTPL. Five of the companies that designate their financial instruments at FVTPL are SOCs (6%) and 52 are companies listed on the JSE (94%).

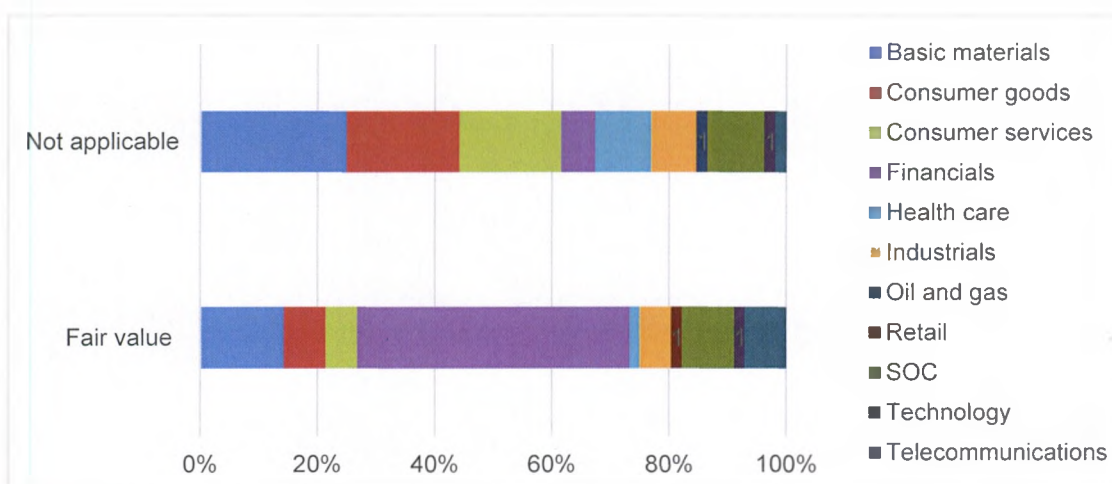
Refer to table 12 in Appendix 3 for the number of companies accounting for financial instruments at fair value through profit or loss taking into account the EY ranking.

Industry analysis

From the 57 companies which designated financial instruments at FVTPL in the 2014 financial year, the five companies listed on the JSE represent ten industries, with the

remaining five companies being SOC's. Figure 4.6 shows the percentage of companies which have financial instruments designated at FVTPL based on industry.

Figure 4.6: Percentage of companies which have financial instruments designated at FVTPL, based on industry



IAS 39: Financial instruments (available for sale)

The results show that 70 companies (65%) have financial instruments which are classified as available for sale and the remaining 38 companies (35%) do not have any financial instruments classified as available for sale. Six of the companies which designate their financial instruments at available for sale are SOC (9%) and 64 of these companies (91%) are companies listed on the JSE.

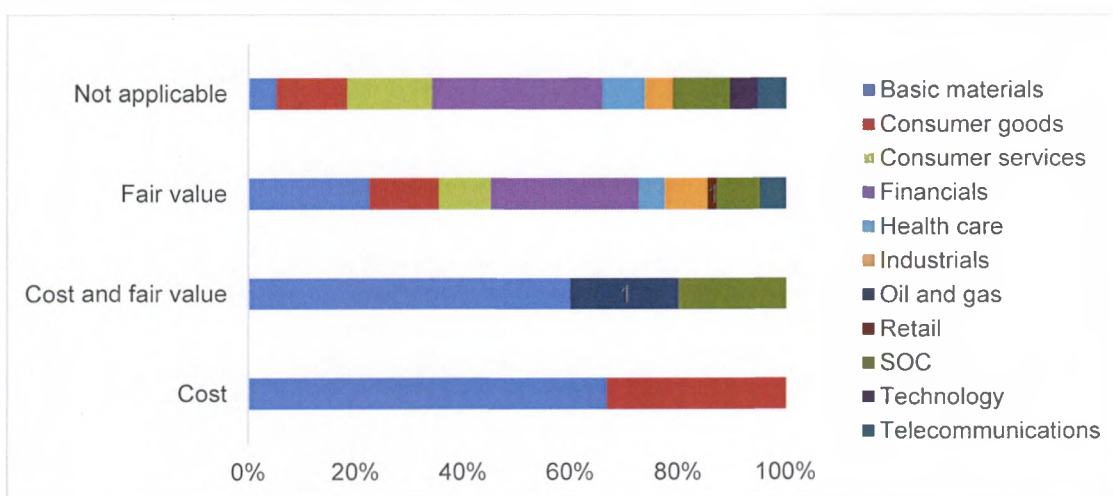
From the 70 companies which have financial instruments which are classified as available for sale, three companies (4%) measure their financial instruments at cost, 62 companies (89%) measure their financial instruments at fair value and five companies (7%) measure their financial instruments at both cost and fair value.

