ACC013

WHAT BASIS OF ACCOUNTING SHOULD BE USED FOR COMPANIES IN FINANCIAL DISTRESS?

ABSTRACT

Listed South African companies in financial distress may apply for business rescue under certain circumstances. In terms of the Companies Act, No. 71 of 2008, listed companies have to apply International Financial Reporting Standards (IFRS) when preparing their financial statements. However, an application of the definition of 'financial distress' stands in contrast to the IFRS 'going concern' assumption that is applied when preparing financial statements in accordance with IFRS in South Africa.

This study investigated the financial reporting requirements of companies under similar rescue regimes in the United States of America, Canada, the United Kingdom and Australia. The study found that due to the application of law and regulation, companies in Canada, the United Kingdom and Australia were obligated to prepare financial statements using IFRS even if the company was not a going concern. However, the United States Generally Accepted Accounting Principles allow a 'bankruptcy accounting' basis of accounting for companies in financial distress under certain circumstances. It is suggested that South African guidelines be developed for a bankruptcy accounting basis of accounting. It is proposed that the bankruptcy accounting basis of accounting be used as a point of departure to develop a guide for listed South African companies in financial distress that have a reporting date during the business rescue period.

KEYWORDS: financial distress, business rescue, going concern, liquidation accounting, financial reporting, IFRS, US GAAP, bankruptcy accounting

STATEMENT WITH RESPECT TO PUBLICATION

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1. INTRODUCTION

In terms of the Companies Act, No. 71 of 2008, listed South African companies in financial distress may apply for business rescue under certain circumstances. The same act also determines that listed companies have to apply International Financial Reporting Standards (IFRS) when preparing their financial statements. However, an application of the definition of 'financial distress' stands in contrast to the IFRS 'going concern' assumption that is applied when preparing financial statements for South African listed companies under business rescue. Moreover, a company making use of the business rescue legislation is also not yet in liquidation, which makes the liquidation base inappropriate for use as a basis of accounting when preparing the annual financial statements of a company under business rescue proceedings.

The research objective was to investigate what basis of accounting was used by listed companies under business rescue proceedings in countries that had rescue regimes similar to those of South Africa and whose financial reporting was guided by IFRS or a similar financial reporting framework. The next section describes the research method applied in order to achieve the objective of the study.

2. RESEARCH METHOD

In order to achieve the objectives of the study, an in-depth literature study was conducted. In this study the financial reporting environment for South African companies under business rescue was examined as a point of departure. Relevant literature pertaining to the financial reporting requirements of companies under restructuring proceedings in countries with well-established business rescue and financial reporting regimes was then investigated. The investigation was done to identify the basis of accounting used, as well as the reasons for the particular choice. The research was concluded with a recommendation for a basis of accounting to be used by listed South African companies under business rescue.

3. BACKGROUND TO BUSINESS RESCUE IN SOUTH AFRICA

In this section the South African legislative environment and the current bases of accounting used are briefly explained. The section also briefly deals with the auditor's dilemma when auditing a company that is under business rescue.

3.1 South African legislative environment

The new Companies Act, No. 71 of 2008, provides the legislative environment for companies in financial distress. Chapter 6 of the Companies Act deals specifically with business rescue, whereas Chapter 2 stipulates that listed companies should comply with the IFRS framework (Republic of South Africa, 2008 s. 29(5)). Chapter 2 and Chapter 6 together set the legal boundaries within which the financially distressed company must operate and report its financial information.

'Business rescue' is defined as proceedings to facilitate the rehabilitation of a company that is 'financially distressed'. A company is financially distressed when it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months or when it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months (Republic of South Africa, 2008 s. 128(1)(f)).

It is important to note that if a company finds itself in financial distress, the directors are compelled to place the company under business rescue. It is also possible for an 'affected person', namely a shareholder, creditor, employee or registered trade union, to apply to the High Court to place the company under business rescue (Republic of South Africa, 2008 s. 128(1)(a), 131).

When examining the provisions of the act, one can reason that one of three possible scenarios for companies in financial distress can emerge:

- If business rescue is unsuccessful, liquidation will still follow.
- If business rescue is successful, the company will continue to exist, or
- The realisation of assets under business rescue will result in a better return for the company's creditors and shareholders than under immediate liquidation.

