

**Standard-setting and Enforcement of financial reporting
standards in South Africa under the old and the new
Companies Acts as well as in the European Union**

by

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.....

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R. SCHMIDT

DATE

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Opsomming

Hierdie tesis handel oor die wyse waarop Suid-Afrika en die Europese Unie (EU) finansiële verslagdoeningstandaarde vasstel en afdwing, sowel as die vereistes waaraan die *Internasionale Rekeningkundige Standaarde Raad (IRSR)* se *Internasionale Finansiële Verslagdoeningstandaarde (IFVSe)* moet voldoen voordat dit gewettig kan word in Suid-Afrika en die EU.

Die nuwe Suid-Afrikaanse Maatskappywet (No. 71 van 2008) verbeter op die gewysigde ou Suid-Afrikaanse Maatskappywet (No. 61 van 1973) en erken in besonder die beduidende rol van administratiewe wetgewing (en van die *Promotion of Administrative Justice Act*) in die bepaling en afdwinging van finansiële verslagdoeningsstandaarde.

Die Raad oor Finansiële Verslagdoeningstandaarde (hierna “die Raad”) se rol in die stel van standaarde is aansienlik verklein onder die nuwe Maatskappywet. Die Raad is nie meer so outonoom soos voorheen nie. Dit sal bloot 'n raadgewende forum vir die Minister wees en sy bevoegheid word beperk tot die formulering van nie-bindende voorstelle. Die Minister van Handel en Nywerheid is die mees gesaghebbende persoon rakende standaardstelling onder die nuwe Wet. Beide die ou en die nuwe Maatskappywet bevat bepalings aangaande finansiële verslagdoeningstandaarde. In teenstelling met die vae bepalings van die ou Maatskappywet, sit die nuwe Maatskappywet die wetlike status van die finansiële verslagdoeningstandaarde duidelik uiteen.

Die Suid-Afrikaanse Wetgewer vereis heelwat groter ooreenstemming tussen die inhoud van die finansiële verslagdoeningstandaarde met die IRSR se IFVSe, as wat die EU se wetgewers vereis. Verder verskil die EU en Suid-Afrika ook wat die belangrikheid aanbetref, wat aan die Raamwerk vir die Voorbereiding en Aanbieding van Finansiële State (asook die Konseptuele Raamwerk vir Finansiële Verslagdoening, onderskeidelik) en die nie-kern komponente van die IFVSe (Inleidings, Basis vir Gevolgtrekkings, Verduidelikende Voorbeelde, ens.) geheg word.

Baie van die institusionele verskille tussen Suid-Afrika en die EU rakende standaardstelling (die bepaling van standaarde) ontstaan vanweë die EU se inmeekaargevlegte strukture, wat nie voldoen aan 'n rigiede verdeling van magte beginsel nie.

Parlementêre kontrole meganismes is sterker in die EU as in Suid-Afrika met verwysing na die bepaling van finansiële verslagdoening standaarde. Daar word in die besonder heelwat meer institusionele en statutêre gewig gegee aan publieke belange aangeleenthede om op te weeg teen die private oorsprong van die IFVSe. Die Suid-Afrikaanse proses, aan die ander kant, is heelwat vinniger. Die Europese Parlement kan die IAS regulasies teenstaan in die hof. Die Suid-Afrikaanse parlement het nie 'n gelykstaande reg in terme van die Suid-Afrikaanse Konstitusie nie. In teenstelling met Suid-Afrika, is daar nog nie 'n eenvormige EU afdwingingsprosedure in plek nie. Regterlike beheer van bepaalde IFVSe in die EU ly onder die ernstige prosedurele swakhede, terwyl dit blyk dat regterlike kontrole oor gewettigde finansiële verslagdoening standaarde in Suid-Afrika meer effektief funksioneer.

Summary

This thesis deals with the way in which South Africa and the European Union (EU) set and enforce financial reporting standards and with the requirements which the International Accounting Standards Board's (IASB's) International Financial Reporting Standards (IFRSs) have to meet before they may become law in South Africa and the EU.

The new South African Companies Act (No. 71 of 2008) improves upon the amended old South African Companies Act (No. 61 of 1973) and in particular acknowledges the significant role of administrative law (and of the Promotion of Administrative Justice Act) in the enactment and enforcement of financial reporting standards.

The Financial Reporting Standard Council's (FRSC's) role in standard-setting has been weakened substantially under the new Companies Act. The FRSC is not as autonomous as it was under the old Act. It is to be a mere advisory forum to the Minister with nothing but non-binding drafting powers. With regard to standard-setting, the Minister of Trade and Industry is the strong man under the new Act. Both the old and the new Companies Act contain provisions regarding financial reporting standards. In contrast to the vague provisions of the old Companies Act, the new Companies Act clearly sets out the legal status of financial reporting standards.

The South African legislator requires much greater conformity of the contents of financial reporting standards with the IASB's IFRSs than the EU legislators do. Furthermore, the EU and South Africa differ in the importance they assign assigned to the Framework for the Preparation and Presentation of Financial Statements (and the Conceptual Framework for Financial Reporting, respectively) and the non-core components of the IFRSs (Introductions, Bases for Conclusions, Illustrative Examples, etc.).

As regards standard-setting (the enactment of standards), many of the institutional differences between South Africa and the EU arise from the EU's intertwined institutional structure which, does not conform to any rigid separation of powers principle.

Legislative control mechanisms are stronger in the EU than in South Africa with regard to the enactment of financial reporting standards. In particular, public interest concerns are given considerably more institutional and statutory weight in order to counterbalance the private origin of the IFRSs. On the other hand, by design, the South African process is swifter. The European Parliament can challenge IAS regulations in court. The South African parliament does not have equivalent right in terms of the South African Constitution. In contrast to South Africa, there is no uniform EU enforcement procedure in effect as yet. Judicial control of enacted IFRSs in the EU suffers from severe procedural flaws, while judicial control of enacted financial reporting standards in South Africa seems set to be more effective.

The law is stated as at the end of August 2011.

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List of abbreviations

A	Appellate Division
AD	Appellate Division
ADR	Alternative Dispute Resolution [= VDR]
ADJR	Australian Administrative Decisions (Judicial) Review Act
AGC	Auditing Guidance Committee (SAICA)
APB	Accounting Practices Board
APC	Accounting Practices Committee (SAICA)
AG	1.) Application Guidelines or 2.) Die Aktiengesellschaft [= German Law Journal]
AJ	Acting Judge
AJA	Acting Judge of Appeal
All ER	All England Law Reports
All SA	All South African Law Reports
ARC	Accounting Regulatory Committee
art.	article
arts.	articles
BaFin	<i>Bundesanstalt für Finanzdienstleistungsaufsicht</i> [= FFSA]
BB	<i>Der Betriebsberater</i> [= German Law and Accounting Journal]
BC	Basis for Conclusions
BCLR	Butterworths Constitutional Law Reports
BFuP	<i>Betriebswirtschaftliche Forschung und Praxis</i> [= German Accounting Journal]
BGH	<i>Bundesgerichtshof</i> [= the German Supreme Court in Civil Matters]
BLLR	Butterworths Labour Law Reports

CC	1.) Circular (issued by SAICA) or 2.) Constitutional Court
CCMA	Commission for Conciliation, Mediation and Arbitration
cf.	confer
CFI	Court of First Instance
CIPC	Companies and Intellectual Property Commission
CIPRO	Companies and Intellectual Property Registration Office
CJ	Chief Justice
CLAA	Corporate Laws Amendment Act No. 24 of 2006
CMLR	Common Market Law Review
cons	consolidated (version of)
DAX	Deutsche Aktienindex
DB	<i>Der Betrieb</i> [= German Law and Accounting Journal]
DCJ	Deputy Chief Justice
DG	Directorate General
DO	Dissenting Opinions
DPR	<i>Deutsche Prüfstelle für Rechnungswesen</i> [= FREP]
DStR	<i>Deutsches Steuerrecht</i> [= German Law Journal]
DTI	Department of Trade and Industry
EC	European Community
ECJ	European Court of Justice
ECOFIN	Council of the Ministers of Economic Affairs and Finance
ECR	European Court Reports
ed(s).	editor(s)
EDL	Eastern District Local Division (Cases of the Supreme Court 1910-1946)

EEC	European Economic Community
EFRAG	European Financial Reporting Advisory Group
ELJ	European Law Journal
EL Rev	European Law Review
et al.	et alii
et seq.	et sequentes
EU	European Union
FASB	Financial Accounting Standards Board
FFSA	Federal Financial Supervisory Authority [= <i>BaFin</i>]
FREP	Financial Reporting Enforcement Panel [= <i>DPR</i>]
FRIP	Financial Reporting Investigation Panel
FRS	Financial Reporting Standard
FRSC	Financial Reporting Standards Council
FSB	Financial Services Board
FSE	Frankfurt Stock Exchange [= <i>FWB</i>]
FWB	<i>Frankfurter Wertpapierbörse</i> [= FSE]
GAAP	Generally Accepted Accounting Practice
GG	1.) Government Gazette 2.) Grundgesetz ('Basic Law') [=the German Constitution]
HGB	Handelsgesetzbuch [= the German Commercial Code]
HL	House of Lords
IAS(s)	International Accounting Standard(s)
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee

IDW	<i>Institut der Wirtschaftsprüfer in Deutschland</i> [= the German equivalent to SAICA]
IE	Illustrative Examples
i.e.	id est
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretations Committee
IFRS(s)	International Financial Reporting Standard(s)
IFRS-IC	IFRS Interpretations Committee
IG	Guidance on Implementing
ILJ	Industrial Law Journal
IN	Introduction
IOSCO	International Organisation of Securities Commissions
IRBA	The Independent Regulatory Board for Auditors
J	Judge
JA	Judge of Appeal
JSE	Johannesburg Stock Exchange
KoR	<i>Zeitschrift für internationale und kapitalmarktorientierte Rechnungslegung</i> [= German Accounting Journal]
LAC	Labour Appeal Court
LAWSA	The Law of South Africa
LC	Labour Court
LCC	Land Claims Court
LR	Listings Requirement (JSE)
MEP	Member of the European Parliament
MR	Master of the Rolls

NamLJ	Namibia Law Journal
NJW	<i>Neue Juristische Wochenschrift</i> [= German Law Journal]
NZG	<i>Neue Zeitschrift für Gesellschaftsrecht</i> [= German Law Journal]
OB	Objective (Conceptual Framework for Financial Reporting 2010)
OJ	Official Journal of the European Communities
OLG	<i>Oberlandesgericht</i> (Higher Regional Court)
PAAB	Public Accountants' and Auditors' Board
PAJA	Promotion of Administrative Justice Act 3 of 2000
par	paragraph
paras	paragraphs
PiR	<i>Praxis der internationalen Rechnungslegung</i> [= German Accounting Journal]
QB	Queen's Bench Division
reg	Regulation (Companies Regulations)
regs	Regulations (Companies Regulations)
s	section
ss	sections
SA	South African
SAC	Standards Advisory Council
SAICA	The South African Institute of Chartered Accountants
SAJAR	South African Journal of Accounting Research
SAJHR	South African Journal on Human Rights
SALJ	South African Law Journal
SAMercLJ	South African Mercantile Law Journal
SARG	Standards Advice Review Group
SCA	Supreme Court of Appeal

SEA	Single European Act
SEC	Securities and Exchange Commission
SENS	Securities Exchange News Service (JSE)
SIC	Standing Interpretations Committee (1996-2009)
SME	Small and medium-sized entity
StellLR	Stellenbosch Law Review
StuB	<i>Zeitschrift Unternehmenssteuern und Bilanzen</i> [=German Accounting Journal]
TEG	Technical Expert Group
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TOR&OP	Terms of Reference and Operating Procedures of the Accounting Practices Committee
TRW	Tydskrif Vir Regswetenskap (Journal for Juridical Science)
UK	United Kingdom
UNCITRAL	United Nations Commission on International Trade Law
v	versus
VDR	Voluntary dispute resolution
viz.	videlicet
WM	<i>Wertpapier-Mitteilungen</i> [= German Law Journal]
WPg	<i>Die Wirtschaftsprüfung</i> [= German Accounting Journal]
WpHG	<i>Wertpapierhaftungsgesetz</i> [= the German Securities Trading Act]
WpÜG	<i>Wertpapiererwerbs- und Übernahmegesetz</i> [= the German Securities Acquisition Act]
WTO	World Trade Organisation
ZASCA	South Africa: Supreme Court of Appeal (SAFLII online database)

ZHR *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* [= German Law Journal]

ZIP *Zeitschrift für Wirtschaftsrecht* [= German Law Journal]

1. Introduction and background to the research problem

1.1 Legal framework and terminology

At the end of 2007, in the dying days of the Companies Act No. 61 of 1973 (henceforth referred to as “the old Companies Act”), legal backing for financial reporting standards and for the setting of such standards was, for the first time, inserted into the Act by virtue of the Corporate Laws Amendment Act No. 24 of 2006 (henceforth referred to as “the CLAA”).

This amendment act was assented to on 11 April 2007 and promulgated on 14 December 2007. It contributed a definition of “Financial reporting standards” (in s 1), s 285A as well as chapter XVB (“Financial Reporting Standards”) to the old Companies Act.

By then, however, the Companies Act No. 71 of 2008 (henceforth referred to as “the new Companies Act”) was around the corner and in its final drafting stage (Companies Bill 61D-2008).

The new Companies Act brings considerable institutional reform with regard to financial reporting standards (henceforth referred to as “FRSs”), their setting and their legal backing. It was assented to on 9 April 2009. According to its original concluding section (s 225), it had to come into operation “on a date fixed by the President ..., which may not be earlier than one year following the date on which the President assented to the new Companies Act”, *i.e.* after 9 April 2010. The delay of a minimum of one year between the Act being enacted and its coming into operation was considered necessary in order to give the Minister of Trade and Industry time to re-arrange the current structure of the Department of Trade and Industry (henceforth referred to as “the DTI”) to accommodate changes envisaged by, and incorporated into, the new Act and to

determine and publish what will constitute “the prescribed manner” as set out in many sections of the Act as well as in order to allow industry and the public to become familiar with it.

In the European Union the European Council, jointly with the European Parliament, issued Regulation No. 1606/2002 on 19 July 2002 (henceforth referred to as “the foundational IAS regulation”). By virtue of this regulation, all existing IASs/IFRSs¹ became European Union legal norms (Community law). It propelled the IASB – until then a rather insignificant private standard-setter – into the centre of attention. The endorsement of the standards of a private standard-setter gave rise to considerable legal issues in those member states which are – like South Africa – constitutional states (in particular Germany).

The Companies Act No. 71 of 2008 was amended by the Companies Amendment Act No. 3 of 2011 and finally came into effect on 1 May 2011. On the same day the Companies Regulations 2011 became effective.

1.1.1 South Africa

The new Companies Act brings significant institutional re-organisation: it provides for the re-establishment of the Financial Reporting Standard Council (henceforth “the FRSC”), although in a watered-down form.² It establishes the new Companies and Intellectual Property Commission (henceforth “the Commission”) and the Companies Tribunal (henceforth “the Tribunal”),³ while abolishing the Financial Reporting Investigation Panel (henceforth “the FRIP”) which was to be

¹ The foundational IAS regulation uses in its art. 2 the term *International Accounting Standard (IAS)* as collective term for all IASs, IFRSs, SIC Interpretations and IFRIC Interpretations. In contrast, the IASB in par 7 of IAS 1 uses the term *International Financial Reporting Standard (IFRS)*, rather than the term *IAS*, as the respective collective term. For the purposes of this thesis, the term *IFRS* is used throughout as the respective collective term, with the exception of those chapters which deal with and refer to EU law.

² See infra Chapter 2.1.1.2.

³ See infra Chapter 2.1.3.

created in terms of the old Companies Act. The new Act also lays down detailed administrative procedures with regard to investigations into alleged non-compliance with financial reporting standards (including alternative dispute resolution and review procedures).⁴

Furthermore, the new Companies Act largely decriminalises company law and generally replaces criminal sanction with a system of administrative enforcement to ensure compliance with the Act (Memorandum to Bill 61D-2008, item 12). Thus, as a rule, non-compliance is no longer prosecuted as a criminal offence ('criminalised'), but is merely addressed via administrative fines. There are very few offences remaining and these are easily identified because of the Act's wording "is guilty of an offence". One such offence is the preparation, approval, dissemination or publication of financial statements which do not materially comply with financial reporting standards (s 29(6)(a)(i), read with s 29(1)(a) and s 214 of the new Companies Act; s 285A(1)(a),(2)(a),(3), read with s 287 of the old Companies Act). Both the old and new Companies Act require participation ("is a party to") in the preparation, dissemination or approval of the non-compliant financial statements. However, the new Act in s 29(6) in addition puts forward the requirement of "knowing that" and defines this in s 1 as including negligence. Under the old Act, the situation was less clear: Delpont *et al.* (2008:163) pointed out that intentional participation was already indicated by the mere words "is a party to". What about negligent participation? The old Act made no explicit mention of this. Delpont *et al.* (2008:560(6)) submitted that negligence was captured under s 287 of the old Companies Act. This seemed at odds with their previous submission that the mere words "is a party to" are indicative of intention (2008:163); however, these words are – it is submitted – nevertheless broad enough to cater for both intentional and negligent participation. In terms of s 287 of the old Companies Act, "the company and every director or officer" could have been guilty of an offence. In contrast, s 29(6) of the new Companies Act simply speaks of the participating "person". Does this again include the company itself? The answer is yes, for the following reason: "Person" in terms of the new Companies Act is statutorily defined in s 1 of the new Companies Act as including juristic persons. A company can thus be a participating person in terms of s 29(6). How does a company participate in the publication or dissemination of its own

⁴ See *infra* Chapter 4.1.

non-compliant financial statements? The answer lies in the legal ‘directing mind’ doctrine, also referred to as the ‘alter ego’ doctrine (Blackman, 1995:54; Schmidt, 2008:190): Directors are considered the company’s directing minds. Their acts and states of mind (knowledge, intention, negligence) are attributed to the company: their minds are its mind; their knowledge its knowledge; their intention its intention. The doctrine applies to both criminal and civil law (Blackman, 1996:54; Schmidt, 2008:203). The doctrine originated in England (*Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd 1914-15 All ER 280 (HL)*). It began to take hold in South African case law long before the old Companies Act even came into effect (*Barkett v SA Mutual Trust & Assurance Co Ltd 1951 (2) SA 353 (A)*) and is undoubtedly applicable to s 29(6) of the new Companies Act too.

Finally and notably, the drafting style of the new Act has improved compared with the old Act. This is particularly noticeable in two areas.

Firstly, in contrast to the old Act, the new Act avoids using the word “shall”. “Shall” in legislative drafting is generally used in an imperative (peremptory) sense which means that something must or must not be done (Burns & Beukes, 2006:193; Botha, 2005:111). Nevertheless, “shall” can have other meanings too and thus can cause ambiguity and difficulties in interpretation (Redux, 1986:186): it can occur as the “creative shall” (“There shall be a council”, meaning: “There is hereby established a council”) or as a “declaratory shall” (“The provisions of section XY shall apply mutatis mutandis”, meaning: “Section XY applies mutatis mutandis”) or even as a “temporal shall”, denoting future time. The “temporal shall” is not often necessary in legislative drafting owing to the established doctrine (as far back as *R v Grainger 1958 (2) SA 443 (A) 447*) that a statute be regarded as always/continuously speaking and therefore that the present tense (rather than future tense) should be used, even though the relevant event or act may only take place long after the statute is passed. The “creative shall” is archaic, and neither the old Companies Act (see s 440P(1)) nor the new Companies Act (see s 193(1)) uses it any longer. It is the “declaratory shall” that causes most problems, since it can at times be difficult to distinguish from the “imperative shall”. For this reason, “shall” is best avoided in legislative drafting and replaced by “must” (imperative) or “may” (discretionary/permissive). The new Companies Act does so consistently: the word “shall” does not appear once in the

statutory body of the new Companies Act. In contrast, the old Companies Act used both “shall” and “must” and “may” in chapter XVB. In the crucial s 440U⁵ this led to ambiguities. Section 440U(2) read: “The Minister *shall* issue financial reporting standards on the advice of the Council ...” If this “shall” were imperative one wonders why the draftsman did not use – as in s 440U(1) – the word “must” for consistency’s sake. If this “shall” was intended to allow for discretion instead, one would have rather expected the word “may”. This is particularly so, since “shall” has only on very rare occasions been read by the courts as a permissive “may” (Du Plessis, 2002:250; Devenish, 1992:230). This rare occasion concerned an instance where an imperative reading of “shall” would have fettered the court’s sentencing discretion; this was not the situation at hand with s 440U(2).

Secondly, compared with chapter XVB of the old Act, the new Act strives for plain language. This becomes obvious in particular in those parts of the Act which govern remedies and enforcement (Chapter 7) and the administration of the Act (Chapter 8).

Botha (2005:28) explains that “the ‘plain’ in ‘plain language’ does not mean monosyllabic words and single clause sentences: the emphasis is on comprehensible language”, where ‘comprehensible’ means ‘comprehensible to the end-user’. It is not the idea which is simplified, but the language used to convey those ideas (Botha, 2005:28). The typical end-user’s intellectual horizon is taken into account by the legal drafter and determines the degree of difficulty of the legislative text. For current purposes, this will notably be the directors and officers of a company.

The old Act left matters somewhat more complicated in this regard: Section 440Z(2), for instance, stated in technical language that “[t]he procedures ... [to be followed by the investigation committee] shall be in accordance with the Promotion of Administrative Justice Act, 2000 (No. 3 of 2000)”, without further clarification. What it primarily referred to is ‘the right to just administrative action’ (the administrator’s duty to act fairly; procedural fairness; the right to written reasons for administrative action), including the control over administrative action (both internal administrative control and judicial control). The new Companies Act does not explicitly refer to provisions of the Promotion of Administrative Justice Act (henceforth “the

⁵ See infra Chapter 2.1.1.2.

PAJA”). Instead, it seemingly strives to set out in detail its own administrative provisions governing procedures with regard to (alleged) investigations into non-compliance with financial reporting standards, including procedures for judicial review.⁶ On the one hand this helps simplify the legal text: references to the PAJA have become superfluous to some extent, although a great number of activities of the Commission, the Tribunal, the Minister as well as of inspectors and independent investigators constitute ‘administrative action’⁷ and the PAJA thus applies in any event.⁸ On the other hand, and more importantly, many of the administrative provisions of the Companies Act are incomplete and fragmentary and must necessarily be supplemented by provisions of the PAJA. In isolated instances, the administrative law provisions of the new Companies Act conflict with those of the PAJA.⁹

1.1.2 European Union

The European Union (henceforth “the EU”) has emerged globally as a “soft giant”, featuring a unique legal structure. It is neither a federation (like Germany) nor a confederation (like the United Arab Emirates), but appears to be something in-between.

It consists of supranational organisations, but is simultaneously subjected to strong inter-governmentalism. Today (June 2011) it comprises 27 member states.

The EU is a juristic person (Craig & De Burca, 2008:95). It was created from what was previously referred to as “the European Community” (which itself was established in 1957 by the Treaty of Rome, known today as “the Treaty on the Functioning of the European Union”, henceforth “TFEU”) by the Maastricht Treaty in 1993 (known as “the *Treaty Establishing the*

⁶ See infra Chapters 4.1.2.2.5 - 4.1.2.2.8.

⁷ See infra Chapter 2.1.1.5, Chapter 2.1.3.4 and Chapter 2.1.4.2.

⁸ See infra Chapter 4.1.1.

⁹ See infra Chapter 4.1.1.

European Union”, henceforth “*TEU*”). The TEU established the internal market and the Economic and Monetary Union. Both the TFEU and the TEU were, by virtue of the Lisbon Treaty, amended and consolidated into one document referred to as “*the Consolidated Versions of the Treaty on European Union and on the Functioning of the European Union*” (henceforth “*consTFEU*” and “*consTEU*”, to distinguish the different documents). The Lisbon Treaty was signed on 13 December 2009 and came into effect backdated on 1 December 2009. It further deepens European integration. Originally conceptualised as a fully-fledged *EU Constitution*, it was subsequently considerably watered down to what is today’s Lisbon Treaty after referenda in France and the Netherlands rejected it in 2005.¹⁰

The EU has traditionally had *three principal institutions*: the European Commission, the Council of the European Union (commonly referred to as “the Council of Ministers”, henceforth “the Council”) and the European Parliament. The Lisbon Treaty created a *fourth institution*, the *European Council*. These institutions are the chief players in Community policy. Which of them is the executive power and which the legislative power? Craig and De Burca (2008:38) dispense sobering advice: The EU

“should not be approached with any pre-conceptions about the traditional division of governmental functions into categories of legislative ... [and] executive. Many of these duties are shared between institutions, thereby rendering it impossible to describe any one of them as the sole legislator or the sole executive. The Community does not ... conform to any rigid separation-of-powers principle of the sort that has shaped ... [national] political systems.”

Nevertheless, as a very crude measure of positioning, one might describe the European Commission as the primary executive institution of the EU, and the Council jointly with the European Parliament as the primary legislative institution.

¹⁰ In the light of the fact that the Lisbon Treaty (*i.e.* the *consTFEU* and *consTEU*) only became effective as recently as 1 December 2009 and that therefore most of the current publications and textbooks on EU law contain references to the TEU, and furthermore in the light of the fact that many of the provisions of the former TEU and the former TFEU have been incorporated into, rather than been replaced by, the *consTEU* and the *consTFEU* (although they have been given a new articles sequence numbering), both the article numbering as per the TEU (referred to as ‘ex-article XYZ TEU’ or as ‘art. XYZ of the former TEU’) and the article numbering as per the TFEU (referred to as ‘article XYZ TFEU’ or as ‘art. XYZ of the former TFEU’) are indicated throughout this thesis next to the articles sequence numbering as per the Lisbon Treaty (referred to as ‘art. XYZ *consTEU*’ and ‘art. XYZ *consTFEU*’, respectively), in accordance with established practice of referencing of EU law.

Among these European Institutions, the *European Commission* has always been the most federalist and pro-integrationist: it has traditionally acted as the engine of European integration (Craig & De Burca, 2008:43 and 47). It consists of a President and one Commissioner of each member state. Linked to it is the Brussels bureaucracy (approximately 24,000 full-time officials). The European Commission's powers were set out in the former art. 211 TEU, which has in substance been replaced by art. 17(1) cons TEU.¹¹ The European Commission plays a central role in the legislative process: it has the right to initiate legislation, and it enacts delegated legislation.

The *Council (of Ministers)* consists of a President (the presidency rotates between the member states on a six-monthly basis) and one representative of each member state at ministerial level who is authorised to commit the government of that state (Craig & De Burca, 2008:48).¹² Linked to the Council is the Secretariat (approximately 2,800 staff in 2005). The Council represents the national interests of member states (Craig & De Burca, 2008:53), consequently the Council and the European Commission have often been at loggerheads. The Council's powers were set out in the former art. 202 TEU, which has in substance been replaced by art. 16(1) consTEU and arts. 290, 291 consTFEU.¹³ The Council has to vote its approval of virtually all European Commission legislative initiatives before they become law (Craig & De Burca, 2008:52). Furthermore, under the TEU (*viz.* the 3rd indent to art. 202 TEU), the Council had the explicit and sole power to delegate to the European Commission powers for the implementation of rules which the Council had laid down beforehand, thus enabling the European Commission to pass

¹¹ See appended documents.

¹² While being unique as a supranational legislative institution, on a national level the Council of Ministers in several respects resembles the German upper house (the *Bundesrat*): the *Bundesrat* members are members of the governments of the members states of Germany (the *Länder*). They can be recalled by the *Länder* governments, who also appoint them (art. 51(1) GG). Elections are not coordinated among the *Länder*. *Länder* vote in blocks and cannot cast fractioned votes (art. 51(3) GG). The members of the *Bundesrat* do therefore not act in an individual capacity but as representatives of the *Länder* governments, and they act according to the *Länder* governments' instructions. The *Länder* have an unequal number of votes (art. 51(2) GG) and the *Bundesrat* presidency rotates between them. However, a distinct difference between the *Bundesrat* and the EU's Council of Ministers is that, unlike the Council of Ministers, the *Bundesrat* does not vary its composition depending on the subject matter under discussion (*i.e.* it does not have different "configurations").

¹³ See appended documents.

further regulations. The procedure by which such delegated legislation is to be passed has been detailed by the Council in several decisions and is referred to as the *comitology procedure*.¹⁴ The consTFEU curtails the Council's competence to some extent by empowering it to pass delegated legislation only jointly with the European Parliament (arts. 289(1), 290(1) consTFEU). Legally speaking, the Council is a single institution, but in practice, depending on the subject matter (*e.g.* agricultural and fiscal affairs, economic and financial affairs, etc.), the Council meets in various "configurations" (art. 16(6) consTEU). Each Council configuration consists of those national ministers within whose portfolios the subject matter falls, and each Council configuration thus deals with a different functional area. At present (June 2011) there are ten Council configurations (for instance, the Economic and Financial Affairs Council, referred to as "ECOFIN" which is made up of the national finance ministers).

The *European Council* consists of the national heads of state or governments plus its President who is appointed for a fixed term of two and a half years) and the (non-voting) President of the European Commission. The Lisbon Treaty made the European Council an official EU institution distinct from the Council of Ministers. In practice, the European Council had already existed before. The pre-Lisbon constitutive treaties referred to it as "the Council, meeting in the composition of Heads of State or Government" (*e.g.* art. 214(2) TFEU). The Lisbon Treaty substituted this phrase with the term "European Council".

The European Council has no legislative powers (art. 15(1) consTEU). Its function is described in the Lisbon Treaty (art. 15(1) consTEU) as "[to] provide the [European] Union with the necessary impetus for its development." Externally, it acts as the EU's 'collective Head of State' and it may be described as the EU's supreme political authority.

The *European Parliament* consists of 750 (2010) members (MEPs). It is only since 1979 that the MEPs have been elected directly. To this day, the European Parliament suffers from two major flaws. Firstly, the European Parliament has thus far not been truly representative, because the number of MEPs for each member state is not proportionate to population size, and the smaller countries are disproportionately over-represented (Craig & De Burca, 2008:59). The Lisbon

¹⁴ See *infra* Chapter 2.2.1.

Treaty, however, is going to change that and provides for the number of MEPs to be digressively proportional to each member state's population size (art. 14(2) constTEU). Secondly, there is no uniform electoral procedure; instead the electorate of each member state votes in accordance with respective national procedure. Because of these flaws the European Parliament was – as regards legislative powers – initially conceptualised as the weakest of the three institutions. However, since the *co-decision legislative procedure* (ex-art. 251 TEU)¹⁵ was introduced in 1993 (which has subsequently become the standard method of passing EU legislation today), the European Parliament has become co-equal with the Council (Craig & De Burca, 2008:61). With the effective date of the Lisbon Treaty, the former art. 251 TEU was replaced by art. 294 constTFEU. Both articles outline the same procedure. The term 'co-decision procedure', however, was replaced by the term '*ordinary legislative procedure*'. The European Parliament has a history of making frequent use of litigation against both the European Commission and the Council to defend and extend its legislative powers (Craig & De Burca, 2008:62). The European Parliament has 20 standing committees which play a vital role as they consider legislative proposals from the European Commission and propose amendments to them (Craig & De Burca, 2008:61).

Overall, the biggest winners from the Lisbon Treaty have been the European Parliament and the European Council, while there has been a shift in leadership from the European Commission to the European Council.

The EU has developed its own body of law (referred to as "*Community law*"), comprising both case law and statutory law. All the legislation passed and decisions taken by the Community are collectively referred to as *acquis communautaire*. On accession, every new member state of the EU has to accept the entire *acquis communautaire*.

Today Community law is no longer regarded as mere international law (like, *e.g.* the Geneva Convention or the WTO), but as a distinct and new legal order (law *sui generis*) of international law (Wojcik, 2008:224 and Craig & De Burca, 2008:274). Oddly, nowhere in statutory Community law is it provided that Community law is superior (*lex superior*) to national law (*lex*

¹⁵ See appended documents and see *infra* Chapter 5.2.2.2 and 5.2.2.2.1.

inferior) (Wojcik, 2008:227). The European Court of Justice (henceforth “the ECJ”)¹⁶ has ruled, however, that – as regards applicability – Community law is superior (*IN.CO.GE* decision, [1998] ECR I-6307, *par* 21). This means that national law inconsistent with Community law is not invalid, but merely not applicable.

Community law has several *sources*: primary, secondary and other. *Primary Community legislation* includes, in particular, the various Constitutive Treaties. There have been several such treaties over the past 50 years, the later ones usually consolidating the earlier ones. Among them, the most important ones are the Treaty of Rome (1957), the Maastricht Treaty (1993) and the Lisbon Treaty (2009), as previously mentioned. There are usually numerous Protocols annexed to these Treaties which have the same legal force as the Treaties themselves.

Secondary Community legislation consists of three different types (art. 288 constTFEU, ex-art. 249 TEU):¹⁷ regulations, directives and decisions. All of them have to be published in the Official Journal of the EU if they have been enacted in accordance with the ‘co-decision procedure’ (today’s ‘ordinary legislative procedure’). There is no formal hierarchy between the three types. As Craig and De Burca (2008:83) point out, it should therefore not be thought that regulations are somehow ‘superior’ to directives, or vice versa. The Constitutive Treaties left much discretion to the Community institutions and rarely prescribe whether to proceed by way of regulation, directive or decision. Often a combination of them will be used to develop Community law in a certain area – as was the case with IASs. For instance, a ‘foundational’ regulation (such as the Council’s and the European Parliament’s joint ‘foundational’ IAS regulation No. 1606/2002¹⁸) may be enacted, and then decisions will be made pursuant to this (like the Council’s comitology decisions¹⁹ which establish general IAS enactment procedures).

Regulations (art. 288(2) constTFEU, ex-art. 249(2) TEU) are binding on and directly applicable in all member states (Craig & De Burca, 2008:83). The phrase ‘directly applicable’ clarifies that

¹⁶ See *infra* Chapter 5.2.1.1.

¹⁷ See appended documents.

¹⁸ See *infra* Chapter 2.2.2.1 and see appended documents.

¹⁹ See *infra* Chapter 2.2.2.1.

regulations become immediately part of national legal systems, without any need for transformation or incorporation by separate legal measures (Craig & De Burca, 2008:84).

Directives (art. 288(3) consTFEU, ex-art. 249(3) TEU) differ from regulations in two ways: they do not have to be directed at all member states; and they are only binding in respect of the objective to be achieved, while leaving to the discretion of the addressed member states the manner in which the directive is to be implemented (Craig & De Burca, 2008:85). Additional national legislation is thus necessary to implement a directive.

Decisions (art. 288(4) consTFEU, ex-art. 249(4) TEU) are binding in their entirety on those to whom they are addressed. Article 288(4) consTFEU (ex-art. 249(4) TEU) is silent regarding their direct applicability and there is thus a need for national transformational legislation in a member state to whom a decision is addressed.

Other sources of Community law are in particular the general principles of Community law (e.g. the principle of protection of human rights; the principle of administrative justice and good governance) and the case law developed by the ECJ.²⁰

In what way did the IASs become Community law? The legal procedure by which the IASs were incorporated into Community law is a two-stage process referred to as *endorsement*.

At its first stage, a ‘foundational’ IAS regulation (No. 1606/2002) was made jointly by the Council and the European Parliament using the ‘co-decision procedure’ in terms of the former art. 251 TEU: The former art. 251 TEU was an enabling regulation, setting the broad preconditions for adopting IASs as Community law and conferring (delegating) – in terms of the 3rd indent to the former art. 202 TEU – on the European Commission the power to implement the adoption of IASs. Furthermore, it prescribed a specific legislative procedure for this implementation – the *comitology procedure*.²¹

At its second stage a series of ‘implementing’ IAS regulations were made by the European Commission pursuant to the comitology procedure. These regulations finally incorporated IASs

²⁰ See infra Chapter 5.2.

²¹ See infra Chapter 2.2.1.

into Community law (e.g. Regulation No. 1725/2003). Since IASs have been incorporated into EU law by means of regulations, they are thus binding on and directly applicable to all member states without any national transformational act being necessary (art. 288(2) consTFEU, ex-art. 249(2) TEU).

1.1.3 Historical development of the international standard-setting bodies

Already half a century ago the international accounting profession recognised a need for comparable national accounting standards (Sacho & Oberholster, 2007:118, referring to the International Congress of Accountants in 1962).

This led to the establishment of the *International Accounting Standards Committee* (henceforth “the *IASC*”) several years later (1973) in London. The *IASC*’s stated goal was to achieve uniformity in accounting principles and to create a single set of international accounting standards suitable for adoption worldwide.

The *IASC* was founded as a private sector body by the national accounting bodies of various countries (all Anglo-Saxon countries as well as Germany, France, Japan, the Netherlands and Mexico). While membership was subsequently expanded to include a wider group of countries and interested organisations, the *IASC* was dominated by the International Federation of Accountants (henceforth “*IFAC*”), which had by then become the global organisation for the accountancy profession. The *IASC*’s standard-setting body was the *IASC Board*. In addition, in 1996 the *Standing Interpretations Committee* (henceforth “the *SIC*”) was set up to issue authoritative interpretations on accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance.

As regards the IASs issued by the *IASC Board* up to the mid-1980s, Sacho and Oberholster (2008:119), referring to Cairns (1997) and Camfferman and Zeff (2007), point out that these standards

“adopted the Anglo-Saxon treatment of most accounting transactions and allowed a choice between two or more treatments to ensure compatibility with the national requirements of member countries ... During this period, the IASC remained rather ineffectual owing to the fact that its Board consisted solely of accountants and it lacked governmental endorsement ...”

In order to gain more widespread recognition the IASC tried to get endorsement of its IASs by the International Organisation of Securities Commissions (henceforth “IOSCO”). This is the worldwide association of national securities regulatory agencies which includes powerful members such as the US Securities and Exchange Commission (henceforth “the SEC”) and the British Financial Services Authority. The South African Financial Services Board (henceforth “FSB”) is an IOSCO member as well.

The IOSCO, however, considered the IASC’s IASs to be of insufficient quality, and in addition regarded the IASC’s organisational structure and standard-setting process as not sufficiently transparent and balanced (Sacho & Oberholster, 2008:121). Consequently, the IASC initially was unable to obtain a full endorsement of all its IASs from the IOSCO (only 30 of its 41 IASs were endorsed in 2000) despite extensive projects to improve its IASs (which resulted in the ‘revised IASs’).

Acknowledging these deficiencies, the IASC underwent a further, more fundamental restructuring in 2000. This brought about the existence of the *IASC Foundation* (renamed *IFRS Foundation* as from 1 July 2010), which is today the umbrella organisation for several new bodies. As per the IASC Foundation Constitution (IASC Foundation, 2010), there are the two main bodies, namely the *(Board of) Trustees* and the *International Accounting Standards Board* (henceforth “the *IASB*”). Furthermore, the IASC foundation also overarches both the *IFRS Advisory Council*, which had been called the *Standards Advisory Council* (henceforth “the *SAC*”) until 2009, and the *IFRS Interpretations Committee* (henceforth “the *IFRS-IC*”). The latter had previously (2002-2009) been called the ‘*International Financial Reporting Interpretations Committee*’ (henceforth “the *IFRIC*”), which had in turn replaced the former *SIC* (1996-2002) – as well as the newly established *Monitoring Board*.

The *IASB* (paras 24-38 of the revised IASC Foundation Constitution) succeeded the IASC Board as the standard-setting body with the sole authority to develop and approve accounting standards. Like the IASC Board, it is based in London and is a private sector body. Members of the IASB are drawn from a broader range of professional and geographical backgrounds than the IASC Board. Accounting standards developed and issued by the IASB are designated *International Financial Reporting Standards (IFRSs)*, while accounting standards developed and issued by the IASC Board were designated *International Accounting Standards (IASs)*. The IASC Foundation Constitution places a strong emphasis on transparency of its bodies' decision-making as well as on IFRSs being developed through a formal procedure that gives effect to due process and broad international consultation.²²

The (*Board of Trustees*) (paras 4-23 of the revised IASC Foundation Constitution), which is to have 16 members as from 2012 (down from 22 members), is responsible for the IFRS Foundation's budget and for changes to the IASC Foundation Constitution. The Trustees appoint both the members of the IASB and those of the IFRS Advisory Council (the former SAC) as well as those of the IFRS-IC (the former IFRIC).

The *IFRS Advisory Council (the former SAC)* (paras 44-46 of the revised IASC Foundation Constitution) provides a forum for participation by organisations with an interest in financial reporting. Its objective is to give advice to the IASB on agenda decisions and on major standard-setting projects. The IASB consults the IFRS Advisory Council (which in 2011 has 50 members, among others, the South African Accounting Practices Board²³) prior to decisions on major projects. The IFRS Advisory Council's advice is not binding on the IASB. The European Commission as well as the SEC hold the status of observers in the IFRS Advisory Council.

²² See the Due Process Handbook for the IASB (IASC Foundation, 2008b) and the Due Process Handbook for the IFRIC (IASC Foundation, 2007). To be fair to the IASC Board, it has to be pointed out that the IASC Board had similar due processes established by the late 1990s.

²³ See *infra* Chapter 1.1.4 and Chapter 3.1. In the light of the fact that, in terms of the new Companies Act, the APB lost both its function and its statutory recognition (see *infra* Chapter 2.1.1), it is doubtful whether the APB will retain its membership in the IFRS Advisory Council after the effective date of the new Companies Act. Rather, it seems probable that the FRSC will take over the APB's membership. Section 203(5) of the new Companies Act seems to support this view.

The *IFRS-IC (the former IFRIC)* (paras 39-43 of the revised IASC Foundation Constitution) has 14 members and a non-voting chairman, the South African Robert Garnett (whose term will expire on 30 June 2012 and who was a member of the IASB from 2001 until 2010). The European Commission as well as IOSCO hold the status of observers in the IFRS-IC.

The newly established *Monitoring Board* (paras 18-23 of the revised IASC Foundation Constitution) consists of the heads of several public authorities which oversee capital markets, viz. the Commissioner for Internal Market and Services of the European Commission,²⁴ the chairmen of both the US Securities and Exchange Commission and the Japan Financial Services Agency, the chairmen of both the IOSCO Technical and the IOSCO Emerging Market Committees as well as, as an observer, the chairman of the Basel Committee on Banking supervision. The *Monitoring Board* has the right to approve Trustee appointments and the right to request meetings with the Trustees. The purpose of the Monitoring Board is to give this group of public authorities an oversight right over the Trustees.

1.1.4 Historical development of the South African standard-setting body: The Accounting Practices Board and SAICA

The first organised body of accountants in South Africa was the *Institute of Accountants and Auditors*. It was established in 1894 in Johannesburg by the British Society of Accountants and Auditors and the Institute of Chartered Accountants in England and Wales (SAICA, 2010b).

Ten years later the *Transvaal Society of Accountants* was incorporated by law. The Society was required to keep a register of all its members, who were entitled to use the designation “Registered Public Accountant (Transvaal)”. In the following two years, accounting societies were also established in the Cape Colony, the Orange River Colony and Natal.

²⁴ As to the role of EU Commissioners see infra Chapter 2.2.2.4.1 (footnote 171).

It was not before 1945, however, that the first national co-ordinating body, the *Joint Council of The Societies of Chartered Accountants (SA)*, was established. In 1966 it was renamed *National Council of Chartered Accountants of South Africa*.

The Joint Council played a pivotal role in the subsequent establishment, by virtue of the Public Accountants' and Auditors' Act No. 51 of 1951 (which was subsequently repealed and replaced by the Public Accountants' and Auditors' Act No. 80 of 1991), of the *Public Accountants' and Auditors' Board* (hereinafter "*the PAAB*"). The PAAB was the statutory body controlling that part of the accountancy profession which is involved with public auditing and accountancy in South Africa. The PAAB had the statutory powers to prescribe standards with which auditors must comply in performing their duties as auditors. In 2005, by virtue of the Auditing Profession Act (No. 26 of 2005), the PAAB was replaced by a new regulator, the *Independent Regulatory Board for Auditors* (hereinafter "*IRBA*").

In 1973 the *Accounting Practices Board* (hereinafter "*APB*")²⁵ was established. Shortly afterwards (1 January 1974) the old Companies Act came into effect. The APB was the first South African body to be tasked with setting South African accounting standards. Before its establishment, there were no written rules in South Africa stating what constitutes generally accepted accounting practice, although there were customary rules that had evolved over time and that were supported by academic textbooks (Delpont *et al.*, 2008:550).

Finally, in 1980 the constituent societies of the National Council of Chartered Accountants of South Africa established today's *South African Institute of Chartered Accountants* (hereinafter "*SAICA*"). SAICA has juristic personality (par 3 of the SAICA Constitution).

1.2 Research questions

This study will address the following questions:

²⁵ Regarding the APB see *infra* Chapter 2.1.2.

- How do the administrative law provisions of the Companies Act (Chapter 7 and Chapter 8 of the new Companies Act) and the Promotion of Administrative Justice Act (henceforth “the PAJA”) interact and affect each other in the areas of standard-setting and enforcement, and how are conflicting provisions dealt with?
- How has the Financial Reporting Standard Council’s role changed under the new Companies Act as compared to the old Companies Act, and what are the relevant functions of the newly created Commission and Companies Tribunal?
- What are the statutory content requirements which the IASB’s IFRSs have to meet before they may be adopted into national South African law and EU law, respectively? To what extent are future South African financial reporting standards and EU IASs going to be identical to, or different from, the IASB’s IFRSs? Finally, as regards enacted IFRSs (this refers thus far to the EU only, since the enactment of financial reporting standards in South Africa will in practice only begin once the new Companies Act comes into operation), are there provisions of IFRSs which have been enacted, although they do not comply with the endorsement requirements and are, thus, voidable?
- How does the process of enacting financial reporting standards work, and what are the strengths and weaknesses of the approaches used in South Africa and the EU, respectively?
- How is compliance with financial reporting standards monitored and enforced in South Africa and in the EU, and how do the approaches differ from each other?
- What means are provided for in South Africa and the EU to have the enacted standards scrutinised by the legislator or in court, and what are the legal consequences if enacted financial reporting standards infringe upon higher-ranking law?

1 3 Hypotheses

The main hypotheses of this thesis with regard to the enactment and enforcement of financial reporting standards are set out below:

- (Hypothesis 1:) The new Companies Act improves upon the old Companies Act, but fails to spell out and acknowledge the significant administrative-law component which the enactment and enforcement of financial reporting standards contain. While the new Companies Act seemingly attempts to formulate its own provisions ('administrative law provisions of the Companies Act'), these are incomplete and fragmentary.
- (Hypothesis 2:) Although nominally to be re-established under its old name, the Financial Reporting Standard Council's role in standard-setting has been weakened substantially under the new Companies Act.
- (Hypothesis 3:) The South African legislator requires much greater conformity of the contents of financial reporting standards with the IASB's IFRSs than the EU legislators do. The current practice of simply copying over the IASB's IFRSs is, however, clearly not required by the law as it stands. Furthermore, the EU and South Africa differ in the importance they assign to the Framework for the Preparation and Presentation of Financial Statements (and the Conceptual Framework for Financial Reporting, respectively) and the non-core components of the IFRSs (Introductions, Bases for Conclusions, Illustrative Examples, etc.).
- (Hypothesis 4:) Legislative control mechanisms seem to be stronger in the EU than in South Africa with regard to the enactment of financial reporting standards. In particular, public interest concerns seem to be given considerably more institutional and statutory weight in order to counterbalance the private origin of the IFRSs. On the other hand, by design, the South African process is swifter.
- (Hypothesis 5:) In contrast to South Africa, there is no uniform EU enforcement procedure in effect as yet. The German enforcement procedure is thus taken as a proxy for current purposes. The South African enforcement process seems to be more streamlined than the German process. In contrast to the German system, however, it goes further and enforces compliance (rectification of financial statements); it does not rely on the merely adverse publicity suffered by the company as a consequence of the compulsory publication of accounting errors detected.

- (Hypothesis 6:) Judicial control of enacted IFRSs in the EU suffers from severe procedural flaws, while judicial control of enacted financial reporting standards in South Africa seems set to be more effective.

1.4 Objective, relevance and methodology of the study

1.4.1 Objective

The study pursues three objectives:

- To compare critically and evaluate the provisions of the old and the new Companies Acts pertaining to financial reporting standards (standard-setting, legal backing, as well as administrative procedure and enforcement in cases of alleged non-compliance with financial reporting standards);
- To compare, thereafter, the situation in South Africa with that in the European Union;
- To elucidate several, thus far unresolved, legal issues as regards the enactment of the IASB's IFRSs in South Africa and the EU.

1.4.2 Relevance

No comparative study has, as yet, been done of the institutional standard-setting under the old and the new Companies Acts, nor has any comparison in this field been made between the position in South Africa and EU.

Given that – in line with the EU’s practice since 2005 – South African financial reporting standards are set to be legal norms as well, the experience gained in the EU with enacted financial reporting standards over the past few years can be valuable as a possible indicator or even predictor of both the prospective development and of impending issues in South Africa.

1.4.3 Methodology

The study is an analysis of the South African and EU legislation in the area of standard-setting and enforcement of financial reporting standards.

It is designed as a literature study, literature being understood as primary (source) literature (legislation, including IFRSs, and case law) and secondary literature (academic findings on, and assessments of, primary literature; literature issued by the accounting profession).

It is not a case study and it is not empirical, although it incorporates the findings of the (few) earlier empirical studies on EU case law. Being a literature study, it has no control over the data (literature), but a very high level of control over data collection and analysis.

It is descriptive to the extent that it details existing institutional structures in the EU and in South Africa, but explanatory to the extent that it suggests reasons for the wording of legislation and the tenor of the case law. It is validational to the extent that it assesses (confirms or rejects) the findings of existing secondary literature.

It is historical to the extent that it uses past legislation and case law as a point of departure to explain the current or new legislation. South African and EU case law is carefully examined in order to trace the development of the judicial approach to issues and areas which are or might become relevant in the field of standard-setting and enforcement, and in order to identify trends and developments in these areas. Both South African and EU academic literature as well as

literature issued by the accounting profession is extensively drawn upon, compared and evaluated.

Being comparative, the study particularly notes relevant developments in the EU and its member states (especially Germany) as a source of ways in which alternative approaches can be developed in South Africa.

1.5 Outline of the study

The overarching focus of this study is the way in which South Africa and the EU set and enforce financial reporting standards and the requirements which the IASB's IFRSs have to meet before they may become law in South Africa and the EU.

Chapter 2 outlines the process by which financial reporting standards become law in South Africa (under the new Companies Act) and the EU, respectively. Given the byzantine structure of the EU process, rather extended explanations as well as flow charts will be incorporated into Chapter 2.

As regards South Africa, Chapter 2 also scrutinises and compares the situation under the old and new Companies Acts; in particular, it focuses on the role of the Financial Reporting Standards Council in setting financial reporting standards. Furthermore, it shows the extent to which the new Companies Act's administrative aspects are intertwined with the PAJA by discussing which of the new institutions (Financial Reporting Standards Council; Companies and Intellectual Property Commission; Companies Tribunal) perform "administrative action" in terms of the PAJA.

Chapter 2 also examines to what extent, according to the law as it stands, the financial reporting standards to be enacted may deviate from the IFRSs as issued by the IASB. The outer limits of

such permissible deviations are identified; these have been set differently by the South African and the EU legislators, respectively.

Chapter 2 finally expounds on the issue as to whether in the EU some provisions of the IASB's IFRSs have been adopted as law in an unconstitutional manner and to what extent similar issues might arise in South Africa in the future.

Chapter 3 briefly states where the statutory duty to comply with enacted financial reporting standards is provided for in both the South African and the EU's legal systems.

Chapter 4 deals with administrative action and enforcement procedures as regards companies which do not comply with enacted financial reporting standards. In the light of the fact that the EU has not managed thus far to enact an EU law of administrative action and enforcement, the German procedure (*Enforcement-Verfahren*) is taken as a proxy and compared to the South African procedure as set out in the new Companies Act.

As regards the South African procedure, Chapter 4 – following on from Chapter 2 and the “administrators” identified there – discusses issues of conflict as regards administrative law provisions of the Companies Act, on the one hand, and the PAJA, on the other hand.

Further, Chapter 4 scrutinizes Chapter 7 of the new Companies Act (ss 156-184: ‘Remedies and Enforcement’) for inconsistencies, ambivalent wordings and regulatory gaps, and proposes solutions to several detected statutory weaknesses and deficiencies.

Chapter 5 focuses on the issue of how financial reporting standards, while being adopted and once adopted (*i.e.* enacted in conformance with due process as discussed in Chapter 2), are subjected to scrutinising control in South Africa and the EU, respectively. Control can be exercised by the legislator and in court. Chapter 5 identifies that parliamentary control is deficient in South Africa, while judicial control is set to be effective. As regards the EU, the situation is the reverse as the result of some severely hampering procedural provisions when it comes to judicial control.

Chapter 6 summarises the main findings and conclusions of the earlier chapters.

2. Institutions charged with standard-setting

2.1 South Africa

2.1.1 The Financial Reporting Standards Council ('FRSC')²⁶

With regard to standard-setting, the Financial Reporting Standards Council (henceforth "the FRSC") is an institution provided for under both the old and the new Companies Acts. It was established statutorily by virtue of s 440P(1) of the old Companies Act and was abolished when the old Companies Act was repealed on 1 May 2011. The new Companies Act mandates its re-establishment.

2.1.1.1 Composition

In terms of the old Companies Act (ss 440P *et seq.*), the FRSC consisted of sixteen members, arranged into seven groups to represent the various stakeholders (s 440P(3)). Each member had one vote and twelve members represented a quorum (s 440R(2)). A simple majority was required to pass a resolution. A minimum of six members was thus able to take a valid decision.

All of the 16 members were to be appointed by the Minister (ss 440Q(1),(2)(b)). Four of them were to be nominated, two company law experts by the Minister himself and one each by the

²⁶ An earlier version of Chapter 2.1 was published as Schmidt *et al.*, 2010.

Financial Services Board and the Johannesburg Stock Exchange (henceforth “the JSE”).²⁷ Regarding the latter two, the Minister did not have any discretion and would thus have been compelled to appoint the nominated persons (s 440Q(1): “shall appoint”).

The remaining twelve vacancies would have had to be advertised by the Minister (s 440Q(2)(a)). There were no specific requirements set out in chapter XVB for such advertising; however, notification to the registered “interested persons” in terms of s 440T was required as a minimum (see the definition of “advertise” in s 440O(1)). In terms of s 440T, a person wishing to receive notice of vacancies on the FRSC could register with the FRSC as an “interested person”. The Minister would then select and appoint twelve members from among the applicants as per s 440Q(2)(b). Selection was, however, not restricted to the pool of “registered persons”.

In terms of the new Companies Act (s 203), the number of members of the FRSC increases to seventeen. The additional position is for a member nominated by the South African Reserve Bank (s 203(1)(g)). Over and above this, the Draft Companies Amendment Bill 2010 (s 107) wanted to add an eighteenth member who would have been nominated by “the body governing the regulation of the accounting professions”, *i.e.* the Independent Regulatory Board for Auditors. This addition, however, did not find its way into the final Companies Amendment Act No. 3 of 2011 (s 116).

There are no longer rules set out in the new Companies Act as to members’ voting rights, quorum or decision-making. Being ancillary matters necessary for the proper implementation of ss 203 *et seq.*, one would have expected these matters to have been addressed in the Companies Regulations 2011, according to s 223(1)(d)(ii), but they were not.

All of the FRSC members are still appointed by the Minister (s 203, last half-sentence). It is not entirely clear whether the Minister is again bound – as in the old Companies Act – to appoint the nominated members. In contrast to the old Companies Act (s 440Q(1)(a)), this is not specifically

²⁷ Section 440P(3)(g) of the old Companies Act (and similarly s 203(1)(h) of the new Companies Act) actually refers to persons nominated, one each by any licensed exchange (licensed in terms of s 10 of the Securities Services Act No. 36 of 2004) which imposes adherence to financial reporting standards as a listing requirement. To keep matters simple, only the JSE is mentioned here.

spelled out in the new Companies Act. This seems to leave the Minister with a discretion regarding the nominated candidates.

The new Act does not provide for the possibility of “interested persons” to register with the FRSC to be notified of vacancies arising. In terms of the Act, vacancies no longer have to be advertised; the entire concept of “interested persons” has been deleted.

In terms of the old Companies Act, the twelve selected members as well as the chairman of the FRSC were to serve a three-year term and were not allowed to serve for more than six consecutive years, s 440Q(3). Chapter XVB was silent on the four nominated members. It therefore appears as though their terms were unlimited; they could in practice have become permanent members. This might have led to an undesirable two-tier membership within the FRSC.

The original new Companies Act (before it was amended) (henceforth “the principal Act”²⁸) did not set any term limits for the members of the FRSC. One exception applied, namely to the member nominated by the JSE (s 203(1)(h) of the principal Act), whose appointment was limited to three years. The Companies Amendment Act (s 116) changed that by applying the three-year limit to all of the FRSC members. Re-appointments are allowed (s 203(4)).

Among the different groups of stakeholders from which the members of the FRSC were to be drawn, the group “users of financial statements” (s 440P(3)(d)) stood out within chapter XVB of the old Companies Act: “users” were to make up a full quarter of the FRSC’s members. The term “user” was vague. It was, however, entrenched in the IASB Framework²⁹ (e.g. in paras 9 and 25) and in the IFRSs/IASs (e.g. in par 7 of IAS 1),³⁰ which was presumably the reason chapter XVB

²⁸ This was the terminology used by the Companies Amendment Bill (s 1).

²⁹ IASB “Framework for the Preparation and Presentation of Financial Statements” (issued July 1989), hereinafter “Framework”. Regarding the Framework see next footnote and *infra* Chapter 2.2.2.2.3.

³⁰ Neither the IASB Framework (which itself was not an IFRS, see par 2 of the Framework) nor any of the IASs/IFRSs defined the term “user”, though. Instead, par 9 of the Framework merely listed a non-exclusive catalogue of categories of users (*viz.* present and potential investors’ employees, lenders, suppliers and trade creditors, customers, governments and their agencies and the public). Furthermore, par 25 of the

gave it statutory recognition in the Companies Act. To overcome this vagueness, a statutory definition of “user” was inserted into s 1 of the old Companies Act: “user” was defined as “any person who relies on information contained in ... [a financial] report”, in particular “a shareholder, prospective shareholder, creditor ... [or] regulator.” In terms of this definition – in particular because of the wording “prospective shareholder” – virtually anybody could have been considered a user.

The new Companies Act has acknowledged this issue and deleted the statutory definition of “user”. What was the stakeholder group “users” in the old Companies Act (s 440P(3)(d)) is now rephrased in s 203(1)(d) of the new Act as “persons who, in their capacity as holders of securities issued by a company, or as creditors of a company, are reasonably expected to rely on financial statements ...” While still very broad, this new wording is an improvement. Only existing shareholders or holders of debentures are included and not prospective ones. Furthermore, regulators are not included. This contributes to a clearer distinction between stakeholder groups. As with the old Companies Act, the group is still made up of four members.

As regards the termination of a person’s membership of the FRSC, the scope of the old Companies Act left much to be desired. An entirely too brief s 440Q(5) listed seven grounds for removal, subdivided into compulsory and discretionary grounds. Rules regarding a member’s resignation were entirely absent. The new Act vastly improves on that (Chapter 8, Part E:

Framework (“Understandability [of financial statements]”) contained in its clause 2 a general assumption about users: they were assumed to “have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information [contained in financial statements] with reasonable diligence.”

Note that the Framework was superseded by the Conceptual Framework for Financial Reporting (henceforth “Conceptual Framework”) which was issued in September 2010 by the IASB. Like the Framework, the Conceptual Framework is not an IFRS (see Foreword to the Conceptual Framework, section “Purpose and status”) and like the Framework, it does not define the term “user”. The Conceptual Framework distinguishes – without establishing a hierarchy among them (see Conceptual Framework, BC 1.18) – two groups of users, namely “primary users” (referred to in OB 2 and in BC 1.16 of the Conceptual Framework as “existing and potential investors, lenders and other creditors”) and “other users” (referred to in OB 10 of the Conceptual Framework as “[o]ther parties, such as regulators and members of the public other than investors, lenders and other creditors”). BC 1.10 of the Conceptual Framework points out that the phrases used in OB2 and OB10 are meant to encompass the user group described by par 9 of the Framework.

Sections 205-207). It distinguishes between initial ineligibility/disqualification and subsequent grounds for removal (ss 205 and 207(3)). Furthermore, it delineates a procedure for members who wish to resign from the FRSC (s 207(1)). Beyond that, it expressly inserts the notion of conflict of interests, focusing on a member's "personal financial interest" that may conflict with his duty as a member (s 205(2)(b)). It sets out the legal consequences of an existing personal financial interest for a member's membership rights – namely no right to attend the FRSC's meetings and no vote in the matter (s 206(2)(b),(c)) – and details the disclosure required (s 206(3)(a),(4)).

A statutory definition of what constitutes "personal financial interest" has been included in s 1 of the new Act. There was no equivalent in the old Companies Act. This definition bears similarity to the one in SAICA's Code of Professional Conduct (SAICA, 2010a: ET5-7), but has been drawn considerably wider. In contrast to SAICA's definition of "financial interest", not only interests in equity or debt instruments are included, but any "direct material interest ... of a financial, monetary or economic nature, or to which a monetary value may be attributed." On the other hand, non-controlling interests in unit trusts or collective investment schemes are not regarded by the Act as "personal financial interests", although being viewed with suspicion in terms of SAICA's definition (such interests are considered to be "indirect financial interest[s]" and thus a potential 'self-interest threat' in terms of s 340.1 of the Code of Conduct, which might lead to a conflict of interest).

As a new feature in the new Act, s 205(2)(a) expressly aims at de-politicising the FRSC by disqualifying any "office-bearer of any party, movement, organisation or body of a partisan political nature from membership."

Juristic persons do not seem to have been excluded from membership in the FRSC. By simply referring to "persons" in s 440P(3), the old Companies Act included them. Chapter XVB did not define "person", nor did the general catalogue of statutory definitions in s 1 of the old Act. It was thus necessary to resort to the Interpretation Act,³¹ which in s 2 defines a person as including

³¹ See appended documents.

“any body of persons corporate or unincorporated”. A juristic person was thus a “person” in terms of s 440P(3) and could have become a member of the FRSC.

The new Companies Act, in contrast to the old Companies Act, defines “person” in s 1 as including juristic persons. A juristic person is thus a “person” in terms of s 205. According to s 205(2)(c), however, a person may not become a member of the FRSC if that person “is disqualified in terms of s 69 from serving as a director of a company.” Section 69 lists grounds which exclude a person from becoming or remaining a director, which are in turn split into grounds for ineligibility (s 69(7)) and grounds for disqualification (s 69(8)). Being a juristic person renders a person ineligible to become a director (s 69(7)). Owing to the wording “persons *disqualified* in terms of s 69”, s 205(2)(c) only refers to s 69(8) and not also to s 69(7). The presumption of statutory interpretation according to which “the same words in a statute bear the same meaning” (Du Plessis, 2002:194) supports this. Being a juristic person therefore does not exclude a person from becoming a member of the FRSC in terms of s 205(2)(c).

The old Companies Act emphasised transparency and encouraged public participation (mainly through the “register of interested persons”). The FRSC would have had to meet at least three times a year and its meetings would have been open to the public (s 440R(4)). This transparency was, however, curtailed to some extent by s 440T, since only persons who had registered with the FRSC had to be notified in advance of meetings and proposed agendas. Public communication was apparently limited to such persons (Delpont *et al.*, 2008: 998(2)). The new Act contains nothing about the FRSC’s meetings being public or about the frequency of its meetings. Again, one would have expected these matters to have been addressed by the Minister in the Companies Regulations 2011 in terms of s 223(1)(d)(ii), but this was not done.

2.1.1.2 Function of the FRSC and definition of ‘financial reporting standards’ (“FRSs”)

In terms of the old Companies Act, the FRSC's functions were twofold, *viz.* to establish financial reporting standards for public interest companies (s 440P(2), s 440S(1)(a)) and to develop accounting standards for limited interest companies (s 440S(1)(b)). The reference to "public interest companies" was erroneous in the CLAA and should have been a reference to "widely held companies" (as defined in s 1(6)(a) of the old Companies Act). Delpont *et al.* (2008:549) observed that the reason for this error was that in a previous version of the Amendment Bill which was to become the CLAA, companies which were later referred to as "widely held companies" were defined as "public interest companies", but the Bill was not amended consistently throughout to reflect the change.

Financial reporting standards were defined in s 1 as "statements of Generally Accepted Accounting Practices adopted by the Accounting Practices Board³² [*i.e.* the IFRSs³³ as defined in par 7 of IAS 1] prior to the establishment of the [Financial Reporting Standards] Council, and thereafter issued in terms of section 440U(2)". The FRSC was established statutorily by virtue of s 440P(1) of the old Companies Act on 14 December 2007. At the same date, therefore, all IFRSs (as defined in par 7 of IAS 1) which had been adopted by the APB as Statements of GAAP prior to that date became FRSs. This includes the IASB Framework: it, too, became an FRS on that date.

Accounting standards for limited interest companies, however, were left undefined by the CLAA amendments. The reason why s 440S spoke of "establishing" financial reporting standards for widely held companies in contrast to "developing" accounting standards for limited interest companies is simple: at the time when the CLAA was assented to (11 April 2007), no accounting standards for limited interest companies were yet in existence. Section 56(3) of the CLAA therefore provided that, transitionally, limited interest companies had to prepare their financial

³² Regarding the APB and its role see *supra* Chapter 1.1.4 and *infra* Chapter 2.1.2.

³³ This emanates from SAICA's Circular 07/04 ("Status and effective dates of statements of Generally Accepted Accounting Practice (GAAP) and interpretation of statements of GAAP"), issued June 2004. This circular clarifies that after an extended period of harmonization of South Africa's GAAP with international standards and with international interpretations of standards, the APB adopted the IASB's IFRSs as Statements of GAAP without amendment.

statements in accordance with a set of accounting practices that are compliant with the IASB Framework. It was only by virtue of Circular 09/07 (issued October 2007) that the Accounting Practices Board adopted the IASB's Exposure Draft on IFRS for SMEs (IASB Foundation, 2007) without any change to the original text, as the transitional South African Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities (henceforth "SMEs"). In the same circular the Accounting Practices Board decided that this Statement of GAAP for SMEs may be applied to limited interest companies (par 10 of Circular 09/07).

The new Companies Act does not retain this distinction between widely held companies and limited interest companies. The relevant statutory definitions have been deleted. Instead, the new Act recognises two types of companies (s 8(1): "profit companies" and "non-profit companies") and further divides profit companies into four categories (s 8(2): "state-owned companies", "private companies", "personal liability companies" and "public companies"). Section 29(5)(c) allows for the establishment of different financial reporting standards for each of the types and categories of companies. The terminological distinction that existed in the old Companies Act between financial reporting standards for widely held companies (now state-owned companies and public companies) and accounting standards for limited interest companies has accordingly been removed. The term "financial reporting standards" is again statutorily defined in s 1 of the new Companies Act. This definition is circular and thus of little value since it simply refers forward to s 29(4), (5).

Within the new Companies Act, s 204 sets out the functions of the FRSC. When compared to s 440P(2) of the old Act ("The Council's objective is to establish financial reporting standards ...") it is apparent, that at least the FRSC's drafting powers regarding financial reporting standards have been retained (s 204(a): "[T]he ... Council must ... adapt international reporting standards for local circumstances ..."). Its position in relation to the Minister, however, has been substantially weakened under the new Act. Section 440(U)(1)(c) of the old Companies Act stated: "The Council must ... submit *financial reporting standards* to the Minister", and s 440U(2) continued, "[t]he Minister shall issue *financial reporting standards* on the advice of the Council by publication in the Gazette." The identical wording "financial reporting standards" in both of the subsections suggested that what is submitted by the FRSC and what is published by

the Minister is one and the same, without any changes. This implied that what is submitted is already the newly established set of financial reporting standards. Furthermore, it implied that the Minister had no discretion but to follow the recommendation of the FRSC. Delpont *et al.* (2008:998(2)) reached this conclusion too. To reach this conclusion, however, it is necessary to construe “shall” in s 440U(2) as an imperative “shall”.³⁴ On this interpretation of s 440U, the Minister’s function was merely to rubberstamp the FRSC’s financial reporting standards and publicise them. That situation has changed drastically under the new Companies Act (s 204): the Minister now clearly has a discretion with regard to the enactment of the financial reporting standards (s 29(4): “[T]he Minister ... *may* make regulations prescribing ... financial reporting standards ...”). Contrary to the wide wording of s 29(4), this is not a full discretion as to whether or not to enact financial reporting standards at all. In terms of s 5(1) of the new Companies Act, the Act must be interpreted in a manner that gives effect to its purposes set out in s 7 of Act. In terms of s 7(1), one purpose of the Act is to “provide a predictable and effective environment for the efficient regulation of companies” (s 7(1)); a further purpose (s 7(c)) is to “promote innovation ... in the South African markets.” The new financial reporting standards that are to be established are, it is submitted, a means to achieve such an efficient regulatory environment and to promote innovation. The Minister thus has no discretion as to whether or not to enact financial reporting standards at all, nor will it be in accordance with the purpose of the Act to neglect to establish financial reporting standards over an extended period of time.

The FRSC has been reduced to a mere consultative forum (see s 204(b): “[To] advise the Minister on matters relating to financial reporting standards ...” and s 204(c): “[To] consult with the Minister on the making of regulations establishing financial reporting standards”). The Explanatory Memorandum to the Companies Bill 61D-2008 (Memorandum: Item 3.)³⁵ speaks of an “advisory committee”, since its advice is not binding on the Minister. The wording of s 204(b) further clarifies that the FRSC’s drafts (adaptations of international reporting standards) are not themselves already regarded as the newly established financial reporting standards. Instead it is the Minister who finally establishes them by virtue of regulations (s 204(c); s 29(4)(a)).

