

# Accounting Practices Board

## Rekeningkundige Praktykeraad

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Ref: #214454

7 August 2008

Ms Marcelle Williams  
Committee Secretary  
Parliamentary Monitoring Group

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Dear Ms Williams

In response to the publication of the Companies Bill published in Government Gazette No 31104 of 30 May 2008, attached please find the submission of the Accounting Practices Board (APB) – the current official standard-setter of South Africa.

In this capacity, the APB submission covers the sections of the Companies Bill which relate to financial reporting and which the APB would like to bring to the attention of the Committee.

We would like to commend the dti for the Bill and the extent to which it meets the main objective to promote the competitiveness and development of the South African economy by simplifying the formation of companies and allowing for flexibility, predictability, efficiency, transparency and an effective regulatory environment.

Our submission is divided into two sections. Firstly we have a section addressing matters that we believe are areas of principle, for consideration at the highest level. The following section deals with specific comments, per section of the Bill, in a table format.

Please do not hesitate to contact me should you require any further information or clarification on any of the matters raised in this submission.

Yours sincerely

Moses Kgosana  
**Chairman of the Accounting Practices Board**

Cc. Tom Wixley, Chairman: SAICA Ad Hoc Committee on Corporate Law  
Ewald Müller, SAICA Senior Executive: Standards

## **COMMENTS OF PRINCIPLE**

**(a) Inter-relationship between this Bill and the Corporate Laws Amendment Bill**

**(b) Regulations proposed in the Bill**

**(c) The authority of the Financial Reporting Standards Committee (FRSC)**

**(d) The monitoring of compliance with the Financial Reporting Standards**

## DETAILED COMMENTS PER SECTION

Section	Issue/Motivation	Proposal
1 (def)	Annual financial statements are not defined in the Companies Bill. Although financial statements are defined, annual financial statements have a different meaning and the lack of definition creates uncertainty and confusion for a critical part of financial reporting.	That annual financial statements should be defined by reference to “ <i>as determined by the Council</i> ”. Annual financial statements must comprise of components of financial statements as defined in financial reporting standards.
2	Subsection 2(1) defines related persons in an interminable chain that could even lead to parties who have never met and have no knowledge of each other’s existence, being classified as related, and the groups they are involved with, to be linked. The third degree of consanguinity and the use of the term “ <i>affinity</i> ” stretches the definition of related persons too far to be useful and will produce financial reporting results that are misleading and contrary to financial reporting standards. In addition, the definition of “ <i>group</i> ” depends on the definition of related persons. For the purposes of financial reporting, group accounts typically refer to the reporting by a juristic person who owns various other juristic persons. Under the proposed use of the word “ <i>group</i> ” companies will be required to report on the unrelated activities of all companies owned by the same natural person. This concept is beyond what has been historically seen or ever intended in financial reporting. See example provided. <a href="#">[Simon to provide example(s)]</a>	Drafters should redefine “ <i>group</i> ” to align it with what is intended in financial reporting. Here perhaps reference can be made to the Council eg. “ <i>as determined by the Council</i> ”. The drafters should also redefine related persons to ensure it does not conflict with financial reporting terminology, whilst still maintaining the intended implications for other parts of the Bill that do not affect financial reporting aspects.
27	Subsection 27(4)(c) limits the period between year-ends to 15 months. This is mirrored in 61(7)(b) which requires an AGM no later than 15 months after the last one. These provisions are impractical, despite the fact that it allows for more recent financial information. For example if a company were legally obliged to	That the period of 15 months be changed to 18 months, as is contained in the current Act. This would still allow companies to present after 12 months should they deem it appropriate. It would further remove a legal impediment to what may a

