The Companies Act
Audit requirement and other matters related to the audit

The Act provides the Minister of Trade and Industry with As stated above, the Act requires public companies and state owned companies to have an audit. In addition, the Regulations, which provide for both activity and size criteria to determine whether or not companies require audited financial statements, require any company that falls within any of the following categories in any particular financial year to have its financial statements audited:

(a) Any profit or non-profit company if, in the ordinary course of its primary activities, it holds assets in a fiduciary capacity for persons who are not related to the company, and the aggregate value of such assets held at any time during the financial year exceeds R5 million;

(b) Any non-profit company, if it was incorporated—
   (i) directly or indirectly by the state, an organ of state, a state-owned company, an international entity, a foreign state entity or a company; or
   (ii) primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direct or indirect initiation or direction of an organ of the state, a state-owned company, an international entity, or a foreign state entity, or for a purpose ancillary to any such function; or

(c) Any other company whose public interest score in that financial year is
   (i) 350 or more; or
   (ii) at least 100, but less than 350, if its annual financial statements for that year were internally compiled.

Financial statements will be internally compiled, unless it was "independently compiled and reported". In terms of the Regulations "independently compiled and reported" means that the annual financial statements are prepared

- by an independent accounting professional
- on the basis of financial records provided by the company, and
- in accordance with any relevant financial reporting standards.

The inclusion of size criteria will inevitably mean that a large number of private companies will be required to have their financial statements audited. All companies with a public interest score of more than 750 will be audited. For those companies with a score below 350, an audit will nonetheless be required if the company meets the requirements of the activity test.

Independent review

All companies that are not required to have audited financial statements must have their financial statements independently reviewed (with the exception of companies where all the shareholders are also directors and therefore are not required to obtain an audit or a review).

The Regulations propose that an independent review of a company's annual financial statements must be carried out —

(a) In the case of a company whose public interest score for the particular financial year was at least 100, by a registered auditor, or a member in good standing of a professional body that has been accredited in terms of section 33 of the Auditing Professions Act (SAICA is the only body so accredited at the moment); or

(b) in the case of a company whose public interest score for the particular financial year was less than 100, by —
   (i) a person contemplated in paragraph (a); or
   (ii) a person who is qualified to be appointed as an accounting officer of a close corporation in terms of section 60 of the Close Corporations Act, 1984.

The effect of this Regulation is that only registered auditors and CA's may perform an independent review of companies with a public interest score of more than 100.

The Companies Act is effective from 1 May 2011. We provide a high level overview of some of the provisions pertaining to the audit requirement, independent review, the audit committee and the financial reporting standards.

Classifying a company

The new Companies Act prescribes a certain level of oversight and audit or review based on the classification of the company. Not all companies are required to have their financial statements audited. Also, of those companies that should have audited financial statements, not all are required to have an audit committee.

Different forms of companies

The Companies Act (the Act) provides for a new classification of companies. The classification of companies as either widely held or limited interest, as introduced in the Corporate Laws Amendment Act, is discarded in favour of a new classification. In terms of the new Act, companies are classified as either profit companies or non-profit companies. Non-profit companies, which are the successors to the current section 21 companies, have to comply with a set of principles set out in Schedule 1 of the Act. These principles relate mainly to the purpose or objectives and policies of the company, matters related to directors and members, fundamental transactions and the winding up of non-profit companies. Also, the Act exempts non-profit companies from certain provisions of the Act.

With regard to profit companies, the Act distinguishes between four different types of companies, namely:

- Private companies (Pty)Ltd: A company that is not a state owned company, and its Memorandum of Incorporation prohibits it from offering any of its securities to the public, and restricts the transferability of its securities.
- Personal liability companies Inc.: The company and the directors are jointly and severally liable for any debts and liabilities of the company.
- State owned companies SOC Ltd.: An enterprise, registered as a company, which is listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act, or is owned by a municipality.
- Public companies Ltd.) A company that is not a state owned company, private company or personal liability company.

