Attention: Date: 11 October 2022
Prof Michael Katz
Chairperson
Specialist Committee on Company Law

Dr SM Masotja
Deputy Director General: CCRD Department of Trade Industry and Competition

[redacted]

Dear Prof Katz and Dr Masotia,

SUBMISSION TO THE DEPARTMENT OF TRADE INDUSTRY AND COMPETITION ON THE PUBLIC INTEREST SCORE

Background

1. The intentions of company law reform leading to the Companies Act 71 of 2008 were announced by the policy paper of the Department of Trade and Industry (DTI) entitled *Company Law for the 21st Century*. The development of a clear, facilitating, predictable, and consistently enforced law was promised, that would provide a protective and fertile environment for economic activity. The policy paper proposed "that company law should promote the competitiveness and development of the South African economy".

2. Consequently, the new Company's Act was promulgated as an **enabling**, **not a punitive legislation** with the objectives to:
   - Encourage entrepreneurship, enterprise development and employment by simplifying the procedures for forming companies, and by reducing the costs associated with the formalities of forming a company and maintaining its existence.
   - Promoting innovation and investment in South African markets and companies by providing for flexibility in the design and organisation of companies and by providing a predictable and effective regulatory environment

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- Promoting the efficiency of companies and their management
- Encouraging transparency and high standards of corporate governance
- Making company law compatible and harmonious with best practice jurisdictions internationally.

3. A focus on simplification, flexibility, corporate efficiency, transparency, and predictable regulation was the order of the day. The unitary approach adopted in drafting the Act makes it important to differentiate between types of companies so as not to overburden smaller ones.

4. The Companies Act, 2008 adopted a differential approach in determining the:
   - Level of the financial reporting standard that should be followed when preparing financial statements
   - Nature and scope of the report that should be issued on financial statements
   - Type of company that should be exempted from the audit and independent review requirement.

5. Examples of differentiation include the following:
   - Distinguishing between public interest and non-public interest companies
   - Prescribing international financial reporting standards for listed and large companies only
   - Allowing smaller companies to prepare financial statements based on a fair presentation framework other than international financial reporting standards. Alternative frameworks include modified cash basis accounting and an entity-specific framework (for example the United Nations SMEGA Level 3 accounting framework)
   - Granting audit exemption for companies below a certain threshold
   - Providing alternative assurance in the form of an independent review for large non-owner-managed private companies
   - Excluding certain types of companies from mandatory compliance to the enhanced accountability requirements of Chapter 3 of the Act.

6. The mechanism used to assist in achieving these objectives is the public interest score (PI score). As per section 26(2) of the Companies Act Regulations, 2011 companies are required to calculate their PI score at the end of each financial year.

The PI score is calculated as the sum of the following:

- **1 point for each employee** or the average number of employees throughout the year.
- **1 point per million rand of third-party liability**. This is the money owed in terms of loans, debentures, and other financing.
- **1 point for each million rand of turnover** during the financial year.
- **1 point for every individual** who, has **direct or indirect beneficial interest** in the company. This will include shareholders, beneficiaries of a trust where a trust is a shareholder and other stakeholders.

7. Financial reporting and audit requirements in the Companies Act are identified based on the size, nature, and ownership of companies. These requirements are demonstrated in the table in Annexure 2.

International best practices

Practices in the European Union

8. In the European Union Directive 2013/34/EU[1] sets out the framework and requirements for statutory audits of annual and consolidated accounts. The legislation applies to limited liability companies in the European Union (EU).

9. It defines and differentiates between micro-, small, medium-sized and large companies, based on the following criteria:

   - **Criterion 1:** balance sheet total
   - **Criterion 2:** net turnover; and
   - **Criterion 3:** the average number of employees during a financial year.

