Companies Act Draft Regulations

The Department of Trade and Industry published a new set of draft Regulations on the Companies Act for public comment. The closing date for comment is 31 January 2011.

This document includes an overview of the new arrangements that might apply to the audit requirement, independent review and the financial reporting standards.

Public interest score

The draft Regulations proposes that every company calculate its 'public interest score' for each financial year. This is a completely new proposal – one that was never tabled before the publication of the draft Regulations.

In terms of this new 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 maximum number of employees of the company at any one time during the financial year;

(b) one point for every R 1 million (or portion thereof) in outstanding unsecured debt of the company held by creditors at the financial year end;

(c) one point for every R 1 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.

IFAC It should also be noted that since the Companies Act now (for the first time) provide for a "public interest" company, this may impact the definition of a public interest entity as per the IFAC independence rules. Currently, only public companies and state owned companies are classified as public interest entities for IFAC purposes, but going forward, some private companies (those with a public interest score of more than 750) may also be included in this category.

Audit requirement

The draft Regulations provide for both activity and size criteria to determine whether or not companies require audited financial statements. We have long asked for the inclusion of size criteria.

The new requirements now require the following companies to have their financial statements audited:

- public companies
- state owned companies,
- any company that falls within any of the following categories in any particular financial year:
  - (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 R 5 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
    - (iii) 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) 750 or more; or
    (ii) at least 300, but less than 750, if its annual financial statements for that year were internally compiled.

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 750, an audit will nonetheless be required if the company meets the requirements of the activity test.

Please note that the activity criteria (as per the earlier draft Regulations) no longer includes "incidental" activity. We now only have to consider a company's primary activity. The 'new' activity test is much clearer than the old test, and will enable directors (and auditors) to come to a clear decision as to whether or not the criteria is met.

Independent review

The draft 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 300, 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); or

(b) in the case of a company whose public interest score for the particular financial year was less than 300, 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 do an independent review of companies with a public interest score of more than 300.

Financial reporting Standards

The draft Regulations make provisions for IFRS, IFRS for SME's and SA GAAP.

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, but in the case of any conflict with the applicable listing requirements of the relevant exchange, the latter prevails provided the exchange's listings requirements require compliance with IFRS as issued by the International Accounting Standards Board.
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 750.	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 300 but less than 750; or (b) whose public interest score for the particular financial year is less than 300, 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 300, and whose statements are internally compiled.	There is no prescribed Financial Reporting Standard.

Non-Profit Companies

Category of Companies	Financial Reporting Standard
Non profit companies that are required in terms of Regulation 28 (1)(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 750.	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 300, but less than 750; or (b) whose public interest score for the particular financial year is at less than 300, 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 300, and whose financial statements are internally compiled.	There is no prescribed Financial Reporting Standard