Public interest score

The Regulations require that every company calculate its 'public interest score' for each financial year. In terms of this requirement every company must calculate its 'public interest score' for each financial year, calculated as the sum of the following:

(a) a number of points equal to the average of employees of the company during the financial year ("employee", has the meaning set out in the Labour Relations Act, 1995);

(b) one point for every R 1 million (or portion thereof) in third party liability of the company, at the financial year end;

(c) one point for every R1 million (or portion thereof) in turnover during the financial year; and

(d one point for every individual who, at the end of the financial year, is known by the company —

  (i) in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities; or

  (ii) in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company.

The company's public interest score will be used to determine whether or not certain companies will require audited financial statements, which financial reporting standards should apply, and who may conduct an independent review for those companies that are not subject to the audit requirement.

Should the company have audited financial statements?

The Act requires public companies and state owned companies to have audited financial statements. The Regulations set out additional categories of companies that are required to have their annual financial statements audited, which are discussed below. Notwithstanding the provisions of the Act and the Regulations, the provisions of the Act related to mandatory audits will also apply to any company that voluntarily choose to have audited financial statements, and provides for this choice in the company's Memorandum of Incorporation.

Financial reporting standards

The Regulations prescribe the application of International Financial Reporting Standards (IFRS), International Financial Reporting Standards for Small and Medium Enterprises (IFRS for SMEs) or South African Statements of Generally Accepted Accounting Practice (SA GAAP) depending on the classification of the company.

State owned and profit companies

Category of Companies	Financial Reporting Standard
State owned companies.	IFRS, but in the case of any conflict with any requirement in terms of the Public Finance Management Act, the latter prevails.
Public companies listed on an exchange.	IFRS.
Public companies not listed on an exchange.	One of — (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is at least 350.	One of — (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.
Profit companies, other than state-owned or public companies — (a) whose public interest score for the particular financial year is at least 100 but less than 350; or (b) whose public interest score for the particular financial year is less than 100, and whose statements are independently compiled.	One of — (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's; or (c) SA GAAP.
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is less than 100, and whose statements are internally compiled.	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed.

Non-Profit Companies

Category of Companies	Financial Reporting Standard
Non profit companies that are required in terms of Regulation 28 (2)(b) to have their annual financial statements audited.	IFRS, but in the case of any conflict with any requirements in terms of the Public Finance Management Act, the latter prevails.
Non profit companies, other than those contemplated in the first row above, whose public interest score for the particular financial year is at least 350.	One of — (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.
Non profit companies, other than those contemplated in the first row above— (a) whose public interest score for the particular financial year is at least 100, but less than 350; or (b) whose public interest score for the particular financial year is at less than 100, and whose financial statements are independently compiled.	One of — (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's; or (c) SA GAAP
Non profit companies, other than those contemplated in the first row above, whose public interest score for the particular financial year is less than 100, and whose financial statements are internally compiled.	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed.

Transparency and accountability

The Act requires companies to adhere to a number of measures to ensure transparency and accountability. These include requirements for a company to: all companies are required to:

- Have at least one office in the Republic, and to register the address of such office (or its principal office) with the Commission;
- Keep certain records in written or electronic form for a period of seven years;
- Keep accurate and complete accounting records;
- Prepare annual financial statements; and
- Submit an annual return, including a copy of its annual financial statements and any other prescribed information. The content of this return will be prescribed in Regulations to the Act.

Enhanced transparency and accountability

Although all companies are subject to the general transparency and accountability requirements as set out above, only certain companies are required to comply with the enhanced accountability and transparency requirements as set out in Chapter 3 of the Act:

- All public companies and state owned companies must appoint an audit committee and a company secretary.
- All companies that must be audited (as discussed above) are obliged to appoint an independent auditor.
- Any company that is not obliged to comply with these requirements may choose to include the enhanced transparency and accountability requirements in its Memorandum of Incorporation.

Audit committee

The King Report on Governance for South Africa 2009 (King III) emphasizes the vital role of an audit committee in ensuring the integrity of financial controls and integrated reporting (both financial and sustainability reporting), and identifying and managing financial risk. This sentiment is confirmed in the Companies Act. The appointment of an audit committee is regulated as part of the enhanced accountability and transparency requirements set out in Chapter 3 of the Regulations. Although the Companies Act only requires public companies and state owned companies (as well as other companies that voluntarily include this requirement in their Memorandum of Incorporation) to appoint an audit committee, King III proposes that ALL companies should have an audit committee.

