To: Ms MA Williams
Secretary to Parliament

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Date: 6 August 2008

Comments on the Companies Bill

The JSE takes keen interest in the Companies Bill, as we recognise the importance of this legislation on corporate South Africa in general and entities listed on the JSE and capital markets in particular. We are therefore appreciative of the opportunity to submit our comment letter, attached, to Parliament.

We commend the dti for the manner in which it considered and successfully incorporated comments raised on the 2007 draft bill into the Companies Bill to significantly improve the proposed legislation, particularly in so far as the categorisation of companies is concerned.

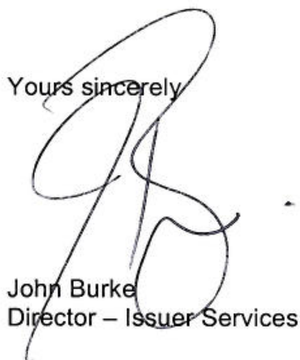
The JSE submission primarily focuses on matters of principle, where we are of the view that changes to the Bill are eminent, in order to address weaknesses, possible conflicts that will arise between the JSE Listings Requirements and the Companies Bill, once enacted, and requirements that are impracticable, create additional red-tape or will have a negative impact on the markets.

Our submission also raises points of less significance, but that would, in our opinion, enhance the Bill.

In general, the comments raised in this submission have already been discussed with the dti in our deliberations with the drafting team. We were disappointed that, despite positive feedback and an initial indication that the dti was in agreement with the comments, the necessary changes was not made to the Bill.

We would welcome an opportunity to raise our principle comments with the Portfolio Committee.

Yours sincerely



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August 2006

PRINCIPLE COMMENTS

1. Financial Reporting Standards Council (FRSC)

1.1 We are concerned that the functions of the FRSC have been scaled down significantly from what is included in the Corporate Laws Amendment Act, to an advisory function only to the Minister as opposed to it being a standard-setter, as initially envisaged.

1.2 The structuring of the standard-setting function is hugely concerning in so far as the timeous issuing of financial reporting standards is concerned. It is unlikely that standard-setting can be done through a ministerial approval process in a speedy manner. We recognise the attempt by the dti to create a mechanism in the Bill to fast-track the issuing of financial reporting standards, as set out in section 223(3). However, this provision calls for ministerial approval and it is anticipated that it would only be implemented in exceptional circumstances. If South African does not issue a new or revised International Financial Reporting Standard (IFRS) very soon after it being issued internationally, a situation is created where South African companies might not be in compliance with the Companies Act if they have adopted the new IFRS that has not yet gone through the full local due process of approval and issuance.

1.3 If South African companies do not adopt every new IFRS in line with international effective dates for these standards, such companies cannot claim compliance with IFRS, which will have a major impact on the credibility of South Africa's reporting. IFRS is a comprehensive reporting framework and it is not possible to switch from one comprehensive accounting framework, such as IFRS, to another, such as South African standards, from one year to the next. The implication thereof would be that companies would have to re-do prior year figures on the other framework, for the sake of comparative information. Furthermore, auditors will have to reconsider the revised information for purposes of expressing an audit opinion. Not only would this result in unnecessary and fruitless costs, it will be hugely confusing for shareholders, local and international investors and other users of financial statements.

1.4 Furthermore, other standard-setting functions, such as auditing standards, are not done in a similar fashion. We are of the view that the promulgation of legislation is an inappropriate and ineffective manner to align South Africa's financial reporting standards with international best practice.

1.5 We would also like to point out that the manner in which the standard-setting function is proposed in the draft Bill is also not in line with standard-setting functions elsewhere in the world.

1.6 We acknowledge the comment from the dti that the Minister cannot delegate the powers to set financial reporting standards to the FRSC or any other body, as the standard-setting function is in fact a law-making ability. We recognise that this is as a result of the Corporate Laws Amendment Act and the Companies Bill providing legal backing for accounting standards, a matter that has been requested for many years. Legal backing enables enforcement of compliance with financial reporting standards and puts appropriate processes and procedures in place for legal action to be taken against companies and their office bearers in instances of non-compliance with the required standards. This being said, we reiterate our view that the legislative process is unsuitable for, and will not be able to keep up with, the multitude of changes of IFRS. It should be noted that numerous changes are made to IFRS on an annual basis.

1.7 We understand that an inherent conflict arises in an attempt to attain legal backing for financial reporting standards on the one hand and achieve a speedy standard-setting process delegated to an independent standard-setting body, such as the Financial Reporting Standards Council on the other. Therefore we would like to see a balance being struck between these objectives without jeopardising the credibility of South African reporting.

1.8 We would therefore like to recommend a model where the criminalisation of non-compliance of financial reporting standards is not the only way in which to achieve legal backing for these standards. We are of the view that administrative action and administrative sanction should be the primary methods of enforcing the financial reporting standards, in addition to the fact that any transgression of these standards may also constitute a criminal offence. The criminal offence route should not be the only sanction as it may be a cumbersome remedy to enforce transgressions of the financial reporting standards. The enforcement of the financial reporting standards will only be adequately addressed if it is done in a timely manner, before markets have made economic decisions based on financial results.