The aims of business rescue and the definition of 'financial distress' make it clear that business rescue provides procedures to save financially distressed but economically viable companies (Van der Walt, 2009:17). In order to provide financial information for companies under business rescue that is useful for making economic decisions, the preparer of the financial statements must make a choice of which basis of accounting to use. Possible bases of accounting are further explored in the following section.

3.2 Bases of accounting

3.2.1 Going concern basis

One of the most important accounting principles in accounting is the concept of the firm as a going concern (Aras & Crowther, 2012:22). The going concern assumption is recognised by the two main accounting bodies, namely the IFRS Foundation and the United States of America (USA)-based Financial Accounting Standards Board (FASB). An entity is a going concern when it is able to remain in existence for the foreseeable future (IASB, 2012a:A32). The going concern assumption is also universally understood and accepted by accounting professionals (Hahn, 2011:26). Following a period of harmonising local standards of generally accepted accounting practice, South Africa adopted IFRS in 2005. Furthermore, the South African Companies Act, No. 71 of 2008, requires listed companies to comply with IFRS in preparing their financial statements (Republic of South Africa, 2011 Regulation 27(4)).

The going concern principle is contained in the International Accounting Standards Board's (IASB's) *Conceptual Framework for Financial Reporting*, which contains the concepts that underlie the preparation and presentation of financial statements (IASB, 2012a:A13–A43). Apart from explaining the going concern principle, the framework also mentions a 'different basis' of preparation of financial statements when the entity needs to liquidate or curtail materially the scale of its operations (IASB, 2012a:A32). Such a basis should then be disclosed, but the framework fails to provide further information on such a basis/bases. Moreover, IFRS do not define the term 'foreseeable future', but it generally refers to a period of at least, but not limited to, 12 months after the end of the reporting period (IASB, 2012b:A567).

The going concern principle is addressed as an underlying assumption in International Accounting Standard (IAS) 1, which specifies the requirements for presentation of financial statements. IAS 1 echoes the conceptual framework in its requirement that an entity should prepare financial statements on a going concern basis unless management intends either to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When an entity does not prepare financial statements on a going concern basis, that fact should be disclosed together with the basis on which it prepared the financial statements (IASB, 2012b:A566). Once again, the basis that should be used when not preparing financial statements on the going concern basis of accounting is not explained.

The International Financial Reporting Group of Ernst & Young confirmed the lack of guidance as to what such a basis might be and what impact there should be on financial statements if it is determined that the going concern basis is not appropriate. The group accordingly advises entities to consider carefully their individual circumstances to arrive at an appropriate basis (International Financial Reporting Group of Ernst & Young, 2011:129).

Preparing financial statements on the going concern assumption indicates the entity's ability to continue in business for the foreseeable future. Accordingly, the measurement (i.e. the monetary amounts at which an item is recognised and carried) of its assets and liabilities will reflect the fact that the assets and liabilities will be realised and settled in the normal course of business. It is therefore important to arrive at the appropriate basis for preparation, as the choice of preparation basis will have a direct impact on the measurement of the entity's assets and liabilities in the financial statements.

In contrast, if management intends either to liquidate the entity or to cease trading, or has no realistic alternative but to do so, the assets and liabilities are measured at amounts reflecting a forced-sale scenario. The measurements at forced-sale amounts represent the liquidation basis, which is discussed in the section below.

3.2.2 Liquidation basis

IFRS do not provide clear guidance on when and how to apply the liquidation base of accounting (FASB, 2013:2) but only refer to the use of the liquidation basis of accounting when management intends either to liquidate the entity or to cease trading, or has no realistic alternative but to do so (IASB, 2012b:A566). The application of the liquidation base of accounting is not explained. Koppeschaar, Binnekade, Janse van Rensburg, Rossouw, Du Toit, Van Wyk, Sturdy and Deysel (2012:19) in their discussion of the going concern assumption under the conceptual framework explain that an entity should consider measuring elements of financial statements using liquidation values if it is no longer a going concern. They do not discuss the basis/bases of valuation of assets and liabilities under liquidation any further, apart from mentioning that provision should also be made for liquidation expenses (Koppeschaar *et al.*, 2012:19).

