

Transparency and accountability under the new company law

CAROLINE B NCUBE*

This paper discusses the two-tier transparency and accountability regime provided for by the Companies Act 71 of 2008 (the Act). It includes a detailed outline and an analysis of the relevant provisions hinged on JL Mashaw's six-facet enquiry into governance. The analysis also includes a comparison with the provisions of the King Code of Governance Principles for South Africa 2009 (King III Code). The paper finds that the Act retains many of the provisions of the Companies Act 61 of 1973 but omits references to public interest, closely held and widely-held companies as these types of company are not provided for in the Act. Further it makes substantive changes such as increasing the minimum audit committee membership from two to three; providing for audits in the public interest; an express statement of a company secretary's accountability to the board and the statutory statement of directors' duties accompanied by the provision for the business judgment rule. These changes serve various ends ranging from confirming the legal position with regard to company secretaries to better protecting society through requiring audits in the public interest and codifying directors' duties. The Act's provisions are largely mirrored by the King III Code although certain inconsistencies are evident, for example, with regard to the appointment of company secretaries. However, in such instances the Act prevails. Overall, the paper concludes that the Act's transparency and accountability provisions are both comprehensive and appropriate.

I INTRODUCTION

Corporate transparency refers to 'the widespread availability of relevant, reliable information about the periodic performance, financial position, investment opportunities, governance, value, and risk' of companies.¹ It is a key element of ensuring good corporate governance because it enables evaluation of company and board performance.² In particular, the financial accounting information disclosed serves three readily identifiable

* LLB (UZ) LLM (CANTAB), Lecturer in Law, Department of Commercial Law, University of Cape Town, Cape Town.

¹ RM Bushman and AJ Smith 'Transparency, Financial Accounting Information and Corporate Governance' 2003 *FRBNY Economic Policy Review* 65 at 76. See also RM Bushman, JD Piotroski, AJ Smith 'What Determines Corporate Transparency?' 2004 *Journal of Accounting Research* 207-252.

² Benjamin E Hermalin and Michael S Weisbach 'Transparency and Corporate Governance' 1. Available at <<http://www.business.uiuc.edu/weisbach/HWTransparencyJan2007.pdf>> (last accessed 25 March 2009); Tarun Khanna, Krishna G Palepu and Suraj Srinivasan 'Disclosure Practices of Foreign Companies interacting with US Markets' 2004 *Journal of Accounting Research* 475 at 476.

roles: first to enable the identification of viable projects; secondly, to motivate directors and managers to be more disciplined and, thirdly, to reduce ‘information asymmetries among investors’.³

An accountability regime must accompany provisions relating to transparency to ensure that those making the disclosures are motivated to do so accurately and properly. It is essential because ‘power without accountability invites abuse’.⁴ An accountability regime provides for six key features, namely:

*who is accountable to whom; what they are liable to be called to account for; through what processes accountability is to be assured; by what standards the putatively accountable behaviour is to be judged; and what the potential effects are of finding that those standards have been breached.*⁵

These six features need to be examined as an integral part of any evaluation of an accountability regime.⁶ Therefore, the discussion that follows on the accountability regime created by the Companies Act 71 of 2008 (the Act) is based on this six-facet inquiry. The answers to this inquiry enable us to describe and critique the regime.

The Act provides for a two-tier accountability and transparency regulatory scheme. The first rung of regulation, provided for in ss 23 to 33, applies to all companies and relates to registration of external companies, form, standards, location of and access to company records. It also provides for the financial year of a company, accounting records, financial statements, annual financial statements, access to financial statements and related information, the use of a company name and registration number and annual returns. The second tier of regulation, provided for in ss 84 to 94, which relates to company secretaries, auditors and audit committees applies only to public companies and state-owned companies⁷ and private companies required to have their financial statements audited.⁸ Other private, personal liability and non-profit companies may voluntarily opt in to this scheme through their memoranda of incorporation.⁹

This two-tier scheme was created in an attempt to balance the need to provide accountability and transparency requirements against the desir-

³ Bushman and Smith (n 1) 66. See also L Lowenstein ‘Financial Transparency and Corporate Governance: You Manage what You Measure’ 1996 *Columbia Law Review* 1335 at 1335–1336, 1342.

⁴ Lowenstein (n 3) 1345.

⁵ J L Mashaw ‘Accountability and institutional design: some thoughts on the grammar of governance’ Yale Law School Research Paper No 116 at 118. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=924879 (last accessed on 12 March 2009).

⁶ Mashaw (n 5) 116 and 118.

⁷ Section 34(1) and s 84(1)(a)–(b).

⁸ Section 84(1)(c).

⁹ Section 34(2).

ability of a 'lightened regulatory burden'.¹⁰ All companies must therefore meet the basic criteria prescribed by the first tier while only certain companies have to comply with the second tier.

This paper discusses both rungs of the two-tier accountability system. It provides a detailed outline of the Act's provisions because the Act has been recently passed by Parliament and not all readers will be familiar with its provisions. This outline is accompanied by some reflection on the provisions. Such reflection includes a comparison to the provisions of the King Code of Governance Principles for South Africa 2009 (King III Code)¹¹ which came into operation on 1 March 2010.¹² Section 225 of the Act provides that it will come into force on a date fixed by the President by proclamation in the *Gazette*, which may not be earlier than one year following the date of presidential assent. The earliest that the Act can come into force is therefore 9 April 2010. However, such comparison is intentionally limited because the relationship between the King III Code, the King Report of Governance for South Africa 2009¹³ and the Act is the subject of the paper by Meryvn E King SC included in this volume. The Companies Act 61 of 1973 (Companies Act, 1973) is also compared with the Act.

II TRANSPARENCY, ACCOUNTABILITY AND INTEGRITY OF COMPANIES

Chapter Two, Part C of the Act applies to all companies and sets minimum standards to ensure transparency, accountability and integrity of companies. From the heading used by the Act for this section it is self-evident that the answer to the first question 'who is accountable?' is that companies are accountable. Deploying the 'grammar of governance'¹⁴ or using the language of the six-facet inquiry, one would say that companies are accountable to the public from which potential investors, creditors and customers will emerge. Companies are accountable about their human participants (shareholders, directors and prescribed officers), their governance structures and financial condition. King III further clarifies this by stating that the board carries responsibility for financial reporting but that this responsibility should be delegated to an audit committee.¹⁵

¹⁰ D Davis et al *Companies and other Business Structures in South Africa* (2009) 117; Memorandum accompanying Companies Act, 2008 para 6.

¹¹ Institute of Directors Southern Africa *King Code of Governance Principles for South Africa 2009* (King III Code). Available at www.iodsa.co.za (last accessed on 11 January 2010).

¹² *Ibid* 19.

¹³ Institute of Directors Southern Africa *King Report on Governance Principles for South Africa 2009* (King III Report). Available at www.iodsa.co.za (last accessed on 11 January 2010).

¹⁴ Mashaw (n 5) 118.

¹⁵ King III (n 11) Principle 3.4 para 20 at 62.

The process through which this accountability is satisfied is through disclosure of information by lodgment at the Companies Commission ('Commission') or maintenance at the companies' premises. The public is to have ready access to such information at those locations. With regard to standards, the information disclosed by companies must be accurate, complete and in some cases audited or independently verified. A failure to meet these standards attracts criminal liability¹⁶ for which a penalty of a fine or imprisonment for up to ten years or both is prescribed.¹⁷ It is also an offence for a company to fail to accommodate any reasonable request for access, or unreasonably refuse access, to any record that a person has a right to inspect or copy or to otherwise impede, interfere with, or attempt to frustrate, the reasonable exercise by any person of their rights to access information.¹⁸ The sections which follow provide further detail, and some commentary on the six features identified above.

(1) *Identifying a company – (who is accountable?)*

As already stated, companies are accountable to the public. To benefit effectively from, and to exercise oversight over company accountability it is essential to establish the identity of companies operating in South Africa. Therefore the Commission is required to keep a register of companies incorporated here¹⁹ and of external companies.²⁰ To enable the Commission to compile the register of external companies, an external company must register with it within 20 business days after beginning to conduct business or non-profit activities in South Africa. However, registration is only required if, within its jurisdiction of incorporation, an external company would have been classified as a profit or non-profit company incorporated under the Act.²¹

It is important to bring external companies into the local regulatory framework because they interact with South African residents and ought

¹⁶ Section 214(1).