1.9 To achieve these goals, the setting of standards should be delegated to another body, such as the FRSC and these standards will then be enforced by administrative action and administrative sanction. For example, the primary method of enforcing the legislation prohibiting market abuse in the Securities Services Act is the action taken by the Enforcement Committee of the Financial Services Board.

2. Monitoring of compliance with financial reporting standards

2.1 One of the urgent and long overdue amendments addressed in the Corporate Laws Amendment Act was the implementation of a monitoring function to ensure compliance with financial reporting standards, especially in companies where public interest plays a role. This is an important element in a legislative framework for confidence in the quality of reporting by our companies and hence enhances the credibility of our markets.

2.2 The Corporate Laws Amendment Act allows for a pro-active review of financial statements of certain categories of companies by the Financial Reporting Investigations Committee, as well as for a mechanism to deal with complaints regarding the quality and accuracy of financial reporting.

2.3 It is concerning that no mention is made of this in the Companies Bill. Indications from the dti are that this would be dealt with by the Commission. However, to ensure the confidence in our legal framework, as referred to above, and to ensure that the matter is given the right priority at the Commission, the Companies Bill should act as the enabler for a monitoring function.

We suggest that section 191 be expanded to also allow for the Minister to appoint a specialist committee of appropriately qualified individuals to address the objectives and function of the Commission (as contemplated by section 186(1)(d) and (e) and section 187(2)(b) and (3)(a) and (b)). This should be with specific reference to the following:

- Monitoring of compliance with financial reporting standards;
- Pro-active identification of contraventions of financial reporting standards;
- Investigations of alleged contraventions of financial reporting standards;
- Appropriate remedial and other action in respect of such contraventions.

3. The role of the shareholders and the board of directors

3.1 An important corporate governance principle embedded in not only in South African legislation, case law and common law, but also in other jurisdictions, is that the board of directors is appointed by the shareholders to execute the mandate of the company as set out in its Memorandum/Articles. The board of directors is therefore accountable to

the shareholders and takes the ultimate responsibility to steer, direct and lead the company and its management.

3.2 The provisions of the Companies Bill are not aligned with these principles as is evident from the following:

- Section 66(4)(b) implies that the shareholders can, on election of the company in its Memorandum of Incorporation, only appoint 50 % of the directors. It is uncertain in such an instance who would appoint the other 50 %. In line with well recognised corporate governance principles all directors should be appointed by the shareholders.

- It is evident that the audit committee, that is in some instances a sub-committee of the board and accountable to the board in so far as fulfilling its function relating to financial reporting, internal controls and risks are concerned, have been assigned 'super' power and instances are created in the bill where the audit committee is directly accountable to the shareholders, e.g. in so far as auditor independence is concerned. This creates an inherently conflicting role and reporting line and contradicts the governance principle previously referred to.

OTHER COMMENTS

4. Definition of 'group of companies'

The Bill defines a group of companies as two or more companies that are related or inter-related. The Bill has numerous references to a group, e.g. when conducting a solvency and liquidity test. This definition is contradictory to what is commonly understood to be a group and also the definition of a group in terms of the financial reporting standards. In both of these instances a group refers to different legal entities that share common control. The definition in the Bill is much wider and has significant unintended consequences that would be impossible to execute in practice.

5. Shareholding of a company

Section 25(1)(b) requires that a company must at all times have at least one share issued to at least one person other than a company that is part of the same group of companies or a juristic person that is controlled by one or more companies within the same group. This implies that a company cannot be a wholly owned subsidiary of another company. We question the rationale for this requirement as it is completely out

of step with the current requirements and there seem to be no valid reason for such a requirement.

6. Impact on changes in financial year-ends

6.1 It is questioned why section 27(4)(c) of requires that a company cannot have a financial year ending more than 15 months after the preceding financial year. The requirement is not in line with that of the current requirement, which allows for 18 months. The 15 month limitation can be problematic in instances where a company changes it year-end.

6.2 For example, if a company with a February year-end becomes a subsidiary of a company with a June year-end, the new holding company would require the subsidiary to change its year-end (in order to simplify reporting). This will result in the subsidiary having a 4 month financial period (to June), as it would not be allowed to have a 16 month financial period from March 2008 to June 2009. This would place be a cost and effort burden on such a company as it will have two year-ends in a short space of time and disregards the importance of allowing companies to continue with reasonable commercial activity.

6.3 We question the importance of requiring that the length of the initial financial period be aligned with subsequent periods.

7. Status of the JSE Listings Requirements in relation to the Companies Bill

There is no general statement to explain the status of the JSE Listings Requirements in instances where they are more stringent than, or in conflict with the Companies Bill, other than the very specific and narrow application in section 84(2). The application of the maxim *expressio unius est exclusio alterius* may lead to an interpretation that the JSE Listings Requirements will only take precedence to the provisions of the Companies Bill in respect of the issues enunciated in section 84(2). By only addressing this matter for individual sections uncertainty is created as to the overall principle when such conflicts exist. The JSE is of the view that all companies have to comply with the provisions of the Companies Bill. It is of vital importance to the JSE in its capacity as regulator of its exchange that the JSE Listings Requirements may prescribe additional or more stringent requirements than those contained in the Companies Bill and, in these instances, that the Listings Requirements should take precedence.