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YOUR WEALTH

For attention 7 August 2008

Ms MA Williams

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SAIPA SUBMISSION ON THE COMPANIES BILL (B61-2008) ("THE BILL")TO THE PORTFOLIO COMMITTEE AUGUST 2008

The Portfolio Committee on Trade and Industry intends holding public hearings on the Companies Bill [B61-2008] during August 2008.

Please receive the SAIPA submission to the Portfolio Committee. We also thank you for the opportunity to make a public submission on the 13th August 2008.

Kind regards

Nicolaas van Wyk Technical Executive SAIPA

TABLE OF CONTENT

EXECUTIVE SUMMARY

1 The publication of this Bill marks an important milestone in the existence of the accounting profession and of SAIPA. SAIPA is particularly grateful for the opportunities it has been afforded in the Company Law process by the DTI and for the engagement that SAIPA has had with the drafting team throughout the process.

2 In the main, SAIPA's proposals seeks to:

- Ensure that accounting records are appropriately defined (Appendix 1);
- Financial statement report providers are appropriately defined (Appendix 1);
- Ensure that the independent review and any other report be appropriately defined in the Bill (Appendix 1);
- The scope of accounting records are appropriately provided for (Appendix 2);
- Ensure that fair presentation in terms of financial statements is defined in terms of financial reporting standards or frameworks (Appendix 3);
- Ensure the establishment of differential financial reporting standards (Appendix 4);
- Ensure that all companies are required to prepare financial statements in accordance to differential financial reporting standards (Appendix 5);
- Ensure that appropriately qualified persons are appointed to report on financial statements of companies (Appendix 1 and 6);
- Ensure an effective and efficient issuing process for financial reporting standards (Appendix 7 and 8)

- Ensure the unfettered future existence of the Close Corporation Act either as a standalone statute or as a chapter within the Bill (Appendix 9);
- Ensure that the regulations pertaining to close corporations are aligned to the conceptual underpinnings of close corporations i.e. a simplistic and straightforward form of business vehicle for the SME sector. (Appendix 9);
- Ensure that the Bill recognise the complex nature of financial reporting standards and provide appropriate penalties for non compliance.

3 Our core comments can be summarised in the table below:

Type of company	Financial Reporting Standards	Financial Statements	Financial Statement Report Providers	Report on financial statements
Public	IFRS/GAAP	Mandatory	Registered auditor registered with the IRBA	Audit report
Non-owner managed private companies	IFRS/GAAP for SME	Mandatory	Registered Auditor registered with the IRBA or	Audit report or
			Professional accountant regulated by IFAC	Independent review (non assurance report; defined by the profession)
Owner managed private companies	Micro-entity Financial Reporting	Mandatory	Professional accountant regulated by IFAC	Report of factual findings (non assurance as defined by IFAC)
Close Corporations	Gaap as appropriate	Mandatory	Accounting officer	Accounting officer report

INTRODUCTION

4 We thank the Portfolio Committee for the opportunity to make a written and oral submission on the Companies Bill [B61-2008], the “Bill”.

5 Our submission consists of two parts: a specific discussion on relevant sections of the Bill and a general conceptual discussion of relevant issues in the Bill. The specific discussion relates primarily to financial reporting and related requirements. The general discussion was not intended to be an exhaustive analysis and aims to note concerns with certain significant issues included in the Bill. An exhaustive analysis was not possible due to the following reasons: limited time allowed for preparing comments on the Bill, the Bill was only preceded by one draft Bill, the Bill presents a significant amendment to the draft Bill.

6 For ease of reference we include an appendix at the end of the document containing a summary of the SAIPA proposals and suggested amendments to the wording of the Bill.

History and scope of the Bill

7 In early 2003 the Department of Trade & Industry (DTI) initiated the Company Law Reform Process which nears completion with the hearing by the Portfolio Committee of submission on the Bill.

8 The Bill is the result of an arduous process which commenced with the drafting and publication of the Policy Document entitled "Company Law For the 21st Century: Guidelines for Corporate Law Reform" (published on 23 June 2004 in Government Gazette No. 26493, Vol. 468). After extensive consultations on the Policy Document during 2004 and 2005, the DTI drafted and published the Draft Companies Bill, 2007, for public comment in February 2007.

9 Whilst drafting the Companies Bill, the DTI engaged in a parallel process of drafting urgent amendments to the Companies Act, 1973, (Act No. 61 of 1973). This process culminated in the enactment of the Corporate Laws Amendment Act, 2006 (Act No. 24 of 2006) which became effective on 14 December 2007.

10 The Corporate Laws Amendment Act, 2006 did not constitute the overall reform of the Companies Act, 1973, as it only brought about interim amendments to the primary legislation (viz. the 1973 Companies Act).

11 After publication of the Draft Companies Bill, 2007, the DTI embarked on an extensive consultation process and the resulting comments were instrumental in the completion of the current Bill.

12 The Bill, unlike the Corporate Laws Amendment Act, regulates all aspects of the corporate existence of companies - starting from the incorporation, registration,

organisation and management of companies of all types; to providing for equitable and efficient amalgamations, mergers and takeovers of companies, the efficient rescue of financially distressed companies; to introducing appropriate legal redress for investors and third parties with respect to companies as well as re-structuring the regulatory framework for the effective enforcement of the legislation.

13 It is envisaged that the Bill will be effective by either late 2009 or early 2010.

Contributors

14 This submission is the official view of SAIPA. The submission was drafted with the assistance of the SAIPA Technical Committee and various experts. The representations does not necessarily reflect the personal views of all those that assisted SAIPA. The following persons contributed to the drafting of this submission:

- Technical Committee:

- Mias Strauss – Chairperson SAIPA Technical Committee;
- Lerato Sebata – Sub committee chairperson: Corporate Law;
- Nicolaas van Wyk – Technical Executive SAIPA

- Experts

- Prof. Farouk Cassim - Corporate law expert
- Prof. Piet Delport – Corporate law expert
- Flip Dwinger – Corporate law expert
- Pieter Stassen – Corporate law expert

- Corrie Cloete – SAIPA practicing member
- Prof. David Venter – Management expert
- Joseph Tshiwilowilo – SAIPA chairperson and member of ABASA
- Saleem Kharwa – International Accounting Education Standards Board of the International Federation of Accountants

SPECIFIC COMMENTS

Financial statements (Clause 29 and 30)

15 SAIPA regards the preparation of financial statements, including annual financial statements as being pivotal to the growth and sustainability of the SMME sector within the country's economy.

16 The financial reporting model that SAIPA has proposed to the DTI may be depicted in the table below. The model proposes that appropriate and less onerous financial reporting standards or guidance should apply to different categories of companies. If alternative standards are made available it should be considered to require all companies to prepare financial statements.

17 Financial statements should be mandatory for all companies due to the following important reasons:

- Differential reporting will allow relevant companies i.e. owner-managed private companies to apply a framework other than IFRS/GAAP. This will significantly reduce the burden of producing financial statements. Financial statements are necessary to make business and economic decision;
- The Business Rescue provisions contained in chapter 3 of the Bill allows a company that is financially distressed to effect business rescue provisions. A company is financially distressed if it displays signs of illiquidity and insolvency. The

effect of business rescue will be a postponement of repayments to creditors. This benefit should only be allowed if financial statements have been prepared;

18 The financial reporting model proposed by SAIPA is as follows:

Type of Company (For profit)	Financial Reporting Requirement
Public companies; State-owned enterprises	Mandatory financial statements in accordance with IFRS/GAAP
Private Company (Separation between ownership and management)	Mandatory financial statements in accordance with IFRS/GAAP for SME
Private Company (Securities are held by one person; or all of the security holders are also directors of the company, or related persons)	Mandatory financial statements in accordance with generally accepted accounting practice as appropriate to the business i.e. - Micro-entity Financial Reporting; - SMEGA level 3 reporting as issued by the UN; - Tax basis of reporting; - Cash basis of reporting
Personal Liability Company	Mandatory financial statements in accordance with generally accepted accounting practice as appropriate to the business i.e. - Micro-entity Financial Reporting; - SMEGA level 3 reporting as issued by the UN; - Tax basis of reporting; - Cash basis of reporting
Close Corporation	General accepted accounting practice as appropriate

19 We therefore propose amendments to clause 1, 29, and 30 so as to adequately provide for:

- Differentiated financial reporting standards and frameworks;
- Mandatory annual financial statements;

the proposed amendments to the wording of the Bill are contained in the appendix clause of this submission.