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	change its year end from December to April, May or June, one would end up with having to prepare annual financial statements for 4-6 months to get back to a normal cycle of 12 months. In addition, it would become impossible for such a company to comply with what may well be a legal requirement elsewhere, in only one year.	<p>legal requirement elsewhere, such as the fact that (newly acquired) subsidiaries may have to have year-ends that are coterminous with their holding companies.</p> <p>Drafters need to note that 15 months is pervasive in the Bill and needs to be reviewed throughout.</p>
28	This section refers to accounting records in terms of their appropriateness in the course of preparing the financial statements, it also refers to prescribed records, but no reference is made to the importance of records in being able to manage the affairs of the company, or indeed provide a trail of transaction recording for regulatory or judicial purposes. This issue is compounded by the fact that if a company falls within the ambit of S30(1)(b) of not being required to prepare annual financial statements, it is even more critical to have appropriate and sufficient accounting records.	That the requirement in the current Companies Act in S284, which indicates what nature of accounting records should contain, should be kept in the Bill.
29	<p>Subsections 29(1)(a) and(b)) require that any financial statements must-</p> <p><i>“(a) satisfy the financial reporting standards as to form and content;</i></p> <p><i>(b) present fairly the state of affairs and business of the company, and explain the transactions and financial position of the business of the company;”</i></p> <p>The current wording does not indicate that application of financial reporting standards is the first and primary requirement and fairness of presentation should be used as a secondary requirement. Past experience has demonstrated that if a company does not like the results produced by FRS and deem the results not to be fair, in their view, they would not comply with FRS. This would result in an</p>	<p>That S29(1)(b) be deleted and that S29(1)(a) be reworded as follows:</p> <p><i>“present fairly the state of affairs and business of the company in terms of financial reporting standards;”</i>.</p> <p>As a result of the changes above, S29(1)(c) should be deleted as this is now superfluous.</p>

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	<p>untenable position for corporate reporting in South Africa where each companies could potentially decide whether or not results in terms of FRS is fair and if not, make adjustments. History has shown that people will often try and manipulate results to hide poor or improper management. The current drafting would make enforcement of financial reporting standards difficult, as any issues of non-compliance could be defended by the offender on the basis that they believe it is a ‘fairer’ position.</p>	
29	<p>Subsection 29(1)(d) requires the date on which the statements are produced. The word “<i>produced</i>” is not used elsewhere in the Bill and the wording should be consistent with other relevant sections, for example the approval of financial statements.</p>	<p>That the word “<i>produced</i>” be replaced with issued or published.</p>
29	<p>Subsection 29(1)(e) including (i) (aa)-(cc) requires the first page of the statements to contain a prominent notice indicating whether the statements have been audited, independently reviewed or not audited. Whilst we agree there should be a prominent notice of this fact, we do not concur that it is necessary to be displayed on the first page.</p>	<p>That “<i>first page</i>” be deleted.</p>
29	<p>Subsection 29(1)(e)(ii) requires the name and professional designation of the individual who prepared the statements. This is misleading since the financial statements are the responsibility of a number of people including the board of directors, and in addition preparation is often a team effort with no single person “preparing” them.</p>	<p>That the reference be deleted (i.e. the whole of subsection 29(1)(e)(ii) and subsection 29(3)(b)(iii)).</p>
29	<p>Subsection 29(4) states that “<i>the Minister, after consulting the Council, may make regulations prescribing – (a) financial reporting standards contemplated in this Part;</i>”. Subsection 203 gives the Minister the power to establish the Council and select and approve appropriately qualified members to the</p>	<p>That Subsection 29(4) be amended to state that “<i>the Council shall make regulations prescribing – (a) financial reporting standards contemplated in this Part;</i>” and Furthermore the regulations shall be promulgated</p>

