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27 October 2003

The Directors  
Corpcapital  
Limited  
P.O.Box  
471917  
PARKLANDS  
2121

Dear Sirs,

REPORT PREPARED BY G.D.COPPIN IN RESPONSE TO THE SUBMISSION TO THE  
MINISTER OF TRADE AND INDUSTRY

1. As requested I have reviewed the draft report prepared by G.D.Coppin (GDR) in response to the statements contained in the Submission to the Minister of Trade and Industry prepared by Webber Wentzel Bowens, dated June 2003.
2. As part of that review I held discussions with GDR which resulted in a number of amendments and additions to the report Accordingly, I am now in full agreement with the contents of the report and conclusions drawn by GDR. It is not intended to reiterate the conclusions of the report other than to confirm specifically that the accounting treatment of Cytech Limited (Cytech), in the financial statements of Corpgro Limited in the year 2000 and in Corpcapital in the years 2001 and 2002, was appropriate. This treatment did not, in my opinion, constitute a contravention of South African Statements of Generally Accepted Accounting Practice (GAAP).
3. In conducting my review I considered it important to determine whether there was any evidence or suggestion of a deliberate attempt by management and the Board of Corpcapital to mislead or confuse the users of the Corpcapital financial statements during the years in question. In an attempt to make that determination I reviewed the accounting policies and financial disclosures of similar entities and examined the Research Reports of Financial Analysts.
4. From my examination of the financial statements of Corpcapital I have concluded that the accounting policies adopted and disclosures made were in accordance with other listed entities engaged in similar activities. In this regard I examined the financial statements of Brait S.A., which has significant investment banking and private equity investments and therefore its operations are closely aligned to those of Corpcapital. It was apparent from a study of the Brait financial statements that the basis of valuation of short-term investments was identical to that of Corpcapital in that gains and losses on revaluation of investments were taken to income. The accounting policy note in respect of these investments is as follows:

### **"Private Equity Interests and Proprietary Investments**

Direct or carried interests in private debt or equity investments are held at estimated fair value as determined by the board of directors at the balance sheet date. The resultant increase or decrease in value is recognised in the income statement. The directors determine the fair value for the group's interests in private equity funds under its management by applying the guidelines of the British Venture Capital Association and the valuation indicators appropriate to the underlying listed or unlisted investments."

No details are given of either the names of the investments, their fair values, or the assumptions used in arriving at the fair values. Accordingly, it is not possible to determine which of the investments contribute significantly to the unrealised gains/losses reflected in the income statement, and the basis on which those values were determined. In this respect, therefore, the accounting treatment and disclosures are no different from those of Corpcapital.

5. A review of Financial Analysts reports issued on Corpcapital, and its predecessor entities, during the period August 1997 to November 2001 gives no indication of any concerns either as to the appropriateness of the accounting policies adopted or confusion as to the extent of unrealised revaluation gains included in earnings. On the contrary, it is evident that the analysts fully understood that revaluation gains and losses on investments were reported in income and that these valuation adjustments were unrealised. In the only reference that I can find to Cytech (previously Netainment), Investec Securities in a report dated 1 October 2001, made the following statement and I quote:

"Closer scrutiny of Corpcap's value highlights that its unlisted portfolio-mainly Infinex, Netainment and its corporate finance operation, represents 30% of its value Infinex consists of payroll-based lenders (Grand Finance, Izwelethu) and a credit agency (Norman Bisset). This leaves that most of the revaluation came from Netainment, an online gaming operator. CorpCap invested R30m in 1998 and the present management valuation amounts to some R150m-an aggregate return of 250% p.a. This is an extraordinary return and is not likely to be repeated or sustainable going forward."

This statement clearly indicates that the analysts were aware of the significance of the contribution to earnings of Cytech and were sounding a warning to investors at that stage that these profits were unlikely to be sustainable. Therefore the inference in the submission that the accounting and disclosures of Cytech were inappropriate, and concealed from the users of the financial statements the materiality of the unrealised gains applicable to this investment, is not sustainable.

Yours faithfully,

*P.L. Wilmot*

## CURRICULUM VITAE- PETER L WILMOT

- Date of birth:** 13 March 1940.
- Marital status:** Married to Wendy in 1964; three children; two sons and one daughter; both sons are Chartered Accountants and our daughter is a senior school teacher.
- Qualifications:** Qualified as a Chartered Accountant S.A. in 1963
- Work career:** Practised as a Chartered Accountant my whole working life; admitted to partnership in Goldby Panchaud & Webber (one of the founding firms of the present day Deloitte & Touche) in 1965 as an audit partner; specialised on the technical side of the practice and became technical partner in charge of Deloitte's; in 1991 became Chairman of the Board of Deloitte's, a position I held until my retirement from the firm in August 1999 after a career of forty one years.
- Professional career:** Chairman of the Accounting Practices Committee of The South African Institute of Chartered Accountants (SAICA); President of The Transvaal Society of Chartered Accountants; President of SAICA; SAICA's previous representative on the Board of the International Accounting Standards Committee; presently the deputy chairman of the Standards Advisory Council of the International Accounting Standards Board; currently Chairman of the Accounting Practices Board; appointed an honorary life member of SAICA in 1999 in recognition of services rendered to the profession.
- Directorships:** Allied Electronics Corporation Limited;  
Allied Technologies Limited;  
Brait S A  
Bytes Technology Group Limited;  
Edgars Consolidated Stores Limited;  
The Federated Employers' Mutual Assurance Company Limited.
- Recreation:** Golf; outdoor pursuits; playing bridge and reading

27 October 2003

The Directors  
Corpcapital Limited  
PO Box 471917  
Parklands 2121

Dear Sirs

**INSPECTION TO INVESTIGATE THE AFFAIRS OF THE CORPCAPITAL GROUP  
OF COMPANIES**

1. As requested I have considered whether certain comments regarding the 2000 annual financial statements of Corpgro Limited ("Corpgro") and the 2000, 2001 and 2002 annual financial statements of Corpcapital Limited ("Corpcapital") appear to be valid or not. For the purposes of this report these two companies are collectively termed "the Group." The comments I have considered are contained in the Submission to the Minister of Trade and Industry for an appointment of inspectors to investigate the affairs of the Corpcapital group of companies in terms of the Companies Act, including the annexures attached to the Submission ("the Submission").
2. For the purpose of this report I have only considered those comments in the Submission that relate to whether the above financial statements comply with the requirements of 'South African Statements of Generally Accepted Accounting Practice ("GAAP") and the Companies Act 61 of 1973, as amended ("the Companies Act") The report does not deal with whether any value placed on the shares in Cytech Limited was a fair or reliable market value during the years covered by the above financial statements.
3. This report contains the following parts:
  - 3.1. Part 1 - summary of the relevant issues noted in the Submission as defined above
  - 3.2. Part 2 - comments, discussion and conclusions on the issues noted in Part 1
  - 3.3. Part 3 - cross reference to where the various issues noted in Part 1 are contained in the Submission
  - 3.4. Part 4 - my curriculum vitae

4. The comments and opinions provided in the report are based on my reading of the Submission, the financial statements referred to above and certain other information provided to myself, which have not necessarily been verified". I have read these documents, Statements of GAAP and the Companies Act to the extent I considered necessary for the purpose set out in 2 above. My judgement on the appropriate application of generally accepted accounting principles for the described specific issues noted in the Submission is based solely on the information provided to me; should my understanding of these facts be incomplete or incorrect, my conclusions may change.

Yours faithfully



G D COPPIN

## **PART 1 - SUMMARY OF ISSUES RAISED IN THE SUBMISSION**

1. Included in the Submission are a number of comments regarding the compliance of the annual financial statements with GAAP and the Companies Act. Some of these comments are repeated a number of times in the Submission, using the same or similar wording. This Part of the report summarises these comments, while Part 2 of the report discusses the validity or otherwise of the comments, while Part 3 of the report provides a cross reference to where the various comments are contained in the Submission.
2. The comments in the Submission are in relation to the 2000, 2001 and 2002 annual financial statements of the Group.
3. The comments in the Submission contend that these financial statements do not comply with GAAP and the Companies Act. The specific contentions in this respect are detailed below.
4. The contentions mentioned in 3 above relate almost exclusively to how the Group accounted for its investment in Cytech Limited ("Cytech"), previously named Netainment, in the above financial statements.
5. The specific contentions in relation to the accounting in the financial statements of the Group are as follows:
  - 5.1. Certain disclosure requirements in terms of the Fourth Schedule to the Companies Act were not provided in relation to Cytech. These relate to the following:
    - 5.1.1. Information material to an appreciation of the Group's affairs (see 2.1 in Part 2)
    - 5.1.2. The name of investments and percentage holdings (see 2.2 in Part 2)
    - 5.1.3. Income from listed and unlisted investments (see 2.3 in Part 2)
    - 5.1.4. Abnormal items of income (see 2.4 in Part 2).
  - 5.2. The accounting treatment and accounting policies used for Cytech were not appropriate in the following respects:

- 5.2.1. The investment in Cytech should have been accounted for at cost or equity accounted in the 2000 and 2001 financial statements (see 3.1 in Part 2)
- 5.2.2. It was inappropriate to value an unlisted investment at a market value (see 3.2 in Part 2)
- 5.2.3. Inappropriate accounting policies were adopted and were coupled with changes in accounting policies (see 3.3 in Part 2)
- 5.2.4. Uniform accounting policies were not used (see 3.4 in Part 2)
- 5.2.5. What was described as a change in classification in the 2002 financial statements should have been accounted for as a change in accounting policy or a fundamental error (see 3.3 in Part 2)
- 5.2.6. There was inadequate disclosure of the change in accounting for associates (see 3.3.11 and 3.3.14 in Part 2).

5.3 The disclosures provided in respect of Cytech were not adequate. This entails the following:

- 5.3.1. Not providing disclosures in respect of accounting standards for associates (see 4.1 in Part 2)
- 5.3.2. Not providing full details on accounting policies and the assumptions for the valuation of Cytech (see 4.2 in Part 2)
- 5.3.3. Not providing all the required disclosures for financial instruments (see 4.2 in Part 2)
- 5.3.4. Not showing the currency effect on the change in value of the investment (see 4.3 in Part 2)

5.4 In addition to the above the following deficiencies that did not specifically relate to Cytech were noted:

- 5.4.1 The 2001 and 2002 financial statements did not disclose the period over which goodwill was being amortised (see 5.1 in Part 2)

- 5.4.2 Providing pro-forma information was an inappropriate accounting treatment for a change in accounting policy in the 2002 financial statements (see 3.3.15 in Part 2)
- 5.4.3 In the 2002 financial statements comparative figures should be given for each investment classified as an associate (see 3.3.14 in Part 2)
  
- 5.5 The lack of adequate disclosures and inappropriate accounting in terms of the specific requirements of GAAP and the Companies Act as detailed above meant the following (see 6 in Part 2):
  - 5.5.1 The financial statements could not be described as being in compliance with GAAP
  - 5.5.2 Fair presentation was not achieved
  - 5.5.3 The information provided was neither reliable nor neutral
  - 5.5.4 All the information relevant to explain the performance of the Group was not provided
  - 5.5.5 Sufficient information to enable a reader to be able to affect evaluations or decisions or to predict future cash flows was not provided
  - 5.5.6 Sufficient disclosure of material items affecting decisions was not provided.

