ACCA

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Portfolio Committee on Trade and Industry

Parliament

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ACCA SUBMISSION ON THE COMPANIES AMENDMENT BILL 2010 [B40-2010]

The Portfolio Committee on Trade and Industry intends holding public hearings on the Bill on the 30th November 2010 and the 1st December 2010. We thank you for the opportunity to deliver an oral and written submission on the Bill. Please accept herewith our submission on the Companies Amendment Bill 2010.

We wish to express our appreciation to the Department of Trade and Industry for their continuous engagement with the business community on the Companies Act 2008. Their commitment to clear and concise legislation is evident from the proposals made in the Companies Amendment Bill 2010. The stated purpose of the Companies Amendment Bill 2010 is to rectify certain grammatical errors contained within the Companies Act 2008. Furthermore the Bill aims to increase the empowering provisions in the Act to ensure that the appropriate regulations can be issued in terms of the Act.

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Our comments are drafted in two parts. Part 1 provides general comment on the Bill. Part 2 provides comment on specific sections of the Bill. Part 2 of our comments are drafted in table form so as to provide ease of reference and enhance clarity.

We also include a number of appendixes so as to provide further information where relevant.

Kind regards

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PART 2: GENERAL COMMENTS

1.1 Principles of the Companies Act 71 of 2008

At this point it would be helpful to be reminded of the initial intention of company law reform that led to the drafting of our new Companies Act 71 of 2008:

> "In 2004, the Department of Trade and Industry (''the dti'') published a policy paper, Company law for the 21st century, which promised the development of a ''clear, facilitating, predictable and consistently enforced law'' to provide ''a protective and fertile environment for economic activity''. The policy paper proposed ''that company law should promote the competitiveness and development of the South African economy'' by—
>
> 1.1.1... **Encouraging entrepreneurship and enterprise development**, and ... employment by ... (a) **simplifying the procedures for forming companies**; and (b**) reducing the costs associated with the formalities of forming a company and maintaining its existence**.
>
> 1.1.2 Promoting innovation and investment in the South African markets and companies by providing for (a) **flexibility in the design and organisation of companies**; and (b) a predictable and effective regulatory environment.
>
> 1.1.3 Promoting the efficiency of companies and their management.
>
> 1.1.4 **Encouraging transparency and high standards of corporate governance**.

1.1.5 **Making company law compatible and harmonious with best practice jurisdictions internationally**.

The policy paper promised an ''overall review of company law'' to develop a ''legal framework based on the principles reflected in the Companies Act, 1973 (Act No. 61 of 1973), the Close Corporations Act, 1984 (Act No. 69 of 1884), and the common law''.

In addition, the process generated specific goal statements related to each of those five objectives, best reflected in the following summary of points set out in the report of the NEDLAC consultations:

1.2.1 Simplification…

1.2.2 Flexibility…

1.2.3 Corporate efficiency…

1.2.4 Transparency…

1.2.5 Predictable regulation

With those objectives and goals in mind, and drawing on the expertise offered through its consultations, the dti prepared a discussion draft of a proposed new Companies Act for South Africa, which was published for public comment after receiving cabinet approval in early 2007. As promised in the policy document in 2004—''*It is not the aim of the dti simply to write a new Act by unreasonably jettisoning the body of jurisprudence built up over more than a century. The objective of the review is to ensure that the new legislation is* ***appropriate to the legal, economic and social context of South Africa as a***

constitutional democracy and open economy. *Where current law meets these objectives, it should remain as part of company law."*[1]

The fundamental principles on which the Act was drafted may therefore be summarised as follows:

1. Alignment of company law to the South African Constitution and Bill of Rights;
2. A unitary statute to govern all corporate business forms i.e. combine the companies act and close corporations act into one new companies act;
3. A single piece of legislation that governs both public and private companies including large and small companies whether managed by their shareholders or managed by professional directors;
4. To simplify and reduce the cost of formation and maintenance of companies;
5. Accountability to minority shareholders and company stakeholders other than shareholders;
6. Emulate international best practice.

