



DEPARTMENT OF PROFESSIONAL PRACTICE

# Companies Bill, 2007

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AUDIT

# Agenda

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- **Companies Bill, 2007**
  - Overview
  - Interesting aspects
  - Discussion

# Overview of the Companies Bill, 2007

# Overview of the Companies Bill: Significance of different kinds of companies

- **Kinds of companies and naming conventions**
  - **Widely held company** (s8) (“Limited”)
    - Differs from the current concept of public company
    - If Memo permits offer of shares to public/limits negates or restricts the pre-emptive right/provides for the unrestricted transfer of any of its shares
    - Subsidiaries of Widely Held Company
  - **Closely held company** (“CHC Ltd”)
    - Not widely held company
    - (Note: s36: general rule: **every shareholder has a pre-emptive right** to be offered or to purchase any shares issued or proposed to be issued “other than shares issued for at least fair value consideration other than money”)

# Interesting aspects: Significance of different kinds of companies (continued)

- **Not for profit company** (“NPC”)
  - Certain provisions of the Companies Act = N/A
- **Public interest company** (s9) (no naming convention)
  - All widely held companies
  - Some closely held and not for profit companies → criteria
  - Minimum of 4 directors required

# Overview of the Companies Bill: Significance of different kinds of companies

- **Public Interest Company**

- Widely Held Company; or
- Closely Held Company (Ltd) or Not for Profit Company that
  - Predominantly engages in one or more activities
    - Take deposits or exercise public trust
    - Substantial/significant impact on environment
    - Contribute to public health
    - Supply or maintain essential goods, services or infrastructure; **or**
  - Meets any two of the three criteria
    - Average asset value >R25m (FPC) and >R10m (NFP)
    - Average turnover >R50m (FPC) and >R20m (NFP)
    - Average employees >200 (FPC) and >50 (NFP)

# Overview of the Companies Bill: Related parties

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- **Individuals**

- Married, live together similar to marriage
- Separated by no more than three degrees of natural/adopted consanguinity

- **Individual related to juristic person if control**

- Power to substantially determine policy and direction
- Voting rights

# Overview of the Companies Bill: Related parties (continued)

- **Juristic persons**
  - Either of them controls the business of the other
  - Either is a subsidiary of the other
    - More than 50% of the shares by second juristic person, wholly owned subsidiaries, nominees
  - A person controls whole/part of both of them
- **Presumed to act in concert**
  - Related/inter-related
  - Juristic person and
    - Director / trustee
    - Juristic person in which directors/trustees exercise more than 35% voting rights

# Overview of the Companies Bill: Financial statements

- **Companies must prepare Financial Statements unless:**
  - All shares held by one person, or by two or more persons who are related/inter-related
  - Company is NOT a holding company/subsidiary of company that is required to prepare AFS
- **No audit or accounting officer report for non-Public Interest Company?**
- **Not exempt from audit committee and auditor?**

# Overview of the Companies Bill: Accounting records and statements

- **Financial reporting standards**
  - Promote sound and consistent accounting practices
  - Must be consistent with
    - International Financial Reporting Standards of the International Accounting Standards Board and
    - gaap?
  - May be different for PIC and non-PIC?
- **AFS must comprise**
  - Balance sheet with notes
  - Income statement with notes
- **Financial Reporting Council advisor to Minister**

# Overview of the Companies Bill: Financial accountability

- **Audit committee**
  - Every PIC except if holding co
  - 2 members **each director** of company and non-executive who acts independently
- **Definition of non-executive**
  - Not involved in management or employed for the last 3 years
  - Not **related** to member of person above
- **Acts independently**
  - Opinions, judgement and decisions impartial; and
  - Not related to the company or any shareholder or other director, or
  - Not related to **material** supplier/customer to conclude that director is compromised by relationship

# Overview of the Companies Bill: Audit committees

- **Functions of the audit committee:**
  - Nominate external auditor
  - Determine fees and terms of engagement
  - Ensure appointment complies with Act
  - Nature and extent of non-audit services
  - Pre-approve any proposed contract
  - Insert statement
    - Describing audit committee functions
    - Satisfied auditor independent
  - Receive and deal with complaints

# Overview of the Companies Bill: Auditor and non-audit services

- **Auditors (continued)**

- Rotation of designated auditor every five years (transitional arrangements unclear)
- Non-audit services prohibited at Public Interest Company
  - **Bookkeeping or accounting**
  - **To the extent subject to own auditing, internal audit or tax advisory**
  - Any other services determined by the audit committee
- One month before approval AFS, auditor must meet with **board**
- Must attend AGM and answer questions relevant to audit

# Directors: Some pertinent aspects

# Directors: Trends

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- **Trend towards personal liability of directors**
- **High standard of conduct expected**
- **Examples**

# Directors: Example of liability

- **Solvency and liquidity test**

- Section 4 – definition;
- Various sections including:

- Section 27(3):

If not solvent and liquid and the board has not started business rescue: 10 business days to give notice to shareholders  
Continuing status report every 60 business days

Question: If no financial statements?

