Grant Thornton

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Success line

October 2015

In this issue

Grant Thornton named one of the 50 'World's Most Attractive Global Employers'

A survey of more than 240,000 business and engineering students from 12 of the world's largest economies named Grant Thornton one of the 50 'World's most attractive global employers'. The survey was conducted as part of the Universum Annual Student Survey.

"We are grateful for this award, but all credit goes to the 40,000 Grant Thornton people in more than 130 countries who make Grant Thornton the global organisation that it is." said Ed Nusbaum, global CEO Grant Thornton. "Grant Thornton strives to provide a workplace where our people can unlock their potential for growth, both at work, at home and in their community."

In 37th position on the Universum list, Grant Thornton is "distinguished as an ideal employer in the professional services sector."

The rankings are based on the opinions of business and engineering students from top universities in the world's 12 largest economies: Australia, Brazil, Canada, China, France, Germany, India, Italy, Japan, Russia, UK and US.

The research was conducted by Universum, a leading global research and employer branding consultancy. To be considered in the World's Most Attractive Employer ranking, an employer must be in the top 90% of the Universum Ideal Employer ranking in at least six of the twelve largest economies.

Grant Thornton and three of its partners accredited by BAOA

Dinesh Mallan
Partner

Aswin Vaidyanathan
Partner

Madhavan Venkatachary
Partner

We are glad to inform you that **Grant Thornton** along with Partners **Dinesh Mallan, Aswin Vaidyanathan** and **Madhavan Venkatachary** have been accredited by the Botswana Accounting Oversight Authority (BAOA) to be **'Certified Auditor of Public Interested Entity'**.

BAOA was established through the Financial Reporting Act, 2010 with the principal objective of providing oversight to accounting and auditing services and to promote Standard, Quality and Credibility of providing financial and non-financial information by entities, including public interest entities.

Grant Thornton and its partners are pleased to be authorized by the esteemed body.

IFRS viewpoint

Compiled by the Grant Thornton International Limited IFRS Team

Related party loans at below-market interest rates

Our 'IFRS viewpoint' series provides insights from our global IFRS team on applying IFRSs in challenging situations. This edition provides a framework for accounting for loans made by an entity to a related party that are at below-market levels of interest. Common examples of such loans include:

- Inter-company loans (in the separate or individual financial statements)
- Employee loans

What's the issue?

Loans are one type of financial instrument. As such they are governed by IFRS 9 (2014) 'Financial Instruments' which requires all financial instruments to be initially recognised at fair value. This can create issues when loans are made at below-market rates of interest, which is often the case for loans to related parties.

Normally the transaction price of a loan (i.e. the loan amount) will represent its fair value. For loans made to related parties however, this may not always be the case as such loans are often not on commercial terms. Where this is the case, the fair value of the loans must be calculated and the difference between fair value and transaction price accounted for.

This IFRS viewpoint provides a framework for analysing both the initial and subsequent accounting for such loans.

Our view

Where related party loans are made on normal commercial terms, no specific accounting issues arise and the fair value at inception will usually equal the loan amount.

Where a loan is not on normal commercial terms however, the 'below-market' element of the transaction needs to be evaluated and separately accounted for.

Practical insight: What are normal commercial terms?

Normal commercial terms include the market interest rate that an unrelated lender would demand in making an otherwise similar loan to the borrower. This interest rate would reflect the borrower's credit risk, taking into account the loan's ranking and any security, as well as the loan amount, currency duration and other factors that would affect its pricing.

The framework for analysing related party loans at below-market interest rates diagram illustrates the framework we believe should be applied in analysing such questions. The first step is to determine whether the loan is on normal commercial terms. If not, this indicates that part of the transaction price is for something other than the financial instrument and should therefore be accounted for independently from the residual amount of the loan receivable or payable. This separate element should be accounted for under the most relevant standard.

For example, in the case of a loan to an employee that pays interest at a rate less than the market rate, the difference between the loan amount and fair value is, in substance, an employee benefit that should be accounted for under IAS 19.