## **PART 2 - COMMENT, DISCUSSION AND CONCLUSION OF ISSUES RAISED IN PART 1**

### Introductory comments and summary conclusion

- 1.1 The issues raised in Part 1 that are included in pages 6 to 43 of the Submission are generally a summary or a repetition of issues raised in the Abrahams Report (annexure C, pages 73 to 405) and the Collett Report (annexure D, pages 406 to 938). In addition issues raised in the Collett Report are often also raised in the Abrahams Report as can be seen from the references contained in Part 3 of this report. For ease of use the references used in this part of the report refer to the paragraph number on the specified page of the Submission (e.g. any reference to pages 73 to 405 would be to the Abrahams report.) Any quote from the Submission or statement of GAAP is given in italics.
  
- 1.2. The following are the names of the statements of GAAP referred to in this part of the report:
  - 1.2.1 ACOOO - Framework for the preparation and presentation of financial statements
  - 1.2.2 AC 100 - Preface to statements of Generally Accepted Accounting Practice
  - 1.2.3 AC101 - Presentation of financial statements
  - 1.2.4 AC102 - Income taxes
  - 1.2.5 AC103 - Net profit or loss for the period, fundamental errors and changes in accounting policies
  - 1.2.6 AC110 - Accounting for investments in associates
  - 1.2.7 AC112 - Accounting for the effects of changes in foreign exchange rates
  - 1.2.8 AC119 - Financial reporting of interests in joint ventures
  - 1.2.9 AC125 - Financial instruments: disclosure and presentation
  - 1.2.10 AC 129 - Intangible assets
  - 1.2.11 AC131 - Business combinations
  - 1.2.12 AC132 - Consolidated financial statements and accounting for investments in subsidiaries
  - 1.2.13 AC133 - Financial instruments: recognition and measurement
  - 1.2.14 AC428 - Business combinations - "Date of Exchange" and fair value of equity instruments

1.3 As noted in 5.5 in Part 1 above the Submission contends that the financial statements could not be described as being in compliance with GAAP and that fair presentation was not achieved. Paragraph 7.1 (pg 136) correctly identifies the basic requirements for fair presentation being contained in section 286(3) of the Companies Act which states that financial statements are required "*in conformity with generally accepted accounting practice, [to] fairly present the state of affairs ..and the profit or loss of the company..*" The Framework for the Preparation and Presentation of Financial Statements gives little guidance regarding fair presentation and states "*Although this ' Framework does not deal directly with such [a] concept[s], the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.*" (AC 000.46) It is noteworthy that the Submission does not contend that section 286(3) of the Companies Act was not complied with, because if this contention had been made it would have been grounds to state that an offence in terms of the Companies Act had been committed. Nevertheless, the requirements of this section of the Companies Act have an important bearing on the contentions made in the Submission.

1.4 The meaning of section 286(3) of the Companies Act was an issue that the standard setters wanted to understand, so in 1977 they obtained an opinion from Senior Counsel on this issue. The appendix to AC 100 deals with the opinion that the Accounting Practices Board ("APB") obtained in relation to two questions dealing with compliance with GAAP, one of which was as follows:

"• *Does compliance with a statement of GAAP, issued by the APB, constitute compliance with the requirements of Section 286(3) of the Companies Act?*

" A summary of Senior Counsel's opinion in relation to this question as contained in the appendix states the following:

- *With reference to the first question posed, Senior Counsel is of the opinion that, having regard to the procedure adopted by the APB in considering and approving statements of GAAP and to the composition of the APB, that to the extent that a company in drawing up its financial statements complies with, and an auditor in carrying out his duties follows, a statement of the APB, they "can safely assume that they have complied with the provisions of the Companies Act in respect of 'generally accepted accounting practice'".*
- *Counsel reached the conclusion that, while compliance with APB statements removes any fear of non-compliance with the requirements of the Companies*

*Act to conform with generally accepted accounting practice, non-compliance "could " or "may " constitute a contravention of the Act in that regard, but would not necessarily do so."*

- 1.5 The appendix to AC 100 is a summary of the opinion prepared by S Kentridge SC. The opinion itself includes the following comments in relation to fair presentation: "There may be no particular practice which is commonly or as a general rule applied. 'Accepted accounting practice' in this context would cover any practice which would in general be regarded by accountants as permissible, or within the tolerated limits of accounting practice, even by accountants who do not use that method themselves. For practical purposes, therefore, the whole phrase can be taken to cover any practice which the bulk of the accounting profession would regard as being within the range of permissible alternatives.

"Whether a practice is 'generally accepted' is a matter partly of fact and partly of professional opinion.

"Nonetheless, the question whether any particular practice complies with the statutory requirement remains a matter of fact and of professional opinion to be decided upon the merits of each particular case."

- 1.6 The comments in 1.4 and 1.5 above are relevant in regard to (1) the application of GAAP and (2) the accounting for issues not covered by GAAP. With GAAP largely being concerned with the minimum requirements of GAAP (see 6.2.3.below), there is little guidance outside of the above comments on issues not covered by GAAP, which, for example, includes disclosures in excess of those required by GAAP and the accounting for investments before AC 133 was issued.

- 1.7 The above comments mean that directors have some discretion that they can use in preparing financial statements. Accordingly compliance with section 286(3) of the Companies Act is achieved if it can be shown that the practices adopted by the Group would "in general be regarded by accountants as permissible." Accordingly those responsible for the preparation of the financial statements, namely the directors, should only be judged on this requirement. This would be the case even if others were to contend there were better alternatives available. In addition, the above means that others should not be judging financial statements based on their specific expectations

without considering whether the financial statements are "within the range of permissible alternatives."

- 1.8 The submission states, "*Financial statements should not be described as complying with Statements of Generally Accepted Accounting Practice unless they comply with all the requirements of each applicable Statement and each applicable approved interpretation.*" (1.3.5.2, pg 76 and AC 101.12) The implications of this requirement on the discussion in 1.3 to 1.7 above needs to be considered. In order to comply with both the Companies Act and GAAP the discretion that the directors have is limited to those areas where GAAP is not prescriptive. Therefore as new GAAP is issued it is likely to either change existing acceptable practices or reduce the number of options considered to be acceptable, but if GAAP does not deal with specific issues then the discretion which directors have remains as long as it does not contradict other requirements of GAAP.
- 1.9 Some of the contentions made in the Submission are based on the extent of disclosures where the Submission contends that additional disclosures should have been provided, but where, as noted below, in my opinion, the disclosures provided are within the range of permissible alternatives. This opinion is based on my knowledge of the extent of disclosures provided at the time the financial statements were prepared by other companies, as a result of reading various financial statements on a periodic basis. It is/not common practice for companies to provide disclosures on individual investments, where they hold a number of investments, other than the disclosures required in terms of the Fourth Schedule to the Companies Act (see 2.2 below).

As noted in part 1 of the report, most of the contentions in the Submission relate to Cytech. In assessing the contentions made regarding Cytech the relative size of this investment should be considered. In paragraph 6.7 (pg 418) it is stated that it represented 85% of total investing income and 60% of profit before tax in the 2000 financial statements and therefore "*Tfie materiality and significance on Netainment or the Netainment group is obvious.*" The Submission however, does not state that investing income comprises 47,5% of an amount of income that was analysed in the notes; in addition it assumes that there were no expenses incurred in relation to Cytech. The Submission d. \ not quantify the impact of Cytech on the 2001 financial statements in the same way as noted in paragraph 6.7 (pg 418). but still contended that disclosures were not provided "*despite the Netainment-group 's' materiality*

*and/or significance to the Group.* "(6.8.8, pg 419). From the financial statements for the three years covered by the Submission Cytech represented 6,8%, 4,4% and 3,7% of the assets of Corpcapital for 2000, 2001 and 2002 respectively. Regarding the revaluation of Cytech it represented 31,5% of total income before interest and bad debts in the 2000 income statement and 10,2% in the 2001 income statement, whereas in the 2002 income statement the investment was equity accounted and the goodwill relating to this investment was both amortised and impaired. Cytech was accounted for on the same basis in the 2000 and 2001 financial statements and based on the above the significance of Cytech in the 2001 financial statements was much lower than it was in the 2000 financial statements, but the Submission does appear to acknowledge this.

1.11 Comments in the Submission can be interpreted as suggesting that it is preferable for investments to be shown at cost and not fair value (see 3.2 below). The reality of the trend in accounting standards in recent years is to focus more on assets and liabilities and less on the income statement and for more emphasis to be placed on the fair values as opposed to cost. This view has been expressed by certain standard setters saying that it is better to be approximately right than precisely wrong when comparing the merits of showing the fair value of assets and liabilities in balance sheets as opposed to stating them at cost Paragraph .06 of AC 101 states, *"The objective of general purpose financial statements is to provide information about the financial position, performance and cashflows of an enterprise that is useful to a wide range of users in making economic decisions. This information, along with other information in the notes to financial statements, assists users in predicting the enterprise's future cashflows and in particular the timing and certainty of the generation of cash and cash equivalents."* The standard setters argue that cost is not useful in predicting future cash flows. In addition, the financial statements should reflect the results of stewardship by the directors; meaning that increases in value should be reported as they arise. If profits were only reported when investments are realised then directors would be able to determine the extent and timing of profits by deciding whether and to what extent investments should be sold. As a result of the possibility of manipulating profits in this way, the standard setters have moved towards requiring investments to be recorded at fair values. As a result of this approach the income statement has largely become the difference between two balance sheets. This has meant that as a consequence the previous distinction between realised and unrealised profits has become less important. In the past only realised profits were included in the income statement, with now unrealised profits being more

commonly included in the income statement, without a split between realised and unrealised amounts always being required for investments. If investors want to know more about the extent of profits that have been realised, then the cash flow statement becomes useful in this regard as it highlights the cash realised from operating activities, whereas the income statement includes both realised and unrealised amounts from operating activities. Another example of a changed approach to accounting issues was the changes made to the Companies Act during 1999 and in particular section 90. In the past companies could only pay dividends out of profits, with some of the case law dealing with whether dividends could be paid out, of unrealised profits, whereas now they can make payments out of capital, regardless of whether there are any profits, as long as they are liquid and solvent after the payment is made. Therefore until 1999 case law was making a distinction between realised and unrealised profits for dividend purposes, whereas now even the distinction between profits and other equity has become less important.

- 1.12 In regard to the various contentions noted in Part 1, a summary of the conclusions I have reached in 6.5 and 7 below is as follows:
- 1.12.1 The disclosures required in terms of the Fourth Schedule to the Companies Act in relation to Cytech were adequate
  - 1.12.2 The accounting treatment and accounting policies used for Cytech were appropriate, except that Cytech should have been regarded as a joint venture and not an associate, but this difference would have had little effect on the financial statements
  - 1.12.3 Except for the issue noted in 1.12.2 above the disclosures provided in respect of Cytech were adequate
  - 1.12.4 The deficiencies noted in the Submission that did not relate specifically to Cytech are not considered valid contentions.
  - 1.12.5 As a result of the above issues, which were the bases of the contentions that fair presentation and compliance with GAAP were not achieved. I believe that the Group can state that their disclosures in the 2000, 2001 and 2002 financial statements in respect of the contentions comply with generally accepted accounting practice without any material deviation.