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	<p>Council. The development and management of financial reporting standards require extremely high levels of technical accounting knowledge, and fast reactions to developing trends. Financial reporting standards are complex and have extensive financial and economic impact. It is appropriate for the Council to be given the authority to manage the entire process of researching, developing and issuing financial reporting standards. S204 will still cater for the Council to advise the Minister on matters relating to financial reporting standards.</p> <p>Subsection 29 (5)(b) states that “<i>financial reporting standards, must be consistent with the international Financial Reporting Standards of the International Accounting Standards Board</i>” There are numerous new standards issued and interpretations to standards issued, as well as a smaller number of amendments to existing standards by the International Accounting Standards Board in any one year. If a new or revised International Financial Reporting Standard (IFRS) is not issued as a financial reporting standard very soon after it has issued internationally, we will create a situation where South African companies who prepare financial statements in terms of IFRS, might not be in compliance with the Companies Act if they adopt (which is permissible) the new IFRS early, because it has not yet passed the local due process of approval and issuance in South Africa as a financial reporting standard. In addition, if South African companies do not adopt every new IFRS in line with international effective dates for these standards, such companies may not - by rule - claim compliance with IFRS. All of this will have a major impact on the credibility of South Africa’s reporting and the ability to attract foreign investment.</p>	<p>before the Act becomes effective, in order to achieve certainty and to give ample warning to companies and the market as to how the process will operate; and  that the Council shall issue a regulation that specifies the transitional arrangements in respect of financial reporting standards, between the current legislative position and that under the new Act, and that such regulation shall be promulgated before the Act becomes effective, in order to achieve certainty and provide timely guidance. (In certain cases it takes more than a year for a large company to prepare for the change to a new accounting standard).</p>
29	Subsections 29(4) and (5) refer to financial reporting standards. The definition of financial reporting standards refer to these sections. It	That both Subsections 29(4) and (5) be amended to say that “ <i>financial reporting standards include</i>

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	needs to state that financial reporting standards include interpretations of financial reporting standards issued by the International Accounting Standards Board as well as those issued by the Council for specific local issues.	<i>interpretations of financial reporting standards</i> ".
29	Subsection 29(5)(b) states that " <i>financial reporting standards must be consistent with the International Financial Reporting Standards of the International Accounting Standards Board</i> ".	That " <i>consistent with</i> " be replaced with " <i>concordant with</i> " to better illustrate the type of alignment required with International Financial Reporting Standards.
29	Subsection 29(5)(c) seemingly provides a qualification of 29(5)(b) but the interpretation is not clear, albeit critical if it were meant to allow for differentiation not allowed by the international standards. Such differentiation may be required for micro enterprises, for example and we would support differentiation for this situation.	That clarification be provided of whether the subsection qualifies the requirement in 29(5)(b), and if necessary, redrafting.
30	Subsection 30(1) refers to " <i>prepare</i> " annual financial statements but not to " <i>prepare and publish</i> ".	That the wording be amended to require that annual financial statements are required to be prepared and published (i.e. finalised by showing them to at least one third party). This is a critical issue, not dealt with elsewhere in the Bill. Only publication provides the financial statements with verifiable status as being those finally approved by the board. (In the case of (Pty) Ltd companies the publication will not be to the public.). The previous Acts had the benefit of referring to the AGM as the target for the annual financial statements, and by inference to their publication.
30	Subsection 30(1)(b) permits certain private (non-dormant) companies, in very specific circumstances, not to prepare annual financial statements. This exception should be deleted, inter alia on	That this exception not to provide annual financial statements be deleted. [For APB discussion – the sub-comm had divergent

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	<p>the basis that the protection of limited liability should be provided only on condition that financial statements are prepared (and published, see above). The requirement to prepare financial statements aligns with the corporate governance principles in the Bill.</p> <p>In addition, creditors and employees would have no proof of recklessness of the directors at a point in time, unless there were financial statements. Furthermore, the provision of financial statements has a legal connotation that is critical for regulatory and judicial purposes.</p> <p>Lastly, statistical analyses may be impacted: both internally for a company's own records as it develops, and externally as the importance of a burgeoning SMME sector grows within the economy.</p> <p>It needs to be underscored that a private company that qualifies under this proposed exemption today, is likely to be the successful public company of tomorrow.</p> <p>If the protection of limited liability were to be allowed without checks and balances of financial statements, it is likely to lead to a contraction of the economy as funders and suppliers believe their creditor position would be too heavily weakened.</p>	<p>views.]</p>
29 and 30	<p>Subsection 30(1)(b) provides relief for owner managed types of business not to have to prepare annual financial statements. The current wording contained within sections 30 and 29 would require that any financial statements prepared “<i>must satisfy the financial reporting standards</i>” (Subsection 29(1)(a)).which would be required to be “<i>consistent with the international Financial Reporting Standards of the International Accounting Standards Board</i>” (Subsection 29(5)(b).</p>	<p>Where a company meets the criteria of Subsection 30(1)(b) not to have to prepare annual financial statements, the reporting requirements of Subsection 29(1)(a) need to be such that the rigorous requirements of Subsection 29(5)(b) are stated not to apply.</p>