Where the 'below-market' element of the loan is not directly addressed by a Standard, reference should be made to the IASB's Conceptual Framework for Financial Reporting (the Conceptual Framework) in determining the appropriate accounting. For example, in the case of a loan from a parent to a subsidiary that pays interest at less than the market rate, the difference between the loan amount and the fair value (discount or premium) will typically be recorded as

- An investment in the parent's separate financial statements (as a component of the overall investment in the subsidiary)
- A component of equity in the subsidiary's individual financial statements (sometimes referred to as a 'capital contribution').

Having separately accounted for this element of the loan, the remaining loan receivable or payable should be accounted for under IFRS 9. IFRS 9 sets out the classification and measurement requirements for the loan receivable or payable as well as the impairment requirements for the receivable.

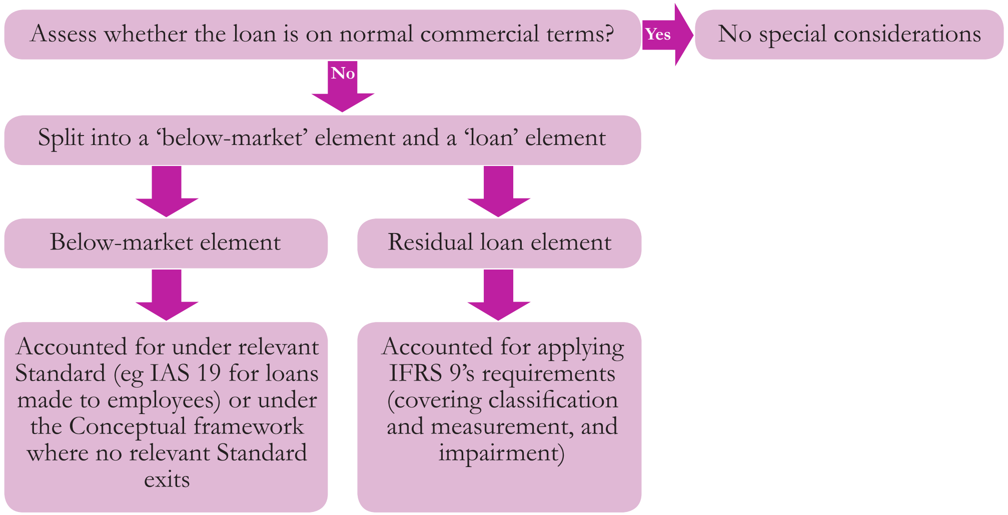


Figure 1: Framework for analysing related party loans at below-market interest rates

Independent Business Review (IBR)

Compiled by the Advisory Services team

What – An Independent Business Review, also referred to as Viability Review, is a process in which a creditor (usually a bank/ funder) requests an independent Advisory Services (AS) consultant to review the business of one of its client and report its findings directly to the bank/ funder.

Why – The IBR is usually prompted when the bank/ funder has concerns about their customer's business, which may relate to profitability, management or operations. The trigger point is often a request for additional funding, or the business exceeding its overdraft level or failure/ delay in debt repayments. It may also be the case that the bank/ funder is simply unable to obtain any reliable information from the customer, and it has to use an IBR to establish the true situation.

Who – The process is tripartite, with the investigating AS team acting as a bridge between the creditor and its customer. It is important that the investigating AS team obtains the buy-in of the customer since building a working relationship with the customer is a key part of the process. If the investigating AS team reports its findings to the creditor without having discussed them with management, the customer will feel alienated and the working relationship will be damaged.

When – IBRs are often undertaken at very short notice in response to a cash crisis. Speed is then of the essence and the investigating AS consultant must be able to respond quickly by fielding an experienced team able to complete the assignment within a short turnaround time.

Where – The IBR should be conducted at the customer's premises. Whilst some work can be conducted back in the office (e.g. desk-top review), it is vital that the investigating AS team understands the business and has engaged with the directors of the customer.