## **Information material to an appreciation of the Group's affairs**

2.1 In relation to the revaluation of Cytech it is contended (8.4.1.1, pg 155; 9.3, pg 167 and 10.4.1.1, pg 179) that certain information was not provided in the 2000 and 2001 directors' reports. This relates to *"The Directors' Report did not deal properly, or at all, with the revaluation of Cytech as required by para 66(2) which states that "Any matter not prescribed by this Schedule but -which is material for the appreciation of the state of affairs of the company and its subsidiaries, if any, shall be dealt with in the directors' report under appropriate headings " and Para 67 which provides that "67(n) [sic] The said report shall generally review the business and operations of the company during the accounting period and the results thereof and shall deal with every fact or circumstance material to the appreciation of the state of affairs and financial position of the company by its members including a statement of the estimated proportion of net income or loss attributable to the various classes of business of the company" and para. 72 which requires that*

2.2 *C GENERAL REVIEW OF GROUP (para. 72)*

*"72 The said report shall-*

*(a) generally review the business and operations of the group during the accounting period and the results thereof and shall deal with every fact or circumstance material to the appreciation of the state of affairs and financial position of the group by the members of the holding company; "(8.4.1.1, pg 155)*

The following comments are made regarding this contention:

2.1.1. As noted in 2.43 and 2.45 below the fact that unlisted investments were shown at fair value and the extent of the income from realised and unrealised changes in the value of investments included in the income statement were both disclosed in the financial statements.

2.1.2. The requirements of the Fourth Schedule to the Companies Act are fairly general and therefore what would be satisfactory to one reader of the financial statements might not be similarly considered by another. From my reading of financial statements it appears that the above requirements are generally interpreted as applying to transactions outside the normal trading activities of a group, which can have an abnormal impact on the income statement, and not to the normal trading activities of a group. For example, if

a contractor makes profits on some contracts but losses on others, there is no requirement that this be disclosed. Accordingly it is difficult to argue that the contention that the Group did not comply with the requirement of the Fourth Schedule would be upheld by a wide body of shareholders particularly as (1) the Group has provided information at a primary (income statement) and secondary level (notes to the income statement) and (2) the level of information provided is similar to that provided by many other companies (e.g. AMB Holdings Ltd, Brait SA Group Ltd, Firstrand Banking Group Ltd, Genbel Securities Ltd, Investec Group Ltd, PSG Group Ltd and Sasfin Holdings Ltd). As noted in 1.7 above, if the extent of disclosures is within permissible alternatives, then the requirements of the Companies Act are regarded as being complied with. This issue is considered further in 6.2 below where I conclude that there is not enough evidence to justify that the disclosures provided were insufficient.

### **The name of investments and percentage holdings**

2.2 The Submission contends (8.4.1.2, pg 155 and 9.3, pg 167) that the 2000 annual financial statements for both Corpgro and Corpcapital did not provide the required disclosures in terms of paragraph 27 of the Fourth Schedule regarding details of investments. What the Submission did not state is that there is an exception from this requirement where there are more than five different listed or unlisted investments. Accordingly I believe that the companies were not required to provide the information stated in the contention seeing that there were more than these number of investments. However, where the Group could be criticised is that when this exemption applies the information may be included in a schedule or register and that the financial statements should state that the schedule or register is open for inspection in terms of section 113 of the Companies Act and no such statement is contained in the financial statements. Even this argument is open to debate as the auditors of the Group have stated they believed that this requirement applies to long-term investments and not investments held for sale, seeing that the Fourth Schedule has a similar requirement for fixed assets (paragraph 22(2) of the Fourth Schedule). Accordingly I believe the contention made in the Submission is not valid.

## Income from listed and unlisted investments

- 2.3 The Submission contends that the requirement in terms of paragraph 42 (a) of the Fourth Schedule to the Companies Act for income from investments to be split between listed and unlisted investments have not been complied with (8.1.1, pg 87; 9.1.1, pg 89; 8.4.1.3, pg 156; 9.3, pg 167; 10.4.1.2, pg 179). In this regard the following issues are relevant:
- 2.3.1 The examples of the types of income given in the paragraph are interest, dividends and other specified income. This implies that the emphasis is on income received from the investment as opposed to profits and losses on the sale of investments.
- 2.3.2 This argument is also supported by the requirement in paragraph 42(n) of the Fourth Schedule to disclose *"the aggregate amount of profits and losses on the realisation, scrapping or other disposal of non-trading, fixed and other non-current assets."* This paragraph is more specific regarding the requirement to show profits and losses on the sale of investments and while requiring the profits and losses on the sale of investments to be disclosed, does not require the profits and losses to be split between listed and unlisted investments.
- 2.3.3 It could be argued that paragraph 42(n) does not relate to unrealised profits and losses, but it needs to be appreciated that the words in paragraph 42(a) and (n) are unchanged from their initial issue in 1973, except for the inclusion of the examples of the types of income, which were added in with effect for financial statements with an issue date after 31 March 1993, and that until in recent years it was not common for the unrealised increase in the value of shares to be included in the income statement. Accordingly I believe that the Fourth Schedule was not drafted to require the disclosure of unrealised profits and losses on investments.
- 2.3.4 Another argument that could be made is that in terms of AC 000 the definition of income includes gains. Again this definition was introduced after the Fourth Schedule was issued, so the intended meaning of income as

contained in paragraph 42(a) should be derived from the examples as noted above.

2.3.5 I accordingly believe that the two paragraphs in the Fourth Schedule would not be expected to be contradictory or repetitious and that the Group has complied with the more directly applicable requirement.

2.3.6 Therefore I agree with the Group's auditors who believe the Group were not in contravention of the Fourth Schedule.

### **Abnormal items of income**

The Submission contends (8.4.1.3, pg 156; 9.3, pg 167 and 10.4.1.2, pg 179) that the requirements of paragraph 42(s) of the Fourth Schedule have not been complied with in respect of the 2000 and 2001 financial statements. This paragraph relates to the disclosure of abnormal items and the contention is that *"The fact that a bulk of the "investing income " comes from an upward revaluation by management of an unlisted investment is particularly relevant to an understanding of the afs. It was also, in my opinion, "abnormal in amount" and so fell to be separately disclosed "* (8.4.1.3, pg 156). The following comments are made regarding these contentions:

- 2.4.1. The income statements in these financial statements are prepared on the "additive" basis, meaning all major categories of income and expense are disclosed on the face of the income statement, supplemented by notes to the income statement.
- 2.4.2. Accordingly major variances from the previous year would be evident from the income statement and related notes.
- 2.4.3. From the accounting policies it is clear that investments are shown at fair value and that changes in fair value are included in the income statement.
- 2.4.4. From the notes to the financial statements it is clear that investments include both listed and unlisted investments because the carrying value for these categories are disclosed.

- 2.4.5. From reading the income statement it would be evident that the change in the fair value of investments would be included in "Investing, trading and fee income" because no other category would be appropriate" in addition from the note to this item it becomes even more evident as it shows "investing income" which is the single biggest item of income. In the 2001 financial statements the note goes even further and splits investing income between realised and unrealised amounts. In paragraph 6.7 (pg 418) it was accepted that the revaluation was included in investing income.
- 2.4.6. AC 133, which was initially issued in December 1999, was the first local accounting statement that required companies (other than long-term insurers) to include investments on the balance sheet at fair value. This statement does not make a distinction between listed and unlisted investments and accordingly as it was giving the direction of accounting standards, could have been taken into consideration after its issue regarding the extent of disclosures as long as it did not contradict existing requirements.
- 2.4.7. The above comments indicate that changes in the value of investments were disclosed and that there was no requirement for the amount relating to unlisted companies to be shown separately and therefore the contention in the Submission is not accepted. In addition, the contention regarding abnormal items is also not accepted seeing that the extent of investing income was disclosed.

### **Investment in Cytech to be equity accounted or shown at cost**

- 3.1 A fair proportion of the Submission deals with the detail of the contention that the accounting for Cytech was inappropriate (8.5, pg 156-164; 9.4. pg 367-168; 10.5. pg 180-185 and 11.15-11.30, pg 195-213).

The contention is that for 2000 and 2001 *"In my opinion, Cytech should have been classified as an "associate" in terms of AC 110 and it should have been accounted for and disclosed in terms of AC J 10" (8.5.\, pg 156) and "To the extent to which Corpcapital held the investment "exclusively with a view to its disposal in the near future " AC 110 required it to be carried at cost rather than at fair value "(8.5.1.5.1,*

pg 157). Paragraph 9.4.1 of the Submission (pg 167) states these comments also relate to the 2000 financial statements of both Corpcapital and Corpgro, whereas paragraph 10.5.1 (pg 180) states these comments also relate to the 2001 financial statements. The following comments relate to these contentions:

- 3.1.1. The contention that Cytech is an associate is based on the argument that the holding was more than 20% (8.5.1.2, pg 156) and that Corpcapital had significant influence over Cytech (8.5.1.3, pg 157). The contention is made without considering whether the investment might have been a joint venture instead.
- 3.1.2. Had this possibility been investigated it would have been found that there is an agreement between Corpcapital and the other major shareholders of Cytech in which the parties agree to jointly control Cytech. AC 119.04 states *"The existence of a contractual arrangement distinguishes interests that involve joint control from investments in associates in which the investor has significant influence."* Corpcapital and these other major shareholders each hold 47,5% of the shares of Cytech, with the remaining 5% of the shares being held by a party who does not have any voting rights.
- 3.1.3. The agreement states that the establishment and management of appropriate corporate structures is subject to Corpcapital's approval. It also requires certain decisions to be approved by both Corpcapital and one of the vendors, including decisions normally requiring the approval of a company in general meeting, unbudgeted capital expenditure, the conclusion of material supply agreements, changes in professional advisors and management fees payable to shareholders. These are conditions that indicate that *"those decisions in areas essential to the goals of the joint venture [that] require the consent of all venturers and those decisions that may require the consent of a specified majority of the venturers"* (AC 119.06) and accordingly meets the requirements for a joint venture.
- 3.1.4. In terms of AC 119.36, as noted in 4.1.2-4 below, a joint venture that is acquired and held exclusively with a view to its subsequent disposal in the near future should be accounted for in accordance with AC 133 (even though AC 133 which had been issued in December 1999 had not become effective).

- 3.1.5. Even if the investment could have been regarded as an associate, the contention in regard to the 2001 financial statements is not correct because in April 2001 the wording of AC110.07 was changed to eliminate reference to the cost method. Instead investments that were not to be equity accounted, were to be accounted for in terms of AC 133 on a similar basis to joint ventures. This change was introduced by AC 102 which was effective for periods commencing on or after 1 January 1999 and therefore retrospectively also allowing fair values to be used in the 2000 financial statements, seeing that the change was not included in the changes effective for periods commencing for periods beginning on or after 1 January 2001. This change to AC 110 follows the same change made to the international equivalent of AC 110, namely IAS 28, in October 2000. The change to IAS 28 became effective when the international equivalent of AC 133, namely IAS 39 became effective. However when AC 110 was changed it was not linked at that stage to AC 133, although the change was later also included in the appendix to AC 133 when its effective date was later delayed by eighteen months. Therefore, while there might be uncertainty about the effective date of the change to AC 110, based on the above it could have been applied in the 2001 financial statements, with a case that could be made for it being applied in the 2000 financial statements. The change to IAS 28 was made before the 2000 financial statements were approved on 17 November 2000 and so at that date a consequential change to AC 110 would have been expected, seeing that it was known that accounting standards in South Africa were being harmonised with international standards, although the effective, date of the change to AC 110 could not have been anticipated then.
- 3.1.6. Accordingly I believe the Group should have shown the investment in Cytech in accordance with AC 133 and that cost or use of the equity method in accordance with AC 110 was not required. In addition, in terms of 3.1.2-.3 above, Cytech should have been disclosed as a joint venture and not as an associate. The implication of this opinion is noted in 4.1.6 below.
- 3.1.7 For an associate to be accounted for as an investment in terms of AC 133 there is a requirement that *"the investment 'is acquired and held exclusively with a view to its subsequent disposal in the near future (AC- 110.07)* The term "near future" is also used in AC 132 and AC 119 for subsidiaries and joint ventures respectively that should be accounted for as investments.

