8th Edition - November 2010

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Contents Next ≫

Welcome

Dear Colleagues

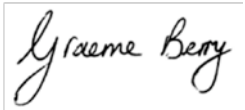
Welcome to our eighth edition of *Technically Speaking!*

This edition includes articles on some of the latest accounting and regulatory developments including the new **Consumer Protection Act**, the **Exposure Draft on Leases** issued by the IASB and **Integrated Financial Reporting**.

We look forward to your comments on the publication and ask that you contact our editor, **Amy Escott,** if you have any questions or suggestions for future issues.

We hope 2010 has been a successful year for you and we wish you well over the festive season.

Kind regards



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Contents

Overview of the some of the features of the Consumer Protection Act

Article by:
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Background

The Consumer Protection Act ("the Act") sets out the minimum requirements to ensure adequate consumer protection in South Africa. This Act constitutes an overarching framework for consumer protection, and all other laws which provide for consumer protection (usually within a particular sector) will need to be read with this Act to ensure a common standard of protection.

All suppliers of goods and services will need to take note of the new measures and ensure that they are able to comply once the Act becomes effective.

The Act will become effective on 31 March 2011.

Application of the Act

The Act affects a wide range of consumers and transactions. The definition of a "consumer" includes not only the person (either a natural or juristic person) to whom goods or services are promoted or supplied, but also the actual user of the goods or the recipients or beneficiary of the services. In other words, a consumer may be a person other than the person who entered into an agreement with a supplier and paid for the goods or services. In practice this would mean that if you are given a spa treatment as a birthday present, you will be entitled to the consumer protection measures set out in the Act, even though you never entered into an agreement with the spa.

With regard to juristic persons, the Act will only provide protection to small businesses (in other words, where the consumer is a juristic person with an asset value or annual turnover below a threshold determined by the Minister). This approach is in line with the approach in the National Credit Act. In terms of the National Credit Act the threshold is set at R1 million. However, the threshold will still need to be finalised for the purposes of the Act.

In terms of Section 5 of the Act, certain transactions will be excluded from the application of the Act. Exempted transactions include those where:

- Goods or services are supplied to the State (transactions where the State will be the consumer)
- Where the transaction constitutes a credit agreement under the National Credit Act (the goods or services that are the subject of the credit agreement are not excluded from the ambit of the Act)
- A transaction pertaining to services under an employment contract
- A transaction which gives effect to a collective bargaining agreement within the meaning of Section 23 of the Constitution and the Labour Relations Act.

The Act further provides for a mechanism in terms of which a regulatory authority may apply to the Minister of Trade and Industry (the Minister) for an industry wide exemption from certain provisions of the Act. The application for such an exemption must be based on the fact that there is an overlap between the provisions of the Act and the regulatory scheme administered by the relevant regulatory authority. The Minister may only grant an exemption if the applicable regulatory scheme provides better, or at least similar, consumer protection than the protection provided for in the Act.

The provisions in the Act regarding safety monitoring and recall (Section 60), and liability for damages caused by goods (Section 61) apply to all transactions, even those transactions exempted from the application of the Act. Thus, in our example above, the distributor will be entitled to protection where she suffered damage as a result of defective goods – even where the transaction was exempted.

The Act will not apply to services which constitute advice or an intermediary service that is subject to regulation in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS), or services in terms of the Long-term Insurance Act, 1998 or the Short-term Insurance Act, 1998. However, it should be noted that the Act prescribes that the Long-term Insurance Act and the Short-term Insurance Act must be aligned with the consumer protection measures in this Act within 18 months from the commencement of this Act. If this is not done, the provisions of this Act will apply to all services rendered in terms of the two Insurance Acts.

Threshold

The Act will not apply to transactions where the consumer is a juristic person with an asset value or annual turnover of more than a threshold value determined by the Minister (Section 6). The Department of Trade and Industry indicated that the threshold will in all probability be set at R5 million.

Product liability

Section 61 of the Act effects a major change with regard to the position of the consumer in cases where the consumer suffers damages as a result of unsafe or defective goods. This provision determines that producers, importers, distributors and retailers of goods will be liable for any harm caused as a result of the supply of unsafe goods, a product failure, a defect or hazard in the product, or interestingly, inadequate instructions for the use of the goods or warnings related to any possible hazard that might be associated with the product. Although the Act determines that labelling of products and trade descriptions are optional, it might be necessary for producers, importers, distributors and retailers of goods to ensure that proper instructions for use, and warnings of potential danger or hazards are provided, as this may prevent a claim for damages by the consumer.

