Enhanced accountability 3

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Contents

1 Introduction
2 General accountability requirements
  2.1 Registered office
  2.2 Annual return
  2.3 Company records
    2.3.1 Types of company records
    2.3.2 Location of company records
    2.3.3 Access to company records
  2.4 Financial statements
    2.4.1 Financial reporting standards
    2.4.2 Annual financial statements
3 The meaning of enhanced accountability
4 Companies that are subject to enhanced accountability
  4.1 Public companies
  4.2 State-owned companies
  4.3 Private companies, personal liability companies and non-profit companies
    4.3.1 The public interest score
  4.4 Close corporations
5 Elements of enhanced accountability
  5.1 Auditors
    5.1.1 Appointment
    5.1.2 Rotation
    5.1.3 Non-auditing services
    5.1.4 Rights
    5.1.5 Duties
    5.1.6 Removal
  5.2 Audit committee
    5.2.1 Appointment
    5.2.2 Duties
  5.3 Company secretary
    5.3.1 Appointment
    5.3.2 Duties
    5.3.3 Removal

5.4 Social and ethics committee ....

5.4.1 Appointment....................

5.4.2 Rights....................

5.4.3 Duties....................

6 Concluding remarks ....

1 Introduction

The modern company is more than the sum of its shareholders and directors. It is a powerful social institution that impacts the communities in which it operates and all that have dealings with it. It is therefore understandable that one of the stated purposes of the South African Companies Act 71 of 2008 (the 2008 Companies Act) is to:[1]

> . . . promote the development of the South African economy by encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of a nation.

The Act recognises this changed reality in recognising a duty for greater responsibility by companies towards persons other than its shareholders and creditors.[2] It follows logically from this that a larger group of persons has a potential interest in the accountability of the board and the transparency of its actions. The greater the company's social impact, the greater the need for transparency and accountability. Put differently, public interest demands greater checks and balances to be put in place for companies that wield greater power.

This chapter will first consider the accountability requirements that are applicable to all companies, regardless of their public, social and economic impact. Thereafter it will consider the thresholds that will determine whether enhanced accountability is required from a particular company. Finally, this chapter will explain the content of enhanced accountability and how it serves to check and support the governance of a company. The role of the external auditor, the company secretary, the audit committee of the board and the social and ethics committee of the board will be considered in this regard.

2 General accountability requirements

All companies need to meet certain accountability and transparency requirements,[3] regardless of the size of their operations or their social impact. Of specific relevance here are record keeping and financial statements of the company, coupled with the compulsory establishment of a registered office and the filing of an annual return to the Companies and Intellectual Property Commission (the Commission).

1 S 7(*b*)(iii).

2 See the provisions requiring a social and ethics committee in s 72(4)–(10) of the 2008 Companies Act, read with reg 43.

3 See ss 23 – 34 of the 2008 Companies Act.

2.1 *Registered office*

Each company must register the address of its principal office initially in its Notice of Incorporation,[4] and subsequently by filing a notice of change of registered office.[5] The registered office of a company is important in determining the jurisdiction of a particular court over the company and for service of process of court.

In terms of the Companies Act 61 of 1973 (the 1973 Companies Act) it was possible for a company to be resident either where its registered office was situated, or where its main place of business was situated.[6] It was therefore possible for the High Court where the registered office of the company was situated and the High Court where its main place of business was situated to have concurrent jurisdiction.[7]

The 2008 Companies Act does not contain a similar provision. However, it was held in *Sibakhulu Construction (Pty) Ltd v Wedgewood Village Gold Country Estate (Pty) Ltd & others*[8] that section 23 of the Companies Act differs from its predecessor in the Companies Act 61 of 1973[9] in that it requires the registered office of the company to be its *principal office*, where the company has more than one office.[10] The Court concluded that the Companies Act requires the registered office of the company to be its main place of business.[11] It is therefore no longer possible for more than one court to have jurisdiction over a company in respect of an action sounding in money.[12]

The Uniform Rules of Court[13] and the Rules of the Magistrates' Courts[14] provide that service of process in the case of a company is effected either at its registered office or at its main place of business. If the interpretation in *Sibakhulu* is accepted by other divisions of the High Court, the registered office and the principal place of business of a company must be the same place, namely the registered office of the company.

It is only compulsory to keep the accounting records of a company at its registered office,[15] but it is usual to also keep the other records as required by the Act there.

2.2 *Annual return*

Every company must file an annual return with the Commission within 30 business days after the anniversary of its date of incorporation,[16] or if it is a domesticated company,[17] within

4 S 23(3)(*b*)(i)(*aa*).
5 S 23(3)(*b*)(ii).
6 S 12(1).
7 *Dairy Board v John T Rennie & Co (Pty) Ltd* (1976) 3 SA 768 (W) paras 14 and 15, confirmed in *Bisonboard Ltd v K Braun Woodworking Machinery (Pty) Ltd* 1991 (1) SA 482 (A).
8 WCC 16 November 2011(case 27956/2010), unreported.
9 S 170(1)(*b*).
10 Para 19.
11 It was held in *TW Beckett & Co Ltd v H Kroomer Ltd* 1912 AD 324 at 334 that where a company had more than one place of business, it is resident where its general administration is located. This approach found favour with the Court in *Sibakhulu* (para 19).
12 See also Delport, Vorster and Burdette et al. *Henochsberg* 104; Locke and Esser 'Corporate law (including stock exchanges)'.
13 Rule 4(1)(*a*)(v).
14 Rule 9(3)(*e*).
15 S 28(2).
16 S 33(1) read with reg 30(1). The annual return is set out in Form CoR 30.1.
17 A domesticated company is a foreign company that has moved its registration to South Africa in the manner prescribed by s 13(5) – (11).

30 business days after the anniversary of the date that its registration was transferred to South Africa. Only *registered* external companies need to file an annual return,[18] which return must be filed within 30 business days after the anniversary of its registration as an external company.[19]

The reasons why an annual return is filed are twofold. Firstly, it enables the Commission to monitor compliance by companies with the mandatory keeping of financial records and the financial reporting of companies.[20] Secondly, it enables the Commission to verify the information it holds about the location of the company's registered office and where it keeps its records, the names of the company's directors, company secretary, auditor and audit committee members and the date of the company's financial year end.

The annual return must be accompanied by the company's annual financial statements, but only if such statements have to be audited.[21] Companies that need not have their annual financial statements audited in terms of the 2008 Companies Act may file their reviewed financial statements voluntarily with the annual return.[22] It seems from this provision that companies that have their annual financial statements audited voluntarily, or because it is required by their memorandums of incorporation, will not be obliged to file their annual financial statements in terms of this regulation. However, companies that do not submit annual financial statements with their annual returns must submit a financial accountability supplement to their annual return in the prescribed form.[23]

Companies need to indicate on the annual return the information required to determine their public interest score.[24] A company's public interest score determines whether it needs to have its annual financial statements audited,[25] as well as whether its board needs to appoint a social and ethics committee.[26] By furnishing this information to the Commission at least once a year, the Commission can monitor whether a company is complying with the applicable accountability provisions of the Act.

Note that a company must indicate on its annual return the name of a director, employee or other person who is responsible for the company's compliance with the accountability and enhanced accountability requirements of the Act.[27] In larger companies this person will typically be the financial director or chief financial officer of the company, or perhaps the chief compliance officer or company secretary. However, the Act and its regulations do not set any requirements or qualifications for the person designated to be responsible in terms of this provision.

The Commission may deregister a company that fails to file its annual returns for two years in succession.[28]

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18 For the requirements for registration as an external company, see s 23.
19 S 33(2) read with reg 30(6).
20 See reg 30(5).
21 See para 5.1 below.
22 Reg 30(3).
23 Reg 30(4). See also Form CoR 30.2.
24 See para 4.3.1 below for more on the public interest score.
25 See para 5.1 below.
26 See para 5.4 below.
27 S 33(3).
28 S 82(3)(*a*) and 82(4), read with regs 40(2) – (7).

2.3 *Company records*

'Company records' refers to any documents, accounts, books, writing, records or other information that a company is required to keep in terms of the 2008 Companies Act or any other public regulation.[29]

These records must be kept in writing or in another form that allows the information to be converted into written form within a reasonable time.[30] Electronic record keeping is therefore allowed in terms of this provision. Note that an unaltered electronically or mechanically generated reproduction of any document may be substituted for the original for any purpose for which the original could be used in terms of the Act, as long as it satisfies any prescribed requirements as to form and manner of reproduction.[31] It follows that although company records need to be kept for a period of seven years, or longer if so determined by a public regulation,[32] the appropriate use of electronic methods to store data will alleviate the burden on space that record keeping might otherwise place on companies.

2.3.1 Types of company records

The company records that must be maintained in terms of the 2008 Companies Act are set out in section 24(3). The company must maintain a copy of its Memorandum of Incorporation, as amended or altered, as well as any company rules. It must keep a record of its present and past directors.[33] Information about past directors must be kept for seven years after their date of retirement as a director of the company.[34] Copies must be kept of all reports presented at the annual general meetings of the company for seven years after the date of such meetings.[35] Although the Act is silent about reports presented at meetings of shareholders other than the annual general meeting, it does require that the notice and minutes of all shareholder meetings be recorded, including all resolutions adopted and any documents made available to the holders of securities in respect of such a resolution, for seven years after the resolution was adopted.[36] This provision is wide enough to include any reports presented to a meeting that is not an annual general meeting.

The annual financial statements of the company must be kept for seven years after they were issued, as must the accounting records for the current financial year of the company and of the previous seven completed financial years of the company.[37] Note that accounting records must be kept in such a manner as to prevent their theft, loss or accidental or intentional destruction

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29 Section 1 read with s 24(1). In terms of s 1 'public regulation' means 'any national, provincial or local government legislation or subordinate legislation, or any license, tariff, directive or similar authorisation issued by a regulatory authority or pursuant to any statutory authority'. 'Regulatory authority' is further defined as 'an entity established in terms of national or provincial legislation responsible for regulating an industry, or sector of an industry'.

30 S 33(1)(*a*).

31 S 6(7).

32 S 24(1)(*b*).

33 The content of this record is set out in s 24(5) read with reg 23. Importantly, details of any other local or foreign company of which the person is appointed as a director must be indicated. The nationality of foreign companies of which the person is a director must also be indicated in the record. This serves as an important indicator of independence.

34 S 24(3)(*b*)(ii).

35 S 24(3)(*c*)(i).

36 S 24(3)(*d*).

37 S 24(3)(*c*)(ii) – (iii). The Act does not contain a list of accounting records that must be kept, but the content of the accounting records that must be kept is set out in reg 25(3) – (4).

or falsification.[38] If the accounting records are kept in electronic format, the company must take adequate precautions against the loss of the records as a result of the damage to, or failure of, the media used to store the information.[39] The retrievability of the information from electronic media must be ensured. Accounting records are discussed in more detail below.[40]

All written communications sent generally by the company to all holders of any class of securities of the company must be kept for seven years after the date that the communication was issued.[41] This only includes communications between the company and a class of its security holders in general – individual communications between the company and security holders need not comply with these record keeping requirements.

The minutes of all meetings and resolutions of the board of directors must be kept for seven years after the date of the meeting or the date on which each resolution was adopted.[42] This includes the minutes of the meetings and the resolutions of the board committees and of the audit committee of the company.

If the company is a profit company it must maintain a securities register.[43] Non-profit companies must keep a register of members. Additionally, if the company is required to appoint an auditor or a company secretary, or if it voluntarily appoints either of these persons, it must maintain a register of the details of its appointed auditors and company secretaries.[44]

2.3.1.1 *Accounting records*

The term 'accounting records' is defined in the 2008 Companies Act[45] as 'information in written or electronic form concerning the financial affairs of the company as required in terms of this Act, including but not limited to, purchase and sales records, general and subsidiary ledgers and other documents and books used in the preparation of financial statements'. Accounting records will include invoices, cash slips, inventory documents etc.

A company must keep accurate and complete accounting records to enable it to comply with the preparation of financial statements as prescribed by the Act and any other applicable law.[46] The specific accounting records kept by the company will therefore be determined with reference to what information is needed by the company when it draws up its financial statements in accordance with the applicable financial reporting standards.[47] The accounting records must also facilitate the proper auditing or independent review of the annual financial statements of the company, whichever is applicable.[48]

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38 Reg 25(5).
39 Reg 25(6).
40 Par 2.3.1.1.
41 S 24(3)(*e*).
42 S 24(3)(*f*).
43 S 24(4)(*a*). The requirements for the securities register are set out in s 50 of the Companies Act, read with reg 32. Disclosures of beneficial interests in securities in terms of s 56 must be recorded and form part of the securities register in terms of reg 32(3).
44 S 24(4)(*b*) read with s 85. Section 85(1)(*a*) – (*c*) sets out the required content of these records.
45 S 1.
46 S 28(1).
47 See para 2.4.1 below. For a summary of the most relevant accounting standards that may influence the type of accounting records held, see Delport, Vorster and Burdette et al. *Henochsberg* 123 – 129.
48 Reg 25(2)(*b*). See paras 2.4.2 and 5.1 below.

To this end a number of accounting records are prescribed by the Companies Regulations:[49]

- The company must keep a record of its assets and liabilities. This includes a register of the acquisition,[50] valuation, re-valuation and disposition of its non-current assets. Non-current assets, also referred to as fixed assets, are assets that are not easily converted into cash and that are not expected to be sold for cash within the next year. This will typically include plant and equipment of the company.
- The company must further keep a record of all loans, liabilities and other obligations incurred in favour of a shareholder, director, prescribed officer or employee of the company, or any person related[51] to these persons. This includes when the company grants security for the obligations of the mentioned persons. This record must include details of the amount borrowed, the interest payable, the terms of re-payment and the material terms for breach, default or re-negotiation of the agreement.
- A record of property held in a fiduciary capacity or in the capacity set out in section 65(2) of the Consumer Protection Act 68 of 2008must be kept by the company. In terms of the mentioned provision of the Consumer Protection Act, a company that has in its possession the property of its client (the consumer) is not allowed to treat that property as its own.[52] The company must exercise the degree of care, skill and diligence in the handling, safeguarding and utilisation of such property that would be expected of a person who manages the property of another[53] and is liable to the client for any loss as a result of the failure to act in such a manner with the property.[54] The type of property belonging to the client that may fall within the meaning of the section is not restricted, but prepayments, deposits and membership fees are expressly included. It therefore seems that any property left with the company by a client, who may later require the return of such property, would fall under the ambit of this section. Evidently, without the existence of such a record, it will be impossible to determine the company's compliance with its obligation to keep these funds separate from its own.
- The revenue and expenditure of the company must be recorded. This includes daily records of money received and paid out, in enough detail to identity the transaction and the names of the parties if the transaction was not for cash. Daily records must be kept of goods purchased or sold, and all services received or delivered, *on credit* in enough detail to identify the transaction and the parties involved. Banking statements and evidence of the transactions reflected on such statements are included in this broad group of accounting records.

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49 See reg 25(3).

50 Delport, Vorster and Burdette *et al*. *Henochsberg* 119 argue that 'acquisition' must be interpreted to mean 'obtaining the ownership of' the asset. They continue that this should not be restricted to an immediate transfer of ownership, but should include the claim to have ownership transferred at a later stage, such as on the expiry of a lease term. This is because the *economic reality* of a lease transaction, for example, is to hold the object immediately for its earning value and with the intention to become the owner at a late stage. For accounting purposes it is the economic reality of the transaction that must be reflected in the accounts. While I agree with this exposition by the authors of *Henochsberg*, it is necessary to place the emphasis of this position in the right place. The inclusion of leased property as fixed assets in the accounting records of a company does not imply that the lease is a simulated transaction for legal purposes. It simply reflects the *economic reality* that the underlying effect of the lease for commercial purposes is the same as in the case of an immediate transfer of ownership, in certain circumstances. For more on simulated transactions, see Joubert 'Asset-based financing, contracts of purchase and sale, and simulated transactions'.

51 See s 2 of the 2008 Companies Act for a description of parties related to one another.

52 S 65(2)(*a*) of the Consumer Protection Act 68 of 2008.

53 S 65(2)(*b*).

54 S 65(2)(*c*).

- Companies trading in goods must keep inventories, statements of annual stocktaking and such other records as to enable to value of the stock at the end of the financial year to be determined.
- Non-profit companies must keep records of donations, grants and members' fees received, as well as any other revenue received from funding contracts or arrangements.[55]

The accounting records listed above must be kept at, or be accessible from, the registered office of the company.[56]

Failure to keep accurate or complete accounting records, or to keep them in a manner and form not prescribed by the Act, with the intention to deceive or mislead any person is a company offence.[57] It is further an offence for any person to falsify a company's accounting records.[58]

2.3.2 Location of company records

The company records must be accessible at the company's registered office or at any other location or locations within South Africa.[59] However, if the records are not accessible at the company's registered office, the company must file a notice with the Commission which sets out the location or locations in South Africa where the records may be accessed.[60] The Commission must be informed if the records are moved.

Note that the company's accounting records must be kept at, or be accessible from, the registered office of the company.[61] If the records are kept at a place other than the company's registered office, the notice requirements set out above must be complied with.