Refer to table 13 in Appendix 3 for the number of companies accounting for financial instruments at fair value through other comprehensive income taking into account the EY ranking.

Industry analysis

Figure 4.7 shows the percentage of companies which have financial instruments classified as available for sale, based on industry. The companies which account for available for sale financial instruments at cost include two companies in the basic materials and one company in the consumer goods industry. The companies which account for available for sale financial instruments at cost and fair value include one SOC, three companies in the basic materials industry and one company in the oil and gas industry. The remaining companies represent SOCs' and companies in the following industries: basic materials, consumer goods, consumer services, financials, health care, industrials, retail, and telecommunications industry.

Figure 4.7: Percentage of companies which have financial instruments classified as available for sale, based on industry



4.2.8. IAS 40: Investment property

37 companies had investment property in the 2014 financial year. Five of these companies were SOCs (14%) and 32 of them were companies listed on the JSE (86%). The results show that ten companies (27%) account for investment property at cost and 26 companies (70%) at fair value. One company (3%) had investment property, but no accounting policy was provided to indicate whether it was measured at fair value or cost.

Refer to table 14 in Appendix 3 for the number of companies accounting for investment property at cost and fair value taking into account the EY ranking.

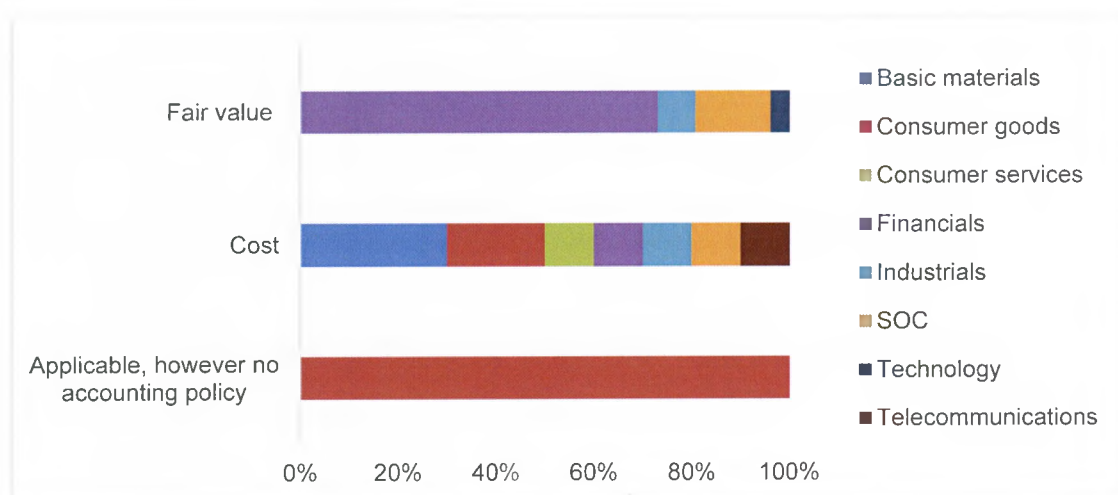
Industry analysis

From the 37 companies which had investment property in the 2014 financial year, the 32 companies listed on the JSE represent seven industries, with the remaining five companies being SOCs. Figure 4.8 shows the percentage of companies which account for investment property at fair value and at cost, based on industry.

26 companies account for investment property at fair value (70%). These are made up of four SOC (representing 80% of SOC) and 22 of the companies are listed on the JSE (representing 69% of companies listed on the JSE). The 22 companies listed on the JSE are made up of 19 companies in the financial industry representing, 95% of this industry, two companies in the industrial industry representing 67% of companies in this industry, and one company in the technology industry, representing 100% of companies in this industry.