Examples of how the Act follows these principles include;

- One of the purposes of this Act is to promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law (S7);
- Simplifying registration of companies by allowing the use of the registration number as the name of the company (S11);

[1] Memorandum of the objects of the companies bill 2008 issued by the DTI

- Simplifying the management of companies by introducing audit exemption for certain types of companies and introducing an alternative to the audit in the form of the independent review to be performed by persons other than auditors (S30);
- Aligning audit exemption and the independent review with similar requirements as found in European company law (S30 and draft regulations) (Refer appendix 1);
- The requirement that certain types of companies establish a Social and Ethics Committee (S72);
- Dissenting shareholders appraisal rights (S164);
- Derivative actions for shareholders and registered trade unions (S165)

It is therefore important that the Companies Amendment Bill 2010 adhere to these very lofty and admirable principles. We therefore support the notion that any amendments should be measured against these principles before being adopted.

1.2 Differential governance – balancing compliance and enterprise development

Based on the unitary approach adopted in drafting our Companies Act 2008 it becomes important to differentiate between types of companies so as not to overburden smaller companies.

The main mechanism used by the Act to differentiate between types of companies is the use of alterable and unalterable provision. Thus business owners have a very enabling and empowering mandate to apply company law that best fit their particular circumstances whilst being obligated to follow a basic set of governance requirements.

Examples of differentiation include the following:

- Differentiating between public interest and non-public interest type of companies;
- Prescribing financial reporting standards for listed and large companies only;
- Allowing smaller companies to prepare financial statements based on a compliance framework such as tax bases of accounting or an entity specific framework such as the United Nations SMEGA level 3 accounting framework;
- Audit exemption for companies below a certain threshold;
- Alternative assurance in the form of the independent review for large non-owner managed private companies;
- Excluding certain types of companies from complying with Chapter 3 of the Act.

The need to differentiate between companies was also recognised by the late Deputy Minister of Agriculture and corporate law expert, Dirk du Toit: "*Thus the legal system looks beyond the class interest of the business elite, doing justice to all classes, applying the moral imperative*"[2]

However to protect against abuse of these enabling provisions, the Act provides significant and enhanced enforcement powers to the new Companies Commission. These include:

- Reckless trading prohibited by (Section 22 and draft Regulation 21)
- Administrative penalties for not keeping and safeguarding accounting records (S. 28 and R. 24)
- Administrative penalties if financial statements are not prepared in accordance with a prescribed standard (S. 29-30, R. 28-29)

[2]As reported by Henning J.J., 2006, Kentucky law journal

- Administrative penalties if a person is party to the preparation of misleading financial statements (S. 214)
- Retention of the audit for public companies, state owned companies and private companies classified as public interest. (S. 30(2)(b)(i) and draft R. 28 - 29)
- Additional accountability requirements for certain companies (S. 34)
- Codifying standards of directors conduct and providing for director and prescribed officer liability (S. 76 and S. 77),
- Establishing a new Companies Commission with extensive enforcement powers i.e. direct complaints to companies commission (S. 168), Commission may issue a compliance notice (S. 171), Commission may issue summons (S. 176), Commission has search and seizure powers (S. 177), Commission actively monitors compliance with the Act (S. 187), Fundamental transactions and take over regulations applies to private companies (S. 112 and S. 118), Remedies and enforcement mechanisms to protect minority shareholders, shareholders and trade unions (Chapter 7), enhanced accountability and transparency requirements applicable to public, state owned and private companies classified as public interest. These companies to appoint company secretary, audit committee, auditor and audit firm rotation (Chapter 3), establish offences related to false statements, reckless conduct and non-compliance (S. 214), establish civil action i.e. "any person is liable to any other person for contravention of the act" (removes causal relationship) (S218).

As a last point it should be noted that the Act adopts the "Enlightened shareholder value" approach with regard to the governance of companies. According to this approach "directors

should have regard, where appropriate, of the need to ensure productive relationships with a range of interested parties – often termed stakeholders – and have regard to the longer term, but with shareholders interest retaining primacy". In other words directors could prioritise stakeholders but only if it promotes the success of the company for the benefit of members as a whole[3]".

We support the differential approach adopted by the legislature in drafting the new Companies Act 2008 in particular to the audit exemption provisions and the current provisions related to the independent review.

We agree with the Department of Trade and Industry that the "*The clear implication of s. 30 (2)(b), read with s. 30 (7)(b) is that an independent review is not just another name for an audit, but is in fact something less: less rigorous, less burdensome, less onerous, and less costly to the company, and is contemplated to be performed by persons other than auditors*."[4]

This view has been supported by a number of commentators[5].