2.3.3 Access to company records

Any person, who has a beneficial interest in any securities of a profit company,[62] or a member of a non-profit company, has the right to inspect certain company records free of charge, or to make copies of such records at a minimal reasonable charge.[63] This excludes the inspection of any accounting records of the company, but includes access to the annual financial statements and their accompanying reports. It further excludes access to the minutes of the meetings and the resolutions of the board and the board committees, as well as of the audit committee. The company must maintain a record of the holders of beneficial interests in its securities.[64]

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55 Reg 25(4).
56 S 28(2) of the 2008 Companies Act.
57 S 28(3)(*a*).
58 S 28(3)(*b*). In terms of s 214(1)(*a*) read with s 216(*a*) conviction of this offence may lead to a fine or imprisonment for up to ten years, or to both a fine and imprisonment.
59 S 25. See also para 2.1 above.
60 S 25 (2) read with reg 22. See also Form CoR 22.
61 S 28(2).
62 S 1 defines 'beneficial interest' when used in relation to a company's securities as 'the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to (*a*) receive or participate in any distribution in respect of the company's securities (*b*) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company's securities; or (*c*) dispose or direct the disposition of the company's securities, or any part of a distribution in respect of the securities.' Persons holding interests in unit trusts or other collective investment schemes in terms of the Collective Investment Schemes Act 45 of 2002 are expressly excluded from this provision. The right of a registered nominee holder of securities to have access to company records will depend on the relationship between it and the beneficial holder of the securities.
63 S 26(1).
64 S 56(7). This information forms part of the securities register of the company. See reg 32(3).

Any other person may inspect the securities register of a profit company or the members' register of a non-profit company, or the register of the directors of a company for a fee, which may not exceed the maximum prescribed fee.[65] Such persons need not provide reasons why they want to inspect these records.[66]

The Memorandum of Incorporation of the company may grant further access to persons, but may not negate or diminish the protection afforded by Part 3 of the Promotion of Access to Information Act 2 of 2000 (PAIA).[67]

The rights of access to information set out above may be exercised by a person for a reasonable period during business hours.[68] The request for access may be made to the company directly in the prescribed manner,[69] or in accordance with PAIA.[70]

If the request is made directly to the company, the company must comply with the request within 14 business days.[71] This section is peremptory. However, it only applies to requests for access to records specifically determined by the Act or by the company's Memorandum of Incorporation, as limited by the provisions of section 63 – 69 of PAIA, to be available to the applicant.

Additionally to the rights of access to records provided for in section 26, section 31 grants certain persons the right to gain access to the annual financial statements of the company. Every holder of a beneficial interest in any securities of the company must receive notice of the publication of the annual financial statements of the company and information about the procedure to obtain a copy of those statements.[72] They must then be provided with a copy of the annual financial statements of the company on demand.[73]

If a judgment creditor of the company is informed by the Sherriff of the Court that there seems to be no disposable property of the company to satisfy a judgment debt, the company must furnish to such a judgment creditor a copy of the most recent annual financial statements of the company within five days after receiving the demand for such a copy.[74]

Trade unions have a right to access of company financial statements through the Commission for the purposes of initiating business rescue proceedings.[75] Clearly this information must be supplied to them by the Commission, and under such conditions as determined by the

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65 S 26(2). The maximum fee for access to the members register or the register of directors is currently set at R100 in s 26(6). This subsection further restricts inspection hours to business hours and for reasonable periods. It appears as if the omission of access to the securities register on similar terms might have been an oversight.

66 In *La Lucia Sands Share Block v Barkhan* 2010 (6) SA 421 (SCA) the Court held, after considering s 113 of the Companies Act 61 of 1973, that it would only limit a person's ability to access the register of members if it was shown that the access was sought for an unlawful purpose (426H – 427A). The Court further held that: 'In a constitutional State in which freedom of association and access to information are valued, courts should be slow to make orders that have a limiting effect [to access to information]' (427I).

67 See also the discussion below. Part 3 deals with access to records of private bodies and ss 63 – 69 provides for the mandatory protection of information of certain parties held in the records of private bodies. Refusal by a company to grant access to records that contain the information set out in these sections is lawful.

68 S 26(4)(*a*).

69 S 26(4)(*b*) read with reg 24(3), by completing Form CoR 24.

70 See below.

71 S 26(5).

72 S 31(1)(*a*).

73 S 31(1)(*b*).

74 S 31(2).

75 S 31(3).

Commission.[76] Note that this access is not restricted to the annual financial statements of the company, but includes all financial statements of the company.

One of the few offences retained in the 2008 Companies Act is in relation to the company's failure to accommodate a reasonable request for access to any records that a person has a right to inspect in terms of the Act.[77] This stands testimony to the importance that the Act places on persons' access to company information, and to the underlying importance that such access has for the proper governance of companies. It is further an offence to impede, interfere with, or attempt to frustrate any reasonable exercise of a person's right to access records of the company as provided for in sections 26 and 31.[78]

2.3.3.1 *Access to company records in terms of the Promotion of Access to Information Act*

Section 32(1) of the Constitution of the Republic of South Africa, 1996 (the Constitution) provides that 'everyone has the right of access to (*a*) . . . (*b*) any information that is held by another person [that is not the state] and that is required for the exercise or protection of any rights.' Furthermore section 32(2) provides that national legislation must be enacted to give effect to the right of access to information. PAIA is the national legislation that was enacted for this purpose. Part 3 regulates access to information held by private bodies, which will include companies.[79] PAIA aims to give effect to the right of access to information subject to justifiable limitations that aim to reasonably protect privacy, commercial confidentiality and effective, efficient and good governance.[80] The promotion of the transparency, accountability and effective governance of all public and private bodies is then also a further stated purpose of PAIA.[81]

Section 50(1)(*a*) of PAIA provides that

> A requester must be given access to any record of a private body if—
>
> (*a*) that record is required for the exercise or protection of any rights;

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76 Neither the Companies Regulations nor the Commission's website contains any generic guidance on how this procedure would work.

77 Ss 26(9)(*a*) and 31(4)(*a*).

78 Ss 26(9)(*b*) and 31(4)(*b*).

79 'Private body' is defined in s 1 to include juristic persons. State-owned companies may be subject to the requirements to grant access to information held by *public bodies*. Section 1 of PAIA defines 'public body' as '*(a)* any department of state or administration in the national or provincial sphere of government or any municipality in the local sphere of government; or *(b)* any other functionary or institution when— (i) exercising a power or performing a duty in terms of the Constitution or a provincial constitution; or (ii) *exercising a public power or performing a public function in terms of any legislation*' (my emphasis). The definition is similar to the definition of 'organ of state' in section 239 of the Constitution of the Republic of South Africa, 1996, apart from the fact that courts and judicial officers are expressly excluded from the definition of 'organ of state'. State-owned companies could fall within the emphasised part of the quotation above. For more on the factors that would determine whether a body is an organ of state, see Mdumbe 'The meaning of 'organ of state' in South African law' 68 – 70; *Institute for Democracy in South Africa v African National Congress* 2005 (5) SA 39 (C) 51A – 53F; *Transnet Ltd v SA Metal Machinery Co (Pty) Ltd* 2006 (6) SA 285 (SCA) 290B – D; *M & G Media v 2010 FIFA World Cup Organising Committee South Africa Ltd* 2011 (5) SA 163 (GSJ) 201G – 213B. If a state-owned company is a public body as defined in PAIA, the requester need not show that it needs the requested information for the protection of any rights, as is the case when information is requested from a private body. For purposes of this discussion, I shall assume that the company is a private body as defined in PAIA.

80 S 9(*b*)(i).

81 S 9(*e*).

(*b*) that person complies with the procedural requirements in this Act relating to a request for access to that record; and

(*c*) access to that record is not refused in terms of any ground for refusal contemplated in Chapter 4 of this Part.

There had been some uncertainty about the interaction between PAIA and the provisions that restricted access to information in the 1973 Companies Act. More specifically, the question arose whether PAIA could be used to give access to a shareholder to the accounting records of a company and in what circumstances the company would be allowed to refuse such access.[82] In this regard the Supreme Court of Appeal held that 'required' in terms of section 50(1)(*a*) of PAIA means 'reasonably required' and that this must 'connote a substantial advantage or an element of need'.[83] It further held that the Companies Act contains several measures to protect the interests of shareholders with regard to financial information. The duty of directors to ensure the veracity of financial statements and the role of the auditors of the company to verify such financial statements were specifically mentioned by the Court.[84] In light of these measures of the Companies Act, the Court held that it could not have been the intention of the legislature to give access to the accounting records of a company to a requester 'on a whiff of impropriety or on the ground that relatively minor errors or irregularities have occurred'.[85]

Every aspect of the governance of companies discussed in this chapter serves to protect the interests of shareholders and other stakeholders of the company regarding the transparency and accountability of companies. The decision of the Supreme Court of Appeal discussed above implies that the limitations placed by the 2008 Companies Act on access to records held by companies are prima facie justifiable.[86] It follows that a requester for company information has a more substantial burden when proving that it reasonably requires that information for the protection of his or her rights.

PAIA gives effect to the right of access to information entrenched in the Bill of Rights. It was therefore not strictly speaking necessary to include specific references to the applicability of this legislation to companies in the Act, nor was it necessary to expressly state that PAIA applies in the case of any irreconcilable differences between its provisions and those of the Act.[87]

A request for access to information made to a private body in terms of PAIA must substantially correspond with the form set out in Form C of Annexure B of the Regulations regarding Access to Information.[88] Besides the personal details of the requester, the request must clearly indicate the right that the person seeks to protect by gaining access to the information and provide reasons why the information is required for the protection of that right.[89]

The company must decide within 30 days after receiving the request whether to grant access to the information requested and must inform the requester of its decision.[90] This period may

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82 See *Clutchco (Pty) Ltd v Davis* 2005 (3) SA 486 (SCA). See also Locke 'Access to a company's accounting records by means of the Promotion of Access to Information Act 2 of 2000', where the decision of the High Court in the matter (*Davis v Clutchco (Pty) Ltd* 2004 (1) SA 75 (C)) is discussed.

83 491J – 492A.

84 492F – 493B.

85 493D.

86 See Locke 'Access to a company's accounting records by means of the Promotion of Access to Information Act 2 of 2000' 227 – 231 for a discussion of the limitation of access to company records in terms of the limitations clause in the Constitution.

87 Section 5(4)(*b*)(i)(*cc*) and s 26(7).

88 GN R187 *GG* 23119 of 15 February 2002, reg 10. A copy of Form C is attached to this chapter for the reader's convenience.

89 S 53(2)(*d*).

90 S 56(1) of PAIA.

be extended by a further 30 days in certain specified circumstances.[91] If the request is granted, the company must indicate on its notice to the requester what the payable fees will be and the form in which access will be given.[92] If access is refused, the notice must indicate to the requester the reasons for the refusal and inform the requester of its right to apply to a court to review the refusal, as well as the procedure and time limits within which to launch such proceedings.[93] Failure to notify the requester of the outcome of his or her request is a deemed refusal of the request.[94]

Chapter 4 of Part 3 of PAIA sets out the grounds for refusal of access to information held by a private body. Section 63 guards against the unreasonable disclosure of personal information of a third party held by a private body. This does not include a request for information about an individual who was an official of a private body where the information sought relates to the position and functions of the individual in the private body.[95] This includes generic details about the classification, salary scale, remuneration and responsibilities of the position held or the services performed by that individual.

Confidential commercial information of a third party held by the company may not be disclosed to a requester.[96] This includes trade secrets and other information, the disclosure of which could prejudice such a third party in commercial competition. This does not include the results of any product or environmental testing, or other investigation, which would reveal a serious public safety or environmental risk.[97] Information that is confidential owing to an agreement with a third party may also not be disclosed to the requester.[98]

A request must be refused if the disclosure would reasonably be expected to endanger the life or the physical integrity of an individual.[99] Access to information, the disclosure of which may prejudice or impair the security of property or the plans to ensure the protection of property, of persons in witness protection or the public at large, may also be refused.[100]

Records that are privileged from disclosure in legal proceedings may not be released to a requester, unless the privilege has been waived by the person entitled to it.[101]

A third party must be informed if a company receives a request for access to information regarding the third party.[102] It may grant permission for the disclosure of the requested information.[103]

The confidential commercial information of the company itself is also protected in section 68 of PAIA. This includes information about its trade secrets and other information that would put it in commercial disadvantage if disclosed. This does not include the results of any product or environmental testing, or other investigation, which would reveal a serious public safety or environmental risk. Research being, or to be, carried out on behalf of a third party or for the

91 S 57(1).
92 S 56(2).
93 S 56(3). Ss 78 – 82, read with the Promotion of Access to Information Rules, GN R965 *GG* 32622 of 9 October 2009, sets out the procedure to apply to court for appropriate relief if a request was denied.
94 S 58.
95 S 63(2)(*f*).
96 S 64.
97 S 64(2)(*b*).
98 S 65.
99 S 66(*a*).
100 S 66(*b*).
101 S 67.
102 S 71.
103 S 72(1).

company's own benefit must not be disclosed to a requester if it would place the third party or the company in a serious disadvantage.[104]

Despite all the above mentioned grounds for refusal of access to records held by a private body, access must be granted if the disclosure would reveal a contravention of the law or an imminent or serious public safety or environmental risk and the public interest in disclosure outweighs the interest protected by the relevant ground of refusal.[105]

I have argued elsewhere that commercial legislation should leave the procedures for persons to gain access to information to PAIA and should rather focus on prescribing adequate record keeping.[106] This is because PAIA does not prescribe record keeping, but only provides for access to records that public and private bodies have already created. If there is no obligation on these bodies to keep the appropriate records, PAIA is only of limited assistance. The extensive record keeping provisions of the Act are therefore to be welcomed.

Note that the 'head of the private body', which in the case of a juristic person is defined as the chief executive officer or the person authorised by the chief executive officer,[107] is tasked with the submission of an information manual to the Human Rights Commission.[108] The manual must provide details about those records kept by the company that is available for inspection without resort to the procedure in PAIA. It must also specifically state how a person may obtain access to such records.[109] Records that are available due to the provisions of any other legislation must also be specifically listed. All companies should list the 2008 Companies Act 71 here. Lastly, the manual must contain 'sufficient detail to facilitate a request for access to a record of the body, a description of the subjects on which the body holds records and the categories of records held on each subject'.[110] This is a particularly onerous requirement. Note that certain private companies are exempted from filing these manuals.[111]

2.4 *Financial statements*

'Financial statements' are defined in the 2008 Companies Act as including annual financial statements and provisional annual financial statements,[112] interim and preliminary reports, group and consolidated financial statements in the case of groups of companies, as well as financial information in a circular, prospectus or provisional announcement of results that actual or prospective creditors, holders of the company's securities, the Commission, the Panel or another regulatory authority may reasonably be expected to rely on.[113] This is not a closed list and it is recommended that the publication of any financial information of the company adhere to the requirements discussed below.

Financial statements can either be compiled internally or independently.[114] Financial statements, including annual financial statements, are independently compiled and reported when

104 S 69.
105 S 70.
106 Locke 'The application of the Promotion of Access to Information Act 2 of 2000 in consumer protection' 465.
107 S 1.
108 S 51. A copy must also be sent to the controlling body of which the private body is a member, if applicable and it must be available on the private body's website, if applicable. See reg 9(*a*).
109 See reg 9A(*b*).
110 S 51(1)(*e*).
111 See GN 1091 *GG* 34914 of 30 December 2011.
112 See para 2.4.2 below.
113 S 1.
114 Reg 27(1).

they are prepared by an 'independent accounting professional', on the basis of the financial records provided by the company and in accordance with the applicable financial reporting standards.[115] A person will be an 'independent accounting professional' when that person is a registered auditor, or a member in good standing who has been accredited in terms of section 33 of the Auditing Profession Act 26 of 2005, or is qualified to be appointed as an accounting officer of a close corporation. Additionally, the person must not have a personal financial interest in the company or a related company and must not be involved in the day-to-day management of the company or be a prescribed officer or full-time executive employee of the company or a related company, nor have been for the past three years.[116] That person must also not be related to any other person who has been involved with the company in the described manner.

Any financial statement presented by the company to any person for any reason must satisfy the requirements of section 29(1) of the Act. The form and content of such statements must adhere to the financial reporting standards applicable for that particular company.[117] At a minimum, such statements must reflect the balance sheet position of the company,[118] as well as its income and expenditure. They must reflect their publication date and the accounting period to which they apply. There must be a prominent statement on the first page of such statements indicating whether the statements have been audited, have been independently reviewed, or have not been audited or independently reviewed. The name and professional designation of the person responsible for the preparation or supervision of the preparation of the statements must be indicated in the statements. Financial statements must not be false or misleading in any manner or be incomplete, except if they comply with the requirements for summaries of financial statements set out below.[119]

Financial statements must be a fair representation of the state of affairs and business of the company, and explain the transactions and financial affairs of the company.[120] They do not constitute a mere summary of the bare accounting records of the company, but are adjusted, within limits prescribed by the applicable financial reporting standards, to incorporate information only available to management. As such they ought to coherently represent the financial affairs of the company.

A company is allowed to furnish a summary of its financial statements to a person, but then that summary must state that it is only a summary and must indicate of which financial statements it is a summary and the date of those statements.[121] Even the summary must indicate whether the financial statements summarised have been audited or independently reviewed, as well as the name and professional designation of the person who prepared the financial statements or supervised their preparation. The summary must also indicate how the reader could obtain a copy of the financial statements it represents.

Material failure to comply with the requirements for financial statements set out above is an offence, which applies to any person who was a party to the preparation, approval, dissemination or publication of such financial statements.[122] The person must have known that the statements materially failed to adhere to the requirements for financial statements. However, 'known' is defined in section 1 as not only including having actual knowledge of a matter, but

115 Reg 26(1)(*e*).
116 Regulation 26(1)(*d*).
117 See para. 2.4.1 below.
118 Equity, assets and liabilities.
119 S 29(2).
120 S 29(1)(*b*).
121 S 29(3).
122 S 29(6).

also where persons were in a position in which they reasonably ought to have had actual knowledge of the matter, or should have investigated the matter to the extent that would have provided the persons with actual knowledge of the matter, or should have taken other measures that would reasonably be expected to provide the persons with actual knowledge of the matter. The negligent failure to materially adhere to the requirements for financial statements could therefore be enough for criminal liability to follow.