20 Our proposals seek to:

- Ensure that accounting records are appropriately defined (Appendix 1);
- Financial statement report providers be appropriately defined (Appendix 1);
- The scope of accounting records be appropriately provided for (Appendix 2);
- Ensure that fair presentation in terms of financial statements is defined in terms of financial reporting standards or frameworks (Appendix 3);
- Ensure the establishment of differential financial reporting standards (Appendix 4);
- Ensure that all companies are required to prepare financial statements in accordance to differential financial reporting standards (Appendix 5);

Third party reporting on financial statements (Clause 29 and 30)

21 SAIPA is supportive of the requirement in the current Bill that public companies and certain private companies (those with a deemed greater responsibility to a wider public as a consequence of their significant social or economic impact) should be

audited by a registered auditor, or where appropriate, independently reviewed as prescribed by regulation.

22 The current Bill provides that certain private companies, for example non-owner managed companies, may choose to either have their financial statements audited by a registered auditor or have their financial statements independently reviewed.

23 The current Bill proposes that regulations will determine the scope of the independent review as well as the profession that would be allowed to perform the independent review. SAIPA believes that the DTI will consult with the accounting profession to determine the above.

24 However SAIPA wish to propose that:

- The scope of the independent review should be set out in the Bill, and not only in regulation;
- The profession that will be recognised to issue the independent review should be set out in the Bill, and not only in regulation;
- A report of factual findings on the financial statements of owner-managed companies should also be a mandatory requirement;
- The profession that will be recognised to issue the report of factual findings should be set out in the Bill;

25 Report providers, as well as the type of reports that they are able to issue on financial statements, should be clearly stipulated in the Bill due to the following important reasons:

- Clause 29(6) of the Bill makes it an offence to prepare or be party to the preparation of ANY financial statement knowing that those statements do not comply with international reporting standards. Preparers of financial statements will therefore be subject to an offence if the statements they prepared do not comply with reporting standards. A high level of competence is therefore required so as to ensure compliance to the reporting standards. In addition, only a professional accountant would likely have access to professional indemnity insurance to compensate companies for damages suffered in the event of such an offence.

- Clause 76(5)(b) allow the directors of a company to rely on information provided by "accountants". The Bill does not define the term "accountant" nor does it set a standard of conduct for "accountants". It is generally accepted that accountants are associated with the preparation or compilation of financial statements. Accountants can be either employed by the company or provide their services as private practitioners for a fee. If directors are to rely on information as provided by "accountants" then it should be considered to clearly define the competence and standard of conduct expected of "accountants";

- According to clause 214(1)(d) a person is guilty of an offence if that person prepared financial statements in accordance with a required financial reporting standard and those financial statements contained a scheme, structure or form of words, that the person knew, or ought reasonably to have known, would cause the financial statements to be false or misleading. A high level of competence and accountability is therefore required so as to ensure that financial statements do not include information that would cause them to be false or misleading.

26 The reporting function provided by a professional accountant is fundamental to the success of any business enterprise. This function assists both business owners and other stakeholders in making economic and related decisions.

27 SAIPA distinguishes the following types of reports that may be issued on financial statements: audit, independent review, and factual findings. Reports should be differentiated based on the type of company for which the report is issued.

28 We believe that the audit should be defined as per the Auditing Professions Act and be required for public companies. In this sense the audit represents an assurance report that expresses an opinion on the fairness of the financial statements.

29 In contrast, the Bill provides that non-owner managed companies will be able to choose between an audit and an independent review. Due to the element of choice

available to the shareholders of this type of company, we believe that the independent review need not be an assurance report. For this reason it would be necessary for the accounting profession, together with the DTI and the IRBA, to further define the scope of the independent review.

30 The current Bill does not require any report to be issued on the financial statements of owner managed companies. We believe that owner managed companies should also be required to obtain a report on their financial statements. We believe that a report of factual findings should be required of owner managed companies. The report of factual findings is a non assurance report, the scope of which is determined by the International Federation of Accountants (IFAC).

31 The profession that will be allowed to issue the independent review and, if our proposals are accepted, the report of factual findings is not defined by the Bill.

32 We would like to propose that this profession be defined as consisting of persons that are members of an accountancy body that is a member of IFAC. Internationally such a person is known as a "professional accountant". If recognition is provided in the manner proposed it would mean that the competence of South African report providers is aligned to that required by the International Federation of Accountants (IFAC).

33 SAIPA is a full voting member of IFAC. This means that SAIPA members are recognised internationally as professional accountants. In South Africa SAIPA members are entitled to the designation “Professional Accountant (SA)”.

34 Other South African bodies that are members of IFAC include: South African Institute of Professional Accountants (SAICA); Associations of Certified Chartered Accountants (ACCA); Chartered Institute of Management Accountants (CIMA). These bodies, including SAIPA, represent approximately 35 000 professional accountants.

35 We further propose that the professional accountant regime as described should replace the current requirement to appoint an accounting officer.

36 Due to the need for meaningful financial and related information various current statutes require the appointment of an accounting officer, for example:

- Accounting Officer for a close corporation;
- Accounting Officer for a body corporate;
- Accountant/Accounting Officer for a trust;
- Accounting Officer for a school;
- Accounting Officer for an insurance intermediary;
- Accounting Officer for Non-profit Organizations;

37 In each case the duty of the Accounting Officer is described by statute as to:

- Compare financial statements with the information contained in accounting records;
- Review the appropriateness of the accounting policies as applied to the preparation of financial statements; and as a secondary duty;
- To report on the contravention of the particular statute, if the Accounting Officer becomes aware of such a contravention.

38 It is clear form the above that various statutes recognize the need to appoint a person to report on the financial statements of an entity. Currently this function is provided by either a registered auditor or an accounting officer. However as a result of the increased complexity of financial reporting standards, the liability the Bill places on the preparers of financial statements, and the new business rescue provisions contained in the Bill we propose the current accounting officer regime should be replaced by a more stringent professional accountant regime. This will ensure:

- Legislative stability in terms of other statutes relying on the appointment of an Accounting Officer;
- Effective financial decision making;
- Compliance with legislative requirements;

39 The model proposed by SAIPA for the recognition of financial statement report providers is depicted in the following table:

Type of Company (For profit)	Financial Statement Report Providers	Report on financial statements
Public companies; State-owned enterprises	Registered auditor registered with the IRBA	Audit report
Private Company (Separation between ownership and management)	Registered auditor registered with the IRBA Or	Audit report
	Professional accountant regulated by IFAC	Independent review (non assurance report; defined by the profession)
Private Company (Securities are held by one person; or all of the security holders are also directors of the company)	Professional accountant regulated by IFAC.	Report of factual findings (non assurance as defined by IFAC)
Personal Liability Company	Professional accountant regulated by IFAC	Report of factual findings (non assurance as defined by IFAC)
Close Corporation	Accounting Officer	Accounting officer report

40 We have made suggested changes to the wording of the Bill so as to give effect to our proposals above. The changes are included in the appendix clause of this submission.

41 Our proposals seek to:

- Ensure that appropriately qualified persons be appointed to report on financial statements of companies (Appendix 1 and 6);

- Ensure that the independent review and any other report be appropriately defined in the Bill (Appendix 1)

Financial Reporting Standards Council (Clause 203 and 204)

42 Chapter 8 of the Bill establishes various regulatory agencies. One of these is the Financial Reporting Standards Council (FRSC).

43 The Corporate Laws Amendment Act, 2006 (Act No 24 of 2006), established a Financial Reporting Standards Council and a Financial Reporting Investigations Panel with similar functions as the Council contemplated in the Bill. The Bill does not provide for any transitional arrangements and the Memorandum on the Objects of the Bill merely states that the Council is re-established in the Bill. The matter needs clarification.

44 The functions of the Council are vaguely described. It would seem from clause 29 (4) and (5) that their main function would be to do the necessary research for and draft financial reporting standards and then advise the Minister thereon. One would expect to find their role and function more clearly defined in the clause in the Bill specifically dealing therewith.

45 Appendix 11 of this submission provides background information to the FRSC and its predecessor the Accounting Practices Board (APB). It also discusses the history and scope of differential reporting at length.

46 The current functions of the FRSC as provided for in the Bill do not include the issuing of financial reporting standards or any another framework for the preparation of financial statements. The Bill currently proposes that the Minister should issue regulations prescribing these standards.

47 We propose two alternate models so as to improve the functioning of the FRSC. These are listed below.

48 We propose that the FRSC be mandated to manage the entire process of researching, developing, requesting comment and issuing financial reporting standards due to the following reasons: "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" and "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."[1]

49 The current model for the creation of the FRSC reflects similar characteristics as the Financial Reporting Council (FRC) of the United Kingdom. The FRC is an independent regulator in the UK that sets both auditing and accounting standards.

50 However the current South African Bill limits the functions of the South African FRSC to advising the Minister on issuing financial reporting standards.

51 An alternate proposal to the above could be to provide legal backing for financial reporting standards by referencing a voluntary body that falls outside the ambit of the Bill.