¹⁷ Section 216(a).

¹⁸ Section 26(6).

¹⁹ Section 14(1)(b)(i).

²⁰ Section 23(5)(b). Section 1 of the Act defines an external company as 'a foreign company that is carrying on business, or non-profit activities, as the case may be, within the Republic, subject to section 23(2)'. Section 23(2) provides that the following activities constitute 'carrying on business':

- (a) Holding a meeting or meetings of the shareholders or board of the foreign company, or otherwise conducting the internal affairs of the company;
- (b) establishing or maintaining any bank or other financial accounts;
- (c) establishing or maintaining offices or agencies for the transfer, exchange or registration of the foreign company's own securities;
- (d) creating or acquiring any debts, mortgages or security interests in any property;
- (e) securing or collecting any debt, or enforcing any mortgage or security interest;
- (f) acquiring any interest in any property; and
- (g) entering into contracts of employment.

²¹ Section 23(1).

to be accountable both to them and the state. An external company is also required to maintain at least one office in South Africa and register the address of such an office, or its principal office if it has more than one office, with the Commission.²² This requirement establishes a physical presence and an address for service which are essential if litigation is instituted against the company. It is also important as the location at which to view certain company records.

A company can only be identified by its name; therefore company law regulates the disclosure of company names.²³ The use of company names and registration numbers is also regulated to prevent the detrimental misuse of the identity of companies. To this end, the Act provides that a company or external company must provide its full registered name or registration number to any person on demand and not misstate its name or registration number in a manner likely to mislead or deceive any person.²⁴ In addition, a person must not use the name or registration number of a company in a manner likely to give an impression that the person is acting or communicating on behalf of that company, unless the company has sanctioned that person to do so.²⁵ Nor may a person use a form of name for any purpose if, in the circumstances, the use of that form of name is likely to convey a false impression that the name is the name of a company.²⁶ Further, every company must have its name and registration number mentioned in legible characters in all notices and other official publications of the company, including those in electronic format, and in all bills of exchange, promissory notes, cheques and orders for money or goods and in all letters, delivery notes, invoices, receipts and letters of credit issued by the company.²⁷ A contravention of these rules is an offence.²⁸

These provisions are largely similar to those found in s 50 of the Companies Act, 1973. However, the requirement to display a company's name outside its registered office is omitted from the Act. The true legal status of a company is to be disclosed and any misrepresentation of this status by the company, an incorporator, shareholder or director, or other authorised person is prohibited.²⁹ If a person contravenes this prohibition, a court, on application by any affected person, may impose personal liability on any shareholder, director or incorporator of the company for

²² Section 23(3).

²³ S Mayson et al *Mayson, French & Ryan on Company Law* 21 ed (2004–2005) 134.

²⁴ Section 32(1).

²⁵ Section 32(3)(a).

²⁶ Section 32(3)(b).

²⁷ Section 32(4).

²⁸ Section 32(5).

²⁹ Section 32(6).

any liability or obligation of the company, to the extent that the court determines to be just and equitable in the circumstances.³⁰

(2) *Form and standards*

Section 24 provides for the form and standards of company records. Any documents, accounts, books, writing, records or other information that a company must keep in terms of the Act or any other public regulation must be kept in written form, or any other form that is readily convertible into written form within a reasonable time.³¹ Such written records will serve as evidence if disputes arise. They should therefore be kept for reasonable periods of time and for at least the prescribed prescription periods for civil claims. Accordingly, the Act provides that such records must be maintained for seven years, or any longer period of time specified in any other applicable public regulation.³² However, if a company has existed for less than seven years, it is required to retain records for that shorter time.³³

Every company is required to maintain:

1. a copy of its Memorandum of Incorporation, any amendments or alterations to it, and any rules of the company;³⁴
2. a record of its directors, including past directors;³⁵
3. copies of all reports presented at an annual general meeting of the company;³⁶
4. required annual financial statements and accounting records;³⁷
5. notice and minutes of all shareholders meetings, including all resolutions adopted by them and any document that was made available by the company to the holders of securities in relation to each such resolution;³⁸
6. copies of any written communications sent generally by the company to all holders of any class of the company's securities;³⁹ and

³⁰ Section 32(7).

³¹ Section 24(1)(a).

³² Section 24(1)(b).

³³ Section 24(2).

³⁴ Section 24(3)(a).

³⁵ Section 24(3)(b). The records of past directors are to be maintained for seven years after the cessation of directorship. Section 24(5) provides that a company's record of directors must include, in respect of each director, that person's full name and any former names; identity number or, if the person does not have an identity number, the person's date of birth; nationality and passport number, if the person is not a South African; occupation; date of their most recent election or appointment as director of the company; name and registration number of every other company or foreign company of which the person is a director, and in the case of a foreign company, the nationality of that company; and any other prescribed information.

³⁶ Section 24(3)(c)(i).

³⁷ Section 24(3)(c)(i)–(ii).

³⁸ Section 24(3)(d).

³⁹ Section 24(3)(e).

7. minutes of all meetings and resolutions of directors, or directors' committees, or the audit committee, if any.⁴⁰

In addition, every profit company must maintain a securities register or its equivalent⁴¹ and a register of its auditors and company secretaries.⁴²

(3) *Location and access*

All these records must be located at, and accessible at or from, the company's registered office or another location, or other locations, within South Africa.⁴³ If records are not kept at or made accessible from the company's registered office, or they are moved from one location to another, a company must file a notice, setting out the location or locations at which any particular records are kept or from which they are accessible.⁴⁴ The register of members and register of directors of a company, must, during business hours for reasonable periods be open to inspection by any member, free of charge and by any other person, upon payment for each inspection of an amount not more than R100.00.⁴⁵

A person who holds or has a beneficial interest in any securities issued by a company has a right to inspect and copy the information a company is required to maintain as detailed above, except for accounting records and minutes of all meetings and resolutions of directors, or directors' committees, or the audit committee, if any.⁴⁶ Such a person also has a right to any other information to the extent granted by the Memorandum of Incorporation,⁴⁷ as long as such right does not negate or diminish any mandatory protection of any record, as set out in Part 3 of the Promotion of Access to Information Act, 2000.⁴⁸ These rights may be exercised by a direct request made to the company in the prescribed manner, either in person or through an attorney or other personal representative designated in writing or in accordance with the Promotion of Access to Information Act.⁴⁹ These rights of access to information are additional to, and are not in substitution for, any rights a person may have to access information in terms of s 32 of the Constitution, the Promotion of Access to Information Act, 2000 or any other public regulation.⁵⁰

⁴⁰ Section 24(3)(f).

⁴¹ Section 24(4)(a).

⁴² Section 24(4)(b) and s 85(1).

⁴³ Section 25(1).

⁴⁴ Section 25(2).

⁴⁵ Section 26(3).

⁴⁶ Section 26(1)(a).

⁴⁷ Section 26(1)(b).

⁴⁸ Section 26(2); Promotion of Access to Information Act 2 of 2000.

⁴⁹ Section 26(1)(c).

⁵⁰ Section 26(4).

In addition to the above rights set out in s 26, a person who holds or has a beneficial interest in any securities issued by a company is entitled without demand to receive a notice of the publication of any annual financial statements of the company required by the Act, setting out the steps required to obtain a copy of those statements.⁵¹ They are also entitled, upon demand, to receive without charge one copy of any annual financial statements of the company.⁵²

A judgment creditor of a company who has been informed, by a person whose duty it is to execute the judgment, that there appears to be insufficient disposable property to satisfy that judgment, is entitled within five business days after making a demand, to receive without charge, one copy of the most recent annual financial statements of the company.⁵³ Trade unions must, through the Commission and under conditions as determined by the Commission, be given access to company financial statements for purposes of initiating a business rescue process.⁵⁴

(4) *Preparation and submission of financial records*

(a) *Financial statements*

The financial condition of a company is arguably the most important information that emanates from a company. It is important to all persons who engage with a company either as employee, customer, creditor or investor. The Act therefore pays particular attention to financial record-keeping. This regulation begins with s 27, which provides for the financial year of a company. The main significance of a financial year is that it constitutes a company's annual accounting period.⁵⁵ It is thus crucial that every company has a clearly delineated financial year. The Act provides that the first financial year of a company begins on its date of incorporation, as stated on its registration certificate;⁵⁶ and ends on the date set out in the Notice of Incorporation, which must be within 15 months after the date of incorporation.⁵⁷ Subsequent financial years will begin when the preceding financial year ends⁵⁸ and end on the first anniversary of that date unless the financial year end has been changed in terms of s 27(4).⁵⁹ Section 27(4) provides that the board of a company may change its financial year end at any time, by filing a notice of that change subject to

⁵¹ Section 31(1)(a).