Triggers for an IBR

The bank/ funder and the company management should intervene and appoint an independent AS consultant to conduct an IBR and jointly develop a strategy when the business hits the following road blocks – (in order to avert a crisis and avoid a situation where the business is unlikely to be saved without formal insolvency procedure or liquidating the security available;)

Stage 1: Financial under-performance

- erosion in gross margins,
- turnover remaining flat or reducing,
- market share reducing,
- poor working capital positionancial under-performance.

Stage 2: Financial problems

- arrears in payment of taxes to BURS (VAT, PAYE, other WHT and SAT). The business cannot pay everyone so it stops paying those creditors from whom it does not need supplies or services,
- agreed creditor payment terms stretched to allow the business to stay within the overdraft,
- round sum payments to creditors – rather than based on invoices,
- new supplier accounts are opened as the business reaches its credit limits with existing suppliers,
- 'hardening' of the overdraft level, such that it is always at or close to the maximum limit,

- letters from solicitors/ attorneys towards final demands from creditors.

Stage 3: Financial distress

- breach of covenants/ loans due for repayment/ renewal,
- no headroom in working capital facilities,
- cheques issued to creditors bounced,
- on stop with key suppliers,
- arrears in rental payments,
- unpaid statutory demands,
- finance companies or enforcement officers issuing walk in possession notices for key assets on lease or hire purchase,
- winding up petitions.

Key focus areas in an IBR

Assessing short-cash requirements

This is the first priority in most IBRs to ensure that the business is at least able to survive long enough to allow a more ordered wind-down, or the implementation of a turnaround strategy. In cases of severe financial distress, short-term viability is likely to depend entirely on the immediate cash requirements of the business. However, the bank/ funder will generally not be prepared to increase its lending unless they are convinced that:

- the business is inherently viable and the additional lending will be recoverable,
- the additional lending will be fully secured (under existing or existing plus new security) and
- the funder's security will be protected in the long term by increased lending in the short-term.

Hence, key issues to consider in assessing short-term viability are as follows.

- Considering whether cash outflow can be reduced by:
  - deferring non-essential expenditure such as capex,
  - delaying payments to creditors, and
  - directors reducing or waiving remuneration.
- Considering whether cash inflow can be improved by:
- directors introducing funds,
- improving credit control and debtor collection,
- selling surplus stock at a loss in the short-term, and
- selling surplus equipment and/ or other assets.
- Available security cover and the potential to provide additional or enhanced security.
- Funder's options for recovery action and likely outcome.
- Reliability of management information on which the above and other decisions are being made.

Review of medium to long term financial forecasts in line with recent business performance

This will cover:

- review of an integrated profit & loss account, balance sheet and cash flow forecasts, together with fully documented underlying assumptions, vis-à-vis recent operating and financial performance,
- review of sensitivity analysis prepared on the forecasts, and
- compliance with agreed covenants.

Establish long-term viability of the business

Long-term viability depends on the ability of the business to generate both profit and cash. A business is unlikely to remain viable unless it has:

- a competent management team with a clear strategy,
- sustainable market position,

- adequate funding with an appropriate funding structure, and
- sufficient financial systems and controls.

To establish whether the business will be viable in the long-term, we need to assess the following seven aspects.

1. Demand for its product/ service:
   - economic factors of the markets in which the business operates and its geographical diversification,
   - demand outlook for the product/ service,
   - size of the target customer base, and
   - pricing policy and strategy.

2. Competitive advantage:
   - focus on product development,
   - counter competitor reaction,
   - expected statutory/ technical changes and its impact, and

3. Ability to produce/ serve:
   - installed capacity and utilization levels,
   - use of technology, and
   - expertise of key staff and their levels of motivation.

4. Support from stakeholders, namely: shareholders/ promoters, banks/ lenders, creditors/ suppliers.

5. Adequate financial systems, internal controls and management information systems (MIS) in line with size of business and the industry requirements to ensure that reliable management information is produced on a timely basis to enable management to implement change in response to variations in market conditions.