[1] Taken from recent discussion on the Bill with a working committee of the APB, of which SAIPA is a member, dated 25 July 2008

52 Such a model is provided for in the Canadian Business Corporations Act. The Canadian act requires that: “"Canadian GAAP"” means generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants, as amended from time to time.”[2]

53 The above proposal will enable the Accounting Practices Board (APB)[3] to continue to operate as it has done for the past number of years. The Bill should then only require relevant companies to follow financial reporting standards as issued by the APB. This proposal may reduce the complexity of the Bill whilst still providing legal backing for financial reporting standards. In this proposal the enforcement action to ensure compliance to financial reporting standards will remain with the proposed companies' commission.

54 We have made suggested changes to the wording of the Bill so as to give effect to our proposals above. The changes are included in the appendix clause of this submission.

55 Our proposals seek to:

- Ensure an effective and efficient issuing process for financial reporting standards (Appendix 7 and 8)

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[2] The Canada Business Corporations Regulations, 2001 (SOR/2001-512) Part 8, Clause 70, Financial Disclosure, Interpretation.

[3] Refer appendix 12 for a discussion on the APB and differential reporting.

Close Corporations Act (Schedule 5)

56 The Bill proposes that the Close Corporations Act should be closed as an avenue for the incorporation of new entities or for the conversion of companies into close corporations. SAIPA believes that this provision, may unnecessarily limit the choice of business owners as to the legal entity they deem most appropriate for their business enterprise.

57 Although the Bill provides for owner-managed companies akin to close corporations this will be a new and untested regime. Variety of choice between either a Close Corporation or, an owner-managed private company, would most likely best suit the business community. The cost of migrating close corporations into the new regime needs further debate and discussion.

58 The main distinction between private companies as envisaged in the Bill and current close corporations relate to their governance. The governance of the new proposed private companies are more flexible but also more complex for third parties dealing with the company; whereas the governance of close corporations are more rigid but provides certainty for third parties dealing with the close corporation.

59 In this regard we include an article by Prof Johan Henning on the history of the close corporation – see appendix 10. The purpose of this guide is to provide a background

to the discussion on the future existence of the close corporation, and to provide information on the different philosophical assumptions related to the companies bill and the close corporations act.

60 The following table provides an indication of the number of close corporations that will be affected by the provisions of the Bill:

Registered Entities (2006)	Number	Percentage (% registered)
Close Corporations	1,276,157	40.51% (75%)
Private Companies	412,233	13.09% (24%)
Public Companies	3,757	0.12% (0.2%)
Incorporated Companies (Professional)	7,976	0.25% (0.5%)
External Companies	1,056	0.03% (0.06%)
Total Registered Entities	1,701,179	54%
Unregistered Entities	**Number**	**Percentage**
Informal economy	749,500	23.8%
Sole proprietorships	699 166	22.2%
Total Enterprises in Economy	3,149,845	100%

61 We have made suggested changes to the wording of the Bill so as to give effect to our proposals above. The changes are included in the appendix clause of this submission.

62 Our proposals seek to:

- Ensure the unfettered future existence of the Close Corporation Act either as a standalone statute or as a chapter within the Bill (Appendix 9);

- Ensure that the regulations pertaining to close corporations are aligned to the conceptual underpinnings of close corporations i.e. a simplistic and straightforward form of business vehicle for the SME sector. (Appendix 9).

Penalties (Clause 216)

63 We welcome the new provisions contained in clause 214 and 216 of the Bill. We believe the aims of these provisions are to:

- Provide a strong deterrent against fraudulent activity, and;
- Make preparers liable for misrepresenting financial statements.

64 We believe that the provision will enable the prevention of possible future scandals such as was reported with regard FIDENTIA.

65 However we would appreciate a review of these clauses so as to ensure they are free form any unintended consequences.

66 According to clause 214(1)(d) a person, such as an accountant, is guilty of an offence if that accountant prepared financial statements in accordance with a required financial reporting standards and those financial statements contained a scheme, structure or form of words, recommended by the accountant, and that accountant knew, or ought reasonably to have known, that the inclusion of the

scheme, structure or form of words would cause the financial statements to be false or misleading.

67 A contravention of clause 216 will result in either a penalty or imprisonment for an accountant.

68 We propose that the DTI consider including the concepts of “bona fide”, “gross negligence” and “materiality” in clause 214 and 216. A review of clause 214 and 216 should also consider the dramatic effect the new reckless trading provisions will have on the liability of preparers. It seems that clause 22 and 218 remove the element of causality when determining the relationship between a particular action and any damage that may have been caused.

69 The application of financial reporting standards to the preparation of financial statements requires a high degree of competence and professional judgement. As such an accountant may inadvertently prepare financial statements that do not comply 100% with a financial reporting standard. As clause 216 does not contain a reference to materiality, a 1% divergence from a financial reporting standard may result in financial statements being misleading.

70 It is also odd that a person preparing financial statements are subject to imprisonment, without first considering if the action was bone fide or subject to gross

negligence. In contrast clause 222 exempt state officials from liability if their actions were bona fide. In addition state officials are only liable if gross negligence is proved.

71 We suggest that the provisions of clause 216 would be rather extreme when applied to some of the accounting offences. We agree that a person that commits fraud should be imprisoned; however the same should not apply to a professional accountant who has failed to comply with some relative minor reporting standard which may cause the financial statements to be technically misleading.

72 Our proposals seek to:

- Ensure that the Bill recognise the complex nature of financial reporting standards and provide appropriate penalties.

GENERAL COMMENTS

CHAPTER 1: INTERPRETATION, PURPOSE AND APPLICATION

Harmonisation with other legislation

The interaction between the Bill and other legislation should be further considered. These include the Banks Act, Collective Investment Schemes Control Act, and the Consumer Affairs Act.

Application of the term "Juristic person" (Clause 1)

The use of juristic person is not consistently maintained throughout the Bill.

Related and inter-related persons and control (Clause 1)

Sub clause 2(1) defines related persons in a manner that could lead even to parties who have never met and have no knowledge of each other's existence, being classified as related. This will result in companies to be classified as a group with higher governance and financial reporting requirements.

Purchase of securities (Clause 1)

The terms "issue", "subscriptions" and "purchase" of securities are sometimes used as synonyms, which they are not in common law. Attention should be paid to avoiding any confusion in this respect.

Anti-avoidance provision (Clause 6(1))

This clause may be open to abuse and needs to be restricted in its ambit. Constitutionality should also be addressed.

Purpose of the bill (Clause 7)

The purpose of the act should be limited to the "regulation of the incorporation, registration, organisation and management of companies." The current content, although agreeable, should be removed and placed under the preamble to the Bill. If the current clause is left unchanged it may result in the interpretation of the Bill becoming very complex and difficult.

CHAPTER 2: FORMATION, ADMINISTRATION AND DISSOLUTION OF COMPANIES

Names of companies (Clause 11)

Clause 11(3)(b) should be removed as the doctrine of constructive notice does not apply. See our comments above related to clause 19(4). In addition the abbreviation "RF" does not have a corresponding meaning.

In addition the most serious objection is that all the required terms and abbreviations are only in English and (probably unconstitutionally) no provision is made for any of the other official languages. The current close corporation act provides abbreviation of the term CC in multiple languages.

Legal status of companies (Clause 19(5)) - Constructive notice

The "adapted" doctrine of constructive notice in clause 19(5) is more onerous and uncertain than the common law doctrine and will place more burdens on the third party to peruse the Memorandum if Incorporation. All company actions are valid, even if the third party is mala fide. A modified statutory Turquand rule is incorporated in clause 20(7), in respect of formal and procedural requirements. The distinction between company actions and internal management rules is blurred by these provisions and the statutory Turquand rule will, due to the "adapted" doctrine of constructive notice leave the company defenceless vis-à-vis third parties.

Pre-incorporation contracts (Clause 21)

This clause should be more clearly formulated. Can the other party to the contract withdraw from the contract before the company has ratified the contract? Pre-incorporation contracts are a very important part of business activities of especially small business companies. The reality of business is that business owners will first want a contract in place before a company is formed. BEE contracts and mining contracts are a particular issue. An option between common law contracts on behalf of a third party and the pre-incorporations contracts in terms of the bill should remain in place. Pre-incorporation contracts should also be required to be in writing in order to eliminate disputes over the contents of the contract.

Reckless trading (Clause 22 and 218)

The powers of the commission should only be used within a clear framework so as to limit abuse. The element of causality under reckless trading should be dispensed however clause 218 should only apply to relevant sections and not be a general statement. There are some offences where the element of causality is crucial and there are offences that these are not. For example causality should not apply to reckless trading; but should apply to the preparation of misleading financial statement and less serious offences. Causality should not be generalised.

Pre-emptive rights (Clause 39)

Note that clause 39(1), (3) and (4) refer to both private and personal liability companies, while clause 39(2) only refers to private companies. This could be an oversight.

