

# TOPIC 5

## ENHANCED ACCOUNTABILITY AND TRANSPARENCY

### TOPIC OVERVIEW

Chapter 3 of the Companies Act, which includes sections 84 to 93, imposes additional accountability and transparency requirements on certain types of companies. These requirements apply to public companies and state-owned companies (that are not exempted from these provisions). Companies may also voluntarily comply with these requirements.

The requirements deal essentially with the appointment of a secretary (in the manner required in section 86–89), an auditor (in the manner required in section 90–93) and an audit committee (in the manner required in section 94).

**Topic 5 is divided into the following learning units:**

Learning unit	Title
<b>5.1</b>	<b>Application of and general requirements regarding enhanced accountability and transparency</b>
5.1.1	Registration of secretaries and auditors (sec 84 & 85) – also refer to Regulation 26 to 28
<b>5.2</b>	<b>The company secretary, including the mandatory appointment of the company secretary, juristic person or partnership as company secretary, and the duties, resignation or removal of a company secretary</b>
5.2.1	Company secretary (sec 86–89)
<b>5.3</b>	<b>Auditors, including the appointment, resignation, rotation, and rights and restricted functions of auditors</b>
5.3.1	Auditors (sec 90–93)
<b>5.4</b>	<b>Audit committees</b>
5.4.1	Audit committees (sec 94) – also refer to Regulation 42

### TEXTUAL AMENDMENTS AND ADDITIONS

Before proceeding with the study of this topic, please refer to Tutorial Letter 102 for this module to acquaint yourself with any textual amendments and additions that may have been indicated.

### LEARNING OUTCOMES

Learning unit	In this topic, we will focus on the following learning outcomes:	Level
5.1 Application of and general requirements	<ul style="list-style-type: none"><li>• Give advice, discuss concerns and apply the requirements for the</li></ul>	2

<p>regarding enhanced accountability and transparency</p>	<p>application of and general requirements regarding enhanced accountability and transparency, and vacancies.</p>	
<p>5.2 The company secretary, including the mandatory appointment of the company secretary, juristic person or partnership as company secretary, and the duties, resignation or removal of a company secretary</p>	<ul style="list-style-type: none"> <li>• Give advice, discuss concerns and apply the requirements for the company secretary.</li> </ul>	<p>2</p>
<p>5.3 Auditors, including the appointment, resignation, rotation, and rights and restricted functions of auditors</p>	<ul style="list-style-type: none"> <li>• Give advice, discuss concerns and apply the requirements for auditors.</li> </ul>	<p>2</p>
<p>5.4 Audit committees</p>	<ul style="list-style-type: none"> <li>• Give advice, discuss concerns and apply the requirements for audit committees.</li> </ul>	<p>2</p>



# LEARNING UNIT 5.1

## APPLICATION OF AND GENERAL REQUIREMENTS REGARDING ENHANCED ACCOUNTABILITY AND TRANSPARENCY

### INTRODUCTION

This learning unit deals with the requirements for appointing a company secretary and an auditor.

#### 5.1.1 REGISTRATION OF SECRETARIES AND AUDITORS (SEC 84 & 85) – ALSO REGULATION 26 to 28

Sections 84 and 85 of the Companies Act apply to

- every public and state-owned company (SOC)
- a private, non-profit and personal-liability company
  - if required by the Companies Act or the Regulations to be audited, but where the appointment of a company secretary and an audit committee are not required, or
  - to the extent that the company's MOI stipulates that the company comply with this requirement

Regulation 28, which forms part of the Companies Act, requires the following in respect of the categories of companies that have to be audited:

1. This Regulation applies to a company unless the company is exempt from having its annual financial statements either audited or independently reviewed in terms of section 30(2).
2. In addition to public companies and state-owned companies, any company that falls within any of the following categories in any particular financial year must have its annual financial statements for that financial year audited. It includes
  - (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 foreign 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,