The Companies Act determines that the audit committee for public companies and state owned companies must be appointed by the shareholders at every annual general meeting. This requirement highlights the importance of the Board's nomination committee. As all audit committee members must be directors (members of the Board), it is important that the nominations committee identifies suitably skilled and qualified individuals to nominate for appointment to the audit committee. Of course, the shareholders may appoint anyone they deem fit and proper.

Section 94 of the Companies Act determines that the audit committee must consist of at least three members who must be directors of the company and not:

- Be involved in the day to day management of the company for the past financial year;
- Be a full-time employee for the company for the past 3 financial years;
- Be a material supplier or customer of the company such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; and
- Be related to anybody who falls within the above criteria.

The requirements of section 94 are prescriptive. If the company appoints an audit committee with persons other than those prescribed, it would not be an audit committee as required by the Companies Act. As a result, any functions undertaken by a non-compliant (that is an "incorrectly constituted") audit committee will be regarded as not performed by the audit committee as required by the Companies Act.

The audit committee can consist of an unlimited number, but each member must meet the criteria in the Act and each member must be a director of the company. The audit committee would be entitled to utilise advisors and assistance from other persons inside and outside of the company and would be able to invite knowledgeable persons to attend its meetings. However, the formally appointed members of the audit committee entitled to vote and fulfil the functions of the audit committee will have to meet the criteria (non-executive independent directors) in accordance with the prescribed requirements.

In this regard, cognisance should be taken of the position of shareholders as potential members of the audit committee. The Act makes no reference to shareholders, and the value judgement pertaining to independence relates only to suppliers and customers. The mere fact that a person holds shares in the company (or meets any of the other factual tests such as being related to a supplier) would not, on its own, preclude such a person from serving on the audit committee. It is proposed that, in line with the best practice principles set out in King III, the appointment of shareholders to the audit committee be carefully considered. A judgment on the effect of the shareholding or other relationship is required in order to establish the likely factual impact on the independence of a particular person.

The legislative duties of the audit committee include:

- Nominating an auditor that the audit committee regards as independent;
- Determining the audit fee;
- Ensuring that the appointment of the auditor complies with the Companies Act and other relevant legislation;
- Determining the nature and extent of non-audit services;
- Pre-approving any proposed agreement with the auditor for the provision of non-audit services;
- Preparing a report to be included in the annual financial statements describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company;
- Receiving and dealing with relevant complaints;
- Making submissions to the board regarding the company's accounting policies, financial controls, records and reporting; and
- Any other function designated by the board.

Since the Act prescribes the appointment process, composition and functions of the audit committee, it can now be described as a statutory committee. The audit committee will bear sole responsibility for its decisions pertaining to the appointment, fees and terms of engagement of the auditor. On all other matters it remains accountable to the board and, as such, it will function as a board committee.

An interesting development is the fact that the audit committee is now obliged to also report to shareholders. The audit committee will report to shareholders by including the audit committee's report in the annual financial statements. The report should describe how the committee carried out its functions, state whether the auditor was independent, and comment on the financial statements, accounting practices and internal financial control measures of the company.

In addition to the legislative duties set out in the Act, King III proposes a number of additional functions, including:

- Overseeing
  - Financial risks and reporting;
  - Internal financial controls;
  - Fraud and IT risks as they relate to financial reporting;
- Ensuring that a combined assurance model is applied to provide a coordinated approach to all assurance activities (in terms of this model, assurance should be done on three levels, i.e. management, internal assurance providers and external assurance providers);
- Overseeing integrated reporting (both financial and sustainability reporting);
- Satisfying itself with regard to the expertise, resources and experience of the finance function;
- Overseeing the internal audit function;
- Playing a key role in the risk management process; and
- Overseeing the external audit process.

Ethical leadership and social responsibility is highlighted in King III. These same sentiments are echoed in the Companies Act. Although it may be argued that the provisions of the Companies Act are onerous and prescriptive, it should be acknowledged that the intention is for the audit committee to play a key role in ensuring accountability and transparency. As an independent, objective body, it should function as the company's independent watchdog to ensure the integrity of financial controls, combined assurance, effective financial risk management, and meaningful integrated reporting to shareholders and stakeholders alike.

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