Ten companies account for investment properties at cost: these are made up of one SOC (representing 20% of SOC), three companies in the basic materials industry, representing all companies in this industry; two companies in the consumer goods industry representing all companies in this industry; one company each from the consumer goods industry (representing 67% of companies in this industry), financial industry (representing 5% of companies in this industry), industrials industry ((representing 33% companies in this industry) and telecommunications industry (representing all companies in this industry).

Figure 4.8: Percentage of companies accounting for investment property at fair value and cost, based on industry



5. Chapter 5: Evaluation of results

In order to evaluate the results, the data were interrogated to test the relationship between the data. This included testing the relationship between the following;

- Whether companies in a specific industry make use of a specific measurement basis; and
- Whether the manner of use has an impact on the specific measurement basis chosen.

5.1. *IFRS 3: Business combinations*

The results clearly show a higher preference to proportionate share as only 11% of companies accounted for their non-controlling interest exclusively at fair value, with another 4% using both fair value and proportionate share. A business combination reflects a transaction in a current period and most companies would conclude that fair value provides more faithful representation due to it reflecting current prices and would then be relevant. The level of uncertainty required in determining the inputs to the valuation technique would impact the reliability of fair value which should be managed through the use of adequate disclosures (IASB 2015).

Although the reason for choosing the measurement bases are not provided, this may be due to the difficulty of obtaining the fair value of the non-controlling interest because in most cases a valuation technique is required to determine the fair value. In contrast proportionate share is more readily available and requires minimum level of effort to determine.

The EY ranking did not provide any indication of the quality of the accounting policies, the researcher expected that companies with higher rankings would have conclusive accounting policies. The results, however, show that this is not the case.

5.2. IAS 16: Property, plant and equipment

The results show that the majority of companies (92%) account for property, plant and equipment at cost. This includes companies from all the various industries represented, which indicates that the industry does not drive the chosen measurement bases.

The remaining 8% of companies account for property, plant and equipment using both cost and fair value. This means that some property, plant and equipment are accounted for at cost while other property, plant and equipment are accounted for at fair value. This represents SOCs and companies in the consumer services and financial services industry.

From the companies that account for property, plant and equipment at both cost and fair value, 89% of them are accounting for land and buildings at fair value. Due to the nature of land and building, entities would hold them over a long-term period, therefore these would not be sold on a regular basis implying that the use of current values is not (IASB 2015). The fair value of land and buildings generally increases considerably over time, so this increases the overall asset base of an entity. Land and buildings is a common asset amongst other entities that only apply cost which should be used in a similar manner by both groups. This implies that the manner of consumption does not impact the measurement basis. The other factor to consider is that the accounting result would influence the chosen measurement basis because although the current value is not required, it may be beneficial for entities as financial statements with a higher asset base are preferred by lending institutions when making funding decisions. This makes one understand Leisenring, Linsmeier et al. (2013) concern about the business model can be seen as the same as management intent.

The other assets accounted for at fair value include an aircraft and port infrastructure assets including a pipeline networks. Both these entities are SOCs. There are 7 other

companies that have aircrafts on their statements of financial positions which are accounted for at cost. This again substantiates that the manner of consumption does not impact the measurement bases chosen. Port infrastructure assets are specialized in nature and are not held by other companies therefore it is difficult to make a conclusion based on the manner of use. This company is subject to price regulation and it would be beneficial to have a higher asset base as it positively impacts the approvals levels provided by the regulators. This would indicate that the accounting result would influence the chosen measurement basis. Interesting to note that another SOC in the population is also subject to price regulation and they do not account for any assets at fair value which may appear to contradict the accounting result notion. The nature of the regulation need to be considered as it may be different in the two SOC's.

5.3. IAS 20: Government grant

Only 2 companies had non-monetary government grants which represent a SOC and a company listed in the JSE. The underlying assets represent property, plant and equipment, intangible assets and investment property. Intangible assets is common to both companies which depicts the manner of consumption, however these were not accounted for using the same measurement basis with one company measuring this at a nominal amount and the other at cost. Both of these measurement are readily available and easy to determine.

5.4. IAS 27: Separate financial statements

The results show that 97% of companies account for investments in subsidiaries, joint ventures and/or associates at cost, while only 2% account for these at fair value. The remaining 1% accounts for investments in subsidiaries, joint ventures and/or associates using both fair value and cost. This again shows a high preference for cost. Although the reason for choosing the cost measurement is not provided, generally

companies acquire subsidiaries, joint ventures and/or associates as long-term investments, which implies that the use of current values is not relevant (IASB 2015). The other consideration is that cost is readily available making it easy to determine. All the various industries are represented by companies applying cost which indicates that the industry does not drive the chosen measurement basis.