³⁴ See supra Chapter 1.1.1.

³⁵ As to the interpretative importance of explanatory memoranda see *infra* in this chapter (footnote 44).

Finally, the legal status of the future financial reporting standards is clearly stated in the new Act. They will be established by regulations (ss 29(4), 204(c) read with s 223(1)(a),(2)-(4)) and thus – being delegated legislation – will be legal norms (law). In contrast, s 440U(2) of the old Act was astonishingly vague in this regard and stated merely that the financial reporting standards were to be issued by the Minister “by publication in the Gazette”. While it is true that all legislation (including delegated legislation such as regulations) has to be published (“promulgated”) in the Gazette in order to become operative (s 13(1) of the Interpretation Act), not everything which is published in the Gazette is necessarily law: legal notices, reports or mere administrative directives, for instance, can be published as well. These are not law.

Mutual consultation between the Minister and the FRSC is mandatory under the new Act. The FRSC is under statutory obligation (s 204: “must”) to advise the Minister and consult with him. In turn – as emanates from s 29(4) (“after consulting the Council”) – the Minister is under a similar obligation before enacting financial reporting standards.

In contrast to the old Companies Act (s 440U(1)(b) with regard to “interested persons”³⁶), public consultation before making regulations regarding financial reporting standards is explicitly no longer required by the new Companies Act (s 223(2), read with s 223(3)). On the other hand, and unlike the old Act, the FRSC may now receive recommendations by the Commission for amendments to financial reporting standards (s 187(3)(b)) and must then mandatorily consider them.

Both the old and the new Acts emphasise that financial reporting standards are to promote “sound and consistent accounting practices” (s 440P(2) of the old Companies Act, s 29(5)(a) of the new Companies Act). The old Act referred in s 440P(2) only to “financial reporting standards” and not also to “accounting standards for limited interest companies”. This was a mere draftsman’s error. It is trite that accounting standards for limited interest companies are to promote sound and consistent accounting practices as well.

³⁶ See supra Chapter 2.1.1.1.

SAICA Circulars did not qualify as “financial reporting standards” in terms of the definition of s 1 of the old Companies Act.

SAICA’s circulars can serve various purposes and can deal with a wide range of topics (par 1 of Circular 08/05). One of them, which is relevant to the topic of this thesis, is to comment on and to interpret (the application of) a provision of an act or a provision of an IFRS. As regards provisions of an act, this applied, for instance, to the former Circular 08/99 (“Compliance with section 286(3) and paragraph 5 of Schedule 4 to the Companies Act, 61 of 1973 and Statements of Generally Accepted Accounting Practice”, issued December 1999). As regards provisions of an IFRS, this applies, for instance, to Circular 03/09 (“Headline Earnings”, issued August 2009, with regard to IAS 33) and to Circular 12/06 (“Operating Leases”, issued August 2006, with regard to IAS 17) as well as to Circular 09/06 (“Transactions giving rise to adjustments to revenue/purchases”, issued May 2006, with regard to IAS 18)³⁷ and Circular 04/05 (“Guidance on the term ‘State-controlled Entities’ in the context of IAS 24 (AC 126) – Related Parties”, issued April 2005). For the purpose of this thesis, these will be referred to as ‘*interpretative (or commenting) circulars*’.

Interpretative circulars are prepared and approved by the Accounting Practices Committee (henceforth “APC” which is SAICA’s technical accounting committee)³⁸ if they relate to accounting, or by the Auditing Guidance Committee (hereinafter “AGC” which is another of the committees established by SAICA) if they are audit related. They are issued by SAICA. They are thus not “approved by the Accounting Practices Board” as required by the definition of “financial reporting standards” and were therefore not “financial reporting standards” in terms of the old Companies Act.

This situation may change under the new Companies Act. Whether or not interpretative circulars are going to become “financial reporting standards” as defined in s 1 of the new Companies Act depends on whether or not the Minister will promulgate them as regulations as well as – in as far

³⁷ See *infra* Chapter 2.1.1.3.

³⁸ Regarding the APC see in detail *infra* Chapter 2.1.2.3.

as they apply to public companies – on whether, in terms of the amended s 29(5)(b),³⁹ they are “in accordance with” IFRSs. It no longer depends on whether they are approved by the APB. As will be shown below,⁴⁰ the criterion “in accordance with” is, for instance, met by the interpretative Circular 09/06. Given the APC’s endeavour (as set out in its TOR&OP⁴¹) to minimize differences with international standards and interpretations, other interpretative circulars are very likely to meet this criterion as well.

2.1.1.3 Contents of FRSs and their accordance with IFRSs

As regards the statutory requirements for the contents of the to-be-established financial reporting standards, neither the old nor the new Act specifies details. Both Acts merely depict the, rather narrow, outer limits of permissible deviations by the future financial reporting standards from the IASB’s IFRSs. In terms of s 440S(2) of the old Act, financial reporting standards had to be “*in accordance with* International Financial Reporting Standards” (in the – unofficial – Afrikaans version of the Act: “*ooreenkomstig die* Internasionale Finansiële Verslagdoeningstandaarde”), while in terms of s 29(5)(b) of the new Companies Act (before it was amended), FRSs prescribed for any category and type of company had to be “*consistent with* International Financial Reporting Standards” (in the – unofficial – Afrikaans version of the Act: “*moet ... strook met die* Internasionale Finansiële Verslagdoeningstandaarde”). The Explanatory Memorandum to the Companies Bill B61D-2008 gave no indication as to the meaning of ‘consistency’ in s 29(5); in contrast, the explanatory memorandum to the Corporate Laws Amendment Bill B6D-2006 did so with regard to the meaning of “in accordance with” in s 440S:⁴² clause 1 of item 4.4 of the

³⁹ See infra Chapter 2.1.1.3.

⁴⁰ See infra Chapter 2.1.1.3.

⁴¹ See supra Chapter 1.1.4.

⁴² As regards the interpretative importance given to *bills* as well as to *explanatory memoranda* which accompany bills and acts (both of which are commonly referred to as ‘preceding deliberations’ or ‘*travaux*

memorandum stated that financial reporting standards have to be “comparable” with IFRSs. Clause 2 of item 4.4 narrowed this down further to a “tight correlation”. The Companies

préparatoires’), the approach adopted by the South African courts is currently undergoing a significant change:

For more than a century up to the turn of the millennium the courts – under the influence of English law (De Ville, 2000:226) – have, when interpreting a statute, consistently refused to take into account the material underlying the passing of the statute, and any information obtained from these sources was therefore excluded from being considered; see for instance *Bok v Allen (1884) 1 SAR 119* and *More v Minister of Co-operation and Development 1986 (1) SA 102 (A) 116G*. This approach (aptly referred to by Du Plessis, 2002:269 as a “common-law taboo”) came to be known as the ‘*the exclusionary rule*’. As regards bills, this taboo was explicitly stated in *R v Ristow 1926 EDL 168 173*, and as regards explanatory memoranda it was explicitly reiterated as recently as 1999 in *Ngcobo v Van Rensburg 1999 (2) SA 525 (LCC) par 27*. In contrast, Roman-Dutch and South African writers on the subjects have always taken a more favourable stance towards *travaux préparatoires* (Devenish, 1992:122): among the Roman-Dutch authors, Eckhard (cited by Steyn, 1981:134) regarded the debates preceding the passing of an act as an important aid in the interpretation of statutes in cases where the intention of the legislature was not clear from the language used. Steyn (1981:134) himself argues that, within the legislative process which an act undergoes, the second reading speech of the Minister who proposed the bill, in which he explains the general tenor of the act, can be useful in clarifying the statute. Hahlo and Khan (1968:184) went even further and expressed clear and serious reservations concerning the merits of the exclusionary rule.

With the advent of constitutionalism in South Africa, the courts’ attitude towards parliamentary materials and the drafting history of a statute became more relaxed (Du Plessis, 2002:269). De Ville (2000:227) shows that the first move in adopting this new approach to the interpretation of statutes was made by Mokgoro J in her minority judgment in *Case & Another v Minister of Safety and Security: Curtis v Minister of Safety and Security 1996 (5) BCLR 609 (CC) par 12*. Expanding on this approach, the courts in *National Union of Mineworkers of SA v Driveline Technologies 2002 (4) SA 645 (LAC) paras 79-80* and *Shoprite Checkers (Pty) Ltd v Ramdau 2001 (3) SA 68 (LC) par 59* relied on the Explanatory Memorandum to interpret the Labour Relations Act No. 66 of 1995. So did Ngcobo J in the Constitutional Court’s decision *Chirwa v Transnet Ltd 2008 (4) SA 367 (CC) paras 100-101*. In a similar fashion, nearly all of today’s South African textbooks on this topic are explicitly in favour of resorting to explanatory memoranda to interpret a statute (Botha, 2005:87; Du Plessis, 2002:269. De Ville, 2000:228 – writing, however, pre-*National Union* and pre-*Shoprite* – is still somewhat more cautious.). Furthermore, Sacks (1982:144) shows that continental countries (notably Germany and the Scandinavian countries as well as, to a lesser extent, France) have always made extensive use of *travaux préparatoires* and Devenish (1992:125) points out that in Australia the exclusionary rule has even expressly been abolished by statute in 1984.

Following this recent trend in South African case law and the opinions expressed by Botha and Du Plessis, this thesis also firmly supports the view that bills and explanatory memoranda (such as, for instance, the Companies Bill 61D-2008 and the Corporate Laws Amendment Bill B6D-2006) should be used to interpret provisions of an act.

Amendment Act deleted the phrase “consistent with” in s 29(5)(b) and aligned the section’s wording with that of s 440S(2) of the old Companies Act (“in accordance with”), but only with regard to public companies. The consistency/accordance requirement has thus been dispensed with for all other categories of companies. Clearly, then, an exact replication of IFRSs is not required for future South African financial reporting standards. Section 204(a) of the new Companies Act expands on this and grants the FRSC an amending role by stipulating that it must “adapt international reporting standards for local circumstances”.

The fact that s 204(a) speaks of “international reporting standards” and not – like s 29(5)(b) – of the “International Financial Reporting Standards of the International Accounting Standards Board” seems to be merely a drafting inconsistency without further significance. The “international reporting standards” referred to in s 204(a) are the IFRSs.

It is then necessary to determine to what extent the FRSC may adapt IFRSs without the resultant financial reporting standards for public companies becoming no longer “in accordance with” IFRSs. The following changes to IFRSs are, it is submitted, permitted by s 29(5)(b): to rearrange the sequence of paragraphs of an IFRS; to delete alternative treatments allowed by IFRSs; to delete non-mandatory rules in IFRSs (in particular encouraged, but not mandatory, disclosure); to insert stricter requirements encompassing IFRS requirements as minimum standards; and to fill gaps (*lacunae*) that exist within the regulatory body of IFRSs. The following examples serve to illustrate this:

Paragraph 93 of IAS 19 (“Employee benefits”) describes the calculation of the portion of actuarial gains or losses to be recognised per year for a defined benefit plan. An excess amount (determined as per par 92) is to be “divided by the expected average remaining working lives of the employees participating in that plan.” The standard does not specify whether this average remaining working life is to be counted as from the beginning of the current financial year or as from the end of the current financial year. Hence a gap (*lacuna*) has been left by IAS 19. A future South African financial reporting standard might opt to close this gap and prescribe a mandatory way of calculation. Such a standard would be consistent with IFRSs.

The filling of gaps has also taken place by way of SAICA's Circular 09/06 ("Transactions giving rise to adjustments to revenue/purchases"). The Circular⁴³ interprets paras 10, 11 and 18 of IAS 2 ("Inventories") as well as par 10 of IAS 18 ("Revenue") with regard to the accounting treatment by the buyer and seller respectively of cash discounts, settlement discounts, rebates and extended payment terms. It sets out which treatments are consistent and which are inconsistent with international practice.

No equivalent interpretation has been issued by the International Financial Reporting Standards Interpretations Committee (the former IFRIC).

Circular 09/06 is, however, not an independent South African interpretation of IFRSs, rather all accounting treatments prescribed in the circular as mandatory have been agreed upon by SAICA with the IFRIC in advance (par 2 of Circular 09/06). The circular is at pains to stress that it only considers the specific topics to the extent that they were considered by the IFRIC too (par 6 of Circular 09/06). The IFRIC has simply not deemed it necessary to issue an interpretation of its own, because it considered the accounting treatments sufficiently clear (par 4 of Circular 09/06). The existence of a regulatory gap might therefore be questioned. Nevertheless, a future South African financial reporting standard on inventories or revenue might incorporate the provisions of Circular 09/06 and would hence be in accordance with IFRSs.

⁴³ SAICA circulars are not as important as bills or explanatory memoranda that accompany bills as aids to the interpretation of provisions of an IFRS or of an act like the Companies Act. (The latter scenario is still theoretical: there have been no South African bills tabled as yet which interpret provisions of an IFRS.)

In contrast to bills or explanatory memoranda accompanying bills, SAICA circulars have never passed through at least some stages of the legislative process, and the legislator can therefore not be said to ever have applied his mind to them. (As to the intricate issue of whose thinking constitutes the 'intention' or the 'mind' of the legislator in present-day legislative processes, see Du Plessis, 2002:95 and Devenish, 1992:13. Details are beyond the scope of this thesis.) Rather, they merely reflect the expert opinion of SAICA. In terms of the old Companies Act, SAICA circulars are thus less significant than bills. In terms of the new Companies Act, this situation may change: in the event of interpretative circulars being enacted as FRS regulations in terms of s 223 of the new Companies Act, these circulars would be law (delegated legislation), see *supra* Chapter 2.1.1.2. Being law, they would have a higher interpretative significance than mere *travaux préparatoires* such as bills or explanatory memoranda accompanying bills.

Excluding alternative treatment allowed by IFRSs and only allowing benchmark treatment is a further way for future South African financial reporting standards to adapt IFRSs while remaining in accordance with them. This is in line with the IASB's stated goal to reduce the number of allowed alternative treatments over time (par 13 of the Preface to IFRSs). The recent elimination by the IASB of the previous choice between capitalising and expensing borrowing costs (see paras 7-9 of IAS 23 as at 30 November 2005) illustrates this. A lack of accordance with IFRSs may, however, arise if – as in the case of borrowing costs – the IASB opts to eliminate the benchmark treatment (expensing) and to allow only the alternative treatment (capitalising) in the future.

IFRSs, like any written rules, suffer from the occasional draftsman's error. One such error is, for instance found in par 120A(c)(iii) of IAS 19. Paragraph 120A(c) governs the disclosure requirements with regard to the reconciliation of the opening and closing balances of the present value of the defined benefit obligation.

The line item "contributions by plan participants" is not part of such reconciliation, yet par 120A(c)(iii) mentions it. In contrast, par 120A(e)(v) correctly sets out the line item "contribution by plan participants" as part of the reconciliation of the opening and closing balances of the present value of the plan assets.

The question then arises whether a future South African financial reporting standard on employee benefits which correctly omits par 120A(c)(iii) would be in accordance with IFRSs. In terms of par 6 of the Preface to IFRSs, one of the IASB's objectives is to develop a single set of high-quality standards. Draftsman's errors run counter to that objective. To correct them, it is submitted, would therefore not lead to future South African financial reporting standards not being in accordance with IFRSs. Furthermore, in terms of s 29(5)(a) of the new Companies Act, the future South African financial reporting standards must promote sound accounting practices. Copying over existing draftsman's errors in IFRSs into future South African financial reporting standards is not sound. Doing so would thus infringe s 29(5). What are the consequences of such an infringement? Parliamentary statutes (such as the Companies Act) are original legislation. Regulations (such as the ones that will be setting out the future South African financial reporting standards) are delegated (subordinate) legislation ranking lower than parliamentary statutes. An

empowering provision within the parliamentary statute (s 223 of the new Companies Act) authorises their enactment. Delegated (subordinate) legislation is subject to judicial review. In terms of the traditional common-law tests, delegated legislation had to comply with original legislation (such as s 29(5) of the new Companies Act) in order to be valid and not to be struck down by the courts (Du Plessis, 2002:44). The Constitution does not expressly mention this requirement. Du Plessis (2002:55) nevertheless advocates retaining it. It is therefore submitted that provisions of the future South African financial reporting standards which incorporate a draftsman's error of the IFRSs (like par 120A(c)(iii) of IAS 19) will be open to successful challenge in court.⁴⁴

2.1.1.4 Legal Status

The old and new Companies Acts differ in respect of how the FRSC is established. The old Act created the FRSC statutorily (s 440P(1): "is hereby established"), while the new Companies Act does not. In terms of the new Companies Act, the Minister of Trade and Industry (henceforth "the Minister") must establish it (s 203(1)). This leaves the FRSC with a considerably lower legal standing. In all probability it will be created by virtue of a mere ministerial order or directive. In principle a ministerial regulation could also be used. Section 223 of the new Act ('Regulations'), however, does not seem to allow this: a ministerial regulation establishing the FRSC is neither expressly authorised or contemplated in the Companies Act in terms of s 223(1)(a), it is not a regulation regarding a form required to be used (in terms of s 223(1)(d)(i)), nor a mere ancillary or incidental matter (in terms of s 223(1)(d)(ii)). By and large, the new FRSC can hardly be said to be as "autonomous" as the old FRSC (s 440P(4)).

⁴⁴ See *infra* Chapter 5.1.2.

The old Companies Act classified the FRSC as a “body corporate”. A body corporate is a juristic person. “Body corporate” in terms of s 440P(1) simply means a juristic person which is not a company. The Afrikaans version of s 440P(1) confirmed this by using the term “*regspersoon*”.

The FRSC loses this status under the new Companies Act. The FRSC now becomes a mere administrative entity within the Department of Trade and Industry, seemingly without a separate legal personality of its own: this seems to emanate from a comparison of the wording of s 203(1) of the new Companies Act, on the one hand, with s 185(1) and s 193(1) of the new Companies Act on the other hand. These three provisions govern the establishment of the FRSC, the Commission and the Companies Tribunal respectively. Both s 193(1) and s 185(1) expressly state that “[there] is hereby established a *juristic person*”, whereas such reference is conspicuously absent from s 203(1).

2.1.1.5 Does the FRSC perform administrative action?

Whether the FRSC’s decisions amount to ‘*administrative action*’ in terms of s 1 of the PAJA is relevant in order to determine whether the principles of just administrative action as set out in the PAJA apply.⁴⁵ Furthermore, s 5(4) of the new Companies Act makes it clear that if there is an irreconcilable inconsistency between a provision of the Companies Act and one of the PAJA, the PAJA’s provision will prevail (s 5(4)(bb)(dd)). No similar provision was introduced in the old Companies Act. Section 5(4)(b) is a new feature of the new Companies Act.⁴⁶

The term ‘*administrative action*’ is not defined in the Constitution. The PAJA, however, defines it in its s 1. The relevant part (for this thesis) of this definition reads as follows: ‘*Administrative action*’ is

⁴⁵ See *infra* Chapter 4.1.1.

⁴⁶ See *infra* Chapter 4.1.1.

“any decision taken ... by (a) any organ of state, when ... exercising a public power or performing a public function in terms of any legislation; or (b) [by] a natural or juristic person, other than an organ of state, when exercising a public power or performing a public function in terms of an empowering provision, which adversely affects the rights of any person and which has a direct, external legal effect, ...”.

This definition further lists a catalogue of exclusions (in particular executive, legislative and judicial functions) which are, however, not relevant here.

An ‘*organ of state*’ is defined in s 239 of the Constitution. The relevant part (for this thesis) of this definition reads as follows: An ‘*organ of state*’ is

“(a) any department of state or administration in the national ... sphere of government; or (b) any ... institution ... exercising a public power or performing a public function in terms of any legislation ...”

Neither the old nor the new Companies Acts expressly state whether or not the FRSC is an *organ of state*. From s 239 it emanates that an organ of state need not be a juristic person, and the FRSC could thus be an organ of state regardless of whether it will be established with separate juristic personality or not.⁴⁷

The term ‘*department*’ denotes, for current purposes, both the Department of Trade and Industry itself as well as the Minister as head of the department and all administrators in the employ of the Department of Trade and Industry (Burns & Beukes, 2006:93). The term ‘*administration*’ is not defined in either the Constitution or in the PAJA, but includes – as emanates from s 195(2)(b) of the Constitution – organs of state. The term ‘*any institution*’ is the broadest and most comprehensive of the three terms (‘*department*’, ‘*administration*’ and ‘*institution*’) and can, it is submitted, easily include the FRSC since the FRSC has a function (*viz.* the drafting of FRSs).

To be an organ of state the FRSC must ‘*exercise a public power*’ or ‘*perform a public function*’. The Constitution does not give a ready answer to the question of what makes a power or function

⁴⁷ See supra Chapter 2.1.1.4.

‘public’, nor have South African courts given a clear answer as yet (Hoexter, 2007:3). Currie (2007:47) notes that “definition or theorisation are seldom ventured because of the difficulty and abstraction of the concept” and defines ‘public power’ as “power with a state-like dimension – either because it derives from the state or because it does what the state typically does – exercising public power in a general and public-regarding way.” Van Dijkhorst J in *Korf v Health Professions Council of SA (2000 (1) SA 1171 (T) 1177H)* held that, in the definition of an ‘organ of state’ the term ‘public function’ means “engaged in the affairs or service of the public.” Plasket J in the subsequent decision *Police and Prisons Civil Rights Union (POPCRU) v Minister of Correctional Services, ([2006] 2 All SA 175 (E) par 53)* specified that

“what makes the power involved a public power is the fact that it has been vested in a public functionary who is required to exercise it in the public interest, and not in his ... own private interest or at his ... own whim.”

Hoexter (2007:3), as well as Burns and Beukes (2006:137, referring to Currie & De Waal, 2005:48), and in a similar way De Ville (2005:44) follow this view and emphasise that what is relevant is whether the power or function is performed in the public interest rather than for private gain. The drafting of FRSs by the FRSC furthers the public interest and the FRSC has no private gain from its drafting activities. The FRSC thus exercises a public function.

In the Constitutional Court’s decision of *Chirwa v Transnet Ltd (2008 (4) SA 367 (CC) par 186)* Langa CJ (with O’Regan J and Mokgoro J concurring) attempted to set out in summary when the requirement of ‘exercising a public power’ or ‘performing a public function’ in terms of the PAJA definition of ‘administrative action’ is met:

“Determining whether a power or function is ‘public’ is a notoriously difficult exercise. There is no simple definition or clear test ... Instead, it is a question that has to be answered with regard to all the relevant factors, including: (a) the relationship of coercion or power that the actor has in its capacity as a public institution; (b) the impact of the decision on the public; (c) the source of the power; and (d) whether there is a need for the decision to be exercised in the public interest. None of these factors will necessarily be determinative; instead, a court must exercise its discretion considering their relative weight in the context.”

Applying these factors to the FRSC, it seems difficult to identify, in terms of factor (a), any relationship of coercion and power that the FRSC could exert either over the Minister or over the general public.⁴⁸ As regards the other factors listed by Langa CJ, factor (d) in essence reflects the definition of ‘public power’ in the *POPCRU* decision. Factor (b) and factor (c) seem to refer to, and coincide with, the ‘impact’ requirement (“adversely affects the rights of any person”)⁴⁹ and the requirement ‘in terms of any legislation’,⁵⁰ respectively, of the definition of ‘administrative action’ in s 1 of the PAJA.

The PAJA’s definition of ‘administrative action’ includes an institution which exercises its public function ‘in terms of any legislation’. The FRSC performs its public function under s 204 of the new Companies Act and s 440S of the old Companies Act.

The FRSC is thus an ‘organ of state’.

Some confusion persisted for some time in the case law as to whether – beyond the wording of s 239 of the Constitution – ‘state control’ is an additional requirement for an organ of state (referred to as ‘the control test’, which had emerged from the decision *Directory Advertising Cost Cutters v Minister of Posts, Telecommunications and Broadcasting 1996 (3) SA 800 (T) 810F-G*, per Van Dijkhorst J). This test, as Woolman (2006:105) points out, has been borrowed from Canadian jurisprudence. Hoexter (2007:54) rightly observes that “[t]his test seems spurious in view of the clear terms of s 239”, and concludes, referring to the recent decision of the Constitutional Court in *AAA Investments (Pty) Ltd v Micro Finance Regulatory Council (2006 (11) BCLR 1255 (CC))*, that it is not an additional requirement, but merely serves as one of several factors (indicators) to show that a function is public rather than private. Similarly, Currie (2007:75) concludes from the wording of s 239 of the 1996 Constitution that “the jurisprudence interpreting the phrase ‘organ of state’ in the interim Constitution [*i.e.* the 1993 Constitution] as turning on a degree of control of the entity by the government is redundant, since it emphasises the nature of the functionary rather than the function.” Burns and Beukes (2006:97) as well as De

⁴⁸ See *infra* in this chapter.

⁴⁹ See *infra* in this chapter.

⁵⁰ See *infra* in this chapter.

Ville (2005:41) seem less convinced and submit that the ‘control test’ (referred to by Burns and Beukes as ‘the narrow test’) is still being retained in the case law alongside two further tests, viz. ‘the public power test’ (referred to by Burns and Beukes as ‘the wider test’) as pronounced in *IFP v TRC (2000 (3) SA 119 (C))* and an even broader test as pronounced in *Baloro v University of Bophuthatswana (1995 (4) SA 197 (B) 246)*, which merely focuses on whether the institution or functionary is “integrated into the structures of state authority.” Which one of these three tests will be applicable? Burns and Beukes do not give a ready answer to that, while De Ville (2005:44) says that, for the purposes of defining ‘administrative action’ in terms of s 1 of the PAJA, it is irrelevant which test is applied, since s 239 of the Constitution defines an ‘organ of state’ in an all-embracing manner. De Ville’s reasoning in the end thus comes down to nearly the same as Hoexter’s and Currie’s.

Does the FRSC perform ‘*administrative action*’ in terms of s 1 of the PAJA?

‘Administrative action’ requires a ‘*decision*’ made by the FRSC. ‘Decision’ in turn is defined in s 1 of the PAJA in very broad terms and means (for the purposes of this thesis) “any decision of an administrative nature made ... or required to be made ... under an empowering provision, including a decision relating to ... (e) making a declaration ... or (g) doing ... any other act ... of an administrative nature ...” This definition can easily encompass the FRSC’s decision to establish and/or develop specific standards (s 440S(1) of the old Companies Act), to submit FRSs to the Minister (s 440U(1) of the old Companies Act), to adapt international reporting standards for local circumstances (s 204(a) of the new Companies Act), to advise the Minister on matters relating to FRSs (s 204(b)) and to consult with the Minister (s 204(a)).

Are these decisions ‘*of an administrative nature*’? De Ville (2005:40), as well as Burns and Beukes (2006:133), submit that this requirement simply serves to exclude private action, and Currie (2007:51) as well as Hoexter (2007:190) conclude that it “is a harmless attempt to underscore the point already made by the list of specific exclusions [as set out in the PAJA]: that executive, legislative and judicial action is not administrative power.” In terms of either interpretation, the FRSC’s decisions are thus ‘of an administrative nature’.

As stated earlier, the FRSC is an *organ of state* and does *perform a public function*. Furthermore, it does so ‘*in terms of any legislation*’, viz. s 204 of the new Companies Act and ss 440S, 440U of the old Companies Act, respectively.

Administrative action in terms of the PAJA further requires that the decision taken ‘*adversely affects the rights of any person*’. This phrase has turned out to be one of the most intricate in the PAJA over the past decade (Quinot, 2007:381 and 231; Hoexter, 2007:186 and 199).

What does ‘*affect*’ mean? It refers to the effect (the impact) of an act (Currie, 2007:78). Currie and Klaaren (2001:76) explain that the verb ‘*affect*’ can have two meanings, either ‘*taking away rights*’ (referred to as the ‘*deprivation theory*’) or, more broadly, ‘*determining rights*’ (referred to as the ‘*determination theory*’). The deprivation theory is stricter: it excludes, as Hoexter (2007:199) points out, ‘*mere applicants*’, *i.e.* applicants for benefits whose entitlement to the benefit has not yet been determined. The language of the PAJA is not clear; its definition of ‘*decision*’ is, however, suggestive of the determination theory, since it specifically includes actions such as the issuing of a permission and the refusal to issue a licence. Hoexter (2007:200), referring to s 33 of the Constitution, suggests that the determination theory ought to be accepted as the meaning in the PAJA, since

“[t]he right to lawful, reasonable and procedurally fair administration in s 33(1) [of the Constitution] is not qualified in the same way as the right to reasons in s 33(2) [of the Constitution]; the application of s 33(2) depends on an affected right, but the application of s 33(1) does not. Thus the use of the deprivation theory to limit the meaning of administrative action would apparently render the Act unconstitutional, as it would fail to give effect to s 33(1) as required by s 33(3) of the Constitution.”

South African courts have begun to move away from a strict interpretation of ‘*rights*’ and broaden the notion of ‘*rights*’. In the leading case *Grey’s Marine Hout Bay (Pty) Ltd v Minister of Public Works (2005 (6) SA 313 (SCA) par 23)* Nugent JA suggested that the phrase ‘*adversely affects the rights of any person*’ should not be read literally and that administrative action is rather to be understood more broadly as “*action that [merely] has the capacity to affect legal rights.*” Hoexter (2007:203) pointed out that this passage may have been merely *obiter*, since the

case ultimately turned not on s 1 of the PAJA and the absence of a right, but rather on s 3 of the PAJA and the failure to establish a legitimate expectation. Fabricius AJ in the subsequent decision *Oosthuizen's Transport (Pty) Ltd v MEC, Road Traffic Matters, Mpumalanga (2008 (2) 579I-580C (T))*, however, adopted and applied Nugent JA's definition and – with sound grammatical analysis – traced it back to the original German definition:

“According to the German definition ... [i]t is sufficient if such administrative act is 'aimed at' such [direct, legal external] consequences (gerichtet ist). When I say 'aimed at' I mean a decision that is addressed at or trained at a certain consequence and not one that will have those consequences. That is how I understand the German authorities, and that is why I presume the learned judge [Nugent JA] ... used the phrase 'capacity to affect legal rights'.”

Four years earlier, Cloete JA in *Bullock NO v Provincial Government, North West Province (2004 (5) SA 262 (SCA) par 19)* had already suggested that “the concept of ‘rights’ ... should not be restricted to rights enforceable in a court of law” and had quoted a remark made by O'Regan J in *Premier, Mpumalanga v Executive Committee, Association of State-Aided Schools, Eastern Transvaal (1999 (2) SA (CC) par 31)* which points in the same direction (“It may be that a broader notion of ‘right’ than that used in private law may well be appropriate.”). Quinot (2007:232) observes that *Van Zyl v New National Party (2003 (3) All SA 737 (C) par 79)*, which in turn quotes Coetzee J in *Secretary for Inland Revenue v Kirsch (1978 (3) SA 93 (T) 94)*

“seems to recognise that the term 'rights' can even be as broadly understood as 'legally recognised interests'.”

Burns and Beukes (2006:144 and 146) also advocate the adoption of the determination theory. Currie and Klaaren (2001:77) observe:

“Had the Act been intended to be more restrictive it would have been a simple matter to use the words 'existing rights' instead of simply 'rights' or to use the word 'depriving' instead of 'affecting'. The 'determination' meaning, which does not restrict the application of the Act to decision affecting established rights, is therefore preferable.”

Finally, Pfaff and Schneider (2001:72), referring to the comparable situation in German administrative law, also opt for the determination theory.

As regards the term ‘*adversely*’, Burns and Beukes (2006:144) say that an ‘adverse effect’ has the same meaning as an ‘onerous effect’, *i.e.* the administration must impose a burden on the individual. Hoexter (2007:204) raises the question whether the adverb ‘adversely’ could be intended to exclude from the definition of ‘administrative action’ any beneficial administrative conduct (such as being issued a license). If not, she reasons, the adverb adds nothing to the definition and is superfluous. Quinot (2007:234) goes even further and emphasises, referring to Nugent JA in *Grey’s Marine*, that the distinction between adverse and beneficial impacts is no longer relevant:

“[T]he impact criterion in [the] PAJA’s definition of administrative action has practically been reduced to vanishing point.”

As to whether the FRSC’s decisions adversely affect the rights of any person, either the rights of the Minister or the rights of any company which will have to comply with the future FRs come to mind. The Minister has – at any rate under the new Companies Act⁵¹ – the power to amend or reject the FRSC’s submissions and is not obliged to issue FRs based on the FRSC’s submissions. His rights are thus not determined by the FRSC’s decisions. The situation is different for companies which have to comply with FRs. Their rights and obligations as to financial reporting will be determined by the future FRs. The FRSC, however, merely drafts these. Given the considerably weakened role of the FRSC under the new Companies Act,⁵² the FRSC’s drafts as such have, it is submitted, no determining effect on companies’ rights or obligations yet. Companies’ rights are thus not determined by the FRSC’s submissions either.

The FRSC’s decisions thus do not affect the rights of any person. Even if they did, they would in addition – in terms of the definition of ‘administrative action’ in s 1 of the PAJA – have to have a ‘*direct, external legal effect*’. This part of the definition of ‘administrative action’ has also

⁵¹ The situation was possibly different under s 440U(2) of the old Companies Act, see *supra* Chapter 2.1.1.2.

⁵² See *infra* at the end of this chapter.

caused much controversy. The phrase ‘direct, external legal effect’ was copied from German administrative legislation (Pfaff & Schneider, 2001:70; Currie & Klaaren, 2001:81 Burns & Beukes, 2006:147; Hoexter, 2007:204).

Pfaff and Schneider observe that this requirement, in terms of German administrative law, is aimed at helping to avoid legal disputes about measures and actions of public authorities that may well influence the final decision, but do not determine individual rights in a binding way (Pfaff & Schneider, 2001:71). Currie (2007:85), interpreting the phrase ‘direct, external legal effect’ in the context of the PAJA, suggests that it captures the idea that “decisions must have a real impact on a person’s rights” and concludes that this interpretation makes the phrase overlap considerably with the ‘adversely affecting rights’ requirement.

‘*Legal effect*’, in German law, means that the decision entails a legally binding determination of someone’s rights, thus covering deprivations as well (Pfaff & Schneider, 2001:72, referred to in *Oosthuizen’s Transport v MEC par 22*; Burns & Beukes, 2006:148; Hoexter, 2007:204). Currie (2007:86) follows this view and says that the decision

“*must establish what someone’s rights are, or change or withdraw them.*”

In the South African context, according to De Ville (2005:55) the phrase ‘legal effect’ means that the decision has to have “a discernable effect on an individual”. This is a broader meaning than the original German meaning ‘legally binding’. Hoexter (2007:206) feels that the word ‘legal’ adds little, since it fails to resolve the determination/deprivation puzzle.

‘*Direct effect*’, in German law, means that the decision must be a final one. Only the last step in the administrative process is thus administrative action and can be taken to court for judicial review. Thus, preparatory proposals, recommendations, expert opinions or decisions in a multi-stage decision-making process cannot be challenged (Pfaff & Schneider, 2001:72, referred to in *Oosthuizen’s Transport v MEC par 22*). According to Hoexter (2007:205), the phrase ‘direct effect’ refers to ‘immediacy’ or ‘finality’ and is, in the South African context, able to capture the common-law idea that administrative action needs to be ‘ripe’ before it can be reviewed (2007:206 and 519). While ‘ripeness’ does, however, not necessarily mean that the decision must

already be finalised (so that preliminary decisions might be reviewable under certain circumstances), it is, according to Hoexter, not certain whether the wording of the PAJA's definition of 'decision' allows such a departure from the requirement of 'finality'. Burns and Beukes (2006:148) propose that this requirement of 'finality' be waived, if the administrator has acted *mala fide* ('in bad faith'), since under these circumstances an individual cannot be expected to wait until all the internal remedies have been exhausted. De Ville follows a similar line, pointing out (2005:56) that the requirement of 'finality' has been applied in South African case law in a flexible manner and advocates (2005:57) its interpretation in line with established common law.

'*External effect*', under German law, is "aimed at excluding administrative measures that are taken within the sphere of public administration. This means that only administrative action that affects a person different from the authority that has engaged in the action can be said to have external effect" (Pfaff & Schneider, 2001:73). Thus, the measure has to affect outsiders and should not be a purely internal matter of departmental administration. Hoexter (2007:206) is of the opinion that the word 'external' adds nothing in the South African administrative-law context. Instead, she argues that distinguishing between internal and external acts is

"a non-issue at [South African] common law."

De Ville (2005:58) supports this view: as long as the internal rules and regulations of an administrative authority do not conflict with the Constitution or legislation or lead to a contravention of administrative-law requirements, they cannot be challenged. De Ville adds further that the phrase 'external effect' is simply to avoid challenges to administrative decisions without any real impact. Burns and Beukes (2006:149) submit that the entire phrase 'direct, external legal effect' limits the scope of the constitutionally guaranteed right to just administrative action (s 33 of the Constitution) and, therefore, question whether this phrase is indeed constitutional at all.

Thus, there seems to be a consensus emerging among South African academics that the requirement of 'external effect' should – contrary to its original German meaning as expressed by Pfaff and Schneider – rather be read down or even be ignored. The case law is not settled as

yet: *SAPU v National Commissioner of the SAPS* ([2005] 26 ILJ 2403 (LC) par 57) broadly accepted the German meaning of the requirement, while *Nxele v Chief Deputy Commissioner, Corporate Services, Department of Correctional Services* ([2006] 10 BLLR 960 (LC) par 74) read the requirement down. In a broader sense Chaskalson CJ in the Constitutional Court's decision *Minister of Health v New Clicks SA (Pty) Ltd* (2006 (2) SA 311 (CC) par 142) pointed out, that

“certain of its [i.e. the PAJA's] provisions have been borrowed from German ... law. PAJA must, however, be interpreted by our Courts in the context of our law and not in the context of the legal systems from which provisions may have been borrowed.”

Hence, the decisions of the FRSC are not subject to administrative review as they have no 'direct, external legal effect' in the sense explained: Their effect is not 'legal', since no rights are determined by them in a legally binding way. Their effect is not 'external' – assuming this criterion is at all relevant in the South African context – since the FRSC's drafts and submissions are not directed towards outsiders (companies), *i.e.* persons outside the administration. Rather, they are merely communication between the FRSC and the Minister. Finally, their effect is not 'direct' since they are not ripe (final). Rather, they are merely preparatory and serve as working papers for the Minister. Overall, under the new Companies Act, the FRSC's role and the impact of its activities on individuals' rights and obligations appear to be considerably weaker than the typical role of a body in a two-stage decision process. They also seem considerably weaker than, for instance, the impact of an inspector's activities (report or recommendation) during (preliminary) administrative investigations whose assessment of a situation feeds into the final decision of another administrator.⁵³ The situation may have been different under the old Companies Act, though.⁵⁴

⁵³ See *infra* Chapter 2.1.3.4.

⁵⁴ See *supra* Chapter 2.1.1.2.

In summation, the FRSC is an organ of state and exercises a public function. Its actions are, however, not ‘administrative action’ in terms of s 1 of the PAJA. Hence, the PAJA does not apply to them.

2.1.2 The Accounting Practices Board (‘APB’)

With regard to standard-setting, the APB was accorded a significant role in terms of the CLAA. In terms of the new Companies Act, however, the APB lost its statutory recognition and most of its functions. Only the Companies Regulations 2011 still accord a marginal role to the APB.⁵⁵

2.1.2.1 Composition and legal status

The APB is a juristic person (s 1 APB Constitution: “body corporate”). It has been established, on a voluntary basis, by several “constituent bodies” (s 2(1) of the APB Constitution). Some of them, such as IRBA, are statutory bodies (s 3(1)(a) of the Auditing Profession Act No. 26 of 2005) and are organs of state, while others, such as the JSE Limited or SAICA, are ‘private’ (‘voluntary’) bodies (being defined as non-statutory bodies whose existence and authority are based on a mere contractual agreement) which perform a public function and which have or have not received statutory mention.

Although the APB is not a statutory body, it received – like the JSE Limited (see s 440B(2)(d) and s 440X(4)(a) of the old Companies Act) – statutory recognition under the old Companies Act, namely in the definition of “financial reporting standards” in s 1 as well as in s 440Q(4)(a) and in par 5 of Schedule 4 of the old Companies Act.

⁵⁵ See infra Chapter 2.1.2.6.

The number of the APB's members is not fixed; rather, with the approval of the APB, new bodies may be given the right to appoint a member to the APB (s 2(3) of the APB Constitution). Today (June 2011), the APB has eleven members, after the Investment Analysts Society of Southern Africa resigned from the APB in June 2011. These are SAICA, the JSE Limited, the Independent Regulatory Board for Auditors (IRBA), the Chartered Institute of Management Accountants (CIMA), the South African Institute of Professional Accountants (SAIPA), the Banking Association South Africa, the Chamber of Mines of South Africa, Die Afrikaanse Handelsinstituut, the Public Sector Accounting Standards Board, the South African Accounting Association, the South African Chamber of Business and the South African Institute of Chartered Secretaries and Administrators (See Appendix 1 to the APB Constitution). Each of these bodies appoints one voting member to the APB, with the exception of the JSE Limited, which appoints two members, and SAICA, which appoints five members. At present (June 2011), the APB therefore has 17 members excluding a non-voting chairman. Each member has one vote (s 9(7)(a) of the APB Constitution). Members are appointed for a minimum of two consecutive years (s 2(4)(b) of the APB Constitution); the appointment of a member may, however, be terminated if the constituent body which appointed the member gives this member a written notice of at least 30 days (s 2(3)(f) of the APB Constitution).

Seventy-five percent of the members of the APB present at an APB meeting represent a quorum (s 9(4) of the APB Constitution). However, a statement by the APB of what is or should be generally accepted or recommended accounting practice may be issued by the APB only if it was, at the very end of the process, approved by at least 75% of the total of the members of the APB (s 10(1)(a) of the APB Constitution), *i.e.* 13 members.

2.1.2.2 Function

The APB's overall objective, according to s 7(a) of the APB Constitution (SAICA, 2009a), is

“[t]o establish ... recognition and acceptance of what the [Accounting Practices] Board considers is or should be generally accepted accounting practice ...”

To this end, the APB

“consider[s] draft statements of [generally accepted] accounting practice prepared by the [South African] Institute [of Chartered Accountants]” (s 7(a)(i) of the APB Constitution)

which, as a rule, are submitted to it by the *Accounting Practices Committee* (hereinafter “APC”) which is itself a SAICA committee. Furthermore, the APB issues and publishes in its name and under its authority “statements of generally accepted accounting practice and of recommended accounting practice” (s 7(a)(ii) of the APB Constitution). SAICA acts as secretaries to the APB (s 5 of the APB Constitution).

It is noteworthy that the APB, when issuing Statements of Generally Accepted or Recommended Accounting Practice, does not publish the views of any member dissenting from the Statement, and furthermore forbids dissenting members to do so (s 10(2) of the APB Constitution). This is markedly different from the IASB’s policy which is to detail in IFRSs the dissenting opinions of its members (referred to, under a specific heading, as “DO”, *i.e.* “Dissenting Opinions”).

2.1.2.3 Interaction between the APB and SAICA in respect of standard-setting

As regards standard-setting, the roles of SAICA and the APB are intertwined to some extent.

Firstly, SAICA has always been the dominant member among the APB’s constituent bodies, representing at present (June 2011) five of the APB’s 17 members.

Secondly, SAICA acts as secretaries to the APB (s 5 of the APB Constitution). This is primarily an administrative function (s 8(j) and s 11(3) of the APB Constitution). It includes, however, a duty to keep records of the APB’s meetings (s 9(9) of the APB Constitution) and gives SAICA the right to call a meeting of the APB (s 9(2) of the APB Constitution).

Thirdly and most importantly, SAICA’s Board has, by virtue of par 10 of the SAICA Constitution, appointed the Accounting Practices Committee (“APC”). The APC is SAICA’s

technical accounting committee. It simultaneously acts, in accordance with par 5.19 of the SAICA Constitution, as a technical advisory body to the APB. Its objectives and responsibilities are set out in the “APC Terms of Reference and Operating Procedures” (hereinafter “TOR&OP”) (SAICA, 2009b).⁵⁶ In contrast to the APB and SAICA, the APC is not a body corporate.

It is noteworthy that s 10(3) of the APB Constitution states that SAICA is not stripped of its competence to issue “statements of recommended accounting practice to its [SAICA’s] members.” Section 10(3) of the APB Constitution makes it clear, however, that such statements of recommended accounting practice must not contradict those already issued by the APB and furthermore, that if such statements are issued by the APB subsequent to a statement issued by SAICA and do contradict an earlier statement issued by SAICA, the APB’s statement prevails.

In terms of the APC TOR&OP, the APC has

“[t]o review ... within the context of existing Statements of Generally Accepted Accounting Practice (GAAP) ... [and] International Financial Reporting Standards (IFRS) ... accounting issues that are likely to require authoritative guidance, with a view to reaching consensus as to the appropriate accounting treatment” (item “Terms of reference, no. 1”).

Furthermore, the APC is

“[t]o prepare accounting pronouncements, with reference to new or revised IFRS, and to propose to the ... APB ... that such pronouncements should be issued.” (TOR&OP, item “Terms of reference, no. 2”).

In addition, the APC is “[t]o develop new local standards, interpretations or opinions in instances where the ... IASB ... does not address issues that are of importance in South Africa” (TOR&OP, item “Terms of reference, no. 3”), such as, for instance, the revised AC 503 (“Accounting for Black Economic Empowerment (BEE) Transactions”). Over and above this, it also prepares comments, on behalf of SAICA, on exposure drafts or on discussion papers prepared by the

⁵⁶ Note that the APC TOR&OP have not been numbered throughout. They do, however, contain subheadings (referred to in this thesis as ‘items’), which are used as references in this thesis.

IASB or by IFRIC. Finally, the APC is to “nominat[e] members to the IASB structures ... in consultation with the APB and, where appropriate, with the approval of the SAICA Board” (TOR&OP, item “Terms of reference, no. 6”). The term “IASB structures” refers in particular to the IASB and to IFRIC (today’s IFRS-IC).⁵⁷

The APC plays a crucial role in drafting and approving SAICA’s Circulars to the extent to which these circulars deal with accounting issues (such as, for instance, Circular 03/09 (‘Headline Earnings’), Circular 12/06 (‘Operating Leases’) and Circular 09/06 (‘Transactions giving rise to adjustments to Revenue/Purchases’)).⁵⁸

As per the APC TOR&OP (item “Membership”) the APC has up to 15 voting members (in June 2011: 15 members), excluding its non-voting chairman and two non-voting *ex officio* members.⁵⁹ All members are appointed by the SAICA Board for a term of three years (to be confirmed annually) which, for continuity’s sake, may be renewed twice. It is noteworthy that the four global audit firms (in the words of TOR&OP, item “Membership”: “the Big 4 audit firms”, *i.e.* Deloitte&Touche, PwC, KPMG, Ernst&Young) have each been granted a permanent seat on the APC. It is furthermore noteworthy that an IASB member may be appointed as a non-voting observer member to the APC.

The APC’s agenda is set by SAICA’s Secretariat (which is defined in par 1.22 of the By-laws to the SAICA Constitution as “the officers and employees appointed by [SAICA’s] Board”) with reference to the work programme of the IASB; outsiders may suggest agenda items (TOR&OP, item “APC agendas”). Fifty percent of the voting members of the APC plus one (*i.e.* in June 2011: 9 members) represent a quorum (TOR&OP, item “Meetings and communication”). The decisions referred to below are taken by consensus. A consensus is deemed to have been achieved when a simple majority of the APC members exercising their vote at a meeting have voted in favour of a proposal (TOR&OP, item “Voting”). Such a consensus is required for any

⁵⁷ See supra Chapter 1.1.3.

⁵⁸ Regarding Circular 09/06 see supra Chapter 2.1.1.3.

⁵⁹ These are: One member of the IASB, and one member of the Public Sector Accounting Standards Board (ASB).

exposure draft or pronouncement to be issued by the APC or to be proposed to the APB (TOR&OP, item “Exposure drafts and final standards”).

As regards the IASB’s Exposure Drafts, the APC prepares and submits, on behalf of SAICA, a South African comment letter to the IASB (TOR&OP, item “Terms of reference, no. 7”).

As regards IFRSs approved by the IASB, the APC considers these and submits a final accounting pronouncement to the APB for approval to be issued as a South African Statement of GAAP (TOR&OP, item “Exposure drafts and final standards” and item “Approval of final pronouncements by the APB”). The APC TOR&OP emphasise that the APC aims at minimising differences between South African and international standards “so as to enhance the credibility of South African accounting pronouncements through harmonisation with international standards”. Accordingly, the APC TOR&OP state that

“[t]he only amendments to be processed to the standard relate to legislative differences in South Africa and, in exceptional circumstances, to the implementation date of a standard” (item “Exposure drafts and final standards”).⁶⁰

As regards topics for which there is no international standard, the APC drafts local pronouncements in accordance with the Framework/Conceptual Framework⁶¹ for approval by the APB. To this end, the AC500 series was created in South Africa.

All APC pronouncements which have been approved by the APB are published by SAICA (TOR&OP, item “Publication of final pronouncements”).

2.1.2.4 What legal effect do the APB’s issued Statements of GAAP have?

⁶⁰ See supra Chapter 2.1.1.3.

⁶¹ Regarding the Framework and the Conceptual Framework see supra Chapter 2.1.1.1 (footnote 32) and infra Chapter 2.1.2.4 (footnote 73).

Section 285A of the old Companies Act established a statutory duty for widely held companies to comply with FRSs as statutorily defined in s 1 of the old Companies Act.⁶² FRSs, in turn, were defined in s 1 as “Generally Accepted Accounting Practice adopted by the Accounting Practices Board prior to the establishment of the [Financial Reporting Standards] Council, and thereafter issued in terms of section 440U(2).” The FRSC was established statutorily by virtue of s 440P(1) of the old Companies Act (“is hereby established”)⁶³ which came into effect on 14 December 2007. This is thus also the date on which the FRSC was ‘established’ in terms of the definition of “financial reporting standards”.

This leaves a vacuum period (which is not covered by either the old Companies Act as amended by the CLAA or the new Companies Act) during which South African FRSs could not be issued: the period between 14 December 2007 and the date at which the future FRSC will be ‘established’ in terms of s 203(1) of the new Companies Act.⁶⁴ Although the APB’s Statements of GAAP became FRSs when the CLAA came into force, no further Statements of GAAP could become FRSs because of the old Companies Act’s statutory definition of FRS. Further FRSs had to be established by the FRSC⁶⁵ which, however, never became operational.

All further Statements of GAAP or changes to Statements of GAAP issued by the APB therefore had no legal basis. In practice this meant that accountants who complied with the latest (*i.e.* post-13 December 2007) APB Statements of GAAP did, strictly speaking, contravene the law, if those Statements conflicted with the Statements that existed (had been issued) on the date when the CLAA came into effect. This unacceptable position can now be rectified only once the new FRSC is established in terms of s 203 of the new Companies Act and once the Minister establishes FRSs in terms of s 29(4) after consultation with the FRSC.

⁶² See *supra* Chapter 1.1 and *infra* Chapter 3.1.

⁶³ See *supra* Chapter 2.1.1.4.

⁶⁴ See *supra* Chapter 2.1.1.4.

⁶⁵ As to the issue of whether the old FRSC was merely competent to draft FRSs or could even set FRSs see *supra* Chapter 2.1.1.2.

The existing *lacuna* has widened with the effective date of the new Companies Act (1 May 2011): on that date the old Companies Act was repealed and the old FRSC (*i.e.* the FRSC established by s 440P(1) of the old Companies Act) was abolished. The new Companies Act's statutory definition of "Financial Reporting Standards" is different from the one of the old Companies Act. In terms of the new Companies Act, Statements of GAAP issued by the APB up to 13 December 2007 are no longer *ipso iure* "financial reporting standards" as defined. Consequently, since 1 May 2011 there have been no South African FRSs at all in effect any longer. The Minister cannot unilaterally issue FRSs, since he is statutorily required to consult with the FRSC beforehand (s 29(4): "after consulting the Council").

Neither have the Companies Regulations 2011 (which were made by the Minister in terms of s 223 of the new Companies Act and which also came into effect on 1 May 2011) remedied this situation.

Regulation (reg) 27 ("Financial Reporting Standards") states that "any financial statements contemplated in section 28 and 29 [of the Companies Act No. 71 of 2008 as amended by the Companies Amendment Act No. 3 of 2011] must comply with the applicable standards for that company" (reg 27(4)), and the Table attached to reg 27(4) sets out which types and categories of companies have to comply with which standards.⁶⁶

As emanates from the wording of reg 27(5) ("The financial reporting standards prescribed by this regulation ..."), reg 27 seems to perceive all the standards it prescribes to be "Financial Reporting Standards" as defined statutorily in s 1 of the new Companies Act. Regulation 27(5) further

⁶⁶ Regulation 27 only describes these standards in three categories, namely firstly "IFRS" (including "IFRS for SMEs"), secondly "SA GAAP" and thirdly "Financial Reporting Standard[s] as determined by the company for as long as no Financial Reporting Standard is prescribed", without referring to any specific IFRS or SA GAAP.

This third category is an oddity. Since the term "financial reporting standards" has received a statutory definition (s 1, read with s 29(4)(a) of the Companies Act), standards "determined by the company" are not FRSs as defined, unless the word "determined" is intended to mean "choosing from among IFRSs (including IFRSs for SMEs) and SA GAAP" (which would, however, render this third category unnecessary). It is also hard to see how they ever could become FRSs. Since these standards would be standards applicable only to individual companies and would thus not be of general application, they can hardly be promulgated by the Minister as regulations in terms of s 223 of the new Companies Act.

states that these prescribed standards apply to every company whose financial years ends after 30 April 2011.

The prescribed (reg 27(5)) ‘financial reporting standards’ are only broadly described in summary terms in reg 27 as “IFRS” and “SA GAAP”. Both these terms are defined in reg 26(1)(b) (“IFRS”) and reg 26(1)(g) (“SA GAAP”). As per their wording, these definitions seem intended to encompass, as regards “IFRS”, all IFRSs issued by the IASB and still effective at 1 May 2011⁶⁷ and, as regards “SA GAAP”, all AC (“Accounting”) series⁶⁸ approved and issued by the APB and still effective at 1 May 2011.

Regulation 27 is flawed as it stands and in all probability voidable, *i.e.* it is invalid, but it is – in line with the presumption of regularity (*Omnia praesumuntur rite esse acta*) – treated as valid until it is pronounced invalid by a court.⁶⁹ Regulation 27 is mere delegated legislation and it

⁶⁷ Presumably, the term “IFRS” in reg 26(1)(b) follows the definition in par 7 of IAS 1, and thus is used as collective term for all IASs, IFRSs, SIC Interpretations and IFRIC Interpretations. See *supra* Chapter 1.1 (footnote 1).

⁶⁸ SA GAAP consists of several categories (“series”) of APB-approved SAICA publications. Each series is abbreviated as “AC” with a serial number. These are AC 000 (“Conceptual Framework”), the AC 100 series (IASs/IFRSs), the AC 400 series (SICs, IFRICs) and the AC 500 series (South African Interpretations).

Pursuant to SAICA Circular 08/05, both AC 000 as well as the AC 100 series and the AC 400 series are exact replicas of the Framework for the Preparation and Presentation of Financial Statements, of the IASB’s/IASB’s IFRSs, and of the International Accounting Standards Committee’s Interpretations. The AC 500 series is an exception: it is comprised of the APB’s interpretation of IFRSs (*i.e.* of the AC 100 series) on transactions which are unique to the South African socio-economic environment, the best-known of which is probably AC 503 (“Accounting for Black Economic Empowerment (BEE) Transactions”).

Regulation 27(4) thus entails that only a subset of smaller companies (see *infra* Chapter 2.1.2.6, footnote 84 and footnote 85) have to comply with the AC 500 series, while all others do not. The rationale of this consequence seems questionable.

⁶⁹ See *Transnet Bpk h/a Coach Express v Voorsitter, Nasionale Vervoerkommissie 1995 (3) SA 844 (T) 846-847* (per De Villiers J). Hoexter (2007:486), referring to *Oudekraal Estates (Pty) Ltd v City of Cape Town 2004 (6) SA 222 (SCA)*, points out that until an invalid administrative act is set aside by a court “it exists in fact and is capable of having legal consequences – meaning that even an obvious illegality cannot simply be ignored.” Assuming that the Minister’s obligation to consult with the FRSC in terms of s 203 is a mandatory and material procedure or condition of the empowering provision s 203, non-compliance by the Minister may constitute a ground for a judicial review of reg 27(4),(5) in terms of s 6(2)(b) of the PAJA. See *infra* Chapter 5.1.2.1.

conflicts with the higher-ranking s 29(4) of the new Companies Act. At 1 May 2011 no FRSC with whom the Minister could have consulted had been established in terms of s 203 of the new Companies Act. Yet s 29(4) of the new Companies Act requires that the Minister must consult with the FRSC before he issues regulations establishing FRs. Section 203 as original legislation trumps delegated legislation such as reg 27.

The standards prescribed by reg 27(4) are therefore not “financial reporting standards” as defined in s 1 of the new Companies Act, and reg 27 does thus not comply with s 29 of the new Companies Act.⁷⁰

Furthermore, regs 26(g) and 27 are not entirely clear as to what they require for Statements of GAAP to become effective “SA GAAP”. The definition of “SA GAAP” in reg 26(g) seems to suggest that adoption by the APB suffices. Yet reg 27, by referring to SA GAAP as “Financial Reporting Standards” (see Heading of reg 27 and the column heading in the Table attached to reg 27(4)), presupposes a two-stage process, consisting of an initial adoption by the APB and a subsequent promulgation as a regulation by the Minister.⁷¹

⁷⁰ In this regard the APB’s statement in its “Discussion Paper on the impact of the Companies Act, no. 71 of 2008 (as amended by the Companies Amendment Act, no. 3 of 2011), on the financial reporting process in South Africa” (ABP, 2010) that “[a]s required in sections 29(4) and (5) above, the Minister issued regulations that clearly indicate the financial reporting standards (FRs) that should be applied by all companies and close corporations” is misleading.

⁷¹ As regards the Framework and the Conceptual Framework, the situation is thus as follows. Between 14 December 2007 and 30 April 2011, the Framework was a “financial reporting standard” as defined by the CLAA. The fact that, by virtue of a decision of the IASB, the Framework was superseded by the Conceptual Framework in September 2010 (see supra Chapter 2.1.1.1, footnote 32) did not change that. Neither was this situation changed by the fact that the APB adopted the Conceptual Framework in December 2010. Since 1 May 2011 the Framework is no longer a “financial reporting standard” as defined, and neither has the Conceptual Framework become a “financial reporting standard”.

Assuming that the interpretation (as set out above in the main text) as to the requirements for “SA GAAP” to become effective is correct, adoption by the APB did not give the Conceptual Framework the status of an “SA GAAP” either. That, however, does not entail that the APB or the APC cannot use the Conceptual Framework for the purpose of drafting “SA GAAP” (see supra Chapter 2.1.2.3).

As to the relevance of the Conceptual Framework in the South African context see infra Chapter 2.2.3.

In any event, s 29(4)(a), read with s 223 of the new Companies Act trumps the Regulations and in order for “SA GAAP” to become “financial reporting standards” and thus law, it therefore need to be promulgated by the Minister in the form of a regulation, after consultation with the FRSC.⁷²

As regards the Status of Statements of GAAP as “financial reporting standards”, the following periods thus have to be distinguished:

All Statements of GAAP issued by the APB up to 13 December 2007 were “financial reporting standards” as defined in the CLAA. Therefore, to the extent to which they were still effective on 14 December 2007 and were not withdrawn, s 285A applied to them and they thus determined companies’ rights and obligations. This situation ended, however, on 1 May 2011 since the statutory definition of “financial reporting standards” of the new Companies Act does not uphold

⁷² A contrary line of reasoning may possibly be acceptable. Practically, one of the chief purposes of the existence of the institution ‘FRSC’ is to have a South African broad-based expert body screen the IABS’s IFRSs for their applicability and suitability in South Africa before they are enacted (promulgated) as FRSs. The requirement “after consultation with” in s 203 of the new Companies Act ensures that this purpose is achieved. This requirement is therefore material. If it is contravened, the promulgated ‘FRSs’ are thus invalid (see *infra* Chapter 2.1.2.5, footnote 77).

As regards “SA GAAP” statements, however, a South African expert body other than the FRSC, namely the APB, had already applied its mind to them before the Minister promulgated them as FRSs (in the form of “SA GAAP”) by virtue of reg 26(g), read with reg 27(4). In this instance, the requirement “after consultation with [the FRSC]” of s 203 therefore rather seems to be a mere statutory formality and reg 26(g), read with reg 27(4) may therefore not be invalid.

This submission, however, leaves out of account the fact that the APB is, as regards its composition, not as broad-based as the FRSC. Furthermore, the danger with this argument lies in its floodgate effect. All Statements of GAAP (except for the AC 500 series) issued thus far (June 2011) by the APB are exact replicas of the IFRSs (see SAICA Circular 08/05), and all of them have been approved by the APB. It could therefore be argued that in all of these instances a South African expert body (the APB) had already applied its mind to them before they were promulgated in reg 27(4). This would in effect make the APB an alternative expert body of ranking and significance equal to the FRSC (at least as regards all IFRSs approved by the APB thus far). This is not, however, what the legislator expressed in the new Companies Act. The legislator of the new Companies Act did no longer incorporate into the new Companies Act a provision similar to the definition of “financial reporting standards” in s 1 of the old Companies Act as amended by the CLAA. A one-time absorption of existing, APB-approved Statements of GAAP as “financial reporting standards” (this time by virtue of a regulation by the Minister) does therefore no longer seem to have been intended by the legislator.

It is therefore submitted that the argument that approval by the APB suffices is wrong.

the statutory definition of “financial reporting standards” of the old Companies Act. Consequently, as from 1 May 2011, no FRSs at all are in effect any longer. The *lacuna* has widened.

Statements of GAAP issued by the APB on or after 14 December 2007⁷³ were never “financial reporting standards” as defined in the CLAA. Section 285A did thus not apply to them and they have never determined companies’ rights and obligations.

In terms of the new Companies Act companies will have to comply with FRSs in terms of s 29(1)(a). These will be promulgated by the Minister in consultation with the new FRSC. The APB does feature in this law-making process only to the extent conceded to it by regs 26 and 27. Statements of GAAP issued by the APB after 1 May 2011 will thus only determine the rights and obligations of those companies that, in terms of reg 27(4), opted to apply SA GAAP.

2.1.2.5 Does the APB perform administrative action when it issues Statements of GAAP?⁷⁴

Whether or not the APB’s decisions to issue Statements of GAAP amount to “*administrative action*” in terms of the PAJA will determine whether the remedies of the PAJA (the primary one of which would be to have the courts set aside the “administrative act” Statement of GAAP and remit it to the APB for reconsideration (s 8(1)(c)(i) of the PAJA)) can be brought to bear against them.⁷⁵

⁷³ E.g. IFRS for SMEs which was approved by the APB for issue as Statement of GAAP in August 2009 or IFRIC 17 (AC 450) [“Distribution of Non-cash Assets to Owners”] which was issued as an interpretation of Statements of GAAP with an issue date of March 2009.

⁷⁴ Regarding the definition of “administrative action” in terms of s 1 of the PAJA see *supra* Chapter 2.1.1.5.

⁷⁵ A challenge to an SA GAAP could occur in the form of a direct challenge or an indirect (collateral) challenge. For current purposes, a collateral challenge could become relevant in the following scenario: in order to enforce compliance, the Companies and Intellectual Properties Commission issues a compliance

When deciding to issue and publish one of the IASB's IFRSs as a Statement of GAAP, the APB surely makes a "*decision*" in terms of s 1 of the PAJA which does not fall into one of the categories of the exclusions in terms of the definition of "administrative action" and is thus "*of an administrative nature*".

The question then arises whether the APB is an "*organ of state*" in terms of s 239 of the Constitution of South Africa.⁷⁶ Due to the broad scope of the requirement "*any institution*" of s 239, the APB can easily be an institution. The definition of an organ of state further requires that the APB "*exercis[es] a public power*" or "*perform[s] a public function*".

The APB is a private body. As to the question of when private bodies can be said to perform a public function (rather than a private function), Wallis J, in *National Horseracing Authority of Southern Africa v Naidoo (2010 (3) SA 182 (N) par 25*, rephrasing Bingham MR's *obiter dictum*

notice (s 171 of the Companies Act) to a company that has opted, in terms of reg 27(4), to comply with a specific SA GAAP but does not comply with it.

This scenario thus involves a compliance notice (being a valid administrative action) issued by the Commission (being the consecutive third actor) to a company in order to enforce compliance with SA GAAP (being a valid administrative action) issued by the APB (being the second consecutive actor). This SA GAAP in turn is based on reg 27(4), read with reg 26(1)(g), which was issued by the Minister (being the first actor) but which is, however, an invalid administrative action, since it contravenes s 203 of the Companies Act.

The issue is whether the validity of the consequent acts (the issuing of the SA GAAP and the issuing of the compliance notice) depend on the validity of the initial act (the issuing of reg 27(5), read with reg 26(1)(g) by the Minister) or merely on its factual existence (Hoexter, 2007:487). In practice, this issue often arises involving only two actors and has become known as 'the Second Actor Theory'.

Hoexter (2007:488), referring to *Oudekraal Estates (Pty) Ltd v City of Cape Town paras 32 and 38* seems to favour an approach which allows a collateral challenge (in the current scenario, of both reg 27(4) and the specific SA GAAP that the compliance notice deals with) in instances where a public authority (in the current scenario, the Commission) attempts to use coercive power (in the current scenario, an enforceable compliance notice, see s 171(5),(7) of the Companies Act) against a subject (in the current scenario, the non-compliant company) and seems to submit that the mere factual existence of the invalid administrative action (in the current scenario, reg 27(5)) is in such instances not enough to support the various subsequent administrative actions that had been taken. This approach is convincing.

As to whether regulations are "administrative action" in terms of the PAJA see *infra* Chapter 2.1.4.2. As to the control by the courts of FRs as administrative action see *infra* Chapter 5.1.3.1.

⁷⁶ Regarding the definition of 'organ of state' in terms of s 239 see *supra* Chapter 2.1.1.5.

in the English decision *R v Disciplinary Committee of the Jockey Club; Ex parte Aga Khan* [1993] 2 All ER 853 CA 866), suggested the following test in an *obiter dictum*:

“If they [i.e. these private bodies] did not exist and regulate that activity in question government would probably intervene and create a public body to do so.”

As regards the JSE, its public function has already been recognised in 1983 by Goldstone J in *Dawnlaan Beleggings (Edms) Bpk v Johannesburg Stock Exchange* (1983 (3) SA 433 (W): “[T]he decisions of the ... stock exchange affect not only its own members or persons in contractual privity with it, but the general public ... It is for that reason that the Act makes the public interest paramount. To regard the JSE as a private institution would be to ignore commercial reality ...”), although Goldstone J explicitly steered clear of answering the question whether public law rather than private law is to be applied to the JSE’s activities (*Dawnlaan v Johannesburg Stock Exchange* 360H-361A).

By comparative reasoning, a public function can be accorded to SAICA and to many, if not all, of the APB’s other constituent bodies.

Valuable guidelines as to when a private body is to be regarded as ‘performing a public function’ also emanate from the decisions in *AAA Investments (Pty) Ltd v Micro Finance Regulatory Council*: Here the courts had to decide whether the Micro Finance Regulatory Council, a private entity, exercised public power when it made its moneylending rules governing an exemption from the Usury Act No. 73 of 1968. In answering that question, the court a quo (Transvaal Provincial Division) per Du Plessis J focused on three issues (2004 (6) SA 558E-G). Firstly, it asked whether the rules of the Council “purported to be of general application, binding the general public”. Secondly, it attempted to establish “whether the rules were coercive” in the sense that they were enforced by direct or indirect sanction. Thirdly, it tried to establish whether “the rules were part of a governmental regulatory structure”, *i.e.* whether they were an integral part of the governmental regulation of microlending. The Supreme Court of Appeal (2006 (1) SA 27 (SCA)) subsequently overturned Du Plessis J’s decision; in the subsequent Constitutional Court’s decision on the matter, O’Regan J submitted a list of criteria to determine whether rules made by a private body are public in character (2007 (1) SA 343 (CC) *par* 119). She focussed on:

“whether the rules apply generally to the public or a section of the public; whether they are coercive in character and effect; and whether they are related to a clear legislative framework and purpose.”

The APB does, in terms of Plasket J’s definition in *POPCRU v Minister of Correctional Services*,⁷⁷ “*exercis[e] a public power*” or “*perform[...] a public function*”, since it performs its function in the public interest and not for private gain. Equally, in terms of Wallis J’s definition in *National Horseracing Authority of Southern Africa v Naidoo*, the APB performs a public function since, if there were no APB and no other South African institution issuing Statements of GAAP, the legislator would probably have to step in and perform this function itself. Finally, the APB’s activities also satisfy O’Regan’s list of criteria in *AAA Investments v Micro Finance Regulatory Council*: the APB’s “rules” (*viz.* its Statements of GAAP) are of general application. Furthermore, in the light of the fact that non-compliance with the APB’s Statements of GAAP led, in terms of the former Circular 08/99, to the auditor’s report having to be modified, and, in terms of the old Companies Act as amended by the CLAA, to companies being statutorily required to comply with the APB’s Statements of GAAP, these “rules” were coercive in character and – to the extent to which they had been issued by 14 December 2007 – they continued to be coercive until 1 May 2011. On that date the situation changed. Now, the APB’s Statements of GAAP (“SA GAAP” in terms of reg 26(1)(g)) are only coercive for non-public companies that opted to apply them, in terms of reg 27(4),(5). Finally, at the very latest since the CLAA, these Statements of GAAP clearly relate to the legislative framework and purpose of the Companies Act. This situation has not changed since 1 May 2011. Thus, the APB has performed a public function at least since the effective date of the CLAA but probably also before that.