- 3.1.8. The Submission has not questioned the meaning of this term nor its application in the case of Cytech, but could have done so.
- 3.1.9. The question is how long is the "near future." The expected time period to be used in relation to this term is not dealt with in AC 110, AC 119 or AC 132.
- 3.1.10. There is currently a proposal to change this term in these statements to "within twelve months from acquisition." The basis of conclusion for the proposed changes to the statements does not provide any comment as to (1) why the change is proposed, (2) whether the standard setters were of the view that this phrase was being interpreted too liberally or not, or (3) whether the change was regarded as increasing or decreasing the period normally associated with the near future. These proposed changes follow those proposed in the international equivalents of AC 110, AC 119 and AC 132.
- 3.1.11. However, from comments I have heard from others involved in the standard setting process in this country it seems that there is consensus that the proposed change is regarded as reducing the maximum period normally associated with the near future. This implies that the near future has until now not just been interpreted as being a period of twelve months or less, but could be a longer period.
- 3.1.12. In terms of US Generally Accepted Accounting Practice ("US GAAP") companies were not required to be consolidated if control was likely to be temporary. I argue that this requirement is similar to that contained in AC 110.07. This wording was contained in US GAAP from 1959 until 2001. Even though in the US guidance and interpretations are often given on various aspects of US GAAP, far more than given in other countries, there was no official guidance or interpretation issued which interprets how long temporary would be considered to be.
- 3.1.13. Some books which deal with International Accounting Standards, while mentioning the term "near future", do not have any discussion on the meaning of this term. This includes books produced by Deloitte & Touche and by the former Secretary-General of the International Accounting Standards Committee (the predecessor to the International Accounting Standards Board, who presently publish International Financial Reporting Standards which are replacing existing International Accounting Standards

and on which SA GAAP is based). The Deloitte & Touche book does however state that the UK requirements are more prescriptive than the requirements in terms of International Accounting Standards.

- 3.1.14. Books produced by Everingham and Watson on SA GAAP and those produced by Coopers & Lybrand and Ernst & Young that deal with International Accounting Standards all state that no clarity is provided on what time period is envisaged, but believe the UK guidance is reasonable and may be useful. It needs to be appreciated however that the views expressed in some of these books are likely be influenced by the fact that some of the authors appear to be based in the UK.
- 3.1.15. The UK guidance refers to "an interest held exclusively with a view to its subsequent resale", with one of the examples provided in the Ernst & Young book having an extract from the Barclays PLC financial statements that deals with a company acquired in 1992 which was not consolidated for this reason and which was sold in two parts during 1997, with the second part due for completion in February 1998. This means that a subsidiary was not consolidated for a five-year period while it was being held exclusively with a view to its subsequent resale.
- 3.1.16. The UK guidance expands on the meaning of "an interest held exclusively with a view to its subsequent resale" by stating that it means "an interest for which a purchaser is being sought and which is expected to be disposed of within one year of its acquisition; or an interest that was acquired as a result of the enforcement of a security, unless the interest has become part of the continuing activities of the group or the holder acts as if it intends the interest to become so." The issue as a result of this is whether a company can follow the general principle outlined in the UK guidance (together with the related example) or whether it should go further and also follow the more detailed guidance.
- 3.1.17. In terms of AC 101.23 management is to use its judgment in developing accounting standards for areas that are not specifically dealt with in GAAP. For this purpose they should consider, inter alia, the requirements in other GAAP statements or International Accounting Standards dealing with similar and related issues (which have no guidance as noted above) and pronouncements of other standard setting bodies and accepted industry

practice. In this regard while there is UK guidance, it seems based on the comment in 3.1.11 above that in this country that this guidance has been widely interpreted (i.e. not taking the detailed guidance noted in 3.1.16 above into account) by some, meaning that this is regarded by those as an accepted industry practice, making it a generally accepted accounting practice. Accordingly the UK guidance is useful but not necessarily prescriptive.

3.1.18. This means, based on the above, that "near future" cannot just be regarded as being twelve months or less, with it being debatable as to how much longer it could represent. Accordingly if shares are not likely to be sold within twelve months, it does not necessarily prevent such investments being considered as being held for disposal in the near future.

3.1.19. It is interesting to note in the UK that investment trusts or venture capitalists are not required to equity account associates. Instead they are held as part of an investment portfolio, with their value to investors being reflected through their balance sheet value. This method of determining the carrying amount in the balance sheet value is not dependent on the extent or the nature of the investment (e.g. investment or associate) because the size of the holding is often not important to the investor and can change as a result of corporate activity (e.g. an associate could become an investment if the company issues shares to acquire another company). These investors are more concerned with the value of their investment than their percentage ownership of another company. In addition, the focus of these investors is to buy shares in order to develop the company so that it can be sold for at an increased value, rather than on the nature of the investment and the extent of influence over the company. While this approach is not currently provided for in SA GAAP, it is included in the current proposed changes to GAAP. Accordingly this proposed change means that the change referred in 3.1.10 above regarding selling within twelve months of acquisition would not be expected to apply to private equity investments. This again supports the contention that private equity type of investments, which in essence is what Cytech was, were not necessarily expected to be sold within twelve months of acquisition. In addition, the focus of reporting is expected to be on the portfolio, rather than on any individual investment, which is what the Group followed.

At present it seems that the standard setter will require all associates to be shown at fair value in the future, although this has not yet been included in any proposed changes to accounting standards.

3.1.20. Regarding the intention to sell Cytech I have been provided with the following information:

3.1.20.1. In May 2000 a sponsoring broker pitched to list Cytech on the Alternate Investment Market ("AIM") market in London

3.1.20.2. Discussions regarding this listing were put on hold as a result of discussions to merge Cytech with another online casino business. One example was a heads of agreement signed in August 2000. The intention was to list the merged group. Merger agreements were signed in October 2000, with due diligence completed in November 2000, but the merger failed in March 2001 when one of the parties required to consent to the merger, namely the software supplier, withheld their consent.

3.1.20.3. In March 2001 merger discussions were held with another internet gambling company but were terminated as a result of the other shareholders in Cjtech not wanting to merge with a company that was less profitable than Cytech and thereby believing they were giving away too much of the potential upside value in Cytech.

3.1.21. Based on this information there is evidence that the group were actively looking to realise their investment in Cytech at the August 2000 year-end. At August 2001 there would have been evidence of two merger attempts during the year, which would have been grounds to support a contention that the group were still looking to sell Cytech, unless there was any evidence to the contrary. The fact that the mergers were not successful was not because of an unwillingness to sell Cytech. Accordingly there appears to be grounds that the Cytech investment could be regarded as being held for disposal in the near future in both the 2000 and 2001 financial statements. This is also supported by the information that the executive chairman of Corpcapital at that time was regularly exhorting the directors to sell the various investments.

3.1.22. Regarding the disclosure in the 2000 and 2001 financial statements, an associate is defined in the accounting policies as "an entity in which the

group has a long-term interest". It is interesting to note that the accounting policy for subsidiaries states that "investments where control is of a temporary nature " are not consolidated, because the phrase "near future" is used in accounting standards in relation to both associates and subsidiaries. This together with the accounting policy for associates implies that "temporary" associates were not equity accounted.

3.1.23. In the 2000 financial statements it states in regard to Netainment that there was a "further development of successful early stage venture capital investment into a leading international online gaming and leisure group" whereas in the 2001 financial statements it states that "The division follows a strategy of maximising the value of strategic investments through active management. The division values each investment to fair market value which process has been validated by consistently realising more than the carrying value of the investment."

3.1.24. In hindsight it could be said that the disclosures in the financial statements should have been more specific concerning the intention of the group to sell certain investments within a specified period, but the financial statements at least indicate that the group may have temporary investments and that it has realised certain investments. Accordingly the disclosures provided would fall within acceptable limits, seeing that there is no requirement for the company's interpretation of the meaning of "near future" to be disclosed.

### **Inappropriate to value an unlisted investment at a market value**

3.2 The Submission contents that it was inappropriate for Cytech to be marked to a market basis of valuation (4.3.7, pg 14). As noted in the covering letter this report does not cover whether the value placed on the Cytech investment was appropriate or not. However the following comments are made regarding the valuation:

3.2.1. As noted in paragraph 10.5.1.5 (pg 181) AC 133 has a presumption that fair value can be reliably measured for most financial assets classified as available for sale or held for trading, but also states that the presumption can be overcome in certain circumstances, particularly unquoted equity

*instruments. Paragraph 10.5.1.7 (pg 181) then quotes AC 133.96-.98,.100-.103 with little comment on their application to Corpcapital. Some of the wording in these paragraphs is relevant. These include the following:*

3.2.1.1 "Situations in which fair value is reliably measurable include..(c) a financial instrument for which there is an appropriate valuation model and for which the data inputs to that model can be measured reliably because the data come from active markets. " (AC 133.97)

3.2.1.2 "The fair value of a financial asset or financial liability may be determined by one of several generally accepted methods. Valuation techniques should incorporate the assumptions that market participants would use in their estimate of fair values..." (AC 133.98)

3.2.1.3 "If a market for a financial instrument is not an active market, published price quotations may have to be adjusted to arrive at a reliable measure of fair value... Techniques that are well established in financial markets include reference to the current market value of another instrument that is substantially the same, discounted cashflow analysis, and option pricing models. "(AC 133.101)

3.2.1.4 "If a market does not exist for a financial instrument but a market exists for a similar, financial instrument, fair value is constructed on the basis of the market value of the similar financial instrument. "(AC 133.102)

3.2.1.5. "It is normally possible to estimate the fair value of a financial asset that an enterprise has acquired from an outside party. "(AC 133.103)

3.2.2 *These quotes indicate that even though the share was unlisted it did not preclude a reliable fair value being placed on the investment in Cytech. AC 133 starts from the presumption that a reliable fair value can be placed on shares, whether listed or not. It does not have a presumption that a reliable fair value cannot be determined for a unlisted share, which seems to be the contention in the Submission which states "Fifthly, the marked to market basis of valuation assumes a ready market for the investment, It is*

*appropriate for listed investments for which there is a ready market, but not for unlisted minority shareholdings such as that of Old CorpCapital in Cytech. "(4.3.7, pg 14)*

- 3.2.3 This contention is not supported by the above quotes from AC 133, because as the quotes from AC 133.101 and .102 show it is acceptable to place a value of shares that are unlisted. As noted in 3.2.1 above the Submission accepts AC 133 has a presumption that fair value can be reliably measured, meaning that if fair value cannot be measured reliably it is the exception.
- 3.2.4 The issue of reliability of measurement is dealt with in the Framework for the Preparation and Presentation of Financial Statements. Paragraph 86 of AC 000 states *"In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability."* Similar wording is used in AC 103.22: *"The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. "*
- 3.2.5 In paragraph 11.25.8 (pg 449) it is contended that *"It seems that the valuation was simply based on the 47,5% of the profits or cashflow to by [sic] received by Cytech Ltd from the Netainment business as a whole. If that is so, the valuation is fundamentally flawed. The future cashflow to the Group and/or Corp-Invest could only come by way of dividends."* This contention is at variance with the definition of value in use quoted earlier in the Submission (11.25.5, pg 448), which also includes cash flows from disposal of the asset. In cases where shares are held for disposal most of the value of use would be expected to consist of disposal proceeds. This comment is reinforced by AC 110.23 which states *"In determining the value in use of the investment, an enterprise estimates:*
- (a) its share of the present value of the estimated future cash flows expected to be generated by the investee as a whole, including the cashflows from the operations of the investee and the proceeds on the ultimate disposal of the investment, or*
  - (b) the present value of the estimated future cashflows expected to arise from dividends to be received from the investment and from its ultimate disposal.*

*Under appropriate assumptions, both methods give the same result.* " Accordingly the Submission is not correct in implying that the valuation of Cytech could only be based on future dividends. In addition the valuation basis as noted in AC 110.23(a) is in line with the basis used as quoted above, meaning that the comment that the valuation is fundamentally flawed is also not correct.