A person who is party to the preparation, approval, dissemination or publication of financial statements knowing that they are materially false or misleading is also guilty of an offence. The same definition of 'knowing' set out above applies here. A person who is party to the preparation, approval, dissemination or publication of a summary of financial statements knowing that the financial statements it represents materially fail to adhere the prescribed requirements, or are materially false or misleading is guilty of an offence. It is also an offence to be party to the preparation, approval, dissemination or publication of a summary of financial statements that do not comply with the requirements set out above.

'Material' as used in these provisions is defined in the Act to mean 'significant in the circumstances of a particular matter, to a degree that is (*a*) of consequence in determining the matter; or (*b*) might reasonably affect a person's judgement or decision-making in the matter.'[123] Note that materiality carries a separate definition in international accounting standards parlance, namely that, 'information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. This materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.'[124] The latter definition could provide guidance as to what is considered significant when false or misleading information is included in financial statements.

Section 214(2) sets out when a person will be party to the preparation of a document, including a financial statement. The document must have included or have been based on a scheme, structure or form of words or numbers devised, prepared or recommended by that person. Additionally the scheme, structure or form of words or numbers must have been of such a nature that the person knew, or reasonably ought to have known, that their inclusion or use would cause the document to be false or misleading. This section read with section 26(6), where it provides for the offence of being party to the *preparation* of financial statements that materially fail to comply with the requirements for financial statements, means that a person could only be guilty of this offence if the material failure to comply with the requirements meant that the financial statements became false or misleading. It sets a higher threshold for the offence of preparing such financial statements than for the approval, dissemination and publication of such statements, and the reason for this is not apparent.

The offences for the *intentional* preparation, approval, dissemination or publication of financial statements and summaries of financial statements will probably fall under the wide ambit of section 214(2), which provides that it is an offence if a person 'with a fraudulent purpose, knowingly provided false or misleading information in any circumstances in which this Act requires the person to provide information or give notice to another person.' Such offences could lead to a fine or imprisonment for up to ten years, or a fine and imprisonment combined.[125] If the offences above were committed negligently and not fraudulently, a fine or

123 S 1.

124 See IAS 1(AC 101).30. See further the discussion in Delport, Vorster and Burdette et al. *Henochsberg* 133.

125 S 216(*a*).

imprisonment of not more than twelve months, or both a fine and imprisonment is the maximum penalty.[126]

2.4.1 Financial reporting standards

The 2008 Companies Act does not attempt to set out the finer detail of the financial reporting standards that particular companies must adhere to. Instead it provides for the appointment of a Financial Reporting Standards Council,[127] which advises the Minster of Trade and Industry on matters relating to financial reporting standards. This includes the consideration of information about the reliability and compliance with financial reporting standards and to adapt international reporting standards for local circumstances.[128]

Most of the prescriptive elements of financial reporting standards are set out in the Companies Regulations.[129] The only exception is with regards to public companies, where section 29(5)(*b*) provides for the compulsory adherence to International Financial Reporting Standards as set out by the International Accounting Standards Board[130] for all public companies. A separate set of reporting standards have been developed by the IASB to cater for the divergent needs of developing economies and small to medium sized entities. These standards are called 'IFRS for SME's'. Note that despite the provisions of section 29(5)(*b*), the Companies Regulations allow for compliance with IFRS for SME's of public companies that fall within the ambit of the scoping requirements set out in the standards themselves.[131] A third possible set of accounting standards that South African companies could adhere to, is the South African Statements of Generally Accepted Accounting Practice (SA GAAP), as adopted from time to time by the Accounting Practices Board.[132]

Every company must determine its 'public interest score'[133] at the end of its financial year end[134] in order to determine with which financial reporting standards it must comply. This is set out in regulation 27(4) as follows:

126 S 216(*b*).

127 S 203.

128 S 204.

129 Regs 26(2) and 27.

130 The International Accounting Standards Board (IASB) is the standard-setting body of the IFRS Foundation, which is a non-profit organization set up to 'to develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards' (see their website at www.ifrs.org/The+organisation/IASCF+and+IASB.htm (accessed 30 April 2012). Note that standards issued by the IASB's predecessor, namely the International Accounting Standards Committee, are known as International Accounting Standards (IAS). For more on the history of accounting standards in South Africa, see Delport, Vorster and Burdette et al. *Henochsberg* 122 – 124.

131 S 1.2 of IFRS for SME's states that small and medium entities are entities that do not have public accountability and that publish general purpose financial statements for external users. An entity has 'public accountability' in terms of s 1.3 if it trades debt or equity instruments on a public market, or is in the process of listing such instruments on a public market, or if it holds assets in a fiduciary capacity on behalf of a broad range of outsiders as its primary business.

132 See para 5.1 below. SA GAAP is currently identical to IFRS, except that the application of IFRS 1 (AC 138), 'First adoption of International Financial Reporting Standards', is not required. See Delport, Vorster and Burdette et al. *Henochsberg* 123.

133 Reg 26(2). See para 4.3.1 below for a detailed discussion.

134 Every company must indicate its financial year end in its Notice of Incorporation, which determines its annual accounting period (s 27(1) read with s 27(7)).

State owned and Profit companies	
State owned companies	IFRS, unless there is a conflict between it and the provisions of the Public Finance Management Act 1 of 1999, in which case the latter prevails
Public companies listed on an exchange	IFRS[135]
Public companies not listed on an exchange	IFRS, or IFRS for SME's provided the company meets the scoping requirements outlined in the latter
Private companies and personal liability companies, whose public interest score for a particular year is at least 350	IFRS, or IFRS for SME's provided the company meets the scoping requirements outlined in the latter
Private companies and personal liability companies, whose public interest score for a particular year is at least 100, but less than 350; or Private companies and personal liability companies, whose public interest score for a particular year is at less than 100, and whose financial statements are independently compiled	One of IFRS, or IFRS for SME's provided the company meets the scoping requirements outlined in the latter, or SA GAAP
Private companies and personal liability companies, whose public interest score for a particular year is less than 100 and whose financial statements are internally compiled	The Financial Reporting Standards as determined by the company for as long as no other Financial Reporting standards are prescribed
Non-profit companies	
Non-profit companies that are required in terms of regulation 28(2)(*b*) to have their annual financial statements audited[136]	IFRS, unless there is a conflict between it and the provisions of the Public Finance Management Act 1 of 1999, in which case the latter prevails
Non-profit companies, other than those mentioned above, which had a public interest score of at least 350	IFRS, or IFRS for SME's provided the company meets the scoping requirements outlined in the latter
Non-profit companies, other than those mentioned above, which had a public interest score of at least 100, but less than 350; or Non-profit companies, other than those mentioned above, which had a public interest score of less than 100, but which had its financial statements independently compiled	One of IFRS, or IFRS for SME's provided the company meets the scoping requirements outlined in the latter, or SA GAAP
Non-profit companies, other than those mentioned above, which had a public interest score of less than 100 and whose financial statements are internally compiled	The Financial Reporting Standards as determined by the company for as long as no other Financial Reporting standards are prescribed

135 Note that this requirement is mirrored in para 8.62(b) of the JSE *Listings Requirements*.
136 See para 5.1 below.

Companies that need only apply IFRS for SME's may instead choose to comply with the higher standard of IFRS.[137] This will be particularly beneficial for companies who intend to apply for a listing on the Johannesburg Stock Exchange ('JSE') in the immediate future, as it is a listings requirement that listed companies adhere to IFRS.[138]

2.4.2 Annual financial statements

Every company must prepare annual financial statements within six months after the end of its financial year.[139] The annual financial statements can be audited,[140] independently reviewed,[141] or in limited instances not subject to either audit or independent review.[142]

Annual financial statements include additional prescribed information not required for financial statements in general. They must include an auditor's report, if the financial statements were audited.[143] They further include a report by the directors about the state of affairs of the company, its business and profits or losses, which may include information about the group of companies, if relevant.[144] This report must include information about any matter that is material for the shareholders to understand the company's state of affairs, and by implication to understand the state of their investment in the company.[145] If the company secretary or the

137 Reg 27(3)(*a*).

138 Para 8.3 read with para 8.4 of the JSE *Listings Requirements* require that a company submit the last three years' financial information, as prescribed, to the JSE and this information must accord with IFRS and the AC 500 standards as set by the Accounting Practices Board. If the financial information of the company were not kept according to IFRS standards, at least the last two years' information must be converted to IFRS standards. It is therefore advisable to adhere to IFRS standards when a listing is foreseen, in order to facilitate the listings application and to save costs.

139 S 30(1) of the Companies Act.

140 See para 5.1 below.

141 Reg 29 sets out the requirements for independent review. The review must be conducted in accordance with ISRE 2400, which is the International Standard on Review Engagements issued by the International Auditing and Assurance Standards Board (reg 29(3)). If the company's public interest score was 100 or more (see para 4.3.1 below), a registered auditor or a person that is a member in good standing of a professional body that has been accredited in terms of s 33 of the Auditing Professions Act 26 of 2005 must perform the independent review (reg 29(4)(*a*)). If the company's public interest score is less than 100, the independent review may additionally be performed by a person who may be appointed as an accounting officer of a close corporation in terms of ss 60(1), (2) and (4) of the Close Corporations Act 69 of 1984. If the annual financial statements were independently compiled (reg 26(1)(*e*)), the independent accounting professional who compiled the statements may not review them (reg 29(4)). Reportable irregularities encountered during an independent review must be reported to the Commission (reg 29(6)). Independent review provides less assurance of the fair representation of the financial statements than a full audit.

142 In terms of s 30(2A) of the 2008 Companies Act, read with reg 28, companies need not have their annual financial statements audited or independently reviewed if every beneficial holder of securities of that company is also a director of the company. The various sections and the regulation cross-refer to each other, resulting in uncertainty over the applicability of the s 30(2A) exemption to public and state-owned companies. It is submitted that since s 30(7)(*a*) specifically refers to s 30(2)(*b*), which do not apply to public companies, the exemption is only applicable in respect of private companies. Reg 28(2) expressly requires state-owned companies to audit their financial statements and therefore in terms of s 30(2A)(a) state-owned companies cannot fall under this exemption. Non-profit companies do not issue securities, which means that they cannot be brought under the ambit of the exemption.

143 S 30(3)(*a*).

144 S 30(3)(*b*).

145 S 30(3)(*b*)(i).

auditor of the company were removed from office during that financial year and they insisted on the inclusion of a statement of the circumstances of their removal in the annual financial statements, this forms part of the directors' report.[146]

Audited annual financial statements must include particulars about the remuneration and other benefits or emoluments paid to directors or other individuals who hold any prescribed office in the company.[147] The 2008 Companies Act has opted to retain a measure of fluidity in its definition of 'prescribed officer',[148] which means that this designation is solely dependent on the degree of control and management that the particular office or individual holds in the company. It is therefore advisable for companies to annually consider which functions and persons in their organisation exercise the degree of control and management foreseen by the definition of 'prescribed officer'. Disclosure of remuneration and benefits received by these persons will then be included in the annual financial statements.

'Remuneration' for purposes of disclosure in the annual financial statements is defined in section 30(6) by way of a non-exhaustive list. It includes fees paid to directors for services rendered, including fees paid to them in return for their acceptance of the position of director. Salaries, bonuses, other performance-related payments, expense allowances for which the person is not required to account, and the value of options or rights given to the person in respect of the subscriptions to shares or other securities of the company[149] must all be disclosed. Such amounts earned in relation to services rendered in the carrying on of the affairs of any of the companies in a company group must be included, as well as fees earned for being directors of other companies in the same group of companies.[150] Financial assistance provided to a past, current or future director, or a person related to them, for the subscription of options or securities, or the purchase of such securities,[151] must be disclosed.[152] Furthermore, any loan or other financial assistance granted by the company to a past, current or future director, or a person related to them, or any loan made by a third person to such a director for which the company is a guarantor, must be disclosed.[153] Note that although only guarantee is mentioned expressly in this provision, section 45 to which it refers includes the provision of any security by the company to secure the obligations of a director as financial assistance within the meaning of the section. In other words, other forms of security apart from guarantee granted in these circumstances must be disclosed in the annual financial statements. Details about any deferred, waived or forgiven interest in relation to such a loan and the difference between the interest

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146 Ss 89(2) and (4). See also paras 5.1.6 and 5.3.3 below.

147 See also Institute of Directors in Southern Africa *King Code of Governance for South Africa* (2009) (the '*King III Code*') Principle 2.25: 'Companies should remunerate directors and executives fairly and responsibly' and Principle 2.26: 'Companies should disclose the remuneration of each individual director and certain senior executives.'

148 In terms of reg 38(1) a person is a prescribed officer of the company if that person '(*a*) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or (*b*) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.' This definition is included on authority of s 66(10) of the Companies Act, where reference is made to a 'prescribed office' instead of 'prescribed officer'. It therefore seems as if the terms are meant interchangeably in the Act. Whether a company secretary will be a prescribed officer for purposes of the Act will depend on the particular powers and functions assigned to that individual in the particular company. See Rheeder 'The evolution of the role of company secretary in South African company law'.

149 See s 42.

150 S 30(5).

151 See s 44.

152 S 30(6)(*f*).

153 S 30(6)(*g*). See also s 45.

charged to the borrower and what would reasonably be charged in comparable circumstances at fair rates in an arm's length transaction must be included in the disclosure.

The source of the remuneration and its relationship with the company is not relevant for purposes of compliance with the disclosure requirements. However, if the payment was made to the director by a third party totally unrelated to the company, the company may not have the relevant information at its immediate disposal to include in the statements. The solution to this is that the director is required to disclose all such amounts received and to certify that the contents of the disclosure made by him or her are correct.[154]

Any pensions paid by the company, or any other company in a company group, to the directors and prescribed officers, or past directors or prescribed officers of the company must be disclosed in the annual financial statements.[155] This includes contributions to pension schemes in favour of the mentioned persons.

The company must disclose any compensation paid for loss of office of directors or prescribed officers of the company.[156] The number and class of securities issued to a director or a prescribed officer, or a person related to a director or a prescribed officer, and the consideration received by those persons in return for the securities, must be disclosed.[157] Furthermore, the annual financial statements must disclose details of the service contracts of current directors and prescribed officers.[158]

Companies listed on the JSE are subject to further disclosure requirements in their annual financial statements.[159] Notably, the annual report needs to explain how the company has applied the principles of the *King Code of Governance for South Africa* (*King III*), the extent of the company's compliance with *King III*, the reasons for any non-compliance with the *Code* and the time period for which there was non-compliance.[160]

The annual financial statements must be approved by the board and signed by an authorised director.[161] A director of a company is liable to the company for any loss, damages or costs sustained by the company as a result of the director having signed, consented to or authorised the publication of any financial statements that were false or misleading in a material respect, despite knowing that the statement was false, misleading or untrue.[162] It is important to keep in mind that, with respect to annual financial statements, the additional information to be disclosed form part of the statements. Any false, misleading or untrue statements in these disclosures would therefore be included in the personal liability provision.

The annual financial statements of a company are presented to the annual general meeting of shareholders which is required in terms of section 61(7) of the Act to be held for *public* companies within prescribed time limits.[163] In the case of all other types of profit companies the annual financial statements must be presented to the first shareholders' meeting after the statements have been approved by the board.[164]

154 See in this regard Delport, Vorster and Burdette et al. *Henochsberg* 149.
155 S 30(4)(*b*) read with ss 30(5) and 30(6)(*d*).
156 S 30(4)(*c*).
157 S 30(4)(*d*).
158 S 30(4)(*e*).
159 See para 8.63 of the *Listings Requirements*.
160 Para 8.63(a) of the *Listings Requirements.*
161 S 30(3)(*c*).
162 S 77(3)(*d*)(i).
163 S 61(8)(*a*)(ii).
164 S 30(3)(*d*).

3 The meaning of enhanced accountability

The transparency and accountability requirements set out above apply to all companies. Companies that have a greater social and economic impact need to comply with additional transparency and accountability requirements, namely that their annual financial statements are subject to external auditing and that they must appoint a social and ethics committee to monitor their companies' activities with regard to social and economic development, good corporate citizenship, the environment, health and public safety, consumer relations, labour practices and any other matter that is drawn into the committee's specific mandate, and to report its findings to the annual general meeting of the company. Similarly, the audit committee of a company fulfills a monitoring function over the internal financial controls and risk management of the company. The 2008 Companies Act prescribes that a company secretary, audit committee and social and ethics committee could be appointed to support the board of directors in the compliance of their enhanced accountability. These combined measures form the enhanced accountability provisions of the Act.

Companies that are required to appoint an auditor, audit committee, company secretary or social and ethics committee and failed to do so may be served with a compliance notice from the Commission.[165] Failure to comply with a compliance notice may lead to an administrative fine, which could be up to ten per cent of the company's annual turnover, but not more than R1 million.[166]

The Commission will issue the compliance notice to the company to the effect that the company must show cause why the Commission should not proceed to convene a shareholders meeting for the purpose of appointing the relevant functionary.[167] Should the company fail to respond to the notice, or fail to convince the Commission that the board will make the appointment or convene the shareholders meeting to make the appointment within an acceptable time, the Commission may give notice to the company' security holders and convene the meeting to make the relevant appointment. In such a case the Commission may assess a pro rata share of the costs of convening the meeting to each director who knowingly permitted the company to fail to make the appointment as required by the Act.[168]

Generally one would consider this assessment to be an administrative fine, which would imply that it could only be imposed through an order of court.[169] However, the Act provides that the director may apply to the Companies Tribunal to set aside in whole or in part the assessed portion of costs,[170] which implies that the Commission will have the power to impose the assessment without court intervention. If this interpretation is correct, the assessment will not be subject to the restrictions in size that apply to administrative fines.