The definition of an organ of state further requires that the APB performs its public function “*in terms of any legislation*”. The term ‘legislation’ is not defined in either the Constitution or in the PAJA. Both use it, however, alongside the term ‘national legislation’. Botha (2005:7) explains that ‘legislation’ comprises any type of enacted law-texts (statutory law), *i.e.* Acts of Parliament, provincial legislation, municipal by-laws, proclamations and regulations. The term excludes the common law.

⁷⁷ See *supra* Chapter 2.1.1.5.

Contrary to what one would expect, there has been – until the effective date of the Companies Regulations 2011 – no enabling provision anywhere in South African statutes, neither in original nor in delegated legislation, which would have empowered the APB to issue Statements of GAAP. Rather, the constituent bodies of the APB themselves simply empowered the APB to do so by virtue of s 7(a)(ii) of the Constitution of the APB. The APB’s Constitution is a contractual agreement between its constituent bodies.

This is in stark contrast to IRBA, for instance, which is empowered statutorily by s 4(1)(e) of the Auditing Profession Act to “prescribe auditing standards”, and by s 10(1)(a) of the Auditing Profession Act to do so by means of law-making (rule-making). The ‘auditing standards’ prescribed thus far by IRBA have, however, not been issued as “rules” (as defined) in terms of s 10(1)(a), but as mere “auditing announcements” (IRBA, 2009), which in terms of the definition of “auditing pronouncements” in s 1 of the Auditing Profession Act only bind registered auditors in the performance of their audit.⁷⁸

Accordingly, until 1 May 2011 the APB did not perform its function “*in terms of any legislation*”. It was thus not an organ of state. Regulation 26(1)(g) of the Companies Regulations 2011 has changed this. This regulation may be understood as an enabling provision. The definition of reg 26(1)(g) acknowledges the existence of “SA GAAP” which are to be maintained and developed by the APB. It thus empowers the APB to issue Statements of GAAP. Therefore, since 1 May 2011 the APB has qualified as an “*organ of state*”. If one were to disagree with this submission, one would have to regard the APB as a “*juristic person*” (“a body corporate”) “*other than an organ of state*”. For “administrative action” in terms of s 1 of the PAJA to be at hand it is

⁷⁸ Why did IRBA, contrary to the comprehensive and wide wording of s 10(1)(a) of the Auditing Profession Act (“any matter that is ... permitted to be prescribed”) opt not to prescribe auditing standards in the form of rules? It seems that IRBA, in the light of the fact that auditing contexts vary considerably from one client and engagement to another, regards ‘rules’ as too rigid a legal instrument which does not allow for the necessary degree of flexibility. The result is that registered auditors are not bound directly by s 42 of the Auditing Profession Act to comply with auditing standards, since these are no “rules” as defined. IRBA, however, has prescribed Disciplinary Rules (in terms of s 10(1) of the Auditing Profession Act) according to which failure to comply with prescribed auditing standards constitutes “improper conduct” and in terms of which disciplinary action is taken by IRBA against a registered auditor who fails to comply with prescribed auditing standards and who, as a consequence, fails to exercise due care in the conduct of an audit or assurance. Consequently, compliance by registered auditors with auditing standards is enforceable. Regarding IRBA’s Disciplinary Rules see IRBA (2010).

then further required that the APB makes its decision under an “empowering provision” (“*in terms of an empowering provision*”). The PAJA defines “empowering provision” in a very broad way; it can be a law, but it can even be “an agreement, instrument or other document in terms of which administrative action was purportedly taken”. Thus, action taken by a juristic person while exercising a public function can qualify as administrative action, even if it is only taken by virtue of a contract or a policy document. Furthermore, the word “purportedly” makes it clear that action which is *ultra vires* can also be administrative action in terms of the PAJA (De Ville, 2005:51). Hoexter (2007:192) and Currie (2007:59) point out that the legislator’s intention with this broad wording was to subject private bodies, which exercise public power, to judicial review under the PAJA. As regards the APB, three possible “empowering provisions” come to mind. Firstly, the APB, in issuing Statements of GAAP, acts in terms of its Constitution, and this Constitution, agreed upon by the constituent bodies of the APB, is an “empowering provision” in terms of s 1 of the PAJA. That a private body’s Constitution can be an “empowering provision” in terms of s 1 of the PAJA has recently been confirmed *obiter* by Wallis J in *National Horseracing Authority of Southern Africa v Naidoo (2010 (3) SA 182 (N) par 19)*. Secondly, the statutory definition of “financial reporting standards” in s 1 of the old Companies Act as amended by the CLAA explicitly referred to “statements of Generally Accepted Accounting Practice adopted by the Accounting Practices Board” and could thus be understood as an “empowering provision”. The CLAA, however, merely gave legislative power to Statements of GAAP which had been issued by the APB at that time. Its effect was therefore not prospective, but merely retrospective, and it did thus not empower the APB to issue further Statements of GAAP. Finally, reg 26(1)(g) of the Companies Regulations 2011 may also be understood as an “empowering provision” in terms of the statutory definition in s 1 of the PAJA.

Currie (207:158) points out, however, that in view of the review ground s 6(2)(a)(i) of the PAJA this wide definition of “empowering provision” in s 1 of the PAJA may need to be read down: Referring to *AAA Investments (Pty) Ltd v Micro Finance Regulatory Council 2007(1) SA 343 CC para 68* (where Langa CJ held that “[t]he doctrine of legality, which requires that power should have a source in law, is applicable whenever public power is exercised”), he concludes that lawful administrative action has to be authorized by law and not simply by an “agreement, instrument or other document” in terms of the definition of “empowering provision” of s 1 of the

PAJA. If an empowering provision were not so authorized, Currie (2007:158) submits, it would render s 6(2)(a)(i) “flatly unconstitutional”. Therefore, as regards the APB, the APB’s Constitution possibly has to be eliminated from this list of possible “empowering provision[s]”.

“Administrative action” further requires that the decision taken “*adversely affects the rights of any person*”.

All statements of GAAP issued by the APB up to 13 December 2007 did determine companies’ rights and obligations,⁷⁹ and those issued after 30 November 2000⁸⁰ therefore also did “adversely affect” these companies’ rights in terms of the PAJA.

Statements of GAAP issued by the APB after 13 December 2007 did not determine companies’ rights and obligations; they therefore also did not “adversely affect” their rights.

Statements of GAAP issued by the APB after 1 May 2011 do determine only the rights and obligations of those companies who opted to apply SA GAAP, and thus do “adversely affect” only these companies’ rights.

Do the APB’s Statements of GAAP have a “direct, external legal effect”? Again, the three time periods have to be distinguished:

Section 285A(1) made all Statements of GAAP issued by the APB up to 13 December 2001 legally binding for all widely held companies. Those Statements which were issued post-30 November 2000 fell within the effective period of the PAJA and thus had a “legal effect” in terms of the PAJA. Furthermore, their effect was immediate and final. They were not preparatory

⁷⁹ See supra Chapter 2.1.2.4.

⁸⁰ This is the commencement date of the PAJA. The PAJA only applies to “administrative action” (in terms of s 1 of the PAJA) taken after its commencement; it does not operate retroactively (Currie, 2007:24). Administrative action taken before 30 November 2000 is thus not governed by the PAJA, but by the ‘just administrative action’ clause (s 33) of the Constitution of South Africa, see *Bullock NO v Provincial Government, North West Province 2004 (5) SA 262 (SCA) par 7*. The practical consequence is, as Currie (2007:25) points out, that “administrative action taken before 30 November 2000 may only be reviewed in the High Courts, the Supreme Court of Appeal and the Constitutional Court, and not in the magistrates’ courts and not in terms of the PAJA.”

decisions and thus had a “direct effect”. Finally, they were aimed at persons outside the public administration and thus had an “external effect”.⁸¹

Statements of GAAP issued by the APB between 14 December 2007 and 30 April 2011 do not legally bind any company and thus have no “legal effect” in terms of the PAJA. They too, however, were not preparatory decisions and were aimed at persons outside the public administration and thus have both a “direct effect” as well as an “external effect”.

Statements of GAAP issued by the APB after May 2011 have a “legal effect” only on those companies that opted to apply SA GAAP, and do have a “direct effect” and an “external effect”.

2.1.2.6 The future role of the APB

Under the new Companies Act and the Companies Regulations 2011, the APB’s role has been reduced drastically. The Companies Act makes no mention at all of the APB, yet reg 26(1)(g) does marginally in its definition of “SA GAAP”.

The (voidable) reg 27(4) allows certain smaller private companies⁸² and non-profit companies⁸³ to apply “SA GAAP”⁸⁴ as an alternative to IFRSs or IFRSs for SMEs. “SA GAAP” statements

⁸¹ The situation was different with regard to parastatal organisations (Telkom, Eskom, SABC, ...). These are part of the public administration (Hoexter 2007:6), while also having to present their annual financial statements in accordance with s 285A. They are thus no outsiders in terms of the notion of “external effect”.

⁸² Namely profit companies which are not state-owned or public companies and “(a) whose public interest score ... is at least 100 but less than 350; or (b) whose public interest score ... is less than 100, and whose statements are independently compiled.” The Public Interest Score calculation is set out in reg 26(2), and “independently compiled” is defined in reg 26(1)(e).

⁸³ Namely non-profit companies that are not required in terms of reg 28(2)(b) to have their annual financial statements audited, and that have the same public interest score as the companies mentioned in the previous footnote.

⁸⁴ It is noteworthy that SAICA’s comment letter to the DTI on the Draft Companies Regulations 2011 (SAICA 2010b) in fact suggested that “given that South African Statements of Generally Accepted

are issued by the APB. The APB's role in the future will thus be to maintain and issue SA GAAP for these companies, and thus to provide for a third-tier set of accounting standards.

2.1.3 The Companies and Intellectual Property Commission ('The Commission') and the Companies Tribunal ('The Tribunal')

The new Companies Act establishes the Companies and Intellectual Property Commission (henceforth "the Commission") and the Companies Tribunal (henceforth "the Tribunal"). Both were unknown under the old Companies Act. What is today referred to, in terms of the Companies Act No. 71 of 2008 and the Companies Bill B61D-2008, as the Companies Tribunal, differs markedly from the institution that was proposed in the earlier stages of the drafting of the new Companies Act, and until the last versions of the Bill (B-61 of 2008) the institution was referred to as the *Companies Ombud*.

2.1.3.1 Composition

The new Companies Act does not deal explicitly with the composition of the Commission. Section 189 merely contains provisions about the head of the Commission ("the Commissioner").

Accounting Practice (SA GAAP) are now in line with the statements that have been issued by the International Accounting Standards Board (IASB), namely IFRS and IFRS for SMEs, we propose that [the phrase] 'SA GAAP' [in the definition of "SA GAAP" which was reg 26(1)(f) of the Draft Companies Regulations and became reg 26(1)(g) of the final Companies Regulations 2011] be removed as a prescribed standard [and that] the following [phrase] be inserted in the table of Financial Reporting Standards: 'Any standards specifically developed for smaller profit and nonprofit companies.'

The Explanatory Memorandum to Bill 61D-2008 (Memorandum, item 3) as well as par 12(2) of Schedule 5 ('Transitional Arrangements'), however, both set out in more detail what the Commission is to be.⁸⁵ The current Companies and Intellectual Property Registration Office (CIPRO) which is part of the administrative structure of the Department of Trade and Industry, is to 'migrate into' the newly established Commission. Paragraph 12 of Schedule 5 states that the staff of CIPRO are to become the staff of the Commission.

The Commissioner is responsible for all matters pertaining to the functions of the Commission (s 189(1)(a)) and its internal control (s 189(3)). He is appointed by the Minister for a maximum term of five years and may be re-appointed (s 189(1)(a),(2)). The Act makes no provision for the Commissioner's resignation or removal from office; s 207 according to its express wording is not applicable.

With regard to the *Tribunal*, the Companies Act's provisions are more detailed (ss 193-194):

The Companies Tribunal consists of a chairperson and a minimum of ten members, all of whom are appointed by the Minister (s 193(4)). These are thus not employees of the Department of Trade and Industry; furthermore, s 193(4) specifically allows appointments on a part-time basis. The Companies Act does not prescribe term limits for the chairperson or for the other members.

To manage the caseload of the Tribunal, the chairperson as a rule assigns each matter referred to the Tribunal to a panel consisting of any three members of the Tribunal (s 195(2)(b)). Decisions of the panel are taken by majority (s 195(6)).

The Tribunal's chairperson may not be re-appointed for a second term (s 194(2)(b)). The Act is silent on the other members. However, s 194(2)(b) should be interpreted (since it uses the wording "as chairperson") to mean that they may be re-appointed and that a former chairperson may also subsequently be appointed as a member of the Tribunal.

Section 194(2)(a) circumscribes the minimum criteria for eligibility as member or chairperson by reference to s 205. Furthermore, s 194(6) refers to s 206 and thus dictates strict rules of conduct

⁸⁵ As to the interpretative importance of explanatory memoranda see supra Chapter 2.1.1.3 (footnote 44).

for members and the chairperson in cases of conflicts of interest. Finally, s 194(6), read with s 207, provides for resignations and removals from office.

2.1.3.2 Functions

The *Tribunal* plays no direct role in standard-setting. Instead, its functions with regard to FRSs are twofold. Firstly, it carries out as an adjudicative body reviews of compliance notices issued by the Commission to a non-compliant company (e.g. non-compliance with FRSs) in terms of s 171 and it adjudicates certain disputes specifically provided for in the Act (s 195(1)(a), read with ss 180 *et seq.*).⁸⁶ Secondly, it serves as a forum for voluntary dispute resolution (s 195(1)(b), read with ss 166-167).⁸⁷

The *Commission* is charged mainly with enforcement and administration of the Act. This includes some role in standard-setting and the enforcement of standards.

As regards standard-setting, the Commission has the right to make non-binding recommendations to the FRSC for amendments to FRSs (s 187(3)(b)). Furthermore, it can review company legislation (such as the provisions of s 29(4),(5) or ss 203-204, all of which deal with standard-setting) and reports its findings to the Minister (s 188(2)(d)). And finally, in terms of s 188(2)(b), it can issue explanatory notices outlining its non-binding opinion on the interpretation of any provision of the Companies Act (“this Act”) and thus – as per the definition of the term “this Act” in s 1 of the Companies Act – on the interpretation of FRSs (“regulations”) as well. It can also apply to a court for a declaratory order on the interpretation or application of provisions of “this Act”.

⁸⁶ See *infra* Chapter 4.1.2.2.5 and Chapter 4.1.2.2.8 for details.

⁸⁷ See *infra* Chapter 4.1.3.

The enforcement of the Companies Act is a stated statutory objective of the Commission (s 186(1)(e)): section 187(2)(b) specifies with regard to s 29(1)(a) that the Commission “must enforce” this provision by monitoring compliance with FRSs. It further must identify patterns of non-compliance by companies with FRSs and make respective recommendations to the FRSC for amendments to FRSs (s 187(3)(a)(b)).

The Commission is the primary institution for receiving or initiating complaints regarding alleged non-compliance with FRSs.⁸⁸

2.1.3.3 Legal status

Both the Commission and the Tribunal are statutorily established juristic persons (s 185(1); s 193(1)), referred to by the Act as “regulatory agencies” (see the Heading to Chapter 8 and reg [2011] 2(f)).

The Act emphasises that both are independent (s 185(2)(b); ss 193(1)(b), 193(2)). While the Tribunal’s independence is comprehensive, the Commission’s independence is limited: in terms of s 185(2)(b)(ii), it is subjected to “any policy statement, directive or request issued to it by the Minister in terms of this Act.”

2.1.3.4 Do the Commission and the Companies Tribunal perform administrative action when they decide whether a company has or has not complied with FRSs?

⁸⁸ See infra Chapter 4.1.2.2 for details.

As discussed earlier,⁸⁹ administrative action in terms of s 1 of the PAJA requires a decision by an organ of state which exercises a public power or performs a public function in terms of any legislation, or a decision by a juristic person other than an organ of state which exercises a public power or performs a public function in terms of an empowering provision. Either way, this decision must adversely affect the rights of any person and must have a direct, external legal effect.

In terms of this definition, both the Commission and the Companies Tribunal make ‘*decisions*’ that relate to whether or not a company complies with FRSs. The Commission, for instance, decides in terms of s 169(1)(a) of the new Companies Act whether or not to investigate a company for alleged non-compliance with FRSs, or decides whether to excuse a company as a respondent in a complaint (s 170(1)(a)), whether to issue a compliance notice (s 170(1)(g)), whether to refer complaints to the Tribunal (s 169(1)(b), s 170(1)(b)) or to the National Prosecuting Authority (s 170(1)(f)), whether to commence proceedings in a court in the name of the complainant (s 170(1)(e)), whether to issue a notice of non-referral (s 170(1)(c)), whether to propose to the complainant consent order proceedings (s 170(1)(d)) and whether to publish an inspector’s report (s 170(2)(a)). The Companies Tribunal also takes relevant decisions, in particular review decisions in terms of s 172(2) of the new Companies Act.

Are the Commission and the Tribunal *organs of state*? As regards the Commission, s 185(1) of the new Companies Act explicitly refers to it as an organ of state and specifies that it is an organ of state “within the public administration”. There is no corresponding provision in the new Companies Act as regards the Tribunal; the Explanatory Memorandum to Bill 61D-2006 (Memorandum: item 3), however, refers to the Tribunal as an organ of state.⁹⁰ When tested against the definition of ‘organ of state’ in the higher-ranking s 239 of the Constitution, the following emerges: both the Commission and the Tribunal are easily encompassed by the broad phrase ‘*any ... institution*’ of s 239. Furthermore, both are engaged in the service of the public and thus perform a ‘*public function*’: the Commission primarily serves the enforcement of the

⁸⁹ See supra Chapter 2.1.1.5.

⁹⁰ As to the interpretative importance of explanatory memoranda see supra Chapter 2.1.1.3 (footnote 44).

Companies Act, while the Tribunal acts as an adjudicative body. Both do so in terms of the Companies Act and thus ‘*in terms of any legislation*’. Both the Commission and the Tribunal are, thus, *organs of state* as defined in s 239 of the Constitution.

The definition of administrative action further requires that the relevant decision of the Commission and the Tribunal ‘*adversely affects the rights of any person*’. As regards decisions of the Commission and the Tribunal concerning alleged non-compliance with FRSs, two persons may potentially be affected: the allegedly non-compliant company on the one hand, and the complainant on the other.⁹¹ That raises the question as to which of their rights or legally recognised interests could possibly be ‘affected’ (in the sense of ‘be determined’).⁹²

One right could be the right to just (lawful and procedurally fair) administrative action in terms of s 33 of the Constitution. Both the complainant and, by virtue of s 8(4) of the Constitution, also a juristic person such as a respondent company have this right. That was the approach adopted by Schutz JA in *Transnet Ltd v Goodman Brothers (Pty) Ltd (2001 (1) SA 853 (SCA) paras 11-12)*. Hoexter (2007:202), however, quoting Currie and Klaaren (2001:81), rightly rejects it as ‘circular reasoning’:

“*It is ... circular to use an allegation that a constitutional right [i.e. s 33 of the Constitution] is affected to cross the threshold to access the protection afforded by a statute [i.e. the PAJA] giving effect to that same constitutional right. The Act [i.e. the PAJA] conditions the holding of the rights it grants on adverse effect to a right. The right affected, logically speaking, must be a right other than the Act’s rights [i.e. a right outside of those rights provided by the PAJA].*”

Adopting a broader notion of ‘rights’, as suggested by the decisions *Bullock* and *Premier Mpumalanga*, a respondent company could probably be said to have a ‘right’ – in terms of a ‘legally recognised interest’ – in its ‘good name’ which could be affected if the company is being

⁹¹ The further issue of whether possibly a *right* of the Commission could also be affected by the Companies Tribunal’s review decision in terms of s 172(4) is beyond the scope of this thesis.

⁹² See supra Chapter 2.1.1.5.

investigated as a consequence of the Commission's decision to do so. It has long been established that a trading company's business reputation is protected by law. It can thus be a 'right' in terms of the PAJA. This business reputation may be tarnished (damaged) as a consequence of the Commission placing the company under investigation. Defamatory statements concerning a trading company which injure the company in its business reputation are actionable without the requirement to prove actual loss (*Dhlomo NO v Natal Newspapers (Pty) Ltd 1989 (1) SA 945 (A) 953C*). Furthermore, an action (*action injuriarum*) may be instituted based on the fact that a false, but not defamatory, statement has been made *mala fide* concerning the company's business (*Dhlomo v Natal Newspapers 950B*, referring to Innes CJ's and Solomon JA's judgments in *GA Fichardt Ltd v The Friend Newspapers Ltd 1916 AD 1 at 7 and 10* both of whom in turn refer to the English case *Ratcliffe v Evans 1892 (2) QB 524*). It is this scenario in particular that may apply to investigations by the Commission, since outright defamatory complaints to the Commission will, in terms of s 169(1)(a) ("complaints ... frivolous or vexatious"), as a rule, not be investigated by the Commission and since a complaint that a company has not complied with FRSs, might probably be below the threshold for defamation. Section 222 of the new Companies Act provides some protection for the Commission. In terms of this section the Commission is not liable for any loss sustained by, or damage caused to, the investigated company as a result of a *bona fide* investigation by the Commission, unless the company can prove that the Commission acted in a grossly negligent way. However, it may not prevent an injured company from challenging actions of the Commission that are defamatory.

As regards the complainant, finding that one of his rights or legally recognised interests has been affected is more difficult. Surely, his right to a complaint in terms of s 168 of the new Companies Act is not affected, since he can in fact complain – even if the Commission decides subsequently not to investigate that complaint (s 169(1)(a), read with regs [2011] 135(4), 137(1)). Could a complainant have the right that the new Companies Act (in particular s 29(1)(a)) be complied with? Given that non-compliance with FRSs constitutes "act[ing] in a manner inconsistent with this [Companies] Act" in terms of the first alternative of the last half-sentence of s 168(1)(b), such a right might be conceivable. This interpretation can, however, be reconciled only with difficulty with the second alternative in the last half-sentence of s 168(1)(b),

which explicitly speaks of “the complainant’s rights under this Act” and seems to distinguish it from the first alternative.

If a complainant is a member of the general public, he may have trouble substantiating that ‘his’ rights are affected by the Commission’s or Tribunal’s decision. However, the PAJA’s definition of administrative action does not require this. It merely speaks of the rights of “any” person. Hence it is sufficient if the complainant submits that someone else’s rights are affected. The problem arising for the complainant then, however, is whether he has *locus standi* (standing) at all to do so. This issue of standing is entirely separate from the substance of a case. It is a question to be decided *in limine* before the merits of the case are considered (Hoexter 2007: 435). The traditional common-law rules of standing were quite restrictive and posed a major obstacle as regards access to the courts. In particular, they did not allow an action in the interest of the public (‘public interest action’ – *actio popularis*). Section 157 of the new Companies Act, however, contains rules that extend standing, and s 157(1)(d) even allows an application in the public interest to the court, Commission or Tribunal.⁹³

Other categories of complainants can more easily substantiate a right or a legally recognised interest. These are, in particular, the company’s shareholders, its directors, and its competitors. It is noteworthy that the term ‘rights’ is not restricted to constitutional rights, but can mean statutory and private-law rights, such as contractual and delictual rights, as well (Currie & Klaaren, 2001:80). Furthermore, Currie (2007:83) notes an approach in several recent decisions (*Dunn v Minister of Defence 2006 (2) SA 107 (T) par 5*, *Tirfu Raiders Rugby Club v SA Rugby Union [2006] 2 All SA 549 (C) par 36* and *Steenkamp NO Provincial Tender Board, Eastern Cape (2007) 3 SA 121 (CC) par 21*) which is even broader and which links the term ‘rights’ firmly to the term ‘legitimate expectations’.

⁹³ The second half-sentence of s 157(1)(d) (“with leave of the court”) is puzzling, though. Clearly, it is aimed to serve as a ‘floodgate’ in order to prevent the Commission and the court from being flooded with litigation (see also Hoexter, 2007:437). Nevertheless, the procedural details envisaged by the wording of the second half-sentence of s 157(1)(d) remain obscure. The provision is open to three interpretations. First it may be argued that public interest proceedings maybe brought only before court. Second, it may be submitted that these proceedings may be brought before other institutions but only with leave of a court. Thirdly it may be contended that the term “court” in s 157(1)(d) is shorthand for all the institutions and that leave will, in each case, have to be given by the relevant institution.

Shares of the company in the hands of the shareholders are the shareholders' assets. As assets, they constitute "property" in terms of s 25 of the Constitution, and these rights might be affected by the Commission's or Tribunal's decision.

The company's directors might face contractual and delictual liability as a consequence of the Commission's or Tribunal's decision that the company has not complied with FRSs. Thus, their rights or legally recognised interests are affected as well.

A company's competitor might also claim to be negatively affected by a Commission or Tribunal decision which is favourable to the company investigated, and might in particular invoke s 9 of the Constitution as their rights to equality may be affected.

Thus, the rights of the company, as well as the rights of certain categories of complainants can be affected by the Commission's decisions on a company's alleged non-compliance with FRSs or by the Tribunal's review decisions regarding a compliance notice. In contrast, the right of a member of the general public will probably not be affected but they may still have *locus standi* to bring administrative-law proceedings before the Commission or Tribunal.

All of the possible decisions of the Commission in terms of ss 169 and 170 have undoubtedly an impact on ('*affect*') the complainant and the respondent company, since all have at least the capacity to impact on the complainant's or the respondent company's legally recognised interests. Either party's legally recognised interest will be determined by the decision, either in a beneficial way (*e.g.* from the complainant's perspective, if the respondent company is being issued a compliance notice), or in an adverse manner (*e.g.* from the respondent company's perspective, if it is being issued a compliance notice). The same applies to the Companies Tribunal's review decision in terms of s 172(4).

The definition of administrative action requires that the impact is *adverse*. However, as was explained earlier,⁹⁴ in the South African context, this requirement is increasingly ignored and both adverse and beneficial impacts are covered by the definition of administrative action.

⁹⁴ See *supra* Chapter 2.1.1.5.

Finally, the relevant decisions of the Commission and the Companies Tribunal need to have a *direct, external legal effect*.

An effect is *legal* if it entails a binding determination of someone's rights or duties. Proposals or recommendations made by the administrator therefore do not have a legal effect.⁹⁵ Apart from s 170(1)(d)⁹⁶ and s 170(1)(e)⁹⁷ all decisions by the Commission in terms of ss 169, 170 have a legal effect, although some doubts may be justified as regards s 169(1)(b)⁹⁸ and s 170(2)(a).⁹⁹ Likewise, the Tribunal's review decision has a legal effect upon the complainant and the respondent (s 172(4): "binding").

An effect is *direct* if the decision is final (ripe). This excludes preparatory steps in an administrative multi-stage decision process.¹⁰⁰ Apart from s 170(1)(b)¹⁰¹ and s 170(1)(d)¹⁰², all

⁹⁵ See supra Chapter 2.1.1.5.

⁹⁶ The decision of the Commission in terms of s 170(1)(d) is to propose to the complainant to engage in consent order proceedings. As a mere proposal it does not have a *legal* effect.

⁹⁷ Formally, it is the Commission's decision (which the Commission makes subsequent to, and based upon, the complainant's consent) to commence court proceedings in the name of the complainant which determines the complainant's right and obligations as a party in court. Viewed from this perspective, this Commission decision has a *legal* effect on the complainant. This decision is, however, conditional upon the complainant's consent, and in substance it is thus the complainant's own prior decision to consent which leads to the Commission's decision to commence proceedings and which sets in motion the chain of events that lead to the subsequent court proceedings which in turn determine his rights and obligations in court.

⁹⁸ Section 169(1)(b) consists of a referral decision and a recommendation. The decision of the Commission to refer the complainant to the Companies Tribunal determines his rights since he now cannot insist any longer on a complaint before the Commission and he cannot refer the matter back to the Commission (see infra Chapter 4.1.2.2.2). It has thus a *legal* effect. The Commission's recommendation to the complainant to seek alternative dispute resolution, however, has no determining or binding effect on him. He can simply refuse to engage in alternative dispute resolution.

⁹⁹ It is submitted that the decision of the Commission to publish the inspector's investigation report determines the ambit of the respondent company's right to have its good name protected (Regarding this right see above in the main text of this chapter). Furthermore, this decision may well set in motion a chain of events which may subsequently have legal consequences for the respondent (such as, for instance, legal action taken by a creditor against the company). This, however, relates to the issue of whether the effect is *external* rather than *legal* (see infra in the main text of this chapter).

¹⁰⁰ See supra Chapter 2.1.1.5.

decisions of the Commission in terms of ss 169 and 170 seem to have a direct effect, although some doubts may be justified as regards s 169(1)(b),¹⁰³ s 170(1)(e)¹⁰⁴ and s 170(2)(a).¹⁰⁵

Likewise, the Tribunal's review decision has a direct effect upon the complainant and the respondent since it is the last step in the administrative process, after which there is only the option of a review by a court.¹⁰⁶

An effect is *external* if the person affected by the decision is someone other than an administrator.¹⁰⁷ All decisions of the Commission in terms of ss 169, 170 as well as the review

¹⁰¹ It is submitted that the Commission's decision (to refer the complainant to the Companies Tribunal because the matter falls within the Companies Tribunal's jurisdiction) has no *direct* effect. The administrative decision process continues after the Commission's decision with the Companies Tribunal's subsequent activity. The situation therefore resembles an administrative multi-stage decision process with the Commission's decision being a preparatory step. Admittedly, it is not a required preparatory step, since the applicant could have brought the matter before the Companies Tribunal from the outset. It is noteworthy that – in contrast to the situation described by s 169(1)(b) – the Commission does not “recommend” that the complainant co-operate with the Companies Tribunal. Rather, the Companies Tribunal is statutorily competent to decide on the matter.

¹⁰² The conducting of consent order proceedings and the recording of draft consent orders by the Commission are not administrative action in terms of s 1 of the PAJA. This is because these activities already fail to meet the requirement “*exercising a public power*” of the definition (see *infra* Chapter 4.1.3.5). The subsequent question whether they have a “*direct, external legal effect*” does thus not arise.

¹⁰³ The Commission's decision to refer the complainant to the Companies Tribunal for alternative dispute resolution is a final administrative decision. The subsequent alternative dispute resolution procedures are not administrative action in terms of the PAJA (see *infra* Chapter 4.1.3.5), and the referral is therefore not a preparatory step in a multi-stage administrative decision process. At any rate, the referral is not a necessary step required for the Companies Tribunal to be competent to conduct alternative dispute resolution. The decision to refer in terms of s 169(1)(b) has therefore a *direct* effect on the complainant.

¹⁰⁴ The Commission's decision to commence court proceedings in the name of the complainant is the last administrative step before court proceedings begin. Court proceedings are judicial action, not administrative action. It is therefore submitted that the Commission's decision is not a preparatory step in a multi-stage administrative decision process. The decision in terms of s 170(1)(e) to commence court proceedings in the name of the complainant therefore has a *direct* effect on the complainant.

¹⁰⁵ The decision of the Commission to publish the inspector's investigation report is not a preparatory step in a multi-stage administrative decision process. Rather, it is a final administrative act. It is therefore submitted that it has a *direct* effect on the complainant and the respondent.

¹⁰⁶ See *infra* Chapter 4.1.2.2.8.

decisions of the Companies Tribunal in terms of s 172(4) affect either the complainant or the respondent or both and thus someone other than an administrator.¹⁰⁸

As regards the review of a compliance notice by the Companies Tribunal in terms of s 172, such a review thus satisfies the requirements of “*administrative action*” in terms of s 1 of the PAJA. However, the exclusions to the definition of administrative action in s 1 of the PAJA have to be taken into account. If the Companies Tribunal’s review is a *judicial review*,¹⁰⁹ the Tribunal would exercise a “*judicial function*” in terms of the Exclusion (ee) to the definition of administrative action and its activity might thus be excluded from the ambit of administrative action. The further requirements of Exclusion (ee) are, however, not met by the Companies Tribunal, since it (or any of its members) is neither “a judicial officer of a court” (“Court” as defined in s 1 of the PAJA) nor a “Special Tribunal established under section 2 of the Special Investigating Units and Special Tribunals Act, 1996 (Act 74 of 1996)”.

Therefore, a judicial review conducted by the Companies Tribunal in terms of s 172(1) is administrative action as defined in s 1 of the PAJA and is not covered by Exclusion (ee).

As regards the Commission’s decision in terms of s 169 to investigate a particular company (as opposed to the Commission’s action taken as a result of its decision to investigate – for example, appointing an inspector and instructing him (s 169(1)(c)) – or the conduct of the investigation itself), it seems difficult to determine when exactly an *external* effect first arises. The mere decision to investigate probably has no external effect yet, given that the Companies Act does not provide for notification of the relevant company by the Commission of its intention or publication of its intention to investigate. However, the inspector’s investigative activities will form the basis for his report to the Commission, and this report will in turn be the basis of the Commission’s decision. The inspector’s conclusion is only a preliminary step in a two-stage

¹⁰⁷ See supra Chapter 2.1.1.5.

¹⁰⁸ It is true that a review decision of the Companies Tribunal does affect the Commission too. Both the Commission and the Companies Tribunal are administrators. In this scenario, thus, there is no *external* effect between the Commission on the one hand and the Companies Tribunal on the other.

¹⁰⁹ Regarding this issue see infra Chapter 4.1.2.2.5.2.

decision process, and it is based on his investigation. Hence, the inspector's investigative activities already have the capacity to affect the investigated company's rights, since they lay the foundation for the Commission's subsequent decision which could have grave consequences for the company. In this regard, Olivier J, in the (pre-PAJA) decision *Director: Mineral Development, Gauteng Region v Save the Vaal Environment (1999 (2) SA 709 (SCA) 718C* states that the merely preliminary decision "opens the door ... and sets in motion a chain of events which, and in the ordinary course of events will, lead to ... [such serious consequences]". The recent decision *Oosthuizen's Transport v MEC (2008 (2) SA 570 (T) 571 D and 579D-E*), applying this *dictum* of Olivier J, confirms its continued correctness. Administrative action thus, it is submitted, occurs at the earlier of either the beginning of the inspector's investigative activities, or the point in time when the company's actual or prospective business partners become aware of the planned investigation against the company.

This submission, however, has to be qualified with two *caveats*, since the facts of both the *Save the Vaal* case as well as those of the *Oosthuizen's Transport* case differ to some extent from the factual scenario of a typical Commission investigation in terms of s 169(2) of the new Companies Act, which makes use of an investigator.

Firstly, in *Save the Vaal* the 'preliminary decision' was a mining licence issued by the Director of Mineral Development in Gauteng (who is a state official) to the company Sasol Mining. The granting of this licence was, in terms of the Minerals Act No. 50 of 1991, a necessary statutory prerequisite before the subsequently necessary 'Environmental management programme' could be approved, which in turn would finally have allowed Sasol to commence mining.

In contrast, with Commission investigations in terms of the new Companies Act, the 'preliminary decision' (*viz.* the investigator's report) is not issued to the affected outsider (*viz.* the investigated company). Furthermore, as emanates from s 169(2)(a) ("may ... designate"), the Commission is not statutorily required to appoint an investigator and to receive an investigator's report. Therefore, an investigator's report is not a necessary statutory prerequisite before the measures and sanctions of s 170(1)(a)-(g) may be taken.

In addition, *Save the Vaal* is a pre-PAJA decision which did not deal with the question of whether or not administrative action in terms of the PAJA is at hand. The court had to determine

whether, in terms of the common law and the ‘principles of natural justice’,¹¹⁰ the *audi et alteram partem* rule had to be applied to the issuing of the licence.

Secondly, in *Oosthuizen’s Transport* the ‘preliminary decision’ was the report of an investigator. This investigator had, by virtue of the National Road Traffic Act No. 93 of 1996, been appointed by the MEC (Road Traffic Matters) in Mpumalanga to investigate the business activities of Oosthuizen’s Transport (Pty) Ltd, a truck company suspected of having committed overloading offences. The MEC directed the investigator to both report on his findings and to make written recommendations as to the measures that should be taken by the MEC as a result of these findings.

In contrast to Commission investigations, the report in *Oosthuizen’s Transport* thus had, in terms of the National Road Traffic Act, to be comprised of both a fact-finding statement as well as a written recommendation, while there is nothing in s 170 of the new Companies Act (‘Outcome of investigation’) to suggest that the inspector’s report is more than a fact-finding statement as to whether or not the company under investigation has complied with FRSs, nor is there anything in s 170 to suggest that the inspector is to make recommendations to the Commission as to which of the measures set out in s 170(1)(a)-(g) should be taken by the Commission.

The ‘recommendation’ component of the report was also the determining criterion which prompted Mbha J in the recent decision *Nedbank Ltd v The Master of the High Court, Witwatersrand Local Division (2009 (3) SA 403 (W) para 47-49)* to distinguish the facts of *Oosthuizen’s Transport* from the ones in *Nedbank v The Master*. In *Nedbank v The Master*, an investigation (‘enquiry’) by the Master in terms of ss 417-418 of the old Companies Act (‘Examinations of persons in Winding-up’)¹¹¹ was at issue.

There are similarities between the role of an investigating ‘commissioner’ (s 418 of the old Companies Act: ‘Examination by commissioners’) and an investigator appointed in terms of 169 of the new Companies Act. Like an investigator’s report to the Commission in terms of s 170 of

¹¹⁰ Regarding the ‘principles of natural justice’ and the ‘*audi et alteram parte*’ rule see *infra* Chapter 4.1.2.1.2.

¹¹¹ See appended documents.

the new Companies Act, a commissioner's report to the Master is purely investigative and fact-finding. Like an inspector's report in terms of s 170 and unlike an investigator's report in terms of the *Oosthuizen's Transport* case, it does thus not include a recommendation (by the commissioner to the Master) as to measures to be taken (by the Master). This led Mbha J to conclude that, in contrast to an investigator's report in terms of the *Oosthuizen's Transport* case, a commissioner's report in terms of s 418 of the old Companies Act does not 'adversely affect the rights' of the investigated company and does therefore not constitute administrative action in terms of the PAJA (*Nedbank v The Master par 49*).

By comparative reasoning, this *ratio decidendi* would apply to an investigator's report in terms of s 170 of the new Companies Act as well.¹¹² It is submitted, however, that an inspector's activities and his reporting in terms of s 170 of the new Companies Act have more drastic consequences for the investigated company than a commissioner's activities and his reporting in terms of s 418 of the old Companies Act, and they therefore do 'affect the rights' of the investigated company and do have an 'external effect', for the following reason: a company's business reputation is an asset to a going-concern trading company (shown as goodwill on its statement of financial position) and is valuable to it for the purpose of both customer retention and customer acquisition. This reputation could easily be damaged by a pending Commission investigation or if word of a pending investigation spreads among the business community. This potential damage is substantially greater than the damage done by a commissioner's s 418 investigation to an insolvent company which is already in the process of being liquidated and is thus not a going concern any longer.

It is thus submitted that a Commission investigation in terms of s 169 of the new Companies Act is to be distinguished from the Master/commissioner enquiry in terms of ss 417, 418 of the old Companies Act as considered in the *Nedbank v The Master* case. In contrast to the decision to appoint a commissioner in terms of s 418 and in contrast to the commissioner's activities and his reporting in terms of s 418, the decision of the Commission to appoint an investigator in terms of s 169 and the investigator's activities and his reporting in terms of s 170 therefore do constitute administrative action in terms of the PAJA.

¹¹² As to a discussion of the 'impact' criterion see *supra* in this chapter.

In summary, with the exception of the Commission's decisions in terms of s 170(1)(b), s 170(1)(d) and s 170(1)(e), the Commission's actions as well as the Companies Tribunal's review action are administrative action in terms of s 1 of the PAJA. The PAJA is, thus, applicable to them.

This conclusion seems in line with recent case law dealing with the comparable issue as to whether decisions by the Competition Commission and the Competition Tribunal are administrative actions in terms of the PAJA (*Seven-Eleven Corporation SA (Pty) Ltd v Simelane NO 2002 (1) SA 118 (T)* and *Patensie Sitrus Beherend Bpk v Competition Commission 2003 (6) SA 474 (CAC) 502B*).

2.1.4 The Minister of Trade and Industry

2.1.4.1 Functions and legal status

The Minister is undoubtedly an organ of state in terms of s 239 of the Constitution.

Compared with the old Companies Act, the Minister's competences with regard to both standard-setting and enforcement of non-compliance have been significantly extended under the new Companies Act. This is true in particular in respect of the issuing of FRSs (s 440U(2) of the old Companies Act; s 29(4),(5), read with s 223 of the new Companies Act). The Minister's powers with regard to issuing FRSs have been widened to the detriment of the FRSC's powers.¹¹³ Furthermore, the Minister now can direct that an individual company be investigated (s 190(2)(b), s 168(3)). Under the old Companies Act the Minister's competence was limited to appointing a 'nominated officer' and drafting a watch list (s 440V(1),(2)). In addition, the FRSC

¹¹³ See supra Chapter 2.1.1.2.

is now established by the Minister (s 203(1)) and not by the statute itself (s 440P(1) of the old Act).

In two respects, however, the Minister's powers have been curtailed in the new Companies Act. The new Companies Act no longer allows the Minister to agree with the investigated company the consequences of its non-compliance with FRSs – as did s 440FF(2) of the old Act.¹¹⁴

New powers were granted to the Minister vis-à-vis the newly established Commission. He has the right to direct the Commission to investigate a company (s 190(2)(b), s 168(3)) and to issue policy directives to the Commission (s 190(2)(a)) and to issue regulations regarding the Commission's functions (s 223(1)(b)). Furthermore, in the area of voluntary dispute resolution, the Minister has now been given the right to designate an organ of state as 'accredited entity' (s 166(5)).¹¹⁵

In contrast, nothing has changed with regard to the way in which the members of the various bodies (Financial Reporting Investigation Panel in terms of the old Companies Act; FRSC and Companies Tribunal in terms of the new Companies Act) are appointed or removed from office. Under both the old as well as the new Companies Act, the Minister is responsible for doing so (ss 440Q(1)-(5), 440X(1)-(5) of the old Act; ss 189(1), 192(1)(b)(i), 194(1)(a), 203(2)-(3), 207(3) of the new Act).

Both under the old and the new Acts the various bodies have to send annual reports on their activities to the Minister (s 440HH of the old Act; s 211(2) of the new Act). The new Act, in addition, charges the Minister with audit reviews of the FRSC, the Commission and the Tribunal (s 211(1)).

¹¹⁴ See infra Chapter 4.1.2.1.3.

¹¹⁵ See infra Chapter 4.1.3.

2.1.4.2 Does the Minister perform administrative actions when he makes decisions that are relevant to standard-setting?

With regard to standard setting and the enforcement of FRs, the following of the Minister's actions are particularly relevant: establishing the FRSC; issuing FR regulations; directing the Commission to investigate; issuing policy directions to the Commission; and designating organs of state as 'accredited entities' in terms of s 166(5).¹¹⁶

The issue, in respect of each of those activities, is whether a decision by the Minister in terms of s 1 of the PAJA is at hand which "*adversely affects the rights of any person*" and which has a "*direct, external legal effect*":

Regulations issued by the Minister in terms of s 223 constitute delegated (subordinate) legislation.

Uncertainty has persisted for some time as to whether delegated legislation constitutes administrative action in terms of the PAJA, given that it is not specifically included in the PAJA's definition of administrative action. The majority of the writers on the subject (Currie & Klaaren; Burns & Beukes; Pfaff & Schneider; De Ville) seem to be of the opinion that it is, with different reasoning.

Pfaff and Schneider (2002:75) pointed out that – while the wording of the PAJA itself is not clear – the Law Commission's draft Bill of the PAJA defined 'administrative action' as, among other things, including any 'rule or standard made', and that 'rule' was understood to include delegated legislation. Based on this they suggested that "[i]t may well be that the courts will rule that the PAJA also applies to subordinate regulation as being matters of an administrative

¹¹⁶ Regarding the *appointment* by the Minister of the Commissioner (s 189(1)), the appointment or removal by the Minister from office of members of the FRSC or of the Tribunal (s 194(1); s 203(2)(3); s 207(3)) see *infra* Chapter 4.1.1 (footnote 223). Furthermore, for current purposes, left out of account are the appointment by the Minister of specialist committees (s 191(1)) and its members (s 192(1)(b)(i)) as well as the conduct by the Minister of an audit review of the Tribunal, the FRSC and the Commission (s 211(1)).

nature.” Currie (2007:87) rejects this reasoning, pointing out that, while the draft Bill submitted by the Law Commission clearly covered rules, the Parliamentary Committee subsequently deleted many of the provisions relating to the Bill’s coverage of rules, including the definition of a ‘rule’.

Currie and Klaaren (2001:84) consider the existence of the notice and comment procedures of s 4 of the PAJA a strong indicator that rule-making is covered by the PAJA. They convincingly point out that

“[t]he inclusion of a section [i.e. section 4 of the PAJA] on notice and comment procedures, a set of procedures historically developed specifically to provide for public participation in rule-making, makes little sense if rule-making is not covered by the Act [i.e. by the PAJA].”

Burns and Beukes (2006:131) believe that, since subordinate legislation can have far-reaching consequences for the individual and may impact harshly on individual rights, it should be included in the definition of ‘administrative action’.

De Ville (2005:40) is of the opinion that delegated legislation could either be classified as ‘administrative action’ or not. Even if it is not considered ‘administrative action’, it remains nevertheless subject to the principle of legality. What does the ‘principle of legality’ encompass? It is a constitutional principle which has only recently been identified by the Constitutional Court and which has rapidly become “the judges’ darling” (Hoexter 2007:321). According to Hoexter (2007:219), it has the ability to operate as a residual source of review jurisdiction: the beauty of it, from a judge’s perspective, would be that “if ... [his] diagnosis of administrative action turns out to be wrong, it makes no real difference because the principle of legality makes the same demands as regular administrative law” (Hoexter 2007:219). At its core is the idea that “the exercise of public power is only legitimate where lawful” (*Fedsure Life Assurance v Greater Johannesburg Transitional Metropolitan Council 1999 (1) SA 374 (CC) par 56*). The principle applies to the exercise of all public power, whether or not it is ‘administrative action’, and thus could act as a “safety net” (Hoexter 2007:118): it could give the courts control over action that is not ‘administrative action’ for the purposes of the PAJA, but that still involves the use of public

power (Hoexter, 2007:118; Quinot, 2007:388). Enacting delegated legislation undoubtedly comes down to using public power; delegated legislation thus falls, from De Ville's perspective, within the ambit of the principle of legality in any event. Currie disagrees with De Ville as to the role of the principle of legality. According to him (2007:45), the principle of legality

“may ... not be used as a substitute for the general administrative justice principles of the PAJA or as a failsafe for applying administrative justice principles to administrative action that has not been included in the definition of ... [‘administrative action’] in the PAJA”,

since – according to Currie (2007:39) –

“[t]reating legality review as a free alternative to review under the PAJA circumvents the Act's [i.e. the PAJA's] attempts to prescribe procedures and remedies for judicial review that are not the same as those in the common law.”

Hoexter (2007:127) follows a less strict line of reasoning, submitting that

“the PAJA must be applied where it is applicable, and the principle of legality, notwithstanding its obvious attractions, cannot be relied on so as to bypass the PAJA.”

As to whether delegated legislation amounts to ‘administrative action’ in terms of the PAJA, Hoexter (2007:188 and 322) is more sceptical than Burns and Beukes and de Ville, and says that there is currently continuing uncertainty as to whether delegated lawmaking amounts to a ‘decision’ in terms of the PAJA's definition of ‘administrative action’. She further points out that administrative lawmaking is an area that is not covered by the Australian Administrative Decisions (Judicial) Review Act (ADJR), which had a determining influence on the wording of the PAJA, in particular its definition of what constitutes a ‘decision’ (Hoexter, 2007:188).

The Constitutional Court in *Minister of Health v New Clicks SA (Pty) Ltd (2006 (2) SA 311 (CC))* did not come to a clear decision either as to whether the PAJA is applicable to regulation-making and whether delegated legislation falls within the definition of ‘administrative action’. However, five (Chaskalson CJ at *paras 128 and 135*, O'Regan J at *par 846*, Langa DCJ at *par 843*, Van der Westhuizen J at *par 851* and Ngcobo J at *paras 422 and 470*) of its eleven judges

were in favour of this, while the remaining six judges found it unnecessary to decide whether the PAJA is applicable. In a dissenting judgment, Sachs J (at *par* 579) held that the PAJA is not generally applicable to delegated legislation; rather, he felt, rule-making by the administration is to be reviewed against the standard of the ‘principle of legality’.

Altogether, thus, it seems reasonable to assume that delegated legislation such as FRS regulations (s 29(4)(5), read with s 223(1)) does constitute ‘*administrative action*’ in terms of the PAJA.

The situation seems different with regard to directions issued by the Minister to the Commission to investigate a company (s 190(2)(b), s 168(3)):

Undoubtedly, this direction is a ‘*decision*’ in terms of s 1 the PAJA by an *organ of state*. Does it ‘*adversely affect the rights of any person*’? Given that the Commission is bound to investigate upon the Minister’s direction, one might argue that it is not only the investigation itself, but already the Minister’s direction which has the ‘capacity to adversely affect the rights’ of the to-be-investigated company. The Minister’s direction further has a ‘*direct effect*’. It is not only an interim decision in a two-step process which leads to the final decision of another higher-ranking administrator. Rather, it is the final decision itself which is not subject to the subsequent discretion of another administrator (the Commission), but which will be implemented by the Commission regardless. It is submitted that the requirements of ‘immediacy’ and ‘ripeness’ are thus met. A ‘*legal effect*’ appears at first glance difficult to argue. Having interpreted the phrase ‘*adversely affects the rights of any person*’ as ‘having the capacity to affect someone’s rights’ and applying the broader notion of ‘*rights*’ as ‘legally recognised interests’, however, ‘*legal effect*’ can consequently be equally broadly interpreted and a ‘legal effect’ can thus be warranted by the Minister’s decision. Finally, as mentioned earlier,¹¹⁷ an ‘*external effect*’ will be at hand at the earlier of either the beginning of the inspector’s investigative activities, or the point in time when the company’s actual or prospective business partners become aware of the Minister’s direction to the Commission.

¹¹⁷ See *supra* Chapter 2.1.3.4.

Thus, a direction by the Minister to the Commission to investigate a particular company does, if submitted, constitute ‘*administrative action*’ in terms of s 1 PAJA.

In contrast, the establishment of the FRSC and designating organs of state as ‘accredited entities’ (s 166(5)) do not constitute ministerial administrative actions yet, since these activities lack a ‘*direct, external legal effect*’. The issuing of policy directives to the Commission (s 190(2)(a)) may or may not have a ‘*direct, external legal effect*’, depending on the subject-matter.

2.1.5 Summary

(1) The *Financial Reporting Standards Council* (‘FRSC’) will be re-established under the new Act, although with weakened competences and weakened status.

(a) While the FRSC was established statutorily as a juristic person under the old Act, under the new Act it can be created only by the Minister. Furthermore, it seems to be at the Minister’s discretion whether or not the FRSC will be granted the status of a juristic person. The FRSC is not as autonomous as it was under the old Act.

(b) The FRSC’s role in standard-setting has been reduced. It is to be a mere advisory forum to the Minister with nothing but non-binding drafting powers.

(c) The workings of the FRSC have become less transparent. A ‘register of interested persons’ is no longer provided for under the new Act.

(2) Both the old and the new Companies Act contain provisions regarding *financial reporting standards* (FRSs).

(a) In contrast to the vague provision of the old Companies Act, the new Companies Act clearly sets out the legal status of the FRSs. They will be regulations (in the form of Government Notices) and will thus be law (delegated legislation).

(b) The FRSC is an organ of state. In drafting FRSs, however, it does not perform administrative action in terms of s 1 of the PAJA, while the Minister, in promulgating FRSs, does. FRSs are delegated legislation and issuing them constitutes administrative action.

(c) Different FRSs may be established for each category of companies.

(d) The Acts' wordings "*in accordance with the International Financial Reporting Standards*" allows for some discretion in drafting FRSs. The APB's current practice of merely replicating IFRSs is clearly not required by law. This practice seems too timid.

(e) Contrary to the wording "*may*" in s 29(4) of the new Companies Act, the Minister has no discretion as to whether or not to issue FRSs at all. Nor will an overly long delay be acceptable. This emanates from a purposive interpretation of s 29(4), read with ss 5 and 7 of the new Companies Act.

(3) With regard to standard-setting, the *Minister of Trade and Industry* is the strong man under the new Act. His powers have been extended considerably.

(a) The uncertainty under the old Act as to whether the Minister had to rubberstamp the FRSC's FRS drafts has disappeared. The Minister has now been granted a full discretion.

(b) In contrast to the old Act, the Minister may now directly instruct the primary investigative body (the Commission) to initiate an investigation.

(4) The *Commission* and the *Tribunal* are new and statutorily established juristic persons.

(a) The Commission will essentially be staffed with the personnel of the Department of Trade and Industry's Companies and Intellectual Property Registration Office (CIPRO).

(b) The Commission's role in standard setting is negligible. Rather, it is the primary body as regards enforcement of FRSs.

(c) The Tribunal plays no role at all in standard setting. Its primary function is to be an adjudicative body able to review the Commission's administrative action.

(d) The Tribunal is charged with voluntary dispute resolution. The Commission plays a merely supportive role in this regard by accrediting entities which are competent to facilitate alternative dispute resolution.

(5) The FRSC, the Commission, the Tribunal and the Minister are *organs of state*. It is more complicated to determine which of their activities that are relevant to standard setting constitute administrative action in terms of s 1 of the PAJA.

(a) The FRSC, in drafting FRSs, does not perform administrative action in terms of the PAJA.

(b) In dealing with a non-compliant company, both the Commission as well as the Tribunal perform administrative action. In particular, the Commission's decision to investigate a company is administrative action. So is the Minister's direction to the Commission to investigate a company.

2.2 European Union

Instrumental for the adoption of IASs in the EU are two legislative procedures: the *comitology procedure* in general and the *endorsement procedure* in particular.

2.2.1 Comitology procedure

For practical purposes, the former art. 202 (3rd indent) TEU¹¹⁸ enabled the Council to delegate to the European Commission the power to implement the Council's rules by means of secondary legislation. Such delegation has become necessary in order to respond expediently to the changing conditions within the EU's internal market.

The Council therefore often, through a 'parent' regulation (foundational regulation), authorised the European Commission to enact more specific regulations (implementing regulations) within a particular area (Craig & De Burca, 2008:118).

Craig and De Burca (2008:118) note that, in doing so,

“[t]he Council was not, however, willing to give the Commission carte blanche to legislate. It made the exercise of delegated legislative power subject to institutional constraints, in the form of committees [in French: comité] through which Member State interests could be represented ... [T]he Council imposed conditions on the delegation of powers to the Commission because of the inter-institutional tensions [between Council and Commission] when the committee structure was created. The Council was wary of the federalizing tendencies of the Commission ... The Council's 'solution' was to condition the exercise of delegated power on the approval of a committee composed of representatives of Member States. This system came to be known as Comitology. There

¹¹⁸ See appended documents.

was no express warrant for such committees in the ... [constitutive] Treaty, and their legality was challenged before the court. The ECJ [, however,] upheld the validity of the committee system ...”

The Council adopted its first Comitology Decision in 1987.¹¹⁹ This Decision laid down the principles and rules and the various forms of comitology procedures. The European Parliament raised strong and persistent objections against this Decision, since it was excluded from the committee system (Craig & De Burca, 2008:119). Therefore the Council adopted a second Comitology Decision in 1999¹²⁰ (referred to as “the 2nd Comitology Decision”) which in turn was amended in 2006¹²¹ (referred to as “the amended (2006) 2nd Comitology Decision”).

According to the amended (2006) 2nd Comitology Decision, there are five different comitology procedures, depending on what purpose the ensuing regulation is to achieve. For the purpose of enacting IASs, only two of them are relevant, namely the “*regulatory procedure*” (art. 2(b) and art. 5 as well as Recital 7 of the 2nd Comitology Decision), and the “*regulatory procedure with scrutiny*” (art. 5a of the 2nd Comitology Decision, which was inserted by the 2006 amendments). Both procedures apply where a foundational/basic instrument (such as the foundational IAS regulation) provides for the subsequent adoption of legislation designed to amend non-essential elements of that basic instrument by way of implementing legislative measures (art. 2(b) of the 2nd Comitology Decision).

There are, however, important differences between them.¹²² In essence, under the *regulatory procedure with scrutiny*, the European Parliament has been accorded a greater role than under the ordinary *regulatory procedure* (Craig & De Burca, 2008:120).¹²³ Furthermore, the *regulatory*

¹¹⁹ Council Decision 1987/373/EEC of 13 July 1987.

¹²⁰ Council Decision 1999/468/EC of 28 June 1999. See appended documents.

¹²¹ Council Decision 2006/512/EC of 14 July 2006. See appended documents.

¹²² See the two flow charts “*Comitology procedure in general*” (Figure 2.1 and Figure 2.2) *infra* in this chapter.

¹²³ See *infra* Chapter 5.2.2.2.2.

procedure with scrutiny has only been effective for IAS enactments from July 2006 onward. In addition, the *regulatory procedure with scrutiny* may only be applied, if the basic instrument was adopted according to the “co-decision procedure” in terms of the former art. 251 TEU (today’s “ordinary legislative procedure” in terms of arts. 289 *et seq.* constTFEU).¹²⁴

The *regulatory procedure* is covered by art. 5 of the 2nd Comitology Decision.¹²⁵ The gist of this procedure is that the European Commission can adopt an implementing legislative measure only if the comitology committee has agreed to it (Craig & De Burca, 2008:120). If it has not agreed or if it does not deliver any opinion on the European Commission’s draft, the European Commission must submit its draft to the Council and in addition must inform the European Parliament. If the European Parliament believes that the European Commission’s draft exceeds the implementing powers granted by the basic/foundational instrument, it has to inform the Council of its view. The European Parliament’s opinion is not binding on the Council, however, nor does the Council have to delay its proceedings until it has received the European Parliament’s opinion. Rather, the Council can, at any time after it has received the European Commission’s proposal and within a period of three months, oppose the proposal. If it does so, the European Commission must re-examine its draft and may then re-submit an amended draft. If the Council, on the expiry of the three-month period, has neither adopted nor opposed the European Commission’s re-submitted draft, the European Commission adopts the draft as legislation.

The *regulatory procedure with scrutiny* is covered by art. 5a as inserted by the amendments (2006) to the 2nd Comitology Decision. In terms of this procedure, if the comitology committee agrees with the European Commission’s legislative draft, the European Commission has to submit its draft to both the Council and the European Parliament. Either of them can, within three months, oppose the draft on three grounds, namely (Craig & De Burca, 2008:120-121) because it exceeds the implementing power as granted by the basic instrument; or because it is not compatible with the aim or content of the basic instrument; or because it does not respect the

¹²⁴ See *supra* Chapters 1.1.2 and 5.2.2.2.1.

¹²⁵ See flow chart “*Legislative procedure regarding implementing IAS regulations*” (Figure 2.3) *infra* in Chapter 2.2.2.2.

principles of subsidiarity¹²⁶ and proportionality. If either the Council or the European Parliament opposes the European Commission's draft, it may not be adopted. However, the European Commission may submit an amended draft. If there is no opposition within three months, the European Commission adopts the draft as legislation.

If the comitology committee does not agree with the European Commission's draft, or if it does not deliver an opinion, the European Commission must submit its draft to both the Council and the European Parliament. If the Council opposes the draft within two months, the draft may not be adopted as legislation; however, the European Commission may submit an amended draft. If the Council, on the other hand, approves of the draft, the Council must submit it to the European Parliament within two months at the latest. The European Parliament can then decide to oppose the draft within four months after it received the draft from the European Commission for the first time. If it does, then the draft may not be adopted; however, the European Commission may submit an amended draft. If the European Parliament does not oppose the draft, the European Commission again adopts the draft as legislation.

Article 290(1) constTFEU read with art. 289(1) constTFEU replaced the former art. 202 TEU on 1 December 2009. In substance, they increase the European Parliament's influence. Now, in contrast to the provision of the 3rd indent to ex-art. 202 TEU ("the Council"), the Council no longer has the sole competence to enact foundational regulations. Rather, the European Parliament and the Council will do so jointly (s 289(1) constTFEU: "joint adoption"). Furthermore, for the sake of clarification, delegating legislation will have to be explicitly titled "delegated" (s 290(3) constTFEU). The choice of this term is clumsy; the term "delegating" should rather have been used. In addition, in terms of art. 291(4) constTFEU, subsequent

¹²⁶ The *principle of subsidiarity* is set out in art. 5 constTEU (ex-art. 5 TEU) which states that the European Union is to take action only if the objectives of that action cannot be sufficiently effectively achieved by the member states. This is also referred to as the 'comparative efficiency test', which asks whether it is better for the action (because of its scale or its effects) to be taken by the European Union or by the member states (Craig & De Burca, 2008:103). As Craig & De Burca (2008:100) observe, "[t]he subsidiarity concept was to be used to defeat those who hoped to increase the federalist leanings of the [European] Community under the TEU." Thus far, however, there have been indications that the ECJ will not lightly overturn Community action on the ground that it does not comply with ex-art. 5 TEU (art. 5 constTEU) (Craig & De Burca, 2008:104).

implementing regulations by the European Commission will have to be explicitly titled 'implementing' regulations.

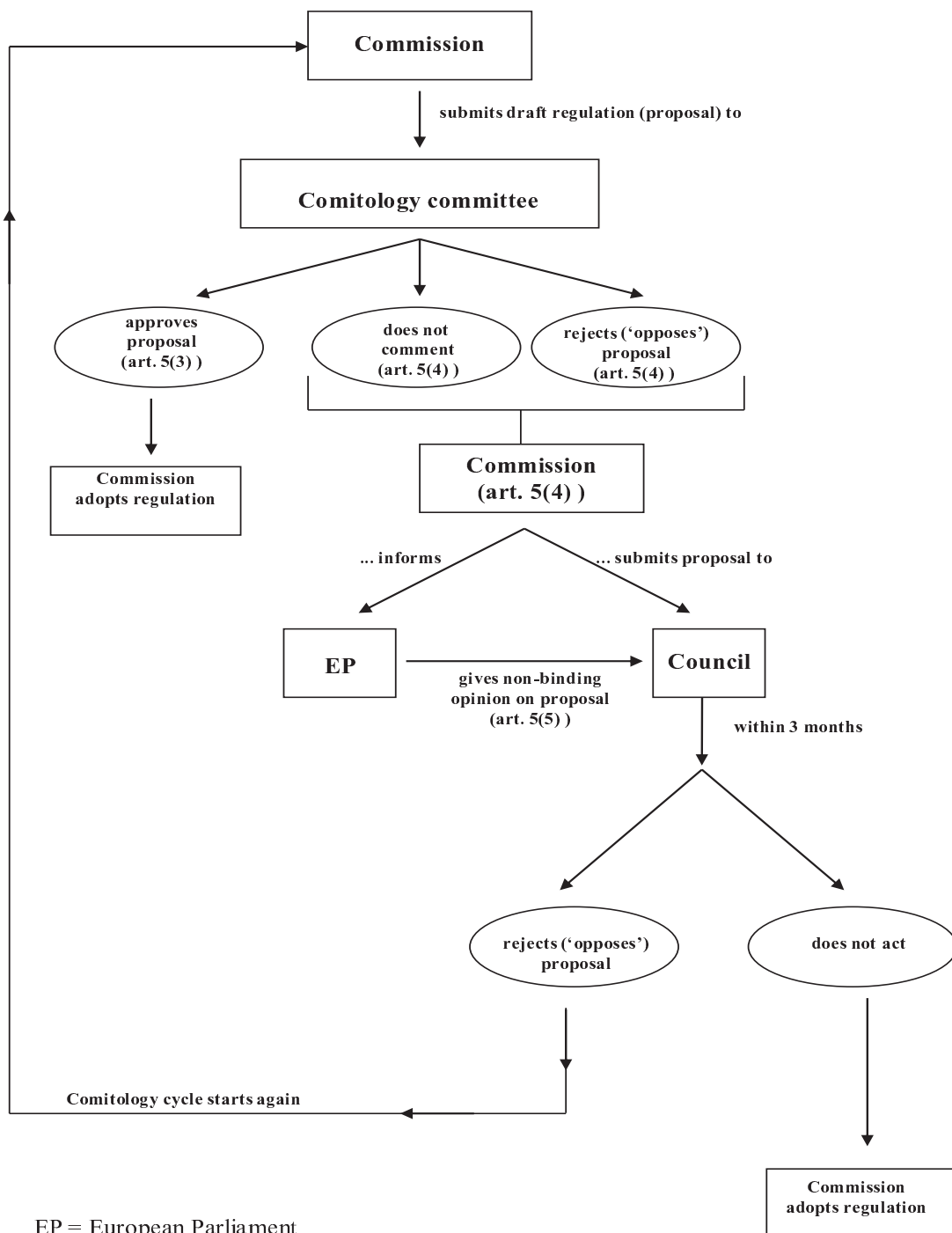
The comitology procedure has met criticism. Concerns were raised about

“the exclusion of the E[uropean] P[arliament], the undemocratic nature of the process, the lack of accountability and transparency, and the corporatist nature of the process. ”

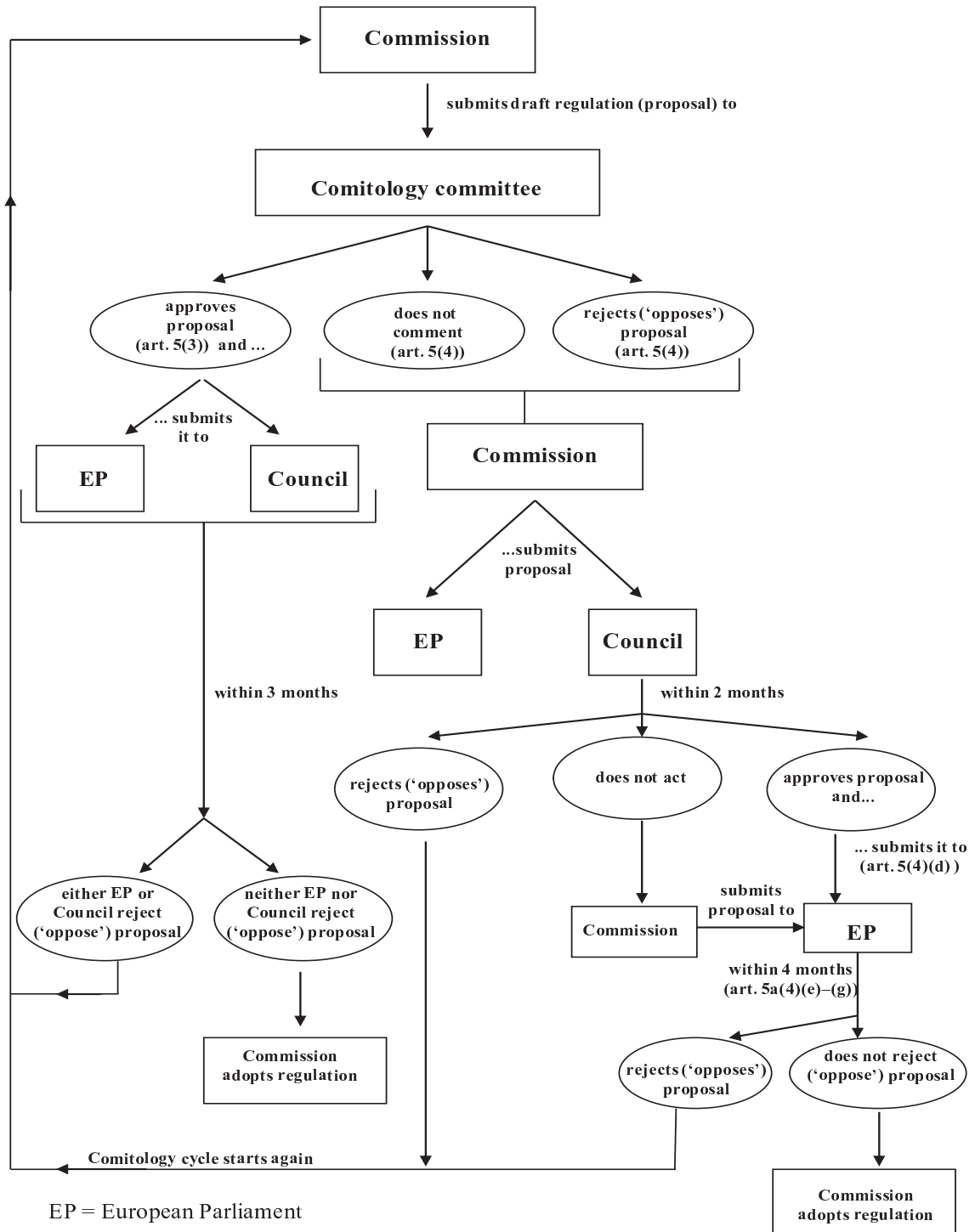
(Craig & De Burca, 2008:122).

This situation, however, was considerably ameliorated in 2006 by way of the introduction of the *regulatory procedure with scrutiny* and the enhanced role which the European Parliament has been accorded in this procedure.