⁵² Section 32(1)(b).

⁵³ Section 31(2).

⁵⁴ Section 31(3).

⁵⁵ Section 27(7).

⁵⁶ Section 27(2)(a).

⁵⁷ Section 27(2)(b).

⁵⁸ Section 27(3)(a).

⁵⁹ Section 27(3)(b).

three conditions. First, such a change may be made only once during any financial year.⁶⁰ Secondly, the newly established financial year end must be later than the date on which the notice is filed.⁶¹ Thirdly, the date as changed may not result in a financial year ending more than 15 months after the end of the preceding financial year.⁶²

Section 27(6) provides that if, in a particular year, the financial year of a company ends on a Saturday, Sunday or public holiday, that financial year will be regarded to have ended on the next following business day.

Once the financial year is established the Act turns its attention to the records that must be kept in relation to that period. Section 28(1) provides that a company must keep accurate and complete accounting records in one of South Africa's official languages as necessary to enable the company to satisfy its legal obligations with regard to the preparation of financial statements, including any prescribed accounting records, which must be kept in the prescribed manner and form. Such accounting records must be kept at, or be accessible from, the registered office of the company.⁶³

The Act provides for criminal liability for a company's intentional and malicious failure to keep accurate or complete accounting records, maintenance of records in a form other than that prescribed manner by the Act or falsification of accounting records.⁶⁴ It is also an offence for any person to falsify a company's accounting records.⁶⁵ The Act also provides that the Commission may issue a compliance notice to a company in respect of any failure by the company to comply with the requirements of s 28, irrespective of whether that failure constitutes an offence.⁶⁶ This provision enables the Commission to exercise oversight over companies in this respect.

With respect to the standards to be met by the disclosed information, s 29(1) stipulates that if a company provides any financial statements, including any annual financial statements, to any person for any reason, those statements must meet six requirements. First, they must satisfy the financial reporting standards as to form and content, if any such standards are prescribed.⁶⁷ Secondly, they must present fairly the state of affairs and

⁶⁰ Section 27(4)(a).

⁶¹ Section 27(4)(b).

⁶² Section 27(4)(c).

⁶³ Section 28(2).

⁶⁴ Section 28(3)(a).

⁶⁵ Section 28(3)(b).

⁶⁶ Section 28(4).

⁶⁷ Section 29(1)(a); s 29(4) provides that the Minister, after consulting the Council, may make regulations prescribing financial reporting standards or form and content requirements for summaries. Section 29(5) further provides that any such regulations contemplated in the subsection must promote sound and consistent accounting practices and in the case of financial reporting standards, must be consistent with the International Financial Reporting Standards of the International Accounting Standards Board or its successor body. Alternatively, these

business of the company, and explain the transactions and financial position of the business of the company.⁶⁸ Thirdly, they must show the company's assets, liabilities and equity, as well as its income and expenses, and any other prescribed information.⁶⁹ Fourthly, they must set out the date on which the statements were produced, and the accounting period to which the statements apply.⁷⁰ Fifthly, the first page of the statements must indicate prominently whether they have been audited or independently reviewed.⁷¹ In the absence of either an audit or independent review, the statements should indicate the name, and professional designation, if any, of the individual who prepared, or supervised the preparation of, those statements.⁷² Finally, the financial statement, including any annual financial statements, must be both accurate and complete in all material respects.⁷³

Companies may also issue summaries of financial statements which should be prominently labeled as such on the first page with an indication of the date of those statements.⁷⁴ This notice should also state whether the financial statements that it summarises have been audited, independently reviewed, or are unaudited.⁷⁵ If the summaries are unaudited, the notice must state the name and the professional designation, if any, of the individual who prepared, or supervised the preparation of, the financial statements that it summarises. The notice must set out the steps required to obtain a copy of the financial statements that it summarises. Finally, such summaries must comply with any prescribed requirements.⁷⁶

Currently s 287 of the Companies Act, 1973 provides that every director or officer who is a party to the issue, circulation or publication of any financial statements which are incomplete in any material particular or otherwise do not comply with the Act, shall be guilty of an offence. The Act expands this provision extensively through s 29(6) and s 214(2). Section 29(6) provides that subject to s 214(2), a person is guilty of an offence if they are party to the preparation, approval, dissemination or publication of any financial statements, including any annual financial statements, knowing that those statements do not comply with the requirements of s 29(1) or are materially false or misleading. Similarly it is an offence to be party to the preparation, approval, dissemination or

regulations may establish different standards applicable to profit and non-profit companies and different categories of profit companies.

⁶⁸ Section 29(1)(b).

⁶⁹ Section 29(1)(c).

⁷⁰ Section 29(1)(d).

⁷¹ Section 29(1)(e).

⁷² Section 29(1)(e).

⁷³ Section 29(2).

⁷⁴ Section 29(3)(b)(i).

⁷⁵ Section 29(3)(b)(ii).

⁷⁶ Section 29(3)(a).

publication of a summary of any financial statements, knowing that the statements that it summarises do not comply with the requirements of s 29(1), or are materially false or misleading, or that the summary does not comply with the requirements of s 29(3), or is materially false or misleading.

Section 214(2) provides that a person is a party to the preparation of financial statements or summaries if those documents include or are otherwise based on a scheme, structure or form of words or numbers devised, prepared or recommended by that person and that scheme, structure or form of words is of such a nature that the person knew, or ought reasonably to have known, that its inclusion or other use in connection with the preparation of the document would cause it to be false or misleading. This section is the equivalent of s 287A of the Companies Act, 1973.

(b) Annual financial statements

Every year, a company must prepare annual financial statements within six months after the end of its financial year.⁷⁷ A public company's annual financial statements must be audited⁷⁸ and the Minister may, by regulation, require other companies to have their annual financial statements audited.⁷⁹ This is an important development as it will enable the Minister to require audits in the public interest. Therefore companies which ordinarily would not be required to audit their financial statements will be required to do so where their activities have significant impact on society.

A company's annual financial statements must include an auditor's report, if the statements are audited⁸⁰ and a directors' report on the company's state of affairs, its business and profit or loss.⁸¹ If the company is part of a group of companies, then the directors' report must also report on the group's state of affairs, business, profit and loss. In contrast s 286 of the Companies Act, 1973 provides that annual financial statements should consist of—

- (a) a balance sheet, income statement and additional components required in terms of financial reporting standards;
- (b) a summary of significant accounting policies and other explanatory notes on the documents listed in (a) above;
- (c) a directors' report; and

⁷⁷ Section 30(1). In terms of this section a company may prepare the annual financial statements within a shorter period as may be appropriate to provide the required notice of an annual general meeting in terms of s 61(7).

⁷⁸ Section 30(2)(a).

⁷⁹ Section 30(2)(b) read with s 30(7).

⁸⁰ Section 30(3)(a).

⁸¹ Section 30(3)(b).

(d) an auditor's report.

The Act's list of components of annual financial statements excludes the components listed in paragraphs (a) and (b).

The annual financial statements must be approved by the board and signed by an authorised director⁸² and be presented to the first shareholders' meeting after the statements have been approved by the board.⁸³ In contrast, currently s 298(1) of the Companies Act, 1973 provides that in companies with two or more directors, the annual financial statements must be signed by two directors. The statements should then be presented to the next annual general meeting and must be sent to members 21 days before such a meeting.⁸⁴ As is evident the differences between the Companies Act, 1973 and the Act relate to signature of the statements and time and forum for presentation. Under the Act the statements may be presented at any general meeting, whilst the Companies Act, 1973 requires that they be presented at an annual general meeting.

