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The Directors,
Corpcapital Limited,
Box 471917,
Parklands,
2121.

Dear Sirs,

Supplementary comment on accounting treatment of investment in Cytech(Pty) Ltd.

1.I have been asked to set out my views as to the treatment of your company's investment in Cytech(Pty)Ltd in the 2002 financial year, on the assumption that the investment was not 'acquired and held exclusively with a view to its disposal in the near future'.

2.As I do not have complete knowledge as to all the circumstances attendant upon the classification of Cytech for the purposes of the 2002 financial statements, I cannot express a useful opinion in that regard.

3.It should also be noted that from the evidence I have seen (and notably that of Mr Coppin's report of 27 October 2003, at p 17) it appears that the nature of the investment was that of a joint venture, rather than an associate. However, prior to 2002, it had been accounted for on a fair value basis rather than on the basis of bringing to account a share of the profits actually earned, as envisaged for associates (in terms of AC110) or joint ventures (in terms of AC119).I have commented on this treatment in my letter of 8 December(at C.2-5); the issue is dealt with much more fully in Mr Coppin's report(from p 16 onwards)

4.Both AC110 and AC119 are aimed at ensuring that where an investor has the ability to influence the operations of an investment, whether by means of 'significant influence' (in the case of associates) or through joint control (in the case of joint ventures), the investor should give account of the performance of the investment. If this were not so, the investor would normally simply record any dividends received from the investment as income as and when received – and this is not necessarily indicative of the underlying earnings of the investment. Put differently, the statements recognise that the element of influence or joint control enjoyed by the investor brings with it a requirement of greater accountability – but not to the same degree as would obtain if absolute control existed and full consolidation were required as a result. Thus application of the statements entails bringing to account the investor's share of the underlying earnings, whether by means of equity accounting (required for associates) or proportionate consolidation (in the case of joint ventures, with equity accounting the 'allowed alternative' treatment).

5.AC110 and AC119 clearly treat equity accounting/proportionate consolidation as the norm, but both documents contain exemptions from the general requirement. The relevant exemption on which I have been asked to express a view is that of an investment in an associate or joint venture 'acquired and held exclusively with a view to its disposal in the near future'(the wording of both statements is identical (AC110:07; AC119: 36(a);I shall refer to this as the 'exemption').

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6.The exemption has the important effect of enabling an investor to avoid bringing to account its share of earnings of an associate or joint venture. It thus potentially presents an opportunity to manipulate earnings by, for example, excluding a loss-making associate on the grounds that it was held for disposal, or, conversely by reporting earnings conservatively with the prospect of reporting a large profit on disposal at a chosen time. The wording of the exemption appears to have been carefully chosen in order to protect against such manipulation –

(a) firstly, it is clear that the investment must have been *both* acquired and held for disposal; if this was not the intention at acquisition,then the exemption would not apply. Thus a revision of intention subsequent to acquisition could not be allowed, for example, to avoid equity accounting in the event of losses occurring in an associate, as both conditions would not have been met(similarly, a change in circumstances for an investment acquired for disposal in the near-term, but no longer held for that exclusive purpose, would also mean that the exemption should not be used, and that equity accounting would be required).

(b) secondly, use of the word 'exclusively' militates against there being multiple objectives in relation to the investment; if,for instance, the intention was to use the ability to exert influence or joint control to enhance the earnings and thus the value of the investment, but at the same time being open to sale at an opportune time and price, it seems to me that one could not claim that the investment was held exclusively for disposal

(c) thirdly,there is the reference to the 'near future'. While the term itself is not defined, the implication is clearly that the standard setters did not contemplate an extended period during which the investor would be able to avoid the preferred treatment of the statements, namely to bring to account its share of earnings.

7.It follows that if Corpcapital ceased to hold the investment in Cytech for disposal in the near future, the correct accounting would be to revert to the normal treatment under AC110 or AC119, as the case may be, applying either equity accounting or(in the case of classification as a joint venture, equity accounting or proportionate consolidation).

8.Finally,I would observe that the change in intention with a consequent change in accounting method, does not imply a change in accounting policy, but simply a change in circumstances requiring a different accounting treatment. There is plenty of precedent for this, both in AC110,AC119, and other statements.

Yours faithfully,

G.K.Everingham