Probably the biggest change to the current legal position is the fact that the Act determines that producers, importers, distributors and retailers of goods will be liable for damage caused by unsafe or defective goods whether or not the harm resulted from their negligence. This means that the consumer will no longer have to prove that the damages suffered as a result of defected goods was due to the fault (negligence or otherwise) of the producer, importer, distributor or retailer (this is referred to as strict liability). The shoe is now on the other foot. Where a consumer claims for damages, the producer, importer, distributor or retailer will have to prove that they are not responsible, and thus not accountable, for the resulting damages.

The Act determines that a consumer may hold the producer, importer, distributor and retailer jointly or severally liable, and a consumer may claim for damages related to death, injury, illness, loss or damage to property, or economic loss as a result of death, injury, illness or, loss or damage to property.

The Act provides for a number of defences which the producer, importer, distributor and retailer may use when a claim for damages is instituted against them by a consumer.

Customer loyalty programmes

Section 35 of the Act determines that a supplier who sponsors a consumer loyalty programme, or accepts loyalty credits in exchange for goods or services (for example frequent flyer miles), may impose a partial or complete restriction on the availability of the goods or services during specific periods of the year. However, the restriction may not exceed 90 days in a calendar year. In addition, the Act requires that certain information be made available to the consumer when an offer to participate in the loyalty programme is made. The information should include the nature of the programme, the goods or services to which it applies, the steps required to receive benefits, and the time, venue and persons from which consumers may obtain access to either the programme or benefits in terms of the programme. This means that a supplier that has a loyalty programme, such as an airline, may restrict the use of frequent flyer miles during certain periods of the year (not exceeding 90 days). However, at any other time of the year, the airline must accept loyalty credits in return for a service as if the consumer offered any other form of consideration (such as cash). The supplier may not benefit consumers who offer to pay cash over consumers who use loyalty credits.

The Act provides for possible defences that a supplier may use when a consumer alleges that the supplier did not have sufficient goods or services available in return for loyalty credits. In essence, it will be a defence where the supplier offers to supply comparable goods or services to the consumer, and the consumer either accepts the offer, or unreasonably refuses the offer.

Overselling and overbooking

The Act provides for the reasonableness test for overselling and overbooking. In terms of this test a supplier may not accept payment for goods or services where it has no reasonable intention to supply the goods or services, or where it intends to supply goods or services that are materially different to the goods or services for which the consumer has paid.

With regard to damages suffered as a result of a supplier's inability to supply goods or services due to overbooking or overselling, the Act provides for a refund of the amount paid plus interest (usually, this would be the deposit plus interest), as well as any consequential damages which directly resulted from the breach of contract.

In practical terms, this would mean that where you booked a flight from Cape Town to Durban for which you paid a deposit of RX, booked and paid for a rental car in Durban in the amount of RY, and set up a meeting with a business associate in Durban to sign a contract valued at RZ, after which the business associate will leave for India. If you are then bumped from the flight as a result of an overbooking, you will be entitled to claim:

- RX plus interest for the deposit you paid for the flight
- RY plus interest for the rental car, which amounts to a consequential loss that is directly resulting from the overbooking.

However, the fact that you suffered a loss because you were not able to sign the contract before your business associate left for India amounts to loss of anticipated use or enjoyment, for which the Act does not provide.

Implied warranty of quality

The Act provides for an implied warranty of quality. In terms of this warranty the producer or importer, the distributor and the retailer each warrant that the goods comply with the requirements and standards contemplated in the Act. However, the implied warranty will not apply where goods have been altered contrary to the instructions of the producer, importer, distributor or the retailer, or altered after leaving the control of the producer, importer, distributor or the retailer.

Failed, unsafe or defective goods may be returned to the supplier within six months after the delivery of the goods to a consumer. In such a case the supplier has to either repair or replace the goods, or refund to the consumer the price paid by the consumer. It is important to remember that the Act allows the consumer to choose whether to be refunded, or to have the goods replaced or repaired.

In instances where the supplier chose to repair the failed or defective goods (or any component of the goods) and within three months after that repair, the failure or defect was not fixed and it recurs, or another failure or defect is discovered, the supplier must replace the goods, or refund the price to the consumer.