6. Profit factors:
   - margin levels vis-à-vis industry benchmarks and key competitors,
   - bargaining power of customers and suppliers,
   - asset utilization levels,
   - efficiency of production, and
   - cost control.

7. Current financial position of the business:
   - level of profitability,
   - operating cash flow levels,
   - capital expenditure requirements,
   - research and development requirements, and
   - financial structure vis-à-vis short to medium term cash flow expectations.

Assessing the company management

The most crucial component in determining whether or not a business is likely to overcome financial distress and return to profitability is the quality of its management team. Assessing the quality of the management team providing an analytical insight into the following is therefore a fundamental element of any IBR:

- key strengths and weaknesses of the management team,
- whether the management team recognizes the causes of the recent performance, and whether they are committed to addressing the issues,
- whether the management team has the necessary skills to successfully address the issues, and

• identification of any changes required to improve the effectiveness of management.

The core areas for assessment of management are as follows:

• **Structure** – Whether or not the structure of the management team has sufficient depth and breadth, is fully understood by management and is appropriate to the size and complexity of the business.

• **Expertise** – Whether the management team has sufficient expertise to manage the business effectively and respond to the challenges it currently faces.

• **Strategic planning and decision making** – Quality and process of strategic decision making in the business and its responsiveness to changes in the competitive environment.

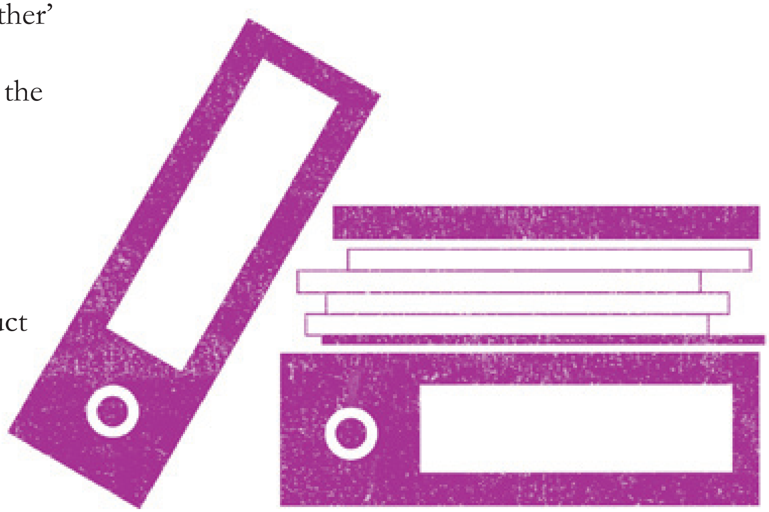
• **Management style and culture** – Is their style supportive to the objectives of the business and its stakeholders or is it an obstacle to progress?

• **Succession planning** – Identify whether plans are in place to protect and sustain the business when change occurs.

• **Commitment** – Extent to which management is committed to the success of the business.

The Advisory Services consultant should also walk around the customer's business premises for 'other' signs like:

• whether the 'reserved' parking spaces nearest the door are for customers or management?
• how busy is the car park?
• does the building need re-decorating?
• how old are the certificates hanging in the reception or in the CEO's office?
• are there latest newspapers/magazines/product brochures for visitors to read?
• how often does the telephone ring at the reception?
• is the reception area welcoming?



BITC accreditation – the advantages

Compiled by Vijay Kalyanaraman, Partner – Advisory Services

Priority sectors and qualifying thresholds

Botswana Investment and Trade Centre (BITC) is a premier investment promotion agency established through an Act of Parliament with an encompassing mandate of investment promotion and attraction, export promotion and development as well as promoting Botswana as a "destination of choice". Through this mandate, BITC provides specific and targeted value proposition to investors premised around a few strategic sectors.