- 3.2.6. In paragraph 4.3.6 (pg 14) it is contended that no minority discount was applied in determining the valuation. This contention is not supported by AC 428.10 which states *"Equity instruments have only one fair value in a market. .. Therefore, estimates of premiums for large, and discounts for small, blocks of equity instruments issued in comparison to that exchanged in observable transactions are not considered."* This supports the argument that it was not necessary for a minority discount to be applied in determining the valuation.
- 3.2.7. Accordingly I do not believe that it is inappropriate to value an unlisted investment at market value.

### **Inappropriate accounting policies and change in comparative figures**

- 3.3 The contention in relation to the 2002 financial statements (11.15-11.30, pg 195-213) revolves around the changed accounting for Cytech and that it should have been revolves around the equity accounting for associated companies that previously were accounted for as investments. As noted in 3.1.3 above I am of the opinion that the investment should be regarded as a joint venture, but for the purpose of the discussion on this particular issue it will be assumed that the investment is an associate seeing that the same issues apply whether the investment is an associate or a joint venture. The following comments are relevant in this regard:

- 3.3.1 The accounting policies for 2001 state that "an associate is an entity in which the group has a long-term interest and over which it has the ability to exercise significant influence but not control." The same wording is used in the 2002 accounting policies. These accounting policies are in line with the

requirements of AC 110, which states that investments acquired and held exclusively with a view to its subsequent disposal in the near future should not be equity accounted. While the investments acquired and held for disposal are in terms of AC 110.09 still termed associate companies, they are not required in terms of AC 101.67 to be grouped together with other associate companies in the balance sheet in that only *"investments accounted for using the equity method"* are required to be shown separately on the face of the balance sheet.

3.3.2. The issue is whether an associate that is required to be accounted for on the equity method, whereas previously it did not meet the requirements to be accounted for on the equity method, is a change in accounting policy.

3.3.3. In this case it appears there was a change in intention regarding certain investments during the year, in that investments acquired with the intention of being held exclusively for sale were no longer held for disposal in the near future. AC 110 does not deal with situations where associates previously not equity accounted are required to be equity accounted, which can arise on a change in intention in holding an investment or when severe long-term restrictions that significantly impair its ability to transfer funds to the investor are removed. A change of intention does not appear to have been accepted in the Submission (11.26.2, pg 210).

3.3.4. My understanding is that old Corpcapital's strategy was to realise its investments in the short term, while Corpgro's approach was to manage and develop its investments over time and that after the merger of the two companies, the Corpgro management philosophy prevailed. This resulted in the classification of certain investments being reviewed in the 2002 financial year as they were no longer regarded as being held exclusively for their disposal in the near future. Cytech was such an investment. Where, however, the financial statements can be criticised is that more explanation could have been provided regarding this change of intention. While the change was disclosed in the financial statements, it focuses on adopting consistent principles of classification and accounting treatment of investments, instead of the change in intention. However, the result of the change in intention is reflected in the financial statements.

- 3.3.5. In this situation, as noted in 3.3.1. above, the stated accounting policy has not been changed and has been applied consistently to both years, but different results have arisen because of changed intentions. The changed intentions are themselves not a change in accounting policy. When a change in accounting policy occurs it is normal for the comparative figures to be restated on the basis that the new principle would have been appropriate to use previously, whereas in this case it was not appropriate for equity accounting to be used in the previous year for these investments.
- 3.3.6. This can be likened to other situations. If for example, investments can be valued either at cost or at valuation, it is appropriate to restate the comparative figures if the accounting policy for investments is changed from cost to valuation. This can be contrasted with valuing inventories at the lower of cost and net realisable value. If in one year cost is less than net realisable value whereas in the next year net realisable value is less than cost, this does not mean there is a change in accounting policy and that the previous year's carrying value is restated from cost to net realisable value. This second situation is similar to that of equity accounting where a change in circumstances does not require the comparative figures to be restated.
- 3.3.7. Another example relates to financial instruments. In terms of AC 133 the classification of certain financial instruments can be changed without the change being regarded as a change in accounting policy requiring the comparative figures to be restated (see AC 133.91) and (93) which deal with a change of intention for held-to-maturity investments). These examples do not seem to have been considered in the Submission.
- 3.3.8. In the Submission it is contended (11.21.1.2, pg 206) that a change in classification is unwarranted because a change in the basis of determining the carrying amount of investments was a change in accounting policies. This contention then seems to argue against itself in that it argues that the requirement for a change in accounting policy had not been met. The argument for a change in accounting policy is not agreed with because as noted above the examples of changes in classification above do not seem to have been considered in the Submission.
- 3.3.9. If there was a change in comparatives it means that the Group could have elected to apply the new policy in the previous year (assuming no change in

accounting standards). However, if the investment was acquired and held exclusively for resale in the previous year, the option of equity accounting the investment was not an option that could have been used in that year; accordingly it is not appropriate to make the change a year later on a retrospective basis.

- 3.3.10. Paragraph 11.21.1.1 (pg 205) argues that there could alternatively have been a fundamental error based on the failure to address accounting policies at the time of the merger. This is based on the assumption that all investments should be accounted for in the same way, whereas as noted in 3.3.1 above it is possible in terms of accounting standards for some associates to be equity accounted and others to be shown at fair value. This being the case the assumption made is not necessarily correct and therefore the contention that there was a fundamental error is not accepted.
- 3.3.11. In paragraphs 11.22-23 (pg 209-210) it is contended that in terms of AC 101.41 that even if there was no change in accounting policy that the comparative figures should have been changed. I believe, however, that this requirement applies to items whose classification is the same for both years and where the presentation in the financial statements has changed. For example, in the 2001 financial statements "Assets of proprietary consolidated investments" is shown as one figure in the financial statements, whereas in the 2002 financial statements "Proprietary consolidated investments" is shown as a total with its five component parts not just for 2002 but also for the comparative figures. My opinion is also based on the premise that it would not be correct to show the investment in Cytech in the 2001 financial statements as an associate because that implies it was an equity accounted associate, which it was not if it was acquired and being held exclusively for disposal in the near future.
- 3.3.12. It is further contended that in the 2002 financial statements that the/cost to be disclosed in respect of Cytech was its original cost rather than its closing value at 31 August 2001 (11.26.3, pg 211). As noted in 3.3.3 above AC 110 does not provide guidance on how to account for an associate accounted for as a financial instrument which later is required to be equity accounted. As noted in the Submission (11.26.2, pr 210) there are other examples to support the treatment adopted by Corpcapital, but these were not accepted because it was contended that there was no change in intention. As noted in 3.3.4-7

above I am of the opinion that there was a change in intention and therefore I believe that the examples are relevant. Another example that supports the approach adopted by the Group is contained in paragraph .10 of AC 110, which states that when the equity method is discontinued, because, for example, an associate becomes an investment, *"the carrying amounts of the investment at that date should be regarded as cost thereafter."* In this case when the investment was equity accounted the carrying amount when equity accounting commenced was regarded as cost thereafter. Accordingly there is not sufficient evidence to justify the treatment adopted as being contrary to GAAP.

3.3.13. Accordingly I do not believe that the change in treatment of certain investments should be regarded as a change in accounting policy or fundamental error. This means there was no requirement for the comparative figures to be restated.

3.3.14. Regarding the contention that comparative amounts and percentages should have been provided for Cytech (11.15, pg 196), as a consequence of the comparatives not needing to be restated, as noted in 3.3.13 above, I believe it is appropriate that the comparative figures comprise amounts in relation to the composition of what was classified as associates in the previous year's balance sheet. In terms of AC 101.67(d) it is not all associates that are - required to be shown separately on the face on the balance sheet, but those investments accounted for using the equity method (and so includes equity accounted joint ventures). Therefore the contention is not accepted. The disclosure of the previous carrying amount for each of the investments affected which was included in the financial statements is considered useful additional information to assist in understanding the change of classification.

3.3.15. With no change to comparative figures being required the provision of pro-forma information, which is not required, is considered useful additional information.

3.3.16. In the Submission it states that the change of accounting had a distorting effect in that the previous increases in value were included in "above the line" profits in 2000 and 2001 but the 2002 decrease in value was included in "below the line" profits (12.4.2.3, pg 456). While this is correct accounting, when the change of intention occurred in the interim results at February 2002

Cytech was valued and at that time no impairment of the investment was necessary. Any such impairment would have been included in "below the line" expenses. It was only later at the August 2002 year-end that a "below the line" impairment charge was recorded. There is an inference that the change in intention was made at the year-end in order to avoid recording losses in the income statement, when in fact the change was reported in the interim results before any reduction in value was recognised.

3.3.17. The Submission also contends that there was a double counting of profits (12.4.2.2, page 456) as a result of cash flow/profits into perpetuity being included in the value of Cytech and that this distorts the results (12.4, pg 455). The nature of valuations is such that they can include discounted cash flows (see 3.2.1.13 above), which is considered to be acceptable accounting in terms of AC 133. If the contention in the Submission was correct it would mean that profits would be distorted if a company received a dividend from an investment seeing that the market value of the shares could be based on future dividends. This "distortion" does not mean that the dividend should not be recorded when it is received. Instead the dividend is recorded and if the value of the investment drops after the dividend is received, then that drop in value is also recorded. The same applies in the case of Cytech; the equity accounted earnings are accounted for and if the value of Cytech drops because, say, the level of profits are lower than previously expected, then the drop of value is recorded as an impairment.

#### **Uniform accounting policies not used**

3.4 The other contention in relation to the 2000 and 2001 financial statements of the Group is that it did not prepare financial statements in terms of uniform accounting policies as required for consolidations (9.4.2, pg 167; 10.5.1.8, pg 185; 9.4, pg 435). The contention concedes this practice was generally accepted in South Africa at the time and when describing the contention that the financial statements were not prepared in terms of GAAP (9.4.3, pg 168) it excludes this issue. Nevertheless the following comment is made regarding the contention:

3.4.1. The contention is based on the argument that investments over which Corpcapital and Corpcapital Bank had significant influence were regarded by one company as an associate but not by the other (9.4.2, pg 167). This contention is disputed in that if certain investments were acquired exclusively with a view to its disposal in the near future and others weren't, then different accounting treatments would be required for the different investments in terms of AC 110.07, even though they have significant influence over all the investments.

3.4.2. Accordingly I do not believe there are grounds for the contention.

### **Disclosures in respect of accounting standards for associates**

4.1 In the Submission it is contended that certain disclosures in relation to associates were not provided (8.1.2, pg 87; 9.1.2, pg 89; 8.5.1.5.3 pg 158; 9.4.1, pg 167; 10.5.1, pg 180). The disclosures required in terms of AC 110.27 for associates are not contained in the international equivalent of AC 110 (namely IAS 28). While on the face of it the disclosures should be required for all associates, even those not required to be accounted for on the equity method, I believe that a case can be made that this contention is open to debate based on the following:

4.1.1. A company with an interest in a joint venture that is not required to be proportionately consolidated or equity accounted is not required to provide summarized financial statement information in respect of that joint venture, so it would be logical to say this information is also not required for associates that are not required to be equity accounted. As joint ventures accounted for in terms of AC 133 would be subject to the disclosures required in terms of that statement, so should associates accounted for in terms of AC 133.