It should be kept in mind that the Act specifically determines that an implied warranty, as provided for in the Act, is in addition to any other implied warranty or condition imposed by the common law, any other legislation, and any express warranty or condition stipulated by the producer or importer, distributor or retailer.

Warranty on repaired goods

The Act provides for a three month warranty on repaired goods. This warranty includes all new or reconditioned parts installed during the repair or maintenance work, as well as the labour to install such parts. However, where a consumer subjected goods to abuse or misuse, the warranty will be void. Also, the warranty does not extend to ordinary wear and tear.

Lease Accounting Exposure Draft set to shake up off balance sheet reporting

Article by:
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The objective of the Board's leasing project is to develop a new approach that would better reflect the economics of a lease and provide greater transparency to users of financial statements. The exposure draft proposes new models for lessees and lessors and would replace the existing standards and related interpretations under International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Practice (US GAAP). The new standard is expected to be issued with an effective date likely to be no earlier than 1 January 2013.

Overview of lessee accounting

At the heart of the proposals for lessees is the elimination of the operating lease accounting model and the introduction of a right-of-use model. This model is based on the premise that the entity has acquired an intangible asset and has financed that asset through a financing arrangement. A lessee would recognise an asset representing its right to use the underlying asset during the lease term and a corresponding liability for its obligation to pay rentals.

After commencement of the lease, a lessee would reflect the following impacts in their financial statements:

- Lease liability at amortised cost
- Right-of-use asset at cost less accumulated amortisation and impairment
- Interest expense using the effective interest method

A lessee would amortise the right-of-use asset on a systematic basis over the lease term or useful life, if shorter. IFRS preparers would be permitted to revalue their right-of-use assets in accordance with the revaluation model in IAS 16 Property, Plant and Equipment if they revalue:

- All owned assets in the class of property, plant and equipment
- All right-of-use assets relating to the class of property, plant and equipment to which the underlying asset belongs.

Revaluation of the right-of-use asset would not be permitted under US GAAP.

Overview of lessor accounting

Two accounting models are proposed for lessors - the performance obligation approach and the derecognition approach.

A lessor that retains exposure to significant risks or benefits associated with the underlying asset would apply the performance obligation approach. Otherwise, the lessor would apply the derecognition approach.

Under the performance obligation approach, the underlying asset remains recognised in the lessor's statement of financial position. The lessor recognises a receivable for the expected rental payments, and a corresponding liability. The lessor would recognise income as the performance obligation is reduced over the lease term and interest income on the receivable.

Under the derecognition approach, a lessor would:

- Recognise an asset for the right to receive rental payments
- Remove a portion of the carrying amount of the underlying asset from its statement of financial position
- Reclassify as a residual asset the portion of the carrying amount of the underlying asset that represents the lessor's rights in the underlying asset that it did not transfer.

This approach results in immediate recognition of revenue from the effective sale of the right-of-use asset and only recognises interest income over the lease term in profit or loss.

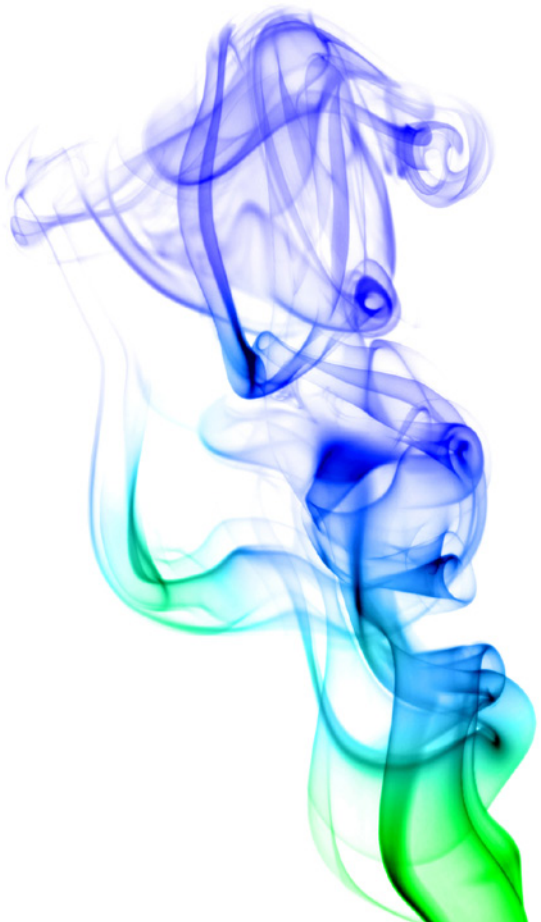
These proposals incorporate several intricacies and judgements which are summarised as follows:

Contracts with service components

If a contract contains a lease, but also contains a service component, the exposure draft would generally not apply to the 'distinct' service components within the contract (the distinct service components would be accounted for in accordance with other IFRS's).