BITC has designated the following sectors as priority sectors for investment – as stipulated in the Botswana Excellence Strategy, National Export Strategy and the Economic Diversification Drive (EDD):

- agriculture & agro-processing,
- mining & mineral beneficiation,
- manufacturing,
- financial and business services,
- business process outsourcing,
- information communication technology (ICT),
- transport, cargo and logistics,
- hospitality & tourism,
- education & skills development,
- health care services,
- qualifying projects sponsored by government economic hubs,
- qualifying projects of strategic national importance.

Both new and existing projects can apply for accreditation with BITC. The organisation facilitates two categories of investors with the following thresholds:

Type of investment	Minimum level of investment
Domestic investment (Citizen)	US$ 125,000 (BWP 1 million)
Foreign investment (Non-citizen)	US$ 500,000 (BWP 4 million)

Other eligibility criteria as laid down by BITC are:

- number and quality/level of employment created,
- potential for skills and technology transfer etc,
- utilization of local raw materials in the production process,
- fast track connection of utilities,
- access to industrial and commercial land allocation and construction permits,
- allocation of BITC factory space (subject to availability),
- environmental Impact Assessment (EIA) certificate (wherever required),
- access to BITC's Export Development, export promotion and export readiness program, and
- no foreign exchange control.
- potential for export and import substitution,
- potential to create backward and forward linkages,
- innovation and creativity.

Fast track residence & work permits and entry visas

Number of permits issued will be dependent on the level of investment and employment created. Following are titles for positions offered to foreign nationals – which facilitates the work permit approval process (as per the local Immigration Act and Employment of Non-Citizens Act):

- Chief Executive Officer, (CEO)
- Production Manager,
- Technical Manager,
- Operations Manager.

Benefits & incentives

BITC facilitates both financial and non-financial incentives to qualifying investment projects that meet the stipulated criteria, via:

- automatic granting of work for deserving investors;
- fast track requirements for business, income tax & VAT registration, and requisite business license,
- Sales & Marketing Manager,
- Financial Manager/ Head of Accounts,
- Head of Treasury,
- Head of the Risk Department, and
- Such other positions as the CEO of the business, after satisfying the BITC, considers appropriate, taking into account the experience and/ or qualification requirements for these positions.

Fiscal incentives

- Development Approval Order (DAO),
- Manufacturing Development Approval Order,
- Botswana International Financial Services Centre (IFSC) Certification,
- Applicable concessions covered by the Income Tax Act,
- Incentivized corporate tax rate of 15%,
- Exemption from WHT on interest, dividends, management fees and royalties paid to non-residents,
- Zero-rate for VAT,
- Exemptions from Capital Gains Tax on the disposal of shares and company assets,
- Access to Double Taxation Avoidance Treaty network,
- Unilateral tax credit of up to 15% for WHT suffered in countries with whom there is no double taxation agreement, and
- Customs and Excise Exemptions and Rebates.

Grant Thornton is a recognized BITC management services firm and can assist in securing BITC accreditation.

We offer

Assurance Services

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- VAT audit, consultancy and compliance
- Expatriate tax
- International tax

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- Outsourcing of personnel
- Payroll processing
- Family business consulting
- Financial statement reviews
- IFRS conversions and compliance

Corporate Services

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- Manufacturing and trading license
- Transfer secretaries
- Incorporation of companies
- Minute secretaries

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- Exit strategy

Contact us

Gaborone

Jay Ramesh – Managing Partner
Acumen Park
Plot 50370 Fairgrounds
P O Box 1157
Gaborone, Botswana
T + 267 395 2313
F + 267 397 2357
E info@bw.gt.com

Francistown

Arjun Surendran – Manager
Botswana Life House
Plot 13993/4
P O Box 101
Francistown, Botswana
T +267 241 8961
F +267 241 8962
E info@bw.gt.com

Editorial Panel

Aswin Vaidyanathan
Pushpa Ramesh
Sakshi Shukla
Itumeleng Moakofhi

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