Board and directors (Clause 66(8))

This clause requires that at least one director should at all times reside within South Africa. This requirement may be appropriate for companies with multiple directors; however owner-managed companies should not be subject to the same limitations. The Bill should encourage business creation and should not limit entrepreneurship. An alternative could be to require that the public officer of a company be at all times a resident in South Africa.

Standards of directors conduct (Clause 76(3))

The double objective requirement together with the subjective test in clause 76(3) is not possible in general company law, although it may work in instances where the regulated entities are homogeneous. The level of care, skill and diligence required would have to be judged in each case, which would make the application of the duty, as opposed to the present situation, impossible to determine. The implications of this clause should be carefully considered.

CHAPTER 6: BUSINESS RESCUE AND COMPROMISE WITH CREDITORS

Business rescue (Chapter 6)

We propose that a profession for business rescue providers be based on the model followed in the close corporation act with regard to the recognition of accounting officers. The Bill does not need to create a separate regulator to govern the affairs of supervisors. This proposal will reduce the complexity associated with the current provisions and will give recognition to professional bodies. A similar model was proposed to the South African Revenue Service (SARS) for the regulation of tax practitioners.

In addition we believe that the current proposals should make the application of business rescue proceedings subject to the preparation of financial statements. In the absence of financial statements it would be very difficult to determine whether business rescue proceedings will be justifiable.

CHAPTER 7: REMEDIES AND ENFORCEMENT

Protection of whistle blowers (Clause 159)

It is unclear why a specific provision is inserted for whistle blowers in respect of public companies in addition to the provisions of the Protected Disclosures Act 2000. The latter deals extensively with the procedures and additional provisions only in respect of public companies (to the exclusion of other companies and bodies corporate) should be reconsidered.

This clause could be removed and replaced with the provisions of the Protected Disclosures Act. Alternatively the Protected Disclosures Act should be included in the list of statutes as provided for under clause 5 (b) (i) so as to aid interpretation of the Bill. The Financial Information Centre Act of 2001 could possibly also be considered for inclusion in clause 5.

The current clause does not advance the purposes of the Act as it:

- does not consider the intention of the Protected Disclosures Act to protect disclosures when they are legitimate;
- is written in a complex manner with cross-references;
- creates unnecessary confusion – a simple amendment to the Protected Disclosures Act can protect and enhance disclosures, in addition the principles of interdepartmental co-operation dictate that the Department of Justice and Department of Trade and Industry

should liaise to improve the Protected Disclosures Act instead of trying to massage protected disclosures into Company law;

- does not consider or protect the legitimate rights of a company or consider that, what is perceived as non-compliance by a person who does not have the complete picture, might in fact be above-board;
- does not provide protection against abuse of the mechanism, under the easily disguised mantle of good faith and reasonable belief;
- does not provide protection against unjustified harassment. A company's brand and reputation is of great importance and should be protected against unjustified harassment.

We also propose that a new clause should be included that provides that a company may approach the court behind closed doors to declare a person a vexatious litigant (similar to the provisions of the Vexatious Proceedings Act) and that such declaration will result in the person first requiring the consent of the court behind closed doors before they may proceed in terms of the Act. This provision will protect the dignity of the declared vexatious litigant and to protect the reputation and legitimate confidential information of the company.

Application to declare director delinquent or under probation (Clause 162)

We propose that the Courts be provided with discretion depending on the severity of the offence whether to exercise its powers or not. The list of legislation included in clause

162(1) may be too broad. Delinquency and probation should be measures of last resort reserved for serious offences. Care should be taken so as not to allow this mechanism to be abused by stakeholders that do not have the best interest of the company at heart.

Sub clause (1)(c) should also be removed as it is unlikely that any one person knows and understands every single law imposing obligations on, prohibiting any conduct by, or otherwise regulating the activities of, a juristic person. The focus should rather be on ensuring that key legislation is complied with and that non-compliance with secondary and tertiary legislation (in relation to a company) is dealt with in terms of the offences and penalties provided for in those laws.

This clause may significantly increase the complexity and burden of doing business, especially the provisions of clause 7(a)(iii) read together with clause 163. It is proposed that the company be protected from vexatious litigants.

Derivative actions (Clause 165)

In principle the ultimate decision making authority should rest with the appointed Board members of a company. We propose that further consideration should be given to protecting the company from vexatious litigants. This clause could hamper the effective operation of the company, especially owner-managed companies.

CHAPTER 8: REGULATORY AGENCIES AND ADMINISTRATION OF ACT

Commission objectives (Clause 186)

The objectives of the Commission are, inter alia, the registration of intellectual property rights in terms of relevant legislation (e.g. Patents Act, Trade Marks Act) and the maintenance of registries of in respect thereof – see also Schedule 6. The Bill, however, contains no provisions assigning these functions to the Commission nor does it contain any consequential amendments to the relevant intellectual property legislation (for instance by the substitution for the relevant Registrar of the Commission). It, furthermore, contains no transitional provisions for any of the activities of these registries or any provisions for the continued existence of the registries. It only provides for the transfer of the staff establishment of these registries to the Commission.

In its present form the Bill would vest the powers of the different Registrars in the Commission without removing the Registrars with the result that there would be two functionaries with conflicting powers. The Bill should replace the Registrars with the Commission.

The required amendments to intellectual property legislation could be contained in a schedule as was done with the consequential amendments to the Close Corporations Act.

The reference sub-clause (1)(b) to “foreign companies” is confusing. The Commission is not mandated to keep a register and up-to-date information of foreign companies and they are not necessarily required to register with the Commission. The correct reference would to “external companies” as the Commission be keeping a register of such companies.

Appointment of commissioner (Clause 189)

Continuity within the Commission would be better served with at least two Deputies.

Establishment of companies ombud and appointment of companies ombud (Clause 193 and 194

The rationale behind the prohibition on appointment for a second term of the chairperson of the Companies Ombud is not clear, especially as the appointment is not linked to a time period as is the case in all the other appointments dealt with in this Chapter. This prohibition could lead to a situation where the chairperson is appointed indefinitely or permanently. This prohibition should be reconsidered and it should also be considered to make the appointment of the chairperson and members subject to a time period. Sub-clause (4) of clause 193 just refers to “on a full or part time basis”.

Functions of panel (Clause 201) – Securities Regulation Panel

The functions of the Panel relate to new business after the effective date of the Bill only. The transitional arrangements in Schedule 7 relating to the Panel seem to be insufficient as they do not provide for the continued application of the existing rules of the Securities Regulation Panel to unfinished matters before the SRP when the Bill becomes law. Similar provisions as contained in items (5) (a) to (c) of the Schedule relating to CIPRO and OCIPE should also be made applicable to the SRP and the Panel as it is also an existing entity that undergoes a conversion.

Conflicting interest of agency members (Clause 206)

The wording of sub-clause (2)(e) is ambiguous and could be interpreted that a member of the Ombud, Panel or Council may not divulge any confidential information to the Commission, Minister, National Treasury, etc. This could obviously not be the intention and the provision needs to be redrafted to overcome this problem.

The expression "as contemplated in clause 212 (5), or-" should be moved from where it currently appears and added to sub-paragraph (ii).

Finances (Clause 210)

It is the stated intention that the Commission and the various agencies should not be an additional financial burden on the State and that they should be financially self sustaining from revenue collected for services rendered or levies imposed. This objective could only be met if the Bill makes proper provision for fees and levies to be charged. The fees that are provided for in the Bill relate solely to company registration, data maintenance and disclosure of information and would be insufficient to cover the operating cost of the Commission, Ombud and the Panel. Furthermore, no provision is made for the funding of the Council. Cross-subsidisation of services is, furthermore undesirable and should be avoided.

No provision at all is made for fees or levies in respect of the services of the Ombud and Panel. The SRP is currently funded mainly from a levy charged annually on public companies listed on the JSE and to a lesser extent from fees charged for various services. The Ombud would be a new institution and fees would have to be determined for its services, preferably by way of regulations, but the Bill should authorise the determination of such fees.

On the other hand the various intellectual property laws provide for fees to be levied for the various services but these fees have not been determined with a view to recovering the full cost of rendering the service.

From the above it is evident that that the question of the funding of the operations of the Commission, the Ombud, the Panel and the Council should be regarded as essential for the success of the Bill and its institutional arrangements. The Bill should therefore fully cater for the funding and the necessary provisions should be added to the Bill, including consequential amendments in this regard to relevant intellectual property legislation.

CHAPTER 9: OFFENCES, MISCELLANEOUS MATTERS, AND GENERAL PROVISIONS

Civil actions (Clause 218)

This clause is presently drafted much too widely. This clause should be reconsidered so as to avoid any unforeseen consequences. Consideration should be given that relates to reasonable foresee-ability.