A service component would be considered distinct if the entity or another entity either sells an identical or similar service separately or the entity could sell the service separately because the service has a distinct function and a distinct profit margin. Lessees would allocate the payments required under the contract between the distinct service and lease components based on the stand-alone selling prices. However, a lessee would treat the entire contract as a lease if it is unable to allocate the payments between the distinct service and lease components or if the service component is not distinct.

These proposals may have an impact on current lease accounting for leases with embedded maintenance clauses.



Contingent rentals

The hurdle for the recognition of contingent rentals is lower for lessees than for lessors. The estimate of contingent rentals would be always be included as part of the right-of-use asset and the lease liability for leasees whilst a lessor would only include contingent rentals if they could be measured reliably.

The entity would be required to reassess its estimates for contingent rentals when circumstances indicate that there would be a significant change in the position since the previous reporting period.

This is expected to have a significant effect on leasees and lessors especially when the parties enter long leases with contingent rentals based on revenue or profitability.

Lease term

In what is a significant change from the current leasing rules, the expected lease term would be based on "the longest possible term that is more likely than not to occur."

As per contingent rentals, the entity would be required to reassess its estimates when circumstances indicate that there would be a significant change in the position since the previous reporting period.

Subleases

An entity may lease an asset from a lessor and then lease that same asset to a different party (commonly referred to as subleases). The same entity is both a lessee that leases an asset from a head lessor, and an inermediate lessor that subleases the same underlying asset to a sub-lessee. Under the exposure draft, an intermediate lessor would account for its assets and liabilities arising from the head lease in accordance with the lessee model and would account for its assets and liabilities arising from the sublease in accordance with the lessor model. As discussed above, the exposure draft proposes two accounting models for lessor accounting, the performance obligation model and the derecognition model.

Calculating payments for leave, severance and notice in compliance with the BCEA

Article by:
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The Basic Conditions of Employment Act ("BCEA") requires an employer to calculate the amounts payable to employees for leave, notice and severance with reference to the remuneration received by such employees. The question is - what constitutes remuneration for purposes of such calculations?

Section 1 of the BCEA defines remuneration as:
"Any payment in money or kind, or both in money or kind, made or owing to any person in return for that person working."

The above definition is not very clear and has unfortunately resulted in much confusion and inconsistency on the issue of what constitutes remuneration. In reaction to the growing uncertainty, the Minister of Labour added to the definition of remuneration in a Government Notice published in May 2003.

The Government Notice made the amended definition of remuneration applicable to two situations only. They are:

- Calculating the amount of remuneration payable to employees whilst on leave
- Calculating the amount of remuneration payable to employees with reference to leave, notice and severance upon termination of employment.

In addition, the new definition has application only to:

- The minimum entitlements that an employer is required to grant in terms of the BCEA
- Payments due to employees for leave, notice and severance after July 2003 and not before.

The BCEA requires the following minimum entitlements / benefits with reference to leave, severance and notice pay:

- A minimum severance pay of one week for every completed year of service
- A statutory minimum of 15 working days per annual leave cycle
- Notice pay of between one week and four weeks depending on the duration of employment.

This means that the statutory method of calculation as set out in the new definition of remuneration does not apply where the employer grants are contractually obliged to or pays in excess of the minimum entitlements established in the BCEA in respect of leave pay, notice pay and severance pay.

The structure of the amended definition sets out a number of inclusions and exclusions from the definition of remuneration and calculations.

The following payments are included for purposes of the calculations:

- Housing or accommodation allowance or subsidy, or housing or accommodation received as a benefit in kind
- Car allowance or the provision of a car, except to the extent that the car is provided to enable the employee to work
- Any cash payments made to an employee, except those listed as exclusions in terms of this schedule
- Any other payment in kind received by an employee, except those listed as exclusions in terms of this schedule
- Employer's contributions to medical aid, pension funds, provident funds or similar schemes
- Employer's contributions to funeral or death benefit schemes.