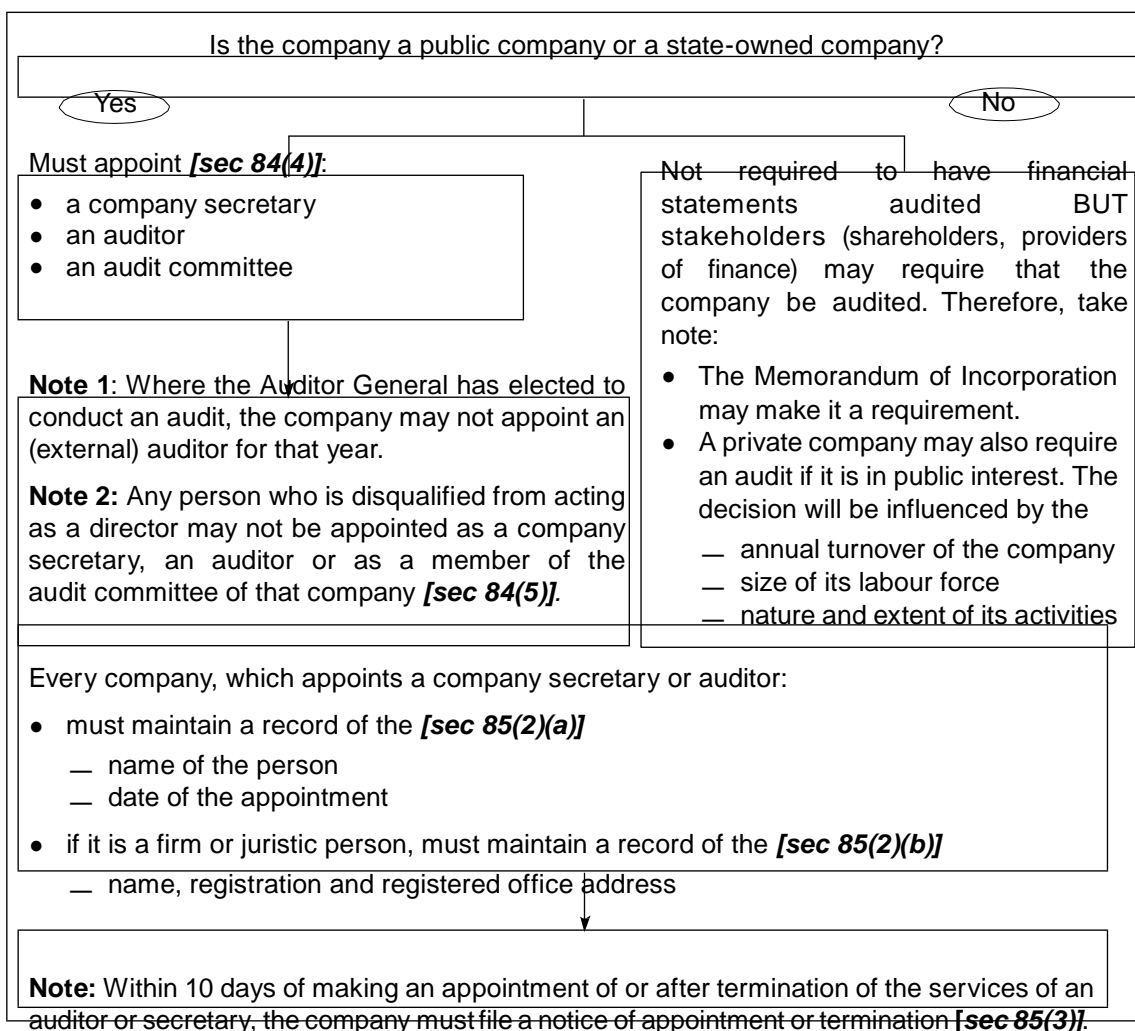
or for a purpose ancillary to any such function

- (c) any other company whose public interest score in that financial year, as calculated in accordance with Regulation 26(2)
  - (iii) is 350 or more; or
  - (iv) is at least 100, if its annual financial statements for that year were internally compiled

Refer back to the Table 2.1.2.1 of learning unit 2, Topic 2., where the above requirements are summarised.

Diagram 5.1.1 below summarises the requirement for companies to appoint a company secretary and an auditor.

### Diagram 5.1.1 Appointment of company secretary and auditor





## STUDY STUDY

Study sections 84 and 85 of the Companies Act, as well as Regulations 26 to 28.

### ACTIVITY 1

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You know much about the Companies Act. Lionel Lester and Wendell Webb have made an appointment to see you about a company they would like to form [Sew-Sew (Pty) Ltd].

Lionel Lester has designed a new industrial sewing machine that he has patented and now wants to sell to the clothing industry. Wendell Webb comes from a wealthy background, and he will provide most of the finance required for the venture. Wendell and Lionel will initially be the only shareholders and directors of the company, but it is expected that over time, a few new shareholders will be found as well as one or two directors appointed.

The company will operate from a factory, which they believe will be suitable for a lease. The owner of the factory wants to tie up the lease as soon as possible. Lionel Lester estimates that in the first year of operation, they will employ about twenty people (including themselves). He also thinks that they will generate a turnover of approximately R20 million, and that their liabilities will not exceed R3 million at any time.