4.1.2. As noted in 3.1.3 above I believe that Cytech should have been accounted for as a joint venture and not an associate. Paragraph .36 of AC of AC 119 states "*A venturer should account for the following investments either at cost or in accordance with the statement on financial instruments: recognition and measurement: [AC 133]*"

(a) *An interest in a jointly controlled entity that is acquired and held exclusively with a view to its subsequent disposal in the near future. "*

4.1.3. AC 119 has an effective date of periods starting on or after 1 March 1997. This means that companies were allowed to apply the requirements of AC 133 to the above interest even before AC 133, which had been issued before the 2000 financial statements were completed, became effective. Therefore it was acceptable to value Cytech in accordance with the requirements of AC 133 even without the change dealt with in 4.1.4 below.

4.1.4. This paragraph was later changed to *"A venturer should account for the following interests in accordance with..."* meaning that the option of cost was deleted. This change was made in April 2001. This change was introduced by AC102 which was effective for periods commencing on or after 1 January 1999 and therefore retrospectively changing AC 119, seeing that the change was not included in the changes effective for periods commencing for periods beginning on or after 1 January 2001. This change to AC 119 follows the same change made to the international equivalent of AC 119, namely LAS 31, in October 2000. The change to LAS 31 became effective when the international equivalent of AC 133, namely IAS 39 became effective. However when AC 119 was changed it was not linked at that stage to AC 133, although the change was later also included in the appendix to AC 133 when its effective date was later delayed by eighteen months. The change to IAS 31 was made before the 2000 financial statements were approved on 17 November 2000 and so at that date a consequential change to AC 119 would have been expected, seeing that it was known that accounting standards in South Africa were being harmonised with international standards, although the effective date of the change to AC 119 could not have been anticipated then.

4.1.5 Paragraph .47 of AC 119 states *"A venturer should disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. A venturer that reports its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation or the equity method should disclose the aggregate amounts of each of current assets, non-current assets, current liabilities, long-term liabilities, income, expenses and cash flows from operating, investing and financing activities related to its interests in joint ventures. Both current and long-term liabilities should be distinguished between interest bearing and non-*

*interest bearing debt.*" The question that can be asked is whether the above disclosures are required for joint ventures accounted at fair value. In terms of the above the disclosures in relation to the income statement, balance sheet and cash flows are only required for joint ventures which are proportionately consolidated or are equity accounted. This means that these disclosures are not required for joint ventures accounted for in terms of AC 133, instead any required disclosures would be in terms of AC 133.

4.1.6. An alternate contention that could have been made is that the required disclosures for joint ventures were not made. However, as noted in 4.1.5 above, most of these disclosures are not required for joint ventures acquired with the intention of being disposed of in the near future. An argument could be made that an accounting policy for joint ventures was not provided and that Cytech was termed an associate and not a joint venture, but a counter to this is that a joint venture can be equity accounted and the requirements for associates and joint ventures are similar. In this case the effect of showing Cytech as a joint venture as opposed to an associate would not be significant as there would be no impact on the income statement and balance sheet, with the disclosures required to be shown in the notes being similar, but it would be expected that the relevant amounts should have been split between associates and joint ventures in the 2002 financial statements. The 2002 financial statements should also have included an accounting policy for joint ventures. There was less of a need for an accounting policy note being included in the 2000 and 2001 financial statements seeing that there were no joint ventures that were equity accounted or proportionately consolidated, but the accounting policy on investments could have included the fact that it included associates and joint ventures acquired and held exclusively for disposal in the near future.

4.1.7. Based on the above the contention that the required disclosures for associates were not provided is not accepted.

#### **Disclosures for financial instruments and of valuation assumptions**

4.2 It is also contended in the Submission that certain of the disclosures required by paragraphs .49, .70 and .81-of AC 125 were not provided (8.5.2.7.4, pg 62; 9.4.1, pg 167 and 10.5.1.7.1, pg 183). The following comments are provided in this regard:

- 4.2.1. The reference to AC 125.70 is not correct; from the wording quoted in paragraph 8.5.2.3 (pg 159) and comparison with the wording of AC 125 it is evident that the references should have been to AC 125.79 instead.
- 4.2.2. From paragraphs 8.5.2.2 (pg 159) and 8.5.2.7.4 (pg 162) it is evident that these contentions are based on the premise that Cytech should have been shown as a separate class of asset. This is based on the significance of the valuation of Cytech to an appreciation of the financial statements. This contention is countered by arguing that accounting standards require items of a similar nature be dealt with in a like manner, supported in some cases by a listing of significant assets. For example, while such a listing is required for associated companies (AC 110.27(a)), joint ventures (AC 119.47) and subsidiaries (AC 132.29(a)), it is not required in terms of AC 133 for investments. The contention suggests that two classes of associates should have been shown on the face of the balance sheet, whereas AC 101.67 states that as a minimum equity accounted investments would be one of the required line items on the face of the balance sheet. To contend that one asset should be shown separately in a class of its own when there are other similar assets is not a specific required consideration in terms of accounting standards.
- 4.2.3. Accordingly my view is that the contention does not represent a requirement of GAAP. This being the case it needs to be considered whether the required disclosures have been provided for the class of assets in which Cytech was included.
- 4.2.4. The accounting policies do give the basis used to value unlisted investments and state "Fair values of unlisted investments are based on discounted cash flow and/or discounted earnings valuation models" in both 2000 financial statements whereas the 2001 and 2002 financial statements state "Fair values for unquoted equity instruments are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer."

4.2.5. Again the issue revolves about whether the degree of information provided was adequate, where I am of the opinion that information to the extent suggested in the Submission is not commonly provided. The requirement in terms of AC 125.49(a) regarding "*conditions that may affect the amount, timing and certainty of cashflows*" is interpreted, in terms of AC 125.50, as relating to contractual terms only, whereas it is not clear from the Submission as to whether this was interpreted as requiring details of the information used to determine the valuation to be disclosed. Again, the requirement in terms of AC 125.81 for significant assumptions to be disclosed could be interpreted as applying to overall assumptions that relate to the various classes) of assets, if any, rather than specific assumptions for any individual asset. Therefore I believe it is unlikely that the contention would be a generally held view by preparers and users of financial statements and based on the comments noted in 1.3-.8 above this would be sufficient to justify the financial statements as being in compliance with GAAP.

#### **The currency effect on the change in value of investments**

4.3 The following comments are relevant regarding the contention that the effect of changes in exchange rates on the value of Cytech should have been disclosed (11.27.2-.4, pg 453-454):

4.3.1. AC 112 defines monetary items as "*money held, and assets and liabilities to be received or paid, in fixed or determinable amounts of money.*" Based on this the investment in Cytech would not be classified as a monetary item. This is supported by the IAS 39 (international equivalent of AC 133) Implementation Guidance when it deals with the interaction of IAS 39 and IAS 21 (the international equivalent of AC 112). This guidance states available-for-sale financial assets comprise both monetary and non-monetary items. This is interpreted as providing for share investments being non-monetary' assets while bonds would be monetary assets.

4.3.2. AC 112.12(c) states "*non-monetary items that are carried at fair value denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.*" AC 112 however does

not require the effect of the change in valuation for such items to be split between a change in the foreign valuation and a change in exchange rates and does not state where the effect of exchange rates on non-monetary items should be disclosed.

4.3.3. In terms of AC 112 the only foreign exchange differences required to be included in the income statement are those relating to monetary items (AC 112.16). Therefore I argue that the requirement in terms of AC 112.43(a) to disclose the amount of exchange differences included in the net profit or loss for the period are intended to apply to monetary items; otherwise I believe the statement would also have required the effect of exchange rates on amounts taken directly to equity, which would apply to some non-monetary assets, to be disclosed.

4.3.4. The IAS 39 Implementation Guidance referred to in 4.3.1 above states that the effect of a change in exchange rates is accounted for in the same way as the change in the value of the non-monetary item is accounted for. This means that if the change in value of the investment is included in income, then the effect due to change in exchange rates is also included in the income statement. Again there is no requirement for the foreign currency effect to be separately disclosed.

4.3.5. Therefore I do not accept the contention that the currency effect on the change in value of investments is required to be disclosed in terms of GAAP.

## **Goodwill amortisation period**

5.1 The issue is whether there has been a contravention of AC 129 in regard to the nondisclosure of the goodwill write off period (10.6.1, pg 185) in the 2001 financial statements. AC 129 excludes from its scope intangible assets covered by other GAAP statements. Therefore in terms of AC 129.03(e) goodwill is excluded from the scope of AC 129 and therefore this issue cannot be a contravention of AC 129. Accordingly the contention is not agreed with..

- 5.2 However, as an alternative, it could have been argued that in terms of paragraph .89 (a) of AC 131, which also applies to goodwill in associates, the amortisation period for goodwill should be disclosed. This paragraph requires the amortisation period adopted to be disclosed. While it could be argued that this should be a specified number of years, the counter is that it is just requiring whether the rebuttable presumption has been rebutted or not and if so then AC 131.89(b) applies. The first of these arguments is the preferred argument in which case it can be argued that the statement has been complied with in that a period has been given (i.e. less than 20 years) and that the statement does not specify the degree of accuracy, required for this disclosure. While a more specific period is not stated in the 2001 financial statements, 92% of the goodwill acquired in that year was amortised during that year and the remaining goodwill comprised just 0,14% of the assets at August 2001 meaning the remaining carrying amount was not regarded as material. Accordingly if this alternate contention had been made, it would be debatable as to whether there had been a contravention of GAAP.
- 5.3 In paragraph 11.27.1 (pg 211) it is contended that there was *"a change in the write off period for goodwill which also fell to be disclosed."* This contention might be valid if all goodwill was expected to have the same useful life but I believe that in terms of AC 131 the useful life of goodwill should be assessed for each acquisition separately. This means that if an acquisition is made in the current year and the useful life of the goodwill that arises differs from prior year acquisitions then the two goodwill amounts would have different useful lives and would not be considered a change in useful life. Accordingly, in this case where goodwill is shown which was not shown previously then the useful life selected for the goodwill is not a change because that goodwill was not shown as an asset in the previous year. As a result the contention is not accepted by me as a valid issue.