In sharp contrast to the limited guidance on any other basis of accounting other than the going concern basis, the United States Generally Accepted Accounting Principles (US GAAP) provide explicit guidance in cases when the liquidation basis of accounting should be used (FASB, 2013). The US GAAP also require that an entity prepare financial statements on the going concern basis unless liquidation is imminent. The FASB explains that the liquidation basis financial statements should reflect relevant information about the value of an entity's resources and obligations in liquidation. In applying the liquidation basis of accounting, financial statements should convey information about the amount of cash or other consideration that the entity expects to collect or the amount that the entity is obligated to pay during the course of liquidation. The measurement should include, amongst others, the costs to dispose of assets or liabilities and any expense to be incurred and income to be earned through liquidation (FASB, 2013).

Until the recent publication of guidance under the US GAAP, the lack of accounting literature to include a clear definition of the going concern assumption led to auditors being tasked to ascertain the going concern status of companies under international auditing standards (Hahn, 2011:31). The following section investigates the auditors' responsibilities regarding management's assessment of the going concern assumption in preparing the company's financial statements.

3.3 Auditor's responsibilities

The Independent Regulatory Board for Auditors (IRBA), which is the governing body for registered auditors in South Africa, adopted the International Auditing and Assurance Standards Board's (IAASB's) International Standards on Auditing and Quality Control in 2009 (IRBA, 2009). The responsibility for preparing financial statements and evaluating the company's ability to continue as a going concern lies with management. International Standard on Auditing (ISA) 570 *Going concern* provides detailed guidance to the auditor, dealing with the auditor's responsibility in the audit of financial statements based on the going concern assumption. ISA 570 par. 2 confirms the measurement base by stating that when the use of the going concern assumption is appropriate, the assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business (IAASB, 2012b:ISA 570-2).

If the financial statements are prepared on a going concern basis and the auditor judges that management's use of the going concern assumption in the financial statements is inappropriate, the auditor must express an adverse opinion. This opinion must be expressed regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern assumption (IAASB, 2012b:ISA 570-12).

The ISA then states that if the entity's management is required or elects to prepare financial statements when the use of the going concern assumption is not appropriate in the circumstances, the financial statements are prepared on an 'alternative basis' and gives the liquidation basis as an example. "The auditor may be able to perform an audit of those financial statements provided that the auditor determines that the 'alternative basis' is an acceptable financial reporting framework in the circumstances" (IAASB, 2012b:ISA 570-12).

From the above it is clear that ISA 570 provides for the audit of financial statements prepared on an 'alternative basis' other than the going concern or the liquidation basis, which was given as an example. The ISA, however, does not give any further examples or guidance on what such a basis might be. ISA 210 *Agreeing the terms of audit engagements* provides more guidance. It states that one of the preconditions of an audit is that the auditor shall determine whether the financial reporting framework applied in the preparation of the financial statements is acceptable. For ISA purposes, the applicable financial reporting framework provides the criteria that the auditor uses to audit the financial statements, including where relevant their fair presentation. ISA 210 further states that without an appropriate financial reporting framework or guide, management does not have a formal basis for the preparation of the financial statements and the auditor does not have suitable criteria for auditing the financial statements (IAASB, 2012a:ISA 210-2, 6).

If the auditor has determined that the financial reporting framework applied in the preparation of the financial statements is unacceptable, the auditor shall not accept the audit engagement, except when law or regulation prescribes this financial reporting framework. The auditor shall then accept the audit engagement only if management provides additional disclosures in the financial statements and certain paragraphs, drawing the users' attention to the matter included in the audit report (IAASB, 2012a:ISA 210-3, 4).

The Regulations to the Companies Act, No. 71 of 2008, in fact determine that IFRS shall be used for public companies listed on an exchange (Republic of South Africa, 2011 Regulation 27(4)). Therefore, an auditor who audits a set of IFRS-based financial statements of a South African Johannesburg Stock Exchange-listed company is still required to accept the audit engagement and perform the audit according to the IFRS framework, even if he/she believes that the use of the going concern assumption is not appropriate.

Because the business rescue model was developed with input from international experts, it is important to investigate the specific financial reporting requirements, if any, for companies that may not be a going concern. The next section details the findings of the investigation into financial reporting during restructuring proceedings and the basis of accounting used by listed companies under rescue regimes similar to the South African business rescue model.