You need to answer the following question:

Wendell Webb heard about something called a public interest score (PIS) and that if your business had such a score, it had to be audited externally. He wanted to know more about the public interest score. Lionel Lester added that he had heard that an auditor would have to review their company independently. (8)

### FEEDBACK ACTIVITY 1

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Reference: Sections 84 and 85, and Regulations 26 to 28 of the Companies Act

All businesses have a public interest score. A public interest score is the sum of the points allocated to four stipulated criteria that apply to every company (and CC) in the financial year. The criteria are as follows:

- A number of points are allocated equal to the maximum number of employees in the business.
- One point is allocated for every R1 million (or portion thereof) of turnover.
- One point is allocated for every individual who has a direct or indirect interest in the shares of the company.
- One point is allocated for every R1 million (or portion thereof) in outstanding unsecured debt of the company held by creditors at year end.

Once a company has calculated its public interest score, it must meet certain requirements, depending on the number of points. For example, a **private** company with a public interest score of 350 or more will have to be audited externally.

As Sew-Sew (Pty) Ltd will initially have a public interest score of less than 100 points (in the range of 45), the company's annual financial statements (AFSs) will not have to be audited externally.

PIS calculation:

Every employee – average number	20
Every security holder	2
Every R1m third-party liabilities	3
Every R1m turnover	<u>20</u>
	<u>45</u>

An independent review of the company's AFSs would normally apply to a company with a public interest score of less than 100 points. However, this will not apply to Sew-Sew (Pty) Ltd because owner-managed companies, that is, those in which the shareholders and the directors are the same individuals, are exempt from this requirement.

## SUMMARY

In this learning unit, we explained and applied the requirements applicable to the registration of the company secretary and auditors in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, you should be able to do the following:

Give advice, discuss concerns, and apply the requirements regarding the registration of the company secretary and auditors.
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# LEARNING UNIT 5.2

## THE COMPANY SECRETARY, INCLUDING THE MANDATORY APPOINTMENT OF THE COMPANY SECRETARY, JURISTIC PERSON OR PARTNERSHIP AS COMPANY SECRETARY, AND THE DUTIES, RESIGNATION OR REMOVAL OF A COMPANY SECRETARY

### INTRODUCTION

Public companies and state-owned enterprises must appoint a company secretary. The secretary acts as a chief administrative officer of the company. This learning unit deals specifically with the duties of the company secretary and with the appointment and removal of the company secretary.

#### 5.2.1 COMPANY SECRETARY (SEC 86–89)

The board of directors appoint the secretary and they must be satisfied that the person is suitably qualified with necessary experience to perform the duties of a company secretary. The secretary is accountable to the board of directors. The secretary's duties are listed below. Study section 88 in this regard.