Audited annual financial statements must include the remuneration and benefits received by each director and individual holding a prescribed office.⁸⁵ Remuneration is defined by s 30(6) to include fees, salaries, bonuses and performance-related payments, some expense allowances, pension scheme contributions, share options, financial assistance for the subscription of shares, and some loans.

As is currently required,⁸⁶ audited annual financial statements must also disclose the following with regard to past and current directors or individuals holding prescribed office⁸⁷ –

1. any pensions paid or receivable;
2. any amount paid or payable to a pension scheme;
3. any compensation paid in respect of loss of office;
4. the number and class of any securities issued and the consideration received by the company for those securities. This includes the issuance of securities to persons related to directors or prescribed officers;

⁸² Section 30(3)(c).

⁸³ Section 30(3)(d).

⁸⁴ Section 302(1).

⁸⁵ Section 30(4)(a). Further, s 30(5) provides that the annual financial statements must show the amount of any remuneration or benefits paid to or receivable by persons in respect of –

(a) services rendered as directors or prescribed officers of the company; or
 (b) services rendered while being directors or prescribed officers of the company –
 (i) as directors or prescribed officers of any other company within the same group of companies; or
 (ii) otherwise in connection with the carrying on of the affairs of the company or any other company within the same group of companies.

⁸⁶ Sections 295–97 Companies Act, 1973.

⁸⁷ Sections 30(4)(b)–(e). See also King III Code Principle 2.26 at 30

5. details of service contracts of current directors and prescribed officers.

Such information must satisfy the prescribed standards.⁸⁸ If the company is part of a group, details of directors' and prescribed officers' remuneration paid for services rendered to other companies in the group or other payments made in connection with the conduct of the group's business must also be disclosed.⁸⁹

(c) Annual return

Every company, including external companies,⁹⁰ must file an annual return which must include a copy of its audited annual financial statements, if the company is required to have such statements audited and any other prescribed information.⁹¹ The annual return must indicate the identity of a director, employee or other person in the company who is responsible for the company's compliance with the transparency and accountability provisions that are applicable to that company.⁹² Section 88(2)(f) provides that in public, state-owned and private companies to whom the enhanced accountability requirements apply, this person will be the company secretary.

Currently s 173 of the Companies Act, 1973 provides for the submission of annual returns by all companies. This section does not provide for the simultaneous lodgment of annual financial statements with the annual return. Currently, companies are required to submit the annual financial statements to the Registrar of Companies at the same time they send copies of the statements to their members.⁹³ That is 21 days before the annual general meeting at which the statements will be presented.

III ENHANCED ACCOUNTABILITY REQUIREMENTS

As already stated in the introduction, the enhanced accountability requirements provided for in Chapter Three relate to company secretaries, auditors and audit committees. This chapter applies to public companies, non-exempted state-owned companies and private companies which voluntarily subject themselves to these provisions and those required to audit their financial statements.⁹⁴

If the provisions of Chapter Three are in conflict with the Public Audit Act, 2004⁹⁵ then the Public Audit Act will prevail.⁹⁶ Further, a state-

⁸⁸ Section 30(5).

⁸⁹ Section 30(5)(b).

⁹⁰ Section 33(2).

⁹¹ Section 33(1).

⁹² Section 33(3).

⁹³ Section 302(4).

⁹⁴ Section 84(1).

⁹⁵ Act 25 of 2004.

owned company will not have to appoint an auditor for a year during which the Auditor-General is auditing it.⁹⁷ In those years where a state-owned company appoints an auditor in terms of the Act, the approval of the Auditor-General for that appointment should also be obtained in terms of the Public Audit Act.⁹⁸

If a company which is required to appoint a company secretary and auditor and constitute an audit committee does not do so, the Commission may issue a compliance notice to that company.⁹⁹ Such a notice would call for the company to show cause why the Commission should not convene a shareholders meeting to make the appointments and constitute an audit committee. If the company does not respond to this notice or submits an unsatisfactory response, the Commission may proceed to call a shareholders' meeting to make the appointments.¹⁰⁰ Further the directors who knowingly allowed the company to fail to make the appointments may be required to bear the costs of convening the shareholders' meeting.¹⁰¹ A director may apply to the Companies Tribunal to set aside the notice and/or assessment for liability to bear the costs of the shareholders' meeting.¹⁰²

Within ten business days after the appointments of company secretary and auditor are made, or terminated, the company must file a notice of the appointment or termination with the Commission.¹⁰³ The first appointments may be notified as part of the company's Notice of Incorporation.¹⁰⁴ In addition a company must maintain a record of its company secretaries and auditors.¹⁰⁵

The following sections will consider the provisions of Chapter Three in detail.

(1) *Company Secretary*

The company secretary is accountable to the company's board of directors¹⁰⁶ with regard to the proper performance of his or her duties as the chief administrative officer¹⁰⁷ of the company. The Companies Act, 1973 does not contain an equivalent express statement of the secretary's

⁹⁶ Section 85(3)(a).

⁹⁷ Section 85(3)(b).

⁹⁸ Section 85(3)(c).

⁹⁹ Section 84(6)(a).

¹⁰⁰ Section 84(6)(b)(i).

¹⁰¹ Section 84(6)(b)(ii).

¹⁰² Section 84(7). The Companies Tribunal is established by s 193, and s 195 provides that it will have adjudicatory powers.

¹⁰³ Section 85(3).

¹⁰⁴ Section 85(4).

¹⁰⁵ Section 85(1).

¹⁰⁶ Section 88(1).

¹⁰⁷ H S Cilliers et al *Cilliers & Benade Corporate Law* 3ed (2000) 168, Davis et al (n 10) 145.

accountability to the board. The Act probably included this express statement as a mere codification of a well-known common-law rule.

A company secretary's duties include:¹⁰⁸

- (a) provision of guidance to the directors of the company with regard to their duties, responsibilities and powers;
- (b) advising the directors of any law relevant to or affecting the company;
- (c) reporting to the company's board any failure on the part of the company or a director to comply with the Memorandum of Incorporation or rules of the company or the Companies Act;
- (d) ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee, are properly recorded;
- (e) certifying in the company's annual financial statements whether the company has filed required returns and notices and whether all these returns and notices appear to be true, correct and up to date;
- (f) ensuring that a copy of the company's annual financial statements is sent to every person who is entitled to it; and
- (g) being responsible for the company's compliance with Chapter Three.

Duties (a) to (e) were introduced by the amendment of the Companies Act, 1973 by s 18 of the Companies Amendment of Act 37 of 1999. Duties (f) and (g) are novel to the Act and so in that sense, a secretary's duties have been expanded.

(a) *Accountability*

The first process through which accountability is assured is the appointment of a knowledgeable or experienced person to the post.¹⁰⁹ There is no provision for additional requirements such as the registration with, or membership of, a professional body. Such provisions are included in the UK Companies Act, 2006 which, in addition to knowledge and experience, requires that a person appointed as company secretary should be a member of listed professional bodies such as the Institute of Chartered Accountants in England and Wales, or have held the office of company secretary of a public company for at least three out of the five years immediately before appointment as secretary, or be a barrister or solicitor called or admitted in any part of the UK, or be a person who appears capable of carrying out the functions of company secretary, because that person holds or has held a similar position in another body or is or was a

¹⁰⁸ Section 87(2).

¹⁰⁹ Section 86(1).

member of another body.¹¹⁰ Such detailed provisions would be of assistance to boards in making appointments and would provide some assurance to shareholders that a worthy candidate will be appointed. However, even in the absence of such detailed provisions directors are obliged to make good appointments in compliance with the duties they owe the company.

The second means of ensuring proper performance of secretarial duties is holding company secretaries to high standards of performance. Company secretaries owe fiduciary duties to the company.¹¹¹ Additionally they are also company employees¹¹² and will be held by their employment contract to certain standards. Accordingly, any failure to meet these standards of performance will be sanctioned by claims for loss, damages or costs occasioned by the breach of fiduciary duties or contractual claims for breach of the employment contract.