4. INTERNATIONAL RESCUE REGIMES REVIEW

The Department of Trade and Industry mentions Australia and Canada as examples of countries that have introduced new systems for business rescue over the past decade (Republic of South Africa, Department of Trade and Industry, 2004:45). According to Harvey (2011:85), the new (South African) business rescue model is now in line with the rescue regimes of foreign jurisdictions such as the United Kingdom (UK), Australia and the USA. For this reason, the financial reporting requirements of companies that are under business rescue (or its equivalent) in these countries will be discussed. Reasons for the particular use or choice are also discussed.

4.1 United Kingdom

Financially troubled companies in the UK are allowed to restructure their affairs under the Insolvency Act of 1986 (Loubser, 2010:164). The act provides for two rescue procedures, namely ‘Administration’ and ‘Company Voluntary Arrangement’. The philosophy born in 1986 was aimed at the rehabilitation and preservation of viable businesses, as well as to offer enterprises in difficulties a better chance of survival by allowing them time to reassess their future rather than facing liquidation or administrative receivership (Broc & Parry, 2004:177; Jones Day, 2007:6). The South African business rescue model was developed with the same philosophy in mind.

Since 2005, listed companies in the UK must present financial statements that comply with IFRS (PwC UK, 2012). Furthermore, the UK's audit regulator, the Financial Reporting Council (FRC), adopted the IAASB's audit standards (for periods ending on or after 15 December 2010) but with supplementary requirements to address specific UK and Irish legal and regulatory requirements. The supplementary requirements also included additional guidance that was appropriate in the UK and Irish national legislative, cultural and business contexts (FRC, 2009b). The FRC supplementary requirements did not include any going concern amendments.

In 2009 the FRC published guidance for directors of UK companies dealing with going concern and liquidity risk (FRC, 2009a). In this guidance, the FRC advised directors to evaluate which one of three potential conclusions was appropriate to the specific circumstances of a company. The conclusions could be as follows:

There were no material uncertainties that might cast significant doubt on the company's ability to continue as a going concern.

There were material uncertainties related to events or conditions that might cast significant doubt on the company's ability to continue as a going concern, but the going concern basis remained appropriate.

The use of the going concern basis was not appropriate; in other words, the company had no realistic alternative but to cease trading or go into liquidation, or the directors intended to cease trading or place the company into liquidation (FRC, 2009a:3).

In 2011, the FRC announced the launch of an inquiry led by Lord Sharman of Redlynch to identify lessons for companies and auditors addressing going concern and liquidity risks (FRC, 2012a). The panel determined that in order to depart from the going concern basis of accounting and to adopt the liquidation basis of accounting, the threshold of distress required (by the UK GAAP and IFRS frameworks) was a level of distress both very high and imminent (FRC, 2012b:2, 25).

From the above it is clear that even if a UK company has undertaken one of the restructuring options under the Insolvency Act of 1986, the going concern basis is appropriate. To depart from the going concern basis of accounting requires a high level of distress, such as when the company has no realistic alternative but to cease trading or go into liquidation, or the directors intend to cease trading or place the company into liquidation.

4.2 Australia

Australian companies in financial difficulties are allowed to be rescued under procedures set out in Part 5.3A Voluntary Administration (VA) of the Australian Corporations Act 2001 (Cth), entitled “Administration of a company’s affairs with a view to executing a deed of company arrangement” (Blazic, 2010:2). Anderson (2008:26) compared the Australian business rescue procedures to the South African business rescue procedures and concluded that the objectives were almost identical and that the two regimes covered many similar areas. Blazic (2010:2) summarises the fundamental objective of VA as the rescue of viable companies that are threatened by insolvency from being wound up. The VA regime seeks to facilitate a stay on creditor claims, whereby it provides an opportunity for a company to restructure its affairs for the benefit of creditors and other stakeholders, compared to liquidation (Blazic, 2010:2).

The Australian Securities Market (ASX) is Australia's primary exchange (Neidermeyer & Lacasse, 2011:37). The Corporations Act of 2001 (Cth) (s. 296) determines that financial reports must comply with accounting standards. Australia's corporate, markets and financial services regulator, the Australian Securities and Investment Commission (ASIC), states that Australian accounting standards meet the requirements of IFRS, as Australia adopted IFRS in 2005 (ASIC, 2003; ASIC, 2012). Furthermore, the Australian Auditing and Assurance Standards Board (AUASB) has since April 2006 released Australian Auditing Standards (ASAs) based on the ISAs issued by the IAASB (AUASB, 2012).