The companies which account for investments in subsidiaries, joint ventures and/or associates using fair value include a SOC and a company in the consumer services industry. The company which applies both fair value and cost is in the financials industry. These appear to be anomalies as the majority of companies in these industries are applying cost. In terms of the company in the financials industry, as both measurement basis are used, this implies that the business model may have an impact on the chosen measurement basis (IASB 2010).

5.5. IAS 28: Investments in associates

The results show that 91% of these companies account for investments in associates and joint ventures using equity accounting (which is a variation of cost as the original cost is adjusted by the earnings of the investment in associate and joint venture). This is again shows a preference for cost.

8% of these companies account for investments in associates and joint ventures, using both fair value and equity accounting. All these companies are in the financials industry. These results are in line with expectation as the financials industry includes banking institutions, which hold investments in private equity. The results show that the underlying assets measured at fair value are private equity investments. These private equity investments meets the venture capital organisation, or a mutual fund, unit trust and similar entities exemption, which allows companies to choose whether they want to account for these investments at fair value or using equity accounting.

The exemption is relevant to a specific business model indicating that the business model impacts the measurement chosen (IASB 2010).

The remaining 1% account for investments in associate and joint venture at fair value less cost to sell is only applicable when the investment is in the scope of IFRS 5 *Non-current assets held for sale and discontinued operations* and its carrying amount is lower than fair value. The application of the fair value less cost to sell measurement is not an accounting policy choice and the company has been excluded from this analysis (IASB 2004).

5.6. IAS 38: Intangible assets

98% of these companies account for intangible assets at cost, with the remaining 2% accounting for intangible assets using both fair value and cost. This also shows a high preference for cost. Intangible assets are either internally generated or purchased. The characteristic which makes them different from other assets and liabilities is that they are not generally replaceable by other identical assets. Due to this nature, determining their fair value maybe difficult, which impacts the reliability of the fair value (IASB 2015).

The two companies which account for intangible assets using both fair value and cost are in the financials industry, while the other company is a SOC. The majority of companies in these industries, however, account for their intangible assets at cost, indicating that the industry does not drive the measurement basis chosen. The type of assets accounted for at fair value are not different to those held by companies applying cost, which indicates that the manner of consumption is the same.

5.7. IAS 39: *Financial instruments*

5.7.1. IAS 39: Financial instruments (FVTPL)

51% of the companies designate some of their financial instruments at fair value through profit or loss. Specific requirements should be met before companies can designate financial instruments at fair value through profit or loss. The requirements are:

- "(i) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- (ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 Related Party Disclosures), for example the entity's board of directors and chief executive officer (IASB 2003)".

Although the above requirements should be met, the requirements are aligned with how an entity manages its financial instruments. This is because the first requirement can only be met if the other assets or liability linked to the accounting mismatch is not managed individually, but it managed together with the asset or liability designated at fair value. The second requirement also requires a group of assets or liabilities to be managed as a collective. This indicates that the manner of consumption impacts the measurement basis (IASB 2010). How an entity manages its financial statements relates to stewardship, indicating that management should be made accountable for the financial assets they manage (Murphy, O'Connell et al. 2013; IASB 2015)

In terms of the industry analysis, the results show that there is a 50/50 split between SOC's which designate financial instruments at fair value through profit or loss and those which do not. The SOC's designate financial instruments such as bonds and foreign currency loans.

In terms of the industry analysis companies which designate financial instruments at fair value through profit or loss, span throughout all JSE industries, with the exception of the oil and gas industry. The results show that, overall, more companies in the financials industry designate their financial instruments at fair value through profit or loss as they represent 52% of all designations. There are various types of financial instruments designated at fair value through profit or loss. The common financial instruments are listed debt, listed equity and listed preference share investments. This is in line with expectation as the fair value of these financial instruments is readily available (refer to table 15 in Appendix 3 for the full list of the types of financial instruments designated at fair value through profit or loss).