4 Companies that are subject to enhanced accountability

Any company could potentially be required to adhere to enhanced accountability. It is possible to provide in the company's Memorandum of Incorporation that some or all of the enhanced accountability requirements must be met.[171] The first enquiry is therefore the content of a particular company's Memorandum of Incorporation. If the Memorandum of Incorporation

165 Reg 44(2) read with s 187(2)(*g*).
166 Ss 175(1) and (5) read with regulations 163 and 164.
167 S 84(6)(*a*).
168 S 84(6)(*b*)(ii).
169 S 171(7)(*a*) read with s 175(1).
170 S 84(7). The Tribunal may also set aside the compliance notice itself.
171 S 34(2) read with s 84(1)(*c*)(ii).

does not require adherence to enhanced accountability, the 2008 Companies Act and the Companies Regulations must be consulted to determine the applicability of enhanced accountability. Different provisions apply to different types of companies, which will now be considered in turn.

4.1 *Public companies*

All public companies must have their annual financial statements audited, appoint a company secretary and an audit committee.[172] Additionally, every *listed* public company and every public company that has had a public interest score[173] of more than 500 for any two of the previous five years must appoint a social and ethics committee.

4.2 *State-owned companies*

Every state-owned company must appoint an auditor, a company secretary and an audit committee,[174] unless that company has been exempted by the Minister of Trade and Industry from compliance with these provision on request from the cabinet member responsible for that particular state-owned company.[175] The Minister may exempt a state-owned company from a particular provision by publishing a notice of such an exemption in the Government Gazette, after taking advice on the matter from the Commission, and only if an alternative regulatory regime achieves the purposes of the relevant sections of the Act at least equally as well.[176] The Minister may set limitations or conditions to the exemption in order to ensure that the purposes of the relevant sections are met equally well.[177]

The provisions of the Public Audit Act 25 of 2004 must be read with the provisions of the 2008 Companies Act when considering the specific accountability requirements of state-owned companies. The Companies Act provides that in the event of an inconsistency between the enhanced accountability provisions of the Act[178] and a provision of the Public Audit Act, the latter Act will prevail.[179] If the Auditor-General has elected to audit a state-owned company in a particular year it is not necessary for that company to also appoint an external auditor for that year.[180] If a state-owned company appoints an external auditor for a particular year, it must comply with the requirement of section 25 of the Public Audit Act to have the appointment of its auditor approved by the Auditor-General.[181] This applies additionally to any requirement the Companies Act may set for the appointment of auditors.[182]

Every state-owned company must appoint a social and ethics committee.[183]

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172 S 34(1) read with s 84(1)(*a*). Companies that are subject to the provisions of the Banks Act 94 of 1990 must comply with s 64 of that Act, which regulates audit committees separately. See also para 5.2.1 below.
173 See para 4.3.1 below.
174 S 34(1) read with s 84(1)(*b*).
175 Ss 9(2) and (3).
176 S 9(3)(*a*).
177 S 9(3)(*b*).
178 Ch 3, ss 84 – 94. Note that the social and ethics committee is dealt with in a separate part of the Act.
179 S 84(3)(*a*).
180 S 84(3)(*b*).
181 S 84(3)(*c*).
182 See para 5.1.1 below.
183 Reg 43(1).

4.3 *Private companies, personal liability companies and non-profit companies*

Private companies, personal liability companies and non-profit companies must appoint an auditor if the Act requires that they have their annual financial statements audited. Companies Regulation 28 sets out which companies must have their annual financial statements audited.

Any profit or non-profit company that in its normal business holds assets in a fiduciary capacity for persons unrelated to that company, must have their annual financial statements audited if the aggregate value of such assets for a particular financial year exceeded R5 million.[184]

Non-profit companies which were directly or indirectly incorporated by the state, an organ of state, a state-owned company, an international entity, a foreign state or a foreign company must have their annual financial statements audited.[185] Also, if a non-profit company was incorporated primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direction of any domestic or foreign state entity,[186] that company must appoint an auditor. The same applies if the non-profit company was incorporated primarily to perform any ancillary function to any statutory or regulatory function, or a direct public function as described.[187]

Any other company must have its annual financial statements audited if it has a public interest score of 350 or more, or if it has a public interest score of at least 100 and had its annual financial statements internally compiled.[188]

Private companies, personal liability companies and non-profit companies may have their annual financial statements audited if a shareholders' resolution or the board of directors so determined.[189] However, this should be seen as ad hoc appointments. The provisions of chapter 3 of the 2008 Companies Act are not applicable in these instances.

It is not necessary for these companies to appoint a company secretary or an audit committee, subject to any alternative provision in the Memorandum of Incorporation.

Every private company, personal liability company or non-profit company that had a public interest score of more than 500 for any two of the five preceding years must appoint a social and ethics committee.[190]

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184 Reg 28(2)(*a*).

185 Reg 28(2)(*b*)(i).

186 This includes an organ of state, a state-owned company, an international entity or a foreign state entity. A non-profit company exercising a public function at the direction of a *foreign company* is not expressly included in this second group of non-profit companies that need to appoint an auditor. 'International entity' is not defined in the Act or in the regulations, but since all the other entities in the list involve some state involvement, the term may be interpreted to mean that some form of international state involvement will be required of such entities. Alternatively, it may refer to international non-governmental organisations that perform a public or humanitarian function. Otherwise, it might be an oversight and could include foreign companies. In any event, the emphasis is on the exercise of a *public function* as the determining criterion. The entity must be able to directly or indirectly initiate or direct the exercise of a public function.

187 Reg 28(2)(*b*)(ii).

188 Reg 28(2)(*c*). See also para. 4.3.1 below.

189 S30(2)(*b*)(ii)(*aa*).

190 Reg 43(1)(*c*).

4.3.1 The public interest score

It is clear from the above that the public interest score of a company often stands central to the determination of whether enhanced accountability is required from that company. The public interest score is the method by which the economic and social significance of the company is determined. A high public interest score indicates that it would be 'desirable in the public interest'[191] to require the company to comply with enhanced accountability.

The public interest score is determined by the Minister of Trade and Industry through regulation, and may be varied from time to time. It is currently set out in Companies Regulation 26(2). Factors specifically indicated in the 2008 Companies Act as determinative of the economic and social impact of companies are their annual turnover, the size of their workforce and the nature and extent of their activities.[192]

The current determination of the public interest score is as follows:

4.3.1.1 *Employees*

The average number of employees for the financial year must be calculated. One point will be awarded for each employee. For example, if the company employed an average of 50 employees during the last financial year, 50 points must be added to the score.

4.3.1.2 *Third party debt*

One point will be awarded for every R1 million or portion thereof of third party debt owed by the company at the end of the financial year end. For example, if the liabilities of the company amount to R20,7 million, 21 points must be added to the score.

'Third party debt' is not defined, but it is safe to assume that this refers to the liabilities of the company generally. There is no reason to exclude liabilities owed to related companies or persons that is immediately apparent from the regulation.[193] One assumes that the annual financial statements of the company will be determinative of this figure, and that the applicable financial reporting standards will determine whether contingent liabilities should be included.

4.3.1.3 *Turnover*

One point will be awarded for every R1 million or portion thereof in turnover of the company at the financial year end. For example, if the turnover amounted to R3,5 million, 4 points must be added to the score. Again, one assumes that the financial reporting standards applicable to the company will determine how this figure is arrived at.

4.3.1.4 *Beneficial holdings in securities*

In the case of a profit company, a point must be awarded for every individual who is known by the company at the financial year end to have a direct or indirect beneficial interest in the securities of the company.

The use of the term 'individual' is regretful, since this only refers to natural persons in terms of the 2008 Companies Act.[194] This leads to uncertainty when securities are held by juristic persons. It is not clear whether holdings by juristic persons should count a single point, or not at all, or whether the natural persons who are the holders of securities in the juristic persons

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191 See s 30(2)(*b*)(i) and s 72(4)(*a*).
192 Ibid.
193 See s 2 for a description of related persons.
194 S 1.

should be counted for purposes of the score. To put it differently, one could argue that if company A holds a shareholding in company B that is calculating its public interest score, the natural persons who are the holders of securities of company A should each count one point in the calculation. This would mean that if company C held a shareholding in company A, one would also have to calculate one point for every natural person who is the holder of securities in company C.[195]

This process could become unmanageable for the company calculating the score. Furthermore, the definition of 'beneficial interest' in the Act excludes interests held by a person in a unit trust or in a collective investment scheme in terms of the Collective Investment Schemes Control Act 45 of 2002.[196] This would mean that, if in our example, company A was a collective investment scheme with 8 000 members, this shareholding will count at most one point, if juristic persons are counted at all.

This provision is therefore in urgent need of clarification. Evidently the secondary holdings of natural persons in juristic persons who invest in companies indicate an enhanced economic and social impact of the calculating company, which is the overriding criterion in determining the public interest score. However, currently there is a blanket exclusion of collective investment schemes from this calculation. There is also no immediately apparent reason why a juristic person should not be awarded at least one point on the score.

Individuals who hold a direct or indirect *beneficial interest* in the securities of the company must be calculated. 'Beneficial interest' is defined as follows:[197]

> when used in relation to a company's securities, means the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to –
>
> (*a*) receive or participate in any distribution in respect of the company's securities;
>
> (*b*) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company's securities; or
>
> (*c*) dispose or direct the disposition of the company's securities, or any part of a distribution in respect of the securities, but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act 45 of 2002)

Section 56(2) of the Companies Act contains a list of person that will be regarded as having a beneficial interest in the securities of the company. The list includes the holding companies of subsidiaries that hold beneficial interests in another company.[198] Subsidiary relationships are set out in section 3 of the Act. A company is a holding company of another company if that company, one or more of its subsidiaries, or one or more of the nominees of that company or its subsidiaries, alone or in combination, have the ability to directly or indirectly exercise, or

195 Cassim, Cassim and Cassim et al. *Contemporary Company Law* 605 seem to favour this approach, although they do not fully describe the implications of such an interpretation.

196 S 1 of the 2008 Companies Act. Section 1 of the Collective Investment Schemes Control Act 45 of 2002 defines a collective investment schemes as 'a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which- *(a)* two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and *(b)* the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a collective investment scheme authorised by any other Act.'

197 S 1 of the 2008 Companies Act.

198 S 56(2)(*d*).

control the exercise, of the majority of the voting rights associated with the issued securities of the company. This could be pursuant to a shareholder agreement or otherwise and is not in any way dependent on a shareholding in the company. A company could similarly be the holding company of another company if that company, one or more of its subsidiaries, or one or more of the nominees of that company or its subsidiaries, alone or in combination, have the right to appoint or elect, or control the appointment or election of directors of that company who control the majority of voting rights at the meeting of the board. We therefore see that the group of persons potentially included as the holders of beneficial interests in securities are very wide and not reliant on direct holdings of securities.

The Act attempts to alleviate the burden of identifying beneficial holders by the company by placing a duty on the registered holder of the security to disclose to the company the identity of any beneficial holders of the securities held in the company.[199] Since the company need only include the number of beneficial holders of securities *known* by the company, it appears that only beneficial holders disclosed by nominee holders need to be calculated for purposes of the public interest score. However, the Act does not require disclosure of the number of *individuals* that are the holders of securities in the beneficial holders if they are juristic persons,[200] which means that the calculating company may inevitably need to make further enquiries from these holders before they can calculated the score.

Note that all individuals that are holders of securities must be counted,[201] not only shareholders.

4.3.1.5 *Members of non-profit companies*

One point must awarded for each member of a non-profit company, or if the member is an association of persons, for each member of that association.

'Member' is defined in section 1 of the Act, when not used in the context of close corporations or non-profit companies, as meaning a person that is a constituent part of the entity referred to. The possible dilemma presents itself in the situation where a profit company is a member of a non-profit company, a scenario that is not uncommon.

'Member' is not a term used in relation to profit companies in the 2008 Companies Act.[202] Taking into account the definition of 'member' set out above, one could possibly argue that the shareholders of a profit company that are natural persons could be counted here. However, it seems doubtful whether the holders of other securities of a profit company would ordinarily be seen as persons forming a constituent part of a profit company. There is no sound reason why

199 S 56(3). Also refer to ch 9 paras 2 and 5 for criticism of this provision. State-owned companies and even certain private companies that are regulated companies for purposes of the takeover provisions (s 117(1)(*i*)) are required to keep a register of disclosure of beneficial interests (s 56(7)(*a*)). It is unclear from the context of s 56 whether the registered holder will be required to make these disclosures or whether the company must enquire about such interests on its own. It is submitted that from a practical point of view the duty to disclose should rest with the registered holder, as in the case of public companies.

200 Reg 32(3) also does not require the disclosure of this information. The addition of a requirement to periodically disclose the number of natural persons who are holders of securities in the beneficial holders of securities may alleviate the burden on the calculating company. However, in the end the increased administrative burden of calculating natural persons with interests in companies will have to be borne by someone.

201 'Securities' is defined in s 1 to mean 'any shares, debentures, or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company'.

202 In the Companies Act 61 of 1973 the term 'member' was used to refer to a shareholder of a company entered in the register of members of the company. See ss 103 and 105.

such persons should be excluded from the calculation for non-profit companies, when they are expressly included for the calculation in the case of profit companies.[203] An express consideration of this scenario in the regulation would have been preferable.

4.4 *Close corporations*

Amendments to the Close Corporations Act 69 of 1984 brought about by the 2008 Companies Act have considerably extended the accountability requirements for close corporations.[204] Previously close corporations enjoyed a relaxed accountability regime in the sense that their annual financial statements did not have to undergo external auditing. Instead they had to appoint an accounting officer,[205] who played a limited monitoring role.[206]

Close corporations now need to comply with the same accountability requirements as private companies. The financial reporting standards applicable to close corporations are the same as those for private companies. The compilation of annual financial statements must now be done within six months after the end of their financial year end, bringing this requirement in line with the requirement for companies generally.

If the close corporation in the ordinary course of business holds assets in a fiduciary capacity for persons who are not related to it, and the aggregate value of such assets held at any time during the financial year exceeds R 5 million, its annual financial statements must be audited.[207] In all other cases, close corporations must determine their public interest score in order to determine whether they need to have their annual financial statements audited.[208] If their annual financial statements need not be audited, the statements must undergo independent review.[209] The exemption from auditing and independent review applicable to private companies, where every holder of a beneficial interest in the securities of the company is also a director of the company,[210] does not apply to close corporations. This means that close corporations are actually subject to more onerous accountability requirements than newly incorporated private companies with similar ownership and management structures.

If a close corporation must appoint an auditor, the provisions of Chapter 3 of the Act applicable to private companies also apply to that close corporation.[211]

The continued role of the accounting officer is uncertain after the amendment of the Close Corporations Act. Essentially the accounting officer fulfilled a form of independent review before, but now it seems that the accounting officer could be used by the close corporation to independently compile the annual financial statements of the close corporation.[212] In such a case the accounting officer may not perform the independent review, which will have cost implications.[213] Internally compiled annual financial statements may be independently reviewed by an accounting officer.

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203 See para 4.3.1.4 above.
204 See specifically Sch 3 item 5 of the 2008 Companies Act.
205 S 59 of the Close Corporations Act.
206 S 62 of the Close Corporations Act.
207 Reg 28(2)(*a*).
208 See para 4.3.1 above.
209 See para 2.4.2 above.
210 S 30(2A). See further para. 2.4.2 above.
211 Ss 90 – 93. See also para. 5.1 below.
212 Regs 26(1)(*d*) and (*e*).
213 Reg 29(5).

Close corporations may only have a maximum of ten members, but there is no restriction on the size of their operations. Taking into account the ethos underlying enhanced accountability, there is no reason to exclude close corporations from their reach. However, by the same token there is no sound reason to subject this form of business to a higher requirement compared to private companies. It is therefore submitted that the section 30 (2A) exemption ought to also be available to close corporations.

The sections of the Act providing for the social and ethics committee are not applicable to close corporations.

5 Elements of enhanced accountability

Each of the elements of enhanced accountability will now be considered in turn. They are the external auditor, the audit committee of the company, the company secretary and the social and ethics committee of the company.

5.1 *Auditors*

An audit is an examination, measured against the financial reporting standards applicable to the audited company, of the financial statements of the company.[214] It is accompanied by an opinion by the auditor of whether the financial statements are a fair representation of the affairs of the company and whether the statements comply with the applicable financial reporting standards. An audit therefore enhances the credibility of the annual financial statements of the company as reported on by the management of the company.[215] Furthermore, an audit has a monitoring function in that it ensures compliance with the applicable financial reporting standards. The auditor also has the duty to report a reportable irregularity when it emerges during the audit.[216]

Auditors in South Africa are regulated by the Independent Regulatory Board for Auditors ('IRBA').[217] Only auditors registered by the IRBA are allowed to be appointed as a company's external auditor.[218] Chartered accountants are usually also members of the South African Institute of Chartered Accountants ('SAICA').[219]

The IRBA sets strict qualification requirements before individuals or firms may be registered as auditors. [220] It is the duty of the IRBA to ensure that registered auditors have the proper professional competence to meet the expectations of its relevant stakeholders and to serve the public interest and the needs of the economy.[221] To this end the IRBA requires of registered auditors to embark on continuing professional development and to report annually about their efforts in this regard.[222]

214 S 1 of the Auditing Professions Act 26 of 2005.
215 See also Wixley and Everingham *Corporate Governance* 171.
216 See para 5.1.5.1 below.
217 S 3 of the Auditing Professions Act.
218 S 90(2)(*a*) of the Companies Act read with s 1. See ss 37 – 40 of the Auditing Professions Act for the registration requirements for auditing firms and individual auditors. Chartered accountants who do not perform auditing functions do not need to register with the IRBA.
219 For a very informative history about SAICA, visit their website at https://www.saica.co.za/About/SAICAHistory/tabid/70/language/en-ZA/Default.aspx. (accessed 6 June 2012).
220 See Independent Regulatory Board for Auditors (IRBA) *Manual of Information* 2-4 – 2-11.
221 Ss 2(*d*) and 4(1)(*c*) of the Auditing Profession Act; IRBA *Manual of Information* 2-5.
222 IRBA *Manual of Information* 2-12. See also section 130 of the IRBA *Code of Professional Conduct for Registered Auditors* (2010) published in BN 89 *GG* 33305 of 18 June 2010.

