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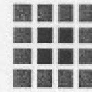

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SAIPA SUBMISSION: CORPORATE LAWS AMENDMENT BILL, B6-2005

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WE STAND FOR ■ INTEGRITY
■ ETHICS
■ EXCELLENCE
■ PROFESSIONALISM
■ PEOPLE - CENTEREDNESS

ECSAFA

MEMBER OF THE Ethics Institute of South Africa

Part 1: Introduction

The South African Institute of Professional Accountants would like to thank the Portfolio Committee on Trade and Industry and the Honourable Members for this opportunity to make a submission on the Corporate Laws Amendment Bill, B6-2006.

SAIPA's comments are presented in two main parts: specific comments and general comments. The Specific comments have been prepared in accordance with the paragraph layout of the Bill whilst the General comments contain our view on issues related to the Bill that we feel the Honourable Members should take into consideration.

The main theme underlying our submission relates to our belief that due recognition should be given in legislation to the specific needs of closely-held companies, as opposed to widely-held companies. We believe that this distinction is becoming more and more important internationally and locally and that our legislator, government departments, the accounting profession and other stakeholders should recognise this development and make the necessary adjustments to legislation and other regulation to further enhance this development. Although this Bill is a good start in this process of differentiation, there remain areas of in legislation that still needs to be reviewed. We hope that our submission will contribute to reducing the compliance burden for not only closely-held companies, but also all other entities that are owner-managed or closely-held.

We also wish to bring to the attention of the Portfolio Committee the prompt and comprehensive response received from the Department of Trade and Industry on our earlier submission on the draft Bill. This is really appreciated.

We want to express our sincere appreciation to the task team members that assisted SAIPA in preparing this submission as well as to the individual SAIPA members and others that responded to the call for comment. Details of the Task Team members as well as the individual contributors are contained in Part 5 of our submission.

Information contained in this submission, including any proposals made, is the view of SAIPA and does not necessarily reflect the view of the individual task team members or the individual respondents.

Regards

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Part 2: Specific Comment

Part 5: Amendment of section 28 of Act 61 of 1973

Section 3 is amendment by including the phrase 'prescribed manner'. We suggest that the Bill should explain clearly what is meant by this phrase "prescribed manner". Perhaps a generic definition of the phrase could be included as part of the definitions in section 1 of the Act.

We suggest that the Bill should explain clearly what is meant by this phrase "prescribed manner".

Part 7: Amendment of section 38 of Act 61 of 1973

The proposed section 38(2A)(a)(i) as well as schedule 4 includes the phrase 'fairly valued'. We suggest that the Bill provides clarity on the meaning of this term especially in relation to "limited interest companies".

Limited interest companies are not required to follow financial reporting standards but only the accounting framework of financial reporting standards.

Only financial statements that are prepared in accordance with the complete suite of International Financial Reporting Standards can be said to be a fair presentation. The financial statements of limited interest companies will therefore not give a fair presentation of the business activities of the company. Based on this conclusion we believe that Limited interest companies should be allowed to deviate from the fair value requirement. This could be replaced for example "Directors Valuation" or "Historical Cost". This suggestion will in effective place fair value outside of the financial statements and only make it mandatory if certain circumstances apply i.e. financial assistance.

We therefore suggest that an amendment be considered that will:

- *require fair value in terms of the amended section 38 but that will,*
- *not require fair value as part of the presentation of financial statements i.e. schedule 4.*

Part 13: Amendment of section 73(a)(3) of Act 61 of 1973

Section 73(a)(3) include the phrase he/she. Although we agree with legislation providing equitable recognition for all genders, including the phrase only in selected sections of the act, might create the impression that those sections of the act that is currently not being amended only applies to one group within the different genders.

We therefore suggest a review of referring to both genders in legislation.

Part 22: Amendment of section 269B of Act 61 of 1973

We suggest the deletion of the entire section as we believe that all public interest companies should be required to appoint an audit committee.

Part 24: Amendment of section 270A(5)(c) and (d) of Act 61 of 1973

Section 270A(5)(c) only refers to the previous appointment as auditor.

We suggest that the words "or consultant" should be included in this section. Consideration of independence should include a consideration not only of previous appointment as auditor but also any previous appointment as consultant.