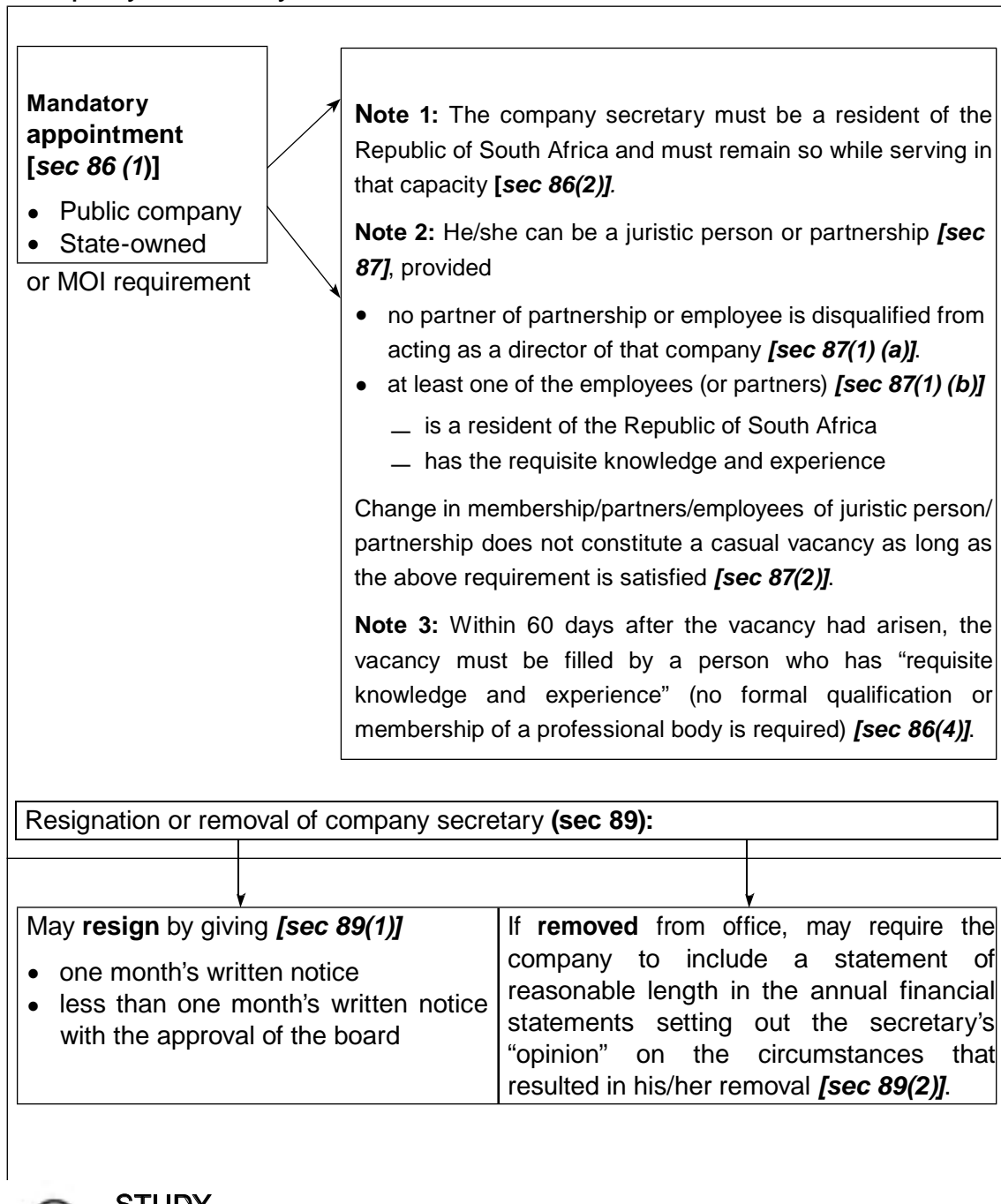
Duties of the company secretary include the following (but are not restricted to):

- Provide directors with guidance with regard to their duties, responsibilities and powers.
- Make directors aware of any relevant law.
- Report any failure on the part of the company/director to the board in order to comply with the Act or the company's Memorandum of Incorporation.
- Ensure that minutes of all meetings (shareholders, directors, board committees and audit committee) are properly recorded.
- Certify in annual financial statements that necessary returns and notices in terms of the Act have been filed and that they appear to be true, correct and up to date.
- Ensure that a copy of the annual financial statements is sent to all persons entitled to receive them.



In diagram 5.2.1 below the requirements concerning the appointment and resignation or removal of the company secretary in terms of the Companies Act are summarised.

Diagram 5.2.1  
Company secretary



**STUDY**

Study sections 86 to 89 of the Companies Act.

## SUMMARY

In this learning unit, you learned about the company secretary, including the mandatory appointment of the company secretary, juristic person or partnership as company secretary, and the duties, resignation or removal of a company secretary.

After having worked through the learning unit and the references to the prescribed study material, you should be able to:

Give advice, discuss concerns, and apply the requirements regarding the company secretary, including the mandatory appointment of the company secretary, juristic person or partnership as company secretary, and the duties, resignation or removal of a company secretary.
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# LEARNING UNIT 5.3

## AUDITORS, INCLUDING THE APPOINTMENT, RESIGNATION, ROTATION, AND RIGHTS AND RESTRICTED FUNCTIONS OF AUDITORS

### INTRODUCTION

Public and state-owned companies (as well as companies required to do so in terms of their MOI or their public interest score) must appoint an individual or firm as their auditor. This learning unit deals with the appointment and resignation of an auditor, as well as with the requirement for auditors to rotate. We will also look at the rights and restricted functions that an auditor has in terms of the Act.

#### 5.3.1 AUDITORS (SEC 90–93)

An auditor can be appointed at incorporation, and thereafter each year at the company's annual general meeting (AGM). The appointed auditor will hold office until the next AGM – in other words, the company cannot remove him or her during the year.

The duties of an auditor in a statutory or voluntary audit are fulfilled in terms of the Auditing Profession Act.

The auditor has, in terms of section 93(1)(a), right of access at all times to

- accounting records
- all books
- documents

The auditor is also entitled to request any information and explanations necessary for performing his or her duties.