We welcome the provision in the Companies Act 2008 to remove the statutory obligation on many companies to have their financial statements audited when there is neither value in it nor any public interest to protect. We believe that this deregulatory measure will bring economic

[3] Davis, D et al; Companies and other Business Structures in South Africa, 2009, Oxford South Africa
[4] The Companies Act, 2008, Development of Regulations, Issues for Discussion, August 2009, issued by the South African Department of Trade and Industry
[5] Davis, D; Geach, W; Mongalo, T; et al; Companies and other Business Structures in South Africa, 2009, p131, Oxford South Africa

benefits to many businesses that are categorised as Small and Medium-sized Enterprises, in line with international developments (Refer appendix 1).

PART 2: SPECIFIC COMMENTS

CLAUSE	DETAIL	COMMENT	PROPOSAL
Section1: Definitions:	**Accounting records -** all information concerning the financial affairs of a company	Definition to broad will require minute details of records to be kept when all that is required is information to fairly present.	Define as per Co Act 1973: "records that are necessary fairly to present the state of affairs and business of a company and to explain transactions and financial position
	Assets - A resource controlled by an entity as a result of past events, and from which future economic benefits are expected to flow	This definition may remove the common law definition of assets and replace with accounting definition. Once act becomes effective this may unwittingly expropriate assets. Accounting definition only applicable for preparation of financial statements. No definition in Co Act 1973 or UK company Act.	Remove the definition entirely or consider moving to section 4 to assist on determining solvency and liquidity test.
	Audit - Has the meaning set out in the Auditing Profession Act [, 2005 (Act 26 of 2005)], but does not include an "independent	Effectively and very appropriately positions independent review outside the scope of	Correct approach – do not remove

	review" of annual financial statements, as contemplated in section 30(2) (b)(ii)(bb).	the Auditing Professions Act 2005. Aligned to international best practice in providing for alternative reports issued by non-auditors.	
	Creditor- A person to whom a company is or may become obligated in terms of any liability or other obligation that would be required to be considered by the company if it were applying the solvency and liquidity test set out in section 4.	See comments under assets – reason for definition relate to reckless trading. Should not replace common law definition.	Remove definition or consider moving to section 4.
	Liability- An existing obligation of an entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits;''	See comments under assets.	Remove definition.
Section 29: Financial statements	29(1) All financial statements must satisfy financial reporting standards (frs) as prescribed; Minister may prescribe frs but is not obligated to do so; if he prescribes then should be in accordance with standards issued by the IASB; if not prescribed then financial statements should meet fair presentation requirement.	The first draft of the companies regulations prescribed IFRS and IFRS for SME for public co/public interest co and non-owner managed private co respectively. Fair presentation does not mean IFRS but requires entity specific framework that is followed consistently.	We agree with the current requirements i.e. small owner-managed companies should be allowed to follow any appropriate framework including a compliance framework or entity specific framework. Follow example of Close Corporations Act 1984 "gaap as

			appropriate"
	29(6) Subject to section 214(2), a person is guilty of an offence if the person is a party to the preparation, approval, dissemination or publication of— *(a)* any financial statements, including any annual financial statements contemplated in section 30, knowing that those statements— **(i) ~~do not comply with the requirements of subsection (1)~~; subparagraph:** **(i) fail in a material way to comply with the requirements of** **subsection (1); or'' or** **(ii) are materially false or misleading, as contemplated in subsection (2);**	The amendment alleviates the liability of the preparer of financial statements by requiring material compliance. Amendments to section 214(2) clarifies that a person is party to the preparation if financial statements contain a scheme suggested by that person and the person knew that the scheme would cause the statements to be misleading.	Agree with proposed amendments.
Section 30: Annual financial statements	All companies must prepare annual fin statements; Financial statements must be audited if company is a public company. All other profit or non-profit companies must either: audited if: required by regulation considering any factors including **any** of the following: turnover, size of workforce, nature and extent of activities; or Voluntary audited. All other companies should be independently reviewed – [sec 30(2A) determines that the minister will set the manner,	No regulation of IR allowed by act; and IR specifically excluded from definition of audit in the Auditing Professions Act 2005. The scope of Auditing Profession Act 2005 limited to regulation of auditors and auditing in the public interest.	Agree with current provisions. Companies Act removes emphasis on audits as protection mechanism. New emphasis is placed on preparers of accounts and enforcement powers of companies commission.