SCHEDULES

Transitional provision (Schedule 7)

Transitional arrangements allow for present provisions in the 1973 Companies Act to co-exist with new provisions that cover substantially the same areas. This may be confusing and may lead to forum shopping. The fact that it is envisaged that the new Companies Act will only come into operation a year after assent by Parliament may not give adequate relief, as it cannot be complied with prior to coming into law, as it could have the effect that the present Companies Act will be contravened. The more complex the company structure (e.g. shareholders' agreements and holding/subsidiary relationship) the more problematic the immediate application of the new Companies Act.

APPENDIX

APPENDIX 1: PROPOSED AMENDMENTS TO CLAUSE 1: INTERPRETATION

(Words in brackets and bold indicate proposed inclusions; Words that are strikethrough indicate proposed deletions)

['accounting records', in relation to a company, includes accounts, deeds, writings and such other documents as may be prescribed;]

['professional accountant" means a member of a professional accountancy body, registered in South Africa, that is a full member of the International Federation of Accountants"]

['independent review' means a report issued in terms of the Standards on Review Engagements (SREs) as issued by a professional accountancy body registered in South Africa that is a full member of the International Federation of Accountants (IFAC)]

['reported' in terms of clause 30, means a report issued in terms of the International Standards on Related Services (ISRSs) as issued by the International Federation of Accountants (IFAC)]

APPENDIX 2: PROPOSED AMENDMENT TO CLAUSE 28: ACCOUNTING RECORDS

~~(1) A company must keep accurate and complete accounting records in one of the official languages of the Republic—~~

~~(a) as necessary to enable the company to satisfy its obligations in terms of this Act or any other law with respect to the preparation of financial statements; and~~

~~(b) including any prescribed accounting records, which must be kept in the prescribed manner and form.~~

(1) [**A company shall keep in one of the official languages of the Republic such accounting records as are necessary fairly to present the state of affairs and business of the company, and to explain the transactions and financial position of the business of the company, including-**

(a) records showing its assets and liabilities, members' contributions, undrawn profits, revaluations of fixed assets and amounts of loans to and from members;

(b) a register of fixed assets showing in respect thereof the respective dates of any acquisition and the cost thereof, depreciation (if any), and where any assets have been revalued, the date of the revaluation and the revalued amount thereof, the respective dates of any disposals and the consideration received in respect thereof: Provided that in the case of a corporation which has been converted from a company , the existing fixed asset register of the company shall be deemed to be

such a register in respect of the corporation, and such particulars therein shall be deemed to apply in respect of it;

(c) records containing entries from day to day of all cash received and paid out, in sufficient detail to enable the nature of the transactions and, except in the case of cash sales, the names of the parties to the transactions to be identified;

(d) records of all goods purchased and sold on credit, and services received and rendered on credit, in sufficient detail to enable the nature of those goods or services and the parties to the transactions to be identified;

(e) statements of the annual stocktaking, and records to enable the value of stock at the end of the financial year to be determined; and

(f) vouchers supporting entries in the accounting records.]

(3) It is an offence for —

(a) a company—

(i) with an intention to deceive or mislead any person –

(aa) ~~to fail to keep accurate or complete accounting records;~~

(bb) to keep records other than ~~in the prescribed manner and form, if any~~; **[the prescribed minimum as required under sub clause (1)]** or

APPENDIX 3: PROPOSED AMENDMENT TO CLAUSE 29: FINANCIAL STATEMENTS

29. (1) If a company provides any financial statements, including any annual financial statements, to any person for any reason, those statements must –

(a) ~~satisfy the financial reporting standards as to form and content~~

(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~~ **[present fairly the state of affairs and business of the company in terms of financial reporting standards as appropriate to the category of the particular company]** ;

(c) ~~show the company's assets, liabilities and equity, as well as its income and expenses, and any other prescribed information~~;

(e) must bear, on the first page of the statements, a prominent notice indicating –

(i) whether the statements –

(aa) have been audited in compliance with any applicable requirements of this Act;

(bb) if not audited, have been independently reviewed in compliance with any applicable requirements of this Act;

[(**cc) have been reported on by a professional accountant in compliance with any applicable requirements of this Act**]; or

(cc) have not been audited; independently reviewed; [**or reported on by a professional accountant]**

(ii) the name, and professional designation, if any, of the individual who [**compiled]** ~~prepared~~, or supervised the [**compilation]** ~~preparation~~ of, those statements, [**where such an individual is not an employee of the company]**.

APPENDIX 4: PROPOSED AMENDMENT TO CLAUSE 29: FINANCIAL REPORTING STANDARDS

Option 1

29 (4) Subject to sub clause (5), ~~the Minister, after consulting the Council~~, [**the Council]** may make regulations prescribing—

(a) financial reporting standards contemplated in this Part; or

(b) form and content requirements for summaries contemplated in sub clause (3).

29 (5) Any regulations contemplated in sub clause (4)—

(a) must promote sound and consistent accounting practices;

(b) must be consistent with International Financial Reporting Standards of the International Accounting Standards Board or its successor body [**as appropriate having regard to different categories of profit and non-profit companies]**; and

~~(c) may establish different standards applicable to—~~

~~(i) profit and non-profit companies; and~~

~~(ii) different categories of profit companies~~.

Option 2

(4) ~~Subject to sub clause (5), the Minister, after consulting the Council, may make regulations prescribing—~~

~~(a)~~ [**financial reporting standards contemplated in this Part consist of pronouncements as issued by the Accounting Practices Board]**; or

~~(b) form and content requirements for summaries contemplated in sub clause (3).~~

~~(5) Any regulations contemplated in sub clause (4)—~~

~~(a) must promote sound and consistent accounting practices;~~

~~(b) in the case of financial reporting standards, must be consistent with the International Financial Reporting Standards of the International Accounting Standards Board or its successor body; and~~

~~(c) may establish different standards applicable to—~~

~~(i) profit and non-profit companies; and~~

~~(ii) different categories of profit companies.~~

APPENDIX 5: PROPOSED AMENDMENT TO CLAUSE 30: ANNUAL FINANCIAL STATEMENTS

30.(1) Each year, a company must prepare annual financial statements within six months after the end of its financial year, or such shorter period as may be appropriate to provide the required notice of an annual general meeting in terms of clause 61 (7), ~~unless—~~

~~(a) the company, having satisfied the Commission that it has not actively carried on business during that financial year, has been exempted from the application of this subsection; or~~

~~(b) subject to subclause (2) and (3), it is –~~

~~(i) a personal liability company; or~~

~~(ii) a private company, and –~~

~~(aa) one person holds, or has all of the beneficial interest in, all of the securities issued by the company; or~~

~~(bb) every person who is a holder of, or has a beneficial interest in, any securities issued by the company is also a director of the company~~

~~unless the company has only one director, and that director is a person contemplated in clause 69 (12).~~

~~(2) Despite subclause (1)(b), the Commission may issue an administrative notice at any time to a company that is exempt in terms of clause (1)(b) from preparing annual financial~~

~~statements requiring that company to prepare such statements in future and until further notice, if the preparation of annual financial statements by that company appears to be—~~

~~(a) necessary to protect the interests of any holders of the company's securities; or~~

~~(b) desirable in the public interest, having regard to the economic or social significance of the company as indicated by—~~

~~(i) its annual turnover;~~

~~(ii) size of its workforce; or~~

~~(iii) the nature and extent of its activities.~~

~~(3) A company may apply at any time to the Companies Ombud for an order setting aside an administrative notice in terms of subclause (2) on the grounds that the preparation of annual financial statements is not, or is no longer, necessary or desirable as contemplated in that subsection~~.

APPENDIX 6: PROPOSED AMENDMENT TO CLAUSE 30: ANNUAL FINANCIAL STATEMENT REPORT PROVIDERS

(4) ~~If a company is required to prepare~~ annual financial statements, ~~by or in terms of this Act or any other national legislation, those statements~~ must –

(a) be audited [**by a registered auditor**], in the case of a public company; or

(b) in the case of any other company –

(i) be audited [**by a registered auditor] [or independently reviewed by a professional accountant]**, if so required by the regulations made in terms of sub clause (10); or

(ii) must be –

(aa) reported on [**by a professional accountant**] in a manner that satisfies the regulations made in terms of sub clause (10) Or bb) be audited [**by a registered auditor**] voluntarily at the option of the company; or

(cc) be independently reviewed [**by a professional accountant**] voluntarily in a manner that satisfies the regulations made in terms of sub clause (10) or

(5) The annual financial statements of a company that is required to produce such statements, in terms of this Act ~~or any other national legislation~~, must—

(a) include a~~n~~ ~~auditor's~~ [**report as per clause 30(4)(a)-(cc)]**, ~~if the statements are audited~~;

(b) include a report by the directors with respect to the state of affairs, the business and profit or loss of the company, or of the group of companies, if the company is part of a group, including –

(i) any matter material for the shareholders to appreciate the company's state of affairs; and

(ii) any prescribed information;

(c) be approved by the board and signed by an authorised director; and

(d) be presented to the first shareholders meeting after the statements have been approved by the board.

