

## **Companies Act Regulations applicable to Close Corporations**

The Department of Trade and Industry published the final Regulations on the Companies Act on 20 April 2011. This document includes an overview of the new arrangements that will apply to close corporations (CCs) regarding the audit requirement, independent review and the financial reporting standards. For all year-ends up to and including 30 April 2011 CCs will comply with the existing requirements, viz. an Accounting Officer's Report accompanying financial statements drawn up based on accounting policies chosen/designed by the CC in question.

### **Public interest score**

The Regulations state that every close corporation shall calculate its 'public interest score' (PIS) at the end of each financial year.

The PIS is calculated as the sum of the following:

- (a) a number of points equal to the average number of employees of the CC during the financial year;
- (b) one point for every R 1 million (or portion thereof) in third-party liabilities of the CC at the financial year end;
- (c) one point for every R 1 million (or portion thereof) in turnover of the CC during the financial year; and
- (d) one point for every individual who, at the end of the financial year, is known by the CC to directly or indirectly have a beneficial interest in the CC.

"Employee" is as defined in the Labour Relations Act, 1995.

"Turnover" is not defined in the context of the PIS, but is defined elsewhere as the gross income derived from the sale of goods, the rendering of services or the use by other persons of the company's assets yielding interest, royalties, or dividends.

The CC's PIS will be used to determine whether or not it will require audited financial statements and which financial reporting standards will apply. The requirement is effectively applied retrospectively to the year for which the PIS is calculated, which has severe repercussions on the audit. It is thus recommended that a cautious approach is used whereby the last financial statements produced are used as the basis for estimating the PIS and material changes to the business are used to adjust this estimate to allow for an orderly audit should it be likely to be required.

### **Accounting officer**

The Close Corporations Act still requires all CCs to appoint an accounting officer.

### **Audit requirement**

The Regulations provide for both activity and size criteria to determine whether or not CCs require audited financial statements.

The requirements for CCs to have their financial statements audited are as follows:

- any close corporation if, in the ordinary course of its primary activities, it holds assets in a fiduciary capacity for persons who are not related to the close corporation, and the aggregate value of such assets held at any time during the financial year exceeds R 5 million (activity test);
- any close corporation whose public interest score in that financial year is
  - (i) 350 or more; or
  - (ii) at least 100, but less than 350, if its annual financial statements for that year were internally compiled.

It is important to note that the activity test relates to the primary activities of the CC, not incidental/resulting activities, and specifically states "in a fiduciary capacity". By way of example, assume a CC operates as an estate agency – the holding of funds in trust is incidental to the primary business and not in a fiduciary capacity. The Companies Act would thus not require an audit on this basis, but laws applicable to Estate Agents might well require an audit.

Where the Accounting Officer is not related to the CC, the CC would not need an audit as the statements were not internally compiled as stated in (ii) above.

### **Independent review**

The inclusion of section 58(2A) in the Close Corporations Act only states that the Companies Act is applicable to CC's that require an audit. CC's are therefore not scoped into the independent review requirement.

### **Audit exemption**

The Amendment Act provides for an exemption with regards to audit and independent review. The exemption states the following:

“30 (2A) If, with respect to a particular company, every person who is a holder of, or has a beneficial interest in, any securities issued by that company is also a director of the company, that company is exempt from the requirements in this section to have its annual financial statements audited or independently reviewed, but this exemption—

(a) does not apply to the company if it falls into a class of company that is required to have its annual financial statement audited in terms of the regulations contemplated in subsection (7)(a); and

(b) does not relieve the company of any requirement to have its financial statements audited or reviewed in terms of another law, or in terms of any agreement to which the company is a party.”

As “company” also includes a CC, this implies that all CCs that meet the requirement to be audited in terms of Regulations, in terms of the PIS or activities engaged in, would require an audit. The section detailing the exemption (section 30(2A) is however not applicable to CC’s and therefore CC’s requiring an audit will never be exempted from an audit . Should the CC not need an audit in terms of the Regulations, then the requirement for an independent review is also not applicable as the new section 58(2A) states the sections applicable to CC’s and the exemption included in section 30(2A) is not included:

“58(2A) Section 30(2)(b), and (3) to (6) of the Companies Act, read with the changes required by the context, apply to a corporation that is required by the regulations made in terms of section 30(7) of the Companies Act, to have its annual financial statements audited.

## Financial Reporting Standards

Section 10 of the Close Corporations Act is amended by the inclusion of section (3).

Section 10(3) states that the “Regulations made by the Minister in terms of section 29(4) and (5), and 30(7) of the Companies Act apply to a corporation as if those regulations had been made in terms of this Act, but any reference in those regulations to a company must be read as a reference to a corporation.”

The Regulations make provision for IFRS, IFRS for SMEs and SA GAAP<sup>1</sup>, and also state that the Financial Reporting Standards apply to every company with a financial year end starting on or after the effective date of the Act. Therefore CCs with a financial year starting on or after 1 May 2011 (year end of 30 April 2012) will have to prepare financial statements in line with the following table:

Public Interest Score	Financial Reporting Standard	AUDIT	INDEPENDENT REVIEW	ACCOUNTING OFFICER’S REPORT
PIS ≥ 350	IFRS / IFRS for SMEs	YES	NO	YES
PIS ≥ 100 and < 350 and AFS were internally compiled	IFRS / IFRS for SMEs / SA GAAP (Withdrawn)	YES	NO	YES
PIS ≥ 100 and < 350 and AFS independently compiled	IFRS / IFRS for SMEs / SA GAAP (Withdrawn)	NO	NO	YES
PIS < 100 and AFS independently compiled	IFRS / IFRS for SMEs / SA GAAP (Withdrawn)	NO	NO	YES
PIS < 100 and AFS internally compiled	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed	NO	NO	YES

Theoretically CCs requiring an audit for year ends from 31 May 2011 to 31 March 2012 would not have to apply IFRS / IFRS for SMEs in those statements. For practical reasons and to avoid unnecessary complications in the audit or review process, it is recommended that CCs adopt the appropriate Financial Reporting Standards for all years ending on or after 1 May 2011.

Updated: January 2014

<sup>1</sup> Although SA GAAP is included in the Companies Regulations as an allowed framework, it has been withdrawn with effect from years commencing after 1 December 2012. To view the withdrawal notice:  
<https://www.saica.co.za/Portals/0/Technical/Future%20of%20SA%20GAAP.pdf>