5.7.2. IAS 39: Financial instruments (available for sale)

63% of the companies have available for sale financial instruments. Financial instruments in this category are measured at fair value through other comprehensive income (IASB 2003). Unlike the fair value through profit or loss category, there are no specific requirements that should be met before a company can measure its financial instruments at fair value through profit or loss. Entities can use this measurement as a default measurement, should the definitions of the other measurement categories not be met, or they can designate financial instruments to this category. The annual financial statements do not disclose which circumstance applied in order for this measurement to be used which makes it impossible to differentiate between the two. Due to the default criteria being a possibility of applying this measurement, no further analysis was done.

5.8. IAS 40: Investment property

70% of the companies account for investment property using fair value, while 27% of companies are using cost. Due to the nature of investment property being held for capital appreciation or to earn rentals (manner of consumption), the expectation was that a higher percentage of companies would account for these at fair value. The companies applying fair value represent three JSE industries (financials, industrials, technology) and SOC's. The companies applying cost represent seven JSE industries (basic materials, consumer goods, consumer services, financials, industrials and telecommunications) and SOC's. There is an overlap between companies applying fair value and those applying cost in the same industries (financials, industrials and SOC's). This indicates that industry does not impact the measurement basis chosen.

IAS 40 requires entities which account for investment property at cost to disclose the fair value, so the effort required to determine the fair value cannot be avoided. This indicates that cost being readily available and easier to determine cannot be the reason why cost is used. The results show that seven out of ten of the companies provided this disclosure.

The other consideration is that the accounting result impacts the measurement bases chosen. It is not immediately clear what the nature of the accounting result is that could be considered when making this decision, so this should be explored further.

The remaining company (representing 3% of the companies) did not have a clear accounting policy stating whether fair value or cost was applied. The company was ranked excellent on the EY rankings, which again indicates that a higher ranking does not necessary mean clearly defined accounting policies.

6. Chapter 6: Conclusion and recommendation

While many annual financial statements provide accounting policies, stating how they account for their assets and liabilities, it is clear that more useful information can be provided to assist users of financial statements to have more understanding of the companies. The results detailed in chapter 4 did not indicate any additional information explaining why a specific measurement bases was chosen, regardless of the ranking achieved in the EY survey. While there was some consistency in the measurement basis chosen under some IFRS standards for entities in the same industry, it is difficult to conclude that the industry impacts the measurement basis chosen. The results did not indicate that the manner of consumption impacts the measurement basis show.

As indicated above, in the literature review, various research has been performed on fair value accounting which measurement bases, between cost and fair value, should be applied. It, however, appears that some elements have not been taken into account. A blanket approach seems to have been applied, which would imply that one approach should be applicable to all entities for all assets and liabilities. Other elements which should be taken into account include, for example, what conditions or circumstances need to be in place in order for fair value accounting to provide information that is both relevant and reliable.

From the above, it appears that both accountability and neoliberalism continue to play a role in financial reporting. In other words, financial statements cannot afford to perform the function of providing only useful information without holding management accountable. Financial reporting should perform both these functions as excluding any one of these will be going against the conceptual framework.

Further research will be helpful in answering the question of how management determine an appropriate measurement basis where IFRS standards allow an accounting policy choice. This research can include developing a questionnaire to be

provided to the existing management of companies to explore what considerations they made when choosing a measurement basis. Specific questions relating to the nature of the accounting result considered may be added to provide more insight on this. The underlying reasons and the degree of importance placed on various considerations, when concluding on an appropriate measurement basis, will provide a more holistic view and assist other entities to make informed decisions when making accounting policy choices. In addition, this will assist the users of financial statements to understand the decisions made by management better.

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Appendix 1: IFRS standards

Table 1: List of IFRS standards containing an accounting policy choice for the measurement basis

	IFRS standard	Description	Available measurement basis	
1	IFRS 3: Business combinations	Initial and subsequent measurement of non-controlling interest	Non - controlling interest: proportionate share in the recognised amounts of acquiree's identifiable net assets	Fair value
2	IAS 16: Property, plant and equipment	Subsequent measurement of property, plant and equipment	Cost less accumulated depreciation and impairment	Revaluation method (fair value at date of valuation less subsequent depreciation)
3	IAS 20: Government grants	Grants of non-monetary assets	Nominal amount	Fair value
4	IAS 27: Separate financial statements	Investments in subsidiaries, joint ventures and associates	Cost less impairment	Fair value
5	IAS 28: Investments in associates ⁴	Investments in joint ventures and associates in consolidated financial statements	Equity accounting	Fair value
6	IAS 36: Impairment of assets	Measurement of recoverable amount	Value in use	Fair value less cost to sell
7	IAS 38: Intangible assets	Subsequent measurement of intangible assets	Cost less accumulated depreciation and impairment	Revaluation method
8	IAS 39: Financial instruments ²	Subsequent measurement of financial instruments	Cost, amortised cost less impairment	Fair value
9	IAS 40: Investment property	Subsequent measurement of investment property	Cost less accumulated depreciation and impairment	Fair value

⁴ Specific requirements are required to be met before the accounting policy choice can be made.