The ASIC (2003:1) provides for relief for externally administered companies from financial reporting obligations under the Corporations Act of 2001 (Cth). Externally administered companies include companies under administration and a company subject to a deed of company arrangement (ASIC, 2003:2). The reporting relief is, however, limited to the deferral of lodging of financial reports.

From the above it is clear that the financial statements of listed companies in Australia have to comply with IFRS, in other words the going concern assumption, even if the company is under VA. Such a company's financial statements are also audited in terms of IAASB-based auditing standards. The result is that, once again, the liquidation basis of accounting will only be applied if the company has decided to liquidate or cease trading, or has no realistic alternative but to do so.

4.3 Canada

Financially troubled companies in Canada are allowed to restructure their affairs under the protection of two separate federal laws, namely the Bankruptcy and Insolvency Act (BIA) and the Companies Creditors' Arrangement Act (CCAA) (Haskin & Haskin, 2012:190). Restructuring through the CCAA is restricted to larger companies (companies owing amounts to creditors in excess of C$ 5 million). Companies below the C$ 5 million threshold may utilise the BIA (PwC Canada, 2012b).

This discussion will focus on the CCAA, being the restructuring alternative for larger companies, such as publicly accountable enterprises (PAEs). A publicly accountable enterprise includes a listed company, namely an entity (other than a not-for-profit organisation, or a government or other entity in the public sector) that has issued debt or equity instruments that are traded in a public market (CICA, 2012b). A company that has filed for protection from its creditors under the CCAA is not in receivership or bankruptcy. In fact, the company has filed under the CCAA in order to develop a plan, while it continues to operate, to *avoid* going into receivership or bankruptcy (PwC Canada, 2012a). The aim of the CCAA is therefore to allow a company to restructure its affairs and to allow creditors to receive some form of payment for amounts owing to them (PwC Canada, 2012b). This aim is similar to the aim in Chapter 11 of Title 11 of the United States Code (hereafter referred to as 'US Chapter 11') (see Section 4.4) and the South African business rescue model.

Canada adopted IFRS as Canadian Generally Accepted Accounting Principles (Canadian GAAP) for PAEs for fiscal years beginning on or after 1 January 2011 (CICA, 2012c). Accordingly, the Ontario Securities Commission (OSC) required listed companies to comply with IFRS for financial years beginning on or after 1 January 2011 (OSC, 2012). Moreover, the Canadian Auditing and Assurance Standards Board (AASB) adopted ISAs as Canadian auditing standards for the audits of financial statements for periods ending on or after 14 December 2010 (CICA, 2012a).

In a matter brought before the Ontario Superior Court of Justice, the court found that companies under CCAA protection were still required to file audited financial statements with the OSC (OSC, 2005). Against this background, it is clear that listed companies under CCAA protection are still required to file financial statements based on IFRS, which have been audited in terms of ISAs. The requirement to use IFRS further implies that the financial statements of companies under the CCAA's protection will be prepared on the going concern assumption. Under ISA 570 *Going concern*, the auditor's responsibility is to assess management's use of the going concern assumption in the preparation of the financial statements (IAASB, 2012b:570–573). In explaining the auditor's responsibility under ISA 570, Turner (2012) refers to ISA 570 par. 2 (IAASB, 2012b:570–572) when he explains that it just means making sure that the entity has not decided to liquidate or cease trading, or has no realistic alternative but to do so. If an auditor is concerned about the company's ability to continue as a going concern, a qualification is made in the auditor's report to that effect (Barrack & Miller, 2011:3).

From the above one can once again conclude that the IFRS going concern basis of accounting will always be applied for Canadian listed companies, even if the company sought protection under the CCAA due to financial difficulties. The liquidation basis of accounting will only be applied if the company has decided to liquidate or cease trading, or has no realistic alternative but to do so.

4.4 United States of America

Companies in the USA are allowed to file a petition with the Bankruptcy Court under the Bankruptcy Code. Filings can be for either a reorganisation action under US Chapter 11 or liquidation (Chapter 7). The goal of the reorganisation proceedings is to maximise the return to creditors and shareholders by preserving the company as a viable entity with a going concern value (AICPA, 1990:19, 271). Therefore, both the US Chapter 11 reorganisation proceedings and the South African business rescue proceedings share the goal of preserving the entity as a going concern for the benefit of stakeholders that might be negatively influenced under immediate liquidation.