Figure 2.1: Comitology procedure in general - “Regulatory procedure” (art. 5) [since 1999]



**Figure 2.2: Comitology procedure in general -
“Regulatory procedure with scrutiny” (art. 5a) [since 2006]**



2.2.2 Endorsement

Endorsement denotes the two-stage process of enacting IASs in the EU.¹²⁷ It consists of one ‘foundational’ IAS regulation (No. 1606/2002), followed by a series of ‘implementing’ IAS regulations (beginning with No. 1725/2003). The latter were enacted using a modified version of the regulatory procedure and – from 2006 – of the regulatory procedure with scrutiny, respectively.¹²⁸

2.2.2.1 The foundational IAS regulation (No. 1606/2002) of the European Parliament and the Council¹²⁹

At the time of its enactment (2002), the foundational IAS regulation affected nearly 7,000 companies in the EU (Van Hulle, 2003:976).

The legal basis for its enactment was the former art. 95(1) TEU.¹³⁰ Ex-Article 95(1) TEU was one of the central provisions of primary EU law for the passing of (secondary) harmonisation legislation (referred to by ex-art. 95 TEU as “measures for the approximation of ... provisions laid down by law ... in Member States”) aimed at establishing the EU’s internal market.¹³¹ Ex-Article 14 TEU set out the EU’s obligation to establish such an internal market. Ex-Article 95(1)

¹²⁷ See supra Chapter 1.1.2.

¹²⁸ See infra Chapter 2.2.2.2.1.

¹²⁹ See appended documents.

¹³⁰ See appended documents. Ex-Article 95 TEU has, in substance, been replaced by art. 114 consTFEU.

¹³¹ In terms of the former art. 14 TEU, see appended documents. Since the internal market has already been established, ex-art. 14 TEU no longer has any equivalent in the consTFEU.

TEU charged the Council with enacting legislation for this purpose.¹³² Ex-Article 202 (3rd indent) TEU¹³³ in turn allowed “the Council” to delegate the power to implement foundational rules, laid down beforehand by the Council, to the European Commission.

The foundational IAS regulation No. 1606/2002 explicitly pursues the aim of establishing an internal market (Recitals 2 and 4 as well as art. 1) and refers to international accounting standards as a means for achieving this end. The regulation views these accounting standards as an important aspect of well-functioning capital markets. It further explicitly refers to the former art. 95(1) TEU, and it delegates – in terms of the 3rd indent to the former ex-art. 202 TEU – to the European Commission the power to implement the foundational regulation No. 1606/2002 by adopting IASs as Community law (art. 3(1), read with art. 6).

There was a degree of controversy for some time as to whether the enactment of the foundational IAS regulation complied with the requirements of the 3rd indent to ex-art. 202 TEU, given that it was enacted jointly by the Council and the European Parliament, while the 3rd indent to ex-art. 202 TEU empowered the Council only (Wojcik, 2008:131). However, this controversy had already abated several years before the effective date of the constTFEU. Writers on this issue (*e.g.* Riedel, 2006:516) typically reasoned that the chief purpose of the 3rd indent to ex-art. 202 TEU was to relieve the Council of its legislative workload. This purpose would be defeated, if the delegation of implementing powers was invalidated merely because the European Parliament was involved as well. This contention is particularly plausible, since today most secondary legislation in the EU is enacted using – up to 1 December 2009 – the ‘co-decision procedure’ in terms of ex-art. 251 TEU¹³⁴ and – since 1 December 2009 – the ‘ordinary legislative procedure’ in terms of art. 289 constTFEU, both of which require the involvement of both Council and European Parliament on an equal basis. Since the foundational IAS regulation was enacted jointly by the Council and the European Parliament, it also complies with the requirements of

¹³² Article 114 constTFEU differs from ex-art. 95 TEU in that it empowers the Council jointly with the European Parliament rather than the Council only.

¹³³ See appended documents.

¹³⁴ See *infra* Chapter 1.1.2 and *infra* Chapter 5.2.2.2.1.

today's arts. 289(1),(3), 290(1), 297(2) consTFEU, being a “non-legislative [legal] act of general application” in term of these provisions.

Article 6 of the foundational IAS regulation determines that the comitology procedure (referred to in the heading to art. 6 as “*committee procedure*”) is to be used when adopting IASs as legislation. Article 6(1) further specifies that the *Accounting Regulatory Committee (ARC)* will be the applicable comitology committee. In addition, it emanates from art. 6(2) that the regulatory procedure is to be followed. As from July 2006 “regulatory procedure” is to be read as “regulatory procedure with scrutiny”.¹³⁵ This regulatory procedure (with scrutiny) has, however, been modified by involving two additional expert bodies, namely the *European Financial Reporting Advisory Group - Technical Expert Group (EFRAG-TEG)* and the *Standards Advice Review Group (SARG)*.¹³⁶ While the involvement of EFRAG-TEG is provided for in Recital 10 of the foundational IAS regulation, SARG is not mentioned at all; its involvement is based on a separate decision of the European Commission.¹³⁷

Article 2 of the foundational IAS regulation defines “international accounting standards” (IAS) as the collective term for all IASs, IFRSs, SIC Interpretations and IFRIC Interpretations. This is the opposite of the IASB’s definition in par 7 of IAS 1, which takes “international financial reporting standards” (IFRS) as the collective term.

Article 4 makes it mandatory for all publicly traded companies of member states to present their consolidated financial statements in conformity with those IASs which have been adopted in terms of art. 6. This obligation applies for all financial years starting on or after 1 January 2005.

Article 5 empowers the EU member states to legislate that, in addition, both the separate financial statements of publicly traded companies as well as the consolidated financial statements of non-publicly traded companies have to be presented in conformity with adopted IASs. Such

¹³⁵ See art. 4 of the Joint Statement of the European Parliament, the Commission and the Council of 17 July 2006 (2006/C 255/01).

¹³⁶ See infra Chapter 2.2.2.2.1 as well as infra Chapter 2.2.2.2.2 (Figure 2.3).

¹³⁷ Commission Decision 2006/505/EC of 14 July 2006. See appended documents.

legislation will only apply nationally. The German legislator, for instance, gave non-publicly traded companies the choice to present their consolidated statements either in accordance with IAS or in accordance with national laws (s 315a(3) of the *Handelsgesetzbuch*, which was effective from 4 December 2004).

Article 3(1) empowers the European Commission to adopt IASs, while art. 3(2) puts forward three substantive requirements (referred to as “*criteria for adoption*”¹³⁸), all of which have to be met by the IASB’s IASs, before these can be adopted as secondary EU legislation. Article 3(2) was not included in the European Commission’s original draft foundational IAS regulation and was only inserted in the course of the enactment of the foundational IAS regulation as a result of political pressure from the European Parliament (Wojcik, 2008:51). The three requirements are as follows:

Firstly, they have to conform with the ‘*true and fair view*’ principle as set out in two earlier Council directives on accounting (referred to as “the 4th Council Directive” and “the 7th Council Directive”).¹³⁹ This emanates from the – somewhat cryptic – reference in the 1st indent to art. 3(2) of the foundational IAS regulation. Until the enactment of the IAS regulations, these two directives have been the EU’s main harmonisation instruments in the area of accounting (Van Hulle, 2003:969): they seek to coordinate national provisions concerning the presentation and content of annual financial statements. Both are still effective. Neither of them, however, defines what constitutes a ‘true and fair view’. Wojcik (2008:140) points out that this term was only inserted into the directives upon an explicit British request. This does not, however, mean that the concept of ‘true and fair view’ has to be interpreted in the way the British accounting profession or the IASB do. Rather, as the ECJ ruled in its *CILFIT* decision,

“legal concepts do not necessarily have the same meaning in Community law and in the law of the various Member States ... [E]very provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole

¹³⁸ Recital 2 of Regulation No. 1725/2003.

¹³⁹ *Viz.* art. 2(3) of the 4th Council Directive of 25 July 1978 “On the annual accounts of certain types of companies”(78/660/EEC [14 August 1978]) and art. 16(3) of the 7th Council Directive of 13 June 1983 “On consolidated accounts” (83/349/EEC [18 July 1983]). See appended documents.

...” (CILFIT and Lanificio di Gavardo SpA v Ministry of Health [1982] ECR 3415, paras 19-20).

Thus, what constitutes a ‘true and fair view’ in terms of art. 3(2) of the foundational IAS regulation is to be determined by referring to what constitutes a ‘true and fair view’ in terms of those two directives (Wojcik, 2008:141). By doing so, the open-ended legal term ‘true and fair view’ is given a sufficiently clearly specified meaning (Alexander, 2006:71 and Nobes, 2006:84). The two directives laid down the principle of ‘true and fair view’ in order to coordinate the content of annual financial statements. Application of this principle should, as far as possible, be guided by the detailed rules set out in art. 31 of the 4th Council Directive.¹⁴⁰ Thus, generally, compliance with the requirements of art. 31 of the 4th Directive ensures a ‘true and fair view’.¹⁴¹ However, Recital 9 of the foundational IAS regulation is problematic as it states that

“this principle [of ‘true and fair view’] ... [is to be] considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives ...”

Wojcik (2008:142) considers this passage in Recital 9 damaging¹⁴² and warns that Recital 9 could prevent the term ‘true and fair view’ from being rendered sufficiently justiciable. Secondly, IASs have to be conducive to “*the European public good*” (art. 3(2), 1st indent). This expression in the English version of the foundational IAS regulation is somewhat unfortunate; it might better have been translated as “*the European public interest*”. Like ‘true and fair view’, it is an open-ended legal term, although it has been broadly circumscribed in the Conclusions of the Council of 17 July 2000 (ECOFIN, 2000)¹⁴³, which are mentioned in Recital 9. Van Hulle (2003:979)¹⁴⁴ observes that the criterion of ‘the European public good’ is “rather of a political

¹⁴⁰ See appended documents.

¹⁴¹ See also *infra* Chapter 2.2.2.2.4 (*Tomberger* decision).

¹⁴² See *infra* Chapter 2.2.2.2.4.

¹⁴³ See appended documents.

¹⁴⁴ Regarding Karel van Hulle see *infra* Chapter 2.2.2.2.4.

nature”, and Wojcik (2008:143) adds that it is meant to give the Council a legal tool to reject the adoption of an IAS even if all the other prerequisites for adoption are met. Van Hulle (2003:979) further points out that the term “the European public good”, read with Recital 5 of the foundational IAS regulation, is also meant to be a tool to exert pressure on the IASB: if the IASB does not achieve convergence of its IASs with US-GAAP in particular, these IASs will not be conducive to the ‘European public good’. Recital 5 is worded: “It is important for the competitiveness of [European] Community’s capital markets to achieve convergence of the standards used in Europe ... with international accounting standards that can be used globally ...”.

Lastly, the IASs have to meet the qualitative characteristics of *understandability, relevance, reliability and comparability* (art. 3(2), 2nd indent). These terms have been copied over from the IASB Framework (paras 24-42). Do they therefore have to be interpreted in the same manner as the IASB interprets par 24-42 of the IASB Framework? There has been no case law thus far. Judging by the ECJ’s *CILFIT* decision, one would expect them to have (or at least to develop over time) a Community law-specific meaning. Oddly and inconsistently, however, and contrary to their opinion on the term ‘true and fair view’, most writers on the subject (even, it seems, Van Hulle in 2003:980) assume that these terms have an identical meaning and that they should be interpreted in an identical way by both the IASB and in Community law.

2.2.2.2 The series of implementing IAS regulations of the European Commission

Beginning with Regulation (No. 1725/2003)¹⁴⁵ of 29 September 2003 the foundational IAS regulation was followed by a series of implementing IAS regulations of the European Commission; most of them amended the annex to regulation No. 1725/2003, which contained the full text of all endorsed IASs. These were the regulations that finally adopted the IASB’s IASs and incorporate them into Community law.

¹⁴⁵ See appended documents.

2.2.2.2.1 Procedure

The procedure that was followed when enacting reporting standards was in essence a modified version of the *regulatory procedure*, and – from July 2006 on – of the *regulatory procedure with scrutiny*, respectively.¹⁴⁶ What does ‘modified’ mean here? Compared to the standard procedure, two additional expert bodies (EFRAG-TEG and SARG)¹⁴⁷ are involved in the early stages of the comitology process: before the European Commission submits a draft regulation on the adoption of a new IAS to the comitology committee (the Accounting Regulatory Committee – ARC), both EFRAG-TEG and SARG have to comment on the IASB’s new IAS.

First, EFRAG, acting through its Technical Expert Group (TEG), examines the IASB’s new IAS and delivers its opinion to the European Commission as to whether the new IAS is compatible with the requirements as set out in art. 3(2) of the foundational IAS regulation¹⁴⁸ (positive/negative “*endorsement advice*”). It does so within two months after being requested to comment by the European Commission. Until February 2007 the European Commission drafted implementing regulations and submitted them to the ARC upon EFRAG-TEG’s positive advice. EFRAG, however, is a private sector body¹⁴⁹, and the European Commission did not entirely trust its impartiality (see Recital 4 of the Commission Decision 2006/505/EC).¹⁵⁰ Therefore the European Commission set up a second body, the Standards Advice Review Group (SARG). SARG acts as the examiner’s examiner: it examines EFRAG-TEG’s opinion (endorsement advice) and within three weeks after receiving EFRAG-TEG’s opinion advises the European Commission as to whether EFRAG-TEG’s opinion is objective and well balanced. EFRAG-TEG

¹⁴⁶ See flow chart “Legislative procedure regarding implementing IAS regulations” (Figure 2.3) *infra* in Chapter 2.2.2.2.2.

¹⁴⁷ See *infra* Chapter 2.2.2.2.2.

¹⁴⁸ See *supra* Chapter 2.2.2.1.

¹⁴⁹ See *infra* Chapter 2.2.2.2.2.

¹⁵⁰ See appended documents.

attends the meetings of SARG as an observer. SARG was established in July 2006 and has been operational since February 2007. It is only upon SARG's advice that the European Commission today submits an implementing regulation to the comitology committee (ARC). Sacho and Oberholster (2008:124) take a rather negative stance on the ARC's role. The ARC is made up of members from the various member states of the EU. It thus represents the various national interests. According to Sacho and Oberholster,

“EFRAG [¹⁵¹] issue[s] recommendations on IFRSs at the technical level, while the Accounting Regulatory Committee (ARC) ... ensure[s] ratification at the political level. This filter mechanism to the adoption of IFRS[s] opened the door for political lobbying to the E[uropean] C[ommission] to amend or screen IFRSs which could adversely affect the financial results of influential institutions.”

2.2.2.2.2 The European Financial Reporting Advisory Group (EFRAG) and the Standards Advice Review Group (SARG)

The European Financial Reporting Advisory Group (EFRAG)¹⁵² was established in 2001 by a group of European umbrella organisations representing influential players in the European financial services sector – referred to by EFRAG as its “founding fathers” (*e.g.* the European Banking Federation, the European Insurance Organisation, the Federation of European Accountants, *etc.*). Its stated mission is to advise the European Commission on issues relating to the endorsement and applicability of IASs in the EU. As Hans-Georg Bruns (2001:968), a former member of the IASB, and Karel van Hulle (2001:1), a key expert official of the European Commission,¹⁵³ point out, EFRAG is thus not a standard-setter. In 2006, the European

¹⁵¹ There is no mention of SARG by Sacho and Oberholster.

¹⁵² See www.efrag.org

¹⁵³ Regarding Karel van Hulle see *infra* Chapter 2.2.2.2.4 (footnote 171).

Commission entered into a written working arrangement¹⁵⁴ with EFRAG which formalised EFRAG's role and enhanced its significance in the endorsement process.

EFRAG, being a private sector body, is entirely privately funded; it appoints and dismisses its members without any formal influence from the European Commission. EFRAG is governed by a supervisory board (13 members) and operates through a Technical Expert Group (TEG) whose members (15, of whom 12 with voting rights) are appointed by EFRAG's supervisory board. The European Commission is merely an observer at EFRAG's supervisory board meetings as well as at TEG's meetings. Furthermore, EFRAG liaises with the IASB: IASB board members participate in every TEG meeting, and in turn EFRAG has been granted observer status in several of the IASB's working groups. In addition (EFRAG, 2006a:2.3), when requested by the European Commission, EFRAG provides the IASB with technical input on exposure drafts with the objective of ensuring that European concerns are properly taken into account. Finally, EFRAG is an official observer at the comitology committee's (ARC's) meetings.

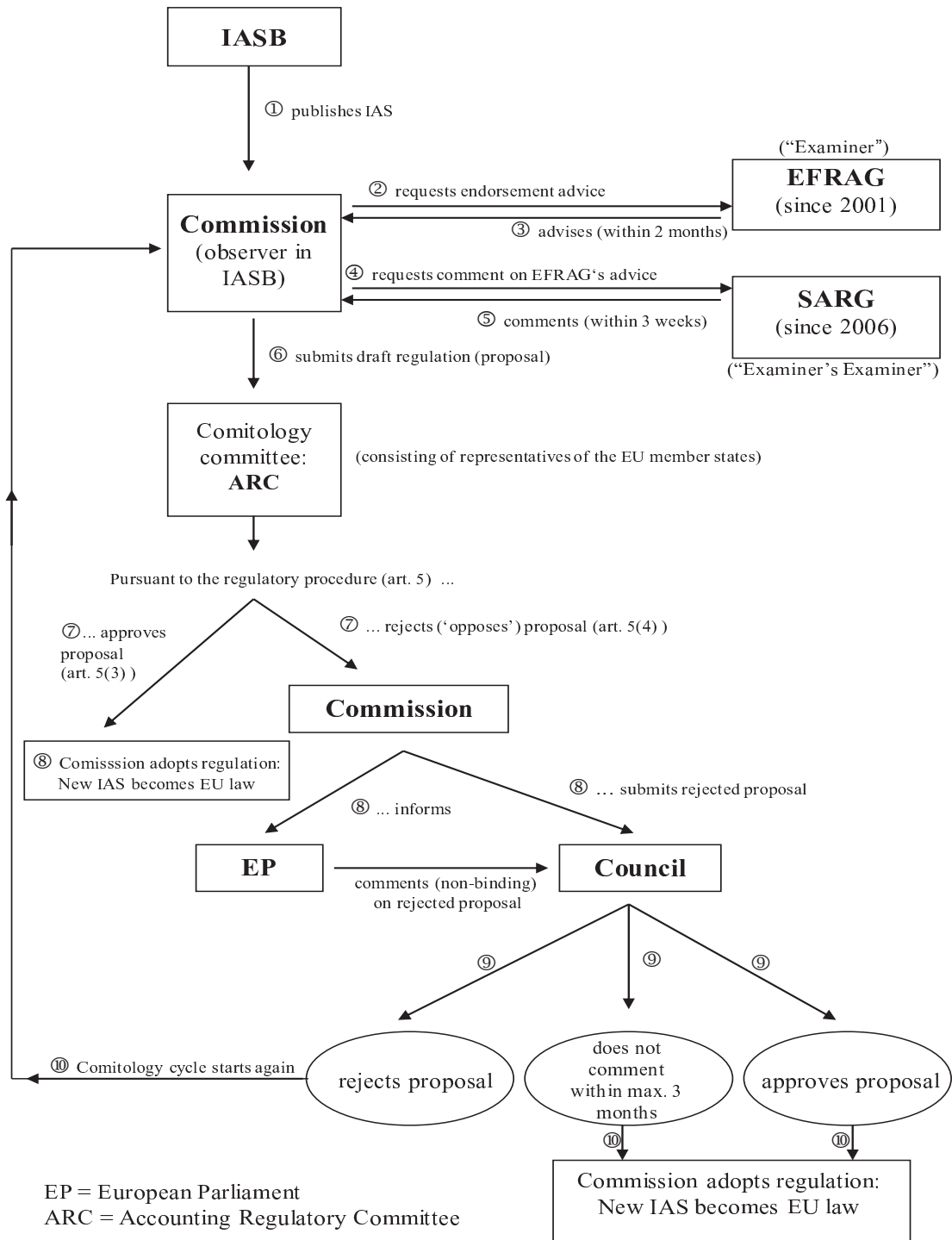
EFRAG has issued an *EFRAG Statement of Due Process* (EFRAG, 2006b) to enhance the transparency of its decision process regarding its endorsement activities. This process shares many similarities with that of the IASB. It is also noteworthy that the TEG's meetings are open to the public. A minor inconsistency does exist though (Wojcik, 2001:213): EFRAG-TEG issues a negative endorsement advice, if two thirds (*i.e.* 8) of its members vote against a new IAS; in contrast, a single majority (*i.e.* 7 members) is necessary for a positive endorsement advice. The reason for this discrepancy is unclear.

In contrast to EFRAG, the Standards Advice Review Group (SARG) is not a private sector body. It was set up by the European Commission by virtue of a Decision¹⁵⁵ and consists of seven independent expert members, all of whom are appointed by the European Commission and can be dismissed by it at any time. In contrast to EFRAG, SARG is thus not biased in favour of any "founding fathers".

¹⁵⁴ 'Working Arrangement between the European Union and EFRAG from 23 March 2006'. See appended documents.

¹⁵⁵ Commission Decision 2006/505/EC of 14 July 2006. See appended documents.

Figure 2.3 (adapted from Wojcik 2008:50): Legislative procedure regarding ‘implementing’ IAS regulations (“Modified regulatory procedure”)



2.2.2.2.3 Contents of endorsed IASs

By virtue of the implementing regulation No. 1725/2003 the European Commission adopted *en bloc* all IASs (as defined in art. 2 of the foundational IAS regulation) which had been issued by the IASB or its predecessor up to that time and which were extant as at 14 September 2002.

Attached to Regulation No. 1725/2003 is a massive annex which contains the full wording of all IASs to the extent to which they have been endorsed.

Subsequent to Regulation No. 1725/2003, nearly 30 further implementing regulations were issued by the European Commission between 2002 and 2008, amending the annex attached to Regulation No. 1725/2003. All of these adopted either new IASs or adopted amendments by the IASB to existing IASs. Finally, at the end of 2008 the amended regulation No. 1725/2003 was repealed and replaced by Regulation No. 1126/2008.¹⁵⁶ This regulation contained nothing new; it simply consolidated all previous amendments to Regulation No. 1725/2003 into one single document.

Two exceptions stood out in 2003: IAS 32 (“Financial instruments: Presentation”) and IAS 39 (“Financial instruments: Recognition and measurement”). Both were in the process of being revised by the IASB at that time and were only endorsed by the European Commission in 2005.¹⁵⁷

It is noteworthy that the European Commission did not endorse the IASB’s IASs in their entirety. In essence, those appendices and other supplements to IASs which the IASs themselves describe as “being an integral part of the IAS” have been endorsed, while those parts of the IASs which the IASs themselves describe as “accompanying, but not being part of, the IAS” have not been endorsed.

¹⁵⁶ Commission Regulation No. 1126/2008 of 3 November 2008. See appended documents.

¹⁵⁷ See *infra* Chapter 2.2.2.2.4.

Often, such integral parts are Definitions or Application Guidelines (AG). Accordingly, for instance, Appendix A and Appendix B to IFRS 2, the Appendix to IAS 32, Appendix A to IAS 39 as well as Appendix A to IFRS 5 have all been endorsed. The same applies to certain explanatory appendices which detail provisions of an IAS, such as Appendix A to IAS 36 (“Using present value techniques to measure value in use”) and Appendix B (“Application supplement”) to IFRS 5.

In contrast, Guidance on Implementing (IG) as well as Illustrative Examples (IE) have not been endorsed. The respective IASs themselves declare them to be “accompanying, but not part of, the IAS” (*e.g.* IGs to IFRS 2 and IAS 39; IEs to IAS 36 and IAS 32 as well as IAS 39).

The Appendix (“Examples of application of the consensus”) to IFRIC 2 is an exception. Although it contains illustrative examples, it is described by IFRIC 2 as an integral part and has thus been endorsed, too.

Bases for Conclusion (BC), Introductions (IN) to IASs, Dissenting Opinions (DO) as well as the Preface and the IASB Framework are not endorsed. As regards BCs, the reason is clear: the majority of the EU member states (*e.g.* France, Germany and the Netherlands) are part of the continental legal family (as opposed to the common-law family) and therefore most of their law is codified. Those codes are typically complemented by commentaries on the codes. These commentaries are not part of the codes; instead, they comprise both the body of case law and academic opinions on the various provisions of the codes and detail their origins and histories. The commentaries are non-binding, although they carry considerable authority and are regularly referred to by the courts. The BCs to a large extent resemble commentaries on the IASs, and therefore the legal tradition of the majority of the EU member states do not allow them to be regarded as part of the law itself. Consequently they have not been endorsed.

The situation is similar with INs. As a rule, they describe the changes made by amendments to an IAS (often under the heading “The main changes”) as well as the purpose pursued by the IASB in making such changes (often under the heading “Reasons for revising”) or they contain an explanatory summary of the revised IAS. They bear greater resemblance to a commentary on a code than to a code itself, and consequently they have not been endorsed.

Succinctly put, the text of EU-endorsed IASs is to a considerable extent identical to, but does not fully cover, the text (including the accompanying texts) of the IASB's IASs ("IASB-IASs").

Only endorsed IASs have been scrutinised as part of the endorsement process for their congruence with the requirements set out in art. 3(2) of the foundational IAS regulation, and only these endorsed IASs have thus become Community law. In contrast, any part of an IAS which has not been endorsed, or any new IAS which has not yet been endorsed, remains a mere non-binding opinion of the private standard-setter IASB. For instance, the appendices to IAS 19 ("Employee benefits") have never been endorsed; or – as at June 2011 – IFRS 9 ("Financial Instruments" – issued by the IASB on 12 November 2009) is currently in the endorsement process and has not been endorsed yet. They are not Community law as yet.

Two further issues concerning endorsements have not been resolved satisfactorily:

One is the legal status of the *IASB Framework*. The Framework has explicitly not been classified as IAS by the IASB (par 2 of the Framework), and presumably for that reason the European Commission did not endorse it in 2003 – contrary to EFRAG-TEG's positive endorsement advice.

Within the system of IASs, however, the Framework plays an important role: in situations where no specific Standard or Interpretation applies, IASs require management to use judgement in resolving accounting issues. In making such judgements, the definitions, recognition criteria and measurement concepts set out in the Framework are to be relied on (par 11(b) of IAS 8). The Framework addresses the concepts underlying the information presented in financial statements. It thus entrenches the underlying idea that IASs are principle-based rather than rule-based.

The European Commission came to realise the Framework's importance shortly after it had issued Regulation No. 1725/2003 (29 September 2003), and in November 2003 thus attempted to improve on this situation, albeit only half-heartedly: it issued an official "Comments concerning certain articles of Regulation (EC) No. 1606/2002"¹⁵⁸ and attached to it the full text of the Framework; furthermore, it published the Framework on its website in all official languages of

¹⁵⁸ See appended documents. These Comments are further referred to as "European Commission Comments, 2003".

the EU.¹⁵⁹ Some authors (Schöllhorn & Müller, 2004:1624) conclude from this that the Framework, having obtained semi-official status by means of the European Commission's web publication, has become Community law too. They are clearly mistaken, for several reasons. Firstly, the enabling foundational IAS regulation No. 1606/2002 empowers the European Commission to enact IASs (as defined in art. 2 of the regulation) only. The Framework, however, is not an IAS as defined, and the European Commission itself has explicitly recognised that (European Commission Comments, 2003:1.9). Secondly, in order to become Community law, the Framework would have to be enacted as part of one of the legislative instruments set out in ex-art. 249 TEU (today's art. 288 constTFEU)¹⁶⁰, ideally as part of a regulation. A mere publication as part of an official comment does not suffice. The entire endorsement process cannot be circumvented by mere publication. Finally, in order to become legally existent at all, the Framework would have to be published in the Official Journal of the EU (ex-art. 254 TEU, today's art. 297 constTFEU)¹⁶¹, which it was not.

It is also not clear what should be done when endorsed (*i.e.* legally binding) IASs contain references to the Framework or to the Bases for Conclusions (BC), to Guidance on Implementing (IGs) or to Illustrative Examples (IEs), *i.e.* to a legally non-binding opinion of a private standard-setter (such as, for instance, paras 15, 19, 20, 23-24 and 28-29 of IAS 1, par 11(b) of IAS 8, par 11 of IFRS 3, par 10 of IFRS 6, par 6 of SIC 25 and par 5 of SIC 32 [all of them as at 30 June 2011] as well as clause 5 of par 18(b) of IAS 32 [as amended in 2003]).

According to the European Commission (European Commission Comments, 2003:2.1.5), users are required to consider the provisions to which reference is made. However, the majority of writers on the subject agree that this conclusion is incorrect from a legal point of view (*e.g.* Wojcik, 2008:266). It would amount to what is known as an (unconstitutional¹⁶²) undated

¹⁵⁹ It seems that, as at May 2011, the Conceptual Framework has not yet been publicised in a similar way by the European Commission.

¹⁶⁰ See *supra* Chapter 1.1.2 and appended documents.

¹⁶¹ See appended documents.

¹⁶² See *e.g.* Karpen, 1970:161 and Sachs, 1981:1651. On EU level, the term "unconstitutional" has – for the time being – to be used with caution, since there is no EU constitution as yet, see *supra* Chapter 1.1.2. This

reference (in German: *dynamische Verweisung*, in French: *référence datée*)¹⁶³ and infringe upon the constitutional principles of democracy, of the *Rechtsstaat* ('the rules of law') and of *Bestimmtheit* ('precision and verifiability of a legal norm').

The principle of democracy would be infringed, since the private body IASB is not empowered by the European Sovereign (*i.e.* the community of the peoples of Europe) or the European legislative power (*i.e.* the Council and the European Parliament) to legislate.

The principle of *Rechtsstaat*¹⁶⁴ would be infringed, since a non-competent private body evades the constitutional statutory law and the common law governing the delegation of legislation.

The principle of *Bestimmtheit* would be infringed, since what is referred to is the latest effective available version of the Framework/IFRS as well as any version of the Framework/IFRS which may become effective in the future (*i.e.* the reference is thus said to be "undated" or "*dynamisch*"); thus at the time when the reference itself was enacted, the lawgiver was unable to know what the reference would be referring to in the future. Future versions of the standard referred to have thus not been covered by the lawgiver's will. As regards the Framework, the issue has thus far been avoided, since the Framework was never amended and thus remained in its original version. Its successor document, the Conceptual Framework,¹⁶⁵ however, was issued by the IASB in September 2010. It is in part still a verbatim copy of the Framework, but these

does not mean that EU primary law has not enshrined what would usually be referred to as constitutional values. This constitutional structure is, however, fragmented and spread over various constitutive treaties. Furthermore, it is also based on what is referred to as the "Community 'general principles' of law"; these in turn are to a considerable extent inspired by common national constitutional traditions. In addition it is also a picture which is influenced by the ECJ's case law. Finally, art. 6 consTEU provides a reference to the EU's Charter of Fundamental Rights, making the Charter legally binding and giving it the same legal ranking as the constitutive treaties have.

¹⁶³ See *infra* Chapter 2.2.2.2.4.

¹⁶⁴ Regarding the principle of *Rechtsstaat* (in Afrikaans: *regstaat*) see Du Plessis (2002:220), Botha (2005:5) and Burns and Beukes (2006:20 and 65). According to Burns and Beukes, this principle denotes the minimum qualities which laws governing public authorities and citizens must possess.

¹⁶⁵ See *supra* Chapter 2.1.1.1 (footnote 32) and *infra* Chapter 2.2.3.

parts are expected to be replaced in due course by a new wording. The issue around the principle of *Bestimmtheit* will therefore arise as soon as this Conceptual Framework is endorsed.

The same issue arises if endorsed IASs refer to provisions of IASs which have not been endorsed yet.

2.2.2.2.4 Critique: Does the European Commission merely rubberstamp the IASB's IASs?

Technically, the legal effect of the European Commission's implementing regulations is to incorporate private rules into Community law. The exact text of IASs as appended in those regulations thus becomes a legal norm. If the IASB subsequently amends an IAS or issues a new IAS, neither these amendments nor these newly issued IASs will become law until they have been formally endorsed too.

Crucially, the implementing regulations are no mere references (*Verweisungen*), nor dated references (*statische Verweisungen*) which would refer to the version of the IASs as at a specific date, nor (unconstitutional) undated references (*dynamische Verweisungen*).¹⁶⁶ Nevertheless, a considerable body of academics views the process with suspicion. They contend that the European Commission's implementing regulations amount in essence to (unconstitutional) *de facto* undated references (e.g. Schulze-Osterloh, 2004:174; Henrichs, 2006a:512). What does *de facto* mean here?

The European Commission's stated objective is to endorse a single set of *global* accounting standards (Recital 2 and 5 of the foundational IAS Regulation No. 1606/2002). While it is true that the European Commission has the discretion to endorse or not to endorse the IASB's standards or to amend the IASB's standards and then only to endorse these amended standards, it is also true that this might lead to the emergence of "*EU-specific IASs*" ("*EU-IASs*"). Such EU-

¹⁶⁶ See supra Chapter 2.2.2.2.3.

IASs, however, would not be global standards any longer, and the European Commission's objectives would thus be compromised. Hence there is some suspicion that the European Commission does not fully apply its mind in exercising its discretion in practice, but rather simply rubberstamps as quickly as possible any IAS which the IASB issues. In practice and *de facto*, the argument goes, the European Commission's implementing regulations thus come down to undated references (*dyamische Verweisungen*) in disguise.

There is some force in this argument. Three reasons are given for the conclusion that the Commission is not sufficiently involved in the determination of IASs.¹⁶⁷

2.2.2.2.4.1 The arguments-for

The following three arguments could be put forward in favour of the submission that the EU Commission simply rubberstamps the IASB's IASs.

Firstly: The European Commission's organisational influence on the IASC and IASB is limited. For one, the European Commission is – as at June 2011 - not represented on the IASC's Board of Trustees. Furthermore, it does not even have observer status in the IASB, although it is represented as an observer in the IFRS Interpretations Committee (the former IFRIC) and the IFRS Advisory Council (the former Standards Advisory Council) and it is a member of the newly established Monitoring Board.¹⁶⁸

Secondly: Karel van Hulle, Head of the European Commission's Division of Accounting and thus a key expert official within the European Commission's bureaucracy as regards its policy on

¹⁶⁷ See infra Chapter 2.2.2.2.4.1.

¹⁶⁸ See infra Chapter 1.1.3.

financial reporting,¹⁶⁹ stated in an academic article published in a German law journal (Van Hulle, 2003:978) that it is – from the European Commission’s perspective –

“unthinkable that an IAS which had been issued by the IASB, should have been re-negotiated on EU-level. Rather, it has been the EU’s policy that once an IAS had been issued by the IASB, it should be regarded as acceptable to the EU as well.” [Translated from the original German text]

He further pointed out that the European Commission has no intention of endorsing an IAS only in parts, in order to avoid the development of EU-IASs (Van Hulle, 2003:980). To many among the European legal profession this statement demonstrated that politically the rejection of an IASB’s IAS is undesirable (*e.g.* Hennrichs, 2006a:512; Wojcik, 2008:124).

Thirdly: Leading legal academics have pointed out (*e.g.* Hennrichs, 2005:785; Schön, 2004:767; further Kleindiek, 2001:2574 and Dobler, 2005:29) that the European Commission has even enacted (endorsed) some provisions of the IASB’s IASs (in particular paras 54 *et seq.* of IFRS 3 (as issued in 2004), par 18(b) of IAS 32 as amended in 2003 and par 30(c) of IAS 18), although they infringed upon the endorsement requirements set out in the 1st indent of art. 3(2) of the foundational IAS regulation (the ‘true and fair view’ principle as set out in the 4th and 7th Council Directives¹⁷⁰) and thus should not have been endorsed. These concerns about paras 54 *et seq.* of IFRS 3 as issued in 2004, par 18(b) of IAS 32 as amended in 2003 and par 30(c) of IAS 18 are based on the following considerations:

¹⁶⁹ Within the European Commission bureaucracy there are essentially four layers (Craig & De Burca, 2008:41): At the very top, there is the Commissioner who has the portfolio for a specific area. Then there are Directors General who each head a particular Directorate General (DG); the DGs cover the major internal areas over which the European Commission has responsibility, *e.g.* the DG “Internal Market and Services”. Each DG has a number of directorates, headed by a director. The DG “Internal Market and Services” has eight such directorates; among them is the Directorate “Free Movement of Capital, Company Law and Corporate Governance”. This directorate, in turn, has four divisions (or units), one of them being responsible for accounting and financial reporting. Professor Karel van Hulle was Head of this division at the time when Regulations No. 1606/2002 and No. 1725/2003 were enacted.

¹⁷⁰ See *supra* Chapter 2.2.2.1 and appended documents.

How did paras 54 et seq. of IFRS 3(as issued in 2004) infringe upon art 3(2) of the foundational IAS regulation?

In terms of paras 54 *et seq.* of IFRS 3 (as issued in 2004), goodwill acquired in a business combination shall not be amortised (par 55 of IFRS 3). Instead, after initial recognition, the acquirer shall measure goodwill at cost less any accumulated impairment losses (par 54 of IFRS 3).

In contrast, the 4th Council Directive¹⁷¹ prescribes that goodwill must be amortised over a period of typically maximum 5 years (art. 37(2), read with art. 34(1)(a) of the 4th Council Directive). In terms of arts 29(1), 30(1) of the 7th Council Directive¹⁷², this applies to consolidated financial statements as well.

Paragraphs 54 *et seq.* of IFRS 3 thus infringed upon these provisions of the two Council Directives.

Article 3(2) of the foundational IAS regulation¹⁷³ further prescribes that endorsed IASs (as defined in art. 2 of the foundational IAS regulation) must conform with the ‘true and fair view’ principle as set out in these two Council Directives.¹⁷⁴

Recital 9 of the foundational IAS regulation determines that “a strict conformity with each and every provision of those [two Council] Directives” is not required. Did Recital 9 therefore get paras 54 *et seq.* of IFRS 3 off the hook? Majority academic legal opinion denied this and reasoned that a teleological interpretation of these provisions of the two Directives shows that the Directives’ requirement of amortising goodwill is to be regarded as part of the fundamental principle of these Directives and thus as a constitutive component of the open-ended legal term ‘true and fair view’.

¹⁷¹ Council Directive 78/660/EEC. See *supra* Chapter 2.2.2.1 and appended documents..

¹⁷² Council Directive 83/349/EEC. See *supra* Chapter 2.2.2.1 and appended documents.

¹⁷³ See *supra* Chapter 2.2.2.1 and appended documents.

¹⁷⁴ Art. 2(3) of the 4th Council Directive (which refers to separate financial statements) and in art. 16(3) of the 7th Council Directive (which refers to consolidated financial statements).

Firstly, the argument goes, annual impairment tests are – in comparison with straight-line amortisation over (typically) 5 years – much more prone to manipulation; this is pertinent since one of the main objectives of the ‘true and fair view’ principle as set out in the two Council Directives is to reduce opportunities for manipulation (Hennrichs, 2005:785; Kleindiek, 2001:2576).

In addition, a minority group of academics (in particular Dobler, 2005:29) has proposed that acquired goodwill will not remain acquired goodwill forever. Rather, in due course, as the business combination prospers, the goodwill at hand turns into internally generated goodwill of the combined entity. Therefore Dobler submits that, in the longer term, failure to amortise acquired goodwill results in the recognition of internally generated goodwill as an asset. This is, however, forbidden under both the IASs as well as the two Council Directives. Dobler’s reasoning does not appear to be convincing.

Since paras 54 *et seq.* of IFRS 3 (as issued in 2204) thus infringed upon both the wording of provisions of the two Council Directives as well as upon the ‘true and fair view’ principle, the requirements of art. 3(2) of the foundational IAS regulation are not met. Paras 54 *et seq.* of IFRS 3 should not have been endorsed.¹⁷⁵

How did par 18(b) of IAS 32 (as amended in 2003)¹⁷⁶ infringe upon art 3(2) of the foundational IAS regulation?

According to overwhelming opinion, par 18(b) of IAS 32 (as revised in 2003) infringed upon the ‘true and fair view’ (art. 2(3)) of the 4th Council Directive) as regards its application to

¹⁷⁵ Regarding the legal consequences of such a finding see *infra* Chapter 5.2.1.2. According to the ECJ’s *Granaria* decision ([1979] ECR 623, par 4) and the majority of the writers on the subject, Community law (such as the implementing IAS regulation which endorsed paras 54 *et seq.* of IFRS 3) which infringes upon higher-ranking Community law (such as the foundational IAS regulation which empowered the European Commission to issue implementing regulations) remains in effect until the ECJ declares it null and void (see Wojcik, 2005:297). A sizable minority of the writers on the subject, in particular German academics (Hennrichs, 2005:785 and 2006b:1259; Schön, 2004:767; Schubert, 2006:1037) submit instead that such infringing Community law is void or, at least, has no legal effect.

¹⁷⁶ See appended documents.

partnerships and thus infringed upon art. 3(2) of the higher-ranking foundational IAS regulation. Consequently, par 18(b) of IAS 32 (2003) was considered vulnerable to challenge in court and thus to be a voidable legal norm.

IAS 32 (“Financial instruments: Presentation”) is an IAS which has stirred up much controversy. Originally issued by the IASC¹⁷⁷ in 1995, it was amended and revised several times, among others in 2003 (henceforth “IAS 32 (2003)”) and in 2008 (henceforth “IAS 32 (2008)”).¹⁷⁸

The 2003 amendments brought the calamitous insertion of the word “partnerships” into the exemplary list of entities mentioned in clause 4 of par 18(b). It was this insertion which raised the question whether par 18(b), as regards partnerships, was voidable. This issue persisted from 2004 (when IAS 32 was endorsed as EU law),¹⁷⁹ until it was finally put to rest by the 2008 amendments to par 18(b) and to the definitions of “financial liability” in par 11 (the insertion into the definition of “financial liability” of the 2nd half-sentences [“except”] to clauses 1, 3 and 4 of par 18(b), and the insertion of the last sentence [“As an exception ...”]), as well as by the insertion of par 16A-16D, all of which are specifically intended to resolve the issue around partnerships. These amendments were duly and fully endorsed by the European Commission in January 2009.¹⁸⁰ Because of the endorsement of the amendments par 18(b) now finally conforms to the higher-ranking art. 3(2) of the foundational IAS regulation and can no longer be said to be voidable.

What was the fuss about? In essence, par 18(b) of IAS 32 (2003), read with the definition of “financial instrument” in par 11 and the classification of a “puttable instrument” as a financial liability in par 18(b) of IAS 32 (2003), meant that a partner’s share in the partnership funds had to be classified as a financial liability of the partnership rather than its equity. This conflicted with principles of the law of partnership and led to misleading financial accounting.

¹⁷⁷ Regarding the IASC see *supra* Chapter 1.1.3.

¹⁷⁸ See appended documents.

¹⁷⁹ Commission Regulation No. 2237/2004 of 29 December 2004.

¹⁸⁰ Commission Regulation No. 53/2009 of 21 January 2009.

The issue mainly affected commercial partnerships. What is a commercial partnership? A commercial partnership is a form of partnership which is recognised in most continental legal systems and thus in most of the EU member states (such as the *offene Handelsgesellschaft (oHG)* in Germany, the *vennootschap onder firma* in the Netherlands and the *société en nom collectif* in France). It is distinct from a civil partnership (such as the *Gesellschaft bürgerlichen Rechts (GbR)* in Germany, the *maatschap* in the Netherlands, and the *société civil* in France). The distinction between a civil and a commercial partnership is fundamental and has its origin in two old and competing theories about the legal nature of a partnership. The theories differ on whether a partnership should be regarded a legal entity ('the entity theory') or merely as a collection of individuals ('the aggregate theory'). Henning and Snyman-Van Deventer (2006:219) explain that

*"[T]he entity theory has its origin in the mercantile concept of the partnership (firm) as a body or entity separate ... from the members composing it and having rights and obligations distinct from those of its members. For this reason it is also known as the mercantile theory. It has been adopted ... in most, but not all civil law jurisdictions with the practical result ..., that a commercial partnership has its own name and ... the capacity to sue and be sued, to own property, to carry on business and to incur attendant rights and obligations ... English law and hence most other common-law jurisdictions did, and for the most part still do, refuse to recognise the partnership as an entity distinct from the members composing it ... [T]he partnership (firm) is treated as merely an aggregate or collection of individuals. The aggregate theory, so closely associated with the common law that it is often called the common-law theory of partnership ignoring the partnership (firm), looks to the partners composing it. The partners are the owners of partnership property and the rights and liabilities of the partnership are their rights and liabilities. Any change of partners destroys the identity of the partnership."*¹⁸¹

In terms of the law of (both civil and commercial) partnerships, a partner has the right to withdraw from the partnership. However, a commercial partnership continues when a partner withdraws from the commercial partnership; it is not dissolved. A claim, however, arises for the

¹⁸¹ Where does the South African law of partnership fit in? From an early date South African courts, mainly under the influence of English law, have adhered to the aggregate theory (Henning & Snyman-Van Deventer, 2006:224 and 231). They have not recognised the firm (partnership) in the mercantile sense. There is no commercial partnership in South African law.

outgoing partner to be reimbursed by the continuing commercial partnership. This claim is not limited to the book value of his earlier contributions to the partnership; rather it amounts to his share in the market value of the partnership funds and thus includes his share in the partnership's goodwill. The claim arises at the moment when the partner declares his intention to withdraw.¹⁸²

National laws vary somewhat when it comes to the legal nature of partnership funds. However, partnership funds are regarded as funds separate from the private assets of the partners.¹⁸³

Paragraph 14 of IAS 32 includes a partnership in its definition of an “entity” for the purpose of IAS 32. IAS 32 therefore must be applied to partnerships too, although its wording is noticeably formulated for companies and it can only be applied rather awkwardly to partnerships.

In terms of the definition in par 11 of IAS 32, a “*financial instrument*” is “any *contract* that gives rise to a financial asset of one entity and a financial liability ... of another entity.” A *partnership agreement* is therefore a financial instrument: it gives rise to a right to a pro rata share in the partnership funds¹⁸⁴ (financial asset of the partner) and to a subsequent obligation to reimburse

¹⁸² In clear contrast, in terms of the (South African) law of civil partnership, when a partner withdraws the civil partnership comes to an end; it does not continue. There can thus be no claim of the withdrawing partner against the continuing partnership. Instead, each partner has a claim against his co-partners to have the partnership property realised and his proportionate share paid out to him (Henning & Snyman-Van Deventer, 2006:286). The outgoing partner's share in the firm therefore consists of his proportionate interest in the partnership property after it has been realised and converted to money and after all the partnership's creditors have been paid (Henning & Snyman-Van Deventer, 2006:236).

¹⁸³ Under the German law of (both civil and commercial) partnership, they are deemed to be transferred to what is referred to as the *Gesamthand*. The partnership, lacking a separate legal personality, is not itself the owner of these partnership assets. Nevertheless, the separation of these assets of the partners from their private assets means that the partners are no longer individually allowed to alienate or pledge these assets. The South African law of civil partnership is only slightly different. It has no term equivalent to the *Gesamthand*, but describes the partnership funds as being in *joint co-ownership of the partners* and thus follows a notion of partnership funds which is in essence the same as the German one. Henning and Snyman-Van Deventer (2006:235) explain that partnership assets are perceived to be “held by the partners as co-owners, that is the partners jointly own the partnership property in undivided shares.”

¹⁸⁴ Alternative terms, used interchangeably, are ‘*partnership property*’ or ‘*partnership assets*’, see Henning and Snyman-Van Deventer (2006:233). Henning and Snyman-Van Deventer observe that common-law authorities have thus far been rather silent on the nature and extent of a partner's share in a partnership

the partner when he withdraws from the partnership (financial liability of the commercial partnership).¹⁸⁵ Is the partnership agreement moreover a “*puttable instrument*” in terms of par 18(b) of IAS 32 and thus a financial liability? Again, the wording of par 18(b) is not comfortably applicable to partnerships. It too is clearly formulated for companies. Legally, the partnership is not an “issuer” and there is no “right to put back [one’s share in the partnership funds]” (rather there is a mere right to withdraw from the partnership). Furthermore, a partner is not a “holder” of the partnership agreement; at best he can be said to be a holder of his pro rata share in the partnership funds. Classifying members’ shares as financial instruments, however, is not unknown to the IASs (see par 5 of IFRIC 2 (as at June 2011) with regard to members’ shares in co-operative entities). Furthermore, the first half-sentence of clause 4 of par 18(b) of IAS 32 seems to refer to partners as “members” albeit that, strictly speaking partners are not ‘members’ of the partnership (as the term ‘member’ is usually reserved for shareholders in companies and holders of an interest in close corporations). It is thus the partner’s share in the partnership (rather than the partnership agreement itself) which is to be regarded as a “puttable instrument” and thus as a financial liability in terms of par 18(b).

As a result, par 18(b) of IAS 32 (2003) led to a partner’s share in the partnership funds having to be recorded in the partnership’s books as a financial liability rather than equity. Clause 5 of par 18(b) did not, it is submitted, overcome that. It allows for a mere “prescriptor” (*i.e.* an explanatory addendum to the line item on the face of the financial statements), while leaving the classification as financial liability untouched.

Moreover, in terms of IAS 32 this financial liability did not only arise once a partner had declared his intention to withdraw from the partnership, but already at the very moment he joined the partnership (Schubert, 2006:1038). Paragraph 18(b) of IAS 32 (2003) assumed from the moment that the partnership is formed, that all partners will have jumped ship by the balance

before the dissolution of the partnership and the general realisation of its property (2006:233) and note that this is an issue that still awaits development by the courts (2006:237).

¹⁸⁵ Note that the situation is different in the South African law of partnerships: when a partner withdraws, the partnership dissolves. It does not continue. Any change of partnership terminates the partnership. An obligation can thus no longer accrue to the partnership; rather, upon dissolution of the partnership, each partner has a right against his co-partners. See *supra* in this chapter.

sheet date. This assumption of a worst-case scenario runs contrary to the going-concern assumption set out in par 25 of IAS 1. Furthermore, in terms of par 18(b) of IAS 32 (2003), no probabilities are taken into account: it does not matter whether it is more or less likely that a withdrawal by a partner will occur, a liability will be recognised anyway. This is in stark contrast with the requirements of par 23 of IAS 37 (“the probability of an outflow of resources”). In addition, the liability which arose from par 18(b) of IAS 32 (2003) contradicted the definition of a liability in par 10 of IAS 37 (“present obligation”): when a partner joins the partnership, the partnership’s liability to reimburse this partner once he withdraws is a future one and should therefore, in terms of par 18 of IAS 37, not be recognised as yet.

Paragraph 18(b) of IAS 23 (2003) led to what has been called “anomalous accounting” (Hennrichs, 2006b:1260) or “counter-intuitive accounting” (BC 50(b) of IAS 32 (2008)): the more the partners contributed, the higher the partnership’s liabilities became. Equally, the financial liabilities of the partnership grew with its market value. Paragraph 18(b) of IAS 32 (2003) turned, as it came to be known, “goodwill into badwill”. For the many commercial partnerships, par 18(b) of IAS 32 (2003) would have had a dramatic effect. By applying it, they would have found themselves thrown into factual insolvency (liabilities exceeding assets) and furthermore, in terms of the usual creditworthiness tests, their equity ratios would have become very poor. In extreme cases par 18(b) of IAS 32 (2003) could even have led to a situation in which a statement of financial position no longer showed any equity at all, although none of the partners had left the commercial partnership.

It was these effects of par 18(b) of IAS 32 (2003) that fed the general consensus that it conflicted with the ‘true and fair view’ principle of art. 2(3) of the 4th Directive and consequently with art. 3(2) of the foundational IAS regulation.

As endorsed EU law,¹⁸⁶ par 18(b) of IAS 32 (2003) had to conform to this principle, and was therefore voidable.

¹⁸⁶ Commission Regulation No. 2237/2004 of 29 December 2004.

In addition, it was submitted (Henrichs, 2006b:1258; Schubert, 2006:1037) that par 18(b) of IAS 32 (2003) did not meet the criterion of ‘understandability of financial information’ of 3(2) of the foundational IAS regulation either: users might be confused by scenarios such as statements of financial position showing an IAS 32-induced factual insolvency, or by successful commercial partnerships which nevertheless show rapidly increasing liabilities.

Why did this issue mainly affect commercial partnerships and not civil partnerships to an equal extent as well? Clause 1 of art. 1(1) of the 4th Directive determines that the 4th Directive applies to companies¹⁸⁷ and under certain circumstances, to commercial partnerships in the continental legal systems.¹⁸⁸ It does not, however, apply to their civil partnerships. The only exceptions seem to be the UK and Ireland, where, again only under certain circumstances, clause 2 can apparently apply to (civil) partnerships.¹⁸⁹

¹⁸⁷ *Viz.* for instance in Germany the *Aktiengesellschaft*, the *Kommanditgesellschaft auf Aktien*, the *Gesellschaft mit beschränkter Haftung (GmbH)*, in France the *société anonyme*, the *société en commandite par actions*, the *société à responsabilité limitée*; in the UK and Ireland *public companies limited by shares or by guarantee*, *private companies limited by shares or by guarantee*; in the Netherlands the *naamloze vennootschap*, the *besloten vennootschap met beperkte aansprakelijkheid*. It is noteworthy that the UK *limited liability partnership (LLP)* is not listed in clause 1 of art 1(1).

¹⁸⁸ Clause 2 of art. 1(1). It applies, for instance, in Germany to the *offene Handelsgesellschaft (oHG)* and to the *Kommanditgesellschaft*; in France to the *société en nom collectif* and to the *société en commandite simple*; in the Netherlands to the *vennootschap onder firma* and to the *commanditaire vennootschap*. It is noteworthy that commercial partnerships are not always and generally covered by clause 2 of art. 1(1). Rather, a specific scenario is required: only those commercial partnerships which effectively have limited the liability of all of their partners are covered. This scenario would, for instance, be at hand under German law in the case of an *offene Handelsgesellschaft (oHG)*, all of whose partners are *Gesellschaften mit beschränkter Haftung (GmbHs)*.

¹⁸⁹ As regards the UK and Ireland, clause 2 lists *partnerships* next to *limited partnerships* and *unlimited companies*. As regards UK law, a civil partnership all of whose partners are private companies limited by shares would thus *e.g.* be covered by clause 2 of art. 1(1). It is noteworthy that the UK *limited liability partnership (LLP)*, which is distinct from the *limited partnership* is not mentioned in clause 1 of art. 1(1).

Note that in South Africa, a ‘limited partnership’ can no longer be established; the respective statutes which provided for it were repealed in 1976, although not with retrospective effect (Henning & Snyman-Van Deventer, 2006:192). Henning and Snyman-Van Deventer point out that the previous South African limited partnership “was in effect merely a commanditarian partnership in a statutory guise”. A commanditarian partnership (partnership *en commandite*) is a partnership which does not disclose the names of all of its partners to outsiders. The ones disclosed are referred to as ‘principal partners’ while the ones not disclosed as ‘partners *en commandite*’. A partner *en commandite* contributes a fixed sum to the partnership funds on

The finding that par 18(b) of IAS 32 (2003) was voidable did, however, not cause immediate widespread practical problems since art. 4 of the foundational IAS regulation mandated the application of par 18(b) of IAS 32 (2003) only for publicly traded companies. Par 18(b) of IAS 32 (2003) did thus not extend to the commercial partnerships mentioned in clause 2 of art. 1(1). However, increased support for the mandatory application of endorsed IASs to commercial partnerships meant that the matter required urgent attention (Schubert, 2006:1033).

The IASB reacted in 2008 by amending IAS 32:¹⁹⁰ the definition of “financial liability” was maintained, but a partner’s share in the partnership funds was excluded from it as an exception. These amendments are, however, as the IASB itself pointed out (IN 24, BC 55 as well as BC 52-54),¹⁹¹ only intended to be a short-term and emergency solution. The amendments excluded two groups of financial liabilities from the definition of financial liabilities, namely “puttable instruments” in terms of paras 16A and 16B and “Instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation” in terms of paras 16C and 16D.¹⁹² Where in these two exceptions does a partner’s share in the partnership fit in? As a consequence of the wording of par 16C (“*only on liquidation*”), it depends on the scenario:

When a partner leaves, a civil partnership is dissolved, while a commercial partnership is not; it continues. Thus, a withdrawal of a partner in a commercial partnership imposes an obligation on the partnership to deliver to the withdrawing partner his pro rata share in the net assets of the partnership without liquidation of the partnership. Paragraphs 16C and 16D do not apply to this scenario. Rather the partner’s share in a commercial partnership is a “puttable instrument” in terms of paras 16A and 16B.

condition that he receives a certain share in the profit, but that in the event of a loss he is liable to his co-partners only to the extent of the fixed amount of his agreed contribution (Henning & Snyman-Van Deventer, 2006:182 and 193). Partnerships *en commandite* can still be established today under the South African law of partnership.

¹⁹⁰ See appended documents.

¹⁹¹ See appended documents.

¹⁹² Regarding paras 16A-16D see appended documents.

In contrast, in the case of civil partnerships, the only situation¹⁹³ in which an obligation is imposed to deliver to the partners their respective pro rata shares in the partnership's net assets is upon liquidation. Therefore, paras 16C and 16D apply. BC 65(b) of IAS 32 (2008) confirms that IAS 32 perceives civil partnerships as falling by and large within the scope of paras 16C and 16D, although – given the differences among the various national laws of partnership – BC 65(b) is worded rather cautiously (“*some* partnership interests”).¹⁹⁴

How does par 30(c) of IAS 18 infringe upon art. 3(2) of the foundational IAS regulation?

Paragraph 30(c) of IAS 18 (“Revenue”) was endorsed in 2003.¹⁹⁵ It states that “[d]ividends shall be recognised when the shareholder’s right to receive payment is established.” In terms of both German¹⁹⁶ and South African company law (as set out in the old Companies Act¹⁹⁷ and the

¹⁹³ Leaving aside the situation where a partner dies (which is to be interpreted as his withdrawal from the partnership) or that the period of time for which the partnership was agreed to exist has expired.

¹⁹⁴ From the perspective of the South African law of civil partnerships, the requirement of par 16C (“impose *on the entity* an obligation *only on liquidation*”) is not quite compatible with partnerships for two reasons. When a partner withdraws from the partnership the partnership dissolves. The legal effect of dissolution is that the partnership comes to an end (Henning & Snyman-Van Deventer, 2006:284). Dissolution usually leads to subsequent liquidation. Thus, although the partnership has been dissolved, it has not yet been liquidated (Henning & Snyman-Van Deventer, 2006:279). Upon dissolution a partner has, notwithstanding an agreement between the partners to the contrary, a right to demand that the partnership must be liquidated. And already upon dissolution – and not, as par 16C requires, only on liquidation – a partner’s right against his co-partners arises to be paid his pro-rata share in the partnership funds (Henning & Snyman-Van Deventer, 2006:286). The obligation in terms of par 16C is imposed neither *on the entity* (partnership) nor is it imposed *only upon liquidation*.

¹⁹⁵ Regulation No. 1725 of September 29, 2003.

¹⁹⁶ German company law is in particular relevant here because of the *Tomberger* case (see *infra* in this chapter).

¹⁹⁷ Note that the South African legal position has changed since the effective date of the new Companies Act: in terms of s 46(1),(2), the right to receive a “distribution” (as statutorily defined in s 1, which includes dividends) is already established once the company’s board has passed a resolution authorising the

accompanying common law), this right is established when the declaration of dividends becomes legally binding. The declaration of dividend becomes legally binding once the board has passed a resolution to declare a dividend (provided the board is authorised by the company articles to make dividend payments) and after the general shareholder meeting has subsequently sanctioned this dividend (see also par 12 of IAS 10).

As regards a final dividend (as in the *Tomberger* case¹⁹⁸), this point in time will necessarily be after the financial year end: dividends can only be paid out of earned and retained profits (if there are no or insufficient retained earnings, a declared dividend would amount to a prohibited repayment of capital). Up until the end of the last day of the financial year, however, the directors cannot know for certain whether there will indeed be enough retained earnings left to cover declared dividends, since theoretically unforeseen circumstances arising in the late hours of the last day of the financial year might reduce retained earnings and the profit for the current year to nil.

Paragraph 30(c) of IAS 18 reflects the traditional position of the national company laws of most of the EU's member states (Berndt & Hommel, 2005:414) such as, for instance, the UK and Germany. In doing so, however, it conflicts with an earlier decision of the ECJ from 1996 (*Tomberger v Gebrüder v.d. Wetter GmbH (Case 234/94) [1996] ECR-I 3133*¹⁹⁹).²⁰⁰

dividend and after the board has applied the solvency and liquidity test as set out in s 4 of the new Companies Act.

In contrast to the old Companies Act, the declaration of a dividend is thus no longer provisional until the company's shareholders approve it. This is counterbalanced, however, by a personal liability of the directors for the decision to approve the dividend if the company turns out to be not solvent or not liquid any longer after the distribution has been made (s 46(6), read with s 77(3)(e)(vi),(4)-(10)).

Were these provisions of the new Companies Act applied to the *Tomberger* case (regarding this case see *infra* in this chapter), the facts of the *Tomberger* case would, it is submitted, not cause any difficulty.

¹⁹⁸ Regarding this decision see *infra* in this chapter.

¹⁹⁹ See appended documents.

²⁰⁰ This is irrelevant in South Africa, of course, since the ECJ's jurisdiction is confined to the EU.

The endorsement of par 30(c) of IAS 18 thus gave rise to the issue of what to do when subsequent secondary Community law (*viz.* Regulation No. 1725/2003, endorsing par 30(c) of IAS 18) contradicts earlier ECJ case law (*viz.* *Tomberger* decision). The issue has thus far not been resolved authoritatively. A majority of academics, however, have submitted (*e.g.* Berndt & Hommel, 2005:414; Wüstemann & Kierzek, 2006:16; Hennrichs, 2006b:1257) that par 30(c) of IAS 18 should not have been enacted in 2003, since at the time of its enactment it infringed upon art. 3(2) of the foundational IAS regulation, *viz.* the ‘true and fair view’ principle of the 4th Directive as interpreted by the ECJ’s *Tomberger* decision of 1996.

In *Tomberger*, a German holding company (H) and its German wholly-owned subsidiary (S), a private company, had the same year-end (31 December). For the year ending 31 December 1989, S’s annual financial statements showed that certain profits had been allocated (the official English translation of the decision speaks of “appropriated”) to H as dividends payable. These dividends had not yet been paid out to H as at 31 December 1989. S’s annual shareholder meeting only approved S’s annual financial statements for the year ending 31 December 1989 on 30 June 1990. H’s separate annual financial statements for the year ending 31 December 1989 did not show these profits allocated to it by S as dividend receivable (debtor). H’s annual shareholder meeting approved H’s separate annual financial statements for the year 31 December 1989 on 19 October 1990.

At issue was whether H should have recognised a dividend receivable (debtor) in its separate annual financial statements for the year ending 31 December 1989.

With the *Tomberger* decision the ECJ firmly asserted its jurisdiction as regards European accounting legislation for the first time. Unfortunately, however, from the viewpoint of accounting terminology, the decision’s wording is imprecise and ambiguous: it is not clear what exactly is meant by S “appropriating” profits to H. Furthermore, in the decision the facts of the case are set out in an unsatisfactory manner: There is no mention of whether or not S’s articles (*Satzung*) authorised S’s directors to pay out a dividend; nor is there any mention made of S’s previous dividend policy. Furthermore, the facts as stated in the decision leave open the question whether S had any unappropriated (retained) earnings at 31 December 1989 out of which the final dividend could have been allocated, or whether this dividend was rather meant to be

allocated from the (expected) net income for the year ending 31 December 1989. The latter scenario is problematic, since dividends can only be allocated out of earned and retained profits. Up until the end of the 31st day of December 1989, S's board could, however, not have known for certain whether there would indeed be enough profit earned during the year ending 31 December 1989 to cover the allocated dividends.

The European statutory provisions which were considered by the ECJ and the parties in the *Tomberger* case are found in art. 31 of the 4th Directive, viz. art. 31(1)(c)(aa), art. 31(1)(c)(bb) and art. 31(1)(d).²⁰¹

Article 31(1)(c)(aa) provides that, for the purpose of valuing items shown in the annual financial statements, "only profits made at the balance sheet date may be included." Article 31(1)(c)(bb) says that "account must be taken of all foreseeable liabilities and potential losses arising in the course of the financial year concerned ..., even if such liabilities or losses become apparent only between the date of the balance sheet and the date on which it is drawn up." Article 31(1)(d) provides that "account must be taken of income ... relating to the financial year, irrespective of the date of receipt ... of such income ..."

As regards H, the requirements of art. 31(1)(d) might arguably have been met at 31 December 1989, provided the dividend income had accrued to H at that date. Again, however, the facts of the case as set out in the decision do not make it sufficiently clear whether H had in fact acquired a right to these dividends and was entitled to them: the fact that S's annual shareholder meeting only approved S's annual financial statements (and thus – presumably – the declared final dividend) for the year ending 31 December 1989 on 30 June 1990 indicates that the dividend accrued to H only on 30 June 1990. This point of view does not, however, take into account that H was S's only shareholder and thus at any point in time knew the intention of all of S's shareholders and could therefore reliably anticipate at 31 December 1989 the resolutions that would be passed at S's annual shareholder meeting on 30 June 1990.

²⁰¹ See appended documents.

In contrast, it is hard to see how art. 31(1)(c)(aa) could have been applicable to H: from H's perspective, dividends accrued are not 'profits' but 'income', and income is not 'made' but accrues. At best, art. 31(1)(c)(aa) is applicable to S: from S's perspective the allocated amounts could come out of its '(net) profits' or retained earnings which had been 'made' (*i.e.* earned or realised) earlier.

All in all, H's approach of not recognising a dividend receivable or dividend income in the year ending 31 December 1989 seemed, it is submitted, correct and in line with art. 31 of the 4th Directive.

That was also the position taken by the Advocate General²⁰² in the *Tomberger* case who based his conclusion on, among others, art. 31(1)(c)(bb). The ECJ would have none of this. It focused, rather oddly, on art. 31(1)(c)(aa) and held – without providing sound reasoning (*Tomberger, paras 17-24*) – that H should have recognised a dividend receivable in its separate financial statements for the year ending 31 December 1989. The ECJ furthermore pointed out that only compliance with this interpretation of art. 31 of the 4th Directive ensured that H's separate annual financial statements presented a "true and fair view" of H's financial position in terms of art. 2(3) of the 4th Directive (see *Tomberger, paras 17-18* and *par 22*). As regards dividend recognition, 'truly and fairly presenting' thus meant to recognise the dividend before the right to the dividend payment was actually established.

The *Tomberger* case was originally brought before a German court and was finally pending with the German Supreme Court (*Bundesgerichtshof – BGH*). In evaluating the facts of the case the *BGH* too – oddly – focused on art. 31(1)(c)(aa) rather than art. 31(1)(c)(bb) and art. 31(1)(d) and held that H had made a profit at 31 December 1989, since S had already made the profits by then and H's "entitlement to ... [these] profits ... is sufficiently certain at the balance-sheet date [*i.e.* 31 December 1989] for it to be regarded as forming part of the assets [debtors] of ... H" (*Tomberger, par 13*). Since the case dealt with the interpretation of Community law, however,

²⁰² Regarding the Advocate General's role see *infra* Chapter 5.2.1.1.

the *BGH* referred the matter to the ECJ for a preliminary ruling in terms of (today's) art. 267 consTEU²⁰³ (*Tomberger*, par 14).

Given that the ECJ's decision did not reject the *BGH*'s reasoning and did not put forward its own reasoning, it seems reasonable to assume that the ECJ endorsed the line of argument of the *BGH* in reaching its decision.

The *Tomberger* decision was highly controversial and stirred up much academic comment, in Germany in particular (e.g. Felix, 1996:396; Herzig, 1996:1400; Schüppen, 1996:1481; Schulze-Osterloh, 1995:170). Nevertheless, *Tomberger* is an authoritative²⁰⁴ interpretation by the highest European court of the phrase 'true and fair view' (in terms of art. 2(3) of the 4th Directive) in the context of dividend recognition and the subsequently enacted par 30(c) of IAS 18 contradicts this interpretation.

2.2.2.2.4.2 The arguments against

The following arguments can be put forward against the proposition that the EU Commission simply rubberstamps the IASB's IASs.

Firstly: The European Commission's endorsement history proves that the Commission is prepared to stand up against the IASB, even if has done so in only two cases (IAS 32 and IAS 39). IAS 32 and IAS 39 were not endorsed by virtue of Regulation No. 1725/2003, since they were at that time being revised by the IASB. However, even after the IASB subsequently re-issued IAS 32 and IAS 39,²⁰⁵ the European Commission only endorsed IAS 32 in full in 2004;²⁰⁶

²⁰³ Regarding preliminary rulings see *infra* Chapter 5.2.1.2.2.

²⁰⁴ Regarding the *stare decisis* rule in Community law see *infra* Chapter 5.2.1.2.2.

²⁰⁵ Revised IAS 39 issued 17 December 2005 and amendment to IAS 39 issued 31 March 2004.

IAS 39 was only endorsed with two carve-outs,²⁰⁷ as a result of concerns raised by the European Central Bank, the European banking industry and the member states' securities regulators about the provisions relating to the option to fairly value all financial assets and liabilities, as well as concerns relating to the accounting treatment of portfolio hedging. The following considerations were at issue. Firstly, the revised IAS 39 (issued 17 December 2003) introduced an option that permitted companies to designate irrevocably on initial recognition any financial asset or financial liability as one to be measured at fair value with gains and losses recognised in the profit and loss (referred to as the 'full Fair Value Option'). The above stakeholder bodies were concerned that an unrestricted fair value option might be used inappropriately, in particular for financial instruments relating to a company's own liabilities. Secondly, an amendment to IAS 39 (issued 31 March 2004) on the fair value hedge accounting of a portfolio hedge of interest rate risk had met with stiff resistance, especially from the French banks. They argued that IAS 39 did not allow them to apply hedge accounting to a portfolio of core deposits and in addition complained that IAS 39 assimilates a prepayment risk to an interest rate risk and by doing so prevents well-recognised risk management techniques from being continued. Sacho and Oberholster (2008:124) mention the political pressure exerted by mainly French banks on French politicians which, in turn, exerted influence on the ARC. It worked: despite EFRAG's positive endorsement advice, the ARC decided to carve out these parts of IAS 39 and to endorse only the remainder of IAS 39. This created, from the IASB's perspective, a dangerous precedent for future carve-outs. It had the potential of undermining the IASB's authority. The European Commission could, as Sacho and Oberholster point out,

“pick and choose between IASB standards (or parts thereof) and effectively by-pass the IASB ...” (2008:125)²⁰⁸ and *“ignore standards that would prove too onerous for the most influential lobbyists”* (2008:127).