### Quality of disclosures

In a number of cases some fairly broad comments have been made regarding the quality of disclosure in the financial statements in terms of GAAP. These include the following:

- 6.1.1 "However, in my opinion, the information is material to an understanding of the financial statements and should be explicitly dealt with, preferably on the face of the income statement or less desirably in the notes and fully explained. " (8.1.5, pg 151 in relation to the unrealised profit on revaluation)
- 6.1.2 "The cumulative effect of the above factors meant that in relation to Cytech, additional "relevant" information was "material enough to affect evaluations and decisions " [AC100.11] and should have been disclosed. The assumptions about future growth in revenues were especially relevant and should have been disclosed. "(8.3.2, pg 154)
- 6.1.3 "The cumulative effect of the above factors meant that in relation to Cytech, additional "relevant" information "material enough to affect evaluations and decisions " [AC100.11] should have been disclosed. Hence the key valuation assumptions, in particular the assumptions about future growth in revenue should have been disclosed "(10,3.3, pg 179.)
- 6.1.4 "Hence the onus was on the Directors to demonstrate that "fair presentation " was achieved. This onus, in my opinion, could not be easily discharged by virtue of materiality of the Cytech investment and its impact on the financial statements and the extent of the disclosures that were made. It is difficult to see how in respect of the 2000 afs the information presented met the purpose/objective set out in AC 101 and the desired characteristics as indicated in para. 06 that "This information, along with other information in the notes to the financial statements, assists users in predicting the enterprise's future cashflows and in particular the timing and certainty of the generation of cash and cash equivalents [AC 101.06] " (8.5.3, pg 163J)
- 6.1.5 "As the above movements impacted materially on both the asset-value and investment income/impairment write-off, the effect of these movements on value and profits should have been disclosed separately in the F/S and interim results. " (11.27.2, pg 453 in relation to the impact of changes in exchange rates on the Cytech investment)
- 6.1.6 "In terms of AC J 03, para 15, (Annexure E2) the influence of exchange rates on profits for the 2000 and 2001 financial years should have been disclosed separately. " (11.27.4, pg 454)

- 6.1.7 *"They did not disclose or deal with all material items, events and/or transactions which was relevant to explain the performance of the enterprise for the 2000/2001/2002 accounting periods or the financial position for the financial periods ending 31 August 2000, 31 August 2001 and 31 August 2002."*(13.2.3, page 459)
- 6.1.8 *"We are of the opinion that the directors did not comply with this important concept in preparation of the 2000/2001/2002 F/S"*(13.7, pg 460) in relation to AC 000.14
- 6.1.9 *"This selective disclosure or non-disclosure of items with a material influence on profits or the Group's financial position has the implication that the information disclosed in the Group's F/S (especially 2000 and 2001) was neither reliable nor neutral (seepar.31 and .36 of AC 000)"*(11.27.6, pg 454)
- 6.1.10 "This information is to be disclosed by "class" of asset, and Cytech, in my opinion, should have been dealt with in a distinct "class" of asset. In any event in terms of AC 100 para. 11 it was a "material item" and warranted separate disclosures in these respects."(8.5.2.2, pg 159)
- 6.2 The following needs to be borne in mind in considering whether these disclosures should have been given:
- 6.2.1 The comments in relation to disclosure of the effect of exchange rates on the Cytech valuation and Cytech being a separate class of asset are dealt with in more detail in 4.3 and 4.2.2 above respectively, while 4.2 above deals with the specific assumptions regarding the Cytech valuation.
- 6.2.2 As noted in 1.7 above the directors are just required to show that the disclosures provided are within the range of permissible alternatives.
- 6.2.3 In this regard the suggested disclosures are rarely provided by other companies in the detail suggested above. This implies that the above interpretation of the requirements of GAAP is not a widely accepted interpretation. Therefore it is possible that some of the companies which provide such disclosures might regard the information provided as voluntary additional information rather than information required in terms of GAAP. Compliance with GAAP normally achieves fair presentation, whereas some of the above comments are not specifically required in terms of GAAP. In

terms of AC 101.16 *"7/i virtually all circumstances, a fair presentation is achieved by compliance in all material respects with the applicable Statements of Generally Accepted Accounting Practice. A fair presentation requires:*

*(c) providing additional disclosures when the requirements in Statements of Generally Accepted Accounting Practice are insufficient to enable users to understand the impact of particular transactions or events on the enterprise's financial position and financial performance. "*

This implies that the need for additional information is the exception and not the norm.

- 6.2.4 In addition there needs to be a balance between providing information that is insufficient and providing excessive information which would be difficult for an average user to absorb. The standard setters acknowledge that there are limitations to financial statements. In AC 000.13 it states *"However, financial statements do not provide all the information that users may need to make, economic decisions ... "*
- 6.2.5 This issue is further commented on in paragraph 44 in the section of AC 000 which deals with the constraints on relevant and reliable information and the balance between benefit and cost: *"In practice a balancing, or trade off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of judgment. "*
- 6.2.6 As noted in part 1 of the report, most of the contentions in the Submission relate to Cytech. In assessing the comments noted in 6.1 above the relative size of this investment should be considered. As noted in 1.10 above for the three years covered by the Submission Cytech represented 6,8%, 4,4% and 3,7% of the assets of Corpcapital for 2000, 2001 and 2002 respectively, while the revaluation of Cytech represented 31,5% and 10,2% of total income before interest and bad debts in the 2000 and 2001 income statement respectively, whereas in the 2002 income statement the investment was equity accounted and the goodwill relating to this investment was both amortised and impaired. As noted in 2.4.5 above the extent of investing

income was shown in the 2000/financial statements and in the 2001 financial statements investing income was split between realised and unrealised amounts, so the extent of income from this source was disclosed.

6.2.7 Accordingly, based on the above, I do not believe there is sufficient justification for the contentions.

6.3 The contentions noted above in this part of the report were used to support the following conclusions:

6.3.1 "The two independent reports indicate that CorpCapital and Old CorpCapital did not comply with material sections of the Companies Act, and Generally Accepted Accounting Practice. " (3.1.3, pg 9)

6.3.2. *"In Mr Abraham's opinion, in the absence of disclosure, in the financial statements of Old CorpCapital for the year ended 31 August 2000, of the information required by AC 100, AC 110 and AC 125 in respect of Cytech, the annual financial statements were not appropriately described as having been prepared in accordance with GAAP. "(4.4.4.8.2, pg 25) Similar wording is used in other parts of the Submission in relation to the other financial statements (4.4.4.8.5, pg 26; 4.4.4.9.4, pg 27; 4.4.4.10.6, pg 28; 8.2, pg 88; 8.5,pg88;9.1.4, pg 89; 10.2.3, pg 90; 8.5.3, pg 163; 9.4.3 pg 168; 10.5.1.9, pg 185 and 11.30, pg 212) with the exception that the contention in relation to the 2002 financial statements does not refer to AC 100, AC 110 and AC 125 but".. of the information required by AC 103 in respect of "fundamental errors" at para. 35 or "changes in accounting policy at para. 45, in relation to the investments/associates..."(4.4.4.10.6, pg 28; 10.2.3 pg 90 and 11.30. Pg212)*

6.3.3. "The Collett Report arrives at similar conclusions, set out in section 13 of the Collett Report. Importantly, the Collett Report concludes that the financial statements for 2000, 2001 and 2002 do not comply with AC 000.. "(4.4.5, pg 28)

6.3.4. "The Netainment-investment was not adequately disclosed in the F/S and/or in accordance with GAAP and/or the provisions of the Companies Act"(4.1.1,pg 413)

- 6.3.5. *"It has been stated emphatically in the F/S of the Group that it complied with GAAP and the Companies Act. The directors also approved the F/S for the distribution to shareholders on that basis. Based on the above, these statements and/or aversions were untrue and misleading. "(9.1, pg 435)*
- 6.3.6. *"Their disclosures of Netainment was incorrect, insufficient and did not comply with GAAP and/or the Companies Act. "(13.2.4, pg 459)*
- 6.3.7. *"The change in accounting policies and/or accounting treatment and/or changes in classification of investments/ associates/subsidiaries were incorrectly disclosed and did not comply with GAAP and/or the Companies Act. "(13.2.5, pg 459)*
- 6.3.8. *"The financial statements did not reflect the true financial position or results in accordance with GAAP and/or AC's or the Companies Act. "(18.1.3,pg 473)*

## **Conclusion**

- 6.4 As noted above the following conclusions were made:
- 6.4.1 There is not enough evidence to justify that the disclosures regarding an appreciation of the Group's affairs were insufficient (see 2.1.2 above).
- 6.4.2 The name of investments and percentages holdings were not required to be given in the financial statements (see 2.2 above)
- 6.4.3 There was no contravention of the Fourth Schedule regarding income from investments (see 2.3.6 above)
- 6.4.4 The income statement disclosure was adequate to show any abnormal items (see 2.4.7 above)
- 6.4.5 The investment in Cytech was not required to be accounted for at cost or equity accounted (see 3.1.6 above)

- 6.4.6 It is not inappropriate to value an unlisted investment at market value (see 3.2.7 above)
- 6.4.7 The change of treatment of Cytech was not required to be regarded as a change in accounting policy or fundamental error and therefore the contention that inappropriate accounting policies were adopted is not accepted (see 3.3.13 above)
- 6.4.8 There are no grounds to the contention that uniform accounting policies were not used (see 3.4.2 above)
- 6.4.9 It was not necessary for the comparative figures to have been changed in the 2002 financial statements (see 3.3.11 and 14 above)
- 6.4.10 The contention that the required disclosures for associates was not provided is not accepted (see 4.1.7 above)
- 6.4.11 The disclosures provided in respect of the valuation of investments and financial instruments can be regarded as adequate (see 4.2.5 above)
- 6.4.12 There is no requirement for the currency effect on the change in valuation of investments to be given (see 4.3.5 above)
- 6.4.13 AC 129 does not require the goodwill write off period to be disclosed (see 5.1 above)
- 6.4.14 As there was no change in accounting policy there was no need for pro-forma information to be provided (see 3.3.15 above)
- 6.4.15 It was not necessary for comparative figures to be given for each investment classified as an associate in the 2002 financial statements (see 3.3.14 above).
- 6.5. The conclusions I reached as summarised in 6.4 above mean the following, subject to the comments noted in 6.7 below:
- 6.5.1 The disclosures required in terms of the Fourth Schedule to the Companies Act in relation to Cytech were adequate (see 6.4.1 to 4 above)

- 6.5.2 The accounting treatment and accounting policies used for Cytech were appropriate (see 6.4,5 to 9 above)
- 6.5.3 The disclosures provided in respect of Cytech were adequate (see 6.4.10 to 12 above)
- 6.5.4 The deficiencies noted in the Submission that did not relate specifically to Cytech were not considered to be valid contentions (see 6.4.13 to 15 above)
- 6.5.5 As a result of the above issues, which were the bases of the contentions that fair presentation and compliance with GAAP were not achieved (see 6.1 and 2 above), I believe that the Group can state that their disclosures in the 2000, 2001 and 2002 financial statements in respect of the contentions comply with generally accepted accounting practice without any material deviation.

6.6. From the specific contentions made to support the conclusions made in the Submission as noted in 6.3 above, I believe, based on the above discussion, that the contentions are not supported. Some of the contentions are situations where, in my opinion, based on the minimum requirements as specified in GAAP and the Companies Act and disclosures provided by other companies the degree of disclosure provided was within a range that would have been considered adequate by accountants in general. Furthermore, some of the contentions make the *same* comment for various years (see 6.1.6 to .9 above) without differentiating between the relative impact of Cytech on each of the years (see 6.2.6 above); also based on the above there is no evidence from the 2001 and 2002 financial statements that the amounts recorded were inappropriate in the year Cytech had the biggest impact, namely 2000.

6.7. In a few cases the disclosures required might not appear to be in terms of GAAP and the Companies Act, but these are issues noted above which are alternate contentions which could have been made. These include the following:

- 6.7.1 Not stating that a list of investments is available for inspection at the registered office of the Group (see 2.2 above).

- 6.7.2. Not stating that Cytech was a joint venture (see 4.1.6 above). This means that an accounting policy should have been provided for joint ventures and Cytech should have been described as a joint venture and not an associate in the 2002 financial statements. This is mitigated by joint ventures being allowed to be equity accounted, which is the basis used to account for associates, and therefore the effect of this is not significant as has been noted in 4.1.6 above, which also explains the minimal impact the classification of Cytech as a joint venture would have had on the 2000 and 2001 financial statements.
- 6.7.3. Not making it sufficiently clear in the financial statements that the intention was that certain associates were being held for disposal in the near future in the 2000 and 2001 financial statements and not adequately explaining the change in intention regarding certain investments in the 2002 financial statements (see 3.1.24 and 3.3.4 above). However, the accounting was adequate to show the effect of the accounting in terms of the accounting policies and the change of intention.