The AICPA acknowledges that current financial reporting literature lacks specific guidance for financial reporting by an entity in reorganisation proceedings. Entities normally continue to apply the reporting principles that they applied before filing the US Chapter 11 petition. However, applying the same principles does not adequately reflect all the changes in the entity's financial position caused by the reorganisation proceedings. The result is that financial statements prepared while entities are under reorganisation proceedings are not as useful to the users of the financial statements as they should be. The needs of financial statement users have changed; therefore, changes in the reporting practices previously followed are necessary (AICPA, 1990:19, 274–19, 275).

To accommodate the changing needs of the financial statement users, the AICPA prepared Statement of Position (SOP) no. 90-7 (also known as Accounting Standards Codification (ASC) 852 under the new FASB codification) to provide guidance on financial reporting by entities that have filed petitions with the Bankruptcy Court and expect to reorganise as going concerns under US Chapter 11 (AICPA, 1990:19, 271). SOP 90-7 states that the objective of financial statements issued by an entity in US Chapter 11 should be to reflect its financial evolution during the proceedings (AICPA, 1990:19, 275).

With respect to the balance sheet (statement of financial position), SOP 90-7 recommends that precommencement liabilities subject to compromise be distinguished from those that are not subject to compromise (such as fully secured liabilities that are expected not to be compromised) and from postcommencement liabilities. Liabilities that may be affected by the plan should be reported at the amounts expected to be allowed, even if they may be settled for lesser amounts. The gain or loss resulting from the entries to record the adjustment should be classified as reorganisation items.

With respect to the statement of operations (statement of profit or loss and other comprehensive income), SOP 90-7 recommends that the statement of operations should portray the results of operations of the reporting entity while it is in US Chapter 11. Revenues, expenses (including professional fees), realised gains and losses, and provisions for losses resulting from the reorganisation and restructuring of the business should be reported separately as reorganisation items, except for those required to be reported as discontinued operations and extraordinary items. Extraordinary items are not allowed under IFRS (IASB, 2012b:A577).

SOP 90-7 further suggests that entities whose reorganisation plans have been confirmed by the court and have thereby emerged from US Chapter 11 should apply the principles of ‘fresh-start reporting’ as of the confirmation date or as of a later date when all material conditions precedent to the plan’s becoming binding have been resolved (AICPA, 1990:19, 277).

Under fresh-start reporting, the entity should report information about the ‘reorganisation value’ in the disclosure statement so that creditors and stockholders (equity holders) can make an informed judgment about the plan. The reorganisation value is a value that approximates a fair value of the entity before considering liabilities and approximates an amount that a willing buyer would pay for the assets immediately after the restructuring (AICPA, 1990:19, 273). The most likely place to report the reorganisation value is in the pro forma balance sheet that is commonly part of the disclosure statement. Because the reorganisation value may not have been allocated to individual assets concurrently with the preparation of the pro forma balance sheet included in the disclosure statement, it may be necessary to include a separate line item in the pro forma balance sheet to reflect the difference of the total reorganisation value of the emerging entity over recorded amounts. When possible, the reorganisation value should be segregated into major categories (AICPA, 1990:19, 278).

Entities that adopt fresh-start reporting should also apply the following principles (AICPA, 1990:19, 278):

All assets and liabilities should be restated at their ‘fair value’, which means that some accounts in the balance sheet will need to be revalued. Moreover, some intangibles such as intellectual property, goodwill and favourable leases may have to be evaluated and new assets created according to FASB Statement No. 141 *Business combinations* (Sasso & Blair, 2008), which is similar to IFRS 3 *Business combinations.*

The reorganisation value of the entity should be allocated to the entity’s assets in conformity with the procedures specified by SFAS 141 *Business combinations.* If any portion of the reorganisation value cannot be attributed to specific tangible or identified intangible assets of the emerging entity, such amounts should be reported as goodwill.

Each liability existing at the plan confirmation date, other than deferred taxes, should be stated at present values of amounts to be paid determined at appropriate current interest rates.