10. Ranking entities into categories is based on the limits set for each of the criterion identified above. **Entity falls within a category when their financial results for two consecutive years, do not exceed the limits of at least two of the three criteria.** The following limits were set for the categories:

    - **micro-undertakings:** balance sheet total (€350,000), net turnover (€700,000), employees (10)

[1] Directive 2013/34/EU, The European Parliament and Of the Council, 2013

- small undertakings: balance sheet (€4 million), net turnover (€8 million), employees (50)
- medium-sized undertakings: balance sheet (€20 million), net turnover (€40 million), employees (250)
- large undertakings are those that exceed the limits of a medium-sized undertaking: balance sheet (€20 million), net turnover (€40 million), employees (250).

11. Public interest entities (PIEs) are broadly those traded in regulated market, credit and insurance institutions and other large and medium sized entities. These entities are automatically subject to statutory audit requirements.

12. The statutory audit of PIEs is subject to strict rules. This is because there is a need for reliable information due to the entity's relevance to the public and investors. The rules include:

- a more detailed audit report which includes information about the conduct of the audit
- auditors/auditing firms must rotate
- a list of non-audit services that cannot be provided by the statutory auditor or audit firm to the audited entity which must be drawn up by EU countries
- limits must be placed on fees charged for non-audit services
- an audit committee is created which has a key role in appointing the auditor and monitoring the audit.

Practices in the United Kingdom

13. As stated on the website of the Government of the United Kingdom[2] criteria to identify larger companies are set out in terms of turnover, total assets, and number of employees. To qualify as large company under the Companies Act 2006, two out of the following criteria have to be met:
    - Turnover of more than £36 million;
    - Balance sheet total of more than £18 million;
    - More than 250 employees.

14. Small companies may qualify for an audit exemption when they fulfil at least 2 of the following criteria:

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[2] UK government website. Available at: https://www.gov.uk/audit-exemptions-for-private-limited-companies (Accessed: 6 October 2022)

- an annual turnover of no more than £10.2 million
- assets worth no more than £5.1 million
- 50 or fewer employees on average.

Problems identified with the PI score

15. We identified the following problems with the application on the PI score:

15.1 The PI score limits are not updated for inflationary increases. This impacts negatively on smaller entities as each year more of them fall into categories that require higher level of financial reporting, review, or audit requirements.

15.2 The lack of adequate practical guidance for the calculation of the PI score leaves uncertainty on how to consider certain aspects, for example, how to include seasonal workers in the calculations.

15.3 When comparing to international benchmarks, we can see that the Companies Act provides for a more rigid approach in ranking entities leading to more entities falling into higher categories.

15.4 Aggregating the PI scores for criteria annually may have a negative impact for small entities with:
- Labour intensive businesses, i.e., small scale farmers with seasonal workers
- Export companies with high levels of reported revenue that may fall into a higher category without an ability to consider other criteria
- Entities where revenue may fluctuate each year resulting in different requirements for these years.

15.5 Although the Companies Act was drafted as an enabling act to provide a simple solution, the table in Annexure 2. shows a highly complex environment that was created.

15.6 In addition, the Companies Act decriminalized and most criminal penalties were removed to ensure the act's enabling nature. For this reason, there are no automatic punitive penalties allocated should a company for example not prepare financial statements within 6 months of year end or miscalculate its PI Score. The PI score provides a general indicator that can guide the company's decision making.

15.7 Given the dynamic economic and business environment within which directors operate a revised PI score framework is advisable. The EU and UK provides for this dynamic environment by requiring in essence the average number over a three-year period. The scientific method used is that of direction and not a fixed value.

Our recommendations

16. We would like to recommend the consideration of the following:

16.1 Provision for inflationary changes with periodic updates to the limits set for the criteria.

16.2 PI score calculation should be brought in line with the international practices. As per practices in the EU and the UK entities the new South African framework should provide for ranking companies into categories when 2 out of 3 criteria is met over a period of 3 years. This gives required flexibility for smaller entities to address unique circumstances that would automatically rank them into higher categories in terms of the current PI score calculation.

16.3 Limits should be set to identify small, medium, and large entities for the following criteria:

- average number of employees
- total assets
- turnover
- number of individuals who, has direct or indirect beneficial interest.