In terms of section 93(1)(c), the auditor is entitled to

- attend any general shareholders meeting (including the AGM)
- receive all notices of and other communications relating to any shareholder's meeting
- be heard at any general shareholder's meeting on any part of the business that concerns his or her duties or functions

When it comes to rotation requirements, bear in mind that counting the five years should only start from the effective date of the Act, in other words, from 1 May

2011. In effect, an individual who had served as an auditor for longer than five years on 1 May 2011 may still serve another five years from that date before the rotation requirement becomes effective. An audit firm may thereafter appoint another designated auditor in the firm. Audit firms with one partner have to resign after five years [Schedule 5 to the Companies Act, sec 7(11)].

Diagram 5.3.1.1 and 5.3.1.2 below summarise the requirements concerning the appointment and resignation, as well as the rotation, of auditors in terms of the Companies Act.

Diagram 5.3.1.1  
Appointment of auditors

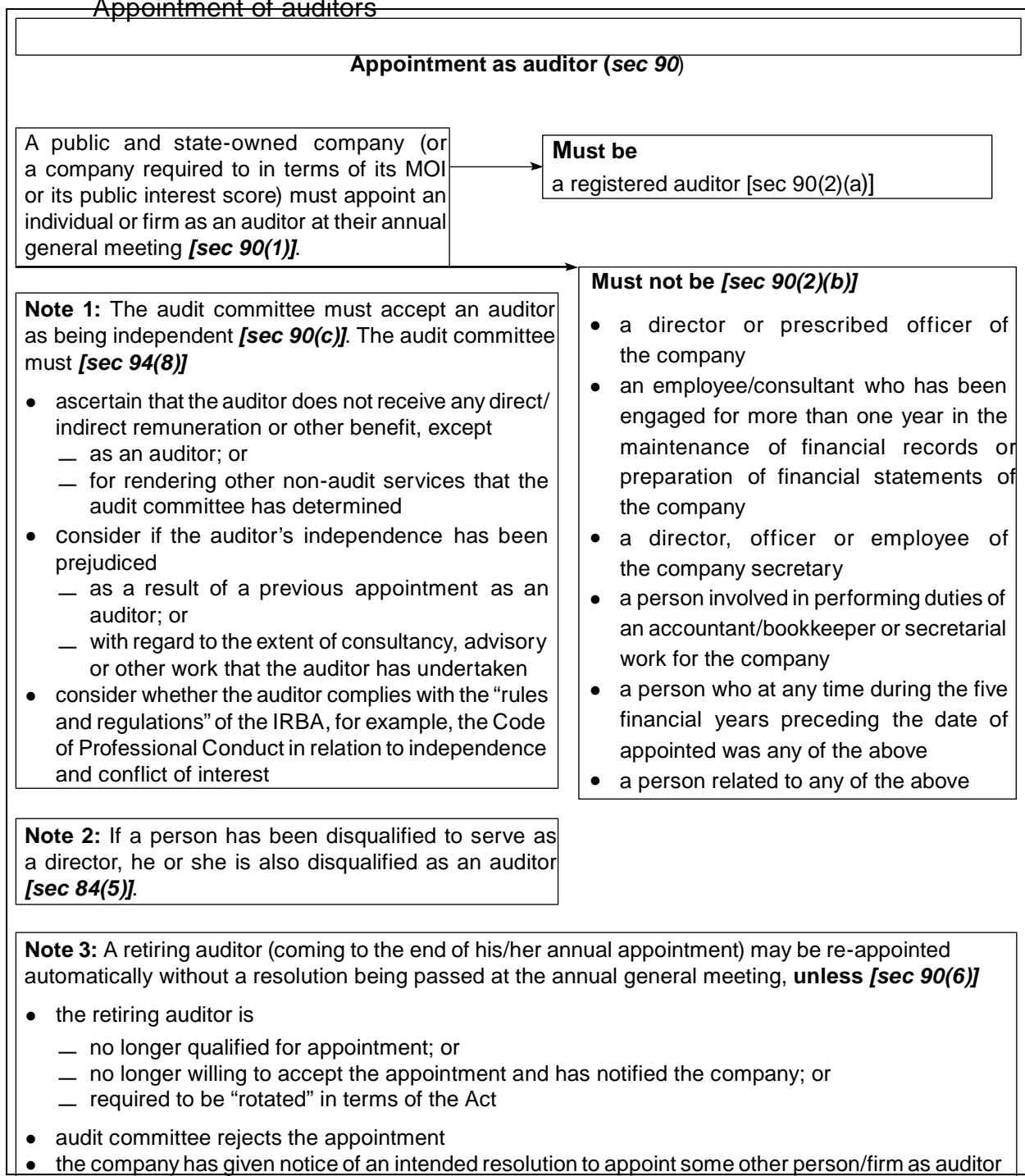
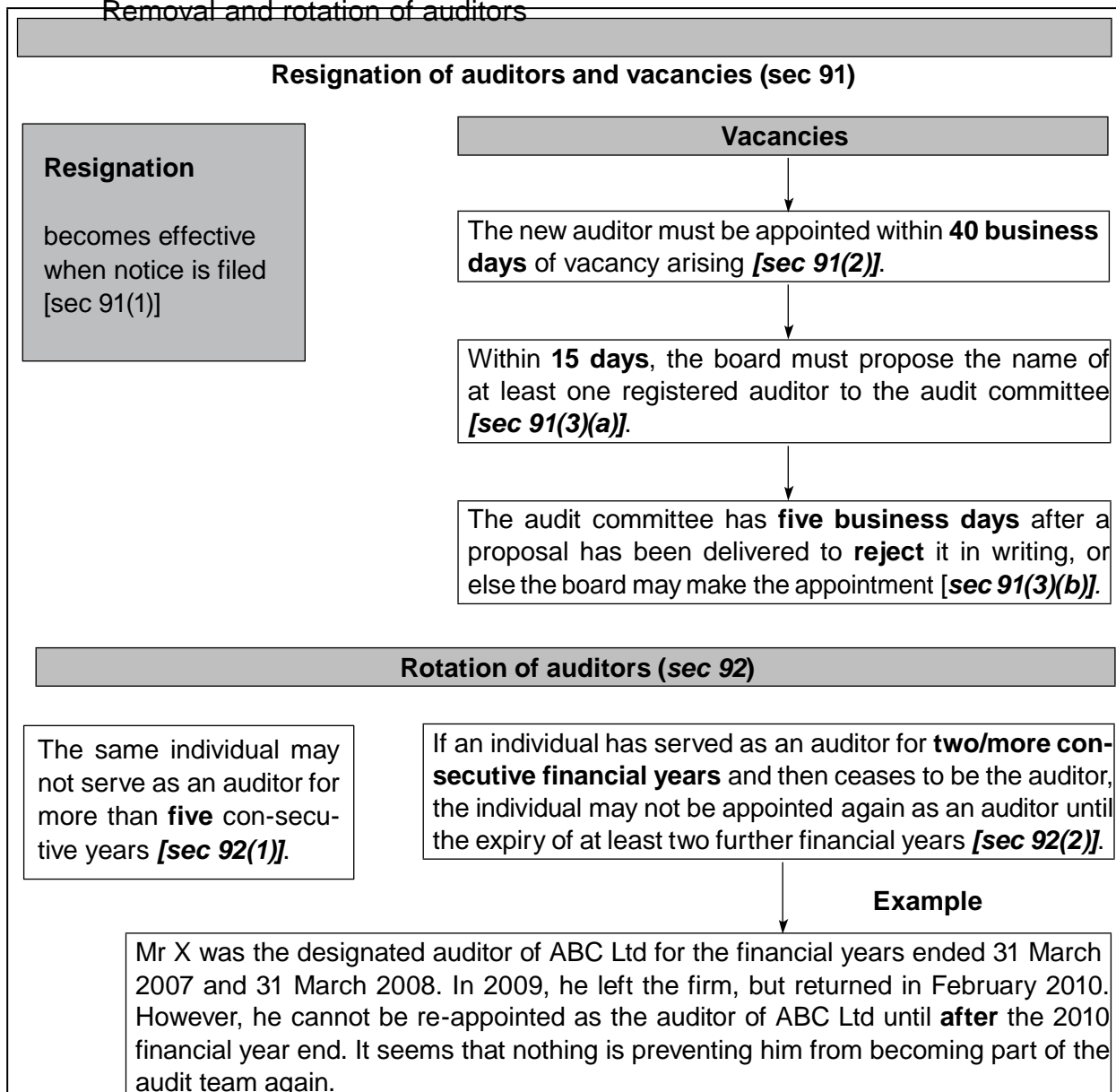