The following payments are excluded for purposes of the calculations:

- Any cash payment or payment in kind provided to enable the employee to work (for example, equipment, tool or similar allowance or the provision of transport or the payment of a transport allowance to enable the employee to travel to and from work)
- A relocation allowance
- Gratuities (for example, tips received from customers) and gifts from the employer
- Share incentive schemes
- Discretionary payments not related to an employee's hours of work or performance (for example, a discretionary profit sharing scheme)
- An entertainment allowance
- An education or schooling allowance.

Fluctuating payments (for example, commissions earned by employees) forms part of the calculations and must be calculated at an average over a period of thirteen weeks, or if the employee has been in employment for a shorter period, that period.

Double payments to employees are excluded from the calculations. An example of a potential double payment is employer contributions to pension and medical aid. If these contributions have been made then they should not be included for the purposes of calculating leave, notice or severance pay at the termination of employment. If the contributions have not been made for such period, then they must be included into the leave, notice and severance calculations.

It is unfortunate that the Minister did not make the amended definition applicable to all payments due to employees in terms of the BCEA. This would have resulted in consistent application and certainty. Restricting it to its current application has and will continue to lead to much confusion on the subject. The fact remains that most employers are still not complying with this definition.

Integrated Financial Reporting

Article by:
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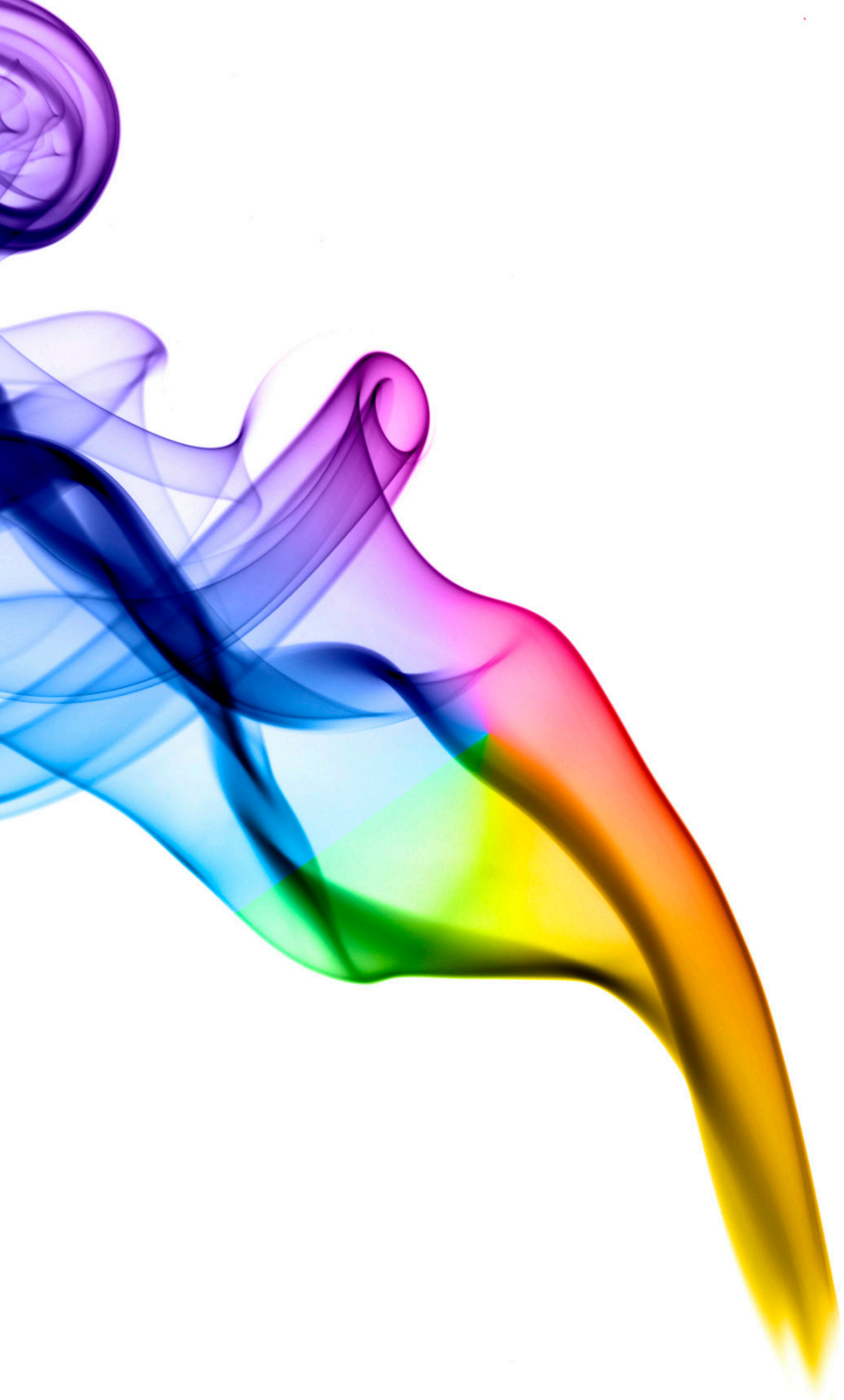
Stakeholders, including regulators, are becoming ever more demanding that organisations improve their sustainability performance and report on an increasing array of robust sustainability data in a comprehensible context. The King III Code of Governance (September 2009) encourages integrated reporting for South African businesses, with year-ends starting on or after March 2010.