²⁰⁶ Commission Regulation No. 2237/2004 of 29 December 2004.

²⁰⁷ Article 1 of Commission Regulation No. 2086/2004 of 17 November 2004.

²⁰⁸ Sacho & Oberholster (2008:127) demonstrate that another similar precedent was about to be created (and was only narrowly avoided) after the IASB issued its IFRS 8 (“Operating Segments”).

The IASB duly reacted to the European Commission's refusal to endorse IAS 39 in full and revised it again, despite its earlier announcement that it would not bow to political pressure by amending its standards to meet the needs of influential stakeholders (Sacho & Oberholster, 2008:125).²⁰⁹ The revised IAS 39 Fair Value Option replaced and inserted several provisions: IAS 39 now restricts the possibility of designating a financial instrument as at fair value through profit and loss to situations where this results in more relevant information, because either it reduces an accounting mismatch or because a group of financial assets and financial liabilities is evaluated at fair value through profit and loss in accordance with a documented risk management or investment strategy and information about the group is provided within the company on that basis to the company's board (Clause 2 of par 9(b) of IAS 39, read with the – newly inserted – par 11A of IAS 39). Finally, IAS 39 now allows companies to designate, in certain circumstances, a forecast intragroup transaction denominated in a foreign currency as the hedged item in consolidated financial statements, since this is an established management practice (par 80 of IAS 39, read with the – newly inserted – paras 108A and 108B of IAS 39).

It was only then that the European Commission finally incorporated the remaining parts of IAS 39 into Community law in 2005.²¹⁰

Secondly: Karel van Hulle went on to say in his academic article (2003:978) that, in his opinion, the EU's influence on the development of IASs by the IASB was already sufficiently assured as a result of EFRAG's activities (at the time when Van Hulle wrote his article, SARG had not been established yet) as well as by the EU's observer status in both the IFRIC (today's IFRS Interpretations Committee) and SAC (today's IFRS Advisory Council).

²⁰⁹ Amendments to IAS 39, issued 14 April 2005 and 16 June 2005.

²¹⁰ Commission Regulation No. 1864/2005 of 15 November 2005 and Commission Regulation No. 2106/2005 of 21 December 2005.

Thirdly: While it is difficult to deny that paras 54 *et seq.* of IFRS 3 (as issued in 2004) as well as par 18(b) of IAS 32 (as revised in 2003) did not conform with art. 3(2) of the foundational IAS regulation (and were thus vulnerable to a challenge in court²¹¹), they were nevertheless isolated examples compared to the thousands of provisions that make up the IASs. Rather than to take them as proof of the European Commission's subservience to the IASB, they should be seen as draftsman's errors or as insufficient diligence exercised by the various legal departments involved.

2.2.2.2.4.3 Evaluation

The arguments in favour of the European Commission are, it is submitted, overall the more convincing ones. In summary, therefore, one would have to agree with Wojcik (2008:127) that the European Commission's implementing regulations are not unconstitutional *de facto* undated references, although there are some problematic issues. To address these, a stronger influence of the EU within the IASB may be desirable. It may, for instance, be helpful if the European Commission were to become a member of the IASC's Board of Trustees and of the IASB.

2.2.3 Summary

(1) In the EU, in areas which are highly technical and with a continuously changing legal environment (such as, for instance, financial reporting, competition or agricultural policy), *legislative powers* are, for practical purposes, usually *delegated by the Council* (in terms of ex-art. 202 TEU) and, from 1 December 2009, *jointly by the Council and the European Parliament* (in terms of arts. 289, 290 consTFEU) *to the European Commission*. If the standard procedure of enacting Community legislation (*viz.* the "co-decision procedure" in terms of ex-art. 251 TEU

²¹¹ See *infra* Chapter 5.2.

which is the “ordinary legislative procedure” in terms of today’s art. 289 consTFEU) were to be applied, the legislative process would grind to a halt, since the large number of necessary legal norms could not be enacted with sufficient speed.

(a) The former *art. 202 TEU* empowered the Council to delegate the power to issue legislation. The Council, however, had to lay down the basic rules beforehand, and powers were only allowed to be delegated to the European Commission for the implementation of those rules. Articles 289, 290 consTFEU amend ex-art. 202 TEU and increase the European Parliament’s influence: from 1 December 2009 the Council is empowered to delegate only jointly with the European Parliament.

(b) Since the Council distrusted the European Commission, however, it was not willing to give the European Commission *carte blanche* to exercise these delegated powers. Instead, the Council made the exercise of delegated powers by the European Commission conditional upon the prior approval by a committee composed of representatives of the member states. This system came to be known as the “*comitology procedure*” or “committee procedure”.

(c) There are various forms of comitology procedures, depending on the purpose that the ensuing legislation is to achieve. For the purpose of enacting IASs, only two of them are relevant: *the regulatory procedure* and *the regulatory procedure with scrutiny*.²¹²

Under the regulatory procedure with scrutiny, the European Parliament has been accorded a greater role.

(d) The Council laid down the rules governing comitology in two *Comitology Decisions* (1987 and 1999, which was in turn amended in 2006).

(2) The legislative process of enacting IASs in the EU became known as *endorsement*²¹³ and comitology is part of this process.

²¹² See the two flow charts “Comitology procedure in general” (Figure 2.1 and Figure 2.2) supra in Chapter 2.2.1.

(a) Endorsement consists – in line with the requirements of the former art. 202 TEU and today’s art. 289-291 consTFEU– of *two separate legislative procedures*:

First, in line with the former art. 202 TEU, a ‘*foundational*’ IAS regulation (No. 1606/2002) was enacted jointly by the Council and the European Commission in 2002, laying down the basic rules of endorsement. The enactment of the ‘*foundational*’ IAS regulation therefore would even have complied with the requirements of today’s art. 290 consTFEU, too.

Thereafter, an ‘*implementing*’ IAS regulation was enacted (and subsequently amended several times) by the European Commission, by virtue of which the IASs finally became Community law.

(b) In addition, two further bodies were involved in the enactment of the ‘*implementing*’ regulations: these are the *European Financial Reporting Advisory Group (EFRAG)* and *Standards Advice Review Group (SARG)*.

EFRAG (established 2001) is a private sector expert body which examines the proposed IASs and advises the European Commission (‘*endorsement advice*’) as to whether they are in conformity with the substantive requirements set out in art. 3(2) of the ‘*foundational*’ IAS regulations. The European Commission merely has observer status in EFRAG.

SARG (established 2006) is a body set up by the European Commission itself in order to examine whether EFRAG’s endorsement advice is well balanced and neutral. It thus acts as an ‘*examiner’s examiner*’.

(3) The crucial ‘*foundational*’ regulation No. 1606/2002 delegates – pursuant to the former art. 202 TEU – the power to adopt IASs as Community law to the European Commission. It also prescribes that the comitology procedure (in the form of the regulatory procedure) be used by the European Commission in doing so and that adopted IASs be published as Community regulations.

²¹³ See flow chart “Legislative procedure regarding implementing IAS regulations (‘Modified regulatory procedure’)” (Figure 2.3) supra in Chapter 2.2.2.2.2.

(a) The ‘foundational’ IAS regulation (art. 2) defines “*IAS*” as the collective term for all IASs, IFRSs, SIC Interpretations and IFRIC Interpretations.

(b) It makes it *mandatory* for all publicly traded companies of EU member states to present their consolidated financial statements in conformity with endorsed IASs (art. 4).

(c) Furthermore, it leaves to the discretion of the member states whether to legislate on a national level that publicly traded companies present their separate financial statements and that non-publicly traded companies present their separate and consolidated financial statements in conformity with endorsed IASs (art. 5).

(d) Crucially, it lists *three substantive requirements (art. 3(2))*, all of which have to be met by an IAS, before it can be endorsed. These are: that an IAS has to conform with the ‘*true and fair view*’ principle as set out in the 4th and 7th Council Directives; that an IAS has to be conducive to “*the European public good*”; and that an IAS has to meet the four principal qualitative characteristics of *understandability, relevance, reliability and comparability*.

(e) According to majority academic opinion, however, some isolated provisions of IASs (*paras 54 et seq. of IFRS 3 (as issued in 2004) and par 18(b) of IAS 32 (as amended in 2003)*) have been endorsed, despite the fact that they *infringe upon the ‘true and fair view’ principle* set out in art. 3(2). These provisions are thus voidable. It is most likely that these were mere draftsman’s oversights.

(4) The ‘*implementing*’ IAS regulation of the European Commission is the legislative instrument which actually adopts IASs into Community law.

(a) Regulation No. 1725/2003 of 29 September 2003 adopted *en bloc* all IASs that were extant at 14 September 2002, except for IAS 32 and IAS 39. This regulation was subsequently amended several times to incorporate newly endorsed IASs or amendments to endorsed IASs. Finally, in 2008, for the sake of simplification, it was repealed and all IASs endorsed thus far were consolidated into a single regulation (No. 1126/2008 of 3 November 2008).

(b) *IAS 32* and *IAS 39* were only finally fully endorsed in 2005, after the IASB made changes to them. These changes, in essence, accommodated the European Commission's requests to the IASB.

(c) The legal effect of 'implementing' regulations is to incorporate IASs into Community law: the exact text of the respective IASs as appended to those regulations thus becomes law. 'Implementing' regulations are neither dated references nor undated references (*dynamische Verweisungen*).

(d) The European Commission's stated objective is to endorse a single set of global accounting standards rather than merely a set of "EU-IASs". Were the European Commission to exclude some of the IASB's IASs from endorsement, that objective would be compromised. Several voices within the continental-legal academic community have thus suspected that the European Commission's 'implementing' regulations *de facto* simply rubberstamp any IAS and any IAS amendment which the IASB issues (and that these are thus 'de facto undated references'). While there is some force in this argument, this suspicion seems on the whole to be unfounded.

(5) Thus far, the European Commission has endorsed all of the IASB's IASs. Usually, a time-lag of between 9 months and 15 months occurs between the date at which the IASB issues its IAS and the date the endorsement process is complete. The overly long endorsement histories of *IAS 32* and *IAS 39* were exceptional.

(a) As regards the contents of the various IASs, the *Introductions (IN)* as well as the *Bases for Conclusion (BC)* were not endorsed.

(b) *Application guidelines (AG)* as well as *Definitions* in IAS appendices were endorsed if IASs declared them to be an 'integral part of the IAS'. In contrast, *Guidance on Implementing (IG)* as well as *Illustrating Examples (IE)* were not endorsed, since the respective IASs themselves declare them 'accompanying, but not being part of, the IAS'. Anything not endorsed has no legal force in the EU and remains the non-binding opinion of a private expert body.

(c) Neither the *Preface* nor the *Framework* nor the *Conceptual Framework* was endorsed. All of them are thus non-binding; none of them is law. With regard to the Framework, legal issues might arise since several provisions of endorsed IASs contain references to the Framework.

2.3 Comparison

(1) As regards *standard-setting (the enactment of standards)*, many of the institutional differences between South Africa and the EU arise from the EU's intertwined institutional structure, which does not conform to any rigid separation of powers principle.

(2) In both South Africa and the EU, standards will be enacted in the form of *delegated legislation (regulations)*.

South Africa follows a straightforward procedure of enabling national legislation (s 29(4) of the new Companies Act), followed by implementing delegated legislation (ministerial regulations) which adopt IASs into national law.

The EU's primary law contains an enabling provision for the delegation of implementing powers to the European Commission (being the EU's primary executive institution): Article 202 of the former TEU empowered the Council (being the EU's primary legislative institution) to do so. Articles 289, 290 consTFEU have changed this by jointly empowering the Council and the European Parliament (being the EU's other legislative institution) to do so.

(a) The Council, jointly with the European Parliament, delegated these powers by virtue of Regulation No. 1606/2002 (the 'foundational' IAS regulation). Based on this 'foundational' IAS regulation, the European Commission subsequently implemented delegated legislation ('implementing' IAS regulations, in particular Regulation No. 1725/2003), which adopted IASs into Community law. The Council is hardly comparable with the South African Council of

Provinces; it has significantly more powers than South Africa's Council and it is still the legislative heavyweight in comparison with the European Parliament. The situation is the reverse in South Africa.

(b) As a result of the traditional, inter-institutional distrust between the Council and the European Commission, the Council devised the 'comitology procedure' (also referred to as 'committee procedure'). This procedure institutionally constrains the power delegated to the European Commission. It subjects the European Commission's implementing legislation to the prior approval by a committee (the Accounting Regulatory Committee) which consists of members inclined to the Council. There is no comparative control mechanism in South Africa.

(c) Furthermore, at least when the 'regulatory procedure with scrutiny' is applied, the European Parliament has a veto right during the enactment process of delegated legislation. The South African Parliament has no comparative power in general.

(3) The EU endorsement process with its 'comitology procedure' is not a *swift* mechanism. It may take around one year after an IAS has been issued by the IASB before it is finally adopted into Community law. By design, South Africa's procedure is more streamlined and thus, it is submitted, quicker in adopting IASs.

(4) There is a risk in South Africa and in the EU that the IASB's IASs would simply be *rubberstamped* (copied and pasted) by either the Minister of Trade and Industry and the European Commission, respectively. This could happen because of the concern that adopted IASs might otherwise differ too much from IASB's IASs and thus will merely turn into another set of national South African and EU standards, rather than being a set of global standards. There is some basis for this concern:

(a) Both South African and EU legislation allows for the adapting of IASs before they are adopted.

On the one hand, the limits set for the South African Minister (s 29(5)(b) of the new Companies Act) that standards for public companies must be “in accordance with” IFRSs seem narrower than the ones set for the European Commission. The European Commission, in its discretion, can decide to adopt EU-IASs which are not in accordance with with IFRSs, or could decide not to adopt a new IFRS at all.

On the other hand, the three substantive requirements set by art. 3(2) of the ‘foundational’ IAS regulation which a new IAS has to meet before the European Commission may adopt it (‘the true and fair view’ as set out in the 4th and 7th Council Directives; ‘the European public good’; and the four qualitative characteristics of ‘understandability, relevance, reliability and comparability’) pose a clear constraint on discretion at adoption. The South African Minister is not bound by similar explicit legislative constraints. The European Commission has, thus far, on occasion delayed the adoption of an IAS with reference to art. 3(2) of the ‘foundational’ IAS regulation.

On rare occasions the European Commission has enacted parts of IASs (paras 54 *et seq.* of IFRS 3 as issued in 2004 and par 18(b) of IAS 32 as revised in 2003) which infringe upon art. 3(2) of the ‘foundational’ IAS regulation. This is unfortunate. These parts of IASs are thus according to the ECJ’s point of view, voidable. If challenged before the ECJ, they will in all probability be declared void. This would cause a gap (*lacuna*) in the system of European IASs.

Thus far, in South Africa no significant academic or judicial opinion has been put forward on the issue as to whether parts of IASs adopted in South Africa are voidable or void.

(b) South Africa’s institutional influence on the IASB and the IASB’s drafting process is naturally smaller than the EU’s. Thus far, South Africa’s primary influence seems personalised: its trump is a South African national (Robert P Garnett) who was a member of the IASB from 2001 to 2010 and is now (until 2012) the chairman of the IFRS Interpretations Committee. There is no institutional influence on the IASB other than that the APB is one of the 50 members of the IFRS Advisory Council.

The EU, astonishingly, has not been represented on the IASB's board thus far. Nevertheless, it has observer status in both the IFRS Interpretations Committee and the IFRS Advisory Council, and it is a member of the newly established Monitoring Board.

(c) The South African Financial Reporting Standards Council (*FRSC*) on the one hand, and the *European Financial Reporting Advisory Group (EFRAG)*, the *Standards Advice Review Group (SARG)*, and the Accounting Regulatory Committee (*ARC*) on the other hand bear only a superficial resemblance.

(aa) The FRSC and *EFRAG/SARG* are both mere advisory forums for the executive institution in charge of adopting the IASB's IAS (Minister of Trade and Industry and European Commission, respectively). Their advice is non-binding.

EFRAG is a private sector body, while the FRSC and SARG are not. Their members, in contrast to EFRAG's, are appointed by the Minister and the European Commission respectively.

The FRSC has been assigned a drafting role; EFRAG and SARG have not. EFRAG is simply to comment on whether the IASB's IASs comply with the requirements of art. 3(2) of the 'foundational' IAS regulation, while SARG is to comment on whether EFRAG's comment is well balanced.

(bb) The FRSC and the *ARC* have entirely different functions: The *ARC* is the Council's of Ministers) agent; its existence is rooted in the EU's inter-institutional tensions and its function is to represent the member states' interests during the procedure of enacting IASs. In contrast, the FRSC is certainly not the agent of the Council of Provinces. The FRSC creates drafts, while the *ARC* receives the European Commission's drafts and approves or disapproves them. While this does not exclude amendment requests by the *ARC*, drafting is nevertheless not its primary function.

(5) The *contents of the IASs* adopted by South Africa and the EU differ in some respects.

(a) Thus far, in terms of SAICA's Circular 08/05, all IFRSs (as defined in par 7 of IAS 1) issued by the APB as Statements of GAAP are exact *replicas* of the relevant IFRSs, except for some

effective dates. This means that all components of IFRSs (Introductions, Guidance on Implementing, Illustrative Examples, Application Guidelines and Bases for Conclusions) bear the same relevance as assigned to them by the IASB. Therefore, for instance, Application Guidelines and Definitions are, as a rule, referred to in IFRSs as being an ‘integral part of the IFRS’, while Illustrative Examples and Bases for Conclusions are, as a rule, referred to in IFRSs as ‘accompany[ing], but not [being] part of, the IFRS.’

When IFRSs received legal backing in s 1 (definition of “financial reporting standards”) and s 285A of the old Companies Act on 14 December 2007, this order of relevance was replicated. Therefore, accordingly, in line with what is stated by each IFRS (as defined in par 7 of IAS 1), each IFRS had to be “read in the context of its objective and the Basis for Conclusions, the Preface ... and the Framework ...” Since 1 May 2011, however, this legal backing has, for the time being, disappeared.

The situation is different in the EU: only those parts of IASs (as defined in art. 2 of the ‘foundational’ IAS regulation) that have been explicitly endorsed (by virtue of an annex to the ‘implementing’ regulation) have been adopted into Community law. All other parts (including the Preface) are merely the opinions of a private standard-setter. The EU-IASs are therefore not merely replicas of the IASB’s IASs. Introductions, Bases for Conclusions, Illustrative Examples and Guidance on Implementing thus have a different significance as aids to the interpretation of IASs in the EU, and IFRSs in South Africa.

(b) The IASB’s *Framework* had not been endorsed in the EU. In contrast, in South Africa a verbatim copy of the IASB’s Framework had been approved and issued by the Accounting Practices Board. The Framework stated that it is itself not an IAS.

In South Africa the Framework became an FRS on 14 December 2007 in the same way as the IFRSs (as defined in par 7 of IAS 1) adopted by the APB as Statement of GAAP prior to 14 December 2007 did. It therefore had a higher interpretational and reference value in South Africa than in the EU. This situation changed on 1 May 2011, however, when the Framework ceased to be an FRS.

References in IASs to the Framework/Conceptual Framework may raise legal issues in the EU. To overcome this, an endorsement of the Conceptual Framework is recommended.

3. Statutory duty to comply with financial reporting standards

Both in South Africa as well as in the EU, companies have a statutory duty to comply with financial reporting standards.

3.1 South Africa

In South Africa, such a duty has long been regarded as essential and overdue. It is true that the former s 286(3) of the old Companies Act established a statutory duty to comply with generally accepted accounting practice (“in conformity with generally accepted accounting practice”). What exactly this term meant however, was not clear for some time. In 1999 SAICA introduced the distinction between ‘GAAP’ and ‘gaap’ in the former Circular 08/99²¹⁴ (par 7): ‘*Statements of GAAP*’ were defined as those described in, or based on, internationally accepted standards and issued (Circular 08/99 spoke of “codified”) by the Accounting Practices Board, while *generally accepted accounting practice* (‘gaap’) was defined as accounting practices that have become generally accepted due to their being followed by a number of companies, without being described in standards.

In SAICA’s opinion, compliance with ‘GAAP’ ensured that the requirements of ‘gaap’ in terms of the Companies Act had been met and complied with. It also ensured that the financial statements fairly presented the company’s financial position. In contrast, compliance with ‘gaap’ would not necessarily do so (par 7 of Circular 08/99): Provided it achieved fair presentation, compliance with ‘gaap’ was considered the bare minimum required to comply with the former s 286(3) of the old Companies Act. Nevertheless, Circular 08/99 made it clear that merely

²¹⁴ Circular 08/99 (issued December 1999; withdrawn) “Compliance with section 286(3) and paragraph 5 of Schedule 4 of the Companies Act, 61 of 1973, and Statements of Generally Accepted Accounting Practice”. The issue is restated in Circular 08/05 (issued August 2005) “Status of professional pronouncements” (paras 2-8).

applying ‘gaap’ would always lead to the auditor modifying his report (see paras 28-40 and Appendix 1 to Circular 08/99).

Circular 08/99 and its opinion on ‘gaap’ was unfortunate and caused uncertainty, since using ‘gaap’ did not give users of financial statements any assurance that financial statements did indeed fairly present the affairs of the company. Furthermore, as Delpont *et al.* (2008:550 and 2008:560(1)) pointed out, the existence of unpromulgated ‘gaap’ as a basis of accounting may have resulted in the adoption of unsound accounting practices.

The CLAA ended this undesirable situation by inserting s 285A and deleting s 286(3). Effective as of 14 December 2007 (the date on which the CLAA came into operation) a statutory duty to comply with FRSs (s 285A(1)(a),(2)(a)) and to clearly state compliance in financial statements (s 285A(3)(b),(c)) was introduced into the old Companies Act by the CLAA.

This duty referred to any financial statements (not only annual financial statements) and was imposed upon widely held companies (s 285A(1)(a)) and limited interest companies (s 285A(2)(a)); the latter, however, had to comply with accounting standards for limited interest companies under s 440S(1)(b).

The new Companies Act reintroduces in s 29(1)(a) a statutory duty corresponding to s 285A: any financial statement must satisfy FRSs, if such standards are prescribed. Again, this duty is imposed upon the company (s 29(1): “a company”; s 30(1) regarding annual financial statements: “a company”).

Furthermore, both the old and the new Companies Act put the responsibility on the board²¹⁵ to ensure that the company issues compliant financial statements (s 286, read with s 285A of the old Companies Act; s 66(1), read with s 29(1)(a) of the new Companies Act). Section 286, read with s 285A appears to limit this duty to annual financial statements. As emanates from s 287, however, it applies to any financial statements which the directors have had the company issue. Under both Acts, non-compliance could lead to personal liability of individual directors (s 286(4)(a) of the old Companies Act, and s 77(2)(b)(ii) of the new Companies Act).

²¹⁵ The old Companies Act speaks of “[t]he directors” (s 286(1)), while the new Companies Act speaks of the “board” (s 66(1)).

It is noteworthy that, under the old Companies Act, what has to be complied with in terms of s 285A are the IFRSs as “adopted by the Accounting Practices Board prior to the establishment of the [Financial Reporting Standards] Council” (s 1, statutory definition of “financial reporting standards”). Nevertheless, it is not adoption by the APB that made them legislation (law).²¹⁶

The legal situation was thus that national legislation (s 285A) referred to, among other things, standards of a private standard-setter (the IASB) adopted and issued by a body (the APB) that did not have legislative powers (powers to make delegated legislation). Nevertheless, this was not an issue as the statutory definition of ‘financial reporting standards’ in s 1 of the old Companies Act included all IFRSs adopted by the APB only up to the 14 December 2007. The reference in s 285A was thus not undated (*dynamisch*), but dated (*statisch*).²¹⁷ Dated references (*statische Verweisungen*) – in contrast to undated references (*dynamische Verweisungen*) – are uncontroversial.

Section 29 of the new Companies Act evades this issue entirely: FRSs will be legal norms (regulations). Presumably, the Minister will summarily enact, in the form of a regulation, all IFRSs adopted thus far by the APB. Therefore in future national legislation (s 29 of the new Companies Act) will refer to delegated legislation (regulations) only. The issue of *statische* or *dynamische Verweisungen* (dated or undated references) will thus no longer arise.

3.2 European Union

By virtue of art. 4 of the ‘foundational’ IAS regulation (No. 1606/2002), a statutory duty came into effect to comply with those IASs which have been adopted into Community law.

²¹⁶ See supra Chapter 2.1.1.2.

²¹⁷ See supra Chapter 2.2.2.2.3 and Chapter 2.2.2.2.4.

This duty is only imposed upon publicly traded companies which are governed by the law of EU member states and it only refers to consolidated financial statements. Member states are empowered, however, to extend this duty to non-publicly traded companies and to separate financial statements by virtue of national legislation.²¹⁸

There is no mention in Regulation No. 1606/2002 as to whether the directors are personally charged with ensuring that the company issues compliant financial statements. This matter is thus left to national legislation.

Art. 4 of the 'foundational' IAS regulation is not an undated reference (*dynamische Verweisung*).

²¹⁸ See supra Chapter 2.2.2.1.

4. Administrative action and enforcement in cases of non-compliance with financial reporting standards

4.1 South Africa

Disputes about non-compliance with FRSs may typically arise in the following two scenarios.

Firstly, in the course of his audit the external auditor might detect non-compliance and will thus require the directors to rectify their company's annual financial statements in order to avoid qualifying his report. The directors might insist that the statements are compliant with FRSs and now complain to the Commission in order to prevent facing the adverse publicity of a qualified report.

It is unlikely that the external auditor himself will complain to the Commission, although in theory he could (s 168(1): "alleging that a person has acted in a manner inconsistent with this Act ..."). Instead, he will typically simply qualify his report and leave the matter at that.

Secondly, it can be that while preparing (annual) financial statements the directors are made aware, by their in-house lawyers or their internal auditors, that a certain regulation prescribing an FRS (s 29(4)(a),(5), read with s 223(1)(a),(2)-(4)) has been incorrectly enacted (*e.g.* has not been issued by notice in the *Gazette*). The company now wants to challenge the faulty FRS itself. Under this scenario it can do so in two different ways: either in terms of the administrative law (PAJA) on the assumption that delegated legislation is administrative action,²¹⁹ or in terms of ss 170, 172(1)(a) of the Constitution (direct constitutional challenge),²²⁰ since delegated legislation is 'law' in terms of s 172(1)(a).

²¹⁹ See *supra* Chapter 2.1.4.2.

²²⁰ See *infra* Chapter 5.1.2.

4.1.1 Is the Promotion of Administrative Justice Act applicable alongside the administrative-law provisions of the new Companies Act (Chapter 7: ‘Remedies and enforcement’)?

As has been shown earlier,²²¹ both the FRSC and the Commission, the Tribunal and the Minister are organs of state. Further, except when dealing with one another (*e.g.* the FRSC submits FRSS to the Minister; the Minister issues policy directives to the Commission),²²² they perform administrative actions.²²³ The PAJA is thus applicable.

The PAJA is legislation of a general and ‘universal’ kind (*Sasol Oil (Pty) Ltd v Metcalfe NO 2004 (5) SA 161 (W) 166C*); it governs general administrative law and gives effect to s 33 of the Constitution (‘the administrative justice clause’). It prescribes the minimum requirements for administrative legality and procedure, and stipulates on what grounds administrative action may be reviewed by the courts (Burns & Beukes, 2006:41). It binds the entire administration in respect of all administrative actions.

How, then, do the PAJA and the administrative-law provisions of the Companies Acts impact on each other? Three approaches to this issue come to mind:

One approach is to apply the rule *lex posterior derogat legi priori*: subsequent legislation (such as the new Companies Act) revokes earlier legislation (such as the PAJA, which was already enacted in 2000) to the extent that they are inconsistent, provided both statutes are *in pari*

²²¹ See supra Chapter 2.1.1.5, Chapter 2.1.3.4 and Chapter 2.1.4.2.

²²² The issue as to whether the *appointment/removal* of members of those bodies (ss 440Q, 440V(2), 440X, 440AA(4)(a) of the old Companies Act; ss 189, 193(4), 194, 203(2)(b),(3), 207(3), 209 of the new Companies Act) constitutes administrative action as well is controversial: For instance, Burns and Beukes (2006:38) consider it administrative action, whereas Pfaff (2002:75) follows – in line with German administrative law – a more cautious and differentiating approach. Details are beyond the scope of this thesis.

²²³ See supra Chapter 2.1.1.5, Chapter 2.1.3.4 and Chapter 2.1.4.2.

materia (i.e. deal with the same subject-matter). As Du Plessis (2002:73) points out, however, this rule is to be applied only with caution, both because of the interpretative presumption against alteration and abrogation of the existing law and because of the *lex specialis* rule.

Another approach is to apply the *lex specialis* rule (*lex specialis derogat legi generali*): The provisions of the administrative company law contain specialised administrative law (*lex specialis*), while the PAJA contains general administrative law (*lex generalis*). According to the *lex specialis* rule, the administrative-law provisions of the Companies Act prevail over the PAJA to the extent that they regulate a particular legal issue. To the extent that they do not regulate a matter, the 'default' provisions of the PAJA continue to apply. The rule, however, has one important exception: it does not apply if the general law (*lex generalis*) is intended to regulate the subject-matter exhaustively. According to Devenish (2005:75) and Currie (2007:5), this is exactly the case with the PAJA: it is intended to deal exhaustively with the performance of administrative action. The PAJA's provisions thus prevail over the administrative-law provisions of the Companies Act in the event of inconsistencies between the two.

A third approach has come to be known as the assumption of the PAJA's 'formal supremacy' over other national legislation (*MEC for Agriculture, Conservation, Environment and Land Affairs v Sasol Oil (Pty) Ltd 2006 (5) SA 483 (SCA) par 28; Sasol Oil (Pty) Ltd v Medcalfe NO 2004 (5) SA 161 (W) 166C*). This is a rather novel idea: the enactment of the PAJA was mandated by the Constitution (Item 23 of Schedule 6 to the Constitution), while the enactment of the administrative-law provisions of the Companies Act was not. The PAJA is thus 'constitutional legislation' aimed at giving effect to the constitutional right to just administrative action (s 33 of the Constitution), while the Companies Act is not. This constitutional status of the PAJA prevents the PAJA's provisions from simply being superseded by the administrative-law provisions of the Companies Act. However, his approach overlooks the fact that the Constitution, while mandating the enactment of certain legislation such as the PAJA, does not mention or suggest any higher ranking of such legislation over other national legislation such as the Companies Act.

Section 5(4) of the new Companies Act roundly rejects the *lex specialis* rule and follows the exception to this rule: as per s 5(4)(a), both the PAJA and the new Companies Act apply

concurrently (provided the PAJA is applicable). In the event of an irreconcilable ‘inconsistency’ (conflict) between a provision of the PAJA and one of the Companies Act, it is, however, the PAJA’s provision and not that of the Companies Act which prevails (s 5(4)(b)(dd)).

One area of conflict between the PAJA and the new Companies Act concerns the statutory time limit for instituting judicial review proceedings: section 7(1) of the PAJA allows up to 180 days, and this time period may even be extended (s 9(1)(b) of the PAJA), but not shortened. As emanates from s 6(1) of the PAJA, read with the statutory definition of “tribunal” in s 1 of the PAJA, the term “judicial review” includes reviews by an adjudicative body like the Companies Tribunal (s 172(4) of the new Companies Act). Section 172(1)(a) of the new Companies Act, however, allows only 15 business days for making a review application.

In terms of s 5(4)(b)(dd) of the new Companies Act, an applicant would thus have a full 180 days to submit his review application to the Companies Tribunal, and a designated magistrates’ court would subsequently be competent to review the Companies Tribunal’s review decision. Is this practical?

If one assumes that the PAJA sets minimum standards of procedural fairness, then no stricter requirements should be allowed as they may be unconstitutional in terms of s 33 of the Constitution. However, it is probably impossible to set a single time limit (limitation clause) that will be appropriate for all situations. Given that annual financial statements have to be published within six months after the end of the financial year (s 30(1) of the new Companies Act – it was previously nine months in terms of s 286(1), read with s 179(1)(b)(ii) of the old Companies Act), allowing 180 days to lodge an objection to a received compliance notice seems exorbitant. For practical reasons and in order to ensure a speedy resolution, the 15 business-day period of s 172(1)(a) of the new Companies Act should prevail over the 180-day period set out in s 7(1) of the PAJA, despite the statutory priorities set out in s 5(4)(b)(dd) of the new Companies Act. This view is broadly in line with the recent decision of *Rustenburg Platinum Mines (Rustenburg Section) v CCMA (2007 (1) SA 576 (SCA) par 27*). In this case, the court was confronted with a similar disparity between the six-week period provided for the review of arbitration awards in s 145(1) of the Labour Relations Act No. 66 of 1995 and the 180-day period of s 7(1) of the PAJA. Cameron JA noted that

“labour disputes require speedy resolution, and the Legislature gave clear effect to this special imperative in s 145(1) by requiring a labour disputant to act quickly. The Constitution does not require that the legislation enacted to give effect to the right to administrative justice [i.e. the PAJA] must embody any particular time periods. This is therefore a question on which the Legislature may be expected to legislate differently in different fields, taking into account particular needs.”

By comparative reasoning, Cameron JA’s *obiter dictum* can be applied to the disparity between s 172(1)(a) of the new Companies Act and s 7(1) of the PAJA. Complaint disputes before the Commission, like labour disputes, need speedy resolution, and s 7(1) of the new Companies Act clearly implies this need by setting out an “effective environment for the efficient regulation of companies” as one of the basic purposes of new Companies Act.

4.1.2 Investigation and subsequent enforcement

Investigation by the Financial Reporting Investigation Panel (ss 440AA-440FF of the old Companies Act) and the Commission (ss 169 *et seq.* of the new Companies Act) are the principal administrative actions that will follow a suspected or alleged non-compliance by the company with FRSs.

4.1.2.1 Investigation under the old Companies Act (ss 440AA-440FF)

4.1.2.1.1 The Financial Reporting Investigation Panel (‘FRIP’) and the ‘nominated officer’

Under the old Companies Act the body charged with investigations was the Financial Reporting Investigation Panel (henceforth “the FRIP”), s 440W(2). The FRIP had replaced, in 2011, the JSE’s earlier GAAP Monitoring panel. Like the Commission, the FRIP was a statutorily established juristic person (s 440W: “body corporate”) and an organ of state. The FRIP was to consist of 19 members (including an executive officer (s 440W(3)(a)) and a chairman (s 440X(2)(c)). They were classified into five different groups (s 440W(3)). Section 440X laid down provisions for their appointment and removal. Decisions of the FRIP were to be taken by a simple majority, provided at least two thirds of the members of the FRIP were present (s 440Z(3)). Both s 440W(3) and s 440X mirrored s 440P(3) and s 440Q, which were applied to the FRSC. Further, as was the case with the FRSC, the concept of “interested persons” was laid down in s 440Y.

Any (natural or juristic) person would have been able to bring a complaint of alleged non-compliance with FRSs before the FRIP (s 440AA(1)). In addition, the Minister was to appoint a “nominated officer” as a watchdog (s 440V(2)). Section 440V actually referred to “a suitably qualified officer”. As emanated from s 440O, this was to be the “nominated officer”.

The nominated officer’s monitoring was to be limited to companies on the specified watch list (440V(1)). Due to the words “[a]ny person” in s 440AA(1) Delpont *et al.* (1998:998(6)), however, submitted, that the nominated officer could also have acted under s 440AA with regard to companies not monitored under s 440V.

Allegations initially would have had to be brought before the executive officer of the FRIP (s 440AA(1)), who would have had to assess within five business days whether the matter warrants investigation and, if so, would have had to recommend investigation to the chairman of the FRIP (s 440AA(3)). In turn, the chairman would have had to appoint an investigation committee within seven business days and notify the company that is being investigated (s 440AA(4)).

4.1.2.1.2 The investigation committee and its powers

The investigation committee would have had no separate legal personality. It was to consist of at least three members of the FRIP (s 440AA(6)). The Act was silent on the investigation committee's decision-making. Delpont *et al.* (1998:998(6)) assumed that the committee was to decide by consensus. It is submitted that this issue were to be set out in the investigation committee's procedures as determined by the FRIP (s 440Z(1)(b)).

The investigation committee was charged with investigating the complaint (s 440AA(7)(b)). The Act did not describe the investigation committee as a standing committee. Instead it appeared that a committee was to be appointed *ad hoc* for each investigation. The investigation committee was to deliver its report on whether there was a failure to comply with FRSs to the FRIP within 18 business days after the beginning of its investigation (s 440AA(7)(e)). Dissenting opinions of the committee members were to be disclosed in its report (s 440AA(9)).

The investigation committee's powers were listed in s 440BB. They were wide and included the right to summon a person before the committee. Delpont *et al.* (1998:998(7)) submitted that the exercise of these powers by the investigation committee was subject to review by the court.

As previously mentioned, the Act foresaw that the committee's investigative procedures had to be determined by the FRIP (s 440Z(1)(b)). Furthermore, s 440Z(2) explicitly stated that these procedures had to be in accordance with the PAJA. Section 440Z(2) thus made the 'principles of procedural fairness' (as set out in the PAJA) applicable to preliminary administrative investigations. These 'principles of procedural fairness' are known at common law as the "rules (or principles) of natural justice" (Hoexter, 2007:325). They are aimed at ensuring a minimum standard for fair administrative enquiries (Burns & Beukes, 2006:51 and 213; Burns, 2003:88) and essentially require a fair hearing by an impartial decision-maker (Hoexter, 2007:326). This ideal is reflected in the two ancient common-law principles *audi et alteram partem* and *nemo iudex in sua causa*. According to the *audi [et] alteram partem* principle, the decision-maker must hear the other party, meaning that the persons affected by his decision should be given a fair hearing by the decision-maker prior to the making of the decision. The *nemo iudex in sua causa* principle, referred to as 'the rule against bias', then states that the decision must be, and must reasonably be perceived to be, impartial.

Before the advent of constitutionalism in South Africa, it was a disputed issue whether the ‘principles of procedural fairness’ apply to preliminary administrative investigations as well: the courts were rather disinclined to allow the rules of natural justice to be applied to administrative investigations reasoning that no rights had yet been affected by the mere investigative action (Hoexter, 2007:392). Botha JA’s questionable majority decision in *SA Defence and Aid Fund v Minister of Justice (1967 (1) SA 263 (A))* illustrates this. In contrast, Trollip JA’s sensible dissenting opinion in that decision correctly points out that an administrative enquiry is not conducted “in vacuo as a fishing expedition” (1967 (1) SA 285).

Since the advent of constitutionalism the courts’ attitude has changed (see *Du Preez v TRC 1997 (3) SA 204 (A)* and *Director: Mineral Development, Gauteng Region v Save the Vaal Environment 1999 (2) SA 709 (SCA)*) and the principles of procedural fairness seem now also to be applicable to administrative enquiries (De Ville, 2003:242; Hoexter, 2007:396). The decision in *Oosthuizen’s Transport v MEC, Road Traffic Matters 2008 (2) SA 570 (T)* confirms this.²²⁴ Section 440(Z)(2) merely codified this new approach.

Within five business days of receiving the investigation committee’s report, the executive officer would have had to send it to the investigated company (s 440EE(1)). The company would in turn then have had a period of seven business days to respond to the investigation committee, which could then subsequently have amended its report and, if it had done so, would have had to re-submit it to the executive officer within 14 business days (s 440EE(2), (3)). After that, the executive officer would have had to submit (the Act spoke of “publish”) the report within two business days to the Registrar and any exchange on which the company is listed (s 440EE(4)(a)). Delpont *et al.* (2008:998(8)) observed that the company would therefore not have been involved in the initial investigation and consequently that any explanation by the company would have been considered by the investigation committee only after the conclusion of its initial investigation. This was consistent with the requirements of the PAJA. Section 3(2)(b)(ii) of the PAJA (‘Procedurally fair administration affecting a person’) only requires “a reasonable opportunity to make representations”. It does not provide for a right to make representations

²²⁴ See supra Chapter 2.1.3.4.

already at the beginning or at an early stage of the investigation. An opportunity to make representations must therefore only be given before the end of the investigation, which would have been the date of the re-submission of the report by the investigation committee to the executive officer in terms of s 440EE(3).

In contrast to the time periods set by s 440AA(3),(4) and (7), which could be extended in terms of s 440AA(10), no provision was made for the extension of s 440EE.

4.1.2.1.3 The outcome of an investigation and its legal consequences

Section 440FF set out the legal consequences where a financial report failed to comply with FRSS. Both the company and every director who was party to the preparation of the non-compliant financial report was guilty of a criminal offence (s 440FF(1)). To avoid mandatory handover to the National Prosecution Authority and possible prosecution (s 440FF(4): “must”), s 440FF offered the offenders alternative courses of action, provided the company could reach an agreement with the Minister (s 440FF(2)): to pay a penalty (*i.e.* to suffer a mere administrative sanction), to revise and republish its financial report, to take other remedial action or to carry out any combination of these actions.

From the wording of s 440FF(2) “[a] company under investigation” it seemed to follow that such an agreement could only have been reached up until the final conclusion of the investigation, *i.e.* up until the publication of the report (s 440EE(4)).

Further, Delpont *et al.* (2008:998(9)) concluded from the wording of s 440FF(5) that the two processes ‘prosecution’ and ‘administrative action’ could run concurrently. However, if the company performed “substantially” in terms of its agreement (s 440FF(2)) with the Minister, the court would not have been able to convict the company or its directors. Delpont *et al.* also pointed out that it was not clear from s 440FF(5) whether the administrative sanctions could proceed if a court found someone not guilty.

If no agreement had been reached between the company and the Minister or if the company failed to honour an agreement “substantially”, the Minister had to hand the matter over to the National Prosecution Authority for possible prosecution (s 440FF(4)).

An agreement between the Minister and the investigated company in terms of s 440FF(2) would have determined the company’s duties arising as a consequence of its non-compliance with FRSs. In terms of Floyd’s (1994:419) classification, this would have been a form of an ‘administrative agreement’ (*owerheidsooreenkoms*).

An administrative agreement is not identical to a private-law contract. While both require consensus between the parties, the distinction between the two is that the administrative agreement contains an element of authoritative power, while the private-law contract is based on equality between the parties (Burns & Beukes, 2006:168). Both Floyd (1994:285) and Burns and Beukes (2006:172 and 178) point out that South African courts have just begun to recognise administrative agreements but have not, as yet, given full recognition to them (in contrast to countries such as Germany). Quinot (2007:457) – whose analysis however focuses on ‘state commercial activity’ (such as tender contracts or sales contracts) rather than administrative agreements in terms of s 440FF(2) – notes that no law of administrative agreements has been developed in South Africa and that the application of private law and public law to these agreements is not clear.²²⁵

²²⁵ Quinot (2007:67 and 123) identifies a ‘classification approach’ as the current judicial approach to agreements between the state and a private person (in the area of state commercial activity): the agreement is classified either as private in nature (and thus subject to the law of contract) or as public in nature (and thus subject to administrative law). As the two most prominent criteria used to classify, Quinot identifies (2007:124 and 243) ‘the source of the power exercised’ and ‘the presence of superior and/or state power in concluding the transaction’. Quinot criticises (2007:482) as inadequate the rather novel ‘framing approach’ (as enunciated by Cameron JA in *Logbro Properties CC v Bedderson NO (2003 (2) SA 460 (SCA) paras 7-8*) with regard to public tenders, according to which public law rules are simply superimposed on contract law rules governing the commercial activity); he also opposes the idea of developing a distinct branch of government contract law arguing that such an approach “remains overly reliant on conceptual reasoning, which is a fundamental stumbling block in most ... of the existing approaches” (2007:483). Rather, he favours – again, referring to state commercial activity – a ‘fluid continuum approach’ (2007:483) which perceives “the basic legal concepts of contract and administrative action at either end with state commercial activity in between, but the criteria that dictate the particular action’s position on that continuum can themselves be viewed in a fluid manner between the extremes of private and public.”

In order to be valid, an administrative agreement has to satisfy the following requirements. Firstly, there has to be an empowering statutory provision (such as s 440FF(2)) and the agreement has to comply with it. According to Burns and Beukes (2006:172), this implies that the agreement must not be prohibited by statutory law, that it must not promote an unauthorised purpose (as regards s 440FF(2), the authorised purpose would have been to achieve compliance with FRSSs), that it must not conflict with the enabling provision, that it must not impose coercive duties on third parties in the absence of statutory authority, and that it must not fetter the discretion of the authoritative body. All of these requirements would have been satisfied by an agreement in terms of s 440FF(2).

Secondly, the administrative agreement has to be concluded in the public interest and has to serve a public purpose. As regards s 440FF(2), achieving the company's compliance with FRSSs would have been in the public interest.

Thirdly, according to Burns and Beukes (2006:172), the rules of procedural fairness ('the principles of natural justice')²²⁶ have to be met. In theory, this requirement seems superfluous when it comes to an agreement concluded in terms of s 440FF(2) as any agreement implies that the two parties presented their respective positions to each other before reaching an agreement. In practice, however, the parties may be in an unequal bargaining position and the company and directors may be coerced into an unreasonable agreement in their desire to avoid criminal prosecution.

It has been a matter of controversy among academics whether the conclusion of administrative agreements is 'administrative action' in terms of s 1 of the PAJA and whether it is thus subject to

An agreement in terms of s 440FF(2) would not have dealt with state commercial activity as analysed by Quinot. Nevertheless, it would have been an agreement between the state and a private juristic person. The degree of state power exercised and thus – to use Quinot's term – the degree of 'publicness' of the agreement – would have been much higher in cases of agreements in terms of s 440FF(2) than in cases of tender or sales contracts: the company's only route to escape unilateral administrative sanctioning by the Minister is to reach an agreement with him; the presence of superior state power is thus obvious. In terms of Quinot's continuum, an agreement in terms of s 440FF(2) would thus have been located in much closer proximity to the 'public nature' pole than to the 'private nature' pole.

²²⁶ See supra Chapter 4.1.2.1.2.

judicial review²²⁷ in terms of the PAJA. The definition of administrative action in s 1 of the PAJA does not explicitly mention administrative agreements. Burns and Beukes (2006:169) - correctly, it is submitted - submit nevertheless that this definition is broad enough to encompass administrative agreements and therefore presume (2006:173 and 178) that administrative agreements are subject to judicial review.

4.1.2.2 Investigation under the new Companies Act (ss 168-179)

Under the new Companies Act, the body charged with investigation is the Commission (s 187(2)(c)). The Commission receives or initiates complaints concerning alleged contraventions of the Companies Act (ss 187(2)(c), read with 168(1)). Procedural aspects of Commission complaints and investigations were dealt with by the Draft Companies Regulations (2010)²²⁸ and are also dealt with by the effective Companies Regulations 2011.^{229 230}

4.1.2.2.1 Can a complaint about the alleged non-compliance by a company with FRSs be brought before the Commission?

²²⁷ Regarding the judicial review of administrative action (in the form of FRSs) see in detail infra Chapter 5.1.2.1.

²²⁸ Draft regs (2010) 136 and 139-146.

²²⁹ Regulations (2011) 129 and 135-140.

²³⁰ In order to keep the main text of the thesis as uncluttered as possible, references to the Draft Companies Regulations (2010) and to the Companies Regulations 2011 appear in the footnotes, unless they contain definitions or essential extensions/specifications with respect to the provisions of the new Companies Act.

Section 187(2)(c) speaks of contraventions of the Companies Act (“this Act”). Since the term “this Act” is statutorily defined in s 1 as including regulations, s 187(2)(c) also covers contraventions of FRSs that have been enacted as regulations. A complaint that a company has not complied with FRSs can thus be lodged with, and initiated by, the Commission.

Any person, natural or juristic, can file a complaint (s 168(1)). Although it is possible to withdraw a complaint, it is left to the Commission’s discretion to continue investigation.²³¹ A complaint may also be initiated by the Commission itself on its own initiative (s 168(2)) or after it has been instructed to investigate by the Minister (s 168(3), read with s 190(2)(b)).

While s 168(2) is silent on this issue, investigations by the Commission are not solely indication-based. The Companies Regulations 2011 also provide for investigations based on sampling, but they only allow for sampling of company annual returns in terms of reg 30(5).²³²

A complaint may only be initiated by, or made to, the Commission within three years after the act that gives rise to the complaint (s 219(1)(a)), *i.e.* within three years after the publication by the company of the non-compliant financial statements.

Except when directed by the Minister to investigate (s 168(3), read with s 190(2)(b)(i)), the Commission may refuse to investigate, if the complainant does not allege facts that would constitute grounds for a remedy under the Companies Act. In this case the Commission issues a formal ‘Notice of Non-investigation’ to the complainant (s 169(1)(a)).

Any company that makes out financial statements, and not only those listed on the JSE, has to comply with FRSs (s 29(1): “a company”), if such FRSs are prescribed. However, listed companies are also subject to separate enforcement procedures under the JSE’s Listings

²³¹ Regulation (2011) 135(2),(3).

²³² In contrast, draft reg (2010) 32(5) had narrowed sampling down further and wanted to allow only for the sampling of financial accountability supplements. These would have had to be submitted by companies whose annual financial statements did not have to be audited; see draft reg (2010) 23(4), read with draft regs (2010) 32(3)(b)(ii) and 32(3)(c).

Requirements (JSE, 2010).²³³ The Draft Companies Regulations 2010 wanted to resolve conflicts between the JSE Listings Requirements and IFRSs²³⁴ in favour of the Listings Requirements (Draft reg [2010] 28(2)), while the Draft Companies Regulations 2011 gave precedence to the IFRSs provided the exchange's listing requirements required compliance with IFRSs (Draft reg [2011] 27(4)).²³⁵ The final Companies Regulations 2011 (reg 27(4)) did away with this proviso and do not mention conflict scenarios any more Regulation 27(4) simply states that listed public companies have to comply with IFRSs. Conflict scenarios between an exchange's listing requirements and provisions of the Companies Act or the Companies Regulations are now dealt with by the newly inserted (by virtue of the Companies Amendment Act) s 5(6) of the Companies Act.

4.1.2.2.2 Referral of a dispute by the Commission for alternative dispute resolution under the auspices of the Companies Tribunal (s 169(1)(b))

Upon receiving a complaint, the Commission may refer the complainant to the Companies Tribunal or an 'accredited entity'²³⁶ for possible alternative dispute resolution (s 169(1)(b), read with reg [2011] 132(2)). Section 169 is primarily concerned with investigations of complaints,

²³³ Listings Requirement (hereinafter "LR") 3.1 states that listed companies are required to comply with the Listings Requirements. The LRs prescribe minimum standards for annual financial statements, in particular compliance with IFRSs (defined as the International Accounting Standards Board's IFRSs), see LR 8.62(b). Procedures for non-compliance are set out in LRs 3.23 *et seq.*: these procedures range from an initial letter of reminder, an annotation attached to the company's listing (namely "RE" in order to indicate to the market that the company has failed to submit its annual financial statements in time), and the release by the JSE of an announcement over SENS (the JSE's News Service) informing the shareholders of the company's non-compliance, to the suspension and eventual termination of the listing.

²³⁴ Draft reg (2010) 28(2) referred to "IFRS" as defined in draft reg (2010) 28(1): these were the IFRSs as adopted by the International Accounting Standards Board and as "approved for use in South Africa ... by the [Financial Reporting Standards] Council."

²³⁵ Regulation (2011) 26(1)(b) defines "IFRS" as the International Accounting Standards Board's IFRSs.

²³⁶ See *infra* Chapter 4.1.3.

whereas a reference to alternative dispute resolution under the auspices of the Companies Tribunal or accredited entity (s 169(1)(b)) is an attempt to resolve the matter without the Commission having to investigate it.

After an investigation report (s 170) has been delivered to the Commission, the Commission may decide that alternative dispute resolution by the Commission followed by a consent order may be appropriate (170(1)(d): “the Commission”).²³⁷ Thus the Commission can itself also be a competent authority for alternative dispute resolution. That requires that it is able to record the resolution of the dispute in the form of an order. Section 173(1)(a) enables the Commission to do so. The Commission can thus record draft consent orders and apply to the High Court to have them confirmed as consent orders.

From the wording of s 169(1)(b) of the new Companies Act (“[I]f ... [the Commission] think[s] it expedient as a means of resolving the matter ...”) it seems to follow that once the Commission has decided to refer a case to alternative dispute resolution under the auspices of the Companies Tribunal, the complainant cannot insist on a complaint being investigated by the Commission.

The Act is silent on whether the Commission’s ‘Notice of Dispute Referral’ in terms of s 169(1)(b) or ‘Notice of Non-investigation’ in terms of s 169(1)(a) is reviewable. An argument against reviewability seems to be that ss 172(1) and (4) explicitly provide for the review of compliance notices by the Companies Tribunal,²³⁸ while there is no equivalent explicit provision in s 169 for the review of dispute referral notices or notices of non-investigation. Section 195(7) does not speak for reviewability either: It is true that s 195(7) states that a “notice ... by the Commission” is subject to review by a court. The word “notice”, however, does not encompass notices of dispute referral or notices of non-investigation since s 195(7) only refers to those instances which are subject to prior review by the Companies Tribunal.

²³⁷ See infra Chapter 4.1.2.2.4.

²³⁸ See infra Chapter 4.1.2.2.5.

4.1.2.2.3 The difference between “inspectors”, “investigators” and “independent investigators” (ss 176 *et seq.*)

As regards the notion of “inspector”, “investigator” and “independent investigator”, the unamended Companies Act No. 71 of 2008 (henceforth “the principal Act”)²³⁹ underwent a mere clarifying change through the Companies Amendment Act No. 3 of 2011.

The principal Act establishes the trias of “inspector”, “investigator” and “independent investigator”. In terms of the principal Act, if the Commission decides to investigate or if it is directed by the Minister to investigate a matter, it can designate or appoint an “inspector” or “investigator” (s 169(1)(c) and (2)(a)). Apart from these two terms, the principal Act further introduces the term “independent investigator” (s 169(2)(b)). The term “independent investigator” has been left undefined, while both the terms “inspector” and “investigator” were statutorily defined in s 1. These definitions simply referred to s 209. Section 209(1) and (2) dealt with inspectors only. Section 209(3) only spoke broadly of a contracted or appointed “person”. From the reference in the definition of “investigator” in s 1 of the principal Act to s 209 as well as from s 209(3) (“[A] person appointed in terms of this subsection is not an inspector ...”) it followed that s 209(3) referred to investigators. The Companies Amendment Act No. 3 of 2011 clarified this by inserting an amended definition of “investigator” which explicitly refers to “section 209(3)”. Judging from the wording of s 169(2) it seems that “independent investigator” is the term preferred by the principal Act for investigations of ‘internal disputes’ in terms of s 169(2)(b). These ‘internal disputes’ are complaints involving no parties other than the company, the holders of its debt or equity securities, its directors or officers or secretary, or its external auditors, and thus exclude complaints by a member of the general public.²⁴⁰

²³⁹ This was the terminology used by the Draft Companies Amendment Bill (19 July 2010).

²⁴⁰ As to whether a member of the general public has any standing at all to file a complaint with the Commission see *supra* Chapter 2.1.3.4.

Inspectors and investigators are appointed by the Commission, while the appointment of an independent investigator is agreed upon between the Commission and the investigated company, or is done by court order on application by the Commission (s 169(2)(b)).

Only inspectors and independent investigators report on their activities to the Commission; investigators do not (s 170(1)).

Inspectors must be employed by the state (s 209(1)) and can thus be chosen from among the employees of the Commission. They are therefore bound by the basic values and principles governing public administration as set out in s 195 of the Constitution. In contrast, investigators in terms of s 209(3) are appointed or contracted from outside the public administration. Neither the principal Act nor the Companies Amendment Act No. 3 of 2011 say much about requirements that inspectors and investigators have to meet. Section 209 merely states that they have to be “suitable” (s 209(1)(a) regarding inspectors: “suitable person”; s 209(3) regarding investigators: “suitably qualified person”). The requirements of s 205 (‘Qualifications for membership’) do not apply to them. Despite its wide heading, s 205 applies only to members of the Tribunal, the FRSC and the Takeover Regulation Panel. In contrast, s 208 (‘Conflicting interests of employees’) applies to those inspectors who are appointed from the Commission’s employees.

The powers given by the principal Act to inspectors, independent investigators and investigators are set out in ss 176 *et seq.* The powers of an inspector are wider than those of an independent investigator, and are considerably wider than those of an investigator.

With the exception of s 176(3) (which deals with interrogations of persons summoned by the Commission, and with the administering of oaths), the powers under s 176 (which deals in general with the questioning of persons summoned by the Commission) are granted to both an inspector and an independent investigator, while they are not given to investigators. The reference in s 176(3) to “investigator” seems to be an anomaly and is probably the result of a draftsman’s oversight: section 176(3) clearly refers to, and builds upon, s 176(1) in that an ‘interrogation’ and the ‘administration of an oath’ in terms of s 176(3) seem to be extensions of the ‘questioning’ of summoned persons in terms of s 176(1).

While s 176(1) uses the term “independent investigator”, s 176(3) speaks of an “investigator”. It would be odd, however, if an investigator were allowed to interrogate persons and to administer oaths, but could not question persons in general. It would be equally odd if an investigator were not otherwise able to exercise any of the powers set out in s 176, but could interrogate summoned persons. It is thus submitted that, for consistency’s sake, the word “investigator” in s 176(3) has to be read as “independent investigator”.

Only inspectors are given the further powers in terms of ss 177-179 of the new Companies Act to enter and search premises (s 177(2)(b)). Investigators and independent investigators are not allowed to exercise these powers.

Section 215 of the principal Act criminalises²⁴¹ the hindering, the obstructing and making of an improper attempt to influence an inspector or investigator. Independent investigators are not mentioned in this section.

Section 213 of the principal Act criminalises the disclosure of confidential information in certain circumstances. Nevertheless, this provision does not apply where the information is disclosed upon the request of an inspector or investigator. This exclusion, however, is not extended to an independent investigator. This is inconsequential, as independent investigators are to deal with internal disputes (as described in s 169(2)(b)), where the potential damage resulting from the disclosure will, by the very nature of the dispute, usually be less than with ‘external disputes’.

The inspector’s or independent investigator’s activities are “administrative action” in terms of the PAJA.²⁴² The Companies Act is silent on the investigation procedures to be followed by an

²⁴¹ Regarding this term see supra Chapter 1.1.1.

²⁴² See supra Chapter 2.1.3.4. As to the separate issue of whether the *appointment* of an inspector or investigator or independent investigator constitutes “administrative action” in terms of s 1 of the PAJA, see the similar issue mentioned supra in Chapter 4.1.1 (footnote 223).

While the appointment of an inspector or investigator by the Commission will probably be classified as “administrative action” in terms of the PAJA, the situation is less clear with regard to independent investigators:

inspector (investigator, independent investigator) or by the Commission. This gap is only partly filled by the Companies Regulations.²⁴³ Given that the conduct of an investigation amounts to “administrative action” in terms of s 1 of the PAJA, the principles of just and procedurally fair administrative action as set out in the PAJA apply. It does not matter, therefore, that there is no longer any provision in the new Companies Act equivalent to s 440Z(1)(b)(2) of the old Companies Act. This section mandated the former FRIP to set up its investigation procedures in line with the requirements of the PAJA. At the end of his investigation, the inspector or the independent investigator delivers his report to the Commission (170(1)). The Commission may, at its discretion, publish this report in its entirety (s 170(2)(a)). In any event, and irrespective of the outcome of the investigation, it must send a copy to both the complainant and the investigated company, as well as to any holder of securities or creditor of that company and to “any other person implicated in the report” (s 170(2)(b)(iv)). Presumably, “implicated” is to be understood as meaning that the report states that the person has acted improperly or has

If an independent investigator is appointed by virtue of a ‘joint agreement’ between the Commission and a company in terms of s 169(2)(b)(i), such an appointment seems to come close to an ‘administrative agreement’ and may possibly be classified as “administrative action”. (see the similar issue regarding agreements in terms of s 440FF(2) supra Chapter 4.1.2.1.3, footnote 226).

If an independent investigator is appointed by court order in terms of s 169(2)(b)(ii), the question arises whether this act falls under the Exclusion (ee) (“the judicial functions of the judicial officer of a court ...”) from the definition of ‘administrative action’ in terms of s 1 of the PAJA. Judicial officers are judges and magistrates (Hoexter, 2007:213). The paradigmatic case of Exclusion (ee) is the conducting by a judge of court proceedings to resolve a legal dispute (Currie, 2007:70). Currie (2007:70) points out that “[i]t is rather more difficult to ascertain whether a judge or magistrate is acting judicially or administratively when a statutory power is exercised outside court proceedings”. In *Pretoria Portland Cement Co Ltd v Competition Commission 2003 (2) SA 385 (SCA) par 41* Schutz JA was prepared to accept for argument’s sake that in issuing a search warrant in terms of the Competition Act 89 of 2003 a judge acted administratively (Hoexter 2007:168). By comparative reasoning, the appointment of an independent investigator also seems rather an administrative than a judicial action.

Viewed from this perspective, the appointment of an independent investigator by court order thus seems to constitute ‘administrative action’ in terms of the PAJA. Details are beyond the scope of this thesis.

²⁴³ Only reg (2011) 137 details certain investigation procedures; so did draft reg (2010) 143 (‘Commission Notice to investigate’) and draft reg (2010) 144 (Request for additional information).

contravened the Act. All these activities of the Commission are “administrative action[s]” in terms of the PAJA.²⁴⁴

4.1.2.2.4 The outcome of a Commission investigation and its legal consequences

After receiving the inspector’s or independent investigator’s report, several options are available to the Commission.

Firstly, it may simply end the matter by excusing the person as a respondent in the complaint (s 170(1)(a)). The result of this is that neither the Commission nor the complainant may refer the matter directly to the court (s 174(1), 2nd half-sentence).

Secondly, the Commission may, in response to a complaint, issue a ‘Notice of Non-referral’ to the complainant. This would subsequently allow the complainant to seek a remedy directly in court (s 170(1)(c), read with the first half-sentence of s 174(1)), provided the court has granted leave (which it may do only if the applicant has no other remedy available to him, s 174(2)(a)). It is clear from the wording of the first half-sentence of s 174(1) that the Commission cannot refer the matter directly to the court. It is not entirely clear what ‘notice of non-referral’ in terms of s 170(1)(c) is intended to mean. It seems that only very few complaints would be referred in practice since as a rule the Commission will simply issue a compliance notice instead. Therefore, what is possibly meant by s 170(1)(c) is rather a ‘Notice that the matter is not taken further’. Such a notice would not excuse the respondent in terms of s 170(1)(a), but would merely mean that he is off the hook for the time being.

Thirdly, the Commission may instigate consent order proceedings (s 170(1)(d): “the Commission”). This provision requires that the Commission and the respondent reach an agreement resolving the dispute and that the Commission then records this agreement as a draft

²⁴⁴ See supra Chapter 2.1.3.4.

consent order (s 173(1)(a), read with draft reg [2010] 142(2) and reg [2011] 138(2): ‘Consent to order’). Although s 170(d) may create the impression that the consent of the complainant to the consent order may also be required, the consent order relates to an agreement between the Commission and the respondent (Reg [2011] 138(2)). The complainant’s consent is only required if the draft consent order includes an order for damages (Reg [2011] 138(3)). If the complainant does not agree, the draft consent order cannot include an award for damages (the apparent intention behind Regulation [2011] 138(4)). After having recorded the consent order, the Commission may then apply to the High Court to have the consent order confirmed (s 173(1)(b)).²⁴⁵ Should the Commission and the respondent be unable to reach an agreement, the Commission issues a ‘Certificate of Failed Dispute Resolution’ (s 173(2), read with s 167(2)-(4)).

Fourthly, the Commission may refer the complaint to the Companies Tribunal (s 170(1)(b): ‘Complaint Referral’). This requires, however, that “the matter falls within [the Companies Tribunal’s] ... jurisdiction[...] in terms of this [Companies] Act.” This reference to the Companies Tribunal is difficult to understand. Two possible scenarios of application of s 170(1)(b) come to mind. On the one hand, complaint referrals under s 170(1)(b), like any other

²⁴⁵ Draft reg (2010) 142(2)(a), which dealt with consent order proceedings, seemed misconceived. In terms of this Draft Regulation, the Commission, once it had recorded the draft consent order, “must refer the complaint to the [Companies] Tribunal”. This clearly contradicted s 173(1)(b) of the new Companies Act, and Draft reg (2010) 142(2)(a) would therefore have been *ultra vires*.

Furthermore, draft reg (2010) 142(4) seemed misconceived too. This draft regulation stated that “[a] draft consent order may be submitted to the [Companies] Tribunal in terms of section 173 and this Rule [*i.e.* draft reg (2010) 142]”. This added to the confusion, since the wording of s 173 of the new Companies Act does not provide for the option to submit a draft consent order to the Companies Tribunal. Draft regulations (2010) 159 and 160, however, which regulated consent hearings before the Companies Tribunal, clearly presupposed that the Companies Tribunal had received a draft consent order from the Commission beforehand (draft reg 159(1)(b)). It appeared that the drafter of the regulation had copied over rules of the competition law (Competition Commission Rules, Part 4 [‘Complaint procedures’], Rule 18 [‘Consent orders’]), where the Tribunal, however, plays a different role.

Regulation (2011) 138(2) – which is the equivalent to draft reg (2010) 142(2) – puts that right (‘Resolving complaints by proposed consent orders’): there is no mention any longer of consent referrals to the Companies Tribunal and of the Companies Tribunal making consent orders. Rather, consent referrals can only be made to the High Court. Regulation (2011) 138(2) is thus in line with s 173 of the Companies Act and is not *ultra vires*. Furthermore, there is no equivalent any longer in the Companies Regulations 2011 to draft regs (2010) 159-160.

action by the Commission under s 170(1), occur after the Commission has received and considered the report of an inspector or independent investigator (see too the heading to reg [2011] 140: “Procedures following investigation”). The Commission could decide that conduct in breach of the Act has taken place and therefore issue a compliance notice under s 170(1)(g). The Commission can alternatively decide that a form of alternative dispute resolution by the Companies Tribunal followed by a consent order in terms of s 170(1)(d) may be appropriate. Section 170(1)(b) will typically be used where the Commission is of the view that the inspector’s or independent investigator’s report does not establish conclusively that there has been non-compliance with the Act, but establishes sufficient grounds to justify an investigation by the Companies Tribunal. This process would, it is submitted, take the form of adjudication by the Companies Tribunal.²⁴⁶ On the other hand, it is conceivable that s 170(1)(b) is rather meant for the small number of situations where the Companies Tribunal is given direct authority to deal with matters (for instance, where a registration of an inappropriate company name is at issue; see s 160(1) of the Companies Act).

Fifthly, it may commence proceedings in a court in the name of the complainant, if the complainant so requests (s 170(1)(e)(ii), read with s 157(2)(a)), or may even refer a matter to the National Prosecuting Authority, if it concludes that an offence has been committed (s 170(1)(f)).

Finally, the Commission may issue a ‘Compliance Notice’ (s 170(1)(g)(i), read with s 171 and draft reg [2010] 146(1), reg [2011] 139(1)), but only in respect of a matter for which the complainant does not otherwise have a remedy in court (s 171(1): “unless”). A compliance notice may be issued against individual directors if they are implicated in a failure to comply with FRSs. The minimum content requirements for a compliance notice are set out in s 171(4). It typically will state that the non-compliant company must rectify and reissue its financial statements (s 171(2)(a),(e)). This will be so even where the finding of a failure to comply with FRSs follows a sample-based investigation. Section 3(2)(b)(iv) of the PAJA requires that the compliance notice – in order for it to be procedurally fair – contains adequate notice of any right

²⁴⁶ See *infra* Chapter 4.1.2.2.6.

of review. Such a right of review is granted in s 172(1).²⁴⁷ This thus has to be pointed out in the compliance notice. Currie would certainly disagree with this. The review right in terms of s 172(1) is, it is submitted, not a right to an internal review, but a right to a judicial review.²⁴⁸ According to Currie (2007:107), however, the wording “right of review” in s 3(2)(b)(iv) of the PAJA refers to a ‘right to an internal review’ only. Quoting Hoexter (2007: 339), he reasons that “[h]aving to give ‘adequate’ notice of the general right to judicial review would be extremely onerous on the administrator and such an interpretation would also make a nonsense of the phrase ‘where applicable’ [in s 3(2)(b)(iv) of the PAJA].”²⁴⁹ Conversely, Burns and Beukes (2006:229) contend that s 3(2)(b)(iv) of the PAJA refers to a review by a superior administrative body rather than to a judicial review. They base their view on the argument “that [the] PAJA clearly stipulates that internal remedies must be exhausted before the courts are approached for relief.” An authoritative judicial interpretation of this ambiguous provision is, as Hoexter (2007:338) notes, awaited. While it is true that the mandatory requirements of s 3(2)(b)(iv) of the PAJA can be departed from in terms of s 3(4) of the PAJA, this is only possible if it is “reasonable and justifiable”. In the context of compliance notices, no such grounds for departure will usually be at hand. Section 171(4) of the new Companies Act further does not explicitly mention that the compliance notice is to contain notice of the right to be furnished reasons for its issuance. Section 3(2)(b)(v) of the PAJA, read with s 5 of the PAJA, however, requires this. Section 3(2)(b)(v) is a mandatory provision.