	form and content of the independent review and the qualification of professional allowed to issue independent review] However private company exempted from both audit and independent review if all shareholders are directors i.e. owner-managed		
Section 30 and 84: Enhanced accountability	Requirement to appoint company secretary, audit committee, auditor and audit rotation.	Chapter 3 clarified - applicable to public companies and companies required to be audited only	Agree with clarity provided.
Section 72: Board Committee: Social and Ethics committee	Act provides that regulation will determine category of companies that should, in the public interest, appoint a Social and Ethics Committee (SECOM); This is determined by turnover, size of workforce, nature and extent of activities; However company may apply for exemption if company does not act in the public interest or have similar committee.	Clarifies application of section 72.	Agree with amended provision.
Section 109: Financial Reporting Standards Council	The Minister must appoint a Financial Reporting Standards Council consisting of amongst others: one person nominated by the body governing the regulation of the accounting professions.	There are no statutory body regulating the accountancy profession.	Replace with "one person nominated by the Accounting Practices Board
Section 134: Business	1) A person may be appointed as the business rescue	Meaning of regulatory authority unclear.	Clarify the meaning of regulatory

rescue	practitioner of a company only if the person: (a) is a member in good standing of: (i) a legal, accounting or business management profession that is subject to regulation by a regulatory authority;		authority.

APPENDIX 1: FEE SURVEY ON ALTERNATIVE ASSURANCE

The European Federation of Accountants (FEE) conducted a survey in 2009 of 27 EU states and Norway and Switzerland. The purpose of the survey was to establish an inventory of alternative assurance or related services available for smaller entities in Europe and to understand similarities and differences of the underlying standards.

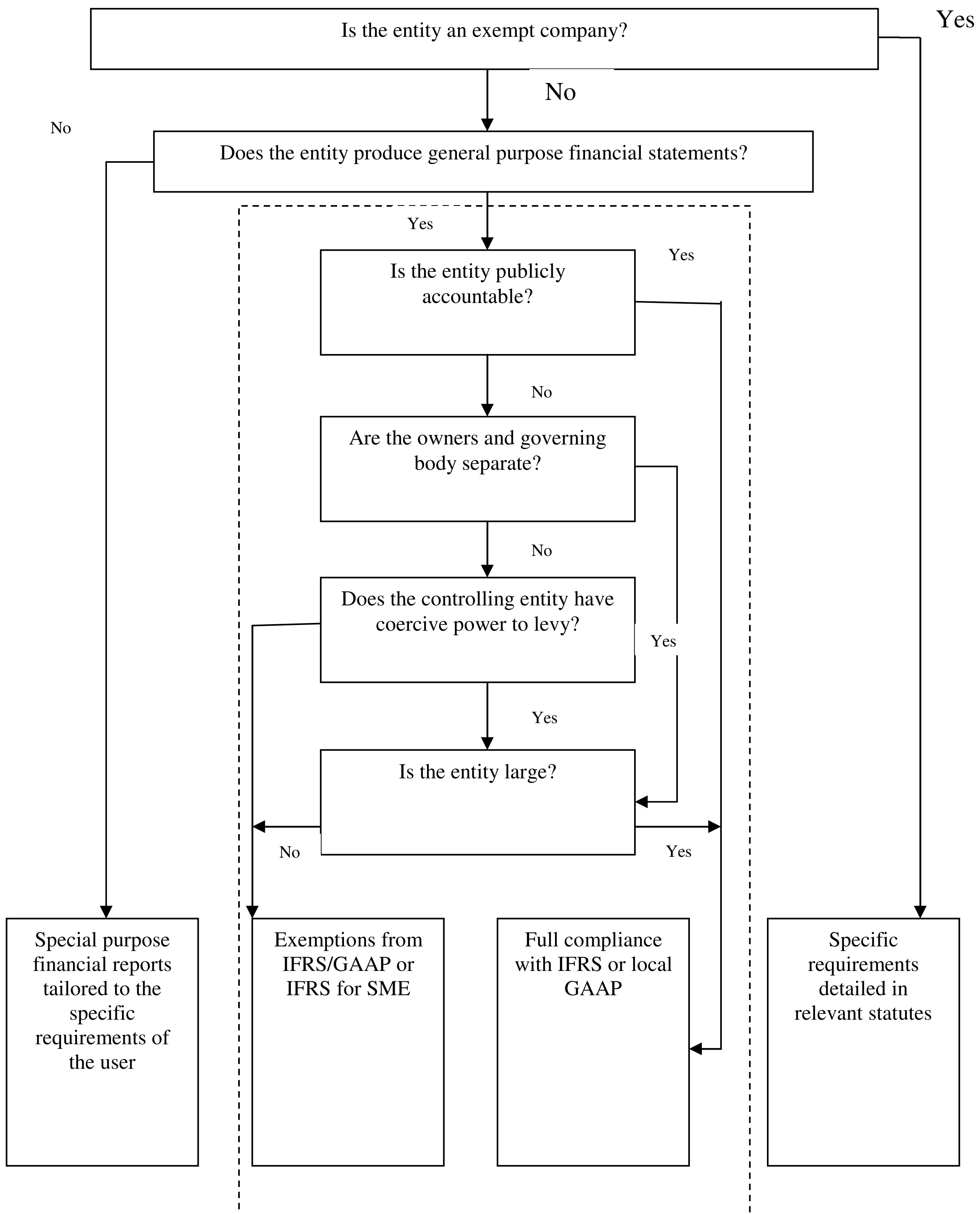
A summary of the FEE survey findings is provided below:

1. European Union states adopt different approaches when developing non-audit reporting **s**ervices. Alternative approaches include**:**
   a. Adopting IFAC standards;
   b. Developing national standards aligned to IFAC standard;
   c. Develop a national standard.
2. Alternative assurances and related services standards are developed for audit exempt entities;
3. The International review standard as issued by IFAC (ISRE 2400) is not the only alternative to small company audits. Examples include:
   a. France's presentation engagement on consistency and plausibility of financial statements;
   b. Germany's assurance on vouchers and not on financial statements;
   c. Italy's assurance on internal control and directors decisions.
4. Each jurisdiction decides if alternative assurance standards should adhere to the IFAC assurance framework;
5. Non-audit assurance and related services are NOT limited to auditors. Professional accountants, lawyers and tax practitioners are allowed to issue such reports;
6. All standards have similar underlying requirements such as documentation;

7. Certain countries do not regulate alternative assurance or related service;
8. Is alternative assurance voluntary or mandatory?
    a. Majority of countries – voluntary;
    b. Certain jurisdictions depends on type of entity i.e. public interest or size;
    c. Certain jurisdictions – mandated if not voluntary audited or internally controlled;
    d. Switzerland, Estonia, Denmark, Malta review (as defined) mandated for SME's
9. What are the requirements related to ethics and independence when conducting alternative assurance and related services?
    a. Majority of countries – adhere to IFAC Code or national equivalent;
    b. Other countries – auditors and non-auditors have to follow same standards;
    c. Some countries – less stringent requirements than IFAC.
10. What are the requirements related to quality assurance?
    a. Vast majority of countries require internal quality assurance;
    b. Majority of countries also require external quality assurance;
    c. Significant number of countries require same standard as for auditor;
    d. Other countries require a standard that is less stringent than the standard required for auditors.
    e. The International Standard on Quality Control (ISQC1) is used as a base in 50% of countries.
11. What model is used to regulate providers of non-audit assurance and related services?
    a. Two distinct approaches were identified:
    b. 50% of countries require **EITHER public** oversight **or oversight by professional** providers
    c. 50% of countries require no oversight function;

APPENDIX 2: DIFFERENTIAL REPORTING IN NEW ZELAND AND AUSTRALIA

Summary of New Zealand and Australian approach to differential financial reporting



APPENDIX 3: ABOUT ACCA

- ACCA is the global body for professional accountants. We aim to offer business relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management. We have 404,000 students and 140,000 members in 170 countries worldwide.
- ACCA has worked with governments, national organisations and development agencies in emerging economies - for over 20 years - promoting the accounting profession, to create value for the communities, businesses and individuals it serves.
- ACCA believes that globalisation of business means that one set of reporting standards is essential. We favour the principles-based IFRS.
- ACCA understands the real issues facings mall businesses as 63,000 of our more than 140 000 members work in SMEs or small partnerships worldwide.
- ACCA is a Recognised Supervisory Body (RSB) and a Recognised Qualifying Body (RQB) under the UK Companies Act 1989 and in the Republic of Ireland where ACCA licenses and regulates auditors under the Companies Act 1990.