Section 270A(5)(d) only refers to any professional or industry code.

This section should be amended to include a consideration of not only a professional and industry code but also compliance with the companies act. The companies act includes other more stringent audit requirements that might be found in a professional or industry code.

Part 28: Amendment of section 275(3) of Act 61 of 1973

We wish to bring to the attention of the committee the implications of this section. This section allows a registered auditor to perform bookkeeping and secretarial services for private companies.

It is the auditors function to determine whether the financial statements of a company fairly reflect the company's position in order to firstly, assist the company in detecting errors and secondly, to provide shareholders with reliable information to enable them to evaluate the conduct of managers.

If the auditor is simultaneously the bookkeeper and auditor of a private company the auditor will determine whether his own work fairly reflects the company's position, and is without error. This places unnecessary strain on the independence assumption underlying all audit work.

If this is to be allowed consideration should be given to whether the audit requirement should still be a mandatory requirement for private companies.

The bill only prohibits the performance of certain non-audit services with regard "public interest companies". If the legislator will allow the individual auditor of a "limited purpose company" to perform non-audit services that is disallowed for the auditor of a "public interest company", the legislator accepts that this type of companies has no or little public accountability. Maintaining the mandatory audit for "limited purpose companies" thus looses all credibility, as the historical reason for making the audit mandatory was and is public accountability. Only if all auditors of all types of companies are prohibited from performing non-audit services will it be morally justifiable to keep the audit mandatory for all types of companies.

We suggest that the audit should not be a mandatory requirement for private companies.

Part 29: Amendment of section 275A of Act 61 of 1973

This section limits the types of services an auditor is allowed to provide to a public interest company.

We suggest that financial advisory services be included as one of the restricted services.

In addition we believe that as auditors are granted a privileged position in legislation they should be accountable to the community in which they operate.

No statutory duty exists to disclose agreements reached between auditors and management. Neither does management have to report on the details of such agreements to shareholders nor is it required of auditors to disclose the profitability or extent of non-audit services in relation to audit services.

We therefore suggest that auditors be required to publish their audited financial statements, as well as disclosure of fees generated by way of audit services and those generated by non-audit services. This information should also form part of the annual reports of public interest companies.

Part 33: Amendment of section 285A(c) of Act 61 of 1973

This section requires that financial statements of Limited interests companies be prepared to **fairly present** the financial position and the result of operations of the company.

We request clarity on whether the word "fairly present" in this section will nullify the otherwise laudable provisions of sections 285A(a) and (b). Refer to our comments under ***Part 7: Amendment of section 38 of Act 61 of 1973*** *and* ***General Comments: Part 1*** *in this regard.*

Part 50: New section 440P in Act 61 of 1973

We suggest amendments to the composition of the Financial Reporting Standards Council.

The regulatory approach that is needed to maintain investor confidence in public interest companies should not be allowed to dominate the enabling approach needed for limited interest companies. The composition of the Council should be such that the risk of domination is minimised.

We therefore suggest the following changes:

- *(a) four persons registered with the IRBA and practising as registered auditors*
- *(c) two persons responsible for preparing financial statements for limited interest companies*

- *(d) two users of limited interest company financial statements; and two users of public interest company financial statements*

Part 50: New section 440Q(4) and in Act 61 of 1973

Section 440A(4)(b) requires that the Council always consist of former members of the Council.

This requirement seems to be in conflict with section 440Q(3) and will limit the membership of the Council to previous Council members.

We suggest that the Council should from time to time be renewed with appropriately qualified persons that were not previous members of either the APB or the Council.

Part 50: New section 440W in Act 61 of 1973

We suggest amendments to the composition of the Financial Reporting Investigations Panel.

Due recognition should also be given to other professional accountancy bodies. We recognise that SAICA has played a major role in the Panel's predecessor, the GAAP Monitoring Panel, however this does not mean that other professional bodies cannot also aspire to contribute to ensuring adherence to financial reporting standards.

We therefore suggest the following changes:

- *(b) six persons registered with the IRBA*
- *(c) six appropriately qualified persons that are members of a professional accountancy body.*

Part 50: New section 440X(4) and in Act 61 of 1973

Section 440X(4)(b) requires that the Panel always consist of former members of the Panel.