Diagram 5.3.1.2

Removal and rotation of auditors



**STUDY**

Study sections 90 to 93 of the Companies Act.

**ACTIVITY 2**

Now try to answer the following question:

One of your audit clients, xYZ Limited, is a public company that owns a number of warehouses. The CEO of xYZ Limited asks you the following questions via e-mail:

- (a) Apparently, your audit firm can only be our auditors for five consecutive years, after which time your firm must step down. This seems quite harsh. Is there any truth in it? (3)

- (b) Is your firm what one could call a “designated auditor”? (2)  
(Adapted from Gower & Jackson 2010)

## **FEEDBACK ON ACTIVITY 2**

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Reference: Section 92 of the Companies Act

- (a) This is not entirely correct. The Act has introduced auditor rotation for public (and certain other) companies. (1)  
The following applies to public companies:
- The same individual (not firm) may not serve as a designated auditor for more than five consecutive years. (1)
  - If an individual has served for two consecutive years and then ceases to fill the role, he or she may not be reappointed until two financial years have elapsed. (1)
- (b) No. The designated auditor is the individual partner responsible for xYZ Limited’s audit. Our audit firm is appointed as your company’s auditors in terms of the Companies Act, and the designated auditor will be the individual auditor (usually a partner) who takes charge of the audit. (2)

## **ACTIVITY 3**

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Read the scenario presented in activity 4 of learning unit 5.4.