APPENDIX 7: PROPOSED AMENDMENT TO CLAUSE 187 AND 191: REGULATORY AGENCIES

187. (3) The Commission must promote ~~the reliability of financial statements~~ [**compliance to financial reporting standards]** by, among other things—

(a) monitoring ~~patterns of~~ [**and enforcing]** compliance with, ~~and contraventions of~~, financial reporting standards; and

(b) ~~making recommendations to~~ [**consult]** the Council for amendments to financial reporting standards, to secure better reliability and compliance;

191. (1) The Minister may appoint one or more specialist committees to (a) [**advise the]** Minister on any matter relating to company law or policy; or

(b) [**advise and guide the]** Commissioner on the management of the Commission's resources [**and performance of the Commissions functions**]or

(c) [**advise and guide the Financial Reporting Standards Council on the performance of the councils functions]**

APPENDIX 8: PROPOSED AMENDMENT TO CLAUSE 203 AND 204: FINANCIAL REPORTING STANDARDS COUNCIL

Option 1

203. (1) The Minister must establish a committee, to be known as the Financial Reporting Standards Council consisting of –

(a) ~~four~~ [**two]** persons, each of whom is registered and practicing as an auditor;

(b) [**two persons, each of whom is registered and practicing as a professional accountant]**;

(b) two persons each of whom is responsible for preparing financial statements on behalf of public companies;

(c) two persons responsible for preparing financial statements for private companies;

(d) four persons who, in their capacity as holders of securities issued by a company, or as creditors of a company, are reasonably expected to rely on financial statements, as contemplated in the definition of 'financial statement' in clause (1);

(e) two persons knowledgeable in company law;

(f) one person nominated by the executive officer of the Financial Services Board as defined in clause 1 of the Financial Services Board Act, 1990 (Act No. 97 of 1990), or any successor body to it;

(g) one person nominated by the Governor of the South African Reserve Bank, or any successor body to it; and

(h) a number of persons not exceeding four, nominated one each by any exchange that imposes adherence to financial reporting standards as a listing requirement each of whom must be appointed by the Minister, to serve for a term of three years.

204. The Financial Reporting Standards Council must –

[(a) Promote openness, participation and transparency in the process of issuing financial reporting standards;]

[(b) issue financial reporting standards subject to the requirements set out in clause 29(5).]

[(c) adhere to any regulations issued by the Minister to further establish its functions]

(d) receive and consider any relevant information relating to the reliability of, and compliance with, financial reporting standards, including information from the Commission as contemplated in clause 187(3)(b);

(e) advise the Minister on matters relating to financial reporting standards; and

(f) consult with the Minister on the making of regulations establishing financial reporting standards, subject to the requirements set out in clause 29(5);

Option 2

Include in Chapter 1 the following interpretation:

“Financial reporting standards” means generally accepted accounting practices as set out by the Accounting Practices Board pronouncements.

Remove the whole of clause 203 and 204 as this function is performed by the current Accounting Practices Board. See our proposals related to clause 29 above.

APPENDIX 9: PROPOSED AMENDMENT TO SCHEDULE 5: CONSEQUENTIAL AMENDMENTS: CLOSE CORPORATION ACT

Amendment of clause 2 of Act 69 of 1984

3. (1) Clause 2 of the principal Act is hereby amended by the substitution for subclause (1) of the following subsection:

"(1) ~~[Any] At any time before clause 13 of the Companies Act comes into operation,~~ any one or more persons, not exceeding ten, who qualify for membership of a close corporation in terms of this Act, may form a close corporation and secure its incorporation by complying with the requirements of this Act in respect of the registration of its founding statement referred to in clause 12.".

Amendment of Clause 58 of Act 69 of 1984, as substituted by clause 12 of Act 38 of 1986 and amended by clause 4 of Act 64 of 1988

(4) Clause 58 of the principal Act is hereby amended by –

(a) the substitution for sub clause (1) of the following subsection:

"(1) The members of a corporation shall within [nine] six months after the end of every financial year of the corporation cause annual financial statements in respect of that financial year to be made out in one of the official languages of the Republic ~~unless –~~

~~(a) the corporation, having satisfied the Commission that it has not actively carried on business during that financial year, has been exempted from the application of this subsection;~~

~~(b) the corporation has only one member, unless that member is a person contemplated in clause 47(1B),~~

~~(c) all of the members of the corporation take part in its management, as contemplated in clause 47, unless the corporation has only one member and that member is a person contemplated in clause 47(1B)~~ ";

Clause 30 (4) (~~a~~) **[(b)]**, and (5) to (9) of the Companies Act, read with the changes required by the context, apply to a corporation that is subject to a notice in terms of clause 62A of this Act, read with clause 30 (2) of the Companies Act.";

APPENDIX 10: ARTICLE BY PROF JOHAN HENNING ON THE HISTORY OF THE CLOSE CORPORATION ACT:

KILL NOT THE CLOSE COPORATION BY ASPHYXIATION

1. INTRODUCTION

Particularly in countries where unemployment levels are high, small enterprises play a valuable role by creating new job opportunities, providing stability, and eliminating poverty, improving competitiveness, promoting the development of labour skills and ensuring economic growth. It is estimated that small enterprises in South Africa employ approximately 40% of economically active South Africans; more than 90% of South Africa's formal business entities could be classified as small businesses; and small enterprises contribute almost 45% of the Gross Domestic Product.

It is of paramount importance that small entrepreneurs have a choice of appropriate business forms at their disposal. The essence is to put small business first in the attentions of policy makers shaping company law reform. The golden thread underlying government policy dealing with small enterprises should be: "think small first." It follows that government should be committed to identifying the needs, characteristics and problems of small businesses and by putting the needs of these enterprises at the centre of any policy making.

In 1984 South Africa became the first country with a British derivative company law system to take a large step forward in providing effectively for the reasonable entrepreneurial legal needs and expectations of the typical small businessman in by way of separate legislation. The recognition of the fact that the small business section forms the very backbone of a market orientated economy, gave added impetus to the introduction of the Close Corporations Act 69 of 1984.

Here a brief overview will be given of the South African close corporation's success during the past twenty one years as well as the recent efforts for its eventual abolition.

2. CONCEPT

The Close Corporations Act 69 of 1984 (the "Act") has proved to be one of the most remarkable innovations in South African company law. It provides a simple, inexpensive and flexible form of incorporation for the enterprise consisting of a single entrepreneur or small number of participants, designed with a view to meeting his or their needs and without burdening him or them with legal requirements that would not be meaningful in his or their circumstances.

Under the Act a close corporation is a fully fledged corporation which confers on its members all the usual advantages associated with legal personality. It is a closely held entity in which all or most members are more or less actively involved. In principle there is no separation between ownership and control. No board of directors or general meeting is required. Every member is entitled to participate in the management of the business and to act as an agent for the corporation. Every member owes a fiduciary duty and a duty of care to the corporation. The consent of all the members is required for the admission of a new member.

In principle membership is limited to natural persons. A close corporation may have a single member. Though the maximum number of members is limited to ten, there is no restriction on the size of a close corporation's business or undertaking, the number of its employees or creditors, the size of the total contributions by members, turnover, value of assets or, generally, the type of business and it need not be an undertaking for gain.

3 NEED

At the root of this development is the conviction that a single Act can no longer present a satisfactory legal form for the large and sophisticated as well as the small and often marginalised entrepreneur. Historically, the Companies Act 61 of 1973 and its British predecessors developed mainly in response to the needs of and problems posed by large public companies. It has to provide for the large industrial or financial conglomerate with its listed shares, professional management reflecting a clear separation between ownership and control or direct and indirect control of say an institutional investor, scattered and powerless small shareholders and group problems. Hence it inevitably outgrows the needs and problems of the small man with his restricted means and limited access to professional advice[4].

The close corporation is evidently aimed at a potentially more informal section of the economy."[5]

4 FEATURES

The following are some of the distinctive features of the close corporation:

- As the name implies, the close corporation is a juristic person distinct from its members who consequently enjoy perpetual succession2 and its members have limited liability in respect of the corporations' debts.
- It has the capacity and powers of a natural person insofar as these are appropriate to a legal person.
- The formation, administration and operation of a close corporation are subject to the minimum formalities, administrative requirements and duties for the participants.
- A single person can form a close corporation and it need not be an undertaking for gain.

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[4] Naudé " The South African close corporation:" 1984 Journal for Juridical Science 117-119.
[5] Du Toit "Applying the moral imperative: The Close Corporation" 1984 Journal for Juridical Science 108.