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30	<p>Subsection 30(5)(d) requires the annual financial statements to be presented to the first shareholders’ meeting after the statements have been approved by the board.</p> <p>The next shareholders’ meeting may be too soon to provide for proper notice and proper consideration of the contents of the financial statements, or may be attended by only a subgroup of shareholders. Such meetings may be called at short notice, and waiver of notice may also be possible.</p>	<p>That this section be amended to refer to the annual general meeting in terms of Subsection 61(7).</p>
30	<p>Subsection 30(6)(b)(i) and (ii):</p> <p>Subsection 30(6)(b)(i) refers to pensions “<i>receivable by current or past directors</i>“ This does not say who the pension is receivable from and could result in all pensions received from any source, not only from the company that is reporting, to be disclosed.</p> <p>Both subsections 30(6)(b)(i) and (ii) refer to “<i>current or past directors</i>“. There needs to be a limit on how far back to go for a past director. It would be ludicrous to require this for somebody who was a director (say) 20 years ago.</p>	<p>That subsection 30(6)(b)(i) restrict “<i>receivable</i>” to only that receivable from the companies within the group that is reporting.</p> <p>That the term or time frame used to determine whether a person was at a certain point a “<i>past director</i>”, be defined.</p>
30	<p>Subsection 30(8) is less onerous than current requirements in the revised Companies Act and does not include benefits in kind.</p>	<p>That the wording be amended to:</p> <ul style="list-style-type: none"> <li>• include the value of share options on the basis of the measurement rules set out in the financial reporting standards;</li> <li>• include benefits in kind;</li> <li>• clarify what term or time frame is to be used to determine whether a person was at a certain point a “<i>future director</i>”.</li> </ul>
35	<p>Subsection 35(3)(b) requires that a company:</p> <p>“(b) <i>must at all times have at least one share issued to at least one person other than—</i></p>	<p>We therefore strongly recommend that this position is reconsidered and that Section 35(b) be revised so that it requires that every company should have at least one issued share, but that it does not place any</p>

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	<p><i>(i) a company that is part of the same group of companies; or</i></p> <p><i>(ii) a juristic person that is controlled by one or more companies within the same group of companies.”</i></p> <p>This implies that one company can no longer hold 100% of the shares of another company, because if they did, the company would <b>not</b> “<i>have at least one share issued to at least one person other than a company that is part of the same group of companies</i>”. We question whether this was the intention of the Bill as this could have a negative impact on foreign investment and could have a significant impact on many groups of companies within the Republic. Many foreign companies form wholly owned subsidiaries in South Africa through which they conduct business. This section would imply that they would need to have at least one other, unrelated shareholder, which in many cases would be undesirable and sometimes impractical. Many South African groups also use wholly owned subsidiaries to conduct business for various reasons. Wholly owned subsidiaries are also a very common phenomenon in the international economic environment and may be critical to qualify for exemptions and specific treatment in other legal jurisdictions.</p> <p>It would also result in a very limited application of Section 30(1)(b)(ii)(aa) which exempts a private company from preparing annual financial statement if “<i>one person holds, or has all of the beneficial interest in, all of the securities issued by the company</i>” as Section 35(3)(b) would limit this to instances where an individual holds all of the shares in a particular company.</p>	<p>limitations on who the holder of such a share may be.</p>
187	<p>Subsection 187(3)(a) refers to the function of, what was termed as the Financial Reporting Investigations Panel (FRIP) in the Corporate</p>	<p>That much greater clarity be provided in respect of monitoring of compliance with financial reporting</p>