### **PART 3 - CROSS REFERENCE OF THE VARIOUS ISSUES NOTED IN PART 1 TO THOSE CONTAINED IN THE SUBMISSION**

Listed below are the specific contentions in relation to the accounting in the financial statements of the Group contained in paragraph 5 of Part 1 of my report. The related cross-reference to the Submission is detailed for each contention. For this purpose the Webber Wentzel Bowens Submission to the Minister of Trade and Industry ("WWB Submission") refers to page 6 to 72 of the Submission, while the Abrahams and Collett Reports refer to pages 73 to 405 and pages 406 to 938 of the Submission respectively. As some contentions are repeated a number of times, not all the cross references noted below are also contained in Part 2 when the various contentions are discussed.

5.1. Certain disclosure requirements in terms of the Fourth Schedule to the Companies Act were not provided in relation to Cytech. These relate to the following:

5.1.1. Information material to an appreciation of the Group's affairs (see 2.1 in Part 2)

#### ***WWB Submission***

Para 4.4.4.4 and 4.4.4.5, Page 22

Para 4.4.4.8.1.1.1, Page 24

Para 4.4.4.8.3.1.1, Page 26

Para 4.4.4.9.1.1.1, Page 26

#### ***Abrahams Report***

Para 8.1.1, Page 87

Para 8.3.1, Page 88

Para 9.1.1, Page 89

Para 8.1.5, Page 151

Para 8.3.2, Page 154

Para 8.4.1.1, Page 155

Para 9.3, Page 167

Para 10.4.1.1, Page 179

#### ***Collett Report***

Para 13.2.3, Page 459

5.1.2 The name of investments and percentage holdings (see 2.2 in Pan 2)

***WWB Submission***

Para 4.4.4.8.U.2, Page 24

Para 4.4.4.8.3.1.1, Page 26

***Abrahams Report***

Para 8.1.1, Page 87

Para 8.3.1, Page 88

Para 8.4.1.2, Page 155

Para 9.3, Page 167

5.1.3 Income from listed and unlisted investments (see 2.3 in Part 2)

***WWB Submission***

Para 4.4.4.8.1.1.3, Page 25

Para 4.4.4.3.1.1, Page 26

Para 4.4.4.9.1.1.2, Page 26

***Abrahams Report***

Para 8.1.1, Page 87

Para 8.3.1, Page 88

Para 9.1.1, Page 89

Para 8.4.1.3, Page 156

Para 9.3, Page 167

Para 10.4.1.2, Page 179

5.1.4. Abnormal items of income (see 2.4 in Part 2).

***WWB Submission***

Para 4.4.4.8.1.1.3, Page 25

Para 4.4.4.8.3.1. L Page 26

Para 4.4.4.9.1.1.2. Page 26

***Abrahams Report***

Para 8.1.1, Page 87

Para 8.3.1, Page 88

Para 9.1.1, Page 89

Para 8.4.1.3, Page 156

Para 9.3, Page 167

Para 10.4.1.2, Page 179

5.2. The accounting treatment and accounting policies used for Cytech were not appropriate in the following respects:

5.2.1 The investment in Cytech should have been accounted for at cost or equity accounted in the 2000 and 2001 financial statements (see 3.1 in Part 2)

***WWB Submission***

Para 4.4.4.4.1, Page 23

Para 4.4.4.6.1.1, Page 23

Para 4.4.4.6.1.2, Page 24

Para 4.4.8, Page 29

***Abrahams Report***

Para 6.1, Page 86

Para 8.5.1.5.1, Page 157

Para 8.5.2.7.2, Page 162

Para 9.4.1, Page 167

Para 10.5.1.7.3.2, Page 184

***Collett Report***

Para 8.6, Page 434

5.2.2 It was inappropriate to value an unlisted investment at a market value (see 3.2 in Part 2)

***WWB Submission***

Para 4.3.7, Page 14

Para 4.4.3, Page 15

5.2.3 Inappropriate accounting policies were adopted and were coupled with changes in accounting policies (see 3.3 in Part 2)

***WWB Submission***

Para 3.4, Page 10

***Abrahams Report***

Para 8.5.2.2, Page 159

Para 9.4.1, Page 167

5.2.4 Uniform accounting policies were not used (see 3.4 in Part 2)

***WWB Submission***

Para 4.4.4.8.4, Page 26

Para 4.4.4.9.3, Page 27

***Abrahams Report***

Para 1.3.5.2, Page 76

Para 8.4, Page 88

Para 9.1.3, Page 89

Para 9.4.2, Page 167

Para 10.5.1.8, Page 185

***Collett Report***

Para 9.4, Page 435

5.2.5 What was described as a change in classification in the 2002 financial statements should have been accounted for as a change in accounting policy or a fundamental error (see 3.3 in Part 2)

***WWB Submission***

Para 4.4.10.2, Page 28

***Abrahams Report***

Para 10.2, Page 90

Para 11.21.1.1, Page 205

Para 11.21.1.2, Page 206

***Collett Report***

Para 13.4, Page 459

- 5.2.6 There was inadequate disclosure of the change in accounting for associates (see 3.3.11 and 3.3.14 in Part 2).

***Abrahams Report***

Para 11.15, Page 197

Para 11.22, Page 209

Para 11.23, Page 210

- 5.3 The disclosures provided in respect of Cytech were not adequate. This entails the following:

- 5.3.1 Not providing disclosures in respect of accounting standards for associates (see 4.1 in Part 2)

***WWB Submission***

Para 4.4.4.8.1.2.1, Page 25

Para 4.4.4.8.5, Page 26

***Abrahams Report***

Para 1.3.5.2, Page 76

Para 6.2, Page 86

Para 8.1.2, Page 87

Para 8.3.2, Page 88

Para 9.1.2, Page 89

Para 8.5.1, Page 156

Para 9.4.1, Page 167

Para 10.5.1, Page 180

Para 11.15, Page 197

***Collett Report***

Para 10.1, Page 436

Para 13.2.1 and 13.2.2, Page 458

- 5.3.2 Not providing full details on accounting policies and the assumptions for the valuation of Cytech (see 4.2 in Part 2)

***Abrahams Report***

Para 4.3.1, Page 85

Para 8.1.2, Page 88

Para 8.3.2, Page 88

Para 8.3.2, Page 88

Para 9.1.2, Page 89

Para 8.3.2, Page 154

Para 8.5.2.3, Page 159

Para 8.5.2.7.4, Page 163

Para 9.4.1, Page 167

Para 10.3.3, Page 179

Para 10.5.1.7.1, Page 183

- 5.3.3 Not providing all the required disclosures for financial instruments (see 4.2 in Part 2)

***WWB Submission***

Para 4.4.4.8.1.2.2, Page 25

Para 4.4.4.8.3.2.1, Page 26

Para 4.4.4.9.2.3, Page 27

***Abrahams Report***

Para 1.3.5.2, Page 76

Para 8.1.2, Page 87

Para 8.3.2, Page 88

Para 9.1.2, Page 89

Para 8.5.2.7.4, Page 163

Para 9.4.1, Page 167

Para 10.5.1.7.3, Page 185

- 5.3.4 Not showing the currency effect on the change in value of the investment (see 4.3 in Part 2)

***Collett Report***

Para 11.27.3- 11.27.4, Page 453 – 454

5.4 In addition to the above the following deficiencies that did not specifically relate to Cytech were noted:

5.4.L The 2001 and 2002 financial statements did not disclose the period over which goodwill was being amortised (see 5.1 in Part 2)

***Abrahams Report***

Para 10.6.1, Page 185

Para 11.26.4, Page 211

Para 11.27.1, Page 211

5.4.2 Providing pro-forma information was an inappropriate accounting treatment for a change in accounting policy in the 2002 financial statements (see 3.3.15 in Part 2)

***Abrahams Report***

Para 11.5, Page 190

Para 11.16.2, Page 199

Para 11.23, Page 210

***Collett Report***

Para 13.4, Page 460

5.4.3 In the 2002 financial statements comparative figures should be given for each investment classified as an associate (see 3.3.14 in Part 2)

***Abrahams Report***

Para 11.15, Page 196

5.5 The lack of adequate disclosures and inappropriate accounting in terms of the specific requirements of GAAP and the Companies Act as detailed above mean! the following (see 6 in Part 2):

5.5.1 The financial statements could not be described as being in compliance with GAAP

***WWB Submission***

Para 3.1.3, Page 9

Para 4.4.3 and 4.4.4, Page 16

Para 4.4.4.8.2, Page 25

Para 4.4.4.8.5, Page 26

Para 4.4.4.9.4, Page 27

Para 4.4.10.6, Page 28

***Abrahams Report***

Para 1.3.5.2, Page 76

Para 1.3.5.3, page 77

Para 8.2, Page 88

Para 8.5, Page 88

Para 9.1.4, Page 89

Para 10.2.3, Page 90

Para 8.5.3, Page 163

Para 9.4.1, Page 167

Para 9.4.3, Page 168

Para 10.5.1.9, Page 185

Para 11.30, Page 212

***Collett Report***

Para 4.1.1, Page 413

Para 9.4, Page 435

Para 9.7, Page 435

Para 13.2.4, Page 459

Para 13.2.5, Page 459

Para 18.1.3, Page 473

5.5.2. Fair presentation was not achieved

***Abrahams Report***

Para 8.5.3, Page 163

Para 9.4.1, Page 167

***Collett Report***

Para 4.1.1, Page 413

5.5.3. The information provided was neither reliable nor neutral

***Collett Report***

Para 11.27.6, Page 454

5.5.4. All the information relevant to explain the performance of the Group was not provided

***WWB Submission***

Para 4.4.4.1.5, Page 17

***Abrahams Report***

Para 4.4, Page 85

***Collett Report***

Para 13.2.3, Page 459

5.5.5. Sufficient information to enable a reader to be able to affect evaluations or decisions or to predict future cash flows was not provided

***WWB Submission***

Para 4.4.5.1, Page 22

Para 4.4.4.8.1.2.2, Page 25

***Abrahams Report***

Para 5.1, Page 85

***Collett Report***

Para 13.7, Page 460

5.5.6. Sufficient disclosure of material items affecting decisions was not provided

***WWB Submission***

Para 4.4.4.9.2.2, Page 27

***Abrahams Report***

Para 8.1.2, Page 87

Para 8.3.2, Page 88

Para 9-1.2, Page 89

## **PART 4 - CURRICULUM VITAE OF GARTH DENNIS COPPIN**

1. Garth Coppin has been a partner in Ernst & Young for 15 years.
2. He has been in the firm's technical department for 15 years and was appointed the firm's National Director of Accounting and Auditing in 2000, being responsible for providing guidance on the application of accounting and auditing standards to specific circumstances as well as related internal training on such issues. In addition during 2001 and 2002 he also oversaw services provided by the firm on corporate governance..
3. He is also an audit partner for clients involved in the insurance and manufacturing industries.
4. He has been involved in the accountancy profession's standard setting process since 1991. This includes the following:
  - 4.1. Being a member of The South African Institute of Chartered Accountants' Auditing Standards Committee from 1991 to 2001.
  - 4.2. Being a member of the Public Accountants' and Auditors' Board's Auditing Standards Board since its creation in 2000.
  - 4.3. Being a member of The South African Institute of Chartered Accountants' Accounting Issues Task Force from 1999 until it was disbanded in 2001.
  - 4.4. Being a member of The South African Institute of Chartered Accountants' Accounting Practices Committee since 2001.
  - 4.5. Being a member of the JSE Securities Exchange's GAAP (Generally Accepted Accounting Practice) Monitoring Panel since its creation in 2002.
5. He has had various articles on accounting published including articles in Accountancy SA, the Financial Mail, Accountancy Update and Professional Management Review. He has also lectured on accounting topics to internal and external audiences.
6. During 2001 and 2002 he was quoted in the press as well as being interviewed on radio and television on corporate governance issues, in addition to authoring articles, presenting at seminars and carrying out consultancy assignments on corporate governance.