- No shares are issued and there is no share capital.
- Instead of the traditional rules relating to the maintenance of capital in company law, the close corporation is allowed to utilise its capital as it pleases provided it maintains the necessary solvency and liquidity.
- Members are allowed the greatest possible flexibility in arranging their internal relationship and the management of the close corporation.
- All the members have in principle an equal say in the management of the business and no provision is made for the appointment of directors. No distinction exists or is made between the providers of capital and management.
- The Act is to a large extent decriminalized and members run the risk of personal liability should it appear that they have contravened the provisions of the Act or have put the close corporation or its creditors in jeopardy.
- The common law principles relating to the fiduciary duties and duties of care and skill in managing the affairs of the corporation are to a large extent codified in the Act with the result that even the unsophisticated member knows exactly what is expected of him and his fellow members.
- Doctrines inherited from English company law and which have fascinated company lawyers for so many years, such as the ultra vires doctrine, the doctrine of constructive notice, the rule in Royal British Bank v Turquand and the rule in Foss v Harbottle, find no application in close corporation law.
- The accounting and disclosure provisions are far less extensive.

It is interesting to note that notwithstanding the United Kingdom's membership of the European Union and the recommendations of the EU High Level Group of Company Law Experts on the need for a European Private Company (EPC), the Report of the UK Company Law Reform Steering Group referred to only two "prominent examples" of "free standing limited liability vehicles for use by small firms" adopted by "overseas jurisdictions" which the Steering Group considered suitable for consideration in the context of the Review, namely the United States limited liability company and the South African close corporation. The basic characteristics of the two vehicles were summarised by the Steering Group. With the necessary corrections as far as the close corporation is concerned[6], the summary may serve for present purposes as a sufficiently brief comparison of the basic characteristics of the two vehicles:

Characteristic	LLC	CC
Limited liability	Yes	Yes
Legal personality	Yes	Yes
Capital maintenance rules	No	No
Requirement to file annual accounts	No	No

[6] E.g. the impression created in the summary that there is no limitation on corporate membership of a CC is obviously incorrect.

Statutory solvency statement	No	Yes
Minimum number of members	Two	One
Maximum number of members	Unlimited	Ten
All members may participate in management	No	Yes
Members are shareholders	No	No shares
Standard set of internal management rules	No	Yes
Membership transferable	Yes	Yes
Ownership restrictions	No	Yes
Transition into full, limited company without loss of legal entity possible	Yes	Yes
Treated as a partnership for tax	Yes	No

5. RESPONSE

During its two decades of existence, the close corporation has met with wide and enthusiastic approval. Until the end of 2004 almost one and a half million close corporations were registered compared to less than four hundred thousand companies of all forms and types, as appears from the following comparative table:

ANNUAL REGISTRATION

Year	*Close Corporations*	*Companies*
1985	15911	5848

1986	23387	5235
1987	29362	6673
1988	36092	7393
1989	41791	7207
1990	38919	7068
1991	34553	6616
1992	35005	6748
1993	33000	8771
1994	43793	12061
1995	56160	15540
1996	65006	19691
1997	71178	23949
1998	74640	26925
1999	72265	26579
2000	78658	33069
2001	87635	31506
2002	108491	33799
2003	113227	33495
2004	131151	37602
2005	186077	44495
2006	118187	21581
Total	**1,494,488**	**387,757**

On the 12th of June last year 1,276,157 close corporations were still active in South Africa.[7]

A few observers deemed it fit to emphasise that close corporations enjoyed certain tax benefits until 1989, after which registrations began to fall. It is quite correct that registrations of close corporations showed a steady decline from 1990 to 1993. But it should be clear that this trend was reversed after the constitutional and political changes in

[7] See http://www.cipro.co.za/about_us/registration_stats.asp.

1994. It should be kept in mind also that the registrations of companies showed a similar downward trend from 1988 to 1992. These statistics and the economic, social and political circumstances in South Africa during the particular period dictate that the impression that the downward trend was maintained only in terms of close corporations and solely due to a change in its tax dispensation, should not be left unchallenged. In fact the number of close corporations registered per annum reached a record high in 2005 notwithstanding the persistent rumours about its eventual demise.

It is also clear that the close corporation provided a very necessary stimulus to the small business section during a very difficult period in the political, social and economic history of South Africa and did in this way make an important contribution to its retention of a market orientated economy.

Developments in South Africa did not pass without remark outside Southern Africa. Thus the Act was judged by Professor Uriel Procaccia of the Hebrew University of Jerusalem as impressive.[8] Professor Len Sealy, previously of Gonville and Caius College, Cambridge described the Act as a model worth very serious consideration and considered it to be a much bigger success than the 'unanimous written resolution' and 'elective regime'

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[8] Procaccia "Designing a new corporate code for Israel" 1987 American Journal of Comparative Law 589

amendments introduced for private companies by the UK Companies Act of 1989.[9]

A report on alternative structures for small businesses in the United Kingdom pointed out that the South African close corporation has been highly successful, inter alia because of “its own intrinsic merit”[10], while some corporate lawyers have expressed a particular fondness for some aspects of the South African close corporation. [11]

In her comprehensive 1996 survey of company law in more than twelve jurisdictions as part of the review of the Hong Kong Companies Ordinance, Professor Cally Jordan stressed that the South African Close Corporations Act “has proved to be one of the most remarkable innovations in South African company law” and one, at that, which appears to have been singularly successful.[12]

Professor Allan Vestal, Dean of the College of Law of the University of Kentucky reacted on an Order of the Coif lecture dealing with the South African close corporation and presented at his College during 2002 by stating that the lecture was an interesting presentation and a valuable reminder of the correct reason for business law reform. It could serve as a much-needed cautionary note for those of us in the United States

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[9] Sealy "Legislating for the small business", paper read at the Company Law Reform Seminar of the Institute of Directors, London on 7 December 1993
[10] Chartered Association of Certified Accountants Alternative company structures for the small business (1995) 44.
[11] Dine “The Comprehensive Review of Company Law” 1998 (March) The Company Lawyer 83.
[12] Jordan *Hong Kong Companies Ordinance Review.* 47-49.

involved in such reforms. Vestal pointed out that business entity reform in South Africa was a response to the economic and political situation in that country. Informed first by the need for business entity laws to facilitate economic development in South Africa's peculiar economy, and informed somewhat later by the need for business entity laws to facilitate the political development of the post-apartheid society, the South African reforms present as a practical and creative response to foster generally accepted social goals. According to Vestal the story of business entity reform during the same period in the United States presents rather differently. The reworking of business entity law in the United States appears much less to do with the pursuit of generally accepted social goals and much more about the combination of academic ideology and private advantage: "It is a reasonable observation that in its business entity reforms South Africa appears to have been on the right path, for the right reason. We should be rather less sanguine about the American reforms." [13]

6 SIMPLIFICATIONS, CONSTITUTIONALITY AND ACCESSIBILITY

The example of the Close Corporations Act has been followed in legislative developments in several jurisdictions aimed at the introduction in various guises of new legal forms for small business. Examples are Namibia and Zimbabwe. Due to political and constitutional developments a rationalisation of the corporate legislation in South Africa was of necessity in the offing. This was affected by the Rationalisation of Corporate Laws Act 45 of 1996,

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[13] Vestal "Business law reform in South Africa: the right path, the right reasons" 2002-2003 (Vol 91) *Kentucky Law Jou*rnal 829-840.

which provides for; inter alia, the application of the Close Corporations Act 69 of 1984 throughout the Republic and the repeal of the erstwhile Transkei, Ciskei, Venda and Bophuthatswana legislation.

The close corporation was the first and still is the only corporate form of business enterprise to comply fully with constitutional imperatives regarding the eleven official languages. Section 22 of the Close Corporations Act, 1984, provided that the abbreviation 'CC' or 'BK' had to be subjoined to the name used by a close corporation. This provision has now been amended and provides that the abbreviation 'CC' or its equivalent in any one of the other official languages must so be subjoined. The terms for 'close corporation' and suitable abbreviations therefore in the other official languages have in consultation with the Director: State Language Services been identified as follows by the Registrar of Close Corporations:

Language	***Term for close corporation***	***Abbreviation***
Sepedi:	Kgwebo e Kgotlangantswego	KK
Setswana:	Dikoporasi tse di Tswaletsweng	KT
siSwati:	LiBhizinisi leliValekile	BV
Sesotho:	Kgwebo e Lekanyeditsweng	KL
Tshivenda:	Dzikoporasi dzo valiwaliwaho	KV

Xithonga:	Ntirhisano wa Nhlangano	NH
Afrikaans:	Beslote Korporasie	BK
isiNdebele:	Ikampani yaba-Thileko	KT
isiXhosa:	Inkampani yabamBalwa	KB
isiZulu:	iKhamphani yabamBalwa	KB

Compared to the Companies Act of 1973, the Close Corporations Act has proved to be relative free of teething troubles. Up to 1992 four Close Corporations Amendments Acts were introduced dealing with a variety of matters of minor significance as they arose.