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	Laws Amendments, only in passing.	<p>standards. The Commission cannot just monitor patterns of non compliance, it should ensure that offenses are investigated, ie there should be a cross reference to 187(2).</p> <p>The term “<i>patterns of compliance</i>” is also a very broad term and strangely does not suggest active monitoring of compliance. We would expect the latter to occur.</p> <p>Furthermore it would be desirable to introduce time frames for creation of the body to monitor compliance with financial reporting standards.</p>
187 & 204	Subsections 187(3) and 204(a): It is unclear what is required of the Council with respect to compliance with financial reporting standards. The Council must be responsible for setting financial reporting standards, not monitoring compliance with those standards too.	The drafters need to clarify the intention in these sections. In this regard it should be clear that the Council alone sets standards, not the Commission. There needs to be greater clarification of the intended use of general compliance notices as they relate to financial reporting standards. The danger to be avoided is that the Commission cannot create financial reporting standards in issuing these general compliance notices. It also needs to be clarified that the Council does not monitor compliance and that the responsibility sits with the Commission. The inter relationship between the two needs to be specified so it is clear as the Council’s responsibility to the Commission when it receives general compliance notices.
191	Section 191 red in conjunction with our comments on Section 187	We suggest that section 191 be expanded to enable

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	<p>above is of concern. It would seem that the Commission will be unable to appoint parties to assist him in monitoring compliance with financial reporting standards as was drafted in the Corporate Laws Amendment Act for the FRIP. The specialist committees in Section 191 do not seem to cover the FRIP type of arrangement. This would mean that it will not be possible to set up a structure as originally envisaged by the Corporate Laws Amendment Act for a FRIP. What is key for enforcement of financial reporting standards is that matters are not always clear cut issues. It will therefore be crucial to have a group to consult with for enforcement purposes.</p>	<p>the Commission to appoint specialists to assist him with monitoring and enforcing compliance with financial reporting standards.</p> <p>We further suggest that in Section 191, a new subsection be drafted indicating that for the purpose contemplated in section 187(3)(a), the Commission will establish a FRIP whose mandate and operation should mirror the sections in the Corporate Laws Amendment Act for “<i>monitoring</i>” all financial reports (reproduce Sections 440(2) and 440W of the Corporate Laws Amendment Act).</p>
203	<p>The section does not state a deadline for the establishment of the FRSC.</p> <p>Subsection 203(1)(d) is intended to broaden the requirement in the Corporate Laws Amendment Act (S440P(2)(d)), which required four users of financial statements. This could be broadened even further to require other users too.</p> <p>Subsection 203(1)(h) has tagged onto the end of the sentence “<i>to serve for a term of three years</i>”. This should be Subsection 203(2) and the subsections from thereon renumbered. In addition, this clause should allow for the members to be appointed every three years with a maximum period as was required in the Corporate Laws Amendment Act (S440Q(3))</p>	<p>That the FRSC be legislated to be established, and commence functioning in respect of the issuing and eventual promulgation of the necessary regulations (see above) <u>before</u> the new Act becomes effective.</p> <p>That subsection 203(1)(d) include the words “<i>or other users</i>”.</p> <p>That a new subsection 203(2) be created to deal with the terms of office of members of the Council; and that this subsection indicate that members are appointed for an initial term of three years and thereafter are appointed every three years with a maximum period of nine years.</p>

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204	<p>Subsection 204(c) currently states that the Council must “<i>consult with the Minister on the making of regulations establishing financial reporting standards</i>”. As per our comments under Subsection 29(4), this should be the Council’s function.</p>	<p>That subsection 204(c) be amended to state that “<i>make the regulations establishing financial reporting standards</i>”.</p>
223	<p>Subsection 223(3) refers to “<i>regulations prescribing financial reporting standards as contemplated in section 29(4)(a)</i>”. As per our comments under Subsection 29(4), this should be the Council’s function and this section should be deleted.</p> <p>Subsection 223(2) states “<i>the Minister must publish proposed regulations for public comment, subject to subsection (3)</i>.” As per our comments under subsection 29(4), regulations for financial reporting standards should be the Council’s function and this section should state that; and allow for the Council to publish proposed regulations for public comment. In light of our comment above, the reference to “<i>subject to subsection (3)</i>” should be deleted.</p>	<p>That subsection 223(3) be deleted.</p> <p>Subsection 223(2) should refer to regulations for financial reporting standards as being the Council’s function and allow for the Council to publish proposed regulations for public comment. Delete the reference to “<i>subject to subsection (3)</i>”.</p>