Appendix 2: Sample of companies

Table 2: Top 100 JSE listed companies

1	Royal Bafokeng Platinum Ltd	51	Impala Platinum Holdings Ltd
2	Standard Bank Group Ltd	52	Investec plc
3	Sasol Ltd	53	Life Healthcare Group Holdings Ltd
4	Truworths International Ltd	54	Mondi Plc
5	Gold Fields Ltd	55	Nampak Ltd
6	Aspen Pharmacare Holdings Ltd	56	Netcare Ltd
7	Kumba Iron Ore Ltd	57	Northam Platinum Ltd
8	Liberty Holdings Ltd	58	Old Mutual plc
9	Clicks Group Ltd	59	Remgro Ltd
10	Exxaro Resources Ltd	60	Reunert Ltd
11	Altron (Allied Electronics) Ltd	61	Sanlam Ltd
12	Anglo American Platinum Ltd	62	Santam Ltd
13	Anglo American plc	63	Sun International Ltd
14	AngloGold Ashanti Ltd	64	Vukile Ltd
15	ArcelorMittal SA Ltd	65	Assore Ltd
16	Barclays Africa Group Ltd	66	AVI Ltd
17	Barloworld Ltd	67	Bidvest Ltd
18	British American Tobacco plc	68	Brait SE
19	Growthpoint Properties Ltd	69	Distell Group Ltd
20	Harmony Gold Mining Company Ltd	70	Fountainhead Property Trust #
21	Illovo Sugar Ltd	71	Hyprop Investments Ltd
22	Intu Properties plc	72	Imperial Holdings Ltd
23	Lonmin plc	73	Massmart Holdings Ltd
24	MTN Group Ltd	74	Mediclinic International Ltd
25	Murray & Roberts Holdings Ltd	75	MMI Holdings Ltd
26	Nedbank Group Ltd	76	Mr Price Group Ltd
27	Oceana Group Ltd	77	Naspers Ltd
28	Omnia Holdings Ltd	78	Pick 'n Pay Stores Ltd
29	PPC Ltd	79	Pioneer Foods Group Ltd
30	Redefine Properties Ltd	80	Steinhoff International Holdings Ltd
31	SABMiller plc	81	Telkom SA SOC Ltd

32 Sappi Ltd	82 Tiger Brands Ltd
33 Tsogo Sun Holdings Ltd	83 Tongaat Hulett Ltd
34 Vodacom Group Ltd	84 Wilson Bayly Holmes-Ovcon Ltd
35 Woolworths Holdings Ltd	85 Capital Property Fund
36 Adcock Ingram Holdings Ltd	86 Caxton and CTP Publishers and Printers Ltd
37 AECI Ltd	87 EOH Holdings Ltd
38 African Bank Investments Ltd #	88 Famous Brands Ltd
39 African Rainbow Minerals Ltd	89 Hosken Consolidated Investments Ltd
40 Aveng Group Ltd	90 Invicta Ltd
41 BHP Billiton plc	91 New Europe Property Investments plc
42 Capital & Counties Properties plc	92 PSG Group Ltd
43 Capitec Bank Holdings Ltd	93 Rand Merchant Insurance Holdings Ltd
44 Coronation Fund Managers Ltd	94 Reinet Investments S.C.A.
45 Datatec Ltd	95 Resilient Property Income Fund
46 Discovery Holdings Ltd	96 Richemont SA
47 FirstRand Ltd	97 RMB Holdings Ltd
48 Foschini Group Ltd	98 Shoprite Holdings Ltd
49 Glencore Xstrata plc	99 The Spar Group Ltd
50 Grindrod Ltd	100 Trencor Ltd

The financial statements of these companies could not be obtained on the entity's official website and have been excluded from the analysis.