### **REQUIRED**

Explain to John Wayne how the external audit of Canyon (Pty) Ltd’s annual financial statements can become a requirement in terms of the company’s Memorandum of Incorporation. Your answer must include details of meetings that may have to be held, for example, notice, quorums, etc. (12)

## **FEEDBACK ON ACTIVITY 3**

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If John Wayne wants to include the audit requirement in the company’s MOI, the MOI will have to be amended in terms of the Act.

A special resolution to amend the MOI is required.

The board (or shareholders) can call a meeting of shareholders to exercise 10% of the votes. John Wayne will therefore need the approval of his board or the relevant shareholders to call the meeting.

As Canyon (Pty) Ltd is a private company, the following will apply to the meeting:

- A notice period of 10 business days must elapse before the meeting is to begin.
- Notices must include the date, time and location of the meeting.
- The specific purpose for which the meeting has been called (to amend the MOI) must be stated.

- A copy of the proposed resolution **and** the percentage of voting rights needed to pass the resolution must be included, that is, the resolution to amend the MOI for an annual audit requirement, and 75% of voting rights.

The notice must also include a reasonably prominent statement that

- a shareholder may appoint a proxy (who does not have to be a shareholder)
- personal identification is required to attend the meeting

To obtain a quorum, the meeting must have

- at least three shareholders present
- shareholders holding 25% of the voting rights, which can be exercised on the amendment, in attendance before the meeting can begin or the matter be discussed

Voting of the matter may be done by a show of hands or by polling those present and entitled to vote.

If the resolution is passed, a Notice of Amendment (with the prescribed fee) must be filed with CIPC (the registrar).

## SUMMARY

In this learning unit, you learned about the requirements relating to auditors, including the appointment, resignation, rotation, and rights and restricted functions of auditors, in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, you should be able to:

Give advice, discuss concerns, and apply the requirements regarding the auditors, including the appointment, resignation, rotation, and rights and restricted functions of auditors.
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# LEARNING UNIT 5.4

## AUDIT COMMITTEES

### INTRODUCTION

All public and state-owned companies must elect an audit committee. Other companies may elect an audit committee voluntarily.

This learning unit deals with the composition and duties of the audit committee in terms of the Companies Act.

### 5.4.1 AUDIT COMMITTEES (SEC 94) – ALSO REGULATION 42

At each annual general meeting, a public company or state-owned company must elect an audit committee (for other companies, this is a voluntary requirement) **[sec 94(2)]**. See diagram 5.4.1 below in this regard.

#### Diagram 5.4.1

##### Audit committees

Composition of an audit committee

An audit committee must consist of at least three members.

A member must **[sec 94(4)(a)]**

- be a director of the company
- satisfy minimum qualifications as prescribed by the Minister (adequate financial knowledge and experience)

A member must not be **[sec 94(4)(b), (c)]**

- involved in day-to-day management (currently or at any time during the previous financial year)
- a prescribed officer, or full-time executive employee of the company or a related/interrelated company, or have held such a post at any time during the previous three financial years
- a material supplier or customer of the company
- a person related to any of the above-mentioned persons



### **Duties of an audit committee [sec 94(7)]**

- Nominates an independent registered auditor for appointment
- Determines the auditor's fees and terms of engagement
- Ensures that the appointment of the auditor complies with provisions of the Act and other legislation
- Determines the nature and extent of any non-audit services
- Pre-approves any proposed agreement with the auditor for provision of non-audit services
- Prepares a report to be included in the annual financial statements for that financial year
  - describing how its functions were carried out
  - stating whether it is satisfied that the auditors were independent
  - commenting on the appropriateness of the financial statements, accounting practices and internal financial control
- Receives and deals appropriately with any concerns/complaints, relating to
  - accounting practices and the internal audit
  - the content or auditing of the financial statements
  - internal financial controls
  - other related matter
- Makes submissions to the board on any matter concerning accounting policies, financial control, records, and reporting of the company
- Performs other functions determined by the board



### **STUDY**

Study section 94 of the Companies Act, as well as Regulation 42.