5.1.1 Appointment

A public company and a state-owned company must appoint an auditor at its incorporation and every year at its annual general meeting.[223] A private company, personal liability company or non-profit company that has to appoint an auditor in terms of the Companies Regulations, or because it meets the requisite public interest score,[224] or if such a company's Memorandum of Incorporation requires the appointment of an auditor, must appoint the auditor at the first annual general meeting of the company after the requirement first applies and at every subsequent annual general meeting.[225] Close corporations do not have annual general meetings, but it may be assumed that the auditor can be appointed at the first properly constituted meeting of the members of the close corporation after the requirement first becomes applicable, and thereafter annually. If the appointment of an auditor is applicable to a company at its incorporation, the auditor must be appointed at that time.[226]

The most important criterion for a person's appointability as a company's auditor is that he or she must have *independence* from the company. If the company has an audit committee, the audit committee needs to assess a candidate's independence from the company.[227] In this regard the 2008 Companies Act contains a list of persons who are prohibited from being appointed as a company's auditor, because of their association with the company.[228] Additionally, a list of factors is included in the Act to assist the audit committee in their assessment of the candidate's independence.[229] The audit committee's acceptance of a candidate's independence is phrased in peremptory terms in the Act.[230] An appointment with which the audit committee is not satisfied based on lack of independence is invalid.

The persons listed below are prohibited from being appointed as auditors of a company if they fell within these descriptions in any of the five financial years immediately preceding that date of appointment of the auditor:[231]

- directors or prescribed officers of the company;
- employees or consultants of the company who have been engaged in the maintenance of the company's financial records or in the preparation of the company's financial statements for more than one year;
- a director, officer or employee of a person appointed as the company secretary of the company;
- a person who regularly performs the duties of accountant or bookkeeper, or who performs related secretarial work, and that person's partners or employees;
- any persons related to the persons listed above.

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223 S 90(1) of the 2008 Companies Act.
224 See para 4.3.1 above.
225 S 90(1A). Note that in terms of s 61(7) only public companies are required to have annual general meetings, which could lead to interpretational problems when determining the time of appointment of company auditors for companies other than public companies.
226 S 90(4) provides that if such an appointment is not made, the directors of the company must appoint the company's first auditor within 40 days after the date of incorporation. This could only be applicable to companies other than public companies or non-exempted state-owned companies, since their annual financial statements must always be audited.
227 S 90(2)(*c*).
228 S 90(2)(*b*).
229 S 94(8).
230 S 90(2)(*c*) read with s 94(9).
231 S 90(2)(*b*).

Additionally, the audit committee must consider whether the auditor receives any direct or indirect remuneration or other benefit from the company or any of its related companies, apart from its auditing fees and any approved non-auditing services, which could hamper his or her independence.[232] Previous appointment as the company's auditor and the extent of consultancy or advisory work undertaken by the auditor for the company or for other companies in a company group may also have prejudiced the auditor's independence and must be taken into account by the audit committee.[233]

The IRBA Code of Professional Conduct for Registered Auditors is specifically relevant in the determination of independence and potential conflicts of interest.[234] Acknowledging that an auditor's duty is not exclusively towards the company that appoints him or her, but that an auditor fulfils his or her functions in the public interest, the Code sets five fundamental principles for proper conduct, namely integrity; objectivity; professional competence and due care; confidentiality; and professional conduct.[235] The fundamental principle of objectivity is the one most closely associated with auditor independence. It requires registered auditors 'not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others'.[236] In Part B of the Code more specific threats to compliance with the fundamental principles of conduct are considered, without attempting to foresee all possible threats. The scenario's set out in Part B could be of specific assistance to an audit committee in identifying potential conflicts of interest and other threats to the independence of auditors. It is therefore important that members of the committee familiarise themselves with its content.

A company may appoint a firm to be its auditor, but in that situation an individual must be determined by that firm who will be responsible for performing the functions of auditor and who will be accountable for the audit.[237] The audit committee must be satisfied that the determined individual complies with the independence criterion as described above.[238] A change in the membership of a firm does not in itself create a vacancy in the office of the auditor,[239] but if less than half of the members of the firm remain after the change, that change will constitute a resignation of the firm as the auditor of the company.[240]

An incumbent auditor may be reappointed at the annual general meeting without the adoption of a new resolution.[241] However, this is not possible if the retiring auditor is no longer qualified or willing to accept the appointment and has notified the company of this fact,[242] or if the rotation period of the auditor has lapsed.[243] Automatic reappointment is also excluded if the audit committee objects to the reappointment, or if the company has received notice of a proposed resolution to appoint a different person as the company's auditor.

232 S 94(8)(*a*).
233 S 94(8)(*b*).
234 Prescribed in terms of s 4(1)(*c*) of the Auditing Professions Act. See also s 94(8)(*c*) of the Companies Act. The Code of Conduct became effective on 1 January 2011. It is based on the International Ethics Standards Board of Accountants *Code of Ethics for Professional Accountants* (2010) with minor variations where necessary. A copy of the Code is included in the IRBA *Manual of Information*, available at www.irba.co.za. (accessed 6 June 2012).
235 Code of Professional Conduct for Registered Auditors Part A. See especially section 100.5.
236 S 120.2 of the Code.
237 S 44(1)(*a*) of the Auditing Professions Act.
238 S 90(3) of the 2008 Companies Act.
239 S 91(4).
240 S 91(5).
241 S 90(6).
242 The resignation of auditors is regulated in ss 89 and 91.
243 See para 5.1.2 below.

If, for any reason, the auditor is not appointed or reappointed at the annual general meeting of the company, the directors must fill the vacancy within 40 business days after the annual general meetings was held.[244] The audit committee must be notified of the proposed auditor and has five business days to consider the proposal and to reject it if necessary. If the proposed auditor is not rejected by the audit committee within five business days, the board may proceed to appoint the proposed person as the company's auditor.[245]

If the company is listed on the JSE, the auditor must be accredited on the JSE List of Auditors.[246]

5.1.2 Rotation

The individual appointed as the auditor of a company must be rotated every five years.[247] If the company appointed a firm as its auditor, the individual determined by that firm who will be responsible for performing the functions of auditor and who will be accountable for the audit must be rotated at least every five years.

The reasoning behind this requirement has again to do with maintaining the independence of the appointed auditor. An association with a particular company that lasts too long may lead to the impaired objectivity of the auditor. The IRBA Code of Professional Conduct for Registered Auditors refers to this threat as 'familiarity'.[248] The Code also indicates that a long-standing professional relationship between the auditor and the client company may lead to what it terms 'self-interest threats'. The auditor may become too dependent on the fees flowing from its relationship with the company, thereby impairing his or her objectivity.

If an individual has served as a company's auditor for two consecutive financial years and then ceases to be the company's auditor, that individual may not be appointed again for at least two further financial years after the end of his or her appointment.[249] This prevents the practice of circumventing the rotation requirement through brief periods of resignation.

A company that has appointed joint auditors must manage the rotation of the auditors in such a manner that they do not relinquish their office in the same year.[250]

5.1.3 Non-auditing services

Most auditing firms do not only provide auditing services to clients, but also offer a range of additional services. For this reason the definition of 'professional services' in the IRBA Code of Professional Conduct for Registered Auditors includes not only audit, review and other assurance related services, but also taxation services and advisory services.[251] Advisory services include advice on accounting and financial management, business management, internal audit, corporate finance, corporate recovery, financial risk management, information technology and forensic audit.

These non-audit services usually form a lucrative part of the business of auditing firms. The extensive engagement of the company's appointed auditor to perform non-auditing services

244 S 90(7).
245 S 91(3). This is also the procedure followed to fill a casual vacancy of auditors.
246 See paras 3.86 – 3.88 read with paras 22.1 and 22.3 of the JSE *Listings Requirements*. Sch 15 sets out the eligibility criteria for auditors to be accredited.
247 S 92(1).
248 See s 290.150 of the Code.
249 S 92(2) of the 2008 Companies Act.
250 S 92(3).
251 S 1.5 of the Code.

may compromise the independence and objectivity of the auditor in its auditing functions, since the firm may be anxious that a disgruntled company may terminate the non-auditing services it engaged from the firm.[252] The Code refers to this as a self-interest threat to objectivity.[253]

Some non-audit services may create threats to the objectivity or confidentiality principles, when for instance the auditor performs services to two companies which are in competition with each other, or services which form the subject of a dispute between two companies that engage the same auditor.[254]

The Code places a duty on the registered auditor to evaluate these threats and to reduce them to an acceptable level when they are present.[255] If the threat cannot be reduced to an acceptable level, the non-audit services must not be provided by the auditor.[256] Therefore, if a company does not need to appoint an audit committee even though it must have it annual financial statements audited, the duty will solely rest with the auditor to ensure that he or she manages threats to their independence.

Additionally, if a company must appoint an audit committee, that committee is tasked with determining the nature and extent of the non-audit services that a company's auditor may perform for the company or for a related company.[257] The extensive guidance provided to registered auditors in terms of the Code may also serve as a guide to the audit committee in the fulfilment of this task. An auditor is not allowed to provide any services excluded by the audit committee to the company.[258]

5.1.4 Rights

A company's auditor has the right to inspect all the accounting records of the company, as well as all books and documents of the company. The auditor may require from the company's directors and prescribed officers any explanations or other information necessary to perform it duties.[259] Furthermore, the auditor has a right of access to the financial statements of any subsidiary of the company that appointed it and it may require such information and explanations from the directors or prescribed officers of the subsidiaries in connection with the financial statements or any accounting records, books or documents of the subsidiaries as is necessary for the proper performance of its duties.[260]

The auditor has the right to attend any general shareholders meetings and to receive all notices and other communications relating to such meetings. He or she has the right to be heard at such a general shareholders meeting on any part of the business of that meeting that concerns the auditor's duties or functions in the company.[261]

5.1.5 Duties

The duties of an auditor are set out in section 44 of the Auditing Professions Act 26 of 2005. What is essentially required of an auditor is that he or she expresses an opinion on two matters,

252 S 290.156 of the Code.
253 S 200.4 of the Code.
254 S 220.1 of the Code.
255 Ss 220.2, 280.4 and 290.158 of the Code.
256 See also s 9(3)(*a*) of the 2008 Companies Act.
257 S 94(7)(*d*).
258 S 93(3)(*b*).
259 S 93(1)(*a*).
260 S 93(1)(*b*).
261 S 93(1)(*c*).

namely whether any financial statement or any supplementary information attached thereto 'fairly presents in all material respects the financial position of the entity and the results of its operations and cash flow';[262] and secondly, whether the financial statements are in all material aspects properly prepared in accordance with the applicable accounting and financial reporting framework. The auditor may only express these opinions if it is satisfied of the following criteria:[263]

- that the audit was carried out free from any restrictions and in compliance with the relevant auditing pronouncements;
- that the auditor has satisfied him or herself of the existence of all the assets and liabilities reflected in the financial statements, by such means and methods that are reasonably appropriate with regard to the size of the company;
- that proper accounting records have been kept by the company in one of the official languages of the country as to reflect and explain all transactions with the company, and all its assets and liabilities, correctly and adequately;
- that all information, vouchers and other documents that were necessary for the proper functioning of the auditor were obtained by the auditor;
- that there was no reason to report a reportable irregularity[264] to the Regulatory Board which became apparent to the auditor during the course of the audit or otherwise during the accounting period to which the financial statements relate
- that all laws relating to the audit of the financial statements of that company have been complied with;
- that the auditor is satisfied with the fairness and correctness of the financial statements, as far as is reasonably practicable taking into account the size of the company and the nature of the audit.

If any of these criteria have not been met, the auditor must qualify the opinion in the manner appropriate in the circumstances.[265] The auditor must indicate if he or she, or another member of the auditing firm of which he or she is a member, was responsible for the keeping of the books, records or accounts of the company.[266]

The auditor of a company listed on the JSE has certain additional duties as set out in section 22 of the *Listings Requirements*.[267] It is further possible that the company's Memorandum of Incorporation or the auditor's contract of appointment specify additional duties.[268] The auditor must ensure that he or she is aware of all their duties.

5.1.5.1 *Duty to report on irregularities*

If the company's auditor is satisfied, or has reason to believe, that a reportable irregularity has taken place, the auditor must immediately inform the Regulatory Board in writing.[269] The auditor must provide such information and particulars about the irregularity as he or she

262 S 44(2)(*a*).
263 S 44(3).
264 See para 5.1.5.1 below.
265 S 44(2).
266 S 44(4) and (5).
267 Paras 22.5 – 22.6.
268 See also Delport, Vorster and Burdette et al. *Henochsberg* 345.
269 S 45(1).

deems appropriate in its notice to the Regulatory Board.[270] 'Reportable irregularity' is defined as follows in the Auditing Professions Act:[271]

> any unlawful act or omission committed by any person responsible for the management of an entity, which –
>
> (*a*) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or
>
> (*b*) is fraudulent or amounts to theft; or
>
> (*c*) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof

Only acts or omissions by individuals can lead to a reportable irregularity in terms of this definition. Unlawful acts by the company as an entity is not a reportable irregularity as defined. The Act requires the auditor to undertake such investigations, and consider all information from any source, as is necessary to support the report.[272]

Within three days after sending the report to the Regulatory Board, the auditor must in writing inform the management of the company of the report and must attach the report to the notice.[273] The auditor must take all reasonable measures to discuss the report with the company's management. This must happen within a reasonable time, but at least within 30 days from the date on which the report was sent to the Regulatory Board.[274] Management must be given the opportunity to make representations about the matters raised in the report.[275] It seems from the context of the following provisions in the Act, that management may then be afforded an opportunity to rectify the acts or omissions and their consequences as raised in the report.[276]

After engaging with management, but not later than 30 days after sending the report to the Regulatory Board, the auditor must report back to the Regulatory Board about the status of the reportable irregularity.[277] This can take one of three forms. The auditor may report that the irregularity in fact did not take place. Alternatively, the auditor may report that although a reportable irregularity did take place, it is no longer taking place and that adequate steps have been taken to address any harm that could have resulted from it. It is also possible that the auditor will report to the Regulatory Board that the reportable irregularity is in fact continuing. In each case the auditor must present such information as is necessary to support the report. If necessary, the Regulatory Board will then inform the appropriate regulator of the reportable irregularity.[278] In the case of companies, this will usually be the Commission.

The duty of the auditor is to verify the financial statements of the company. If this task is fulfilled with proper care, skill and diligence, there is no additional duty on an auditor to discover fraud or irregularities.[279] Only reportable irregularities detected in the course of the audit need to be reported in the described manner.

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270 S 45(1)(*b*).
271 S 1.
272 S 45(5).
273 S 45(2).
274 S 45(3)(*a*).
275 Se 45(3)(*b*).
276 See s 45(3)(*c*)(i)(*bb*).
277 S 45(3)(*c*).
278 S 45(4).
279 See *Tonkwane Sawmill Co Ltd v Filmalter* 1975 (2) SA 453 (W) at 455E-G: 'An audit is not a substitute for management control and no guarantee is given or to be implied that an audit will necessarily dis-

continued

5.1.6 Removal

If a company auditor is removed from office by the board, he or she may insist on the inclusion of a statement in the annual financial statements of the company relating to that financial year setting out the auditor's submission of the circumstances that led to his or her removal.[280] The statement must be of a reasonable length. The removed auditor must inform the company in the notice of his or her intention to have the statement included. The notice must include the statement to be included in the annual financial statements and must be sent to the company not later than the financial year end in the year that the removal took place.[281] The statement forms part of the directors' report of the annual financial statements.[282]

5.2 *Audit committee*

The *King III Report* considers the functioning of an independent audit committee as vital for the proper corporate governance of a company.[283] It is critical in 'ensuring the integrity of integrated reporting and financial controls, the proper identification and management of financial risks and the integrity of the reporting practices'.[284]

The 2008 Companies Act provides that the functioning of the audit committee does not reduce the functions or duties of the board of directors of the company, *except* with respect to the appointment, fees and terms of engagement of the external auditor of the company.[285] It therefore seems as if the board of the company will not have the power to overrule a decision of the audit committee on the latter three aspects. Note that a different auditor than the one recommended by the audit committee may be appointed by the shareholders in general meeting, but then subject to the audit committee's approval of the independence of that auditor.[286] On all aspects apart from the appointment, fees and terms of engagement of the company's auditor, the audit committee reports to the board of the company, which take the final decision on a particular matter.

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close fraudulent misappropriations. Responsibility for the financial control and accounts of an undertaking rests upon those who are entrusted by the proprietors with its direction and management. It is for them to ensure that adequate records are maintained and that such accounts as may be required by statute or for other reasons, are prepared so as to give a true and fair view and such information as may be required by law or is considered desirable or useful as the particular circumstances may suggest. Management is responsible for safeguarding the assets of the undertaking and is not entitled to rely upon the auditor for protection against defects in its administration or control.' The liability of auditors for the negligent performance of their duties falls outside the scope of this discussion. For more on this aspect, see Delport, Vorster and Burdette et al. *Henochsberg* 348 – 351.

280 S 89(2).

281 S 89(3).

282 S 89(4).

283 Principle 3.1. Also see Principles 2.6 and 3.1 of the *King III Code*: 'The board should ensure that the company has an effective and independent audit committee.'