If the company is listed on the JSE, one copy of the compliance notice will be sent to the Financial Services Board as the “regulatory authority” in terms of s 171(3) of the Companies Act.

²⁴⁷ See infra Chapter 4.1.2.2.5.2.

²⁴⁸ See infra Chapter 4.1.2.2.5.2.

²⁴⁹ It is noteworthy that the context of Hoexter (2007: 338-339) from where Currie’s (2007:107) quote is extracted is not dealing with internal reviews. Hoexter distinguishes between a special statutory review (where, pending judicial clarification, notice may be required) and ordinary review by the courts (where notice is not required). As regards the wording of s 3(2)(b)(iv) of the PAJA, she submits (2007: 338) that “[t]he use of the qualifier ‘internal’ in relation to ‘appeal’ and not ‘review’ suggests ... that ‘review’ is intended here in a broader and not purely domestic sense” and refers to Burns & Beukes (2006: 229), as discussed above.

What would the consequences be if the Commission failed to comply with the requirements of the mandatory s 3(2)(b)(iv) and s 3(2)(b)(v) of the PAJA? Section 3(4) of the PAJA allows the administrator to depart from any of the requirements of s 3(2) of the PAJA, but only if this departure is “reasonable and justifiable”. Examining recent case law, Currie (2007:112) comes to the conclusion that section 3(4) of the PAJA has been applied by the courts in a restrictive way and that “[t]he only elements likely to be justifiably departed from are the notice and prior hearing requirements”. As regards the consequences of non-compliance with s 3(2) of the PAJA, Currie (2007:108) suggests that it is necessary to distinguish between elements of procedural fairness and statutory formalities. Out of the five requirements of s 3(2)(b) of the PAJA, two namely s 3(2)(b)(i) (‘Adequate notice of the nature and purpose of the proposed administrative action’) and s 3(2)(b)(ii) (‘Reasonable opportunity to make representations’) reflect the straightforward common-law core elements of procedural fairness. In contrast, s 3(2)(b)(iii) (‘Clear statement of the administrative action’), s 3(2)(b)(iv) (‘Adequate notice of any right of review or internal appeal’) and s 3(2)(b)(v) (‘Adequate notice of the right to request reasons’) are mere statutory formalities. Currie then suggests that non-compliance with the requirements of procedural fairness (s 3(2)(b)(i) and s 3(2)(b)(ii)) always invalidates the administrative action, while non-compliance with s 3(2)(b)(iii)-(v) does not necessarily have this effect. Rather, substance prevails over form and administrative action will remain valid, provided the administrator has complied in substance with these requirements. Discussing Currie’s position, Hoexter (2007:347) argues in a similar way.

The compliance notice remains in force until one of two things happens. Either the Commission issues a ‘Compliance Certificate’ confirming that the requirements of the compliance notice have been satisfied by the company (s 171(5)(b),(6), read with reg [2011] 139(2)), or the company successfully challenges the compliance notice before the Companies Tribunal²⁵⁰ or a court (s 171(5)(a)(i), read with s 172(1)). If the respondent fails to comply with the notice, the Commission may either apply to a court for an administrative fine (s 171(7)(a), amounting to, as per s 175,²⁵¹ the higher of R1 million or 10 per cent of the company’s turnover for the period

²⁵⁰ As regards an application to the Tribunal see *infra* Chapter 4.1.2.2.5.

²⁵¹ Regulations (2011) 163 and 164.

during which the company failed to comply with the compliance notice) or may refer the failure to comply to the National Prosecuting Authority for prosecution as an offence (s 171(7)(b), read with s 214(3)). Criminal prosecution and the imposition of an administrative sanction are mutually exclusive and cannot run concurrently (s 171(7), read with s 214(3)). Section 81(1)(f) of the new Companies Act further makes it clear that, in the case of a recidivist company that has failed to comply, been fined and continues to contravene the Companies Act, the Commission may apply to a court for an order to wind up the company.²⁵²

4.1.2.2.5 Review of a ‘Compliance notice’ by the Companies Tribunal in terms of s 172(1)

Section 172(1) grants the right to have a compliance notice reviewed by the Companies Tribunal to a person who has been issued with such a notice.

In order to exercise this right, the company is required, within 15 business days after receiving the compliance notice, to apply to the Companies Tribunal to review such notice (s 172(1)(a)). This period of 15 days is not in line with the deadline set out by the PAJA for review applications (s 7(1) of the PAJA).²⁵³ The Companies Regulations deal in detail with procedural aspects of applications to the Tribunal in regs (2011) 149-162; so did the Draft Regulations (2010) in draft regs 147-173

4.1.2.2.5.1 What is the difference between review and appeal?

²⁵² See also the Explanatory Memorandum to Companies Bill B61D-2008, item 12, which speaks incorrectly, however, of “dissolving”.

²⁵³ See supra Chapter 4.1.1.

Section 172(1) only allows a *review* by the Companies Tribunal, not an *appeal* to it. What is the difference between the two and what are the resulting legal consequences?

Wade and Forsyth (1994:38) point out:

“The system of judicial review is radically different from the system of appeals. When hearing an appeal, the court is concerned with the merits of the decision ... When subjecting some administrative act or order to judicial review, the court is concerned with its legality. On an appeal the question is ‘right or wrong’? On review the question is ‘lawful or unlawful’?”

An appeal amounts to a re-hearing of the matter (*i.e.* the body to whom the appeal is made steps into the shoes of the original decision-maker and decides the matter afresh). A review is a mere re-examination of the legality of an administrative action in question. In a review an adjudicating body will have to establish whether such an action complies with all the requirements for just administrative action.

In practice, however, this clear theoretical distinction is not as hard and fast as it appears. In particular, in respect of the review ground ‘unreasonableness’ (s 6(2)(h) of the PAJA) the distinction may become blurred.²⁵⁴

A review in terms of s 172(1) is a ‘special statutory review’ as opposed to an ‘ordinary review’ in terms of the PAJA or the common law (Hoexter, 2007:109 and 514). Older case law (*Johannesburg Consolidated Investment Co. v Johannesburg Town Council 1903 TS 111 116*) expressed the view that special statutory reviews were “far wider” than ordinary reviews. However, recent case law (*Nel NNO v The Master 2005 (1) SA 276 (SCA) par 23*) has pointed out that the true extent of statutory review powers always depends on the terms of the relevant statutory provision. It may thus be wider or narrower than an ordinary review. Further, De Ville (2005:387) and Hoexter (2007:514) indicate that – as regards special statutory remedies – the mere statutory labelling as ‘review’ and ‘appeal’ respectively does not necessarily finally determine the essence of the remedy.

²⁵⁴ See *infra* Chapter 5.1.2.

The extent of the Tribunal's review powers seem wide. According to s 172(2), the Companies Tribunal can consider "any representations by the applicant and any other relevant information". This could amount to a full re-hearing, since s 172 does not confine the Companies Tribunal to the records of the Commission's proceedings or the inspector's or independent investigator's report. In fact, Part D (ss 168-175) does not provide for any record-keeping. "Representations by the applicant" should not to be read to mean "representations in the records", but as "any new or previous representations". Furthermore, the Companies Tribunal's procedural powers of enquiry in terms of s 182 are also wide and comprise – like the Commission's (s 176) – the power to summon,²⁵⁵ but not the power to enter and search. When it comes to the Companies Tribunal's decisions, however, its powers do not seem to exceed those of an ordinary review. It may only "confirm, modify or cancel all or a part of a compliance notice." Seemingly, it cannot fully substitute it and decide the matter afresh.

It appears therefore that the review in terms of s 172(1) is in essence a wide review, but falls short of an appeal.

4.1.2.2.5.2 Is an application to the Companies Tribunal in terms of s 172(1) a mere *internal* review or does it amount to a *judicial* review?

For the Companies Tribunal to be competent to exercise a judicial review of administrative action in terms of s 6 of the PAJA, it needs to meet the requirements of a '*tribunal*', in terms of the definition in s 1 of the PAJA, *i.e.* it must be "[an] independent and impartial tribunal established by national legislation for the purpose of judicially reviewing an administrative action in terms of this Act": Section 193 of the Companies Act which establishes the Companies Tribunal²⁵⁶ is national legislation, and s 193(1)(b) and (d) explicitly state the Tribunal's

²⁵⁵ Regulation (2011) 160.

²⁵⁶ See *supra* Chapter 2.1.3.3.

independence and impartiality. Furthermore, compliance notices are administrative action in terms of the PAJA,²⁵⁷ and the Tribunal was – as emanates from s 172(1) – established, among others things, for the purpose of reviewing them. The question arises then whether this review is *judicial*.

Currie (2007:70) defines a judicial function as follows:

“The exercise of the judicial authority takes place when a tribunal, acting under the authority of the state, decides authoritatively and conclusively, controversies between subjects of the state, or between the state and its subjects.”

Applying this definition to the Companies Tribunal, the Companies Tribunal performs a judicial function: it is an organ of state²⁵⁸ and thus acts under the authority of the state. It decides in terms of s 172(1) authoritatively (leaving out of account the possibility of a curial review, s 172(4)) a controversy (namely a dispute about a compliance notice) between an organ of state (the Commission²⁵⁹) and the respondent company (being a subject of the state).

A better point of departure seems to be to focus on the fact that the defining characteristic of judicial administrative action, in contrast to a mere internal review, is that its effect is final and binding. The tribunal may no longer revoke or amend its decision. It is said to be *functus officio* (Burns & Beukes, 2006:180 and Hoexter, 2007:247). Instead, its decision can only be altered by a court on review or appeal (Burns, 2003:61).

This is the situation with the Companies Tribunal: in terms of s 172(4), its decision is binding on the Commission and only “subject to any right of review by, or appeal to, a court” (s 172(4)).²⁶⁰

²⁵⁷ See supra Chapter 2.1.3.4.

²⁵⁸ See supra Chapter 2.1.3.4.

²⁵⁹ See supra Chapter 2.1.3.4.

²⁶⁰ See infra Chapter 4.1.2.2.8.

There is, as Burns and Beukes (2006:270) observe, no internal control of judicial administrative action. The reason for this is that judicial tribunals (adjudicative administrative bodies) do not fall within the ordinary departmental hierarchy. This applies to the Companies Tribunal: it is not part of the Department of Trade and Industry's hierarchy. In contrast, in the case of an internal (domestic) remedy, administrative action (like the issuing of a compliance notice) is usually subjected to internal control by senior administrators within the same administrative hierarchy. This characteristic is not all-defining, however, since an internal remedy may also occur in the form of a so-called domestic tribunal (Burns & Beukes, 2006:104 and 477) which does not form part of a departmental hierarchy. Crucially, however, in both cases decisions are not binding, *i.e.* the tribunal is not *functus officio*. Furthermore, as a rule an internal remedy is not limited to a mere review, but may also amount to a full appeal (*Reed v Master of the High Court [2005] 2 All SA 429 (E) par 25*).

A further characteristic of judicial review is that, in terms of s 7(2) of the PAJA, it is denied until and unless the applicant has first exhausted any internal remedy provided for. It is noteworthy that s 7(2) of the PAJA has become controversial among South African academics and that its constitutionality has even been questioned: Plasket (2002b: 50 and 62) considers s 7(2) of the PAJA "retrogressive" and unconstitutional, reasoning that – given the practical inefficiency of South African administration – it infringes on the right of access to court (s 34 of the Constitution). Hoexter has a similar viewpoint (2007:480) and further points out (2007:478) that s 7(2) of the PAJA is more stringent than the common-law duty to exhaust domestic remedies. Burns and Beukes (2006:476) follow a middle-view. According to them, the right of access to court does, as a rule, not override s 7(2) of the PAJA, since the administration should be afforded an opportunity to rectify its mistakes. If the matter is not resolved, the person concerned then has the right to approach the courts for final resolution of the dispute. An exception to this rule applies, according to Burns and Beukes, where the administration has shown *mala fides* ('bad faith'). Under such circumstances, Burns and Beukes argue that the person concerned should be allowed to approach the court directly. However, these issues regarding s 7(2) of the PAJA do not arise with regard to decisions by the Companies Tribunal. No internal remedy (which would first have to be exhausted) is provided for by the new Companies Act where the Tribunal has reviewed a decision of the Commission to issue a compliance notice.

In summary, thus, the Companies Tribunal is not a mere domestic tribunal, but an adjudicative body performing *judicial* reviews.

This interpretation is, it is submitted, supported by the wording of s 172(1) (“[M]ay apply to the Companies Tribunal ... *or* to a court ... to review the [Commission’s compliance] notice”) which seems to regard both paths to review (Tribunal and court) as being of a similar (judicial) kind.

4.1.2.2.5.3 Adjudication procedures of the Companies Tribunal (ss 180 *et seq.*)

Since the Companies Tribunal’s activity in terms of s 172(1), read with s 172(4) and regs (2011) 149-162 (draft regs [2010] 153-173) is of judicial nature (‘judicial review’²⁶¹) and is thus ‘adjudication’ in terms of s 195(1)(a), ss 180 *et seq.* apply to hearings before the Tribunal.

Section 180(1)(a) provides that the “principles of natural justice”²⁶² (*i.e.* the rules of procedural fairness) apply to adjudication proceedings. Section 180(1)(a) has probably been inserted into the new Companies Act for greater certainty: Section 3(2)(b)(i),(ii) of the PAJA today encapsulates the minimum requirements for the procedural fairness of administrative actions. Since the actions of the Companies Tribunal are ‘administrative actions’ in terms of the PAJA,²⁶³ s 3(2)(b) of the PAJA and the principles of natural justice apply. Section 183 allows the Companies Tribunal to set its own rules of procedure. However, there are two reasons why this is not a *carte blanche* power. Firstly, s 183 itself states that these procedural rules are “[s]ubject to the requirements of the applicable sections of this Act” and they are therefore subject to s 180(1)(a). Secondly, s 3(5) of the PAJA draws the same line in the sand. Procedural rules which deviate from the PAJA’s rules of procedural fairness are only allowed provided they are fair (“fair, but

²⁶¹ See supra Chapter 4.1.2.2.5.2.

²⁶² See supra Chapter 4.1.2.1.2.

²⁶³ See supra Chapter 2.1.3.4.

different”). Currie, referring to the decision *Police and Prisons Civil Rights Union (POPCRU) v Minister of Correctional Services* ([2006] 2 All SA 175 (E) par 71) further points out (2007:113) that procedural fairness may require following different procedures that are more extensive than the minimum standards of the PAJA. As per the Companies Regulations,²⁶⁴ the procedure to be followed at a hearing before the Tribunal is to be determined at the pre-hearing conference, which is presided over by a member of the Tribunal.²⁶⁵ If during the subsequent hearing a procedural question arises which was not provided for, the High Court Rules may be resorted to.²⁶⁶

Section 182 sets out the powers of the Companies Tribunal during adjudication proceedings (summons; questioning; directions regarding the publication of evidence). These are wide powers. Exercising them constitutes a “decision” by the Companies Tribunal in terms of s 172(4) and is thus, it is submitted, subject to review by a court. The Companies Regulations provide that records of the hearing have to be kept.²⁶⁷ As regards matters considered at the pre-hearing conference, the Companies Regulations even provide for an order to be made by the presiding member of the Companies Tribunal which records any agreements or rulings made during the pre-hearing conference.²⁶⁸ Section 184(2), re-stating the common-law position, extends the witness’s private privilege in a criminal case to persons providing information during an adjudication hearing. Section 184(2) thus covers both aspects of private privilege under the common law, namely the privilege against self-incrimination and legal professional privilege (which also applies in criminal proceedings). In contrast, s 184(4) has a narrower scope. It

²⁶⁴ Regulation (2011) 149(5)(c)(viii), draft reg (2010) 157(1)(a)(viii).

²⁶⁵ The purpose of the pre-hearing conference is essentially case management to give effect to the Tribunal’s duty under s 180(1)(a) to conduct the proceedings expeditiously, facilitated by s 180(1)(b), which allows the proceedings to be conducted informally. The High Court Rules provide for a pre-hearing conference between the parties’ lawyers but the judge is not present. Preliminary meetings presided over by the arbitrator are common in arbitration to promote effective case management and such meetings presided over by the judge have been standard practice in the English High Court for more than a decade.

²⁶⁶ Regulation (2011) 154(1)(b), draft reg (2010) 171(1)(b).

²⁶⁷ Regulation (2011) 155, draft reg (2010) 172.

²⁶⁸ Regulation (2011) 149(7), draft reg (2010) 157(3).

applies to any persons questioned before the Companies Tribunal and restricts - by referring to s 176(4) and s 176(5) - protection to the privilege against self-incrimination.

4.1.2.2.6 Proceedings before the Companies Tribunal in cases of ‘Complaint Referrals’ (s 170(1)(b)) and ‘Consent Referrals’ (s 170(1)(d)) to the Tribunal

Apart from review applications to the Companies Tribunal in terms of s 172(1), complaint referrals to the Companies Tribunal in terms of s 170(1)(b)²⁶⁹ as well as consent referrals to the Companies Tribunal in terms of s 170(1)(d)²⁷⁰ are provided for in the new Companies Act.

As regards complaint referrals,²⁷¹ the final Companies Regulations 2011 assume that the Companies Tribunal adjudicates complaints directly, while the Draft Regulations (2010) were still less explicit as to the form of the procedure to follow.²⁷² Both Draft and final Companies Regulations set out lengthy details of complaint proceedings before the Tribunal (Draft regs [2010] 153 *et seq*, regs [2011] 141 and 143-160).²⁷³ That the process to be followed takes the

²⁶⁹ See supra Chapter 4.1.2.2.4.

²⁷⁰ See supra Chapter 4.1.2.2.4.

²⁷¹ Draft reg (2010) 136(e) defined a “complaint referral” to the Companies Tribunal with clear reference to s 170(1)(b) of the Companies Act. In contrast, draft reg (2010) 149 (‘Initiating complaint proceedings’) blurred this reference: Draft reg (2010) 149(1)(a) corresponded to draft reg (2010) 136(e) and to s 170(1)(b) of the Companies Act and dealt with a referral by the Commission to the Companies Tribunal, while draft reg (2010) 149(1)(b), referring to a “Notice of non-referral” in terms of s 170(1)(c) of the Companies Act, allowed alternatively the complainant to refer his complaint to the Companies Tribunal. Draft reg (2010) 149(1)(b) seemed misconceived, since s 170(1)(c) of the Companies Act does not provide for a referral to the Companies Tribunal and draft reg (2010) 149(1)(b) would therefore have been *ultra vires*. The Companies Regulations 2011 have corrected this: there is no equivalent to draft reg (2010) 149(1)(b) any longer.

²⁷² Draft reg (2010) 149(1), read with draft reg (2010) 136(e); reg (2011) 141, read with reg (2011) 129(e).

²⁷³ In terms of Part E of Chapter 7 (‘Tribunal Proceedings’: Draft regs [2010] 153-173) of the Draft Regulations (2010) as well as in terms of Part F of Chapter 7 (‘Conduct of Tribunal Proceedings’:

form of adjudication emanates from the wording of reg [2011] 141, which states under the heading “Complaint Referrals to the Tribunal”: “A complaint proceeding to be *adjudicated* by the Tribunal may be initiated only by filing a Complaint Referral ...”. Regs [2011] 143-160 set out the procedure for how the Companies Tribunal deals with a complaint referral or other application by means of adjudication.

As regards consent referrals, s 170(1)(d) states that the Commission may refer a complaint matter to the Companies Tribunal in order to attempt to have it resolved by a consent order in terms of s 167(1). Again, the Companies Regulations (draft regs 2010 and final regs 2011) set out details of the consent order proceedings conducted by the Companies Tribunal. Those of the Draft Regulations 2010 seemed in part to have been copied misguidedly from the Competition Tribunal Rules (Rules 24-25) and the Competition Commission Rules (Rule 18: ‘Consent orders’).²⁷⁴

Regulations [2011] 149-162) of the Companies Regulations 2011, the Tribunal may, at any time before it makes a final order in a complaint proceeding, adjourn its proceedings to give the participants a chance to settle the issue by themselves (Draft reg [2010] 158, reg [2011] 150: ‘Settlement Conference’).

Alternatively, if the initiating party is not present at the hearing, the Tribunal may simply strike the matter off the roll, and the matter may then, as a rule, not be re-enrolled (Draft reg [2010] 169, reg [2011] 152).

Alternatively, if the respondent has not filed a response (referred to as the ‘Answer’, draft reg [2010] 151 and draft reg [2011] 143) within 20 days after being served with the Complaint Referral, the initiating party may apply to have the order sought issued against the respondent by the Tribunal (Draft reg [2010] 170 and reg [2011] 153: ‘Default order’). The Draft Regulations ([2010] 151(5)) and the final Companies Regulations 2011 (reg 143(4)) contain a specific *onus* provision according to which an allegation of facts set out in the complaint referral, which is not specifically denied or admitted in an ‘Answer’, will be deemed to have been admitted.

²⁷⁴ See also *supra* Chapter 4.1.2.2.4 (footnote 37). In terms of draft regs (2010) 159-160, Tribunal proceedings could end with a ‘Consent Order’ made by the Tribunal. To this end, the Tribunal – after a preceding complaint referral to it (draft reg [2010] 159(1)) – would have convened a consent hearing after having received both a draft consent order from the Commission and a ‘consent to order’ from the person who has filed the complaint referral (draft reg [2010] 159(1)(b)). Draft Regulation (2010) 159(1) clearly presupposed that a complaint referral had already taken place before a consent hearing began. This was in conflict with draft reg (2010) 142(1), which assumed that the Commission can only record the required draft consent order (which would subsequently have been sent to the Tribunal in terms of draft reg (2010) 159(1)) *before* a complaint referral had taken place.

4.1.2.2.7 Can the Commission or the Companies Tribunal withdraw unlawful administrative action?

Regrettably, the PAJA and the old and new Companies Acts entirely omit to lay down any rules for the withdrawal of an unlawful administrative act (such as an unlawful compliance notice, an unlawful compliance certificate or an unlawful decision by the Companies Tribunal) by the administrator (*e.g.* the Commission or the Companies Tribunal) himself. These matters are, thus, left to the common law, where at least some rules to this effect exist (Hoexter, 2007:249). For systematic reasons, such rules – being part of the general administrative law – should rather have been incorporated into the PAJA. The advantages of rules like these are obvious (Pfaff & Schneider, 2001:85): administrators such as the Commission can correct incorrect decisions before an application for review or appeal is lodged by the affected person.

4.1.2.2.8 Is the right mentioned in s 172(4) and s 195(7) to have the decision of the Companies Tribunal reviewed by a court a right to *review* or a right to a full *appeal*?

Section 172(4) and s 195(7) mention a right to have the Companies Tribunal's decision reviewed by a court. These provisions are ambiguous. They could mean that they themselves grant a statutory judicial (curial) right to review the Commission's compliance notice. However, the

In terms of draft reg (2010) 160(2), the Tribunal could have made the consent order as requested, which could have then, in terms of s 195(8) of the Companies Act, be filed in the High Court as a court order. It could also have refused to do so. The refusal decision could have been appealed against by the parties in court. If it was not appealed, or after "the time for an appeal from the decision of the Tribunal" had expired (draft regs [2010] 160(2)(c)(i) and 147(3)(b)(ii)), the Tribunal would subsequently have had to treat the matter as a standard complaint referral in terms of 170(1)(b) of the Companies Act (draft reg [2010] 160(2)). Neither the Draft Companies Regulations (2010) nor the new Companies Act (s 195(7)) specifies how long that time for an appeal is.

wording “any right of” rather suggests that, instead of giving the courts the statutory power to review, s 172(4) merely refers to a review right granted elsewhere. This view is supported by a comparison of the wording of s 172(4) (“subject to any right of review ...”) with the phrase used by the Act in s 160(4) which clearly grants a review right (“[M]ay apply to a court to review the notice ...”).

It is therefore submitted that s 172(4) and s 195(7) do not establish a statutory judicial (curial) review right, but refer to a right of review granted elsewhere.

The Companies Tribunal’s review decisions on compliance notices (s 172(1)) constitute administrative action in terms of the PAJA.²⁷⁵ As a result of the absence of a special statutory review provision, review will take place in accordance with the PAJA (s 6 of the PAJA) or since the PAJA’s enactment is mandated by s 33(3) of the Constitution the ‘administrative justice’ clause of the Constitution or, more broadly, in accordance with the ‘principle of legality’.²⁷⁶

While for some time there was a tendency to treat these various pathways to judicial review as alternatives (“[O]ne may pick and choose between them at will”, Hoexter, 2007:125, referring to *New Click South Africa (Pty) Ltd v Tshabalala-Msimang NO 2005 (2) SA 530 (C)*), a hierarchy has now emerged (*Bato Stars Fishing (Pty) Ltd v Minister of Environmental Affairs (2004 (4) SA 490 (CC) paras 22 and 25*). The Constitutional Court has confirmed that the court’s power to review administrative action no longer flows directly from the common law²⁷⁷ but from the Constitution, and more immediately from the PAJA (Hoexter, 2007:463). As O’Regan in *Bato*

²⁷⁵ See supra Chapter 2.1.3.4.

²⁷⁶ Regarding the ‘principle of legality’ see supra Chapter 2.1.4.2.

²⁷⁷ The common law is thus not a source of judicial review powers as regards the review of the Companies Tribunal’s review decisions. The reason is that the common-law administrative law was ‘constitutionalised’ by the recognition of the right to administrative justice in s 33 of the Constitution and was, thus, “subsumed” by the Constitution (*Pharmaceutical Manufacturers Association of South Africa; In re: ex parte President of the Republic of South Africa 2000 (2) SA 674 (CC) par 33*).

The common law’s role as regards judicial review has, accordingly, today been greatly reduced to a review of the exercise of a private power or the performing of a private function by a private body (Hoexter, 2007:113 and Currie, 2007:37); this is not what the Companies Tribunal is or what it does.

Stars Fishing (Pty) Ltd v Minister of Environmental Affairs (2004 (4) SA 490 (CC) par 25) phrased it: “The cause of action for the judicial review of administrative action now ordinarily arises from PAJA, not from the common law as in the past.” While it might be tempting to rely on the ‘principle of legality’ in order to bypass some of the procedural requirements of the PAJA, the PAJA is now the primary pathway to review and it cannot be sidestepped where it is applicable (*Minister of Health v New Clicks South Africa (Pty) Ltd 2006 (2) SA 311 (CC) paras 96-97*, per Chaskalson CJ, *par 437*, per Ngcobo J and *par 586*, per Sachs J).²⁷⁸

Nevertheless, the wording of s 172(4) remains puzzling, since it refers to “any right of review ... or appeal”. The PAJA, however, governs only the *review* of administrative action; it does not make any provision for a right to *appeal* to court. Section 172(4) could therefore be read as simultaneously referring to the review right in terms of s 33 of the Constitution, read with s 6 of the PAJA, and granting a subsequent appeal to a higher court against the decision of the lower court regarding the review. Given the wording of s 172(4), however, this interpretation seems farfetched. Rather, the wording “or appeal” of s 172(4) seems to be the result of a draftsman’s error and s 172(4) does thus not grant a statutory right to an appeal. Section 172(4) could, however, be read as referring to the common-law principles relating to a right to appeal. These, in contrast to the common-law principles on judicial review, would not have been subsumed by the PAJA. However, traditionally, the common law has not established a general right to an appeal in administrative law. The problem around the wording of s 172(4) has been aggravated by a subsequent amendment to s 195(7), which now raises the identical problem.²⁷⁹

4.1.3 Alternative dispute resolution (‘ADR’)

²⁷⁸ See supra Chapter 2.1.4.2.

²⁷⁹ The Companies Amendment Act (s 133) amended the principal Act’s wording of s 195(7) (“subject to any review by the court”) and aligned it with the wording of s 172(4). The amended s 195(7) now also reads “subject to any review by, or appeal to, a court”.

In contrast to the old Companies Act, the new Companies Act provides in Part C of its Chapter 7 (ss 166-167) for alternative (voluntary) dispute resolution (henceforth referred to as “ADR”).²⁸⁰

4.1.3.1 Is ADR in terms of ss 166-167 of the new Companies Act mediation or arbitration?

Arbitration is

“an adjudicative process which takes place pursuant to an agreement between the parties to a dispute whereby that dispute is referred for final determination to an independent and impartial arbitral tribunal appointed by or on behalf of the parties” (Butler, 2003:399).

The core principle of arbitration is that the arbitral tribunal’s decision (referred to as an ‘award’) is final and not subject to an appeal to the courts (Butler, 2003:442). Arbitration can occur as consensual arbitration (in terms of a private agreement) or compulsory arbitration (in terms of a statute).

Arbitration is to be distinguished from mediation or conciliation (Butler, 2003:406). Mediation is

“a dispute resolution process whereby a third person acceptable to all parties to a dispute helps to bring the parties to an agreed solution of their dispute. Unlike the arbitrator, the mediator usually has no decision-making powers and may not impose a binding settlement or finding on the parties. Unlike an arbitrator, who must observe due process, a mediator may meet separately with one party in the absence of the other to discuss the dispute ...”

²⁸⁰ The terms “alternative dispute resolution” and “voluntary dispute resolution” are used interchangeably throughout this thesis.

With respect to the difference between conciliation and mediation, Butler (2003:406) points out that, from a legal perspective, there is no fundamental difference between the two.

Judging from the wording of s 166(2) (“conciliation, mediation or arbitration”), the Act seems to cater for both arbitration and mediation.

Contrary to the broad wording of s 166(2), however, it is submitted that the Act does not confer a statutory power to arbitrate disputes upon the Companies Tribunal. The Companies Tribunal is not a statutory arbitral tribunal, since the ‘order’ which it can record in terms of s 167(1)(a) is not a final and binding determination of the dispute. It is thus not an ‘award’ (decision of the arbiter) in terms of arbitration. Rather, it reflects the consensus of the parties achieved with the assistance of the Companies Tribunal, and it is not binding on the parties until the Court has confirmed it as ‘consent order’. The Companies Tribunal’s activity is thus *mediation*.

With this interpretation, it is difficult to see what significance the lawgiver intended to attribute to the word “arbitration” in s 166(1) and s 166(2). The purpose of using the word “arbitration” may simply be to point out that the parties may use ordinary (consensual) arbitration in terms of the Arbitration Act No. 42 of 1965 instead of making use of the Companies Tribunal’s services. The Companies Tribunal’s role would then be that of a mere facilitator assisting the parties in reaching a contractual arbitration agreement. Once this arbitration agreement is effective, the Companies Tribunal’s role ends and the arbiter (as determined by the arbitration agreement) takes over. The ‘Certificate of Failed Dispute Resolution’ in terms of s 166(2) would thus only refer to the parties’ failure to reach an arbitration agreement.

On the other hand, “arbitration” in s 166(1) may mean that it is left open to the parties to explicitly agree that the Tribunal shall have the power to resolve their dispute in a binding manner. This would be an arbitration agreement and the Companies Tribunal’s activity would then be (*consensual*) *arbitration*, even though its decision would probably still have to be confirmed by the court in terms of s 167(1).

An arbitration award (decision on the merits) following consensual arbitration could also be made an order of court under s 31 of the Arbitration Act No. 42 of 1965 and an application to the court for the setting aside of the award could be brought on the grounds set out in s 33 of that

Act. Modern arbitration legislation (see the UNCITRAL Model Law of 1985, art. 30) empowers the arbitral tribunal to record a settlement reached after its appointment as an arbitral award on agreed terms (the primary purpose of which would be to facilitate enforcement of that award by a court). South Africa's elderly Arbitration Act does not deal with the point. The parties may not have to resort to s 167 of the Companies Act for this purpose. The Supreme Court of Appeal has recently decided that an arbitral tribunal does have the power to make an award on agreed terms (see *Bidoli v Bidoli* [2011] ZASCA 82), with the result that such an award could also be made an order of court under s 31 of the Arbitration Act.

4.1.3.2 Competent bodies

Both the Companies Tribunal as well as the Commission and entities "accredited" by the Commission may be competent to conduct ADR.

ADR can be instigated by the Commission both before starting an investigation by means of a dispute referral (s 169(1)(b))²⁸¹ and also after the end of an investigation (s 170(1)(d)).

Judging from the wording of s 187(2)(a) (which charges the Commission with "promoting voluntary resolution of disputes"), this competence of the Commission seems to be limited only to certain disputes, namely disputes "between a company on the one hand and a shareholder or director on the other hand." This wording of s 187(2)(a) is puzzling and possibly merely the result of a draftsman's oversight: there seems to be no particular reason why shareholders are included while holders of debt securities are excluded. Furthermore, the omission of auditors and of the general public seems odd.

²⁸¹ As to the issue whether the Commission's decision in terms of s 169(1)(a) is reviewable see supra Chapter 4.1.2.2.2.

The principal body competent to conduct ADR, however, is not the Commission, but rather the Companies Tribunal (s 166(1)(a), read with s 195(1)(b)) and “accredited entities” (s 166(1)(b)).

What are “accredited entities” in terms of s 166(1)(b), read with s 166(3)-(5)? The Act differentiates between two types of accredited entities: firstly, the ones selected and accredited by the Commission (s 166(3)(a),(4)²⁸²); secondly, organs of state or entities which have been established in terms of public regulations (as defined in s 1 of the new Companies Act) and have been mandated to perform ADR and which have been designated by the Minister to do so. Both juristic persons and voluntary associations can become accredited entities (s 166(3)(a)).

The Commission is charged by the Act (s 166(4)(b)) to monitor the effectiveness of both types of accredited entities. Furthermore, the Commission can withdraw any accreditation granted by it in terms of s 166(3)(a). These powers do not extend to those accredited entities which were designated by the Minister. Section 166(4) sets minimum eligibility requirements for becoming an “accredited entity”.

4.1.3 3 Parties to ADR

As emanates from s 187(2)(a), ADR is available for disputes between the company and its shareholders and disputes between the company and its directors. Furthermore, it is also available for disputes between the company and its external auditor about alleged non-compliance with FRSs both on application by the company (s 166(1), read with s 157(1)(a)) and on application by the external auditor who has extended standing in terms of s 157(1)(c) (“acting ... in the interest of ... a group ... of affected persons”, *i.e.* the users of financial statements) and

²⁸² Regulation (2011) 134.

in terms of s 157(1)(d) (“acting in the public interest”). In either of these scenarios an application for ADR must be made to the Companies Tribunal or an accredited dispute resolution entity.²⁸³

Both the Companies Act and the Companies Regulations (draft regs 2010 and final regs 2011) are silent on the extent to which disputes with the Commission can go to the Companies Tribunal for ADR. Disputes with the Commission could arise about notices issued or decisions made by the Commission in terms of s 169 or s 170.

Assuming ADR in the sense of a *consensual arbitration* (with the Companies Tribunal as arbitral tribunal)²⁸⁴ is conducted, the Commission’s powers in terms of ss 169, 170 would effectively be shifted via ADR to the Companies Tribunal with the Commission’s consent. This would run counter to the basic assignment of competences set by the Companies Act as regards the Commission and the Companies Tribunal.

Assuming ADR in the sense of *mediation* is conducted by the Companies Tribunal,²⁸⁵ the effect of ADR would merely be to slow down the Commission’s decision process until the Companies Tribunal has issued its ‘Certificate of failed dispute resolution’ (s 166(2)). Thereafter ss 169,170 would apply anyway. It therefore seems unlikely that the Commission would participate in this kind of ADR since the resulting consent order (drafted by the Companies Tribunal) would effectively weaken its position.

It seems therefore preferable to deny ADR in cases of disputes with the Commission. This would have to be true in any event for ADR proceedings conducted by entities accredited by the Commission in terms of s 166(3)(a),(4) in order to preclude the potential bias resulting from the fact that the Commission would be both the accrediting entity and party to the dispute.

²⁸³ Regulation (2011) 132(1).

²⁸⁴ See supra Chapter 4.1.3.1.

²⁸⁵ See supra Chapter 4.1.3.1.

4.1.3.4 The outcome of ADR

ADR can have one of two outcomes:

If it fails, the Companies Tribunal or the accredited entity must issue a ‘Certificate of Failed Dispute Resolution’ to the parties (s 166(2)²⁸⁶).

If the parties have succeeded in resolving their dispute, the Companies Tribunal or the accredited entity or the Commission (in the event s 170(1)(d) applies) record the resolution of that dispute in the form of a draft ‘Consent order’ and, if the parties consent to that order, submit it to a court to be confirmed as a consent order (s 167(1), read with reg [2011] 133). The court may confirm the draft order, refuse it or request that changes be made to it (s 167(2)).

4.1.3.5 Is a ‘Consent order’ recorded by the Companies Tribunal in terms of s 167(1)(a) administrative action in terms of the PAJA?

As regards *mediation*, an order recorded by the Companies Tribunal in terms of s 167(1)(a)²⁸⁷ does not meet the requirements of administrative action in terms of s 1 of the PAJA.²⁸⁸ There is no ‘*decision*’ by the Companies Tribunal or the accredited entity. Rather, with mediation, the Companies Tribunal or the accredited entity merely records the parties’ consensus.

²⁸⁶ Regulation (2011) 132(3).

²⁸⁷ The same applies to draft consent orders recorded by the Commission in terms of s 170(1)(d). See *supra* Chapter 2.1.3.4.

²⁸⁸ As to these requirements see in detail *supra* Chapter 2.1.1.5.

Furthermore, it may be questioned whether the requirement ‘*exercising a public power or performing a public function*’ is met. Hoexter (2007:174) infers from the decision *Total Support Management (Pty) Ltd v Diversified Health Systems SA (Pty) Ltd* (2002 (4) SA 661 (SCA) 673H-674H) that the element of ‘consensus’ means that the requirement of ‘exercising a public power’ in the definition of administrative action is not satisfied. While this case involved private consensual arbitration rather than mediation, its statement as to the effect of a consensus applies, by comparative reasoning, to mediation as well.

An order recorded in terms of s 167(1)(a) by the Companies Tribunal is thus not administrative action in terms of the PAJA.

The same applies to those instances where the parties have agreed beforehand that the Companies Tribunal shall be an arbitral tribunal. Recent case law (*Rustenburg Platinum Mines v CCMA* 2007 (1) SA 576 (SCA) par 25, *Carephone (Pty) Ltd v Marcus NO* 1999 (3) SA 304 (LAC) paras 11-15) has held that compulsory (statutorily imposed) arbitration is administrative action in terms of the PAJA. These cases dealt with arbitration conducted in terms of the Labour Relations Act under the auspices of the CCMA. They point out that the decisive criterion of compulsory arbitration is that it does not require the consent of the parties (*Carephone (Pty) Ltd v Marcus NO* par 11). This is not the case at hand, where the parties agree beforehand to subject themselves to the Tribunal’s award. Therefore, these instances do not constitute administrative action either.

4.1.4 Summary

Several noticeable differences exist between the old and the new Companies Act regarding administrative action and enforcement in cases of non-compliance with FRSs.

(1) While neither the old nor the new Companies Act provides for an *internal remedy (internal administrative appeal)*, only the new Act has established an *adjudicative administrative body* in the form of the Companies Tribunal to review compliance notices.

(2) The *time limitation clause* for bringing review applications as set out in the new Companies Act (15 days after the receipt of the compliance notice) is *inconsistent* with the one set out in PAJA (180 days). According to s 5(4)(b)(i)(dd) of the new Companies Act, the inconsistency will have to be resolved in favour of the PAJA. While this is consistent with the idea that the PAJA sets minimum standards for just administrative action, it does not seem to be a practical solution. It is thus submitted that the 15 days limitation clause is to be applied despite s 5(4)(b)(i)(dd) of the new Companies Act.

(3) The *range of legal consequences* resulting from non-compliance with FRSs is much broader under the new Act than under the old Companies Act.

The old Act focused on prosecution, leaving an ‘administrative agreement’ between the Minister and the company as the only alternative.

The new Act focuses on administrative sanctions (compliance notice procedure and draft consent order procedures). Persons who contravene the Act are only prosecuted as a last resort. The Minister’s option to conclude an administrative agreement with the investigated company is no longer available in the new Companies Act.

(4) Only under the new Act is provision made explicitly for *alternative (voluntary) dispute resolution (ADR)*. The relevant competencies have been assigned primarily to the Companies Tribunal.

(a) Voluntary dispute resolution in terms of the new Companies Act is as a rule not arbitration, but mediation. However, arbitration possibly can be agreed upon by the parties to be consensual arbitration. In either scenario the Tribunal's activities during voluntary dispute resolution are not administrative action in terms of the PAJA.

(b) It is not clear from the Act whether the Commission's decision to refer the complainant to the Tribunal for voluntary dispute resolution is reviewable; the better arguments seem to be against it.

(c) As part of the voluntary dispute resolution, the concept of '*accredited entities*' has been introduced into the new Act, presumably to reduce the Companies Tribunal's workload.

(5) The old Act provided a *strict procedural time-table* (beginning with the nominated officer's action and ending with the publication of the investigation committee's final report), allowing a clear and predictable day-count.

The new Companies Act does not do this at all; these matters are now for the Minister to regulate in terms of s 223(1)(b)(ii) ("time periods").

(6) When it comes to compliance with financial reporting standards, the *primary investigative body* under the old Companies Act was the Financial Reporting Investigations Panel ("the FRIP"), while the primary body under the new Companies Act is the Commission.

(a) The FRIP's *composition* was set out in a transparent way in the old Act, while there is no information in the new Act with regard to the Commission's composition.

It seems questionable whether ministerial regulations regarding the Commission's composition would be covered by the wording of s 223: they are neither "matters relating to the functions of the Commission" in terms of s 223(b) nor a mere "ancillary matter" in terms of s 223(d).

(b) Similarly, there are no provisions about decision-making or the *quorum* of the Commission under the new Act, while those matters were explicitly dealt with under the old Act with regard to the FRIP.

(c) The old Act provided for the appointment of *ad hoc investigation committees* by the FRIP to deal with individual investigations; the new Act is silent in this regard.

‘Specialist committees’ can be established under the new Act (ss 191, 192) by the Minister; these, however, do not deal with investigations, as emanates from s 191(1),(2).

(7) With the ‘*nominated officer*’, the old Act provided for a watchdog to be appointed by the Minister for monitoring companies’ compliance with FRSs. This specific watchdog falls away under the new Act.

(8) The main administrative tool for both the FRIP and the Commission is the *administrative investigation*.

(a) The old Act specifically recognised that *investigation procedures* must be in accordance with the PAJA; the new Act omits such reference. However, since an administrative investigation by the Commission constitutes administrative action in terms of the PAJA, the PAJA applies nevertheless. Recent case law confirms too that administrative enquiries are increasingly perceived to be subject to the principles of procedural fairness.

(b) The new Act provides for a *right to a complaint* to the Commission and statutorily provides for specific administrative action such as the notice of non-referral to the complainant (s 170(1)(c)) and specific time-limitation clauses (s 219(1): three years). This right is available to anyone (s 168(1)). The old Act fell far short of that: the only right any person had was the right to be an informer to the FRIP (s 440AA: “Any person who has reason to believe ... may refer the matter to the ... Panel”).

(c) The *powers to support investigations and inspections* are set out in a much more detailed manner under the new Act (ss 176-179) than the sporadic provisions in the old Act (s 440V(3), s 440BB).

(9) As regards the *compliance-notice procedure* in terms of the new Companies Act, the Act does not state the legal consequences if the Commission fails to observe mandatory procedural requirements. Currie sensibly suggests a differentiating approach: The compliance notice will only be invalid if it fails to comply with the gist of the principles of procedural fairness (adequate notice of the administrative action; reasonable opportunity to make representations).

(10) If a company does not comply with a compliance notice, the Commission may ultimately apply to the court for an order to wind up the company.

(11) A review by the Companies Tribunal in terms of s 172(1) of a compliance notice issued by the Commission, if it is submitted, is not a mere internal review but a judicial review.

(12) The Tribunal's decision made as a consequence of an application to it in terms of s 172(1) is subject to judicial review (s 172(4) of the Companies Act, read together with s 6 of the PAJA). Section 172(4) does not itself grant a right to a curial review. Neither does it grant a right to an appeal.

(13) Neither the PAJA nor the old or the new Companies Act includes provisions as to the withdrawal of unlawful administrative action. These matters are thus left to the common law.

4.2 European Union²⁸⁹

Within the EU, administrative action and enforcement in cases of non-compliance with IASs (as defined in art. 2 of the ‘foundational’ IAS regulation) is not the domain of Community law, but of national law. Consequently, there are as many enforcement laws and procedures as there are member states in the EU (27); they have not been harmonised yet.

To illustrate the system of administrative action and enforcement, the legal situation in Germany will be detailed in this chapter. The example of Germany has been chosen for several reasons: Germany and its economy are the financially and economically dominant force within the EU; the UK, whose system comes to mind first in comparison with South Africa’s system, will possibly exit the EU in the near future and will then no longer be a member state; and the German model is, to a sizeable extent, modelled on the older UK model. Germany’s system therefore seems to be a valid model to compare with South Africa’s.

4.2.1 Enforcement procedure in Germany

In Germany, in order to monitor and enforce compliance with IASs (in particular as regards consolidated financial statements), a new *Enforcement-Verfahren* (“enforcement procedure”) was introduced in 2004 (Grossfeld & Luttermann, 2005:1794 and 146).

This *Enforcement-Verfahren* consists of two stages. The first is performed by the *Deutsche Prüfstelle für Rechnungswesen (DPR)*, “Financial Reporting Enforcement Panel (FREP)”.²⁹⁰ The DPR (FREP) is to a large extent modelled on the English Financial Reporting Review Panel

²⁸⁹ An earlier version of Chapter 4.2 was published as Schmidt *et al.*, 2011.

²⁹⁰ See www.frep.info [Accessed 2010, August 31].

(Gelnhausen & Hönsch, 2005:512). In the second stage, the powerful *Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin*, “Federal Financial Supervisory Authority (FFSA)”) ²⁹¹ in Frankfurt steps in.

The *Enforcement-Verfahren* is a hybrid procedure. Its first stage is governed entirely by unenforceable private law, while its second stage is governed by enforceable administrative law.

The *Enforcement-Verfahren* is designed to cope with the vast majority of investigations (‘examinations’²⁹²) in the course of the first stage. BaFin’s involvement is intended to be only residual.

The DPR has its legal basis in the German Commercial Code (*Handelsgesetzbuch*, abbreviated as *HGB*), notably s 342b of the HGB,²⁹³ whereas BaFin has its legal basis in ss 37n-37s of the German Securities Trading Act (*Wertpapierhaftungsgesetz*, abbreviated as *WpHG*).²⁹⁴

Any company of any country whose debt and equity instruments are admitted to trade on the *Regulierter Markt* (‘Regulated Market’,²⁹⁵ which has its equivalent in the JSE’s Main Board

²⁹¹ See www.bafin.de [Accessed 2010, August 31].

²⁹² The English versions of the DPR and BaFin websites refer to these investigations as “examinations”.

²⁹³ See appended documents.

²⁹⁴ See appended documents.

²⁹⁵ Until 1 November 2007 the present-day *Regulierter Markt* was made up of two different market segments, namely the first-tier *Amtlicher Handel* (‘Official List’, whose counterpart was the JSE’s Main Board Listing) and the second-tier *Geregelter Markt*. Regarding these two previous market segments see Schmidt & Kloppers (2003:174). With the establishment of the *Regulierter Markt*, the *Geregelter Markt* and the *Amtlicher Handel* were merged and the listing requirements and post-listing obligations of the *Amtlicher Handel* are now applicable to all companies admitted to the *Regulierter Markt*. The newly created *Regulierter Markt* was segmented, in turn, into the residual ‘*General Standard*’ and the (higher) ‘*Prime Standard*’. Inclusion into the *Prime Standard* is a presupposition for being eligible to be included into the *Deutsche Aktienindex (DAX)*. The *Prime Standard* imposes considerably stricter post-listing disclosure obligations on the companies than the *General Standard* does, see Regulations 65-70 of the FSE Regulations (FSE, 2010). Notably, according to Regulation 65 of the FSE Regulations companies listed on the *Prime Standard* have to submit to the FSE financial statements which comply with the European Union’s International Accounting Standards (hereinafter “EU-IASs”).

Listing) of one of the German Stock Exchanges (notably the *Frankfurter Wertpapierbörse* ('FWB'), hereinafter "Frankfurt Stock Exchange" ('FSE')²⁹⁶) is subject to the *Enforcement-Verfahren*. As at 31 August 2010, there were 970 such companies. At present no South African or Namibian company is listed on this market segment of any of the German stock exchanges. Two South African companies²⁹⁷ currently trade on the second-tier *Freiverkehr* ('Open Market') of German stock exchanges. The bulk of all foreign companies trading on German exchanges are found in this segment. The regulation of the *Freiverkehr* is comparatively light (Schmidt & Kloppers, 2003:174). Notably, companies trading on the *Freiverkehr* are not subjected to the *Enforcement-Verfahren* and the DPR's investigations.

What are the legal consequences if accounting errors are detected? BaFin requires the company to publish the error on the internet in the *Elektronischer Bundesanzeiger* (Electronic Federal Official Gazette),²⁹⁸ s 37q(2) of the WpHG. Thus, the non-compliant company suffers adverse publicity.²⁹⁹ However, neither the DPR nor BaFin instructs the company to correct the error or tells it how the error should be corrected;³⁰⁰ nor is the company prevented from commenting publicly on its publicised accounting error. Furthermore, the precise wording of the error publication is not prescribed by BaFin.

²⁹⁶ There are several German stock exchanges. Among them, the role of the FSE is pre-eminent. In 2009, more than 80% per cent (by turnover) of all securities deals on German exchanges were carried out on the FSE. See www.deutsche-boerse.com [Accessed 2010, August 31]. To keep matters simple only the FSE is mentioned in this article.

²⁹⁷ Harmony Gold Mining Ltd (www.harmony.co.za) and Highveld Steel and Vanadium Corporation (www.highveldsteel.co.za) [Accessed 2010, January 15].

²⁹⁸ See www.ebundesanzeiger.de.

²⁹⁹ In practice, this is a powerful means: a survey conducted by PricewaterhouseCoopers in 2009 showed that 89% of the surveyed companies are of the opinion that such error publication leads to severe reputational damage (DPR, 2009:10).

³⁰⁰ In practice, subsequent to having been investigated by the DPR and subsequent to an error having been detected by the DPR in their financial statements, one third of these companies voluntarily rectify their financial statements (DPR, 2009:10).

Only the most recent set of financial statements is subject to the *Enforcement-Verfahren* (s 342(b)(2) of the HGB). Furthermore, companies listed on the *Regulierter Markt* of the FSE are subject to a separate enforcement procedure under the *Frankfurter Wertpapierbörse Börsenordnung* (FSE Regulations; FSE, 2010).³⁰¹

4.2.1.1 The German Financial Reporting Enforcement Panel (FREP): *Deutsche Prüfstelle für Rechnungslegung (DPR)*

The DPR is a private body (in the form of an *eingetragener Verein*, i.e. a registered association) with juristic personality and is governed by private law. It is not an administrator and does not perform administrative actions.³⁰² The German administrative law does not apply to its actions.³⁰³

The recently inserted enabling provision s 342(b) of the HGB³⁰⁴ empowers the German Federal Department of Justice (*Bundesjustizministerium*) to recognise – with the approval of the German Federal Department of Finance (*Bundeswirtschaftsministerium*) – an “institution governed by private law” as competent body to investigate financial statements for the purpose of detecting non-compliance with IASs. The Federal Department of Justice did so in an agreement with the DPR dated 30 March 2005 and thus conferred upon the DPR the power to perform enforcement investigations.

³⁰¹ As regards a company’s annual financial statements, Regulations 62(1) and 70(2) of the *FWB Börsenordnung* set out procedures for non-compliance. These procedures are to be followed if the company does not comply with EU-IASs. Ultimately, the *FWB Börsenordnung* provides for the FSE’s management to terminate a company’s listing.

³⁰² See *infra* Chapter 4.2.1.3.

³⁰³ See *infra* Chapter 4.2.1.3.

³⁰⁴ See appended documents.

There are three types of DPR enforcement investigations ('examinations'), namely: 'random sample investigations', 'investigations requested by BaFin' and 'indication-based investigations'³⁰⁵ (in circumstances where there are specific indications of non-compliance with financial reporting requirements).

Since an investigation by the DPR is entirely consensual, the DPR can only investigate a company's financial statements, if the company concerned agrees. If the company refuses to cooperate, the DPR has no further powers and an investigation by the DPR will thus not take place. The second stage of the *Enforcement-Verfahren* will come to bear. At this stage BaFin has the discretionary power to order a compulsory enforcement investigation.

The DPR has several standing committees: among others, there is the "Pre-review Committee" (which assesses whether to initiate an 'examination with cause') and the "Sampling Committee" (which determines the principles for sampling testing).

For each particular DPR investigation, a member of the DPR is designated as the investigator-in-charge ('examiner-in-charge') and is responsible for performing all investigative activities. He answers to the specific DPR *Kammer* ("chamber")³⁰⁶ to whom the investigation has been assigned, and is bound by its instructions. The *Kammer* is responsible for the ultimate findings of an investigation. There are several *Kammern* within the DPR in order to cope with the DPR's workload. Each comprises three members of the DPR, and makes decisions by majority vote. The investigator-in-charge is not part of the *Kammer* to which he reports.

The chairperson of a *Kammer* designates a member of the DPR to act as Quality Control Member (*Berichtskritiker*). The Quality Control Member must not be a member of the relevant

³⁰⁵ The term used for indication-based investigations in the unofficial translation of the HGB and the WpHG is "examination with cause". This term is unfortunate. The term "indication-based examination" should rather have been used – as in the DPR's annual activity report 2009 (DPR, 2009; see appended documents).

³⁰⁶ The official translation of the DPR's Code of Procedure (as per the DPR's website) uses the term "chamber" to translate the German term *Kammer*. This is an unfortunate translation; the term "committee" should rather have been used.

Kammer. He must critically review the enforcement investigation documentation prepared by the investigator-in-charge and report his conclusions to the chairman of the *Kammer*.

The DPR's Code of Procedure (DPR, 2005) sets out detailed rules to ensure that all staff involved in investigations act impartially.

When initiating its investigation the DPR contacts the company's management and requests the company's audit reports in addition to its individual and consolidated financial statements. The DPR also requests from the company's board a list of unadjusted audit differences as well as a management declaration stating that these audit differences do not have a material effect on the financial statements. It is noteworthy that the company's external auditors are not obliged to furnish the DPR with any information, unless the company has given its prior consent.

Once the company's board has agreed to cooperate in the DPR's investigation, the assigned DPR *Kammer* will set specific focus areas for the investigation based on the documents received from the company. The investigation is, thus, not a full-scale audit. Notably, it is not aimed at the company's internal control system (Gelnhausen & Hönsch, 2005:513), but is limited to accounting errors only. The company's board members do not have to give self-incriminating answers (s 342(b)(4) of the HGB). The investigator-in-charge performs the investigation according to the set investigation plan,³⁰⁷ and is subject to review by the *Kammer's* designated Quality Control Member.³⁰⁸ Based on the results of the investigation, the *Kammer* decides whether the company's reporting complies with the required standards or whether it contains errors.³⁰⁹ Thereafter, the *Kammer* notifies both the company and BaFin of the result and, in the event erroneous accounting was detected, further requests that the company state whether or not

³⁰⁷ ss 6 (2) of the Code of Procedure of the DPR.

³⁰⁸ ss 8(2), 17(4) of the DPR Code of Procedures.

³⁰⁹ ss 4(1), 17(5) of the DPR Code of Procedures.

it agrees with the results.³¹⁰ In either case, at that stage, the DPR's competence to decide on the matter comes to an end.

If the company does not concur with the DPR's error assertion,³¹¹ BaFin will initiate its own additional enforcement investigation in order to confirm or refute the DPR's findings. If BaFin's investigation confirms the accounting error, BaFin has the error publicised whether the company concurs or not.

If the company refuses to cooperate in the DPR's investigation, the DPR has no further powers and an investigation by the DPR will thus not take place. The matter will simply be handed over to BaFin, which decides whether it will launch an investigation itself. This time, the company has no choice: it has no right to refuse to be investigated by BaFin. BaFin can enforce any investigation.

In practice, the DPR works speedily³¹² and the DPR's approach is assertive, to say the least. Companies usually get set very tight deadlines of between a few days to a fortnight to respond to the DPR's questions and to submit the requested documentation.³¹³ The DPR usually views delays as a discontinuation of the company's cooperation and the case is then immediately referred to BaFin.

³¹⁰ s 17(6) of the DPR Code of Procedures.

³¹¹ In practice, 80% of the investigated companies agree with the DPR's error assertions (DPR, 2009:5 and 2009: Appendix 4).

³¹² As per its annual activity report (DPR, 2009:3, see appended documents) the DPR has a target corridor of 110-140 sampling investigations per year in order to ensure an investigation cycle of investigating all publicly traded companies every 8 to 10 years. In 2009 118 companies were investigated, of which 103 were 'sampling investigations' and 14 were 'indication-based investigations'. Accounting errors were found in 23 cases (DPR, 2009:2 and 3). Most errors occurred in applying IFRS 3, IAS 39 and IFRS 8. As to the further types of accounting errors detected, see DPR, 2009:6 and DPR, 2009: Appendix 6.

³¹³ Bockmann (2009: E-mail).

4.2.1.2 The German Federal Financial Supervisory Authority: *Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*

In contrast to the DPR, BaFin is not a private body. Rather, it is an independent institution with juristic personality which is part of the federal public administration, but is positioned outside the federal administrative hierarchy. It is thus governed by administrative law, performing a public function (*viz.* the monitoring and enforcement of compliance with IASs) in terms of national legislation (ss 37n-37s of the WpHG). Its actions *vis-à-vis* an investigated company are administrative actions; the German administrative law applies and so do the principles of administrative procedural fairness (principles of natural justice). So there are marked differences between investigations performed by the DPR and those performed by BaFin.

BaFin is independent, *i.e.* it is not part of the federal administrative hierarchy. Although the Federal Department of Justice exercises technical supervision, it is not an administrative entity superior to BaFin within the administrative hierarchy. There is thus no review by, or appeal to the Federal Department of Justice against BaFin's administrative action.³¹⁴

BaFin operates in the public interest. Its primary objective is to guarantee the functioning, stability and integrity of the German financial system. BaFin has the power to instruct the DPR to initiate an investigation as well as the power to define the scope of such investigation (s 342(b)(2) no.2 of the HGB, read with s 37p(2) of the WpHG). Furthermore, it has the power to initiate its own investigation of a company, once the company has refused to co-operate with the DPR (s 37p(1) of the WpHG).

BaFin notifies the company of the result of its investigation. If accounting errors are found, BaFin has them publicised. Both the result notification and the publication are *administrative action* in terms of the German administrative law.

³¹⁴ See *infra* Chapter 4.2.1.3.

As regards a company's investigation by BaFin itself, BaFin has been granted extensive statutory powers (s 37o(4)-(5) of the WpHG). It may require the members of the company's boards (both the management and supervisory boards³¹⁵) as well as its employees and its external auditors and the company's subsidiaries, if any, to furnish information and documentation to BaFin to the extent required for the purposes of the investigation. This includes the power to issue summons. This right does not extend to the company's majority shareholders (Gelnhausen & Hönsch, 2005:520). The company's external auditor has a duty to provide any information BaFin requests from him. This duty is, however, limited to facts disclosed to the external auditor "within the context of the audit" (Gelnhausen & Hönsch, 2005:520). Notably, it does extend to the auditor's working papers (*Arbeitspapiere*) as well.³¹⁶ Again, the parties are not obliged to give self-incriminating answers (s 34(4) of the WpHG, read with s 4(9) of the WpHG). The Act explicitly states that the persons concerned have to be informed of this right as well as of their right to legal counsel. BaFin may commission persons to act as investigators and may use DPR staff to aid in its investigations.

Persons obliged to furnish information have to grant BaFin's employees access to their business premises during normal business hours to the extent required for the purpose of an ongoing investigation. Entry by BaFin's employees without permission is allowed only in exceptional cases, namely to prevent imminent danger to public order, and only if there is evidence indicating that the person required to provide information is contravening the WpHG. The WpHG explicitly states that, under these circumstances, the affected persons' constitutional right to the "inviolability" of their premises in terms of art. 13 of the German Constitution ("Inviolability of a person's home") – which has its equivalent in s 14(a) and (b) ("Privacy") of

³¹⁵ Note that Germany, in contrast to South Africa, operates a two-tier board system, consisting of a management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*).

³¹⁶ *OLG* (Higher Regional Court) Frankfurt a.M., Decision of 12 February 2007 (2007 *Betriebsberater* 1383) and *OLG* (Higher Regional Court) Frankfurt a.M., Decision of 19 November 2007 (2007 *Der Betrieb* 629). See Paal (2007:1778) and Zülch & Hoffmann (2010:945). Concerns regarding the constitutionality of these two decisions have, however, been voiced by several authors on this subject, see Fölsing (2008:394). Gelnhausen & Hönsch (2005:523) also firmly reject the view that this duty of the auditor extends to the auditor's working papers as well. Regarding the *OLG* Frankfurt's unique role as regards the enforcement of IFRSs see *infra* Chapter 4.2.1.3.

the South African Constitution) – is restricted. This entails the following: firstly, no advance judicial warrant is required for BaFin’s employees in order to enter the premises. Instead, BaFin is statutorily authorised ultimately to do so in the course of its enforcement investigation (s 37o(5) of the WpHG). Secondly, even the external auditor’s business premises can be searched. Neither situation has occurred to date.³¹⁷

4.2.1.3 Review and appeal

From a South African perspective and South Africa’s definition of *administrative action* in s 1 of the PAJA, BaFin’s activities would undoubtedly be classified as administrative action. Given the considerable degree of similarity between South African and German administrative law, in particular as regards the definition of administrative action, it is not surprising that this is exactly the German position, namely that BaFin’s activities constitute *administrative action*. BaFin is part of the federal public administration, and it performs a public function in terms of national legislation. Thus it is governed by administrative law, and its actions vis-à-vis an investigated company are administrative actions. German administrative law therefore applies.³¹⁸

As regards the DPR’s activities from a South African perspective, again in terms of s 1 of the PAJA, the DPR makes ‘*decisions*’ (namely the decision to initiate investigations), it ‘*performs a public function*’ (namely monitoring compliance with IASs and performing enforcement investigations) and it does so ‘*in terms of an empowering provision*’ (namely s 342(b)(1) of the HGB). Providing information and documentation imposes a burden on the investigated company; thus, provided the company has agreed beforehand to be investigated, the DPR’s decision to investigate it ‘*adversely affects*’ it. Whether any ‘*rights*’ of the company are ‘*affected*’ seems to

³¹⁷ Bockmann (2009, E-mail).

³¹⁸ See supra Chapter 4.2.1.2.

be more difficult to establish.³¹⁹ The company's right to undisturbed trading or its right not to have its 'good name' affected by a compulsory publication of a detected accounting error might, however, suffice. Finally, the DPR's decision has to have a '*direct, external legal effect*' on the company. The effect is indeed '*external*', since the company is an entity outside the public administration. The effect is '*direct*', since there is no statutory review procedure regarding the DPR's decision to investigate.³²⁰ The effect is, however, not '*legal*': 'legal' in terms of s 1 of the PAJA means (Pfaff & Schneider, 2001:72) that the DPR's action determines the company's rights and duties in a binding manner. The company, however, can simply refuse to be investigated. The DPR's action (request to investigate) thus does not determine any duties.

Thus, in terms of South African administrative law, the DPR's activities would not be regarded as administrative action in terms of s 1 of the PAJA.

Given the considerable degree of similarity between South African and German administrative law (in particular as regards the definition of administrative action), it is not surprising that, according to overwhelming opinion, the private body 'DPR' is not regarded as performing administrative action under German administrative law either (Wojcik, 2008:326). That also clearly emanates from the Explanatory Memorandum to s 342(b) of the HGB (Wojcik, 2008:327). That is why there is no internal administrative review or appeal (referred to in German as *Widerspruchsverfahren*³²¹) provided for in s 342(b) of the HGB and why the German Administrative Courts Code (*Verwaltungsgerichtsordnung*³²²), which codifies general principles of administrative law, among others the *Widerspruchsverfahren* (ss 68 *et seq.*), does not apply either.

³¹⁹ Regarding these requirements see *supra* Chapter 2.1.1.5, Chapter 2.1.3.4 and Chapter 2.1.4.2.

³²⁰ See *infra* in this chapter.

³²¹ For a concise (English) description of the German *Widerspruchsverfahren* see Pfaff & Schneider (2001:63).

³²² For a concise (English) description of the German *Verwaltungsverfahrensgesetz* see Pfaff & Schneider (2001:62).

Oddly, in addition, s 342(b)(6) of the HGB explicitly states that there is no review by, or appeal to, the (civil) courts either. Thus, if the investigated company, after it has agreed to an investigation by the DPR, disagrees with the result of the investigation, there is no right of access to court. For this reason, s 342(b)(6) of the HGB on its own would undoubtedly not pass constitutional muster in Germany, had it not been for s 37u of the WpHG which grants full access to the courts at the second stage of the *Enforcement-Verfahren*. The majority of German academic writers on the subject (see Wojcik, 2008:326) regard s 342(b)(6) of the HGB as being within constitutional boundaries because of the inclusion of s 37u of the WpHG, and because a company's participation in an investigation by the DPR is entirely consensual.

At the second stage of the *Enforcement-Verfahren*, provision has been made for both an internal administrative appeal (*Widerspruchsverfahren*) in s 37t of the WpHG as well as, after this remedy has been exhausted, for an appeal to court (s 37u of the WpHG). After the DPR has, as a result of its investigation, found an accounting error, or after BaFin has, as a result of its own investigation, confirmed an accounting error, BaFin issues a unilateral administrative act – of the sort referred to by Burns and Beukes (2006:173) as “administrative dispensation” – to the company. This disposition is declaratory: it merely states that an accounting error (non-compliance with IASs) has been detected and names the error. It is this declaratory disposition which is subject to subsequent administrative appeal in terms of s 37t of the WpHG. This appeal has to be lodged by the company within one month of receiving the administrative disposition. This appeal is peculiar in two respects. Firstly, it has no suspending effect (s 37t(2) of the WpHG). Secondly, the appeal is to BaFin itself, *i.e.* to the very administrative entity which issued the dispensation in the first place. This is because BaFin is an independent administrative entity outside of the administrative hierarchy. There is, thus, no superior administrative entity to which the company can appeal.

After this administrative appeal in terms of s 37t of the WpHG has been exhausted, recourse to court is granted in terms of s 37u of the WpHG in the form of a rescissory action (*Anfechtungsklage*, see Pfaff and Schneider, 2001:63). The action has to be initiated by the company within one month after its receipt of BaFin's decision on the internal administrative appeal. This appeal, too, is peculiar in two respects. Firstly, it does not have a suspending effect

either (s 37u(1) of the WpHG). Secondly, in terms of s 37t(2) of the WpHG, read with s 48(2) of the WpÜG,³²³ this appeal is to the civil court – more specifically, to the Higher Regional Court (*Oberlandesgericht*) Frankfurt – and not to the administrative courts³²⁴ (*Verwaltungsgerichte*). This is inconsequential, since BaFin's declaratory disposition constitutes administrative action and, thus, in terms of the German Administrative Courts Act (*Verwaltungsgerichtsordnung*, s 40), the specialised administrative courts would ordinarily be competent to hear the appeal and not the civil courts. As per the Explanatory Memorandum to s 37u of the WpHG, the Frankfurt court was specifically selected because, due to its proximity to the Frankfurt Stock Exchange, the legislator regarded it as being particularly familiar with matters of this kind. In 2009, an action in terms of s 37u of the WpHG was brought before the *Oberlandesgericht* Frankfurt for the first time. In its decision, the court fully confirmed the DPR's and BaFin's findings.³²⁵

Section 50 of the WpÜG provides for an interim interdict (*einstweiliger Rechtsschutz*) because neither the internal administrative appeal nor the judicial appeal has a suspending effect. Its requirements, however, are quite strict.

4.3 Comparison

Thus far there is no EU enforcement procedure in place. Instead, the monitoring and enforcement of compliance with IASs is a matter for national legislation. There are thus as many enforcement procedures in the EU as there are member states.

³²³ Securities Acquisition Act (*Wertpapiererwerbs- und Übernahmegesetz - WpÜG*) of 20 December 2001 as amended by the Act of 30 July 2009.

³²⁴ Specialised administrative courts like the German *Verwaltungsgerichte* are, thus far, unknown in South Africa. Instead, administrative disputes have always been resolved by civil courts. Burns and Beukes (2006:278) strongly advocate the introduction of specialised administrative courts in South Africa.

³²⁵ *OLG* Frankfurt a.M., Decision of 24 November 2009 (2009 *Betriebsberater* 111). See Gödel (2009:435) und Zülch & Hoffmann (2010:87).

The South African monitoring and enforcement procedure and the German one (*Enforcement-Verfahren*) display significant differences.

(1) In South Africa, *any company* that has to comply with FRSs is subject to the enforcement procedures. In contrast, in Germany, only domestic and foreign companies which are admitted to trade on the *Regulierter Markt* of a German stock exchange are subject to the *Enforcement-Verfahren*. Both in South Africa and Germany, listed companies are further subject to separate monitoring and enforcement procedures under the JSE Limited's Listings Requirements and the FSE Regulations, respectively.

(2) South Africa operates a straightforward one-stage procedure: the investigating body is the Companies and Intellectual Property Commission ("the Commission"). Germany operates a *two-stage* procedure: the investigating bodies are the DPR and BaFin. Investigations by the DPR can only be conducted if the company concerned agrees to be investigated. In contrast, investigations by BaFin as well as by the Commission do not require the company's prior consent: they are compulsory. As a rule, BaFin only launches an investigation once a company has refused to be investigated by the DPR.