Business impact

Integrated reporting is no doubt the wave of the future for sustainability reporting. The recent Global Reporting Initiative (GRI) Conference on Sustainability and Transparency in Amsterdam, only further reiterated this point. Also termed "One Report", integrated reporting is defined in the simplest terms, as the combining of a company's financial and non-financial information (environmental and social) into a way that enables all stakeholders to assess the value of the company. More non-financial information will be reported in Annual Reports and Boards are requiring greater comfort over the accuracy, quality and completeness of reported content.

Business enterprises are asked for information on their vision, values and principles, governance structures, objectives, as well as past and current performance (in comparison with their peers and targets) and the management systems and actions in place to support these. Meaningful reports place a focus on consistency between the different layers. Responsible, future-active companies need to ask the following questions when preparing for integrated reporting:

- How well is our sustainability initiative integrated into the strategy and operations?
- Who do we need to engage with when developing our strategy, in order to capture the relevant sustainability issues?
- How do we determine what information to report on, and the process for reporting?
- How do we address matters such as completeness, materiality, transparency and balance?



Desirable characteristics of sustainable annual reports include:

- Effective communication
- Relevance
- Consistency
- Commitment and management quality
- Addresses the sustainable development agenda
- Quantifies performance
- Achieves credibility

Challenges

- No official framework exists for developing an integrated report
- The contents of existing reports are often still the result of available information, rather than an integrated strategy that takes the various stakeholders into consideration
- The integrated strategy should consider matters such as product / service innovation and supply chain management
- The focus of reporting needs to change from a public relations initiative, to a report that reaches the targeted audience and helps create acceptance for the activities and behaviour of the reporting company.

Benefits

Although some sceptics see integrated reporting as just the creation of a page intensive and exhaustive document, proponents see it as the opportunity to tie environmental and social sustainability performance to financial performance. The benefits include:

- Better exposure of a company's sustainability performance against goals, increasing the company's reputation amongst a wider group of stakeholders
- Greater visibility into the costs and benefits of a company's non-financial performance
- Better information to enable a company to make smarter business decisions and develop a long term strategy

Organisations should ensure that the positive and negative impacts of the company's operations, as well as plans to improve the positives and eradicate the negatives, are conveyed in the integrated report. Trust in a company is achieved through transparent behaviour and is a key success factor for the business to operate, innovate and grow. Clear values, principles, objectives, governance structures and implementation should lead to clear reporting on values, management practices and performance, which should aid a company in obtaining independent assurance through a phased approach to external reporting and assurance.

What counts is whether or not a report reaches the targeted audiences and can help create acceptance for the activities and behaviour of the reporting company. It is key that the report provides the information that stakeholders request and captures the organisation's relevant sustainability issues. Sustainability issues are not only 'green' issues, they impact on the economy, society and the environment.

In closing
Note from the Editor

Dear Colleagues

I hope you have enjoyed reading this issue of *Technically Speaking*. Please continue to send us your comments or suggestions on how we can improve our future issues to **technicallyspeaking@deloitte.co.za.**

We look forward to sharing our next edition of *Technically Speaking* with and value your continued support.

Best wishes for the festive season!

Kind regards

Amy Escott

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