### **ACTIVITY 4**

Canyon (Pty) Ltd is a private company in the paint wholesaling business. John Wayne, the newly appointed chief executive officer, is keen to improve the company's corporate governance. He has subsequently approached you for some advice on various aspects of the Companies Act, 2008, which directly affect governance. Currently, the company's public interest score is about ninety and the company's annual financial statements are subject to independent review.

However, John Wayne informs you that he would like the company's annual financial statements to be audited externally annually, and an audit committee to be appointed. He tells you that the directors have agreed to have the financial statements of the current year audited voluntarily, but that he wants to make the annual external audit a requirement in terms of the company's Memorandum of Incorporation. He believes that an external audit is very beneficial and that it should not be dependent on the company's public interest score.

With regard to appointing an audit committee, John Wayne requires that the audit committee be constituted as required by the Companies Act, 2008, and that its duties be at least those that are required by the Act.

For the voluntary audit of the current financial statements, the board of directors will appoint the auditor but for future years, the auditor will be appointed as laid

down in the Companies Act. This is of course, assuming that the annual audit becomes mandatory in terms of the Memorandum of Incorporation.

Canyon (Pty) Ltd's Memorandum of Incorporation is consistent with the Companies Act, 2008, and contains no variations on quorums, notice periods, approval of resolutions, appointments of directors, etc. The company has twenty shareholders.

## REQUIRED

Describe to John Wayne the requirements applicable to appointing an audit committee and outline the duties of the audit committee in terms of the Companies Act, 2008 (do not concern yourself with the King III report). (15)

## FEEDBACK ACTIVITY 4

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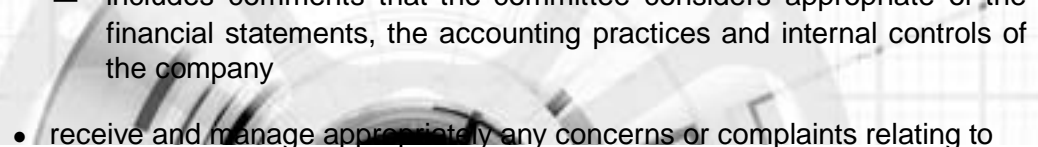
Reference: Section 94 and Regulation 42 of the Companies Act

To comply with the requirements regarding the appointment of an audit committee in terms of the Companies Act

- shareholders must appoint the audit committee at each annual general meeting
- it must consist of at least three members
- each member must be a director of the company
- each member must satisfy the minimum qualifications prescribed by the minister to ensure that the audit committee as a whole comprises persons with adequate financial knowledge and experience (Regulation 42 requires that at least one third of the members of the audit committee have academic qualifications or experience in economics, law, accounting, corporate governance, etc.)
- members of the audit committee **must not be**
  - involved in the day-to-day running of the company or have been so involved at any time during the previous financial year
  - prescribed officers, or full-time executive employees of Canyon (Pty) Ltd (or any related or interrelated company), or have held such post at any time during the previous three financial years
  - material suppliers or customers of the company, such that a reasonable and informed third party would conclude that, in the circumstances, the integrity, impartiality or objectivity of that member of the audit committee would be compromised
  - “related persons” to any person subject to these prohibitions, for example, the wife of a full-time executive employee of Canyon (Pty) Ltd

The duties of the audit committee are to

- nominate a registered auditor in order that the shareholders appoint him/her as auditor (The shareholders must be satisfied that the nominated person/firm is independent of Canyon (Pty) Ltd.)
- determine the auditor's fees and terms of engagement
- ensure the appointment of the auditor complies with the Companies Act and the Auditing Profession Act
- determine the nature and extent of any non-audit services the auditor may provide to Canyon (Pty) Ltd and pre-approve any agreement with the auditor for the provision of these services
  - prepare a report to be included in the AFS, which
    - describes how the audit committee performed its functions

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- states whether the auditor was independent of the company
  - includes comments that the committee considers appropriate of the financial statements, the accounting practices and internal controls of the company
  - receive and manage appropriately any concerns or complaints relating to
    - the accounting practices and internal audit of the company
    - the content or audit of the AFS
    - internal financial controls
    - any other related matters
  - submit to the board any matters dealt with above
  - perform other functions determined by the board

## SUMMARY

In this learning unit, you learned about the requirements for audit committees in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, you should be able to:

Give advice, discuss concerns, and apply the requirements for the audit committee.

## CONCLUSION

In this topic about **enhanced accountability and transparency**, we explained and applied the Companies Act requirements and Regulations regarding the topic. In the following topic, we will be looking at company transactions.