(a) The Commission's activities vis-à-vis the investigated company are governed by administrative law. Its actions are administrative actions in terms of the PAJA. As per s 5(4) of the new Companies Act, therefore, the new Companies Act and the PAJA concurrently govern the Commission's actions. In the event of inconsistencies between the new Companies Act and the PAJA, however, the provisions of the PAJA prevail.

In Germany only BaFin's activities are *governed by administrative law* and, only its actions are administrative actions in terms of the German administrative law. Because the DPR is not an administrator, German administrative law does not apply to its actions: its activities are governed entirely by private law.

(b) While the Commission can investigate companies on its own initiative, its usual routine seems to be to initiate *investigations on complaint*. Sampling investigations are confined to a subset of companies.

The DPR can also initiate investigations on complaint (“*examinations with cause*”). This is, however, not the norm. Rather, the DPR focuses on performing – on its own initiative – random investigations (“*random sample examinations*”) and strives to have investigated the population of the approximately 1,000 companies in question within an investigation cycle of around ten years. ‘Random sample examinations’ account for over 85% of the DPR’s annual investigations.

(c) Both the Commission and BaFin are *independent* administrative entities outside of the hierarchy of their respective public administrations. Nevertheless, the Commission can still be instructed by the Minister to launch an investigation, while BaFin cannot be so instructed.

The DPR, on the other hand, is not an administrative entity at all: it is a private body upon which the Federal Ministry of Justice conferred the power to conduct (non-compulsory) investigations. BaFin, however, retains the right to instruct DPR to launch an investigation in certain circumstances.

(3) As regards the conduct of investigations, there are differences between the German and the South African *investigation procedures*.

(a) As regards the DPR’s investigations, the involvement of the *Quality Control Member (Berichterstatter)* is an additional safeguard to ensure impartiality and quality. There is no equivalent in the South African Commission’s investigations. Neither is there an equivalent in BaFin’s investigations. One might argue, therefore, that the Quality Control Member has only been introduced because the DPR – in contrast to BaFin and the Commission – is merely a private body.

(b) *Search and entry powers* during investigations seem wider under German law than under South African law. In contrast to the situation in South Africa, no advance judicial warrant seems necessary in Germany prior to entering business premises.

(4) As regards the courses of action resulting from an investigation, German and South African procedures differ:

(a) South African procedure aims at correcting the detected non-compliance (*compliance notice*). Pressure is maintained on the company up to the point when the Commission issues a compliance certificate. Only this certificate finally gets the investigated company off the hook.

The German system, in contrast, does not enforce correction of the detected non-compliance. BaFin simply notifies the company of the detected error and requires this error to be publicised in the Electronic Federal Official Gazette (*Elektronischer Bundesanzeiger*). Thus, pressure only exists in the form of adverse publicity from which the company might suffer.

(b) Publication of the error is, thus, the default sanction under the German system. In South Africa, publication of the Commission's report is also possible. However, such publication does not have to be as prominent as it is in Germany (Electronic Federal Official Gazette).

(5) Under the South African system, there is regrettably no provision in either the PAJA or the new Companies Act for the *withdrawal* by the Commission or by the Tribunal of its own unlawful administrative acts.

In contrast, German statutory general administrative law deals with the issue: BaFin can withdraw its own unlawful administrative action.

(6) No *internal administrative review or appeal* is provided for under the South African enforcement procedure. Review by the Companies Tribunal is not internal; it is a judicial administrative review.

Under the German procedure, there is no judicial administrative review comparable to the one performed by the Companies Tribunal. However, there is an internal administrative appeal against BaFin's administrative action. This appeal has no suspending effect. Moreover, the

appeal is to BaFin itself and, thus, to the very administrative entity which issued the original administrative act.

There is no internal review of, or appeal against, the findings of the DPR's investigations. However, these findings are not binding on the company in any event. If the company disagrees with the DPR's findings, BaFin simply starts an investigation of its own.

(7) The new Companies Act refers to a right to judicial review granted in terms of the PAJA. It does not grant a statutory right to appeal. The German law goes further and allows for a full appeal. Under the South African system, having the Commission's administrative action reviewed by the Companies Tribunal is not a prerequisite for an appeal to court. Since South Africa does not have specialised administrative courts, all appeals are to the civil courts. Germany, on the other hand, has specialised administrative courts (*Verwaltungsgerichte*). Nevertheless, appeals against BaFin's administrative acts go to a civil court. In addition, in Germany, one particular court (the Higher Regional Court Frankfurt) handles all appeals. There is no such concentration of competence in South Africa.

5. External control of financial reporting standards

5.1 South Africa: External control of FRS regulations

South African law provides for control of FRS regulations by both Parliament and the courts.³²⁶

It is worthwhile noting that there is no control of FRS regulations by the Companies Tribunal. The Tribunal as an adjudicative body merely reviews the Commission's administrative action aimed at achieving compliance with FRSs. It is, however, not competent to review FRS regulations themselves, irrespective of whether one regards them as administrative action (performed by the Minister) or as delegated legislation.

5.1.1 Parliamentary control

Section 55 of the Constitution imposes on Parliament the general duty to provide mechanisms "to ensure that all executive organs of state in the national sphere of government [which includes the Minister of Trade and Industry] are accountable to it."

FRS regulations have a dual nature: they are both ministerial administrative action,³²⁷ on the one hand, and delegated legislation.³²⁸ In either capacity, they are subject to parliamentary control.

³²⁶ See infra Chapter 5.1.1. and Chapter 5.1.2.

³²⁷ See supra Chapter 2.1.4.2.

³²⁸ See supra Chapter 2.1.1.2.

Section 92(3) of the Constitution states that ministers “must act in accordance with the Constitution ... and must provide Parliament with full and regular reports on matters under their control.” Section 92 of the Constitution entrenches the principle of ‘executive accountability’: cabinet ministers (such as the Minister of Trade and Industry) are “accountable collectively and individually to Parliament for the exercise of their powers and the performance of their functions” (s 92(2)). Hence, this includes administrative actions that are performed in the issuing of FRSs.

The Minister of Trade and Industry is responsible to Parliament for FRS regulations issued by him in terms of s 223 of the new Companies Act. This accountability entails that the Minister has to give Parliament reasons and explanations for his actions and it is usually discharged by the Minister’s participation in *interpellations* (which is a parliamentary procedure whereby the Minister is required to explain some action or policy in the course of a short debate) and by parliamentary question time.

These control mechanisms have their flaws, though: Currie and De Waal (2001:256) note that while members of Parliament may ask the Minister questions, the Constitution does not explicitly require the Minister to answer them satisfactorily. Hoexter (2007:72) points out that “the expectation that Ministers are capable of accounting for all the actions of their officials is a hopelessly optimistic one.” Rautenbach and Malherbe (2004:179) note that in practice Parliament has had trouble forcing individual ministers to resign, since ministers have been slow to accept individual ministerial responsibility for maladministration in their department. Burns and Beukes (2006:139) observe that, since ministers belong to the majority group in Parliament, they are very rarely taken to task by members of the majority group for undesirable administrative action taken.

As regards FRSs as delegated legislation, s 101(4) of the Constitution provides that national legislation “may specify the manner in which, and the extent to which” delegated legislation must be “tabled in Parliament ... and approved by Parliament.”

This national legislation is currently s 17 of the Interpretation Act No. 33 of 1957: it requires a list of delegated legislation (though not the delegated legislation itself) to be tabled in Parliament

within 14 days after the promulgation of such legislation. Section 17 of the Interpretation Act has, however, been interpreted by the courts (*Bloem v State President of the Republic of SA 1986 (4) SA 1064 (O) 1089*) as being merely directory, rather than mandatory. What does that entail? At common law the failure to comply exactly with a mandatory provision generally results in the action being invalid, while failure to comply exactly with a directory provision does not (Botha, 2005:109); partial compliance or even non-compliance is thus more likely to be acceptable.

Apart from this general provision in s 17 of the Interpretation Act, specific statutes may also require delegated legislation to be tabled in Parliament or even approved by Parliament before promulgation (Hoexter, 2007:74, citing s 10(4) of the PAJA as an example). The new Companies Act, however, contains no such provision.

This control mechanism is flawed, too. Both Burns and Beukes (2006:139) and Hoexter (2007:73) agree that in practice the system of parliamentary scrutiny of delegated legislation has always been weak and ineffective in South Africa.

5.1.2 Control by the courts

As with control by parliament, control of FRS regulations is influenced by their dual nature.

5.1.2.1 FRSs as administrative action

As the establishment of FRSs is an administrative action in terms of the PAJA,³²⁹ judicial control occurs in the form of review by the court (s 6 of the PAJA).³³⁰ In contrast, no right to an appeal is provided for by the Companies Act.³³¹

However, as was indicated earlier,³³² the distinction between review and appeal is not as hard and fast as it seems theoretically. Delegated legislation in its capacity as administrative action is, among other things, subject to review on the basis of ‘unreasonableness’ as set out in s 6(2)(h) of the PAJA. Review for reasonableness has, however, always been considered a murky area, where there is a danger that courts cross over from review to appeal and in fact assume the role of the administrator. Assessing reasonableness without scrutinising the merits of administrative decisions is hardly ever possible. Hoexter (2007:316) submits that review for reasonableness threatens the very distinction between review and appeal. Burns and Beukes (2006:279) aptly speak of “the blurring of the distinction between review and appeal” in this area. Recent case law supports this: in *Carephone (Pty) Ltd v Marcus NO (1999 (3) SA 304 (LAC) par 36*), Froneman J, while equating reasonableness with justifiability (see Hoexter, 2007:303), said that,

“[i]n determining whether administrative action is justifiable ..., value judgements will have to be made which will, almost inevitably, involve the considerations of the ‘merits’ of the matter in some way or another.”

Equally, Cameron JA in *Rustenburg Platinum Mines (Rustenburg Section) v CCMA (2007 (1) SA 576 (SCA) par 31*) found that the line between review for reasonableness and appeal is “notoriously difficult to draw”. Nevertheless, as Hoexter (2007:107) points out, the distinction between review and appeal continues to be upheld by South African courts (see *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs 2004 (4) SA 490 (CC) par 45*), and it is unknown for them to question this distinction. The reason is that this distinction expresses the

³²⁹ See supra Chapter 2.1.4.2.

³³⁰ See supra Chapter 4.1.2.2.8.

³³¹ See supra Chapter 4.1.2.2.8.

³³² See supra Chapter 4.1.2.2.5.1.

doctrine of separation of powers, which holds that judges must not pronounce on the merits of administrative decisions, since they would then encroach on the functions entrusted by the Constitution to the executive branch (Hoexter 2007:107).

The High Courts and the Constitutional Court as well as “designated magistrates’ courts” (in terms of the definition of “court” in s 1 of the PAJA) are competent to perform a judicial review. Burns and Beukes (2006:277) point out that this inclusion of magistrates in the review of administrative action is not unproblematic for two reasons.

Firstly, in *Van Rooyen v S* (2002 (5) SA 246(C)) it was controversial whether the statutes governing magistrates (Magistrates Act No. 90 of 1993 and Magistrates’ Courts Act No. 32 of 1944) provide sufficient institutional independence of magistrates from the executive branch. The High Court found that they do not, while the Constitutional Court (per Chaskalson CJ) subsequently held that, although the executive branch has a strong influence on the appointment of the Magistrates’ Commission, the magistrates’ courts nevertheless do not lack institutional independence. Strong concerns about the independence and the accountability of the magistrates’ courts have also been expressed by Plasket (2002a:511). He doubts whether magistrates are equipped to deal with matters of administrative law, a discipline that many judges have difficulty with. He further points out that magistrates’ courts are the most under-resourced in South Africa, often lacking such basic necessities as law reports.

Secondly, as per s 170 of the Constitution,³³³ magistrates’ courts are prohibited from enquiring into the constitutionality of legislation (including delegated legislation such as FRS regulations). With regard to the dual nature of FRS regulations as both administrative action and delegated legislation this leads to the odd result that a designated magistrates’ court may perform an administrative review of FRS regulations, but must not perform a constitutional review of FRS regulations. This raises the issue of whether the constitutional prohibition in s 170 of the Constitution for consistency’s sake also prohibits an administrative review in terms of the PAJA or the Companies Act. The fact that s 170 is part of the Constitution as *suprema lex* and that its review prohibition must thus not be undermined by lower-ranking national legislation such as the

³³³ See *infra* in this chapter.

PAJA or the Companies Act speaks in favour of this conclusion. Nevertheless, it can be argued that that constitutional review and administrative review pursue – at least partly – different purposes. Further, Burns and Beukes (2006:277) point out that administrative review of delegated legislation has traditionally always been allowed at common law. Currie and De Waal (2005:116) offer an elegant solution to this dilemma. Section 170 of the Constitution also allows magistrates' courts to decide “any matter determined by any Act of Parliament”. According to Currie and De Waal, it is open to an Act of Parliament such as the PAJA to confer jurisdiction on magistrates to test the validity of legislation *on statutory grounds*, since this would not involve the direct application of the Constitution. Instead, what would be at issue is simply “whether or not the provisions of ... [the] PAJA have been complied with”, which means that the constitutionality of the PAJA will not be directly tested.

Subsequent to its review, the court may grant remedies and orders to rectify the matter. The administrative-law provisions of the Companies Act are silent as to remedies and orders, while the PAJA provides for them in its s 8 of the PAJA.³³⁴ Burns and Beukes (2006:506) note that

“[t]he heading to section 8 refers to remedies in proceedings for judicial review. However, there is no further reference to remedies made after that – the drafters of [the] PAJA refer only to the orders which a court may make in the proceedings. The failure to refer to remedies is probably of limited significance since the orders which the court may make include the remedies which have always been available at common law. It would appear therefore, as if the terms remedies and orders are used interchangeably.”

Among the remedies and orders listed in s 8 of the PAJA, the following seem suitable to FRS regulations.

The courts may set FRS regulations aside and remit them for re-consideration to the Minister (s 8(1)(c)(i) of the PAJA). What is the legal effect on an FRS regulation, if it is set aside? Because of the presumption of validity (*omnia praesumuntur rite esse acta*), all administrative action including delegated legislation remains in effect (*i.e.* is treated as valid) until it is set aside by a

³³⁴ Regarding the issue as to how the PAJA and the administrative law provisions of the Companies Act affect each other see *supra* Chapter 4.1.1.

court. The effect of setting aside is not prospective (*ex nunc*), but retrospective (*ex tunc*), i.e. the FRS regulation is treated as if it never existed (Hoexter, 2007:485). The court may grant a temporary interdict or other temporary relief (s 8(1)(e) of the PAJA) in order to suspend quickly and temporarily the legal effect of an FRS regulation.

Furthermore, a declaratory order in terms of s 8(1)(d) of the PAJA can be a suitable remedy. It enables a court to declare the rights and obligations of the parties or to state and clarify their legal position. There is no need for an existing dispute: the parties can obtain a final (though appealable) determination of their rights before a dispute has arisen (Hoexter, 2007:493). As Currie (2007:195) points out, however, s 8(1)(d) places two limits on this remedy. First, the declaration can only be obtained for the rights and obligations of the “parties”. The “parties” are the person instituting the proceedings (*viz.* the company which has to comply with a specific FRS regulation) and the administrator (*viz.* the Minister of Trade and Industry). In contrast, the rights and obligations of third parties (*viz.* all the other companies which have to comply with this specific FRS regulation, too) are not affected and cannot be the subject of a declaratory order. Secondly, from the wording “in respect of any matter to which the administrative action relates” it follows that the right or obligation in question has to be relevant to the parties and must not be a purely abstract and intellectual one.

In contrast, directing the administrator (the Minister) in terms of s 8(1)(a)(ii) of the PAJA to act in the manner the court requires (mandatory interdict) is not a suitable remedy. This remedy gives the court the power to substitute its own discretion for that of the administrator. It is set to compel the administrator to perform some or other statutory duty; it can thus not be used when the administrator is not obliged to do something specific under the enabling statute, because he is granted discretion. A mandatory interdict cannot be used to prescribe how the discretion must be exercised. The enabling s 29(4) of the new Companies Act grants precisely such discretion to the Minister (“the Minister ... may ...”) to issue FRSs.

The remedies available in terms of s 8 of the PAJA are, from a constitutional point of view, somewhat problematic when they are applied to FRSs. Section 172 of the Constitution³³⁵

³³⁵ See *infra* in this chapter.

provides for a specific constitutional review of delegated legislation which would include FRSs. How then – as regards FRS regulations – does s 172 of the Constitution affect the remedies granted under s 8 of the PAJA (s 8(1)(c)(i), s 8(1)(e))?

Section 172(1)(a) empowers the courts to declare invalid “any law or conduct” that is inconsistent with the Constitution. This means that administrative action (‘any conduct’) which falls within the definition of s 1 of the PAJA may be declared invalid. What is the difference between setting an FRS regulation aside in terms of s 8 of the PAJA and declaring it invalid in terms of s 172 of the Constitution? Practically none (De Ville, 2005:335). De Ville submits, however, that issuing a declaration of invalidity (in the event that a ground for review in terms of s 6 of the PAJA is at hand) is more suitable than setting the administrative action aside, since the existence of a ground for review equates to an ‘inconsistency with the Constitution’ in terms of s 172 of the Constitution.

In addition to the option of a declaration of invalidity, s 172(1)(b) empowers the courts to ‘make any order that is just and equitable’.

5.1.2.2 FRSs as delegated legislation

As regards FRSs as delegated legislation, judicial control occurs in the form of s 172 of the Constitution.

As mentioned above, s 172(1)(a) prescribes that a competent court declare subordinate legislation such as FRS regulations invalid to the extent that they are inconsistent with the Constitution. When a competent court strikes down delegated legislation such as FRS regulations (Government Notice) such an order would typically read (Du Plessis, 2002:83): “It is declared that Government Notice XYZ is invalid.” Strictly speaking, it is thus not a judicial revocation of delegated legislation. Rather, the effect of such an order is that the affected FRS regulation (Government Notice) is null and void *ab initio* (Du Plessis, 2002:86), *i.e.* it is considered never

to have existed. Mindful of possible adverse consequences of this retrospective effect, s 172(1)(b)(i) explicitly allows a court order to limit retrospective effect. Furthermore, s 172(1)(b)(i) allows an order which suspends the declaration of invalidity for any period and further allows conditions to be attached to it. Du Plessis (2002:85) observes that the Constitutional Court has, for instance, invoked s 172(1)(b) to order the reading of words into a statutory provision. This kind of interpretation (“reading in”) could happen in cases of impugned FRS regulations (Government Notices) as well. ‘*Reading in*’ means that the court would change the text of an FRS provision by adding words to cure a constitutional defect. As a further remedy, (emanating from the words “to the extent” of s 172(1)(a)), the court could limit the impact of an FRS provision by severing it. ‘*Severance*’ means that the court would ‘cut out’ an invalid part of an FRS regulation from the rest of the FRS regulation. Apart from the remedy of ‘severance’, the remedy of ‘notional severance’ is also available to the court. ‘*Notional severance*’, in contrast to severance, does not excise words from an FRS provision; rather, it leaves the words of the provision unaltered but limits the scenarios to which the FRS provision can apply or subjects it to a condition (Bishop *et al.*, 2006:9/102). Finally, and similar to notional severance, the court could read down a provision of an FRS regulation: ‘*reading down*’ could occur when a provision of an FRS regulation possesses two or more possible interpretations, one of them constitutional and the other(s) unconstitutional. Reading down then means choosing the constitutional one (Bishop *et al.*, 2006:9/87).

Any such order or remedy by a competent court other than the Constitutional Court, according to s 172(2)(a), read with s 167(5), has no force unless it is confirmed by the Constitutional Court. As emanates from s 172(2)(a) (“an Act of Parliament”), this confirmation requirement, however, does not apply to delegated legislation such as FRS regulations (Government Notices). Section 170 clarifies that a court “of a status lower than a High Court” is not competent to strike down delegated legislation on constitutional grounds. Therefore, only the High Courts, the Supreme Court of Appeal and the Constitutional Court are competent, while magistrates’ courts and even ‘designated magistrates’ courts’ in terms of item (b)(ii) of the definition of ‘court’ in s 1 of the PAJA are not.

5.2 European Union: External control of IAS regulations

Like South African law, European Union law provides for both parliamentary and judicial control of IAS regulations.

5.2.1 Control by the courts

5.2.1.2 The European Courts and the Advocate General

The European Court of Justice ('ECJ', established in 1952), the Court of First Instance ('CFI'³³⁶, established in 1989 and renamed 'General Court' in 2009 by the Lisbon Treaty) as well as judicial panels (since 2003, referred to as 'specialized courts') constitute the European Community's judicial branch (arts. 251-281 consTFEU, ex-arts. 220-245 TEU).

Both the CFI and the judicial panels were established to ease the workload of the ECJ and the CFI, respectively. Initially, the CFI had only subordinate institutional status vis-à-vis the ECJ (Craig & De Burca, 2008:68). Since 2003, however, each has been given their own respective jurisdictions.

Under certain circumstances an appeal on points of law from judicial panels to the CFI and from decisions of the CFI to the ECJ is allowed. There is no further appeal from the judgments of the ECJ, which is the supreme court of the EU (Craig & De Burca, 2008:71).

³³⁶ Known in French as the *Tribunal de Première Instance*, which explains the T used before the case number when a case is registered with the CFI (e.g. *Jégo-Quéré et Cie. SpA v Commission (Case T-177/01) [2002] ECR II-2365*). See Craig and De Burca 2008,68.

The ECJ consists of one judge per member state, *i.e.* 27 judges (June 2011). The Court may sit as a full Court (27 judges), a Grand Chamber (13 judges) or – in the great majority of cases (75%) – a chamber (3-5 judges) (Craig & De Burca, 2008:68).

The ECJ is assisted by the Office of the Advocate General (8 Advocates General). The Advocate General is a full member of the Court and participates at the oral stage of the judicial hearing. His most important task is to produce a written opinion (the “*reasoned submissions*” mentioned in art. 252(2) consTFEU and ex-222(2) TEU) for the Court (Craig & De Burca, 2008:70). This opinion is delivered before the court makes its decision; it does not bind the Court, but is very influential and is followed by the ECJ in a majority of cases (Craig & De Burca, 2008:70). The Advocate’s General opinion is intended to constitute impartial advice and in practice it tends to be a comprehensive, reasoned account of the law governing all aspects of the case (Craig & De Burca, 2008:70).

5.2.1.2 Access to justice and review of the legality of IAS regulations

There are in essence three ways in which Community norms like the IAS regulations can be challenged in court. These are the *action for annulment* (art. 263 consTFEU, ex-art. 230 TEU), the *preliminary ruling procedure* (art. 267 consTFEU, ex-art. 234 TEU), and the *plea of illegality* (art. 277 consTFEU, ex-art 241 TEU).

5.2.1.2.1 Action for annulment

An action for annulment (art. 263 consTFEU, ex-art. 230 TEU) allows for a Community norm to be challenged in court directly. Ex-Article 230(1) TEU explicitly stated that the court may review the legality of “acts adopted jointly by the European Parliament and the Council ... [or]

the Commission”. Article 263(1) consTFEU, in slightly different wording, states the same. The IAS regulations are precisely such acts.

If the action is successful, the ECJ declares the act null and void (Hoerspool and Humphreys, 2006:277). Declared nullity is retroactive: once the regulation is annulled in terms of art. 264(1) consTFEU (ex-art. 231(1) TEU), it is void *ab initio* (Craig & De Burca, 2008:572), *i.e.* it is considered never to have existed. Such retroactive nullity can cause problems in the case of regulations, since these are of an abstract and general nature and are relied upon by many. Therefore, art. 264(2) consTFEU (ex-art. 231(2) TEU) allows the ECJ to rule that certain or all parts of a measure which has been declared void will, nonetheless, continue in force for certain periods of time, if it considers such an action necessary.

A person (including a company) challenging the legality of an IAS regulation must have standing to do so (*locus standi*). The former art. 230 TEU differentiated between privileged applicants (ex-art. 230(2) TEU: a member state, the European Parliament, the Council, and the European Commission) and non-privileged applicants.

According to the former art. 230(4) TEU, non-privileged applicants could only institute proceedings

“against a decision which, although in the form of a regulation ..., is of direct and individual concern”

to them. The purpose of the former art. 230(4) TEU was

“to prevent the Community institutions from being in a position, whereby by choosing the form of a regulation, to exclude an application by an individual against a decision which concerns him directly and individually; it therefore stipulates that the choice of form cannot change the nature of the measure” (Calpak SpA and Società Emiliana Lavorazione Frutta SpA v Commission [1980] ECR 1949, par 7).

The requirement of ‘*direct concern*’ in terms of ex-art. 230(4) TEU was considered to be satisfied if the measure (the IAS regulation) directly affected the legal situation of the applicant (*i.e.* if it is capable of conferring rights on him or imposing duties or obligations on him) and left

no discretion to those institutions that are entrusted with its implementation (Craig & De Burca, 2008:509). This implementation, therefore, had to be automatic and had to result from Community rules without the application of intermediate rules (Craig & De Burca, 2008:509 and *Société Louis Dreyfus & Cie. v Commission* [1998] ECR I-2309). The IAS regulations are self-executing measures and thus require no further implementation measures.³³⁷ Furthermore, the endorsed IASs impose legal compliance duties on the companies' drawing up of financial statements and thus directly affect their legal situation. The requirement of 'direct concern' was thus satisfied.

The requirement of '*individual concern*' and its judicial interpretation had been at the centre of controversy and critique over the past five decades: The 'abstract terminology' test became the general test applied by the ECJ (Craig & De Burca, 2008:515) when considering challenges to regulations in terms of ex-art. 230(4) TEU. It is exemplified by the *Calpak* decision (Craig & De Burca, 2008:515) and required the court to look behind the form of the measure in order to determine whether in substance it really was a 'true regulation' or not. A 'true regulation' was considered to be at hand if

"the measure applies to objectively determined situations and produces legal effects with regard to the categories of persons described in a generalized and abstract manner"
(*Calpak* [1980] ECR 1969, par 9).

In terms of the 'abstract terminology' test, the IAS regulations would qualify as 'true regulations'. If a regulation was found to be a true one, then the case would stop at this point and the Court would simply conclude that the applicant was not individually concerned (Craig & De Burca, 2008:516).

The case law under this test produced unsatisfactory results and has been duly criticized (Craig & De Burca, 2008:516). The Community courts therefore subsequently eased their stance and were willing to admit that a regulation could be a 'true' regulation as assessed by the 'abstract terminology' test, and yet could be of 'individual concern' to an applicant (*Cordoniu SA v*

³³⁷ See supra Chapter 1.1.2.

Council [1994] ECR-I 1853). Even according to the *Cordoniu* decision (*[1994] ECR I-1853, par 20*), however, an applicant still had to show ‘individual concern’ in terms of the notorious so-called *Plaumann* formula. This formula has been around for over 50 years (since *Plaumann & Co. v Commission [1963] ECR 95*); it is an overly narrow judicial approach to the interpretation of the requirement of ‘individual concern’ and has virtually prevented all direct action (in terms of the former art. 230(4) TEU and its predecessors) brought by private persons (Craig & De Burca, 2008:513). It has faced strong and persistent academic criticism (e.g. Craig & De Burca, 2008:512). According to the *Plaumann* formula as set out in the *Cordoniu* decision, the applicant

“may claim that a contested provision is of individual concern to ... [him] only if it effects ... [him] by reason of certain attributes which are peculiar to ... [him] or by reason of circumstance in which ... [he is] differentiated from all other persons”
(*Cordoniu [1994] ECR I-1853 par 20*).

With regard to the IAS regulations it is thus obvious that a company would hardly ever have been able to demonstrate ‘individual concern’ under the *Plaumann* test.

Up to the effective date of the Lisbon Treaty, the dominant approach of the ECJ remained ‘pure *Plaumann*’ (Craig & De Burca, 2008:517). The ECJ sought to defend its position (e.g. in *UPA v Council [2002] ECR I-6677, par 40*) on the ground that the Treaty on the European Union (TEU)³³⁸ provided for a complete regime of legal protection in terms of access to court (Craig & De Burca, 2008:525): applicants who did not have standing for a direct action under ex-art. 230 TEU could nonetheless test the legality of the Community measure indirectly through ex-art. 234 TEU (Craig & De Burca, 2008:521).³³⁹ Such reasoning comes dangerously close to reductionism (Craig & De Burca, 2008:526) and has been strongly criticised by academics (e.g. Craig & De Burca, 2006:340-344) and even by Advocate General Jacobs in the *UPA* case (*UPA v Council [2002] ECR I-6677, par 102*). Jacobs suggested that standing should be accorded where the contested measure (regulation) had a “substantial adverse effect” on the applicant (Craig & De Burca, 2008:521). Even the CFI deviated from the ECJ’s position: in *Jégo-Quéré et Cie. SpA v*

³³⁸ See supra Chapter 1.1.2.

³³⁹ See infra Chapter 5.2.1.2.2.

Commission ([2002] ECR II-2365) it developed its own, more relaxed test: an individual should be regarded as ‘individually concerned’ by a true regulation if it affected his legal position in a manner which was both definitive and immediate, by restricting his rights or by imposing obligations. Under both the Jacobs test and the CFI’s *Jégo-Quéré* test a company could reasonably easily have been considered individually concerned by IAS regulations. The ECJ, however, did not follow either of those more liberal tests.

The new art. 263 constTFEU is meant to change that situation. It upholds the differentiation between privileged applicants (art. 263(4) constTFEU) and non-privileged applicants (art. 263(4) constTFEU). Furthermore, its wording seems to be aimed at improving on the wording of the former art. 230(4) TEU by stating that non-privileged applicants may institute proceedings “against a regulatory act which is of direct concern to them and does not entail implementing measures.” Unfortunately, as regards ‘implementing’ IAS regulations, art. 263(4) constTFEU is, thus, not in any sense progress. It is true that it only requires – in contrast to the former s 230(4) TEU – ‘direct concern’ and thus frees non-privileged applicants of the additional requirement to prove ‘individual concern’. The severely hampering effect of the *Plaumann* formula has thus now finally vanished in this area. However, art. 263(4) constTFEU explicitly excludes ‘implementing’ regulatory acts from its scope, which is exactly what ‘implementing’ IAS regulations are. ‘Implementing’ IAS regulations are therefore excluded from the scope of art. 263(4) constTFEU and cannot be challenged by means of an annulment action.

Under the former art. 230 TEU, a further difficult obstacle to a successful annulment action was the tight time limit of two months set by ex-art. 230(5) TEU for initiating a direct action. This limit is upheld by art. 263(6) constTFEU. In the case of Community norms (such as IAS regulations) which are to be published in the *Official Journal of the EU*, the time limit is extended by 14 days. In addition, as per art. 102(1)(2) of the ECJ’s Rules of Procedure (ECJ, 2009), another 10 days are added. The overall practical time limit is thus approximately three months. For annulment actions against IAS regulations, the countdown starts with the publication of the IAS regulation in the *Official Journal of the EU*. Clearly then, annulment actions in terms of ex-art. 230 TEU (art. 263(6) constTFEU) has long since prescribed regarding

all currently enacted IAS regulations. This forces applicants to resort to the preliminary ruling procedure discussed in the next section.

5.2.1.2.2 Preliminary ruling procedure

Article 267(1)(b) consTFEU (ex-234(1)(b) TEU) allows an applicant to challenge indirectly the validity of the Community acts (such as IAS regulations) via the national courts.

Already during the effective period of the TEU (ex-art. 230 TEU), the preliminary ruling procedure had become critically important for private applicants because of the ECJ's narrow interpretation of the standing criteria under ex-art. 230 TEU (Craig & De Burca, 2008:528, referring to Rasmussen, 1980:122). In 2008 more than 50% of all new cases brought before the ECJ were preliminary ruling procedures (Wojcik, 2008:311). The preliminary ruling procedure has become even more important since the effective date of the Lisbon Treaty, since art. 263(4) consTFEU excludes 'implementing' IAS regulations from the scope of annulment actions brought by non-privileged applicants.³⁴⁰

What does indirect challenge mean? As Craig and De Burca (2008:460) point out,

“[t]he relationship between national courts and the ECJ is reference-based. It is not an appellate system. No individual [natural or juristic person] has a right of appeal to the ECJ. It is for the national court to make the decision to refer. The ECJ will rule on the issues referred to it, and the case will then be sent back to the national courts, which will apply the Community law to the case at hand.”

Article 267(1)(b) consTFEU (ex-art. 234(1)(b) TEU) thus requires a case, in which the issue of the validity of an IAS regulation arises, to be pending before a national court. Article 267

³⁴⁰ See supra Chapter 5.2.1.2.1.

constTFEU draws a distinction between courts or tribunals of a member state which may (art. 267(2)) or must (art. 267(3): “shall”) make a reference. Courts or tribunals “against whose decisions there is no judicial remedy under national law” have an obligation to refer in terms of art. 267(3). As Craig and De Burca (2008:465) point out, the rationale of art. 267(3) is to prevent a body of national case law that is not in accordance with Community law from being established in any member state (*ICC v Amministrazione delle Finanze dello Stato* [1981] ECR 1191, par 11). National courts cannot themselves find a Community norm to be invalid (*Firma Foto-Frost v Hauptzollamt Lübeck-Ost* [1987] ECR 4199, par 15).

Do ECJ rulings establish a binding precedent? The principle of *stare decisis* is not laid down anywhere in the Community law. Moreover, it is unknown to the legal systems of some of the EU’s most influential member states such as Germany. However, the ECJ has, nevertheless, in two key decisions (*Da Costa en Schaake NV, Jacob Meijer NV and Hoechst-Holland NV v Nederlandse Belastingadministratie* [1963] ECR 31; *CILFIT and Lanificio di Gavardo SpA v Ministry of Health* [1982] ECR 3415, par 13-15) initiated and further developed what is in effect a system of precedent (Craig & De Burca, 2008:468). As Craig and De Burca (2008:478) observe, this has had a transformational effect on the relationship between the ECJ and the national courts: when the ECJ has decided an issue, national courts apply that ruling without further resort to the ECJ. The national courts thus become part of the broader Community judicial hierarchy with the ECJ at the top. The system seems to work: a recent study (Nyikos, 2003:397, referred to by Craig & De Burca, 2008:478) found a very high rate of national implementation of ECJ rulings (96.3%).

A national court may be requested to order interim measures pending a ruling from the ECJ under art. 267 constTFEU (ex-art. 234 TEU), since cases referred to the ECJ take a long time before they are completed. In 2008, for instance, references for preliminary rulings took on average 16.8 months (ECJ, 2008). The decision *Foto-Frost* ([1987] ECR 4199, par 19) suggested that a national court might grant such relief even pending a ruling on validity. In its subsequent *Atlanta* decision (*Atlanta Fruchthandels-gesellschaft mbH v Bundesamt für Ernährung und Forstwirtschaft* [1985] ECR I-3761) the ECJ provided guidance on the issue of interim relief (Wojcik, 2008:337). This case dealt with the scenario that a national measure is

challenged because of the alleged invalidity of the EU regulation on which it was based. The ECJ held that the national court could grant interim relief, provided the following conditions were met (Craig & De Burca, 2008:472): the national court must have serious doubts about the validity of the EU regulation and must have referred the measure to the ECJ for a ruling. The interim relief must be necessary to prevent serious and irreparable damage to the applicant. The national court must take due account of the Community interest. And finally, it must take into account any decision of the ECJ or the CFI already given on the substance of the disputed measure.

Can the ECJ reject cases referred to it by the national courts? The ECJ regards itself as having the ultimate authority to decide whether a reference is warranted or not (*Pasquale Foglia v Mariella Novello (No. 2) [1981] ECR 3045, par 19*). Over the past nearly 30 years the ECJ has established several case categories where it would decline to accept cases under ex-art. 234 TEU (Craig & De Burca, 2008:492), *i.e.* today's art. 267 constTFEU. All of them could be applicable in a dispute involving IAS regulations. These are (Craig & De Burca, 2008:492-493): where the question referred to is hypothetical, where it is not relevant to the substance of the dispute, where the question is not sufficiently clear for any meaningful legal response, and where the facts are insufficiently clear for the application of the legal rules.

The preliminary ruling procedure in terms of art. 267 constTFEU (ex-art. 234 TEU) is today the most important tool for private applicants to challenge the validity of IAS regulations in court. Craig and De Burca (2008:460) refer to ex-art. 234 TEU as being “very much the ‘jewel in the Crown’ of the ECJ’s jurisdiction”. But this procedure is also not flawless. Firstly, the average time of 16.8 months which it takes for a preliminary ruling indicates the ECJ’s practical workload problems. Secondly, there is always the risk that the national court inadvertently omits to refer the matter to the ECJ.

5.2.1.2.3 The plea of illegality

Like the annulment action, the plea of illegality (art. 277 consTFEU, ex-art. 241 TEU) allows regulations to be challenged. Unlike the annulment action, however, the plea of illegality only allows them to be challenged indirectly.

If the plea of illegality is successful, the regulation is declared inapplicable. It will, however, not be annulled (Horspool & Humphreys, 2008:282).

Article 277 consTFEU (ex-art. 241 TEU) does not constitute an independent form of action (Craig & De Burca, 2008:533). Rather, the plea of illegality of a regulation may only be raised incidentally in the context of proceedings which have already been initiated on other grounds. Article 277 consTFEU cannot, however, be used in proceedings before a national court. Typically, the plea under art. 277 consTFEU is an incidental additional challenge in an existing annulment action brought under art. 263 consTFEU (ex-art. 230 TEU). Without a principal action, there is thus no plea of illegality.

During the effective period of the TEU, the plea could be used in particular by non-privileged applicants in terms of the former art. 230(4) TEU to challenge a regulation (such as an IAS regulation) which would not have been challengeable under the former art. 230 TEU, because the applicant could not show ‘direct concern’ and/or (in terms of the *Plaumann* formula) ‘individual concern’. In this regard, the situation has improved for non-privileged applicants (s 263(4) consTFEU) since the effective date of the Lisbon Treaty. They now merely have to show ‘direct concern’, but no longer ‘individual concern’.³⁴¹

The former art. 241 TEU stated that the plea may only be raised in proceedings “in which a regulation adopted jointly by the European Parliament and the Council [such as the foundational IAS regulation No. 1606/2002], or a regulation of the ... Commission [such as the implementing IAS regulation No. 1725/2003] ... is at issue.” The new art. 277 consTFEU is less pointed but is similar in tenor by stating that the plea may be raised in proceedings “in which an act of general application adopted by an institution ... of the [European] Union” is at issue. Regulations are “acts of general application” (art. 288(2) consTFEU).

³⁴¹ See supra Chapter 5.2.1.2.1.

However, implementing IAS regulations are implementing regulatory acts (“implementing measures”) in terms of s 230(4) constTFEU. As such, they cannot be challenged by an annulment action.³⁴² There is thus no principal action and there can therefore be no incidental plea. This clearly is a dramatic change for the worse for a non-privileged applicant compared with his position under the TEU.

It also renders irrelevant the fact that, under the constTFEU, the situation has remained unchanged as regards the short time limit allowed for a plea of illegality. The applicant has to meet the time limit for the principal action, *i.e.* in the event of an annulment action the two-month period of art. 263(6) constTFEU (ex-art. 230(5) TEU). This had been a major stumbling block for the plea of illegality under the TEU, since annulment actions regarding an IAS regulations would usually have been prescribed.³⁴³

The plea is therefore of no use any longer to companies who want to challenge IAS regulations.

5.2.1.2.4 Summary

In order to review the legality of IAS regulations, only the preliminary ruling procedures in terms of art. 267 constTFEU (ex-art. 234 TEU) are a reasonable option under Community law for companies. In practice, however, it takes far too long (16.8 months). A company’s reporting deadlines will long have lapsed and its external auditor will have issued a qualified audit report by then. However, a reference in terms of art. 267 constTFEU (ex-art. 234 TEU) presupposes a case pending before a national court, and a company may request this national court to order interim measures under national law pending a ruling from the ECJ under art. 267 constTFEU (ex-art. 234 TEU).

³⁴² See supra Chapter 5.2.1.2.1.

³⁴³ See supra Chapter 5.2.1.2.1.

A direct annulment action in terms of the former art. 230 TEU, although theoretically perfectly suited, was practically of no use to a company with regard to existing IAS regulations. Because of the short deadline in ex-art. 230(5) TEU as well as the ECJ's notorious *Plaumann* formula, it would, as a rule, not have been allowed before the ECJ during the effective period of the TEU. Consequently, an incidental plea of illegality in terms of ex-art. 241 TEU would not have been allowed either. The situation has worsened even further since the coming into effect of the Lisbon Treaty: a direct annulment action in terms of art. 263 consTFEU is no longer of any use to a company that wants to challenge an IAS regulation since art. 263(4) consTFEU explicitly disallows an annulment action against implementing regulatory acts.

5.2.2 Parliamentary control

IAS regulations are subjected to parliamentary control in two ways, *viz.* in court (in an action or plea brought by the European Parliament as applicant) or in plenum. Admittedly, parliamentary control via a court is strictly speaking control by the courts themselves than by Parliament.

5.2.2.1 Action for annulment and plea of illegality

According to art. 263(2) consTFEU (ex-art. 230(2) TEU), the European Parliament is a privileged applicant and thus can be a plaintiff in an annulment action.³⁴⁴ As a rule, privileged applicants are always allowed to bring an action, even where the decision is addressed to some other person (Craig & De Burca, 2008:508). From the wording of the former art. 230(2) TEU it was clear that there was no requirement of 'direct concern' or 'individual concern' as in the

³⁴⁴ See supra Chapter 5.2.1.2.1.

former art. 230(4) TEU. The ECJ has, however, held that the European Parliament can be a plaintiff only where its prerogatives (as set out in the 2nd Comitology Decision³⁴⁵) have been infringed (Craig & De Burca, 2008:62). The new art. 263(2) constTFEU neither requires ‘direct concern’ nor ‘individual concern’. In addition and in contrast to non-privileged applicants (s 263(4) constTFEU), privileged applicants may also challenge implementing regulatory acts since s 263(2), in contrast to s 263(4), does not exclude this option.

An action brought by the European Parliament under art. 263 constTFEU (ex-art. 230 TEU) still faces the short time-limit clause of art. 263(6) constTFEU (ex-art. 230(5) TEU).

Can a privileged applicant such as the European Parliament thus resort to art. 277 constTFEU (ex-art. 241 TEU) in order to raise the plea of illegality? This issue is controversial. Bebr (1966:7, referred to by Craig & De Burca, 2008:536) is against it, reasoning that privileged applicants can challenge any binding act of Community law under art. 263 constTFEU (ex-art. 230 TEU) within the time limit of two months. Barav (1974:371, referred to by Craig & De Burca, 2008:536) is in favour of it, reasoning that the irregularities in a general act may appear only after the implementation measure has been adopted, and hence the privileged applicant may not have realised the necessity for challenging the general act until the two-month time limit has lapsed. The ECJ has not dealt with this issue yet.

5.2.2.2 Co-decision procedure and comitology procedure

Pure parliamentary control of the foundational IAS regulation (No. 1606/2002) and the various subsequent implementing IAS regulations (such as No. 1725/2003) differ. The former came into existence using the ‘*co-decision legislative procedure*’ (pursuant to the former art. 251 TEU), while all the past and future implementing IAS regulations have come/will come into existence

³⁴⁵ See supra Chapter 2.2.1 and infra Chapter 5.2.2.2.2.

using the ‘*comitology legislative procedure*’ (pursuant to the 2nd Comitology Decision³⁴⁶). It is thus only the comitology procedure which will still be of importance in the future. The co-decision procedure which was renamed “the ordinary legislative procedure” by the consTFEU, is today the EU’s default legislative procedure, while the comitology procedure is the standard procedure when delegated legislative power is exercised (as in all cases of implementing IAS regulations). The controlling power of the European Parliament differs depending on the procedure followed.

5.2.2.2.1 Co-decision procedure

As regards the enactment of the foundational IAS regulation, the European Parliament had veto powers under clause 5(b) of the former art. 251(2) TEU (which it did not exercise). It also had the right to amend the European Commission’s legislative proposal for the foundational IAS regulation, which it did exercise.

The proposal was initiated by the European Commission. Pursuant to clause 1 of the former art. 251(2) TEU, the European Commission submitted its proposal to the European Parliament, where it went to the appropriate standing committee (the Economic and Social Committee). This committee considered the European Commission’s legislative proposal, proposed amendments and prepared a draft report. Thereafter, the Council obtained the European Parliament’s opinion, approved it and adopted the foundational IAS regulation pursuant to the first indent of clause 2 of the former art. 251 TEU.

5.2.2.2.2 Comitology procedure

³⁴⁶ See appended documents.

Under the comitology procedure³⁴⁷ (both in the form of the *regulatory procedure* (art. 5) as well as the *regulatory procedure with scrutiny* (art. 5(a)), the European Parliament's position is considerably weaker than under the co-decision procedure (the 'ordinary legislative procedure').

Only under the new art. 5a (enacted 2006) of the comitology procedure is the European Parliament given a formal right to veto the comitology committee's final draft of an implementing IAS regulation. This veto, however, can only be exercised on specific grounds, *viz.* because this final draft of an implementing IAS regulation exceeds the implementing power granted in the foundational IAS regulation; because it is not compatible with the aim or content of the foundational IAS regulation; or because it does not respect the principles of subsidiarity³⁴⁸ and proportionality.

Furthermore, both art. 5(5) as well as art. 8 give the European Parliament a right to comment on the European Commission's draft implementing IAS regulations, if the European Parliament believes that these proposed IAS regulations would exceed the implementing powers provided for in the foundational IAS regulation.

The European Parliament's right under art. 8 is stronger than its right under art. 5(5): if the European Parliament passes a resolution in terms of art. 8, the European Commission must re-examine its draft regulation (which it had submitted to the comitology committee). It may then submit an amended draft or alternatively continue with its original draft. It is noteworthy that the European Commission thus does not have to comply with the European Parliament's comments (Lenaerts & Verhoeven, 2000:681). The European Commission must, however, inform the European Parliament what it has done and provide reasons.

In contrast, the European Commission merely has to take notice of the European Parliament's comments given under art. 5(5). No re-examination is required. Furthermore, the European

³⁴⁷ See supra Chapter 2.1.1.

³⁴⁸ See supra Chapter 2.2.1.

Parliament's right to comment in terms of art. 5(5) only arises once the Accounting Regulatory Committee (ARC)³⁴⁹ has disapproved of the European Commission's draft (Wojcik, 2008:153).

Article 8 will in due course be rendered redundant by the new art. 5a (Craig & De Burca, 2008:122): Article 5a, however, applies only to implementing IAS regulations which were enacted after July 2006 and which specify the use of the new *regulatory procedure with scrutiny* rather than the old *regulatory procedure*. In a joint statement the European Parliament, the European Commission and the Council further agreed that earlier implementing IAS regulations which are subject to the regulatory procedure will have to be amended in order to render the new regulatory procedure with scrutiny applicable.³⁵⁰

How does the European Parliament obtain knowledge of the European Commission's draft implementing IAS regulations? It has been granted a right to be informed under art. 7(3) and art. 5(4). In terms of art. 7(3) the European Parliament is to be informed by the European Commission of all the comitology committee's agendas. To this end it receives, among other things, the European Commission's proposed implementing IAS regulations submitted to the comitology committee as well as the result of voting and summary records of the committee's meetings (art. 7(3), clause 2). Article 5(4) specifies – with regard to the 'regulatory procedure' – this right to be informed. If the comitology committee disagrees with the European Commission's draft implementing IAS regulation or if it delivers no opinion, then the European Commission must notify the European Parliament.

5.2.3 Summary

³⁴⁹ See supra Chapter 2.2.2.1 and Chapter 2.2.2.1.

³⁵⁰ Joint Statement of 17 July 2006 ([2006] OJ C 255/1).

During the effective period of the TEU, the action for annulment (ex-art. 230 TEU) was – in theory – the primary tool for private applicants to challenge implementing IAS regulations in court. In practice, however, the action was ineffective for two reasons: Firstly, the ECJ has traditionally interpreted the requirement ‘individual concern’ of the former art. 230(4) TEU too narrowly (*Plaumann* formula) and thus has regularly denied annulment actions brought before it. Secondly, the tight time limit of a mere two months set by ex-art. 230(5) TEU to initiate proceedings was too short in practice. Consequently, an incidental plea of illegality (ex-art. 241 TEU) would have regularly failed as well, since it requires a principal action (which would usually have been an annulment action).

These failures explained the practical popularity of the preliminary ruling procedure (ex-art. 234 TEU). This procedure requires a case pending before a national court of a member state during which the issue of the validity of an IAS regulation arises. The national court then has to refer the issue to the ECJ. Pending a ruling from the ECJ, private applicants will be able to seek interim measures (temporary interdicts) under national law before the national courts.

Since the effective date of the Lisbon Treaty, the annulment action is no longer of any use. Art. 263(4) consTFEU explicitly disallows actions for annulments of implementing regulatory acts which are brought before it by non-privileged applicants. Implementing IAS regulations are implementing regulatory acts. Without a principal action, there can also be no incidental plea (art. 277 consTFEU). Preliminary ruling procedures (art. 267 consTFEU) are thus now the only option left for non-privileged applicants.

Parliamentary control is also exercised over implementing regulations. The European Parliament can be an applicant to an annulment action (art. 263 consTFEU, ex-art. 230 TEU) and a plea of illegality (art. 277 consTFEU, ex-art. 241 TEU). But practical difficulties remain (art. 263(5) consTFEU, ex-art. 230(5) TEU).

Furthermore, the European Parliament had – during the enactment process of the foundational IAS regulation (No. 1606/2002) – a full veto right pursuant to the legislative co-decision procedure (in terms of the former art. 251 TEU), at which time it did not exercise this right.

As regards all past (*e.g.* No. 1725/2003) and future implementing IAS regulations, the European Parliament has – pursuant to the legislative comitology procedure (in terms the 2nd Comitology Decision) – a full veto right (art. 5a). Furthermore, under art. 8 and art. 5(5), it has the right to comment on draft regulations. Finally, it has strong and extended rights to be informed about the comitology committee’s workings and decisions.

5.3 Comparison

In both South Africa and the European Union there are judicial as well as parliamentary controls over IAS regulations.

(1) The position of the European Parliament is considerably stronger than that of the South African parliament. It exercises stronger control over legislation such as FRSs.

(a) The European Parliament can challenge (implementing) IAS regulations in court either directly by means of an annulment action or indirectly by means of a plea of illegality. However, the tight time limitation (two months) placed on the initiation of proceedings is a major flaw of both the annulment action and the plea of illegality.

The South African parliament does not have equivalent right in terms of the South African Constitution.

(b) Furthermore, the European Parliament has a veto right regarding draft (implementing) IAS regulations (*i.e.* IAS draft regulations as proposed by the European Commission in terms of art. 5a of the Comitology procedure). Admittedly, however, this veto right can only be exercised on special grounds.

There again is no equivalent right of the South African parliament provided for in general with regard to the Minister's draft FRS regulations.

Apart from this fully-fledged veto right, the European Parliament has a further (weaker) right in terms of art. 8 of the Comitology procedure to slow down the European Commission's drafting process, as well as an even weaker right in terms of art. 5 of the Comitology procedure to merely comment on the draft.

Again, there is no equivalent in South Africa.

(d) The South African Parliament merely has a right to be informed of all enacted delegated legislation, such as FRS regulations (s 17 of the Interpretation Act).

The European Parliament has similar rights to be informed of implementing IAS regulations (art. 7(3) and art. 5(4) of the Comitology procedure), with two noticeable differences. Firstly, the European Parliament's right vests much earlier in the legislative process, *viz.* already at the drafting stage of the regulation. Secondly, the European Parliament's right is more comprehensive: it includes access to the voting results and summary records of the comitology committee's meetings as well.

(2) In respect of judicial control, in contrast to South Africa (s 172 of the Constitution), the ECJ and the CFJ have no constitutional powers to declare IAS regulations null and void. The reason for this is simple: there is no European Constitution as yet.

The judicial review in terms of an annulment action (art. 263 TFEU, ex-art. 230 TEU) bears some similarities to, but also differs from, constitutional review in terms of s 172 of the South African Constitution and judicial review of administrative action in terms of ss 6 and 8(1) of the PAJA.

(a) Articles 263, 264 consTFEU (ex-arts. 230, 231 TEU) and ss 6, 8(1) of the PAJA are similar in that both can be used to review the legality of IAS regulations and FRS regulations. In contrast

to s 6 of the PAJA, however, the catalogue of grounds for review set out in art. 263(2) consTFEU (ex-art. 230(2) TEU) is considerably less comprehensive and only applies to actions brought by privileged applicants. Much is thus left to EU common law; there is no such thing as a codified 'EU-PAJA'.

If a regulation is declared null and void in terms of art. 264 consTFEU (ex-art. 231 TEU), it is null and void *ab initio*, i.e. it is considered never to have existed. The same applies to an FRS regulation which is set aside in terms of s 8(1)(c) of the PAJA.

Differences are that a review in terms of the former arts. 230, 231 TEU focused on IAS regulations exclusively as legal norms (delegated legislation), while a review in terms of the PAJA focuses on FRS regulations exclusively as administrative action. This difference has become greater with the coming into effect of the Lisbon Treaty. Articles 263, 264 consTFEU do not allow a judicial review of implementing regulatory acts such as IAS regulations any longer, unless the action is brought by a privileged applicant in terms of article 263(2) consTFEU.

Furthermore, while the court may set aside both IAS regulations and FRS regulations in terms of both art. 264 consTFEU (ex-art. 231 TEU) as well as in terms of s 8(1)(c) of the PAJA, it may – in terms of s 8(1) of the PAJA – also grant “any order that is just and equitable”. Article 264 consTFEU (ex-art. 231 TEU) does not offer this option.

(b) Articles 263, 264 consTFEU (ex-art. 230, 231 TEU) and s 172 of the South African Constitution are similar as reviews in both cases can only be undertaken by higher or the highest courts.

Furthermore, in both cases the legal effect is that the reviewed IAS regulations and FRS regulations will be declared null and void *ab initio*. However, in terms of s 172(1)(b) of the South African Constitution the court may in addition make “any order that is just and equitable” whereas art. 264 consTFEU (ex-art. 231 TEU) does not offer that option. Furthermore, s 172 is a review on constitutional grounds, while art. 264 consTFEU (ex-231 TEU) is confined to a review for legality. Finally, s 172 does not contain any equivalent to the short time limit of art. 263(6) consTFEU (ex-art. 230(5) TEU).

(c) Section 172 of the South African Constitution is thus a considerably more powerful and effective tool than arts. 263, 264 consTFEU (ex-art. 230, 231 TEU). Since it does not fail as regularly in practice as art. 263 consTFEU (ex-art. 231 TEU) does, there is thus no urgent practical need in South Africa for an equivalent to the plea of illegality.

Given that South Africa is a national state and not a supranational organisation like the EU, there is consequently not a need in South Africa for a preliminary ruling procedure equivalent to art. 277 consTFEU (ex-art. 241 TEU) either.

(d) In the course of a judicial review of an FRS and an IAS regulation, a company wishing to fend off the legal effects of such a regulation can be helped in both South Africa and the European Union by interim measures (temporary interdicts). It is noteworthy, however, that such temporary interdicts are to be sought in the EU under national laws and not under EU law.

6. Conclusions

In summary, the following general conclusions can be drawn about standard-setting and enforcement of FRSs³⁵¹ in South Africa (under both the old and the new Companies Act) and the EU, respectively.

(1) Standard-setting under the old Companies Act and the new Companies Act

(a) Although the Financial Reporting Standards Council was retained under the new Companies Act, its role in standard-setting has diminished: it is now merely a consultative forum. Under the new Companies Act the competencies for standard-setting clearly vest solely in the Minister.

The new Companies Act does not state whether the Financial Reporting Standards Council will – as under the old Companies Act – again have juristic personality.

(b) Future South African FRSs will be regulations and thus be delegated legislation. The old Companies Act was unclear in this regard.

(c) The Commission plays hardly any role in standard-setting, and the Companies Tribunal plays no role at all.

(d) The Financial Reporting Standards Council, the Commission and the Companies Tribunal are all organs of state. Not all of their actions, however, are administrative action in terms of s 1 of the PAJA.

In particular, it is submitted that the Financial Reporting Standards Council's drafting activities as regards FRSs fall short of what constitutes administrative action in terms of the PAJA. This is

³⁵¹ In this chapter, the terms FRSs, IASs and IFRSs are used interchangeably. They all denote 'IFRSs' as defined in par 7 of IAS 1.

primarily due to the considerably weakened status of the Financial Reporting Standards Council under the new Companies Act. The situation may have been different under the old Companies Act.

(2) Standard-setting in South Africa and the EU

(a) Most differences between the approaches of South Africa and the EU arise from the fact that the EU's institutional structure does not conform to the traditional separation-of-powers doctrine of ordinary nation states.

This applies in particular to the comitology procedure ('Committee procedure': 'Regulatory procedure with scrutiny').

(b) Both South Africa and the EU set standards in the form of regulations (delegated legislation), based on enabling legislation (Companies Act in South Africa; Treaty on European Union and Lisbon Treaty in the EU).

(c) The competencies of the legislative branch (Parliament in South Africa; Council and European Parliament in the EU) pertaining to the enactment of regulations (delegated legislation) by the executive branch (Minister in South Africa; European Commission in the EU) are wider in the EU than in South Africa.

(d) In both South Africa and the EU there remains some risk that the Minister or the European Commission will simply rubberstamp the IASB's IASs/IFRSs without duly exercising their discretion. This risk stems from the desire to adopt a uniform set of global standards.

(e) The Financial Reporting Standards Council's role vis-à-vis the Minister and the roles of the European Financial Reporting Advisory Group's (EFRAG) and the Standards Advice Review Group's (SARG) vis-à-vis the European Commission are not comparable.

(3) *The contents of adopted FRSs*

(a) Thus far, in practice, in South Africa all adopted FRSs have been exact replicas of the IASB's IFRSs. In contrast, the EU has excluded parts of the IASs (Bases for Conclusions, Introductions, Guidance on Implementing, Illustrative Examples) from endorsement. These parts have thus not become Community law; they remain the mere opinion of the private body 'IASB'.

(b) The Framework for the Preparation and Presentation of Financial Statements (that was published in 1989) had been absorbed as an FRS in South Africa between 14 December 2007 and 30 April 2011, while it has not been endorsed in the EU. References in IASs to the Framework may thus raise legal issues in the EU since they may be (unconstitutional) undated references (*dynamische Verweisungen*).

(4) *The lacuna period in South Africa*

(a) In practice, as a result of the wording of the CLAA, a vacuum period existed in South Africa during which South African FRSs could not be issued: the period between 14 December 2007 and the date at which the future FRSC will be established in terms of s 203(1) of the new Companies Act. Although the APB's Statements of GAAP became FRSs when the CLAA came into force, no further Statements of GAAP could become FRSs because of the old Companies Act's statutory definition of FRS. Further FRSs had to be established by the FRSC which, however, never became operational.

All further Statements of GAAP or changes to Statements of GAAP issued by the APB therefore had no legal basis. In practice this meant that accountants who complied with the latest (*i.e.* post-13 December 2007) APB Statements of GAAP did, strictly speaking, contravene the law, if those Statements conflicted with the Statements that existed (had been issued) on the date when the CLAA came into effect.

(b) The existing *lacuna* has widened with the effective date of the new Companies Act (1 May 2011): on that date the old Companies Act was repealed and the old FRSC (*i.e.* the FRSC

established by s 440P(1) of the old Companies Act) was abolished. The new Companies Act's statutory definition of "Financial Reporting Standards" is different from the one of the old Companies Act. In terms of the new Companies Act, Statements of GAAP issued by the APB up to 13 December 2007 are no longer *ipso iure* "Financial Reporting Standards" as defined. Consequently, since 1 May 2011 - there have been no South African FRSs at all that are in effect any longer. The Minister cannot unilaterally issue FRSs, since he is statutorily required to consult with the FRSC beforehand (s 29(4): "after consulting the Council").

(c) Neither have the Companies Regulations 2011 (which were made by the Minister in terms of s 223 of the new Companies Act and also came into effect on 1 May 2011) remedied this situation: Regulation 27 is flawed as it stands and is in all probability voidable, *i.e.* it is invalid, but it is treated as valid until it is pronounced invalid by a court. Regulation 27 is mere delegated legislation and it conflicts with the higher-ranking s 29(4) of the new Companies Act. At 1 May 2011 no FRSC with whom the Minister could have consulted had been established in terms of s 203 of the new Companies Act. Yet s 29(4) of the new Companies Act requires that the Minister consults with the FRSC before he issues regulations establishing FRSs. Section 203 as original legislation trumps delegated legislation such as reg 27.

(d) The standards prescribed by reg 27(4) are therefore not "Financial Reporting Standards" as defined in s 1 of the new Companies Act, and reg 27 does thus not comply with s 29 of the new Companies Act.

(5) *The statutory duty to comply with FRSs*

Both the old Companies Act (as amended by the CLAA) as well as the new Companies Act provide for a *statutory duty to comply with FRSs* (s 285A of the old Companies Act, s 29 of the new Companies Act).

(6) Administrative action and enforcement in cases of non-compliance with FRSs under the old and the new Companies Act

(a) The primary enforcement body under the old Companies Act was the Financial Reporting Investigation Panel. It has not been re-established under the new Companies Act. The primary enforcement body under the new Companies Act is the Companies and Intellectual Property Commission.

(b) The standard procedure under the new Companies Act is the compliance notice procedure. Only the new Companies Act provides, in addition, for voluntary dispute resolution.

(c) Only the new Companies Act provides for an administrative judicial body (adjudicative body) in the form of the Companies Tribunal to review the Commission's compliance notices on application. Under the old Companies Act there was no comparable body to review the Financial Reporting Investigation Panel's administrative actions.

(7) Administrative action and enforcement in cases of non-compliance with FRSs in South Africa as opposed to the situation in the EU

(a) Thus far, there is no EU enforcement procedure in place. Monitoring and enforcement of compliance with IASs is rather a matter of national legislation. There are thus as many enforcement procedures in the EU as there are member states (27).

When the South African enforcement procedure is compared to the German one (*Enforcement-Verfahren*), several differences emerge.

(b) In South Africa any company which "provides any financial statements ... to any person for any reason" (s 29(1) of the new Companies Act) is subject to enforcement as regards compliance with FRSs if such FRSs are prescribed. In Germany only those domestic and foreign companies which are admitted to the *Regulierter Markt* of a German stock exchange are subject to the *Enforcement-Verfahren*. Both in South Africa and Germany listed companies are further subject

to separate monitoring and enforcement procedures under the JSE Limited's Listings Requirements and the FSE Regulations.

(c) In South Africa a one-stage procedure (investigation by the Commission) applies. Germany operates a two-stage procedure (DPR and BaFin).

(d) South Africa's enforcement procedure is entirely governed by administrative law. Germany's procedure is a hybrid governed partly by private law (DPR's activities) and partly by administrative law (BaFin's activities).

(e) The German procedure chiefly follows an investigation cycle (all companies are to be investigated at least every ten years), based on random sample selection. South Africa's procedure seems to be devised chiefly as a system of investigations upon complaint.

(f) Search and entry powers during investigations are wider in Germany than in South Africa, since no judicial warrant is necessary.

(8) *External control of FRS regulations in South Africa as opposed to the situation in the EU*

(a) The position of the European Parliament seems stronger than that of the South African Parliament. As a privileged applicant, it can challenge implementing IAS regulations before the European Court of Justice, either directly by means of an annulment action, or indirectly by means of a plea of illegality.

The South African Parliament, in constitutional theory, does not need comparable standing in the Constitutional Court, since the principle of 'executive accountability' applies (s 92(2) of the Constitution). In terms of this principle the Minister of Trade and Industry is accountable to Parliament with regard to the exercise of powers such as enacting delegated legislation (FRS regulations). In practice, however, this control mechanism has always been flawed.

Equally, Parliament's right to have a list of all enacted delegated legislation tabled before it (s 101(4) of the Constitution read with s 17 of the Interpretation Act) is a toothless tiger in practice.

(b) The judicial review by the ECJ in terms of an annulment action is altogether a less powerful tool than constitutional review in terms of s 172 of the South African Constitution. The primary reason for this is the short time period allowed to initiate an annulment action. Furthermore, while s 172 of the Constitution is a review on constitutional grounds, an annulment action confines the ECJ to a mere review for legality.

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THE PRESIDENCY

No. 421 9 April 2009

It is hereby notified that the President has assented to the following Act, which is hereby published for general information:—

No. 71 of 2008: Companies Act, 2008.

...

CHAPTER 1

INTERPRETATION, PURPOSE AND APPLICATION

Part A

Interpretation

Definitions

1. In this Act, unless the context indicates otherwise—

...

“**Commission**” means the Companies and Intellectual Property Commission established by section 185;

“**Commissioner**” means the person appointed to or acting in the office of that name, as contemplated in section 189;

“**Companies Tribunal**” means the Companies Tribunal established in terms of section 193;

...

“**Council**” means the Financial Reporting Standards Council established by section 203;

“**effective date**”, with reference to any particular provision of this Act, means the date on which that provision came into operation in terms of section 225;

“**exchange**” when used as a noun, has the meaning set out in section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004);

“**financial reporting standards**”, with respect to any particular company’s financial statements, means the standards applicable to that company, as prescribed in terms of section 29(4) and (5);

“**financial statement**” includes—

- (a) annual financial statements and provisional annual financial statements;
- (b) interim or preliminary reports;
- (c) group and consolidated financial statements in the case of a group of companies; and
- (d) financial information in a circular, prospectus or provisional announcement of results, that an actual or prospective creditor or holder of the company’s securities, or the Commission, Panel or other regulatory authority, may reasonably be expected to rely on;

“**inspector**” means a person appointed as such in terms of section 209;

“**investigator**” means a person appointed as such in terms of section 209;

“**juristic person**” includes—

- (a) a foreign company; and
- (b) a trust, irrespective of whether or not it was established within or outside the Republic;

“**knowing**”, “**knowingly**” or “**knows**”, when used with respect to a person, and in relation to a particular matter, means that the person either—

- (a) had actual knowledge of that matter;
- (b) was in a position in which the person reasonably ought to have—
 - (i) had actual knowledge;
 - (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or
 - (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter;

“**non-profit company**” means a company—

- (a) incorporated for a public benefit or other object as required by item 1(1) of Schedule 1; and
- (b) the income and property of which are not distributable to its incorporators, members, directors, officers or persons related to any of them except to the extent permitted by item 1(3) of Schedule 1;

“**person**” includes a juristic person;

“**personal financial interest**”, when used with respect to any person—

(a) means a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed; but

(b) 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 No. 45 of 2002), unless that person has direct control over the investment decisions of that fund or investment;

“personal liability company” means a company whose Memorandum of Incorporation states that the company is a personal liability company, as contemplated in section 8(2)(c);

“prescribed” means determined, stipulated, required, authorised, permitted or otherwise regulated by a regulation or notice made in terms of this Act;

“private company” means a profit company that—

(a) is not a company or a personal liability state-owned company; and

(b) satisfies the criteria set out in section 8(2)(b);

“profit company” means a company incorporated for the purpose of financial gain for its shareholders;

“public company” means a profit company that is not a state-owned company, a private company or a personal liability company;

“public regulation” means any national, provincial or local government legislation or subordinate legislation, or any licence, tariff, directive or similar authorisation issued by a regulatory authority or pursuant to any statutory authority;

“regulated person or entity” means a person that has been granted authority to conduct business by a regulatory authority;

“regulation” means a regulation made under this Act;

“regulatory authority” means an entity established in terms of national or provincial legislation responsible for regulating an industry, or sector of an industry;

“state-owned company” means an enterprise that is registered in terms of this Act as a company, and either—

(a) falls within the meaning of “state-owned enterprise” in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999); or

(b) is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000), and is otherwise similar to an enterprise referred to in paragraph (a);

“this Act” includes the Schedules and regulations;

...

General interpretation of Act

5. (1) This Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7.

(2) To the extent appropriate, a court interpreting or applying this Act may consider foreign company law.

(3) When, in this Act, a particular number of ‘business days’ is provided for between the happening of one event and another, the number of days must be calculated by—

(a) excluding the day on which the first such event occurs;

(b) including the day on or by which the second event is to occur; and

(c) excluding any public holiday, Saturday or Sunday that falls on or between the days contemplated in paragraphs (a) and (b), respectively.

(4) If there is an inconsistency between any provision of this Act and a provision of any other national legislation—

(a) the provisions of both Acts apply concurrently, to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second; and

(b) to the extent that it is impossible to apply or comply with one of the inconsistent provisions without contravening the second—

(i) any applicable provisions of the—

(aa) Auditing Profession Act;

(bb) Labour Relations Act, 1995 (Act No. 66 of 1995);

(cc) Promotion of Access to Information Act, 2000 (Act No. 2 of 2000);

(dd) Promotion of Administrative Justice Act, 2000 (Act No. 3 of 2000);

(ee) Public Finance Management Act, 1999 (Act No. 1 of 1999);

(ff) Securities Services Act, 2004 (Act No. 36 of 2004); or

(gg) Banks Act,

prevail in the case of an inconsistency involving any of them, except to the extent provided otherwise in section 49(4); or

(ii) the provisions of this Act prevail in any other case, except to the extent provided otherwise in subsection (5) or section 118(4).

(5) If there is a conflict between a provision of Chapter 8 and a provision of the Public Service Act, 1994 (Proclamation No.103 of 1994), the provisions of that Act prevail.