(b) Qualification and disqualification for appointment

Every company secretary must be permanently resident in South Africa, and must remain so while serving in that capacity.¹¹³ Section 87(1) of the Act provides that a juristic person or partnership may be appointed company secretary, subject to two conditions. First, every employee of that juristic person, or partner and employee of that partnership who provides company secretary services must not be disqualified from acting as a director of a company. Secondly, at least one employee of that juristic person, or one partner or employee of that partnership, must be permanently resident in South Africa and continue to be so resident whilst that juristic person continues to act as company secretary. A change in the membership or composition of a juristic person or partnership that holds office as company secretary will not constitute a casual vacancy in the office of company secretary if the juristic person or partnership continues to satisfy these two conditions.¹¹⁴ If the juristic person or partnership no longer satisfies these conditions, it must immediately send a notice to that effect to the directors of the company concerned. Such a notice will be deemed to be a resignation from the office of company secretary.¹¹⁵ In the absence of any such notice, a company is entitled to assume that the juristic person or partnership satisfies the two conditions.¹¹⁶ Any action taken by the juristic person or partnership in the performance of its functions as company secretary will not be invalidated merely because the

¹¹⁰ Section 273(2)–(3).

¹¹¹ Cilliers & Benade (n 106) 168.

¹¹² Ibid.

¹¹³ Section 86(2).

¹¹⁴ Section 87(2).

¹¹⁵ Section 87(3)(a).

¹¹⁶ Section 87(3)(b).

juristic person or partnership had ceased to satisfy the two conditions at the time of that action.¹¹⁷

A person cannot be appointed company secretary if she or he is disqualified from appointment as director as provided for by s 69(8).¹¹⁸ In summary, a person is so disqualified if he or she:

1. has been prohibited by a court from being a director or declared delinquent in terms of s 162 of the Act, or s 47 of the Close Corporations Act, 1984;¹¹⁹
2. is an unrehabilitated insolvent;
3. is prohibited in terms of any public regulation from being a director of a company;
4. has been removed from an office of trust, on the grounds of misconduct involving dishonesty; or
5. has been convicted anywhere and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence –
 - (a) involving fraud, misrepresentation or dishonesty;
 - (b) in connection with the promotion, formation or management of a company, or in connection with acting as director whilst disqualified or prohibited from doing so;
 - (c) under the Act, the Insolvency Act, 1936,¹²⁰ the Close Corporations Act, 1984, the Competition Act,¹²¹ the Financial Intelligence Centre Act, 2001,¹²² the Securities Services Act, 2004,¹²³ or Chapter 2 of the Prevention and Combating of Corruption Activities Act, 2004.¹²⁴

Disqualification on the basis of removal from an office of trust or conviction as detailed above terminates after five years from the date of removal or conviction unless a court has extended this period upon application by the Commission.¹²⁵ There is no provision for how this rule will be applied where a person has been sentenced to a suspended sentence.

It is possible for a person to be appointed company secretary despite her or his disqualification per grounds 2–5 above if a court exempts them from the applicable provisions in the Act.¹²⁶

¹¹⁷ Section 87(3)(c).

¹¹⁸ Section 84(5).

¹¹⁹ Act 69 of 1984.

¹²⁰ Act 24 of 1936.

¹²¹ Act 89 of 1998.

¹²² Act 38 of 2001.

¹²³ Act 36 of 2004.

¹²⁴ Act 12 of 2004.

¹²⁵ Section 69(9).

¹²⁶ Section 69(11).

(c) *Appointment and cessation of office*

The incorporators of a company may appoint the first company secretary,¹²⁷ failing which, the directors or shareholders of that company must appoint the first company secretary within 40 business days of incorporation.¹²⁸ King III differs from the Act in that it recommends that appointments and removals are a matter for the board¹²⁹ while the Act provides that a company's incorporators may appoint a secretary.¹³⁰

Section 86(4) provides that within 60 business days after a vacancy arises in the office of company secretary, the board must fill the vacancy by appointing a person whom the directors consider to have the requisite knowledge and experience. Under s 286C of the Companies Act, 1973 a vacancy must be filled within 90 days. The Act has shortened the period by 30 business days.

Section 89(1) provides that a company secretary may resign from office by giving the company one month's written notice or less than one month's written notice, with the approval of the board. If the company secretary is removed from office by the board, the company secretary may require the company to include a statement in its annual financial statements relating to that financial year, not exceeding a reasonable length, setting out the company secretary's contention as to the circumstances that resulted in the removal.¹³¹ If the company secretary wishes to exercise this power he or she must give written notice to that effect to the company by not later than the end of the financial year in which the removal took place and that notice must include the statement to be included in the annual financial statements.¹³² Such a statement must then be included in the directors' report in the company's annual financial statements.¹³³

(2) *Auditors*

An auditor is appointed by the company to carry out the independent function of reporting to shareholders on the financial statements of the company which have been prepared and presented by the directors.¹³⁴ Auditors are crucial to good corporate governance because they verify company financial disclosures which, as already stated in the introduction, serve important protective and economy-enhancing functions. Their rights and restricted functions are provided for in s 93(1), which is

¹²⁷ Section 86(3).

¹²⁸ *Ibid.*

¹²⁹ King III Code (n 11) Recommended Practice 2.21 at 27.

¹³⁰ Section 86(3)(a).

¹³¹ Section 89(2).

¹³² Section 89(3).

¹³³ Section 89(4).

¹³⁴ *Powertech Industries Ltd v Mayberry and Another* 1996 (2) SA 742 (W) at 746.

identical to s 281 of the Companies Act, 1973. However, s 93(2) goes beyond the 1973 Act by providing that an auditor may resort to litigation to enforce these rights.

The King III Code contains no principles that are applicable to external auditors. However, its Principle 3.9, which relates to audit committees details audit committee functions in relation to the appointment of external auditors and the oversight of the external audit process.

(a) *Accountability*

Assuring auditor independence is an important tool to ensure proper performance of the audit function within a company and the reliability of the auditor's report that accompanies a company's annual financial statements.¹³⁵ Such independence is secured in a number of ways. First, by the appointment of an auditor who is independent from the company. Secondly, post-appointment, maintaining this independence by auditor rotation. Thirdly, by limiting the provision of non-audit services by an auditor to the company of which he is auditor.

The independence of an auditor upon appointment is determined by the audit committee, which must nominate independent persons for appointment as auditor.¹³⁶ A company may only validly appoint a person who was not nominated by its audit committee to the position of auditor if the audit committee is convinced of such a person's independence.¹³⁷ In assessing a potential auditor's independence, the audit committee must ascertain that such person will only be directly or indirectly paid for his role as auditor and permissible non-audit functions.¹³⁸ Regard should also be had to whether that person's independence has been compromised by their previous appointment as auditor or their previous or current provision of non-audit services to the company.¹³⁹ Finally, the audit committee should apply any other criteria prescribed by the Independent Regulatory Board for Auditors (IRBA).¹⁴⁰ If the client company is part of a group of companies then the audit committee must extend the above considerations to the proposed auditor's relations with other companies in the group.

When a firm is appointed as auditor, that firm must immediately identify and designate an individual or individuals as being responsible for and accountable for that audit and notify the client company of the

¹³⁵ J Bourne 'Auditor Independence: An analysis of the Legislation in the United States of America and South Africa' (2007) 19 *SA Mercantile LJ* 492–501 at 492.

¹³⁶ Section 94(7)(a).

¹³⁷ Section 94(9).

¹³⁸ Section 94(8)(a).

¹³⁹ Section 94(8)(b).

¹⁴⁰ Section 94(8)(c).

designation.¹⁴¹ Currently only widely held companies need to designate individual auditors.¹⁴² This designated individual's term of service is limited to five consecutive financial years;¹⁴³ therefore the client company is forced to rotate individual auditors every five years. Such rotation may occur within a firm. A person who has served for longer than two consecutive financial years as designated auditor may not be appointed again to that role for a further two financial years.¹⁴⁴ Where two or more individuals had been designated auditors within a firm, their rotation is to be staggered so that they do not all relinquish office simultaneously.¹⁴⁵ The same auditor rotation clauses are to be found in s 274A of the Companies Act, 1973, having been introduced by the 2006 amendments.