Table 1. below shows the limits for South Africa based on the benchmarks set by the EU model for annual turnover, employees and total assets. These limits are for illustration purposes and should be subject to further consideration based CIPC information.

Table 1. Limits based on the EU benchmarks

Types of entities	Application of criteria	Annual turnover	Employees	Total assets	Persons with direct interest
Micro entities	Do not exceed the limits of at least 2 criteria over 3 years	Less than R12.4 million	Less than 10	Less than R6.2 million	Less than 5
Small entities		Less than R141.3 million	Less than 50	Less than R70.6 million	Less than 20
Medium entities		Less than R706.4 million	Less than 250	Less than R353.2 million	Less than 50

Types of entities	Application of criteria	Annual turnover	Employees	Total assets	Persons with direct interest
Large entities – exceeds	Exceeds the limits of at least 2 criteria over 3 years	More than R706.4 million	More than 250	More than R353.2 million	More than 50

16.4 Reporting and audit requirements are identified for entities based on the limits fulfilled:

- Public interest entities are required to have statutory audits with mandatory partner rotation and independence requirements for performing non-assurance services.
- Large entities are required to be audited.
- Medium entities are required be independently reviewed when the entity is non-owner managed or, if owner managed, have financial statements compiled by a qualified professional.
- Small entities similarly to medium entities should either undergo either an independent review (non-owner managed) or a compilation engagement (owner managed).
- Micro entities should be exempt from all audit requirements.

For the detailed characteristics of the different types of reporting engagements refer to Annexure 3. The reporting and audit requirements are demonstrated in Table 2.

Table 2. Audit requirements for entities

Criteria	Consideration	Description	Audit requirement
1. Nature of the entity	Listed companies State Owned companies	Public Interest Entities	Statutory Audit Performed by registered auditor
2. Size of the entity	Entities that fulfill 2 out of 3 relevant limits over a 3-year period: 1. Annual turnover more than R706.4 million 2. Number of employees more than 250 3. Total assets more than R353.2 million 4. Individuals with beneficial more than 50	Large Entities (Privately owned)	Full audit in line with International Standards on Auditing

Criteria	Consideration	Description	Audit requirement
3. Nature and size of the entity	Entities that fulfil more than 2 out of 3 relevant limits over a 3-year period: 1. Annual turnover less than R706.4 million 2. Number of employees less than 250 3. Total assets less than R353.4 million 4. Individuals with beneficial interest less than 50	Medium Non-Owner-Managed Entities	Independent review
		Medium Owner-Managed Entities	Compilation engagement undertaken by a professional person who is a member of a professional body recognized by CIPC and qualifies as an accounting officer[3]
	Entities that fulfil more than 2 out of 3 relevant limits over a 3-year period: 1. Annual Turnover less than R141.3 million 2. Number of employees less than 50 3. Total assets less than R70.6 million 4. Individuals with beneficial interest less than 20	Small Non-Owner-Managed Entities Directors are not shareholders	Independent review
		Small Owner Managed Entities	Compilation engagement

17. Adequate guidance should be provided demonstrating the application of the framework with examples to promote understanding and consistent application of requirements.

Conclusion

18. While SAIBA fully supports the intention of the Company's Act to implement criteria to distinguish between small and large entities, it is important that this is done in a manner that supports the original intention of the Act in promoting a simple enabling environment. The PI score s been such criteria, especially when linked to monetary amounts need to be periodically reviewed.

[3] CIPC. (2022) Notice 28 of 2022. Available at: https://www.cipc.co.za/wp-content/uploads/2022/09/Revised-List-of-Accredited-Professional-Bodies-as-of-22-September-2022-2-1.pdf (Accessed: 6 October 2022)

19. We appreciate your time and consideration regarding the above recommendations. Please do not hesitate to contact us should the need arise.

Yours sincerely

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Eszter Rapanos
SAIBA Technical Manager

ANNEXURE 1. Background Document on Independent Review Engagements of SAIBA –
Refer to document enclosed.