284 Audit committees are dealt with in ch 3 of the *King III Report*.

285 S 94(10).

286 S 94(9). See also para 5.1.1 above.

5.2.1 Appointment

Public companies and state-owned companies must appoint an audit committee, as well as any company that has as a requirement in its Memorandum of Incorporation the appointment of an audit committee.[287]

287 S 84(1).

A company's audit committee is comprised of at least three members. Every member of the audit committee must also be an independent non-executive director of the company.[288] In many cases this requirement will determine the minimum number of directors that a company must appoint to its board.[289] For instance, a private company only needs to appoint one director. However, if the Memorandum of Incorporation of the private company provides that the company must appoint an audit committee, the company will have to appoint at least four directors, of whom at least three will have to be independent non-executive directors. The *King III Report* recommends that the chairman of the audit committee also be an independent non-executive director, and a different person to the chairman of the board.[290]

The criteria for determining the independence or the non-executive nature of the directors are set out in section 94(3)(*b*). Directors will only be eligible for appointment to the audit committee if they have not been involved in the day-to-day management of the company's business during the past financial year. Furthermore, they cannot be appointed to the audit committee if they are prescribed officers or full-time employees of the company, or of a related company, or have been such officers or employees during the previous three financial years. Lastly, persons who are material suppliers or customers of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality and objectivity of the director would be compromised by that relationship, are excluded from appointment to the audit committee.

The appointed directors must furthermore not be related to any person who would fulfil these criteria. Relatedness here has not been extended to include directorships held in juristic persons who may be material suppliers or customers of the company. The definition of relatedness in section 2 provides that an individual is only related to a juristic person if the individual directly or indirectly controls the juristic person. 'Control' is then defined to mean the direct or indirect ability to exercise control over the majority of the voting rights associated with the securities of the company, or the right to appoint or elect, or to control the appointment or election, of the majority of the directors of the company who control a majority of the votes at a meeting of the board.[291] It may further mean that the person has the ability to materially influence the policy of the company in a manner comparable to a person who would in ordinary commercial practice be able to exercise 'control' as set out in the previous point.

Neither of these two elements is wide enough to include a directorship held by a single person on a board of a company. In section 75 of the 2008 Companies Act the definition of relatedness for purposes of identifying conflicting interests of directors is expressly extended to include other companies which have appointed the director to their boards.[292] One could argue that a similar extension for purposes of determining the independence of directors when they are appointed to the audit committee of a company would have been warranted. An individual will not often be a material supplier or customer of a company. It is more probable that such a supplier or customer will be another company.

Furthermore, I submit that the objective consideration of whether *any relationship* between a director and any other party would compromise the integrity, impartiality, and objectivity of the director should have been an overarching factor in determining the independence of a director. While family relationships are expressly included in the definition of relatedness

288 S 94(4). This corresponds with the recommendations of the *King III Code* in Principle 3.2.

289 See s 66(2) for the minimum number of directors that a specific type of company must appoint.

290 See Principle 3.3. See also Principle 3.3 of the *King III Code* and Principle 3.2, recommended practice 3.2.3.

291 S 2(2)(*a*)(ii).

292 S 75(1)(*b*).

between individuals,[293] friendship is not so included. It is foreseeable that the executive directors of a company could appoint close friends to the audit committee, and other committees that require independence, in which case such persons could not be said to have uncompromised impartiality or objectivity. As the criteria currently stands, friendship with executive directors will not bar appointment to the audit committee of the company.

The consideration of independence in the *King III Report* is to my mind much preferable.[294] It states that 'independent non-executive directors should be independent in fact and in the perception of a reasonably informed outsider. Independence is, however, more a state of mind than an objective fact and perception.'

The audit committee is elected annually at the company's annual general meeting.[295] This sets the audit committee apart from other board committees, which are appointed by the board. It is submitted that the independence of the incumbent members must be assessed each year if they are nominated for re-election. If a vacancy occurs on the audit committee of a public or state-owned company, the board must fill the vacancy within 40 business days after the vacancy arises.[296]

The Minister of Trade and Industry is tasked with prescribing minimum qualification requirements for members of the audit committee to ensure that the committee comprises of persons with adequate and relevant knowledge and experience for them to fulfil their function.[297] The current qualification requirements for members of the audit committee are set out in such broad terms that they do not make sense. Regulation 42 provides that at least one third of the members of the committee must have academic qualifications or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resources management. Taking into account the functions of the audit committee, which are discussed in detail below,[298] the mandatory inclusion of qualifications or experience in any field except those strictly relevant to the monitoring of internal and external assurance providers seems absurd. Furthermore, it is unclear what is meant by the reference to 'industry; and 'public affairs', or how broad experience of these could assist the functioning of an audit committee.

To my mind the qualifications and experience of at least one third of the members of the audit committee should be in finance and accounting.[299] A sound understanding of the financial reporting standards applicable to most companies in South Africa will include an understanding of the principles of integrated reporting.[300] Any specific issues about which the committee needs more specialised input may come from sub-committees or from individuals approached by the committee.

These observations are supported by the recommendations of the *King III Report*, which broadly provides the following guidelines for the qualifications of members of the audit committee:[301]

- a good collective understanding of financial risks, financial and sustainability reporting and internal controls, appropriate for the company's size, circumstances and industry;

293 See s 2(1)(*a*).
294 See annex 1.3.
295 S 94(2).
296 S 94(6).
297 S 94(5).
298 See para 5.2.2 below.
299 See also Principle 3.1 para 4.2 of the *King III Report*, where an appropriate level of financial literacy is set as a recommended qualification.
300 See Principle 3.4 of the *King III Code*: 'The audit committee should oversee integrated reporting.'
301 Principle 3.2 paras 6 – 8.

- sufficient and relevant knowledge of corporate law;
- a thorough understanding of the financial reporting standards applicable to the company.

5.2.2 Duties

The audit committee has a reporting duty and a monitoring duty. The committee must prepare a report, which is included in the annual financial statements for that year, wherein it describes how it carried out its functions during that year, whether it is satisfied of the independence of the auditor of the company, and commenting on the financial statements, accounting practices and the internal financial controls of the company in any manner it deems appropriate.[302]

The monitoring duties of the audit committee entails the monitoring of the internal assurance providers of the company, namely its internal auditing and risk management systems, and the monitoring of its external assurance provider, namely the auditor of the company.[303] Each of these functions is considered in more detail below. The audit committee must serve as a bridge between these two assurance providers, to ensure that the combined assurance provided addresses all significant risks to the company and that sufficient controls have been put in place to mitigate against such risks.[304]

The audit committee may be required by the board to fulfil additional oversight functions not specifically set out in the 2008 Companies Act.

5.2.2.1 *Monitoring of internal assurance providers*

The 2008 Companies Act tasks the audit committee with the monitoring of the accounting practices and internal audit of the company, the content of the company's financial statements, the internal financial controls of the company and of any related matter.[305] It is also the body that receives and deals with complaints relating to these matters, whether originating inside the company or externally.

While the board of a company is in the final instance responsible for the financial reporting of the company,[306] the audit committee assists the board in this task. In this regard the *King III Report* sees a role for the audit committee in considering any subjective need of the board to present the financial statements in a more favourable light than objectively the case.[307] It mentions two examples, namely to counter perceived negative market sentiment or when reporting on performance targets on which bonus payments are dependent.

The audit committee should consider the appropriateness of the expertise, resources and experience of the senior management of the company responsible for financial matters.[308] This will include a consideration of the appropriateness of the expertise, resources and experience of the chief financial officer of a company. *The King III Report* recommends that this be undertaken at least annually.

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302 S 94(7)(*f*). See also Principle 3.10 of the *King III Report* and Principle 3.10 of the *King III Code*.

303 See Principle 3.5 of the *King III Code*: 'The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities.'

304 Principle 3.6 paras 50 and 51 of the *King III Report*.

305 S 94(7)(*g*).

306 S 30(3)(*c*) and s 77(3)(*d*)(i). Principle 2.10 of the *King III Code* states that: 'The board should ensure that there is an effective risk-based internal audit.' See also para 2.4 above.

307 See Principle 3.4 para 23.

308 Principle 3.5 para 38 of the *King III Report*. See also Principle 3.6 of the *King III Code*: 'The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function.'

The design, implementation and effectiveness of the company's system of internal financial controls must be reviewed at least annually.[309] This task is undertaken by the company's management by conducting suitable tests on the system. They must then report their findings back to the audit committee. The audit committee must determine the scope of the review and they must ensure that management has adequate capacity to conduct such a review.[310] While this internal review must be documented, neither the *King II Report* nor the Act requires the results to be made public. It is solely meant for internal use.

If the review shows that financial reporting inadequacies have led, singularly or in combination with other inadequacies, to material financial loss, fraud or material errors, this should be disclosed to the board.[311] The board ought then to include such findings in its annual report to shareholders. The *King III Report* does not require the board to include a detailed list of such findings, but rather to describe any material failures in the financial reporting of the company.

The audit committee is responsible for the internal audit of the company, which includes matters outside of financial reporting. Chapter 5 of the *King III Report* sets out the function of the internal audit of a company.[312] The following responsibilities are placed with the internal audit of a company in terms of the *King III Report*:[313]

- it must review the company's governing process, including its ethics;
- it must perform and objective assessment of the company's risk management and other aspects of the company's internal controls;
- it must systematically analyse and evaluate the company's business processes and associated controls;
- it must be a source of information of instances of corruption, fraud, unethical behaviour and other irregularities.

The *King III Report* recommends that the internal audit, at a minimum, complies with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing and Code of Ethics.[314]

General risk management therefore falls under the mandate of the audit committee of the company. 'Risks' in this context refers to those aspects that threaten the achievement of the company's strategic goals.[315] The *King III Report* also places the oversight function of the information technology risks of the company with the audit committee.[316] Information technology plays a significant role in the proper functioning of many companies and its failure may lead to grave losses to such companies. The audit committee may, of course, leave the detail of these enquiries to a sub-committee and may use consultants to assist it in this process.[317]

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309 Principle 3.8 para 60 of the *King III Report*.
310 Principle 3.8 para 61 of the *King III Report*.
311 Principle 3.8 para 64 of the *King III Report*.
312 See Principles 3.7 and 7.4 of the *King III Code*: 'The audit committee should be responsible for overseeing of internal audit.'
313 Principle 5.1 para 2.
314 Principle 5.1 para 6. See also www.iiasa.org.za. (accessed 6 June 2012).
315 Principle 5.4. See also Principle 3.8 of the *King III Code*: 'The audit committee should be an integral component of the risk management process.'
316 Principle 3.8 paras 70 – 73.
317 For further reading on risk management and internal control, see Wixley and Everingham *Corporate Governance* 83 – 97.

It is recommended that a company's internal audit function should be scrutinised by an independent review at least every three years.[318]

5.2.2.2 *Monitoring of external assurance providers*

The audit committee of a company oversees the appointment of a company's auditor in the sense that it must be satisfied of the independence of the auditor.[319] It must determine the fees to be paid to the auditor and the terms of engagement of the auditor's appointment.[320] These matters fall under the sole authority of the audit committee and may not be overruled by the board.[321]

The appointment of the auditor in compliance with the requirements of the 2008 Companies Act and any other applicable legislation is the duty of the audit committee.[322] The audit committee must determine the nature and extent of any non-audit services that the auditor may provide to the company and may pre-approve any proposed agreement with the auditor for such services.[323] The rotation of the company's auditors is overseen by the audit committee.[324]

The emphasis of the Act is very much on the determination of the auditor's independence. However, the audit committee must also ensure that the auditor has the expertise, qualifications, resources and experiences necessary to fulfil its functions properly.[325] If the company is a listed company, it must ensure that the auditor is accredited by the JSE.[326]

The planning and execution of the annual external audit of the company must be overseen by the audit committee.[327] It is the audit committee that will receive a report from the external auditor if he or she has come across a reportable irregularity during the audit that they have reported to the Regulatory Board.[328] The *King III Report* recommends that the audit committee compile a protocol to receive, evaluate and resolve such reportable irregularities.[329] After the external audit the audit committee must evaluate the effectiveness and quality of the audit process.[330]

5.3 *Company secretary*

Every public company and state-owned company must appoint a company secretary.[331] It is also possible to include the requirement of the appointment of a company secretary in the company's Memorandum of Incorporation, if the company is not a public company or a state-owned company. The *King III Report* recommends that every company assigns the functions of a

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318 Principle 5.6 para 30 of the *King III Report*. See also Principle 2.13 of the *King III Code*: 'The board should report on the effectiveness of the company's system of internal controls.'

319 Ss 94(7)(*a*), 94(8) and 94(9) of the Companies Act and Principle 3.9 of the *King III Code*: 'The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process.' See also para 5.1.1 above.

320 S 94(7)(*b*).

321 S 94(10).

322 S 94(7)(*c*).

323 Ss 94(7)(*d*) and (*e*). See also para 5.1.3 above.

324 S 92. See para 5.1.2 above.

325 Principle 3.9 para 74 of the *King III Report*.

326 JSE *Listings Requirements* paras 3.86 and 3.88 read with section 22.

327 Principle 3.9 para 75 of the *King III Report*.

328 See para 5.1.5.1 above.

329 Principle 3.9 para 81 of the *King III Report*.

330 Principle 3.9 para 82 of the *King III Report*.

331 S 86(1).

company secretary to an appropriate person within the organisation, even if a company secretary is not formally appointed.[332]

The only mention in the 2008 Companies Act of any qualifications that the company secretary must have is that the company secretary must have the requisite knowledge of, or experience in, relevant laws that impact the company and must be a permanent resident in the Republic.[333] I submit that the knowledge and experience requisite of a company secretary will depend on the needs of the particular company, as well as the specific duties assigned to the company secretary in that company.[334] The knowledge and experience required from a company secretary may also change as the company expands or diversifies. In particular, the company secretary will have to play a supporting role if the company is required to appoint a social and ethics committee,[335] which could imply that the knowledge required from the company secretary is extended.[336]

The Act does not specifically provide that the company secretary is a prescribed officer of the company. The definition of 'prescribed officer' in regulation 39 provides that:

> (1) Despite not being a director of a particular company, a person is a "prescribed officer" of the company for all purposes of the Act if that person–
>
> (*a*) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or
>
> (*b*) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

It will therefore have to be determined with reference to the role that a particular company secretary plays in a particular company whether that company secretary falls within the definition.[337] The company secretary has been termed the 'chief administrative officer' of a company, and implied authority may vest in a company secretary to contract on behalf of the company in respect of dealings related to the administration of the company.[338] However, whether these functions would necessarily fall within the ambit of the above definition cannot be predicted without taking into account the role of the particular secretary.

If the company secretary is a prescribed officer of the company, that person will be subject to the same duties imposed on directors of the company in terms of sections 75, 76 and 77 of the Act. In particular, the company secretary will have to act with the degree of care, skill and diligence that the office requires.[339] This directly obliges the company secretary to keep him or herself informed of legislative changes that may affect the company and of the requirements of good corporate governance generally, otherwise that person will be hard-pressed to meet the standard of care, skill and diligence reasonably expected of a company secretary.

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332 Principle 1.22 para 122. See also Principle 2.21 of the *King III Code*: "The board should be assisted by a competent, suitably qualified and experienced company secretary."

333 S 86(2).

334 See also Rheeder 'The evolution of the role of the company secretary in South African company law' 13 where the author shares this opinion.

335 See para 5.4 below.

336 Rheeder 'The evolution of the role of the company secretary in South African company law' 16.

337 Rheeder 'The evolution of the role of the company secretary in South African company law' 18 – 24.

338 *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971] 2 QB 711; [1971] 3 All ER 16 (CA) 717. See however Delport, Vorster and Burdette et al. *Henochsberg* 333, where the authors are of the view the company secretary does not have any usual authority to deal on behalf of the company.

339 See s 76(3)(*c*).

5.3.1 Appointment

The company secretary is usually appointed by the board of the company. The board must therefore keep the duties of the company secretary and the qualifications and experience required from a person to fulfil those duties in mind before appointing a specific person in that position.[340]

The person appointed as the company's company secretary must not be disqualified from being a director of a company.[341] If the company has appointed a juristic person or a partnership to act as its company secretary, none of the persons employed by that juristic person or partnership to provide company secretary services may be disqualified to be a director of a company.[342]

For public companies and state-owned companies the first company secretary is appointed by the incorporators of the company, or within 40 days after the incorporation of the company by either the board of directors or through an ordinary resolution of the holders of the company's securities.[343]

If any other type of company requires the appointment of a company secretary in its Memorandum of Incorporation at the date of incorporation, the first company secretary is appointed by the incorporators of the company, or within 40 days after the incorporation of the company by either the board of directors or through an ordinary resolution of the holders of the company's securities.[344] If the requirement is inserted in the Memorandum of Incorporation at a later stage, the company secretary may be appointed within 40 business days after the requirement first applies to the company by either the board of directors or by an ordinary resolution of the holders of the company's securities.[345]

If a vacancy occurs the board of the company must appoint a company secretary within 60 business days after the vacancy occurs. The person appointed must have the requisite knowledge and experience in the opinion of the directors.[346]

Note that while it is not prohibited in the 2008 Companies Act, the company secretary should not be a director of the company.[347]

5.3.2 Duties

There is no closed list of duties of a company secretary, but the 2008 Companies Act does list certain duties that will apply to all company secretaries.[348] The primary duty of a company secretary is to advise the board of directors collectively and individually on their duties, responsibilities and powers and to alert them to any law relevant to or affecting the company.[349] In this regard the *King III Report* recommends that a direct channel of communication should exist between the company secretary and the chairman of the board and that the company secretary must especially play a supportive role of the non-executive directors of the

340 See also Principle 1.2 paras 120 and 121 of the *King III Report*.
341 See s 69(8).
342 S 87(1)(*a*).
343 S 86(3).
344 S 83(3A)(*a*).
345 S 86(3A)(*b*).
346 S 86(4).
347 See Delport, Vorster and Burdette et al. *Henochsberg* 333. This is also recommended by the *King III Code* in Principle 2.21, recommended practice 2.21.4.
348 S 88.
349 See also Principle 1.22 paras 113 and 116 of the *King III Report*.

company.[350] It further requires the company secretary to assess the skills needs of directors and to recommend training in aspects that may be necessary for a directors to fulfil their functions properly.[351]

Additionally, the Act prescribes certain reporting duties for the company secretary. Any failure of the company or of a director to comply with the Memorandum of Incorporation or the company rules must be reported to the board. The company must certify in the annual financial statements of the company that the company has filed its annual return[352] and any notices required in terms of the Act. It is also the company secretary's task to file the annual return.[353]

Finally, certain administrative duties are ascribed to the company secretary. It is the company secretary's task to ensure that proper minutes are kept of the shareholders meetings of the company, its board meetings, as well as the meetings of board committees. The company secretary must also ensure that every person who is entitled to receive the annual financial statements of the company is sent such statements. The *King III Report* further tasks the company secretary with the collection of appropriate feedback, responses or input for purposes of specific agenda items of the board meetings or of the board committee meetings.[354]

The following duties not already mentioned are recommended to be fulfilled by the company secretary in terms of the *King III Code*:[355] assisting the nominations committee with the appointment of new directors; assisting with director inductions and training programmes; ensuring that board and committee charters are kept up to date; preparation and circulation of board papers; assisting in drafting yearly work plans; and assisting in the evaluation of the board, board committee members and individual directors.