Deferred taxes should be reported in conformity with generally accepted accounting principles. Benefits realised from preconfirmation net operating loss carryforwards should first reduce reorganisation value in excess of amounts allocable to identifiable assets and other intangibles until exhausted and thereafter be reported as a direct addition to paid-in capital.

SOP 90-7 presents some interesting principles under fresh-start reporting. The question is whether fresh-start reporting can be applied in a business rescue context. The possibility of applying fresh-start reporting is considered in the next section.

5. PRACTICAL RECOMMENDATIONS

Fresh-start reporting presents viable principles that should be researched in the South African business rescue context but within the IFRS environment. The latter is important, as some adaptations to known IFRS measurements may have to be made. For example, IFRS 13 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (IASB, 2012d:A501). However, an orderly transaction specifically excludes a distress sale (IASB, 2012d:A525), which is exactly what may happen in a business rescue situation.

While there are some similarities between South African and other countries' corporate rescue procedures, financial reporting requirements and auditing standards applied, there are also noticeable differences. Table 1 below summarises the corporate rescue procedures, financial reporting requirements and auditing standards applied for South Africa, the UK, Australia, Canada and the USA.

Table 1: International reorganisation procedures, financial reporting requirements, basis of accounting used and auditing standards applied

Country	Reorganisation procedures	Definition of financial distress?	Financial reporting during reorganisation procedures	Basis of accounting during reorganisation procedures	Audit standards applied
South Africa	Companies Act (Chapter 6)	Yes	IFRS	Going concern	ISA
UK	Insolvency Act (Administration)	No	IFRS	Going concern	ISA
Australia	Corporations Act (Voluntary Administration)	No	IFRS	Going concern	ISA
Canada	Companies Creditors Arrangement Act	No	IFRS	Going concern	ISA
USA	United States Code (Chapter 11)	No	US GAAP	ASC 852 fresh-start reporting	ISA

When comparing the different countries' rescue procedures, it is notable that the South African business rescue model is the only one in which the state of financial distress has been defined. Moreover, the time frame included in this definition seems to create a unique accounting problem when evaluated against the going concern assumption. None of the countries investigated defined the state of financial distress as the 2008 Companies Act had done. Consequently, no direct conflict with the IFRS going concern assumption as a base to prepare the financial statements on exists.

In a recent paper published by Haskin and Haskin (2012:189), the authors asserted that in the movement to convergence between the US GAAP and IFRS, bankruptcy accounting was not addressed. They therefore investigated whether companies in countries that used IFRS were influenced by the guidance of ASC 852 (SOP 90-7) when confronted with the accounting treatment of companies undergoing reorganisation under bankruptcy laws similar to US Chapter 11.

Haskin and Haskin (2012:193) concluded that accounting for reorganisations under bankruptcy was somewhat of an unknown and that the IASB had not issued any guidance with respect to accounting situations that were controlled by ASC 852 (SOP 90-7). The reported findings in the above sections pertaining to the UK, Australia and Canada are in agreement with Haskin and Haskin's conclusion. Furthermore, Haskin and Haskin (2012:193) pointed out that in terms of the hierarchy of IFRS (IASB, 2012c:A636), the preparer should turn to national standards if the other levels of hierarchy did not address the issue.

6. CONCLUSION

The objective of the study was to determine the basis of accounting used by listed companies under similar rescue and financial reporting regimes in different parts of the world. The findings of the study indicate that due to the application of law and regulation, companies in the UK, Australia and Canada are obligated to prepare financial statements using IFRS, even if the company is not a going concern. However, the US GAAP allow a bankruptcy accounting basis of accounting for companies in financial distress under certain circumstances. A similar approach may be appropriate in a South African business rescue context, as the findings of the study indicate the need for specific guidance in IFRS with respect to a basis of accounting that can be employed in a situation where a company is not a going concern but not in liquidation either.

It is suggested that the accounting profession, the South African Institute of Chartered Accountants, academics and standard setters take note of the findings of this study. Possible guidance pertaining to a bankruptcy accounting basis of accounting may serve the decision-making needs of the users of the financial statements of a company finding itself under business rescue at its reporting date particularly well. Such guidance could even be complemented by principles for the recognition and measurement of assets and liabilities. Further research into these principals for the recognition and measurement of assets and liabilities when applying such a bankruptcy accounting basis of accounting would also be needed.

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