ANNEXURE 2. Companies Act 2008 and Companies Regulations 2011: How to prepare and report on financial statements for companies

INDEPENDENT ACCOUNTING PROFESSIONAL (IAP)

Function	Qualification	Statutory appointment	Independence
1. Company may request IAP to independently compile financial statements. Company not obligated to do this. 2. Company may request a non-IAP to compile financial statements. This affects the applicable Financial Reporting Standard and audit or review	1. Registered auditor 2. Member of SAICA	1. Companies are not require the appoint an IAP	1. No personal financial interest in company or related company 2. No day to day management involvement 3. Not a prescribed officer or full time executive employee 4. Not related to any person performing above 5. IAP and independent reviewer may not be the same person if mandatory engagement
	3. Accounting Officer as per Close Corporation Act	2. Companies Act are not required to appointment an IAP	

PREPARATION OF FINANCIAL STATEMENTS AND FINANCIAL REPORTING STANDARDS

Applicability	Definition	Types of FRS	Statutory allocation	Statutory accountant	Independent or internally compiled
For financial year ends after 1 May 2011. All companies are required to prepare financial statements within the following parameters: • in accordance with a prescribed Financial Reporting Standard (FRS) • to enable fair presentation • not be false or misleading in material respect • not be incomplete in material respect	The prescribed standards that a company should use to prepare financial statements. FRS as prescribed in the Companies Act should not be confused with standards issued by the IASB. FRS includes IASB standards but is not limited to them.	IFRS	1. State owned companies, 2. Listed public companies, 3. Non-profit companies required to be audited i.e. state owned or state run	No	NA
		IFRS for SME or higher	1. Unlisted public companies; 2. Profit and Non-Profit companies with public interest score of 350 or more;	No	NA
		SA GAAP or higher	1. Profit and Non-Profit companies with public interest score of 100 – 349 and FS independently compiled;	No	Independently compiled if FS prepared by an IAP
			2. Profit and Non-Profit companies with public interest score of 100 – 349 and FS internally compiled; or		Internally compiled if FS prepared by a non-IAP. A non-IPA is any person other than an IAP.
			3. Profit companies with public interest score less than 100 and financial statements are independently compiled	No	Independently compiled if FS prepared by an IAP
		The company specific standard for recognition, measurement, presentation, disclosure as detailed in the firms accounting policies. Accounting policies should achieve FS that: a) Achieve fair presentation, b) Are not false or misleading (material), c) Are not incomplete (material)	1. Profit and Non-Profit companies with public interest score less than 100 and financial statements are internally compiled.	No	Internally compiled if FS prepared by a non-IAP. A non-IPA is any person other than an IAP.

Public interest score

Employees:	1 point allocated for the average numbers of employees (as per labour law) during the financial year
Shareholders:	1 point for each shareholder
Third party liability:	1 point for each million rand in third party liabilities at financial year end
Turn over:	1 point for each million rand turn over during the financial year

ANNEXURE 2. Companies Act 2008 and Companies Regulations 2011: How to prepare and report on financial statements for companies (continued)