Auditor rotation is required because it is believed that lengthy auditor–client relationships compromise audit quality.¹⁴⁶ Such rotation can take two forms, namely firm rotation or partner rotation. The first form requires a change of auditing firm whilst the second requires a change of designated individual auditor within the same firm. South Africa has chosen the second form, following the Sarbanes–Oxley Act.¹⁴⁷ This appears to be the better choice because the benefits of firm rotation are doubtful¹⁴⁸ whilst there are clear costs that are occasioned to companies as they rotate firms. Such costs include the risk of poor audit quality immediately after firm rotation and increased first-year audit costs.¹⁴⁹ In my view individual auditor rotation may not be very effective as loyalty to a client will probably be shared by audit partners in the audit firm. Rotating audit partners will therefore probably not substantially improve the audit quality.

The audit committee is charged with the task of pre-approving any proposed agreements with the auditor for the provision of non-audit services to the company.¹⁵⁰ This is of utmost importance because the provision of non-audit services by auditors to the client company is often

¹⁴¹ Section 44(1) of the Auditing Profession Act (APA) 26 of 2005.

¹⁴² Section 274(3).

¹⁴³ Section 92(1).

¹⁴⁴ Section 92(2).

¹⁴⁵ Section 92(3).

¹⁴⁶ M Schelker 'Auditors and Corporate Governance: Evidence from the Public Sector' (March 2008). Available at SSRN: <http://ssrn.com/abstract=959392> (last accessed on 30 March 2009) at 12.

¹⁴⁷ American Institute of Certified Public Accountants (AICPA) 'Audit partner rotation – issue brief'. (2003) Available at www.aicpa.org/download/statelegis/Audit_Partner_Rotation.doc (last accessed 30 March 2009) at 1.

¹⁴⁸ M Cameran et al 'The Audit Firm Rotation Rule: A Review of the Literature' (2005) SDA Bocconi School of Management, Working Paper. Available at SSRN: <http://ssrn.com/abstract=825404> (last accessed 30 March 2009).

¹⁴⁹ J Blouim, B Grein and R Rountree 'The Ultimate Form of Mandatory Auditor Rotation: The Case of Former Arthur Anderson Clients' (February 2005). Available at papers.ssrn.com/sol3/papers.cfm?abstract_id=667524 (last accessed on 30 March 2009).

¹⁵⁰ Section 94(7)(f).

implicated in corporate failures. For example, in 2000 Enron is said to have paid \$27 million to Arthur Anderson for non-audit services in addition to the \$25 million it paid for audit services.¹⁵¹ It would therefore appear that Arthur Anderson overlooked some irregularities in Enron's financial records because Enron was a major source of both audit and non-audit services income.

(b) Standards of performance

In order to enable auditors meaningfully to perform their duties, the Act provides for their right to access companies' accounting documents accompanied by an entitlement to an explanation of any information by directors and prescribed officers.¹⁵² If the client company is a holding company such right and entitlement extends to the subsidiaries of that company.¹⁵³ Auditors may obtain court orders to enforce these rights.¹⁵⁴ Further, auditors are entitled to attend any general meetings, receive notices of and other communications in relation to such meetings and to be given an opportunity to address general meetings on matters pertaining to their audit function.¹⁵⁵ Similar provisions are contained in s 281 of the Companies Act, 1973. The only difference is that the Act provides for enforcement of these rights by court application.

Auditors are expected to execute their duties to the highest professional standards by the Auditing Profession Act (APA)¹⁵⁶ and by their contract with the client company. At common law an auditor must perform his duties with the 'skill, care and caution which a reasonably competent, careful and cautious auditor would use'.¹⁵⁷ Auditors can incur both civil and criminal liability and may also be subjected to disciplinary proceedings administered by the IRBA for failing to meet these standards. Particularly, auditors may be either contractually or delictually liable to their client company or delictually liable to third parties who acted to their detriment on the strength of financial information prepared or certified by an auditor.¹⁵⁸

Auditors will incur criminal liability for a failure to report a reportable irregularity as required by s 45 of the APA and 'knowingly or recklessly express[ing] an opinion, making a report or other statement which is false

¹⁵¹ MJ Barrett 'Enron, Accounting and Lawyers' 2002 *Notre Dame Lawyer* 14–20 at 16. Available at SSRN: <http://ssrn.com/abstract=782365> (last accessed on 30 March 2009).

¹⁵² Section 93(1)(a).

¹⁵³ Section 93(1)(b).

¹⁵⁴ Section 93(2).

¹⁵⁵ Section 93(1)(c).

¹⁵⁶ Section 44(2), (3) and (6).

¹⁵⁷ Cilliers and Benade (n 106) 411 quoting from *In re Kingston Cotton Mill Co (2)* [1896] 2 Ch 279 (CA) at 288.

¹⁵⁸ Section 46(3) of the APA.

in a material respect'.¹⁵⁹ The prescribed sentence for such offences is a term of imprisonment up to a maximum of 10 years or a fine or both fine and imprisonment.¹⁶⁰ It is also an offence to practise as auditor while not registered as required by s 41, or to fail to make certain disclosures to the IRBA as required by s 43 or to fail to perform the prescribed duties in relation to an audit as required by s 44.¹⁶¹ These three offences are punishable by a fine or imprisonment up to a maximum of five years or both fine and imprisonment.¹⁶² It is an offence to resist or hinder inspections of auditors undertaken by the IRBA under s 47 punishable by a fine or imprisonment up to a maximum of one year.¹⁶³ There are also numerous offences in relation to failing to co-operate with or participate in disciplinary hearings¹⁶⁴ punishable by a fine or imprisonment up to a maximum of five years or both fine and imprisonment.¹⁶⁵

Finally, auditors are enjoined from performing any non-audit services for their clients that would place them in a conflict of interest or that have been expressly prohibited by the relevant audit committee.¹⁶⁶ However, no penalty or sanction is provided for a violation. Currently s 275A prohibits only auditors of widely held companies from performing non-audit services prohibited by APA or the company's audit committee. The Act excludes any references to widely held companies and extends the provisions on non-audit services to all companies required to appoint auditors and those that voluntarily do so.

(c) *Qualification and disqualification*

To qualify for appointment as auditor a person or firm must be a registered auditor.¹⁶⁷ Individuals are registered in terms of s 37 of APA if they meet the following criteria:

1. completion of prescribed education, training and competency requirements;
2. arrangement for continuing professional development or membership of an accredited professional body;
3. residence in South Africa;
4. being a fit and proper person to practise the profession; and
5. satisfaction of any further requirements prescribed under s 6 of APA.

¹⁵⁹ Section 52(1) of the APA.

¹⁶⁰ Section 52(3) of the APA.

¹⁶¹ Section 54(1) of the APA.

¹⁶² Section 54(1) of the APA.

¹⁶³ Section 54(2).

¹⁶⁴ Section 53(1)–(3).

¹⁶⁵ Section 53(4).

¹⁶⁶ Section 93(2).

¹⁶⁷ Section 90(2)(a).

Firms are registered under s 38 of APA if their partners, sole proprietors or shareholders are registered auditors.

There are three distinct statutory provisions on disqualification from appointment as auditor of a company. First, s 37(3) of APA provides that an individual is disqualified from registration as auditor if she or he has been removed from an office of trust due to misconduct related to that office, or has been convicted of certain offences,¹⁶⁸ declared by a court to be of unsound mind or unable to manage his or her own affairs or otherwise disqualified by a sanction imposed in terms of APA. As only registered auditors are qualified for appointment as auditors, disqualification from registration equates to disqualification from appointment.

Secondly, the Act provides that a person is disqualified from appointment as auditor of a company if she or he is currently a director or prescribed officer,¹⁶⁹ employee or consultant,¹⁷⁰ bookkeeper or accountant¹⁷¹ of that company or is a director, officer or employee of that company's company secretary.¹⁷² Disqualification on these grounds extends to persons who have held the above positions in the company or its company secretary at any time within the preceding five financial years.¹⁷³ Persons who are related to the above-described disqualified persons are also disqualified.¹⁷⁴ Therefore, even if a person is a registered auditor, she or he will not be eligible for appointment if any of the above grounds apply to her or him.