The comprehensive Close Corporations Amendment Act 26 of 1977 further simplified the Close Corporations Act to a very significant extent and inter alia dramatically improved the protection of bona fide third parties dealing with a member of a close corporation. The Close Corporations Amendment Act 25 of 2005 enabled a trustee of a trust inter vivos to be a member of a close corporation under certain conditions, thus enhancing the accessibility of the close corporation significantly.

7 FUTURE

7.1 Introduction

In 1997 the chairperson of the Standing Advisory Committee on Company Law released a press statement dealing with the development of corporate law in South Africa within a strategic framework of five principal statutes, only four of which will necessitate new legislation since the Close Corporations Act was to be retained in its present form, due to its unqualified success.

There was every reason to assume that the future of the close corporation seemed secure.

However, towards the end of 2004 reports started appearing in newspapers suggesting that close corporations had to convert to private companies to avoid losing their corporate status. Starting with relatively low key and tentative statements, these reports eventually became a virtual tidal wave explicitly consigning the close corporation to the dustbin of corporate law reform. Prominent headings in newspapers proclaimed: “End of the road for close corporations”, “Close corporations to be axed”, “The demise of the close corporation”, “Death knell for close corporations”.

If these were intended as flyers sent up to test public reaction to such an eventually, they certainly succeeded far better than expected. It caused such an furore and so much uncertainty that the Department of Trade and Industry was constrained to issue an urgent statement in February 2005 expressly refuting “these rumours” and stating “categorically” that there is no plan to compel close corporations to convert to private companies, or that they will lose their corporate status.

How did this state of affairs come about?

In December 2001 the Committee on Corporate Laws of the Section of Business Law of the American bar Association released its Report on South African Companies Act No 61 of 1973 and Related Legislation containing numerous recommendations for amending the Companies Act as well as, to a lesser extent, the Close Corporations Act. A few years later it was revealed that the Department of Trade and Industry (DTI) "has decided to revamp the company law in this country to bring it into line with international trends, although the intention is that the revised product should resonate with the South African situation".[14] The DTI published its policy document on corporate law reform for public comment on the 24th of June 2004. [15]

The policy document suggests that only one formal business vehicle should be recognised, which should be distinguished on the basis of size of turnover, which will in turn determine their reporting requirement. According to the South African Institute of Chartered Accountants: "The policy document asserts that the current distinction between close corporations, private companies and public companies, which is based on shareholding, is artificial and does not allow an easy transition from one type of company

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[14] Mongalo "South African company law reform" 2004 *South African Law Journal* 93.
[15] See http://www.pmg.org.za/bills/040715companydraftpolicy.pdf

form to another. The policy document envisages one model with a series of thresholds: the smaller you are the less the mandatory requirements".[16]

It has been pointed out that the proposals in the policy document appear to lean too heavily on recommendations of international case practice, and that "a cursory glance of recommendations by the American Bar Association seems to have influenced the guidelines disproportionately". Confidence was expressed that other perspectives and recommendations will receive due consideration by the DTI. [17]

In its Working Paper of August 2004 Business Unity of South Africa (BUSA) disagreed with the DTI proposals concerning close corporations and recommended that the Close Corporations Act be retained in its present form. It is important to note that, according to the final Nedlac Report, it was agreed by Nedlac's constituencies (business, labour and government) towards the end of 2004 that "a corporate structure which includes the characteristics of the current close corporation will be one of the available structures". It seems that consensus was reached eventually by those concerned to recommend that the close corporation be kept in place at least until it is clearly proved that it has been outperformed by an alternative, more effective, corporate structure designed specifically for small businesses.

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[16] Ibid

[17] *COSATU Input: Guidelines for Corporate Law reform* 4 (presented to the Corporate Law Reform Task Team of Nedlac on 18 October 2004).

In its statement of February 2005 the Department of Trade and Industry spared no pains to emphasise although its policy document of 23 June 2004 on South African Corporate Law Reform' states that: 'The current division between close corporations, private companies and public companies offers limited opportunities for progression from one form of company to another and has resulted in distrust by financiers of close corporations. For this reason, it is necessary to move away from the largely artificial separation between the different business forms, to recognise only one formal business vehicle and to provide for a simple, easy company formation process', this statement should not be interpreted "to mean that close corporations should convert to private or public companies. The corporate law reform process is still at its embryonic stage and the type(s) of business vehicle that will be provided for in the proposed legislation has not been finalised yet. [I]t is envisaged that the Corporate Law reform review will be finalized in 2007."

7.2 Draft Bill of 2007

In the event, very little, if anything, came of the intention "to recognise only one formal business vehicle". To the contrary, the Draft Companies Bill 2007, which was distributed for comment early in 2007, recognised numerous types and categories of companies, ranging from "not for profit" to ""for profit" companies, and the latter from "closely held" to "widely held" companies, while all are susceptible to the very strict "public interest company" regime. And the plot thickened. In December 2007, the Corporate Laws

Amendment Act 24 of 2006, in addition to maintaining the present distinctions between companies limited by shares and those limited by guarantee as well as between private and public companies, introduced a further distinction namely between a “widely held company” and a “limited purpose company”. Although the Amendment Act also refers to a “public interest company” this term is, strangely enough, not defined.

There are also other developments causing concern. That is a clearly discernible tendency to subject the close corporation to increasingly more onerous administrative duties and arrangements. A prime example is the introduction of annual returns for close corporations, with its attendant duties and liabilities. Another case in point is that the Draft Bill of 2007 envisaged that the close corporation will also be susceptible to the “public interest company” regime. The reason advanced for this is that it evens the playing field. This may be true if the paying field is intended as a graveyard for close corporations. It is patently unfair to expect a close corporation to perform optimally in a legal milieu for which it was not designed and encumbered by onerous duties and obligations contrary to its fundamental design philosophy. The only way in which the playing field can be fairly levelled is to ensure that the Act is retrospectively ring fenced against these and similar encroachments.

Section 226 (1)(b) of the Draft Bill makes provision for the repeal of the Close Corporations Act. However, section 2 of Schedule 6 of the Draft Bill stipulates that the President may not bring section 226 (1)(b) into operation before a date at least 10 years after the general effective date of the new Companies Act; and the Minister has reported to Parliament, no earlier than 8 years after the general effective date of the new Act, the utility of continuing the dual system of incorporation of under the new Companies Act and the Close Corporations Act, and the advisability at that time of the repeal of the Close Corporations Act.

Thus the Draft Bill envisages that close corporations will continue to exist for a period of at least ten years in tandem with the "closely held" company after the new Companies Act eventually comes into operation. This is not to say that the Close Corporations Act will inevitably be repealed at that stage. The 2007 Bill expressly created the possibility that the Close Corporations Act may continue in existence indeterminately and does not envisage of necessity a prohibition on the incorporation of new close corporations during the interim period of ten years.

Whether this interim "in tandem" arrangement will survive the Draft Bill's passage through cabinet and parliament remained to be seen. Even if it did, it was clear that for the close corporation "the struggle continues" for its political survival. Should it eventually lose, it will not only be to the detriment of corporate law and practice in South Africa in general, but will also represent a large step backwards for the small business sector in particular.

7.3 Companies Bill of 2008

The remarks in the previous paragraph were indeed prophetic: The “in tandem” arrangement did not even survive the passage of the draft legislation through cabinet. The dispensation for close corporations contained in the Companies Bill 2008 as introduced in the National Assembly, differs in materially from that envisaged in the Draft Bill of 2007.

The proposed “closely held company” is now renamed a “private company” and the possible sunset clause contained in the proposed in tandem arrangement, is now replaced by a clear and definite prohibition on the incorporation of new close corporations or the conversion of companies to close corporations. This does not mean that the 1, 2 million close corporations will be left to whither slowly and in peace on the vine. To the contrary their demise (by conversion to companies) will be hastened by applying more and more of the provisions of the Companies Act to a form of incorporation marked by and chosen by many for its simplicity, until the close corporation will at best be hardly distinguishable from a company incorporated under the Companies Act – at worst it will become one of the most complex and overregulated forms of business enterprise to operate and administer due to the overlay of onerous Company law provisions that negates its most essential and fundamental principles.

The solution is clear: Ring fence the present provisions of the Close Corporations Act for the benefit of the whole small business sector, by immediately incorporating it as a separate chapter in the new Companies Act, with the possible exception of the Close Corporations Act’s liquidation and winding-up provisions.

Prof J J Henning

Bloemfontein

30 July 2008

APPENDIX 11: DIFFERENTIAL REPORTING IN SOUTH AFRICA:

The article was first published in the SAIPA TechNews (volume 3 issue 3) at:

http://www.saipa.co.za/documents/Differential%20reporting%20in%20South%20African%20Corporate%20legislation-15March08.pdf