5.3.3 Removal

If a company secretary is removed by the board of the company, the company secretary may require that the company include a statement in its annual financial statements for that financial year setting out the company secretary's contention as to the circumstances of his or her removal.[356] The company secretary must give written notice to this effect to the company not later than the end of the financial year during which the removal took place.[357] The notice must include the statement to be included in the annual financial statements. This statement forms part of the directors' report in the company's annual financial statements.[358]

5.4 *Social and ethics committee*

The enhanced accountability requirement that best illustrates the prominence that the 2008 Companies Act places on the role of companies in greater society is the requirement to appoint a social and ethics committee. This requirement is also supported by Principle 1.1 of the *King III Code*, namely that the board should provide effective leadership with an ethical foundation, which includes the responsibility to promote the stakeholder-inclusive model of corporate governance. Every state-owned company and every listed public company must appoint a social

350 Principle 1.22 para 115.
351 Principle 1.22 para 122.
352 See para 2.2 above.
353 S 88(2)(*g*) read with s 33(3).
354 Principle 1.22 para 118. See also Principle 2.21, recommended practice 2.21.10 of the *King III Code*.
355 Principle 2.21 recommended practices 2.21.3 – 2.21.13.
356 S 89(2).
357 S 89(3).
358 S 89(4).

and ethics committee.[359] Any other type of company which has scored more than 500 points on the public interest score in any two of the preceding five financial years must also appoint a social and ethics committee.[360]

A company that has to appoint a social and ethics committee according to these criteria may apply to the Companies Tribunal for an exemption from the requirement to appoint such a committee.[361] To be successful with such an application, the applicant must show one of two situations. Firstly, the applicant could satisfy the Tribunal that it is already required to have a similar form of formal mechanism in accordance with another regulation to substantially perform the functions that the social and ethics committee would otherwise perform.[362] Alternatively, the applicant must satisfy the Tribunal that it is not reasonably necessary in the public interest to require the company to have a social and ethics committee, when the nature and extent of the company's activities are taken into account.[363]

If granted, the exemption will be valid for five years or such shorter period as the Tribunal might indicate.[364] However, the exemption may be set aside before the expiry of these periods on the basis that the ground on which the exemption was granted no longer applies to the company.[365] This is done by way of an application to the Companies Tribunal. The Commission, on its own initiative[366] or on the request of a shareholder of the company, or a person who was granted standing by the Tribunal at the hearing of the exemption application have standing to launch such an application.

A company that must otherwise appoint a social and ethics committee may also leave this function to the social and ethics committee of its holding company, if that holding company has a social and ethics committee.[367]

The *King III Report* considers the company's interaction with its stakeholders as a continuous dialogue in order to build relationships of trust and mutual cooperation. The fostering of mutual respect between the company and its stakeholders is a stated principle of the Report.[368] It is another stated principle of the Report that the company should strive to reach a balance between the various stakeholder interests in the company, with the primary aim of serving the best interests of the company.[369]

As will be discussed below, a great range of stakeholders and issues need to be considered by this committee, making their task quite onerous.

5.4.1 Appointment

State-owned companies must appoint a social and ethics committee within one year after its incorporation. *Listed* public companies must appoint the committee within one year after it becomes listed. Every other company must appoint the committee within one year after it first

359 Reg 43(1).
360 Reg 43(1)(*c*).
361 S 72(5).
362 S 72(5)(*a*).
363 S 72(5)(*b*).
364 S 72(6).
365 S 72(7).
366 It is submitted that the annual return will aid the Commission in this respect in that it will provide the company's public interest score information to the Commission on an annual basis. See para 2.2 above.
367 Reg 43(2)(*a*).
368 Principle 8.7.
369 Principle 8.4.

achieves a public interest score of more than 500 for the second time within a five year period.[370] The social and ethics committee is a board committee and is appointed by the board of directors.[371]

The committee is comprised of at least three directors or prescribed officers of the company. At least one of the members of the committee must be a director who is not involved in the day-to-day management of the company and has not been so involved in the previous three financial years.[372] Note that the regulations do not require this person to be independent as well as non-executive. This person could therefore be a representative of the company's holding company or of another related person, or of a creditor or other stakeholder, and still meet the requirement of not being involved with the day-to-day management of the company. It is not immediately apparent why the stringent independence and non-executive criteria set for members of the audit committee of a company do not equally apply to at least some of the members of the social and ethics committee.[373] Perhaps the reason for this is that sustainability reporting must be subject to independent assurance,[374] similarly to financial reporting, and as such the audit committee plays the central oversight function and not the social and ethics committee.

5.4.2 Rights

The rights of the social and ethics committee are set out in section 72(8) of the 2008 Companies Act. The committee may require any explanation or information necessary for the performance of its functions from any director, prescribed officer or employee of the company. The members of the social and ethics committee are entitled to receive all notices and communications relating to a general shareholder meeting, to attend such meetings and to be heard at such meetings on any business of the meeting that concerns the committee's functions.

The company must pay or reimburse all expenses reasonably incurred by the social and ethics committee, including the costs or fees of engaging consultants or specialists in the performance of its functions.[375]

5.4.3 Duties

The duties of the social and ethics committee of the company are not set out in the Act. Instead the 2008 Companies Act allows these duties to be prescribed by the Minister of Trade and Industry in the Companies Regulations,[376] which means that the duties could be extended or reduced by the Minister without the need for adherence to extensive legislative amendment processes.

Regulation 43(5) sets out the duties or the functions of the social and ethics committee. As in the case of the auditing committee, the functions of the social and ethics committee consist of monitoring and reporting duties. The committee must report, through one of its members, to

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370 Reg 43(3)(*b*).

371 Reg 43(3). Delport, Vorster and Burdette et al. *Henochsberg* 274 are of the opinion that reg 43(2) leaves one uncertain as to whether the power to appoint the board rests with the board or with the company in general meeting. In my opinion the two sub regulations must be read together to mean that the board has the power to appoint the members of the social and ethics committee. Wixley and Everingham *Corporate Governance* 79 share this view.

372 Reg 43(4).

373 See s 94(4) and para 5.2.1 above.

374 Principle 6.5 of the *King III Report*.

375 S 72(9).

376 S 72(4)(*b*).

the annual general meeting of the company on the matters that fall within its mandate.[377] Neither the Act nor the regulations clearly set out whether this report will formally form part of the annual financial statements of the company. However, it is submitted that it should form part of the directors' report, and as such is subject to external assurance from the auditor of the company. The committee must further continuously draw matters within its mandate to the attention of the board if so required.[378] In other words, the committee plays a supportive role to the board in addressing stakeholder interests.

The committee is required to monitor the company's compliance with a broad range of codes of best practice and legislation to ascertain the effect of the company's dealings on the interests of certain stakeholders. It is important to note that the matters mentioned in the regulation do not form a closed list. The company's board may add any other matter to the committee's mandate that it feels should also be considered.

The committee must consider matters relating to the company's social and economic development, which includes the company's standing in terms of the goals and purposes of the ten United Nations Global Compact Principles,[379] the Organisation for Economic Co-operation and Development's recommendations regarding corruption, the Employment Equity Act 55 of 1998 and the Broad-Based Economic Empowerment Act 53 of 2003.

Matters regarding the company's corporate citizenship must be considered by the committee.[380] This includes the promotion of equality, the prevention of unfair discrimination and the reduction of corruption; the contribution of the company to the development of the community in which the operations of the company is based, or to whom products or services are predominantly marketed; and the company's record of sponsorship, donations and charitable giving.

The committee must consider the company's impact of the environment, health and public safety, including the impact of the company's products or services. Consumer relationships must be considered, including the company's advertising, public relations and compliance with consumer protection laws. Finally, the committee must consider the company's activities relating to labour and employment, including the company's standing in terms of the International Labour Organisation's protocol on decent work and working conditions, the company's employment relationships and the company's contributions towards the development of its employees.

A possible duty of the committee not mentioned in the Companies Regulations, but implied by the *King III Code*, is the responsibility to develop a Code of Conduct and Ethics-related Policies to be implemented in the company.[381] While the responsibility of the development,

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377 Reg 43(5)(*c*).

378 Reg 43(5)(*b*).

379 The Global Compact is a United Nations initiative to align businesses internationally towards practices that will benefit society as a whole. The initiative is based on ten universally accepted principles in the fields of human rights, the environment, anti-corruption and labour. It includes a great emphasis on sustainability. See www.unglobalcompact.org. The Compact works on the basis that corporations must voluntarily join the project and assess their compliance with the ten principles with an instrument called the Communication on Progress. The regulation does not go as far as requiring companies to actually join the Compact, only that they should assess their standing according to the ten principles.

380 See also Principle 1.2 of the *King III Code*: 'The board should ensure that the company is and is seen to be a responsible corporate citizen.'

381 Principle 1.3, recommended practices 1.3.6, 1.3.7 and 1.3.8: 'The board should ensure that the company's ethics are managed effectively . . . The board should ensure that a code of conduct and ethical-related policies are implemented; compliance with the code of conduct is integrated in the operations of the company; and the company's ethics performance should be assessed, monitored, reported and disclosed.'

implementation and monitoring of such a Code is placed with the board, it seems intuitive that this task will be delegated to the social and ethics committee.

Each of the interests specifically mentioned in the Companies Regulations will now be considered in turn.[382]

5.4.3.1 *Labour*

Principle 3 – 6 of the United Nations Global Compact Principles deal with labour related matters. Principle 3 holds that businesses should uphold freedom of association and the right to collective bargaining.[383] This means that employees must be free to elect representatives to negotiate on their behalf with companies about the terms and circumstances of their employment. It further implies that such representatives, including trade unions, must be able to freely gather and conduct their operations. Negotiations must be conducted in good faith, both from the side of management and from the side of the trade unions. In South Africa freedom of association and the right to fair labour practices are human rights entrenched in the Bill of Rights of the Constitution,[384] which means that this principle overlaps locally with Principles 1 and 2 of the Global Compact.[385]

Principle 4 is that businesses should uphold the elimination of all forced or compulsory labour.[386] Again, this principle is supported by several human rights.[387] Forced labour is a societal wrong, hampering development especially of children, but also of human resources generally. The principle entails that labour should be offered freely and that one should be able to freely withdraw labour within the confines of mutually agreed terms. Slavery, debt bondage, child labour and compulsory community labour on fear of state penalties are all examples of forced labour. The overlap with Principle 2 of the Global Compact means that companies must also be careful not be complicit in forced labour practices.[388]

Principle 5 is that businesses should uphold the effective abolition of child labour.[389] The overlap with Principles 1, 2 and 4 is apparent. The International Labour Organisation Minimum Age Convention No. 138 and the Worst Forms of Child Labour Convention No. 182 is particularly instructive in this regard.[390] The social and ethics committee must thoroughly familiarise themselves with these conventions. The minimum age for work in South Africa coincides with the minimum age for compulsory schooling, which is 15 years. Children between the ages of 12 and 14 may partake in light work – that is work that cannot threaten their health and safety, or

382 See in general Wilkinson 'Will social and ethics committees enlighten shareholders? A comparison of the South African provisions relating to social and ethics committees with the enlightened shareholder value approach in the United Kingdom Companies Act of 2006' 46 – 58.

383 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle3 (accessed 2 July 2012).

384 Ss 18 and 23 of the Constitution of South Africa, 1996.

385 See para. 5.4.3.2 below.

386 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/Principle4 (accessed 2 July 2012).

387 S 10 of the Constitution of South Africa, 1996: 'Human dignity – everyone has inherent dignity and the right to have their dignity protected and respected'; s 13:'Slavery, servitude and forced labour – no one may be subjected to slavery, servitude or forced labour'; s 22: 'Freedom of trade, occupation and profession – every citizen has the right to choose their trade, occupation or profession freely . . .'

388 See para 5.4.3.2 below.

389 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle5 (accessed 2 July 2012).

390 Both conventions are available at www.ilo.org/ipec/facts/ILOconventionsonchildlabour/lang--en/index (accessed 2 July 2012). South Africa has ratified both these conventions.

hinder their education or vocational orientation and training. Companies should guard against any allegation of complicity in child labour.[391]

Principle 6 is that businesses should uphold the elimination of discrimination in respect of employment and occupation.[392] This principle overlaps with the stated function in the Companies Regulations that the social and ethics committee must consider the promotion of equality and the prevention of unfair discrimination as part of its corporate citizenship. Again we see the strong overlap with Principles 1 and 2 of the Global Compact.[393] This principle is further supported by the express function of the social and ethics committee to consider the company's standing in terms of the goals and objectives of the Employment Equity Act 55 of 1998.

The Companies Regulations require the social and ethics committee to consider the company's standing in terms of the International Labour Organisation's (ILO) protocol on decent work and working conditions.[394] The regulation is misleading in the sense that it implies that a single ILO protocol for decent work and working conditions exists. In truth the concept of decent work and working conditions is explored in a number of ILO conventions, agendas and declarations. Of particular importance here is the ILO 2008 Declaration on Social Justice for a Fair Globalisation[395] read with its Decent Work Agenda.[396] Underlying the Decent Work Agenda is the principle that work is more than simply a means of deriving an income. Work is acknowledged as being a tool through which persons and wider communities are empowered, but only if that work conforms to certain criteria. The ILO supports the advancement of decent work through the achievement of four objectives, namely job creation, guaranteeing workers' rights, extending social protection[397] and promoting social dialogue.

The social and ethics committee is tasked to consider the company's relationships with its employees in general, as well as the company's development of its employees. It should be supported extensively by the company's human resource personnel in this regard. The management of the principles set out above must be reported to the social and ethics committee.[398]

5.4.3.2 *Human rights*

Principle 1 and Principle 2 of the United Nations Global Compact Principles relate to companies' realisation of human rights. Principle 1 is that businesses should support and respect the protection of universally proclaimed human rights. Principle 2 is that businesses should not be complicit in human right abuses. The basis of these two principles is the UN Universal Declaration of Human Rights. The United Nations recommends that companies at a minimum look towards the International Bill of Human Rights and the International Labour Organisation Conventions when considering the content of human rights. In South Africa we have the benefit of the inclusion of a Bill of Rights in the Constitution, to which companies may look to provide

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391 See para 5.4.3.2 below.

392 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle6 (accessed 2 July 2012).

393 See para 5.4.3.2 below.

394 Reg 43(5)(*a*)(v)(*aa*).

395 The declaration is available at www.ilo.org/public/english/bureau/leg/declarations (accessed 2 July 2012).

396 See in this regard www.ilo.org/global/about-the-ilo/decent-work-agenda/lang--en/index (accessed 2 July 2012).

397 In South Africa the Basic Conditions of Employment Act 75 of 1997 supports this objective.

398 For general guidance and further reading on labour related principles associated with the Global Compact, visit www.unglobalcompact.org/issues/Labour/Tools_Guidance_Materials (accessed 2 July 2012). For more information on South African labour law, see Van Niekerk & Christianson *Law@work*.

content to the principles. Note that several of the Articles of the UN Universal Declaration of Human Rights directly or indirectly relate to employees' rights.

The underlying rationale of the advancement of human rights by business is that societies where human rights are acknowledged tend to be more conducive to stable economic environments.[399] Consumer rights generally have human rights as a foundation, including the right to a free and informed choice and rights relating to one's health.

Companies should not only consider the human rights record of their own operations, but also those of the companies with which they do business up and down in the supply chain.

The United Nations sets out three criteria based on which companies should assess the extent of their responsibility to address human rights. The first is the country and the local context in which it is operating, and any particular challenges that the context might pose to human rights. The second is the potential impact that the businesses' own activities might have on human rights. The third is an analysis of the business' relationship with government, business partners, suppliers and so forth if those other entities might pose a risk to the business' human rights track record. The United Nations recommends a comprehensive human rights management approach, and provides tools and other support for this purpose. The idea is that a pro-human rights culture should permeate throughout the operations of the company.

A human rights management approach is also recommended for the prevention of complicity in human rights abuses. 'Complicity' is described by the United Nations as an act or omission by a company, or someone representing the company, that facilitates a human rights abuse perpetrated by another, while knowing that the act or omission will facilitate such an abuse.[400] The extent of complicity is quite controversial, since it seems that 'complicity' is used here in a wider sense than acts that could lead to legal liability. While direct complicity, such as trading in arms with countries while knowing that the weapons will be used to perpetrate genocide, might be an obvious deviation of what is expected of companies, the line becomes less clear when one considers beneficial complicity or silent complicity.