# Directors: Example of liability

- Solvency and liquidity test (continued)
  - Financial assistance re company shares (section 40(4)) AND
  - Loans or other financial assistance to directors (section 92A):  
Directors liable to compensate company & shareholders; AND  
“may be held as responsible as the company for the contravention”
  - **Distributions**: Directors jointly and severally liable (section 49) to reimburse the company
  - **Buy-backs**: Directors may be jointly and severally liable (section 49) for legal costs and to reimburse company

# Directors: Standards of conduct

- S91

- 1. A duty to exercise the degree of care, skill and diligence that would be exercised by a **reasonably** diligent individual
  - that may **reasonably** be expected of a person carrying out those functions (obj. test) **AND**
  - with the general knowledge, skill and experience of that director (subj. test)
- 2. Fiduciary duty to act
  - honestly
  - in good faith
  - manner that the director **reasonably believes** to be in the best interests of and for the benefit of the company

# Directors: Standards of conduct

- S91 (continued)
- Director's judgement that in the best interest/for the benefit of the company is **reasonable** if:
  - that director has taken **reasonably** diligent steps to become informed; AND
  - that director does not have a personal financial interest; AND
  - it is a judgement that a **reasonable** individual in a similar position could hold in comparable circumstances

# Directors: Standards of conduct

- S91 (continued)
- Further duties
  - comply with the Companies Act and Memo;
  - to communicate to the board “any material information” that comes to the director’s attention;
  - But: director is entitled to rely on employees and experts if “reasonably believes”
- Section 91 does not substitute the common law

# Directors: Standard of conduct

- S92
- Director must not, directly or indirectly:
  - make secret profit
  - gain advantage for someone else
  - cause detriment to the company
  - use information obtained improperly with the above result, even after no longer a director

(Note: Transaction no longer void/voidable if ratified by an ordinary shareholders resolution)

# Directors: Standard of conduct

- **S92 (continued)**
- **Conflicting financial interest**
  - must not improperly use office in this regard
  - must inform board and not participate any further
  
  - Conflicting financial interest does not arise purely from shareholding in the company
  - Conflicting financial interest N/A if 1 dir & dir = shareholder and all share are held by related persons
  - Duty to inform board N/A if company has only 1 director

# Directors: Liability

- **S93: Director may not be relieved of liability:**
  - for gross negligence, wilful misconduct or breach of trust;
  - to the company and any other person
    - if signed or consented to, **knowing or with reckless disregard** as to whether
      - **financial statement** was false or misleading
      - a **prospectus** contained an untrue statement
    - **knowingly** been a party to
      - **reckless** carrying on of company's business
      - act or omission **calculated to defraud** creditor/employee/security holder
  - company may advance legal expenses (s93(3))

# Directors: Delinquent or on probation

- S163
- Application to court by company / shareholder / secretary / registered trade union / **representatives of employees** of the company
- to declare a director **delinquent** (=disqualified s89(5)(f))
  - if, for example:
    - grossly abused position
    - has repeatedly been subject to compliance notice/administrative fine
  - declaration may subsist for lifetime or other period (default = 7 yrs)

# Directors: Delinquent or on probation

- S163 (continued)
- to declare a director **under probation** (= must not serve as director except to the extent permitted by the probation order s89(4))
  - if, for example
    - “improperly” supported a resolution contrary to solvency and liquidity test
    - have been a director of 2 or more companies which failed to pay all its creditors
  - court has discretion depending on circumstances
  - period of not more than 5 years
- For both delinquency and probation the court may also order, inter alia, “remedial education” or community service

# Some thoughts

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- **If you are a director, in particular Widely Held Company/Public Interest Company:**
  - Employ good company secretary
  - Record keeping = very important (proof of compliance with duties)
  - Acknowledge interest of employees of company

# Business rescue

- **Current legislation – creditor friendly**
- **Proposed business rescue**
  - Company/board assess liquidity and solvency
  - Appoint supervisor with veto rights
  - Approved by creditors
  - Employees more status than secured creditors
  - Voting rights determined by outstanding value
  - Automatic moratorium on claims
  - Right to suspend all contracts
  - Complete in 3 months

# Questions