Table 3: State owned companies

1 Eskom Holdings (SOC) Ltd
2 Industrial Development Corporation of SA Ltd
3 Transnet (SOC) Ltd
4 Airports Company SA Ltd
5 Development Bank of Southern Africa
6 South African Post Office (SOC) Ltd
7 Central Energy Fund (SOC) Ltd
8 Land and Agricultural Development Bank of SA
9 South African Airways (SOC) Ltd
10 Trans-Caledon Tunnel Authority

Appendix 3: Results

Table 4: IFRS 3 Business combinations contingency table

Measurement	Basic materials	Consumer goods	Financials	Health care	Industrials	SOC	Technology	Telecommunications	Total
0	2	5	3	1	3	2	2	1	19
1			1	1	1				3
2			1						1
Total	2	5	5	2	4	2	2	1	23

Under the measurement column 0 indicates proportionate share, 1 fair value indicates and 2 indicates both proportionate share and fair value.

Table 5: IAS 16 Property, plant and equipment contingency table

Measurement	Basic materials	Consumer goods	Consumer services	Financials	Health care	Industrials	Oil and gas	Retail	SOC	Technology	Telecommunications	Total
0			1	3					5			9
1	21	14	11	26	6	7	1	1	5	2	5	99
Total	21	14	12	29	6	7	1	1	10	2	5	108

Under the measurement column, 0 indicates cost and 1 indicates both cost and fair value.

Table 6: IAS 27 Separate financial statements contingency table

Measuremen t	Basic material s	Consume r goods	Consume r services	Financial s	Health care	Industrial s	Retail	SOC	Technolog y	Telecommunication s	Total
3				1							1
0			1					1			2
1	17	11	10	25	6	7	1	7	2	4	90
Total	17	11	11	26	6	7	1	8	2	4	93

Under the measurement column, 0 indicates fair value, 1 indicates cost and 2 indicates both cost and fair value.

Table 7: IFRS 3 Number of companies accounting for non-controlling interest at fair value and/or proportionate share

Measurement applied per EY ranking	Total
Proportionate share	19
Average	2
Excellent	7
Excellent - SOC	2
Good	5
Progress to be made	3
Fair value	3
Average	1
Good	2
Fair value and proportionate share	1
Progress to be made	1
In conclusive	5
Average	1
Excellent	1
Progress to be made	3
Total	28

Table 8: IAS 16 Number of companies accounting for property, plant and equipment at cost and/or fair value

Measurement applied per EY ranking	Total
Cost	99
Average	18
Average - SOC	2
Excellent	34
Excellent - SOC	1
Good	27
Progress to be made	15
Progress to be made - SOC	2
Cost and fair value	9
Average	1
Average - SOC	1
Excellent	1
Excellent - SOC	2
Good	1
Progress to be made	1
Progress to be made - SOC	2
Total	108

Table 9: IAS 27 Number of companies accounting for investments in subsidiaries, associates and joint ventures at cost and/or fair value in separate financial statements

Measurement applied per EY ranking	Total
Cost	90
Average	17
Average - SOC	2
Excellent	27
Excellent - SOC	2
Good	23
Progress to be made	16
Progress to be made - SOC	3
Fair value	2
Excellent - SOC	1
Good	1
Cost and fair value	1
Good	1
Total	93

Table 10: IAS 28 Number of companies accounting for investments in, associates and joint ventures using equity accounting and/or fair value through profit or loss in consolidated financial statements

Measurement applied per EY ranking	Total
Equity accounting	85
Average	16
Average - SOC	1
Excellent	27
Excellent - SOC	2
Good	22
Progress to be made	15
Progress to be made - SOC	2
Equity accounting and FVTPL	7
Average	1
Excellent	4
Good	2
Equity accounting and fair value less cost to sell	1
Good	1
Total	93

Table 11: IAS 38 Number of companies accounting for intangible assets at cost and fair value

Measurement applied per EY ranking	Total
Cost	94
Average	17
Average - SOC	3
Excellent	31
Excellent - SOC	2
Good	27
Progress to be made	11
Progress to be made - SOC	3
Cost and fair value	2
Excellent - SOC	1
Good	1
Total	96

Table 12: IAS 39 Number of companies accounting for financial instruments at fair value through profit or loss