Beneficial complicity is when the business benefits from another's human rights abuses. An example would be if that company did business with a supplier that used child labour in the manufacturing of the goods supplied, enabling it to provide the goods at much cheaper rates. Silent complicity becomes even less clear, because it simply entails silence in the face of systematic and consistent human rights abuse. One could possibly place any company that conducts business with governments with poor human rights records under this category. The United Nations acknowledges that business could play an important role in putting pressure on such governments to improve their practices, but it seems that it stops short of positively advising against any business with such governments.

The social and ethics committee of the company is therefore tasked with developing and monitoring a human rights management policy and system.[401]

5.4.3.3 *Environment, health and public safety*

It is a constitutionally protected right to live in an environment that is not harmful to one's health or well-being and to have the environment protected.[402] A company's approach to the

399 See www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle1 (accessed 2 July 2012) where the principle is discussed is some depth.

400 See www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/Principle2 (accessed 2 July 2012).

401 For guidance in this regard, see www.unglobalcompact.org/Issues/human_rights/Tools_and_Guidance_Materials (accessed 2 July 2012).

402 S 24 of the Constitution of South Africa, 1996 reads as follows: 'Everyone has the right – (*a*) to an environment that is not harmful to their health or well-being; and (*b*) to have the environment

continued

environment therefore also has bearing on its human rights record and the principles of the UN Global Compact set out above.[403] As with other issues that have an influence on human rights, companies also need to be aware of their direct or indirect complicity in practices that may have an effect on the environment.

Principles 7 – 9 of the United Nations Global Compact relates to the impact of business on their environment. These principles were drawn from the Declaration of Principles and an International Action Plan that emerged from the United Nations Conference on Environment and Development held in Rio de Janeiro in 1992.[404]

Principle 7 holds that businesses should support a precautionary approach to environmental challenges.[405] This entails systematic risk assessment, risk management and risk communication. The underlying basis for this principle is that prevention in this area is safer, and cheaper, than the cure. One must also consider that in the case of environmental damage it might be impossible to completely rectify the damage that a company could potentially cause.

Principle 8 is that businesses should engage in initiatives to promote greater environmental responsibility.[406] This principle is introspective in nature. It expects companies to look at their own policies, internal codes, sustainability targets and indicators in order to foster a culture of environmental responsibility. It also promotes the communication of such initiatives to stakeholders. The 'triple bottom line' of sustainable development must be incorporated into the company's vision, mission and other strategic planning initiatives.[407]

Principle 9 is the development and diffusion of environmentally friendly technologies.[408] Companies should continuously attempt to make their production and other operations more environmentally sustainable by, amongst other things, polluting less, recycling more of their wastes and products and to dispose responsibly of their residual wastes.

Apart from these principles of the UN Global Compact that relate to environmental protection, the Companies Regulations also imposes a general duty on the social and ethics committee to consider the environment, health and public safety, including the impact of the company's activities and of its products or service.[409] The committee will therefore also have to keep in mind any domestic legislation regarding environmental protection,[410] as well as international agreements on the environment which South Africa has ratified.

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protected, for the benefit of present and future generations, through reasonable legislative and other measures that (i) prevent pollution and ecological degradation; (ii) promote conservation; and (iii) secure ecologically sustainable development and use of natural resources while promoting justifiable economic and social development.'

403 See para 5.4.3.2 above.

404 See www.un.org/esa/dsd/agenda21 (accessed 2 July 2012) for access to the full documents.

405 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle7 (accessed 2 July 2012).

406 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle8 (accessed 2 July 2012).

407 See also ch 2 paras 4.1 and 4.9.

408 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle9 (accessed 2 July 2012).

409 Reg 43(5)(*a*)(iii).

410 See especially the National Environmental Management Act 107 of 1998, but also the National Water Act 36 of 1998, the National Environmental Management: Air Quality Act 39 of 2004, the National Environmental Management: Waste Act 59 of 2008, the Hazardous Substances Act 15 of 1973, the National Environmental Management: Protected Areas Act 57 of 2003, the National Environmental Management: Biodiversity Act 10 of 2004, the Marine Living Resources Act 19 of 1998, the National Environmental Management: Integrated Coastal Management Act 24 of 2008 and the National Forests Act 84 of 1998. For further reading, please refer to Kidd *Environmental Law*.

5.4.3.4 *Anti-corruption*

Three parts of regulation 43 requires the social and ethics committee to consider the standing of the company in its attempts to reduce corruption. Apart from forming part of good corporate citizenship, the committee must consider the company's standing against the OECD recommendations regarding corruption,[411] and Principle 10 of the UN Global Compact states that businesses should work against corruption in all its forms, including extortion and bribery.[412] It is submitted that the committee need not consider each recommendation and principle separately, but should rather form a holistic opinion of the company's culture and standing regarding corruption.

Being inherently unethical, participation in corruption holds legal and reputational risk for companies.[413] Large scale corruption increases the costs of doing business. It further exposes the management of companies to blackmail, and once a business has bent the knee once to corrupt practices, it is harder for that business to refuse a corrupt offer in future. Zero tolerance is therefore the only answer. A culture of ethical behaviour, starting with a company's management, also seeps down to the entire enterprise. However, the reverse is also true: unethical behaviour from management makes it hard to expect ethical behaviour from employees generally.

Corruption diverts resources from their proper use, ending up in the pockets of corrupt beneficiaries rather than being utilised for the improvement of communities. One could therefore argue that a company's record on corruption also has a direct bearing on the function of the social and ethics committee to consider the company's contribution to the development of the communities in which it operates and to which it distributed products and services. No doubt corrupt practices end up in higher cost to the consumer, which also makes this relevant to consumers as stakeholders in business.

Regulation 43 requires that the social and ethics committee consider 'the OECD recommendations'. The OECD described its legal instruments by a variety of terms, of which 'recommendation' is one. However, it is doubtful that the legislature intended the social and ethics committee to only consider two of the seven legal instruments available from the OECD that deals with corruption. It is therefore submitted that all six of these instruments should be taken into account, where relevant for the operations of the company.[414]

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411 See in general www.oecd.org/document/53/0,3746,en_2649_34135_2516085_1_1_1_1,00 (accessed 2 July 2012).

412 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle10 (accessed 2 July 2012). The 2003 UN Convention against Corruption lies as the basis for this principle. South Africa has ratified this Convention.

413 See in general www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/anti-corruption (accessed 2 July 2012).

414 The following instruments are relevant: OECD *Guidelines for Managing Conflicts of Interests in the Public Service* (2003); OECD *Principles for Managing Ethics in Public Service* (1998); OECD *Principles for Transparency and Integrity in Lobbying* (2010); OECD *Principles for Enhancing Integrity in Public Procurement* (2008); OECD *Recommendation on Bribery and Export Credits* (2006); OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (1997); OECD *Recommendation for Further Combating Bribery of Foreign Public Officials in International Business Transaction* (2009). The 2009 Recommendation followed from the Convention, which is the only legally binding document among those mentioned. South Africa has adopted the Convention.

5.4.3.5 *Black economic empowerment*

The social and ethics committee must determine and monitor the company's standing in terms of the goals and purposes of the Broad-Based Black Economic Empowerment Act 53 of 2003.[415]

'Broad-based black economic empowerment' is defined as follows in the Act:[416]

> the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to –
>
> (*a*) increasing the number of black people that manage, own and control enterprises and productive assets;
>
> (*b*) facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;
>
> (*c*) human resource and skills development;
>
> (*d*) achieving equitable representation in all occupational categories and levels in the workforce;
>
> (*e*) preferential procurement; and
>
> (*f*) investment in enterprises that are owned or managed by black people

The objectives of the Act are set out in section 2. The Act was introduced to facilitate the economic transformation of South Africa in order to enable black people[417] to become meaningful participants in the economy. It aims to change composition of the ownership and management of businesses, as well as the skilled occupations within those businesses, to include more black people. The Act further aims to facilitate the extent to which communities and other forms of collective enterprises can start businesses, and to assist such enterprises with their access to economic activities, infrastructure and skills training. The empowerment of black women is specifically listed as an objective of the Act. The Act aims to promote investment programmes that will lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity. The empowerment of rural and local communities through access to economic activities, land, infrastructure, ownership and skills is specifically mentioned as an aim of the Act. Finally, the Act aims to promote access to finance for the objective of black economic empowerment.

The Act operates in conjunction with Codes of Good Practice[418] that further elaborate on the meaning of broad-based black economic empowerment within certain sectors, to provide for qualification criteria for preferential purposes of public procurement or otherwise, to provide for indicators for broad-based black economic empowerment and their weighting, to provide guidance for the drawing up of sector charters[419] and any other matter to promote the objectives of the Act.[420]

The scoring set out in the Codes of Good Practice is then used by organs of state and public entities when deciding on the issuing of licenses, concessions or other authorisations in terms

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415 Reg 43(5)(*a*)(i)(*dd*). The Department of Trade and Industry has created a portal where business can access all relevant BEE legislation in one place. See http://bee.thedti.gov.za (accessed 2 July 2012).

416 S 1.

417 'Black people' is defined in s 1 to mean Africans, Coloureds and Indians.

418 See GN 112 *GG* 29617 of 9 February 2007. There are also several sector specific Codes of Good Practice, which are available at http://bee.thedti.gov.za (accessed 6 June 2012).

419 The following sector charters have been issued: the Financial Sector Charter on Black Economic Empowerment GN 110 *GG* 29610 of 9 February 2007; the AgriBEE Sector Charter on Black Economic Empowerment GN 314 *GG* 30886 of 20 March 2008. The Mining and Petroleum and Liquid Fuels Industries have issued charters under the Mineral and Petroleum Resources Development Act 28 of 2002. All the Charters are available at http://bee.thedti.gov.za (accessed 6 June 2012).

420 S 9.

of law, the development and implementation of a preferential procurement plan, the qualification criteria for the sale of state-owned enterprises and for the development of criteria for entering into partnerships with the private sector.[421] In other words, the state prefers to do business with private businesses that have a good broad-based black economic empowerment score.

The scoring must be verified by an accredited B-BEE Verification Agency.[422] The agencies must be accredited by the South African National Accreditation System. The Department of Trade and Industry has further published a Verification Manual to assist the verification agencies in the uniform certifications of BEE scores.[423]

It is widely acknowledged that the Act has failed to achieve the 'broad-based' part of its objectives.[424] One practice that became common after commencement of the Act, its Codes and the various Charters, was so-called 'fronting'. This term includes a variety of practices which aims to include black people formally as being part of the ownership or management structures of businesses, but to exclude them from active or meaningful participation in such ownership or management. It also includes practices by which the economic benefit from black persons' participation as reflected in the relevant scorecards does not effectively reach the persons in the ratios specified. Legislation to amend the Act in certain respects to address these concerns is in its draft phase and will not be discussed in detail at this time.[425]

5.4.3.6 *Consumer relationships*

The social and ethics committee must monitor a company's activities with regards to its consumer relationships, including the company's advertising, public relations and compliance with consumer protection laws.[426] The *King III Report* also emphasises the importance of acknowledging the customer or consumer as a stakeholder in the company and fostering of the relationship with consumers.[427]

Responses from consumers are expected by the *King III Report* in circumstances where the company does not act in a responsible manner or where a product of the company or its use is harmful to the environment, produced in employee working conditions outside of the reasonably accepted norms, produced outside of diversity and equal opportunity norms or harmful to the health of consumers.[428] The committee will have to take these concerns into account when monitoring consumer relationships.

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421 S 10.

422 On the verification of BEE scores generally, see www.thedti.gov.za/economic_empowerment/bee_veri.jsp.

423 GN 776 *GG* 31255 of 18 July 2008.

424 See for instance K Motlanthe 'Opening address by President Jacob Zuma to the inaugural meeting of the President's Broad-Based Black Economic Empowerment (BBBEE) council' (February 2010): 'We also have to admit that the "broad-based" part of BEE has seemed elusive. In the main, the story of black economic empowerment in the last 15 years has been a story dominated by a few individuals benefiting a lot. The vast majority of those who are truly marginalised: women, rural poor, workers, the unemployed, and the youth have often stood at the sidelines. Only a few benefit again and again from the bounty of black economic empowerment.' The full address is available at http://www.theforumsa.co.za/forums/showthread.php/6705-K-Motlanthe-on-behalf-of-J-Zuma-Broad-Based-Black-Economic-Empowerment-(BBBEE)-counc (accessed 2 July 2012).

425 The draft Broad-Based Black Economic Empowerment Amendment Bill was published in GN 893 GG 34845 of 9 December 2011. A copy of the Bill is available at www.thedti.gov.za/economic_empowerment/Bee.jsp.

426 Reg 43(5)(*a*)(iv).

427 Principle 8.7 paras 57 – 61.

428 Principle 8.7 para 60.

In recent years consumer protection has received considerable legislative attention in South Africa. Companies must make sure that they comply with the relevant provisions of the National Credit Act 34 of 2005 and the Consumer Protection Act 68 of 2008. Especially the latter which introduces legislation that has bearing on most businesses in South Africa. Members of the social and ethics committee will have to have at least a basic understanding of the content of the Consumer Protection Act.

6 Concluding remarks

'The application [of the *Code*] will differ for each entity and is likely to change as the aspirational nature of the *Code* should drive entities to continuously improve governance practices.'[429]

In this chapter the different aspects of accountability applicable to companies have been fully explained. While the *King III Code* and the *King III Report* apply to all business entities and to all companies, this chapter also explained that the extent to which enhanced accountability applies to a particular business entity is dependent on its social and economic impact. Furthermore, the extent of the duties of the company secretary, the audit committee and the social and ethics committee will not only differ between different companies, but is also dynamic and will change over time. It is therefore important for companies to continuously assess the governance needs of their business and to amend the mandate of these committees as determined by those needs.

The different aspects of enhanced and other accountability measures described in this chapter must be seen by the board of directors of a company as a support structure for the proper fulfilment of their duties. These functions must form a seamless whole towards the creation of a responsible and accountable company.

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Annexure

Form C
REQUEST FOR ACCESS TO RECORD OF PRIVATE BODY

(Section 53 (1) of the Promotion of Access to Information Act, 2000
(Act No. 2 of 2000))

[Regulation 10]

A. Particulars of private body

The Head:

....

....

....

B. Particulars of person requesting access to the record

(*a*) *The particulars of the person who requests access to the record must be given below.*
(*b*) *The address and/or fax number in the Republic to which the information is to be sent must be given.*
(*c*) *Proof of the capacity in which the request is made, if applicable, must be attached.*

Full names and surname: ....

....

Identity number: ....

Postal address: ....

....

....

.... Fax number: ....

Telephone number: .... E-mail address: ....

Capacity in which request is made, when made on behalf of another person: ....

....

C. Particulars of person on whose behalf request is made

This section must be completed ONLY if a request for information is made on behalf of another person.

Full names and surname: ....

....

Identity number: ....

D. Particulars of record

(*a*) *Provide full particulars of the record to which access is requested, including the reference number if that is known to you, to enable the record to be located.*

(*b*) *If the provided space is inadequate, please continue on a separate folio and attach it to this form.* ***The requester must sign all the additional folios.***

1. Description of record or relevant part of the record:..
....
....
....
....
2. Reference number, if available: ....
3. Any further particulars of record: ....
....
....
....

E. Fees

(*a*) *A request for access to a record, other than a record containing personal information about yourself, will be processed only after a* ***request fee*** *has been paid.*

(*b*) *You will be notified of the amount required to be paid as the request fee.*

(*c*) *The* ***fee payable for access*** *to a record depends on the form in which access is required and the reasonable time required to search for and prepare a record.*

(*d*) *If you qualify for exemption of the payment of any fee, please state the reason for exemption.*

Reason for exemption from payment of fees:...
....
....

F. Form of access to record

If you are prevented by a disability to read, view or listen to the record in the form of access provided for in 1 to 4 hereunder, state your disability and indicate in which form the record is required.

Disability:	Form in which record is required: ....
....	....
....	....

Mark the appropriate box with an **X.**

NOTES:

(*a*) *Compliance with your request in the specified form may depend on the form in which the record is available.*

(*b*) *Access in the form requested may be refused in certain circumstances. In such a case you will be informed if access will be granted in another form.*

(*c*) *The fee payable for access to the record, if any, will be determined partly by the form in which access is requested.*

1. If the record is in written or printed form:			
	copy of record*		inspection of record

2. If record consists of visual images (this includes photographs, slides, video recordings, computer-generated images, sketches, etc.):					
	view the images		copy of the images*		transcription of the images*

3. If record consists of recorded words or information which can be reproduced in sound:			
	listen to the soundtrack (audio cassette)		transcription of soundtrack* (written or printed document)

4. If record is held on computer or in an electronic or machine-readable form:					
	printed copy of record*		printed copy of information derived from the record*		copy in computer readable form* (stiffy or compact disc)

*If you requested a copy or transcription of a record (above), do you wish the copy or transcription to be posted to you? **Postage is payable.**	YES	NO

G. Particulars of right to be exercised or protected

If the provided space is inadequate, please continue on a separate folio and attach it to this form. ***The requester must sign all the additional folios.***

1. Indicate which right is to be exercised or protected: ....
....
....

2. Explain why the record requested is required for the exercise or protection of the aforementioned right: ....
....
....
....

H. Notice of decision regarding request for access

You will be notified in writing whether your request has been approved/denied. If you wish to be informed in another manner, please specify the manner and provide the necessary particulars to enable compliance with your request.

How would you prefer to be informed of the decision regarding your request for access to the record?..

....

....

Signed at.................................... this.................................day of... 20 ....

....

SIGNATURE OF REQUESTER/PERSON ON WHOSE BEHALF REQUEST IS MADE