Thirdly, the grounds for disqualification provided for by s 69(8) and described in the section on company secretaries above, also apply to appointments of auditors.¹⁷⁵ Briefly, a person is not qualified for appointment as auditor if he or she would have been disqualified from appointment as director of that company.

¹⁶⁸ The offences listed by s 37(3)(b) are 'theft, fraud, forgery, uttering a forged document, perjury, an offence under the Prevention and Combating of Corrupt Activities Act, 2004 (Act 12 of 2004), or any offence involving dishonesty, other than theft, fraud or forgery, committed prior to 27 April 1994 associated with political objectives, and has been sentenced to imprisonment without the option of a fine or to a fine exceeding such an amount as may be prescribed by the Minister'.

¹⁶⁹ Section 90(2)(b)(i).

¹⁷⁰ Section 90(2)(b)(ii).

¹⁷¹ Section 90(2)(b)(iv).

¹⁷² Section 90(2)(b)(iii).

¹⁷³ Section 90(2)(b)(v).

¹⁷⁴ Section 90(2)(b)(vi). Section 2(1) provides that persons are related if they:

- (i) are married, or live together in a relationship similar to a marriage; or
- (ii) are separated by no more than two degrees of natural or adopted consanguinity or affinity;

¹⁷⁵ Section 84(5).

(d) Appointment and cessation of office

An auditor must be appointed upon incorporation and at each annual general meeting thereafter.¹⁷⁶ If the initial appointment is not made upon incorporation, it must be made by the directors within 40 business days after incorporation.¹⁷⁷ Appointment by the board is problematic as it does not augur well for auditor independence, because permitting the board to appoint its own supervisor may increase the risk of collusion.¹⁷⁸ However, this risk is minimised by the requirement of satisfying the audit committee of the proposed auditor's independence prior to the making of any appointment.

The first auditor will hold office until the first annual general meeting¹⁷⁹ where he may be automatically reappointed unless he is no longer qualified for appointment, has notified the company that he does not wish to continue in that post, a statutory audit committee has objected to his reappointment or the company has been notified of an intention to replace him.¹⁸⁰ If none of these eventualities occur, the first auditor will hold office until he is required to relinquish his post in terms of s 92 which provides for auditor rotation. Any subsequent auditor will also hold office under the same above described terms.

If a sole auditor resigns, his replacement must be appointed within 40 business days.¹⁸¹ In companies with more than one auditor, if one of them resigns, the vacancy created by her or his resignation may be filled at any time provided the remaining auditor(s) continues to serve as auditor.¹⁸² A vacancy can also be created by a substantial change in the membership of a firm acting as a company's auditor. Section 91(5) provides that a change in more than half of a firm's membership post-appointment will constitute a resignation of that firm as auditor.

Before a vacancy is filled, the replacement auditor's name must be forwarded by the board to the audit committee within 15 business days of the vacancy.¹⁸³ The audit committee has five business days after receipt of such notification to send any written objections to the appointment of the proposed auditor to the board. If no such objection is sent to the board by the audit committee, the board may proceed to make the proposed appointment.¹⁸⁴

¹⁷⁶ Section 90(1).

¹⁷⁷ Section 90(4).

¹⁷⁸ Schelker (n 145) 6.

¹⁷⁹ Section 90(5).

¹⁸⁰ Section 90(6).

¹⁸¹ Section 91(2)(a).

¹⁸² Section 91(2)(b).

¹⁸³ Section 91(3)(a).

¹⁸⁴ Section 91(3)(b).

(3) *Audit committees*

Public companies or state-owned companies must elect an audit committee, which consists of at least three members, at each annual general meeting.¹⁸⁵ Currently, an audit committee must consist of at least two non-executive director members.¹⁸⁶ It is not clear why this increase has been legislated. An audit committee does not have to be elected where the company is a subsidiary of a company that has an audit committee that will serve it.¹⁸⁷ Generally, King III Code and the Act are in agreement on audit committees, although there are slight variations with regard to certain details which are highlighted below.

(a) *Accountability*

Unlike the position with regard to company secretaries, there is no express statement of whom the audit committee is accountable to. However, the audit committee as a sub-committee of the board of directors is liable first to the full board¹⁸⁸ and ultimately to the company. Its duties pertain to oversight of the audit of a company's financial records, and in particular, include¹⁸⁹ –

1. nominating auditors for appointment. Such nominees must, in the opinion of the audit committee, be independent of the company;¹⁹⁰
2. determining the fees to be paid to the auditor and the auditor's terms of engagement;
3. ensuring that the appointment of the auditor complies with the provisions of the Act and any other legislation relating to the appointment of auditors;
4. determining the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company, or a related company;
5. pre-approving any proposed agreement with the auditor for the provision of non-audit services to the company. The King III Code recommends that the audit committee prepares a policy in this regard;¹⁹¹
6. preparing a report, to be included in the annual financial statements for that financial year –
 - (i) describing how the audit committee carried out its functions;

¹⁸⁵ Section 94(2). See King III Code (n 11) Recommended Practice 3.2.2 at 31 for a similar provision.

¹⁸⁶ Section 296A.

¹⁸⁷ Section 87(2)(a)–(b).

¹⁸⁸ I Ferreira 'The Effect of Audit Committee Composition and Structure on the Performance of Audit Committees' (2008) 16 *Meditari Accountancy Research* 89 at 93. See King III Code (n 11) Principle 3.10 at 35.

¹⁸⁹ Section 94(7).

¹⁹⁰ Section 94(7)(a).

¹⁹¹ King III Code (n 11) Recommended Practice 3.9.4 at 34.

- (ii) stating whether the audit committee is satisfied that the auditor was independent of the company; and
 - (iii) commenting in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company. This is largely repeated by King III.¹⁹²
7. receiving and dealing appropriately with any concerns or complaints, whether from within or outside the company, or on its own initiative, relating to –
 - (i) the accounting practices and internal audit of the company;
 - (ii) the content or auditing of the company's financial statements;
 - (iii) the internal financial controls of the company; or
 - (iv) any related matter.
 8. making submissions to the board on any matter concerning the company's accounting policies, financial control, records and reporting; and
 9. performing other functions determined by the board, including the development and implementation of a policy and plan for a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes within the company.

Similar provisions are contained in s 270A of the Companies Act, 1973, having been introduced by the Corporate Laws Amendment Act 24 of 2006, which became operative on 14 December 2007. King III's chapter 3 lists substantively the same duties. However, it is more detailed with regard to an audit committee's role in the internal audit function and overall risk management processes.

(b) Standards of performance

Audit committee members are held to high standards of performance because as directors they owe fiduciary duties to the company as well as the duty of care and skill. These duties have now been partly codified by s 76 of the Act. This codification does not exclude the common law and therefore common-law rules that are not amended by s 76 or are not in conflict with it, will still apply. As the common-law principles are well known, this section focuses only on the statutory codification of directors' duties by s 76.

Section 76(2)(a) provides that a director of a company must not use the position of director, or any information obtained while acting in that capacity, to gain an advantage for himself, or for another person other than the company or a wholly owned subsidiary of the company or to knowingly cause harm to the company or a subsidiary of the company.

¹⁹² King III Code (n 11) Principle 3.10 and its accompanying recommended practice at 35.

Further, a director must disclose any information that he receives as soon as possible unless he reasonably believes that the information is immaterial to the company, or in the public domain and generally available to the public, or known to the other directors, or he is bound not to disclose that information by a legal or ethical obligation of confidentiality.¹⁹³ A director is required to exercise the powers and perform the functions of director in good faith and for a proper purpose in the best interests of the company.¹⁹⁴ He must also act with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director and having the general knowledge, skill and experience of that director.¹⁹⁵ The import of these duties is not discussed here because it is the subject of two articles by Professors Michael Katz and Jean Du Plessis included in this volume.