Measurement applied per EY ranking	Total
Fair value	57
Average	8
Average - SOC	2
Excellent	18
Excellent - SOC	1
Good	13
Progress to be made	13
Progress to be made - SOC	2
Not applicable	51
Average	11
Excellent	17
Excellent - SOC	2
Good	15
Average - SOC	1
Progress to be made	3
Progress to be made - SOC	2
Total	108

Table 13: IAS 39 Number of companies accounting for financial instruments at fair value through other comprehensive income

Measurement applied per EY ranking	Total
Fair value	62
Average	11
Average - SOC	1
Excellent	25
Excellent - SOC	2
Good	16
Progress to be made	5
Progress to be made - SOC	2
Cost	3
Average	1
Good	2
Cost and fair value	5
Good	2
Average - SOC	1
Excellent	2
Not applicable	38
Average	7
Average - SOC	1
Excellent	8
Excellent - SOC	1
Good	8
Progress to be made	11
Progress to be made - SOC	2
Total	108

Table 14: IAS 40 Number of companies accounting for investment property at cost and fair value

Measurement applied per EY ranking	Total
Fair value	26
Average	2
Average - SOC	1
Excellent	7
Excellent - SOC	2
Good	7
Progress to be made	6
Progress to be made - SOC	1
Cost	10
Average	1
Average - SOC	1
Excellent	2
Good	5
Progress to be made	1
Applicable, however no accounting policy	1
Excellent	1
Total	37

Appendix 4: Financial instruments

Table 15: List of type of financial instruments designated at FVTPL based on industry

	Number of companies
Basic materials	
Environmental rehabilitation funds	1
Environmental trust deposits (equity-linked deposit)	1
Equity investments held by environmental trust	1
Equity-linked investments in rehabilitation trust and social trust fund	1
Financial liabilities at FVTPL (corporate bonds containing an embedded derivative)	1
Trade and other receivables	1
Trade and other receivables and trade and other payables	2
Consumer goods	
Investments in money market and government bond funds	1
Loans to/from group companies and non-controlling shareholder loan	1
Other financial assets and liabilities. The specific type has not been disclosed	1
Fixed and negotiable deposits	1
Consumer services	
Insurance cell-captive	1
Non-controlling interest financial liability	1
Trade and other receivables and trade and other payables	1
Financials	
Bonds, bank repurchase agreements and market instruments of major South African banks, government securities and government-related entities	1
Debt securities and money market securities and equity linked notes and Inflation linked securities	1
Underlying financial instruments not disclosed	1
Investments backing policyholder funds, investments held through investment partnerships, policyholder investment contract liabilities and liabilities to holders of interests in investment partnerships	1
Investments/securities – underlying investments not disclosed	6
Issued convertible bonds	1
Debt securities, unit-linked investments, investment in investment contracts and third-party liabilities arising on consolidation of mutual funds	1
Equities held by consolidated investment funds	1
Unit linked investments	1
Government, municipal and utility bonds, commercial term deposits, mutual funds and preference shares	1
Funds on deposit and other money market instruments and unit-linked investments at fair value	1
Loans and advances to banks and customers, government, municipality and utility bonds, commercial term deposits and mutual funds and unit-linked investments	1
Loans and advances to banks and customers, other debt securities, other securitised assets and other assets. deposits by banks, customer accounts (deposits), debt securities in issue, liabilities arising on securitisation of other assets, other liabilities and subordinated liabilities	1
Long-term interest bearing loan asset and liabilities, debentures (prior to the conversion to a REIT thereafter not at FVTPL)	1
Short term securities, government and other securities, loans and advances	2
Treasury bills, investment in negotiable certificates of deposits and SARB debentures	1
Investments – underlying investment not disclosed	1

Various advances to customers, structured notes and other investments held by the investment banking division and private equity and other investment securities	1
Health care	
Cell Captive	1
Industrials	
Fixed rate advances which are hedged	1
Investment in infrastructure service concession	1
Investments – underlying investment not disclosed	1
Retail	
Long-term receivables	1
SOC	
Bonds	1
Funding debt securities	1
Collective investment schemes and government bonds, cash, deposits and similar securities and investment policy	1
Other financial liabilities - foreign loan	1
Trade and other payables	1
Technology	
Amounts owing to vendors (purchase considerations owing in respect of acquisitions), debt securities, foreign assets and money market securities	1
Telecommunications	
Cell captive preference shares	1
Contingent consideration	1
insurance cell captives	1
Unit trust and money market investments	1
Total	54