AUDIT AND INDEPENDENT REVIEW								
Applicability	Definition	Types	Ownership structure, size and type of preparer	Provider	Standard	Reportable irregularity	Independence	Additional requirements
			Non-owner managed and Owner managed companies					
Regulations do not specify from which date the required report becomes effective. The criteria to determine if a company is required to be audited or independently reviewed consist of the following: • Size, • Ownership structure, • Function • The person that prepared the financial statements	• Audit as per Auditing Profession Act • Independent Review as per ISRE 2400	Mandatory Audit	1. State owned companies, 2. Listed public companies, 3. Non-profit companies that are state owned or state run 4. Unlisted public companies 5. Profit companies with public interest score of 350 or more; 6. Profit companies with public interest score of 100 – 349 and FS internally compiled; 7. Profit and non-profit company in the ordinary course of its primary activities, it holds assets in a fiduciary capacity for persons who are not related to the company, and the aggregate value of such assets held at any time during the financial year exceeds R 5 million	Registered auditor	ISA	Yes to IRBA	IFAC independence requirements as for public interest companies i.e. same independence requirements as for listed companies (Section290 of IFAC Code)	Mandatory application: 1. Chapter 3 i.e. audit committee, auditor rotation, company secretary 2. Enhanced Director remuneration disclosure
			Non-owner managed and Owner managed companies					
		Voluntary audit	MOI or directors opt for an audit report	Registered auditor	ISA	Yes to IRBA	IFAC independence requirements as for non-public interest companies	No
			Non-owner managed					
		Mandatory independent review	1. Profit and Non-Profit companies with public interest score of 100 – 349 and financial statements independently compiled	Independent reviewer: 1. Registered auditor or 2. Member of IRBA accredited body i.e. SAICA	ISRE 2400	Yes to Companies Commission. Limited in scope.	1. IFAC independence requirements as for non-public interest companies 2. IAP and Independent reviewer may not be same person	No
			Non-owner managed					
			1. Profit and Non-Profit companies with public interest score of less than 100	Independent reviewer: 1. As above or 2. Accounting Officer	ISRE 2400	Yes to Companies Commission. Limited in scope.	1. IFAC independence requirements as for non-public interest companies 2. IAP and Independent reviewer may not be same person	No
			Owner-managed					
		Voluntary alternative reports	1. A profit company with a public interest score of 100 – 349 and FS independently compiled 2. Profit companies with public interest score of less than 100 irrespective if independently or internally compiled	1. RA, 2. IR, 3. Accounting officer 4. Compiler	1. ISA 2. ISRE 3. AO 4. ISRS	Companies Commission to issue practice note- not clear if applies as voluntary engagement	Companies Commission to issue practice note – not clear if applies as voluntary engagement	No

ANNEXURE 3. Characteristics of reporting engagements

Subject	**Audit**	**Review**	**Accounting officer/AUP**	**Compilation**
Assurance level	High	Limited	Minimal	Minimal
Subject matter	Financial statements	Financial statements	Financial statements, accounting policies, compliance	Financial statements
Parties	Three	Three	Two	Two
Nature of opinion	Reasonable assurance – "financial statements present fairly"	Moderate – "nothing came to our attention to indicate"	No opinion – state facts	No opinion
Purpose of procedures	Reduce risk of material statement	Obtain plausibility	Obtain facts and apply judgement	Obtain facts and apply judgement
Type of procedures	Inquiries, observation and inspection, analytical procedures	Inquiries of management and others, Analytical procedures	May include inquiry and analysis, recomputation, comparison and other clerical accuracy checks, observation, inspection, obtaining confirmations.	Inquiries of management and others,
Procedures not required		Assess internal controls, verify any matters;, verify any explanations.	Inquiries of reliability and completeness , Assess internal controls, verify matters or explanations.	Inquiries of reliability and completeness , Assess internal controls, verify any matters;, verify any

ANNEXURE 3. Characteristics of reporting engagements (continued)

Subject	**Audit**	**Review**	**Accounting officer/AUP**	**Compilation**
Understanding the entity	In depth	General	General	General
Relative cost	High	Medium	Low	Low
Typical framework	IFRS	IFRS for SME	gaap as appropriate	IFRS, IFRS for SME, gaap as appropriate
Standard	ISA	ISRE 2400	ISRS 4400	ISRS 4410
Practitioner	Auditor	Independent reviewer	Accounting officer/Practitioner	Compiler
Report addressee	Shareholders	Shareholders		Entity
Professional liability	Yes	Yes	Yes	Yes
Liability protection	S 46 of APA – limits liability to third parties S58 of APA – allows apportionment of damages to clients	No statutory provision – have to rely on contract law	No statutory provision – have to rely on contract law	No statutory provision – have to rely on contract law
Regulation	IRBA	CIPC/Professional bodies	CIPC/Professional bodies	Professional bodies
Applicability	SOE, Public Company, PIC, Companies that voluntary opt-in	Non-owner managed company, Companies that voluntary opt-in	Close corporation / companies that voluntary opt-in	CC and Co that voluntary opt in