Section 76(4)(a) provides for the Business Judgement Rule in terms of which a director will be taken to have acted in good faith and for a proper purpose in the best interests of the company if he proves the following three elements: First, that he has taken reasonably diligent steps to become informed about the matter. Secondly, that he had no material personal financial interest in the subject-matter of the decision nor had any reasonable basis to know that any related person had a personal financial interest in the matter. Alternatively, he or related people have such an interest which has been disclosed under s 75. Thirdly, that he has made a decision, or supported the decision of a committee or the board and had a rational basis for believing, and did believe, that the decision was in the best interests of the company. In addition, in reaching this decision such a director is entitled to rely on the performance of and information supplied by company employees, legal counsel, accountants, or other professionals retained by the company or a committee of the board of which the director is not a member as long as he has no reason to doubt their reliability or competence.¹⁹⁶ This rule guides courts in their review of directors' actions by providing the above grounds for excusing directors from personal liability.¹⁹⁷ In addition it encourages directors to take risks, attracts high-quality directors and stops shareholders from usurping board functions.¹⁹⁸

The liability for breach of directors' duties is provided for by s 77. Briefly, a director may be held liable in accordance with the principles of

¹⁹³ Section 76(2)(b).

¹⁹⁴ Section 76(3)(a)–(b).

¹⁹⁵ Section 76(3)(c).

¹⁹⁶ Section 76(4)(b) and s 76(5).

¹⁹⁷ Stephen Kennedy-Good and Lindi Coetzee 'The Business Judgment Rule (part 1)' 2006 *Obiter* 62 at 63.

¹⁹⁸ *Ibid* 65.

the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of his duties –

- (a) to disclose information about his personal financial interests under s 75,
- (b) not to abuse information obtained whilst acting as director,
- (c) to disclose material non-privileged information to the board,
- (d) to exercise the powers and perform the functions of director in good faith and for a proper purpose in the best interests of the company.

A director will also be liable under the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of his duty of care, skill and diligence under s 76(3)(c), or a breach of any provision of the Act or any provision of the company's Memorandum of Incorporation.

(c) *Qualification and disqualification*

Only directors of a company are eligible for election to an audit committee.¹⁹⁹ Section 94(5) provides that 'the Minister may prescribe minimum qualification requirements for members of an audit committee as necessary to ensure that any such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions.' This is a crucial provision, because its use will ensure the appointment of appropriately skilled persons to audit committees. The success of an audit committee depends to a large extent on the skills and qualifications of its members. The most relevant skills are accounting and financial skills.²⁰⁰ It may be that it will be unnecessary for the Minister to use these powers because studies have shown that South African audit committees currently consist of adequately skilled persons.²⁰¹

Section 84(5) of the Act provides that a person who is disqualified from being a director is disqualified from appointment to an audit committee.²⁰² However, this provision is made redundant by the requirement that only directors may be audit committee members. A more meaningful provision for disqualification is found in s 94(4)(b)–(c), which provides that the following directors are disqualified from election to audit committees –

1. those involved in the day-to-day management of the company's business or have been so involved at any time during the previous financial year;

¹⁹⁹ Section 94(4)(a).

²⁰⁰ Ferreira (n 188) 97.

²⁰¹ Ibid 98.

²⁰² Section 84(5).

2. those who are also prescribed officers, or full-time employees, of the company or another related or inter-related company, or have been such an officer or employee at any time during the previous three financial years; or
3. those who are also material suppliers or customers 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
4. those who are related to any person who falls within any of the above criteria.

These criteria are meant to ensure the independence and impartiality of audit committees. The amendments to the Companies Act, 1973 in 2006 introduced similar provisions as outlined below.

Section 269A(3) of the Companies Act, 1973 provides that audit committee members must be non-executive directors who act independently. Section 269A(4)(b) then defines a non-executive director as a director who –

- (i) is not involved in the day to day management of the business and has not in the past three financial years been a full-time salaried employee of the company or its group;
- (ii) is not a member of the immediate family of an individual described above.

Section 269A(4)(c) then provides that a director acts independently if he ‘expresses opinions, exercises judgment and makes decisions impartially and is not related to the company or to any shareholder, supplier, customer or other director of the company in a way that would lead a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that director is compromised by that relationship’. There does not appear to be any substantive difference in the import of the provisions of the Act and the Companies Act, 1973. The Act seems to have simply streamlined the provisions of the Companies Act, 1973 and presented them slightly differently.

(d) Appointment and cessation of office

As directors, the provisions relating to the appointment and removal of directors will apply to audit committee members. This section only focuses on appointment to and removal from an audit committee.

The first audit committee of a company may be appointed by the incorporators of the company or by the board within 40 business days of incorporation.²⁰³ A vacancy on the audit committee arising thereafter must

²⁰³ Section 94(3).

be filled within 40 days of its creation.²⁰⁴ There is no express provision for resignations or removal of committee members, therefore this is a matter which will be determined by a company in its MOI or committee constitutive resolution. It has been suggested that the rotation of audit committee members is an important issue that ought to be carefully watched by companies.²⁰⁵ In my view there is no need for legislative regulation but companies should decide on rotation internally, perhaps in an audit committee charter.

IV CONCLUSION

The Act's transparency and accountability provisions are both comprehensive and appropriate. They are substantively similar to provisions in the Companies Act, 1973. In many instances the Act retains amendments made to the Companies Act, 1973 by the Corporate Laws Amendment Act, but strips away references to public interest, closely held and widely held companies, as these types of company are not provided for in the Act.²⁰⁶ The Companies Act, 1973 also had a dual accountability and transparency scheme. The retention of this dual regulatory scheme is prudent because it is rightly premised on the recognition that it is not necessary to subject all companies to onerous accountability provisions. Therefore the enhanced accountability and transparency provisions in chapter 3 of the Act do not apply to most private companies. There are a few substantive changes such as increasing the minimum audit committee membership from two to three. Other changes include the possibility of regulations requiring audits in the public interest, an express statement of a company secretary's accountability to the board and the statutory statement of directors' duties accompanied by the provision for the business judgement rule. These changes serve various ends, such ranging from confirming the legal position with regard to company secretaries to better protecting society through requiring audits in the public interest and codifying directors' duties.

The Act's provisions are largely confirmed by the King III Code although certain discrepancies are apparent, for example with regard to the appointment of company secretaries. As the Act will become law whilst the code is non-binding, the code will have to be implemented in a manner that is consistent with the Act.

²⁰⁴ Section 94(6).

²⁰⁵ Ferreira (n 188) 99.

²⁰⁶ These types of company were introduced by the Corporate Laws Amendment Act, 2006. For an explanation of their import see SM Luiz 'Company Law (Including Close Corporations)' 2007 *Annual Survey of South African Law* 149 at 149–50.




... opening access
to research


Search - Publisher copyright policies & self-archiving

One journal found when searched for: **acta juridica**

Journal: [Acta Juridica](#) (ISSN: 0065-1346, EISSN: 1996-2088)

RoMEO: This is a RoMEO white journal

Author's Pre-print:  author **cannot** archive pre-print (ie pre-refereeing)

Author's Post-print:  author **cannot** archive post-print (ie final draft post-refereeing)

Publisher's Version/PDF:  **subject to Restrictions below**, author **can** archive publisher's version/PDF

Restrictions:

- 6 months embargo

General Conditions:

- On institutional repository affiliated with the author
- Publisher's version/PDF must be used
- On a non-profit server
- Publisher copyright and source must be acknowledged with citation
- Must link to publisher version

Mandated OA: *(Awaiting information)*

Copyright: Not available online

Updated: 01-May-2014 - [Suggest an update for this record](#)

Link to this page: <http://www.sherpa.ac.uk/romeo/issn/0065-1346/>

Published by: [Juta Law](#) - [White Policies in RoMEO](#)

This summary is for the journal's *default* policies, and changes or exceptions can often be negotiated by authors.

All information is correct to the best of our knowledge but should not be relied upon for legal advice.

RoMEO Colour

Archiving policy

Green	Can archive pre-print <i>and</i> post-print or publisher's version/PDF
Blue	Can archive post-print (ie final draft post-refereeing) or publisher's version/PDF
Yellow	Can archive pre-print (ie pre-refereeing)
White	Archiving not formally supported

[More on colours and restrictions](#)

or [View all publishers](#)

Use this site to find a summary of permissions that are normally given as part of each publisher's copyright transfer agreement.

The RoMEO Journals database is supplemented with information kindly provided by:

- the British Library's [Zetoc](#) service hosted by MIMAS,
- the [Directory of Open Access Journals](#) (DOAJ) managed by Infrastructure Services for Open Access,
- the [Entrez](#) journal list hosted by the NCBI.