Part B

Purpose and application

Purposes of Act

7. The purposes of this Act are to—

- (a) promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law;
- (b) promote the development of the South African economy by—
 - (i) encouraging entrepreneurship and enterprise efficiency;
 - (ii) creating flexibility and simplicity in the formation and maintenance of companies; and
 - (iii) encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation;
- (c) promote innovation and investment in the South African markets;
- (d) reaffirm the concept of the company as a means of achieving economic and social benefits;
- (e) continue to provide for the creation and use of companies, in a manner that enhances the economic welfare of South Africa as a partner within the global economy;
- (f) promote the development of companies within all sectors of the economy, and encourage active participation in economic organisation, management and productivity;
- (g) create optimum conditions for the aggregation of capital for productive purposes, and for the investment of that capital in enterprises and the spreading of economic risk;
- (h) provide for the formation, operation and accountability of non-profit companies in a manner designed to promote, support and enhance the capacity of such companies to perform their functions;
- (i) balance the rights and obligations of shareholders and directors within companies;
- (j) encourage the efficient and responsible management of companies;
- (k) provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders; and
- (l) provide a predictable and effective environment for the efficient regulation of companies.

Categories of companies

8. (1) Two types of companies may be formed and incorporated under this Act, namely profit companies and non-profit companies.

(2) A profit company is—

- (a) a state-owned company; or
- (b) a private company if—
 - (i) it is not a state-owned company; and
 - (ii) its Memorandum of Incorporation—
 - (aa) prohibits it from offering any of its securities to the public; and
 - (bb) restricts the transferability of its securities;
- (c) a personal liability company if—

- (i) it meets the criteria for a private company; and
 - (ii) its Memorandum of Incorporation states that it is a personal liability company; or
- (d) a public company, in any other case.
- (3) No association of persons formed after 31 December 1939 for the purpose of carrying on any business that has for its object the acquisition of gain by the association or its individual members is or may be a company or other form of body corporate unless it—
- (a) is registered as a company under this Act;
 - (b) is formed pursuant to another law; or
 - (c) was formed pursuant to Letters Patent or Royal Charter before 31 May 1962.

CHAPTER 2

FORMATION, ADMINISTRATION AND DISSOLUTION OF COMPANIES

...

Part C

Transparency, accountability and integrity of companies

Financial statements

- 29.** (1) If a company provides any financial statements, including any annual financial statements, to any person for any reason, those statements must—
- (a) satisfy the financial reporting standards as to form and content, if any such standards are prescribed;
 - (b) present fairly the state of affairs and business of the company, and explain the transactions and financial position of the business of the company;
 - (c) show the company's assets, liabilities and equity, as well as its income and expenses, and any other prescribed information;
 - (d) set out the date on which the statements were produced, and the accounting period to which the statements apply; and
 - (e) bear, on the first page of the statements, a prominent notice indicating—
 - (i) whether the statements—
 - (aa) have been audited in compliance with any applicable requirements of this Act;
 - (bb) if not audited, have been independently reviewed in compliance with any applicable requirements of this Act; or

- (cc) have not been audited or independently reviewed; and
 - (ii) the name, and professional designation, if any, of the individual who prepared, or supervised the preparation of, those statements.
- (2) Any financial statements prepared by a company, including any annual financial statements of a company as contemplated in section 30, must not be—
 - (a) false or misleading in any material respect; or
 - (b) incomplete in any material particular, subject only to subsection (3).
- (3) A company may provide any person with a summary of any particular financial statements, but—
 - (a) any such summary must comply with any prescribed requirements; and
 - (b) the first page of the summary must bear a prominent notice—
 - (i) stating that it is a summary of particular financial statements prepared by the company, and setting out the date of those statements;
 - (ii) stating whether the financial statements that it summarises have been audited, independently reviewed, or are unaudited, as contemplated in subsection (1)(e);
 - (iii) stating the name, and professional designation, if any, of the individual who prepared, or supervised the preparation of, the financial statements that it summarises; and
 - (iv) setting out the steps required to obtain a copy of the financial statements that it summarises.
- (4) Subject to subsection (5), the Minister, after consulting the Council, may make regulations prescribing—
 - (a) financial reporting standards contemplated in this Part; or
 - (b) form and content requirements for summaries contemplated in subsection (3).
- (5) Any regulations contemplated in subsection (4)—
 - (a) must promote sound and consistent accounting practices;
 - (b) in the case of financial reporting standards, must be consistent with the International Financial Reporting Standards of the International Accounting Standards Board or its successor body; and
 - (c) may establish different standards applicable to—
 - (i) profit and non-profit companies; and
 - (ii) different categories of profit companies.
- (6) Subject to section 214(2), a person is guilty of an offence if the person is a party to the preparation, approval, dissemination or publication of—
 - (a) any financial statements, including any annual financial statements contemplated in section 30, knowing that those statements—

- (i) do not comply with the requirements of subsection (1); or
 - (ii) are materially false or misleading, as contemplated in subsection (2); or
- (b) a summary of any financial statements, knowing that—
- (i) the statements that it summarises do not comply with the requirements of subsection (1), or are materially false or misleading, as contemplated in subsection (2); or
 - (ii) the summary does not comply with the requirements of subsection (3), or is materially false or misleading.

Annual financial statements

30. (1) Each year, a company must prepare annual financial statements within six months after the end of its financial year, or such shorter period as may be appropriate to provide the required notice of an annual general meeting in terms of section 61(7).

(2) The annual financial statements must—

(a) be audited, in the case of a public company; or

(b) in the case of any other company—

(i) be audited, if so required by the regulations made in terms of subsection (7) taking into account whether it is desirable in the public interest, having regard to the economic or social significance of the company, as indicated by—

(aa) its annual turnover;

(bb) the size of its workforce; or

(cc) the nature and extent of its activities; or

(ii) be either—

(aa) audited voluntarily at the option of the company; or

(bb) independently reviewed in a manner that satisfies the regulations made in terms of subsection (7) unless exempted if it is a private company and—

(AA) one person holds, or has all of the beneficial interest in, all of the securities issued by the company; or

(BB) every person who is a holder of, or has a beneficial interest in, any securities issued by the company is also a director of the company unless the company has only one director, and that director is a person contemplated in section 69(12).

(3) The annual financial statements of a company must—

(a) include an auditor's report, if the statements are audited;

(b) include a report by the directors with respect to the state of affairs, the business and profit or loss of the company, or of the group of companies, if the company is part of a group, including—

(i) any matter material for the shareholders to appreciate the company's state of affairs; and

(ii) any prescribed information;

(c) be approved by the board and signed by an authorised director; and

(d) be presented to the first shareholders meeting after the statements have been approved by the board.

(4) ...

(5) ...

(6) ...

(7) The Minister may make regulations, including different requirements for different categories of companies, prescribing—

(a) the categories of any private companies that are required to have their respective annual financial statements audited, as contemplated in subsection (2)(b)(i); and

(b) the manner, form and procedures for the conduct of an independent review other than an audit, as contemplated in subsection (2)(b)(ii)(bb), as well as the professional qualifications, if any, of persons who may conduct such reviews.

.....

Part F

Governance of Companies

...

Ineligibility and disqualification of persons to be director or prescribed officer

69. (1) In this section, “director” includes an alternate director, and—

(a) a prescribed officer; or

(b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company's board.

(2) A person who is ineligible or disqualified, as set out in this section, must not—

(a) be appointed or elected as a director of a company, or consent to being appointed or elected as a director; or

- (b) act as a director of a company.
- (3) A company must not knowingly permit an ineligible or disqualified person to serve or act as a director.
- (4) A person who becomes ineligible or disqualified while serving as a director of a company ceases to be a director immediately, subject to section 70(2).
- (5) A person who has been placed under probation by a court in terms of section 162, or in terms of section 47 of the Close Corporations Act, 1984 (Act No. 69 of 1984), must not serve as a director except to the extent permitted by the order of probation.
- (6) In addition to the provisions of this section, the Memorandum of Incorporation of a company may impose—
- (a) additional grounds of ineligibility or disqualification of directors; or
 - (b) minimum qualifications to be met by directors of that company.
- (7) A person is ineligible to be a director of a company if the person—
- (a) is a juristic person;
 - (b) is an unemancipated minor, or is under a similar legal disability; or
 - (c) does not satisfy any qualification set out in the company's Memorandum of Incorporation.
- (8) A person is disqualified to be a director of a company if—
- (a) a court has prohibited that person to be a director, or declared the person to be delinquent in terms of section 162, or in terms of section 47 of the Close Corporations Act, 1984 (Act No. 69 of 1984); or
 - (b) subject to subsections (9) to (12), the person—
 - (i) is an unrehabilitated insolvent;
 - (ii) is prohibited in terms of any public regulation to be a director of the company;
 - (iii) has been removed from an office of trust, on the grounds of misconduct involving dishonesty; or
 - (iv) has been convicted, in the Republic or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence—
 - (aa) involving fraud, misrepresentation or dishonesty;
 - (bb) in connection with the promotion, formation or management of a company, or in connection with any act contemplated in subsection (2) or (5); or
 - (cc) under this Act, the Insolvency Act, 1936 (Act No. 24 of 1936), the Close Corporations Act, 1984, the Competition Act, the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001), the Securities Services Act, 2004 (Act No. 36 of 2004), or Chapter 2 of the Prevention and Combating of Corruption Activities Act, 2004 (Act No. 12 of 2004).

- (9) A disqualification in terms of subsection (8)(b)(iii) or (iv) ends at the later of—
- (a) five years after the date of removal from office, or the completion of the sentence imposed for the relevant offence, as the case may be; or
 - (b) at the end of one or more extensions, as determined by a court from time to time, on application by the Commission in terms of subsection (10).
- (10) At any time before the expiry of a person's disqualification in terms of subsection (8)(b)(iii) or (iv)—
- (a) the Commission may apply to a court for an extension contemplated in subsection (9)(b); and
 - (b) the court may extend the disqualification for no more than five years at a time, if the court is satisfied that an extension is necessary to protect the public, having regard to the conduct of the disqualified person up to the time of the application.
- (11) A court may exempt a person from the application of any provision of subsection (8)(b).
- (12) Despite being disqualified in terms of subsection (8)(b)(iii) or (iv), a person may act as a director of a private company if all of the shares of that company are held by that disqualified person alone, or by—
- (a) that disqualified person; and
 - (b) persons related to that disqualified person, and each such person has consented in writing to that person being a director of the company.
- (13) The Commission must establish and maintain in the prescribed manner a public register of persons who are disqualified from serving as a director, or who are subject to an order of probation as a director, in terms of an order of a court pursuant to this Act or any other law.

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CHAPTER 7

REMEDIES AND ENFORCEMENT

Part A

General principles

Alternative procedures for addressing complaints or securing rights

156. A person referred to in section 157(1) may seek to address an alleged contravention of this Act, or to enforce any provision of, or right in terms of this Act, a company's Memorandum of Incorporation or rules, or a transaction or agreement contemplated in this Act, the company's Memorandum of Incorporation or rules, by—

- (a) attempting to resolve any dispute with or within a company through alternative dispute resolution in accordance with Part C of this Chapter;

- (b) applying to the Companies Tribunal for adjudication in respect of any matter for which such an application is permitted in terms of this Act;
- (c) applying for appropriate relief to the division of the High Court that has jurisdiction over the matter; or
- (d) filing a complaint in accordance with Part D of this Chapter within the time permitted by section 219 with—
 - (i) the Panel, if the complaint concerns a matter within its jurisdiction; or
 - (ii) the Commission in respect of any matter arising in terms of this Act, other than a matter contemplated in subparagraph (i).

Extended standing to apply for remedies

157. (1) When, in terms of this Act, an application can be made to, or a matter can be brought before, a court, the Companies Tribunal, the Panel or the Commission, the right to make the application or bring the matter may be exercised by a person—

- (a) directly contemplated in the particular provision of this Act;
 - (b) acting on behalf of a person contemplated in paragraph (a), who cannot act in their own name;
 - (c) acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or
 - (d) acting in the public interest, with leave of the court.
- (2) The Commission or the Panel, acting in either case on its own motion and in its absolute discretion, may—
- (a) commence any proceedings in a court in the name of a person who, when filing a complaint with the Commission or Panel, as the case may be, in respect of the matter giving rise to those proceedings, also made a written request that the Commission or Panel do so; or
 - (b) apply for leave to intervene in any court proceedings arising in terms of this Act, in order to represent any interest that would not otherwise be adequately represented in those proceedings.
- (3) For greater certainty, nothing in this section creates a right of any person to commence any legal proceedings contemplated in section 165(1), other than—
- (a) on behalf of a person entitled to make a demand in terms of section 165(2); and
 - (b) in the manner set out in section 165.

Remedies to promote purpose of Act

158. When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act—

- (a) a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act; and
- (b) the Commission, the Panel, the Companies Tribunal or a court—
 - (i) must promote the spirit, purpose and objects of this Act; and
 - (ii) if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of this Act, and will best improve the realisation and enjoyment of rights.

...

Part C

Voluntary resolution of disputes

Alternative dispute resolution

166. (1) As an alternative to applying for relief to a court, or filing a complaint with the Commission in terms of Part D, a person who would be entitled to apply for relief, or file a complaint in terms of this Act, may refer a matter that could be the subject of such an application or complaint to—

- (a) the Companies Tribunal; or
- (b) an accredited entity, as defined in subsection (3), for resolution by mediation, conciliation or arbitration.

(2) If the Companies Tribunal, or an accredited entity, to whom a matter is referred for alternative dispute resolution concludes that either party to the conciliation, mediation or arbitration is not participating in that process in good faith, or that there is no reasonable probability of the parties resolving their dispute through that process, the Companies Tribunal or accredited entity must issue a certificate in the prescribed form stating that the process has failed.

(3) In this section, “accredited entity” means—

- (a) a juristic person or an association of persons accredited by the Commission in terms of subsection (4); or
- (b) an organ of state, or entity established by or in terms of a public regulation that—
 - (i) is mandated, among other things, to perform mediation, conciliation or arbitration; and
 - (ii) has been designated by the Minister in terms of subsection (5) as an accredited entity for the purposes of this Part.

(4) For the purposes of this Part, the Commission—

- (a) may accredit, with or without conditions, a juristic person or an association that—

- (i) functions predominantly to provide conciliation, mediation or arbitration services;
 - (ii) has the demonstrated capacity to perform such services within the context of company law; and
 - (iii) satisfies the prescribed requirements for accreditation;
- (b) must monitor the effectiveness of any accredited person or an association relative to the purposes and policies of this Act; and
- (c) may—
- (i) reasonably require any person or association accredited by it to provide information necessary for the purpose of monitoring in terms of paragraph (b); and
 - (ii) with reasonable notice, withdraw any accreditation granted by it in terms of this section if the person or association no longer satisfies the criteria set out in paragraph (a).
- (5) The Minister, after consulting the Commission—
- (a) may designate any organ of state or other entity contemplated in subsection (3)(b) as an accredited entity for the purposes of this Part; and
 - (b) must prescribe criteria for the Commission to follow in assessing whether an applicant for accreditation in terms of subsection (4) meets the requirements of this section.

Dispute resolution may result in consent order

- 167.** (1) If the Companies Tribunal, or an entity accredited in terms of section 166, has resolved, or assisted parties in resolving, a dispute in terms of this Part the Tribunal or accredited entity may—
- (a) record the resolution of that dispute in the form of an order; and
 - (b) if the parties to the dispute consent to that order, submit it to a court to be confirmed as a consent order, in terms of its rules.
- (2) After hearing an application for a consent order, the court may—
- (a) make the order as agreed and proposed in the application;
 - (b) indicate any changes that must be made to the draft order before it will be made an order of the court; or
 - (c) refuse to make the order.
- (3) A consent order confirmed in terms of subsection (2)—
- (a) may include an award of damages; and
 - (b) does not preclude a person applying for an award of civil damages, unless the consent order includes an award of damages to that person.

(4) A court hearing any proceedings concerning a dispute arising out of a consent order may order the proceedings closed to the public if it is in the interest of the confidentiality of the parties to the consent order to do so.

Part D

Complaints to Commission or Panel

Initiating a complaint

168. (1) Any person may file a complaint in writing—

(a) with the Panel in respect of a matter contemplated in Part B or C of Chapter 5, or in the Takeover Regulations; or

(b) with the Commission in respect of any provision of this Act not referred to in paragraph (a), alleging that a person has acted in a manner inconsistent with this Act, or that the complainant's rights under this Act, or under a company's Memorandum of Incorporation or rules, have been infringed.

(2) A complaint may be initiated directly by the Commission, or the Panel, as the case may be, on its own motion or on the request of another regulatory authority.

(3) The Minister may direct the Commission, as contemplated in section 190(2)(b), or the Panel to investigate—

(a) an alleged contravention of this Act; or

(b) other specified circumstances.

Investigation by Commission or Panel

169. (1) Upon initiating or receiving a complaint, or receiving a direction from the Minister, in terms of this Act, the Commission or Panel, as the case may be, may—

(a) except in the case of a direction from the Minister, issue a notice to the complainant in the prescribed form indicating that it will not investigate the complaint, if the complaint appears to be frivolous or vexatious, or does not allege any facts that, if proven, would constitute grounds for remedy under this Act;

(b) if they think it expedient as a means of resolving the matter, refer the complainant to the Companies Tribunal, or to an accredited entity, as defined in section 166(3), with a recommendation that the complainant seek to resolve the matter with the assistance of that agency; or

(c) direct an inspector or investigator to investigate the complaint as quickly as practicable, in any other case.

(2) At any time during an investigation, the Commission or Panel, as the case may be, may—

(a) designate one or more persons to assist the inspector or investigator conducting the investigation; or

(b) if a complaint concerns a dispute that is internal to a particular company, and does not appear to implicate a party other than the company, the holders of its securities, its directors, committees, prescribed officers, company secretary, or auditor—

(i) submit a proposal to the company seeking an agreement to jointly appoint an independent investigator—

(aa) at the expense of the company, or on a cost-shared basis; and

(bb) to report to both the company, and to the Commission or Panel, as the case may be; or

(ii) apply to a court for an order appointing an independent investigator—

(aa) at the expense of the company; and

(bb) to report to both the Commission or Panel, as the case may be, and the company.

(3) In conducting an investigation contemplated in this section an inspector or investigator may investigate any person—

(a) named in the complaint, or related to a person named in the complaint; or

(b) whom the inspector reasonably considers may have information relevant to the investigation of the complaint.

Outcome of investigation

170. (1) After receiving the report of an inspector or independent investigator, the Commission or Panel, as the case may be, may—

(a) excuse any person as a respondent in the complaint, if the Commission or Panel considers it reasonable to do so, having regard to the person's conduct, and the degree to which the person has cooperated with the Commission or Panel in the investigation;

(b) refer the complaint to the Companies Tribunal, or to the Commission or the Panel as the case may be, if the matter falls within their respective jurisdictions in terms of this Act;

(c) issue a notice of non-referral to the complainant, with a statement advising the complainant of any rights they may have under this Act to seek a remedy in court;

(d) in the case of the Commission, propose that the complainant and any affected person meet with the Commission or with the Companies Tribunal, with a view to resolving the matter by consent order;

(e) commence proceedings in a court in the name of the complainant, if the complainant—

(i) has a right in terms of this Act to apply to a court in respect of that matter; and

(ii) has consented to the Commission or Panel, as the case may be, doing so;

(f) refer the matter to the National Prosecuting Authority, or other regulatory authority concerned, if the Commission or Panel, as the case may be, alleges that a person has committed an offence in terms of this Act or any other legislation; or

(g) in the case of—

(i) the Commission, issue a compliance notice in terms of section 171; or

(ii) the Panel, refer the matter to the Executive Director, who may, among other things, issue a compliance notice in terms of section 171.

(2) The Commission or Panel, as the case may be—

(a) in its sole discretion, may publish a report contemplated in subsection (1); and

(b) irrespective whether it publishes such a report, must deliver a copy of the report to—

(i) the complainant, or a regulatory authority that requested the initiation of the complaint;

(ii) any person who was a subject of the investigation;

(iii) any court, if requested or ordered to do so by the court; and

(iv) any holder of securities, or creditor, of a company that was the subject of the report, or any other person implicated in the report, upon payment of the prescribed fee.

Issuance of compliance notices

171. (1) Subject to subsection (3), the Commission, or the Executive Director of the Panel, may issue a compliance notice in the prescribed form to any person whom the Commission or Executive Director, as the case may be, on reasonable grounds believes—

(a) has contravened this Act; or

(b) assented to, was implicated in, or directly or indirectly benefited from, a contravention of this Act, unless the alleged contravention could otherwise be addressed in terms of this Act by an application to a court or to the Companies Tribunal.

(2) A compliance notice may require the person to whom it is addressed to—

(a) cease, correct or reverse any action in contravention of this Act;

(b) take any action required by this Act;

(c) restore assets or their value to a company or any other person;

(d) provide a community service, in the case of a notice issued by the Commission; or

(e) take any other steps reasonably related to the contravention and designed to rectify its effect.

(3) When issuing a notice in terms of subsection (1) to a regulated person or entity, the Commission or Executive Director, as the case may be, must send a copy of the notice to the regulatory authority that granted a licence or similar authority to that regulated person or entity, and in terms of which that person is authorised to conduct business.

- (4) A compliance notice contemplated in subsection (1)—
- (a) must set out—
 - (i) the person or an association to whom the notice applies;
 - (ii) the provision of this Act that has been contravened;
 - (iii) details of the nature and extent of the non-compliance;
 - (iv) any steps that are required to be taken and the period within which those steps must be taken; and
 - (v) any penalty that may be imposed in terms of this Act if those steps are not taken.
- (5) A compliance notice issued in terms of this section, or any part of it, remains in force until—
- (a) it is set aside by—
 - (i) the Companies Tribunal, or a court upon a review of the notice, in the case of a notice issued by the Commission; or
 - (ii) the Takeover Special Committee, or a court upon a review of the notice, in the case of a notice issued by the Executive Director; or
 - (b) the Commission, or Executive Director, as the case may be, issues a compliance certificate contemplated in subsection (6).
- (6) If the requirements of a compliance notice issued in terms of subsection (1) have been satisfied, the Commission or the Executive Director, as the case may be, must issue a compliance certificate.
- (7) If a person to whom a compliance notice has been issued fails to comply with the notice, the Commission or the Executive Director, as the case may be, may either—
- (a) apply to a court for the imposition of an administrative fine; or
 - (b) refer the matter to the National Prosecuting Authority for prosecution as an offence in terms of section 214(3), but may not do both in respect of any particular compliance notice.

Objection to notices

172. (1) Any person issued with a compliance notice in terms of section 171 may apply to the Companies Tribunal in the case of a notice issued by the Commission, or to the Takeover Special Committee in the case of a notice issued by the Executive Director, or to a court in either case, to review the notice within—

- (a) 15 business days after receiving that notice; or
- (b) such longer period as may be allowed on good cause shown.

(2) After considering any representations by the applicant and any other relevant information, the Companies Tribunal, the Takeover Special Committee, or a court may confirm, modify or cancel all or part of a compliance notice.

(3) If the Companies Tribunal, the Takeover Special Committee or a court confirms or modifies all or part of a notice, the applicant must comply with that notice as confirmed or modified, within the time period specified in it, subject to subsection (4).

(4) A decision by the Companies Tribunal or the Takeover Special Committee in terms of this section is binding, subject to any right of review or appeal by a court.

Consent orders

173. (1) If a matter has been investigated in terms of this Part, and the Commission and the respondent have agreed a resolution of the complaint, the Commission may—

(a) record the resolution in the form of an order; and

(b) if the person who is the subject of the complaint consents to that order, apply to the High Court to have it confirmed as a consent order, in terms of its rules.

(2) Section 167(2) to (4), read with the changes required by the context, applies to an application contemplated in subsection (1).

Referral of complaints to court

174. (1) If the Commission or Panel, as the case may be, issues a notice of non-referral in response to a complaint, the complainant concerned may apply to a court for leave to refer the matter directly to the court, but no such complaint may be referred directly to a court in respect of a person who has been excused as a respondent, as contemplated in section 170(1)(a).

(2) A court—

(a) may grant leave contemplated in subsection (1) only if it appears that the applicant has no other remedy available in terms of this Act; and

(b) if it grants leave, and after conducting a hearing, determines that the respondent has contravened the Act, may—

(i) require the Commission or Executive Director, as the case may be, to issue a compliance notice sufficient to address that contravention; or

(ii) make any other order contemplated in this Act that is just and reasonable in the circumstances.

Administrative fines

175. (1) A court, on application by the Commission or Panel, may impose an administrative fine—

(a) only for failure to comply with a compliance notice, as contemplated in section 171(7); and

(b) not exceeding the greater of—

- (i) 10% of the respondent's turnover for the period during which the company failed to comply with the compliance notice; and
 - (ii) the maximum prescribed in terms of subsection (5).
- (2) When determining the amount of an appropriate administrative fine, the following factors must be considered:
- (a) The nature, duration, gravity and extent of the contravention;
 - (b) any loss or damage suffered as a result of the contravention;
 - (c) the behaviour of the respondent;
 - (d) the market circumstances in which the contravention took place;
 - (e) the level of profit derived from the contravention;
 - (f) the degree to which the respondent has co-operated with the Commission or Panel, as the case may be, and a court; and
 - (g) whether the respondent has previously been found in contravention of this Act.
- (3) For the purpose of this section, the annual turnover of any person, is the amount determined in the prescribed manner.
- (4) A fine payable in terms of this section must be paid into the National Revenue Fund referred to in section 213 of the Constitution.
- (5) The Minister may make a regulation prescribing the maximum amount of an administrative fine, which amount must be not less than R1 000 000.

Part E

Powers to support investigations and inspections

Summons

176. (1) At any time during an investigation being conducted by it, the Commission, or the Panel, as the case may be, may issue a summons to any person who is believed to be able to furnish any information on the subject of the investigation, or to have possession or control of any book, document or other object that has a bearing on that subject to—

- (a) appear before the Commission or Panel, or before an inspector or independent investigator, to be questioned at a time and place specified in the summons; or
 - (b) deliver or produce to the Commission or Panel, or to an inspector or independent investigator, any book, document or other object referred to in paragraph (a) at a time and place specified in the summons.
- (2) A summons contemplated in subsection (1)—
- (a) must be signed by the Commissioner or the Executive Director, as the case may be, or by an employee of the Commission or Panel designated by the Commissioner or the Executive Director, as the case may be; and

- (b) may be served in the same manner as a subpoena in a criminal case issued by the magistrate's court.
- (3) An inspector or investigator before whom a person is summoned to appear, or to whom a person is required to deliver any book, document or other object, may—
- (a) interrogate and administer an oath to, or accept an affirmation from, the person named in the summons; and
 - (b) retain any such book, document or other object for examination, for a period not exceeding two months, or such longer period as the court, on good cause shown, may allow.
- (4) A person questioned by the Commission, the Panel, or an inspector or independent investigator conducting an investigation must answer each question truthfully and to the best of that person's ability, but—
- (a) a person is not obliged to answer any question if the answer is selfincriminating; and
 - (b) the person asking the questions must inform that person of the right set out in paragraph (a).
- (5) No self-incriminating answer given or statement made by any person to the Commission, Panel, or an inspector or independent investigator exercising powers in terms of this Act will be admissible as evidence against that person in criminal proceedings against that person instituted in any court, except in criminal proceedings for perjury or in which that person is tried for an offence contemplated in section 215(2)(e), and then only to the extent that the answer or statement is relevant to prove the offence charged.

Authority to enter and search under warrant

- 177.** (1) A judge of the High Court or a magistrate, may issue a warrant to enter and search any premises that are within the jurisdiction of that judge or magistrate, if, from information on oath or affirmation, there are reasonable grounds to believe that—
- (a) a contravention of this Act has taken place, is taking place, or is likely to take place on or in those premises; or
 - (b) that anything connected with an investigation in terms of this Act is in the possession of, or under the control of, a person who is on or in those premises.
- (2) A warrant to enter and search may be issued at any time and must specifically—
- (a) identify the premises that may be entered and searched; and
 - (b) authorise an inspector or a police officer to enter and search the premises and to do anything listed in section 178.
- (3) A warrant to enter and search is valid until one of the following events occurs:
- (a) The warrant is executed;
 - (b) the warrant is cancelled by the person who issued it or, in that person's absence, by a person with similar authority;

- (c) the purpose for issuing it has lapsed; or
 - (d) the expiry of one month after the date it was issued.
- (4) A warrant to enter and search may be executed only during the day, unless the judge or magistrate who issued it authorises that it may be executed at night at a time that is reasonable in the circumstances.
- (5) A person authorised by a warrant issued in terms of subsection (2) may enter and search premises named in that warrant.
- (6) Immediately before commencing with the execution of a warrant, a person executing that warrant must either—
- (a) if the owner, or person in control, of the premises to be searched is present—
 - (i) provide identification to that person and explain to that person the authority by which the warrant is being executed; and
 - (ii) hand a copy of the warrant to that person or to the person named in it; or
 - (b) if none of those persons is present, affix a copy of the warrant to the premises in a prominent and visible place.

Powers to enter and search

178. (1) A person who is authorised under section 177 to enter and search premises may—

- (a) enter upon or into those premises;
- (b) search those premises;
- (c) search any person on those premises if there are reasonable grounds for believing that the person has personal possession of an article or document that has a bearing on the investigation;
- (d) examine any article or document that is on or in those premises that has a bearing on the investigation;
- (e) request information about any article or document from the owner of, or person in control of, the premises or from any person who has control of the article or document, or from any other person who may have the information;
- (f) take extracts from, or make copies of, any book or document that is on or in the premises that has a bearing on the investigation;
- (g) use any computer system on the premises, or require assistance of any person on the premises to use that computer system, to—
 - (i) search any data contained in or available to that computer system; or
 - (ii) reproduce any record from that data; and
- (h) seize any output from that computer for examination and copying; and
- (i) attach, and, if necessary, remove from the premises for examination and safekeeping, anything that has a bearing on the investigation.

(2) Section 176(4) and (5) apply to—

- (a) any person questioned by an inspector or police officer in terms of this section; or
- (b) to any answer given or statement made to an inspector or police officer in terms of this section.

(3) An inspector authorised to conduct an entry and search in terms of section 177 may be accompanied and assisted by a police officer.

Conduct of entry and search

179. (1) A person who enters and searches any premises under section 178 must conduct the entry and search with strict regard for decency and order, and with regard for each person's right to dignity, freedom, security and privacy.

(2) During any search under section 178(1)(c), only a female inspector or police officer may search a female person, and only a male inspector or police officer may search a male person.

(3) A person who enters and searches premises under section 178, before questioning anyone—

- (a) must advise that person of the right to be assisted at the time by an advocate or attorney; and
- (b) allow that person to exercise the right contemplated in paragraph (a).

(4) A person who removes anything from premises being searched must—

- (a) issue a receipt for it to the owner of, or person in control of, the premises; and
- (b) return it as soon as practicable after achieving the purpose for which it was removed.

(5) During a search, a person may refuse to permit the inspection or removal of an article or document on the grounds that it contains privileged information.

(6) If the owner or person in control of an article or document refuses in terms of subsection (5) to give that article or document to the person conducting the search, the person conducting the search may request the registrar or sheriff of the High Court that has jurisdiction to attach and remove the article or document for safe custody until that court determines whether or not the information is privileged.

(7) A police officer who is authorised to enter and search premises under section 177, or who is assisting an inspector who is authorised to enter and search premises under section 178 may overcome resistance to the entry and search by using as much force as is reasonably required, including breaking a door or window of the premises.

(8) Before using force in terms of subsection (7), a police officer must audibly demand admission and must announce the purpose of the entry, unless it is reasonable to believe that doing so may induce someone to destroy or dispose of an article or document that is the object of the search.

(9) The Commission may compensate anyone who suffers damage because of a forced entry during a search when no one responsible for the premises was present.

Part F

Companies Tribunal adjudication procedures

Adjudication hearings before Tribunal

180. (1) The Companies Tribunal—

(a) must conduct its adjudication proceedings contemplated in this Act expeditiously and in accordance with the principles of natural justice; and

(b) may conduct those proceedings informally.

(2) If adjudication proceedings before the Tribunal are open to the public, the Tribunal may exclude members of the public, or specific persons or categories of persons, from attending the proceedings—

(a) if evidence to be presented is confidential information, but only to the extent that the information cannot otherwise be protected;

(b) if the proper conduct of the hearing requires it; or

(c) for any other reason that would be justifiable in civil proceedings in a High Court.

(3) At the conclusion of adjudication proceedings, the presiding member must issue a decision together with written reasons for the decision.

Right to participate in hearing

181. The following persons may participate in an adjudication hearing contemplated in this Part, in person or through a representative, and may put questions to witnesses and inspect any books, documents or items presented at the hearing:

(a) The Commission;

(b) the applicant or complainant; and

(c) any other person who has a material interest in the hearing, unless that interest is adequately represented by another participant.

Powers of Tribunal adjudication hearing

182. The Companies Tribunal may—

(a) direct or summon any person to appear at any specified time and place;

(b) question any person under oath or affirmation;

(c) summon or order any person—

(i) to produce any book, document or item necessary for the purposes of the hearing; or

(ii) to perform any other act in relation to this Act; and

(d) give directions prohibiting or restricting the publication of any evidence given to the Tribunal.

Rules of procedure

183. Subject to the requirements of the applicable sections of this Act, the Companies Tribunal may determine any matter of procedure for an adjudication hearing, with due regard to the circumstances of the case.

Witnesses

184. (1) Every person giving evidence before the Companies Tribunal at an adjudication hearing must answer any relevant question.

(2) The law regarding a witness's privilege in a criminal case in a court of law applies equally to a person who provides information during an adjudication hearing.

(3) During an adjudication hearing, the Companies Tribunal may order a person to answer any question, or to produce any article or document, subject to subsection (4).

(4) Section 176(4) and (5) apply to any person questioned, or any evidence given, before the Companies Tribunal in terms of this section.

CHAPTER 8

REGULATORY AGENCIES AND ADMINISTRATION OF ACT

Part A

Companies and Intellectual Property Commission

Establishment of Companies and Intellectual Property Commission

185. (1) The Commission is hereby established as a juristic person to function as an organ of state within the public administration, but as an institution outside the public service.

(2) The Commission—

(a) has jurisdiction throughout the Republic;

(b) is independent, and subject only to—

(i) the Constitution and the law; and

(ii) any policy statement, directive or request issued to it by the Minister in terms of this Act;

(c) must be impartial and perform its functions without fear, favour, or prejudice; and

(d) must exercise the functions assigned to it in terms of this Act or any other law, or by the Minister, in—

(i) the most cost-efficient and effective manner; and

(ii) in accordance with the values and principles mentioned in section 195 of the Constitution.

(3) Each organ of state must assist the Commission to maintain its independence and impartiality, and to exercise its authority and perform its functions effectively.

(4) Except to the extent prescribed otherwise by or in terms of this Act, a certificate, notice, decision, determination or ruling issued or made with respect to any particular matter contemplated in this Act by—

(a) the Commissioner; or

(b) a person designated by the Commissioner to perform a particular function of the Commission,

is the certificate, notice, decision, determination or ruling of the Commission with respect to that matter.

Commission objectives

186. (1) The objectives of the Commission are—

(a) the efficient and effective registration of—

(i) companies, and external companies, in terms of this Act;

(ii) other juristic persons, in terms of any applicable legislation referred to in Schedule 4; and

(iii) intellectual property rights, in terms of any relevant legislation;

(b) the maintenance of accurate, up-to-date and relevant information concerning companies, foreign companies and other juristic persons contemplated in subsection (1)(a)(ii), and concerning intellectual property rights, and the provision of that information to the public and to other organs of state;

(c) the promotion of education and awareness of company and intellectual property laws, and related matters;

(d) the promotion of compliance with this Act, and any other applicable legislation; and

(e) the efficient, effective and widest possible enforcement of this Act, and any other legislation listed in Schedule 4.

(2) To achieve its objectives, the Commission may—

(a) have regard to international developments in the field of company and intellectual property law; or

(b) consult any person, organisation or institution with regard to any matter.

Functions of Commission

187. (1) In this section, “this Act” has the meaning set out in section 1, but also includes any legislation listed in Schedule 4.

(2) Other than with respect to matters within the jurisdiction of the Takeover Regulation Panel, the Commission must enforce this Act, by, among other things,—

- (a) promoting voluntary resolution of disputes arising in terms of this Act between a company on the one hand and a shareholder or director on the other, as contemplated in Part C of Chapter 7, without intervening in, or adjudicating any such dispute;
- (b) monitoring proper compliance with this Act;
- (c) receiving or initiating complaints concerning alleged contraventions of this Act, evaluating those complaints, and initiating investigations into complaints;
- (d) receiving directions from the Minister in terms of section 190, concerning investigations to be conducted into alleged contraventions of this Act, or other circumstances, and conducting any such investigation;
- (e) ensuring that contraventions of this Act are promptly and properly investigated;
- (f) negotiating and concluding undertakings and consent orders contemplated in section 169(1)(b) and 173;
- (g) issuing and enforcing compliance notices;
- (h) referring alleged offences in terms of this Act to the National Prosecuting Authority; and
- (i) referring matters to a court, and appearing before the court or the Companies Tribunal, as permitted or required by this Act.

(3) The Commission must promote the reliability of financial statements by, among other things—

- (a) monitoring patterns of compliance with, and contraventions of, financial reporting standards; and
- (b) making recommendations to the Council for amendments to financial reporting standards, to secure better reliability and compliance.

(4) The Commission must—

- (a) establish and maintain in the prescribed manner and form—
 - (i) a companies register; and
 - (ii) any other register contemplated in this Act, or in any other legislation that assigns a registry function to the Commission;
- (b) receive and deposit in the registry any documents required to be filed in terms of this Act;
- (c) make the information in those registers efficiently and effectively available to the public, and to other organs of state;
- (d) register and deregister companies, directors, business names and intellectual property rights, in accordance with relevant legislation; and
- (e) perform any related functions assigned to it by legislation, or reasonably necessary to carry out its assigned registry functions.

(5) Subject to the provisions of subsections (6) and (7), any person, on payment of the prescribed fee, may—

- (a) inspect a document filed under this Act;
- (b) obtain a certificate from the Commission as to the contents or part of the contents of any document that—
 - (i) has been filed under this Act in respect of any company; and
 - (ii) is open to inspection; or
- (c) obtain a copy of or extract from any document contemplated in paragraph (b); or
- (d) through any electronic medium approved by the Commission—
 - (i) inspect, or obtain a copy of or extract from, any document contemplated in paragraph (b) that has been converted into electronic format; or
 - (ii) obtain a certificate contemplated in paragraph (b).

(6) Subsection (5) does not apply to any part of a filed document if that part has been determined to be confidential, or contain confidential information, in accordance with section 212.

(7) The Commission—

- (a) must waive any prescribed registry fee contemplated in subsection (5) if the Commission is satisfied—
 - (i) that an inspection, certificate, copy or extract is required on behalf of a foreign government accredited to the Republic; and
 - (ii) that no fees are payable in the foreign country concerned in respect of such inspection, certificate, copy or extract required on behalf of the Republic; and
- (b) may waive any such fee if satisfied that any inspection, certificate, copy or extract is required for the purposes of research by or under the control of an institution for higher education.

Reporting, research, public information and relations with other regulators

188. (1) In addition to any other advice or reporting requirements set out in this Part, the Commission is responsible to—

- (a) advise the Minister on matters of national policy relating to company and intellectual property law, and recommend to the Minister changes to bring the law and the administration of this Act up to date and in line with international best practice;
- (b) report to the Minister annually on the volume and nature of registration and enforcement activities in terms of this Act and on any other matter as prescribed by the Minister; and
- (c) enquire into and report to the Minister on any matter concerning the purposes of this Act, and advise the Minister in respect of any matter referred to it by the Minister.

(2) The Commission must increase knowledge of the nature and dynamics of company and intellectual property law, and promote public awareness of company and intellectual property law matters, by—

- (a) implementing education and information measures to develop public awareness of the provisions of this Act, and in particular to advance the purposes of this Act;
- (b) providing guidance to the public by—
 - (i) issuing explanatory notices outlining its procedures, or its non-binding opinion on the interpretation of any provision of this Act; or
 - (ii) applying to a court for a declaratory order on the interpretation or application of any provision of this Act;
- (c) conducting research relating to its mandate and activities and, from time to time, publishing the results of that research; and
- (d) over time, reviewing legislation and public regulations, and reporting to the Minister concerning matters relating to company and intellectual property law.

(3) The Commission may—

- (a) liaise with any regulatory authority on matters of common interest, and without limiting the generality of this paragraph, may exchange information with, and receive information from any such regulatory authority pertaining to—
 - (i) matters of common interest; or
 - (ii) a specific complaint or investigation;
- (b) negotiate agreements with any regulatory authority, and exercise its authority through any such agreement, to—
 - (i) co-ordinate and harmonise the exercise of jurisdiction over company and intellectual property law matters within the relevant industry or sector; and
 - (ii) ensure the consistent application of the principles of this Act;
- (c) participate in the proceedings of any regulatory authority; and
- (d) advise, or receive advice from, any regulatory authority.

(4) The Commission may liaise with any foreign or international authorities having any objects similar to the functions and powers of the Commission.

(5) The Commission may refer to—

- (a) the Competition Commission any concerns regarding conduct that may be prohibited or regulated in terms of the Competition Act;
- (b) the South Africa Revenue Service any concerns regarding behaviour or conduct that may be prohibited or regulated in terms of legislation within the jurisdiction of that Service;
- (c) the Independent Regulatory Board for Auditors any concerns regarding behaviour or conduct that may be prohibited or regulated in terms of the Auditing Profession Act; or

(d) any other regulatory authority any concerns regarding behaviour or conduct that may be prohibited or regulated in terms of legislation within the jurisdiction of that regulatory authority.

Appointment of Commissioner

189. (1) The Minister must appoint a suitably qualified and experienced person to be—

- (a) the Commissioner of the Commission, who—
 - (i) holds office for an agreed term not exceeding five years; and
 - (ii) is responsible for all matters pertaining to the functions of the Commission; and
- (b) the Deputy Commissioner of the Commission, who—
 - (i) holds office for an agreed term not exceeding five years; and
 - (ii) may perform any function of the Commissioner when the office of the Commissioner is vacant, or when the Commissioner is absent or is for any reason unable to perform the functions of that office.

(2) A person may be reappointed as Commissioner or Deputy Commissioner on the expiry of an agreed term of office.

(3) The Commissioner is the accounting authority of the Commission, and as such, is responsible for—

- (a) the proper control and management of the Commission;
- (b) the effectiveness and efficiency of the Commission;
- (c) all income and expenditure of the Commission;
- (d) all revenue collected by the Commission;
- (e) all assets, and the discharge of all liabilities, of the Commission; and
- (f) the proper and diligent implementation of the Public Finance Management Act, 1999 (Act No. 1 of 1999), with respect to the Commission.

(4) The Commissioner may—

- (a) assign management or other duties to employees of the Commission, who have appropriate skills to assist in the management, or control over any function of the Commission; and
- (b) delegate, with or without conditions, any of the powers or functions of the Commissioner to the Deputy Commissioner or any other suitably qualified employee of the Commission, but any such delegation does not divest the Commissioner of responsibility for the exercise or any power or performance of any duty.

Minister may direct policy and require investigation

190. (1) In this section, “this Act” has the meaning set out in section 1, but also includes any legislation listed in Schedule 4.

(2) The Minister—

(a) by notice in the Gazette, may issue policy directives to the Commission with respect to the application, administration and enforcement of this Act, but any such directive must be consistent with this Act; and

(b) may at any time direct the Commission to investigate—

(i) an alleged contravention of this Act; or

(ii) any matter or circumstances with respect to the administration of one or more companies in terms of this Act, whether or not those circumstances appear at the time of the direction to amount to a possible contravention of this Act.

Establishment of specialist committees

191. (1) The Minister may appoint one or more specialist committees to advise the—

(a) Minister on any matter relating to company law or policy; or

(b) Commissioner on the management of the Commission’s resources.

(2) The Minister may assign specific powers to the members of a specialist committee for the purposes of performing any function contemplated in subsection (1).

(3) A specialist committee may—

(a) be established for an indefinite term, or for a period determined by the Minister when the committee is established; and

(b) determine its own procedures.

Constitution of specialist committees

192. (1) A specialist committee established under section 191 must—

(a) perform its functions impartially and without fear, favour or prejudice; and

(b) consist of—

(i) not more than eight persons who are independent from the Commission and are appointed by the Minister to serve for a period of not more than five years, as determined by the Minister when the person is appointed; and

(ii) not more than two senior employees of the Commission designated by the Commissioner.

(2) To be appointed or designated as a member of a specialist committee in terms of this section, a person must—

(a) be a fit and proper person;

(b) have appropriate expertise or experience; and

- (c) have the ability to perform effectively as a member of that committee.
- (3) The members of a specialist committee must not—
 - (a) act in any way that is inconsistent with subsection (1)(a) or expose themselves to any situation in which the risk of a conflict may arise between their responsibilities and any personal financial interest; or
 - (b) use their position or any information entrusted to them to enrich themselves or improperly benefit any other person.
- (4) A member ceases to be a member of a specialist committee if the—
 - (a) person resigns from the committee;
 - (b) Minister terminates the person's membership because the member no longer complies with subsection (2) or has contravened subsection (3); or
 - (c) member's term has expired.
- (5) A member of a specialist committee who has a personal or financial interest in any matter on which the committee gives advice must disclose that interest and withdraw from the proceedings of the specialist committee when that matter is discussed.
- (6) The Commission must remunerate and compensate for expenses—
 - (a) a member mentioned in subsection (1)(b)(i), as determined by the Minister; and
 - (b) a member designated as contemplated in (1)(b)(ii), to the extent that the member's remuneration and expense compensation as an employee of the Commission does not extend to that person's services as a member of the specialist committee.

Part B

Companies Tribunal

Establishment of Companies Tribunal

193. (1) There is hereby established a juristic person to be known as the Companies Tribunal, which—

- (a) has jurisdiction throughout the Republic;
 - (b) is independent, and subject only to the Constitution and the law;
 - (c) must exercise its functions in accordance with this Act; and
 - (d) must perform its functions impartially and without fear, favour, or prejudice, and in as transparent a manner as is appropriate having regard to the nature of the specific function.
- (2) Each organ of state must assist the Companies Tribunal to maintain its independence and impartiality, and to perform its functions effectively.
- (3) In carrying out its functions, the Companies Tribunal may—
 - (a) have regard to international developments in the field of company law; or

- (b) consult any person, organisation or institution with regard to any matter.
- (4) The Companies Tribunal consists of a chairperson and not less than 10 other women or men appointed by the Minister, on a full or part-time basis.

Appointment of Companies Tribunal

194. (1) The Minister must—

- (a) appoint the chairperson and other members of the Companies Tribunal no later than the date on which this Act comes into operation; and
- (b) appoint a person to fill any vacancy on the Tribunal.

(2) A person may not be—

- (a) appointed as chairperson or member of the Tribunal unless the person satisfies the requirements of section 205; or
- (b) reappointed to a second term as chairperson of the Tribunal.

(3) The Tribunal must comprise—

- (a) persons with suitable qualifications and experience in economics, law, commerce, industry or public affairs; and
- (b) sufficient persons with legal training to satisfy the requirements of subsection 3(a).

(4) The Minister must designate a member of the Tribunal as deputy chairperson of the Tribunal.

(5) The deputy chairperson performs the functions of chairperson whenever—

- (a) the office of chairperson is vacant; or
- (b) the chairperson is for any other reason temporarily unable to perform those functions.

(6) Sections 206 and 207 apply to the chairperson and other members of the Tribunal.

Functions of Companies Tribunal

195. (1) The Companies Tribunal, or a member of the Tribunal acting alone in accordance with this Act, may—

- (a) adjudicate in relation to any application that may be made to it in terms of this Act, and make any order provided for in this Act in respect of such an application;
- (b) assist in the resolution of disputes as contemplated in Part C of Chapter 7; and
- (c) perform any other function assigned to it by or in terms of this Act, or any law mentioned in Schedule 4.

(2) The chairperson is responsible to manage the caseload of the Companies Tribunal, and must assign each matter referred to the Tribunal to—

- (a) a member of the Tribunal, to the extent that this Act provides for a matter to be considered by a single member of the Tribunal; or

- (b) a panel composed of any three members of the Tribunal, in any other case.
- (3) When assigning a matter to a panel in terms of subsection (2)(b), the chairperson must—
- (a) ensure that at least one member of the panel is a person who has suitable legal qualifications and experience; and
 - (b) designate a member of the panel to preside over the panel's proceedings.
- (4) If, because of resignation, illness, death, or withdrawal from a hearing in terms of section 206(3), a member of the panel is unable to complete the proceedings in a matter assigned to that panel, the chairperson must—
- (a) direct that the hearing of that matter proceed before the remaining members of the panel, subject to the requirements of subsection (3)(a); or
 - (b) terminate the proceedings before that panel and constitute another panel, which may include any member of the original panel, and direct that panel to conduct a new hearing.
- (5) The decision of a panel on a matter referred to it must be in writing and include reasons for that decision.
- (6) A decision of a single member of the Companies Tribunal hearing a matter as contemplated in subsection (1)(a), or of a majority of the members of a panel in any other case, is the decision of the Tribunal.
- (7) A decision by the Companies Tribunal with respect to a decision, notice or order by the Commission is binding on the Commission, subject to any review by the court. (8) An order of the Companies Tribunal may be filed in the High Court as an order of the court, in accordance with its rules.
- (9) A member of the Tribunal may not represent any person before the Tribunal. (10) If, on the expiry of the term of office of a member of the Companies Tribunal, that member is still considering a matter before the Tribunal, that member may continue to act as a member in respect of that matter only.

...

Part D

Financial Reporting Standards Council

Establishment and composition of Council

- 203.** (1) The Minister must establish a council, to be known as the Financial Reporting Standards Council consisting of—
- (a) four persons, each of whom is registered and practicing as an auditor;
 - (b) two persons each of whom is responsible for preparing financial statements on behalf of public companies;

- (c) two persons responsible for preparing financial statements for private companies;
 - (d) four persons who, in their capacity as holders of securities issued by a company, or as creditors of a company, are reasonably expected to rely on financial statements, as contemplated in the definition of “financial statement” in section (1);
 - (e) two persons knowledgeable in company law;
 - (f) one person nominated by the executive officer of the Financial Services Board as defined in section 1 of the Financial Services Board Act, 1990 (Act No. 97 of 1990), or any successor body to it;
 - (g) one person nominated by the Governor of the South African Reserve Bank, or any successor body to it; and
 - (h) a number of persons, nominated one each by any exchange that imposes adherence to financial reporting standards as a listing requirement each of whom must be appointed by the Minister, to serve for a term of three years.
- (2) The Minister must select candidates—
- (a) with the qualifications, knowledge and experience necessary to further the functions of the Council; and
 - (b) appoint the chairperson and deputy chairperson of the Council.
- (3) Persons appointed as members of the Council—
- (a) must satisfy the requirements of section 205; and
 - (b) are subject to sections 206 and 207.
- (4) A person may be reappointed to the Council, subject to section 205.
- (5) The Minister may require the Council to be a member of a relevant international accounting standards setting organisation.

Functions of Financial Reporting Standards Council

204. The Financial Reporting Standards Council must—

- (a) receive and consider any relevant information relating to the reliability of, and compliance with, financial reporting standards and adapt international reporting standards for local circumstances and consider information from the Commission as contemplated in section 187(3)(b);
- (b) advise the Minister on matters relating to financial reporting standards; and
- (c) consult with the Minister on the making of regulations establishing financial reporting standards, subject to the requirements set out in section 29(5).

Part E

Administrative provisions applicable to agencies

Qualifications for membership

205. (1) To be eligible for appointment, designation or co-option as a member of the Companies Tribunal, the Panel, or the Council, and to continue to hold that office, a person must, in addition to satisfying any other specific requirements set out in this Act—

- (a) not be subject to any disqualification set out in subsection (2); and
- (b) have submitted to the Minister a written declaration stating that the person is not disqualified in terms of subsection (2).

(2) A person may not become, or continue to be, a member of the Companies Tribunal, the Panel, or the Council, if that person—

- (a) is an office-bearer of any party, movement, organisation or body of a partisan political nature;
- (b) personally or through a related person has or acquires a personal financial interest that may conflict or interfere with the proper performance of the duties of a member of the Tribunal, Panel, or Council;
- (c) is disqualified in terms of section 69 from serving as a director of a company; or
- (d) is subject to an order of a competent court holding that person to be mentally unfit or disordered.

Conflicting interests of agency members

206. (1) A member of the Companies Tribunal, the Panel or the Council, must promptly inform the Minister in writing after that person or a related persons acquires a personal financial interest that is, or is likely to become, an interest contemplated in section 205(2)(b).

(2) A member of the Companies Tribunal, the Panel or the Council, must not—

- (a) engage in any activity that may undermine the integrity of the Companies Tribunal, the Panel or the Council, as the case may be;
- (b) attend, participate in or influence the proceedings during a meeting of the Companies Tribunal, the Panel, or the Council, as the case may be if, in relation to the matter being considered, that member has a personal financial interest—
 - (i) contemplated in section 205(2)(b); or
 - (ii) that precludes that person from performing the functions of a member of the Companies Tribunal, the Panel or the Council, in a fair, unbiased and proper manner;
- (c) vote at any meeting of the Tribunal, Panel or Council, as the case may be, in connection with a matter contemplated in paragraph (b);
- (d) make private use of, or profit from, any confidential information obtained as a result of performing that person's functions as a member of the Companies Tribunal, the Panel or the Council; or

(e) divulge any confidential information referred to in paragraph (d) to any third party, except as contemplated in section 212(5), or—

(i) to—

(aa) the Commission, the Minister, or the National Treasury to the extent required by this Act or a law mentioned in Schedule 4;

(bb) the South African Reserve Bank;

(cc) the Independent Regulatory Board for Auditors, in terms of the Auditing Profession Act;

(dd) the Financial Intelligence Centre established by the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001); or

(ii) as otherwise required as part of that person's official functions as a member of the Companies Tribunal, the Panel or the Council.

(3) If, at any time, it appears to a member of the Companies Tribunal, Panel, or Council that a matter being considered at a meeting concerns a personal financial interest of that member or a related person, as contemplated in subsection (2)(b), that member must—

(a) immediately and fully disclose the nature of that interest to the meeting; and

(b) withdraw from the meeting to allow the remaining members to discuss the matter and determine whether the member should be prohibited from participating in any further proceedings concerning that matter.

(4) The disclosure by a person in terms of subsection (3)(a), and the decision by the Companies Tribunal, the Panel, or the Council in terms of subsection (3)(b), must be expressly recorded in the minutes of the meeting in question.

(5) Proceedings of the Companies Tribunal, the Panel, or the Council, and any decisions taken by a majority of the members present and entitled to participate in those decisions, are valid despite the fact that—

(a) a member failed to disclose an interest as required by subsection (3); or

(b) a member who had such an interest attended those proceedings, participated in them in any way, or directly or indirectly influenced those proceedings.

Resignation, removal from office and vacancies

207. (1) A member of the Companies Tribunal or the Council may resign by giving to the Minister—

(a) one month written notice; or

(b) less than one month written notice, with the approval of the Minister.

(2) A member of the Panel may resign by giving written notice jointly to the Minister and the relevant entity responsible for the designation of that member, if any.

(3) The Minister, after taking the steps required by subsection (4), may remove a member of the Companies Tribunal, Panel or Council only if that member has—

- (a) become disqualified in terms of section 205(2);
 - (b) acted contrary to section 206(2);
 - (c) failed to disclose an interest or withdraw from a meeting as required by section 206(3); or
 - (d) neglected to properly perform the functions of their office.
- (4) Before removing a person from office in terms of subsection (3), the Minister must afford the person an opportunity to state a case in defence of their position.

Conflicting interests of employees

208. The Commissioner, and each other employee of the Commission, and the Executive Director, and each other employee of the Panel and members and employees of the Council, must not—

- (a) engage in any activity that may undermine the integrity of the Commission or Panel, as the case may be;
- (b) participate in any investigation, hearing, or decision concerning a matter in respect of which that person has a personal financial interest;
- (c) make private use of, or profit from, any confidential information obtained as a result of performing that person's official functions in the Commission or panel; or
- (d) divulge any information referred to in paragraph (c) to any third party, except as required as part of that person's official functions within the Commission or panel.

Appointment of inspectors

209. (1) The Commissioner and the Executive Director—

- (a) may each appoint any suitable employee of the Commission or Panel, as the case may be, or any other suitable person employed by the State, as an inspector; and
- (b) must issue each inspector with a certificate in the prescribed form stating that the person has been appointed as an inspector in terms of this Act.

(2) When an inspector performs any function of an inspector in terms of this Act, the inspector—

- (a) must be in possession of a certificate of appointment issued to that inspector in terms of subsection (1); and
- (b) must show that certificate to any person who—
 - (i) is affected by the inspector's actions in terms of this Act; and
 - (ii) requests to see the certificate; and
- (c) has the powers—
 - (i) set out in Part E of Chapter 7; and

(ii) of a peace officer as defined in section 1 of the Criminal Procedure Act, 1977 (Act No. 51 of 1977), and may exercise the powers conferred on a peace officer by law.

(3) The Commissioner and Executive Director may each appoint or contract with any suitably qualified person to assist the Commission, or the Panel, as the case may be, in carrying out its functions, including, but not limited to, conducting research, audits, inquiries or other investigations on behalf of the Commission or Panel, as the case may be, but a person appointed in terms of this subsection is not an inspector within the meaning of this Act.

(4) The Minister, with the concurrence of the Minister of Finance, may determine the remuneration to be paid to a person appointed in terms of this section, if that person is not in the full-time service of the Commission or Panel, as the case may be.

...

Reviews and reports to Minister

211. (1) At least once every five years, the Minister must conduct an audit review of the exercise of the functions and powers of the Commission, the Companies Tribunal, the Panel and the Council.

(2) In addition to any other reporting requirement set out in this Act, the Commission, Tribunal, Council and Panel must each report to the Minister at least once every year on its activities, as required by the Public Finance Management Act, 1999 (Act No. 1 of 1999).

(3) As soon as practicable after receiving a report of a review contemplated in subsection (1), or after receiving a report contemplated in subsection (2), the Minister must table it in Parliament.

Confidential information

212. (1) When submitting information to the Commission, the Panel, the Companies Tribunal, the Council, or an inspector or investigator appointed in terms of this Act, a person may claim that all or part of that information is confidential.

(2) Any claim contemplated in subsection (1) must be supported by a written statement explaining why the information is confidential.

(3) The Commission, Panel, Companies Tribunal, Council, inspector or investigator, as the case may be, must—

(a) consider a claim made in terms of subsection (1); and

(b) as soon as practicable, make a decision on the confidentiality of the information and access to that information, and provide written reasons for that decision.

(4) Section 172, read with the changes required by the context, applies to a decision in terms of subsection (3).

(5) When making any ruling, decision or order in terms of this Act, the Commission, the Panel, the Companies Tribunal or the Council may take confidential information into account.

(6) If any reasons for a decision in terms of this Act would reveal any confidential information, the Commission, the Panel, the Companies Tribunal or the Council, as the case may be, must provide a copy of the proposed reasons to the party claiming confidentiality at least five business days before publishing those reasons.

(7) Within five business days after receiving a copy of proposed reasons in terms of subsection (6), a party may apply to a court for an appropriate order to protect the confidentiality of the relevant information.

CHAPTER 9

OFFENCES, MISCELLANEOUS MATTERS AND GENERAL PROVISIONS

Part A

Offences and penalties

Breach of confidence

213. (1) It is an offence to disclose any confidential information concerning the affairs of any person obtained—

- (a) in carrying out any function in terms of this Act; or
- (b) as a result of initiating a complaint, or participating in any proceedings in terms of this Act.

(2) Subsection (1) does not apply to information disclosed—

- (a) as contemplated in section 206(2)(e)(i) or (ii) or 212(5) to (7);
- (b) for the purpose of the proper administration or enforcement of this Act;
- (c) for the purpose of the administration of justice;
- (d) at the request of the Commission, the Panel, an inspector or investigator, the Companies Tribunal, or a court entitled to receive the information; or
- (e) when required to do so by any court or under any law.

False statements, reckless conduct and non-compliance

214. (1) A person is guilty of an offence if the person—

- (a) is a party to the falsification of any accounting records of a company;
- (b) 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;
- (c) was knowingly a party to—
 - (i) conduct prohibited by section 22(1); or

- (ii) an act or omission by a business calculated to defraud a creditor, employee or security holder of the company, or with another fraudulent purpose; or
- (d) is a party to the preparation, approval, dissemination or publication of—
 - (i) financial statements or summaries, to the extent set out in section 29(6);
 - (ii) a prospectus, or a written statement contemplated in section 101, that contained an ‘untrue statement’ as defined and described in section 95.
- (2) For the purposes of subsection (1)(d), a person is a party to the preparation of a document contemplated in that subsection if—
 - (a) the document includes or is otherwise based on a scheme, structure or form of words or numbers devised, prepared or recommended by that person; and
 - (b) the scheme, structure or form of words is of such a nature that the person knew, or ought reasonably to have known, that its inclusion or other use in connection with the preparation of the document would cause it to be false or misleading.
- (3) It is an offence to fail to satisfy a compliance notice issued in terms of this Act, but no person may be prosecuted for such an offence in respect of a particular compliance notice if the Commission or Panel, as the case may be, has applied to a court in terms of section 171(7)(a) for the imposition of an administrative fine in respect of that person’s failure to comply with that notice.

Hindering administration of Act

215. (1) It is an offence to hinder, obstruct or improperly attempt to influence the Commission, the Panel, the Companies Tribunal, an inspector or investigator, or a court when any of them is exercising a power or performing a duty delegated, conferred or imposed by this Act.

- (2) A person commits an offence who—
 - (a) does anything calculated to improperly influence—
 - (i) the Commission, the Panel, the Companies Tribunal, an inspector or investigator concerning any matter connected with an investigation; or
 - (ii) the Companies Tribunal in any matter before it;
 - (b) anticipates any findings of the Commission, the Panel, the Companies Tribunal, an inspector or investigator in a way that is calculated to improperly influence the proceedings or findings;
 - (c) does anything in connection with an investigation or hearing that would have been contempt of court if the proceedings had occurred in a court of law;
 - (d) refuses to attend when summoned, or after attending, refuses to answer any question or produce any document as required by the summons, other than as contemplated in section 176(a);
 - (e) knowingly provides false information to the Commission, the Panel, the Companies Tribunal, an inspector or investigator;

- (f) improperly frustrates or impedes the execution of a warrant to enter and search, or attempts to do so;
- (g) acts contrary to or in excess of a warrant to enter and search; and
- (h) without authority, but claiming to have authority in terms of section 177—
 - (i) enters or searches premises; or
 - (ii) attaches or removes an article or document.

...

Part B

Miscellaneous matters

Civil actions

218. (1) Nothing in this Act renders void an agreement, resolution or provision of an agreement, resolution, Memorandum of Incorporation or rules of a company that is prohibited, void, voidable or may be declared unlawful in terms of this Act, unless a court declares that agreement, resolution or provision to be void.

(2) Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

(3) The provisions of this section do not affect the right to any remedy that a person may otherwise have.

Limited time for initiating complaints

219. (1) A complaint in terms of this Act may not be initiated by, or made to, the Commission or the Panel, more than three years after—

(a) the act or omission that is the cause of the complaint; or

(b) in the case of a course of conduct or continuing practice, the date that the conduct or practice ceased.

(2) A complaint may not be prosecuted in terms of this Act against any person that is, or has been, a respondent in proceedings under another section of this Act relating substantially to the same conduct.

Serving documents

220. Unless otherwise provided in this Act, a notice, order or other document that, in terms of this Act, must be served on a person, will have been properly served when it has been either—

(a) delivered to that person; or

(b) sent by registered mail to that person's last known address.

Proof of facts

221. (1) In any proceedings in terms of this Act, if it is proved that a false statement, entry or record or false information appears in or on a book, document, plan, drawing or computer storage medium, the person who kept that item must be presumed to have made the statement, entry, record or information, unless the contrary is proved.

(2) A statement, entry or record, or information, in or on any book, document, plan, drawing or computer storage medium is admissible in evidence as an admission of the facts in or on it by the person who appears to have made, entered, recorded or stored it unless it is proved that that person did not make, enter, record or store it.

State liability

222. The State, the Commission, the Commissioner, the Companies Tribunal, the Panel, an inspector, or any state employee or similar person having duties to perform under this Act, is not liable for any loss sustained by or damage caused to any person as a result of any bona fide act or omission relating to the performance of any duty under this Act, unless gross negligence is proved.

Part C

Regulations, consequential matters and commencement

Regulations

223. (1) The Minister—

(a) may make any regulations expressly authorised or contemplated elsewhere in this Act, in accordance with subsection (2);

(b) in consultation with the Commission, and by notice in the Gazette, may make regulations for matters relating to the functions of the Commission, including—

(i) forms;

(ii) time periods;

(iii) information required;

(iv) additional definitions applicable to those regulations;

(v) filing fees;

(vi) access to confidential information;

(vii) manner and form of participation in Commission procedures; and

- (viii) forms of Memorandum of Incorporation and requirements concerning the offering of securities;
 - (c) in consultation with the Chairperson of the Panel, and by notice in the Gazette, may make—
 - (i) regulations for matters relating to the functions of the panel, respectively; and
 - (ii) rules for the conduct of matters before the Panel; and
 - (d) may make regulations regarding—
 - (i) any forms required to be used for the purposes of this Act; and
 - (ii) in general, any ancillary or incidental matter that is necessary for the proper implementation and administration of this Act.
- (2) Before making any regulations in terms of this Act, the Minister must publish the proposed regulations for public comment, subject to subsection (3).
- (3) In the case of regulations prescribing financial reporting standards as contemplated in section 29(4)(a), the provisions of subsection (2) do not apply.
- (4) A regulation in terms of this Act must be made by notice in the Gazette.

Consequential amendments, repeal of laws and transitional arrangements

- 224.** (1) The Companies Act, 1973 (Act No. 61 of 1973), is hereby repealed, subject to subsection (3).
- (2) The laws referred to in Schedule 3 are hereby amended in the manner set out in that Schedule.
- (3) The repeal of the Companies Act, 1973 (Act No. 61 of 1973), does not affect the transitional arrangements, which are set out in Schedule 5.

Short title and commencement

- 225.** This Act is called the Companies Act, 2008, and comes into operation on a date fixed by the President by proclamation in the Gazette, which may not be earlier than one year following the date on which the President assented to this Act.

COMPANIES ACT 61 OF 1973

[ASSENTED TO 19 JUNE 1973]

[DATE OF COMMENCEMENT: 1 JANUARY 1974]

(Unless otherwise indicated)

(Afrikaans text signed by the State President)

as amended by

Corporate Laws Amendment Act 24 of 2006

...

Section 1 Definitions

(1) In this Act, unless the context otherwise indicates-

...

'Council' means the Financial Reporting Standards Council established by section 440P;
[Definition of 'Council' inserted by Act 24 of 2006.]

...

'financial report' means financial statements and any financial information in a circular, a prospectus or a provisional announcement of results upon which users may reasonably rely;

'financial reporting standards' means statements of Generally Accepted Accounting Practice adopted by the Accounting Practices Board prior to the establishment of the Council, and thereafter issued in terms of section 440U (2);
[Definition of 'financial reporting standards' inserted by Act 24 of 2006.]

'financial statements' means annual financial statements, provisional annual financial statements and interim or preliminary reports and includes, where applicable, group and consolidated financial statements;

[Definition of 'financial statements' inserted by Act 24 of 2006.]

'inspector' means a person appointed by the Minister in terms of section 254, 257 or 258;
[Definition of 'inspector' inserted by Act 24 of 2006.]

'**Minister**', in relation to any matter to be dealt with in the office of a Master in connection with the winding-up or judicial management of companies, means the Minister responsible for Justice and, in relation to any other matter, means the Minister of Trade and Industry;

'**Panel**' means the Financial Reporting Investigations Panel established by section 440W; [Definition of 'Panel' inserted by Act 24 of 2006.]

'**regulations**' means the regulations made or in force under this Act;

'**this Act**' includes the regulations;

'**user**' in relation to a financial report, means a shareholder, prospective shareholder, creditor, regulator or any person who relies on information contained in the report; [Definition of 'user' inserted by Act 24 of 2006.]

...

(6) (a) A company is a **widely held** company: if-

- (i) its articles provide for an unrestricted transfer of its shares;
- (ii) it is permitted by its articles to offer shares to the public;
- (iii) it decides by special resolution to be a widely held company; or
- (iv) it is a subsidiary of a company described in subparagraph (i), (ii) or (iii).

(b) A company with two or more types or classes of shares is a widely held company if its articles provide for the unrestricted transfer of shares in one or more of these types or classes.

(c) For the purposes of this subsection-

- (i) a transfer of shares is unrestricted if it is not subject to an effective right of pre-emption;
- (ii) an effective right of pre-emption is a right of pre-emption which operates in favour of all shareholders of the company and upon every proposed sale of shares to a person who is not a shareholder of the company.

(d) A company is a **limited interest company** if it is not a widely held company.

(e) An effective right of pre-emption contained in the articles of a limited interest company shall be deemed also to operate, with the necessary changes, upon-

- (i) the disposal of a beneficial interest in a share of the company; and
- (ii) an offer by the company of shares created in terms of section 75 (1) to any person who is not a shareholder of the company.

(f) For the purposes of paragraph (e) (i), 'beneficial interest' shall be as defined in subsection 140A (1), except that it shall apply in relation to a share rather than to a security.

(7) A widely held company, which on or prior to its annual general meeting ceases to fall within the definition of a widely held company, may by a special resolution passed at that meeting

become a limited interest company if the directors certify that the company will not in the following financial year seek to become a widely held company.

...

CHAPTER VII

ADMINISTRATION OF COMPANIES (ss 170-207)

Meetings of the Company (ss 179-192)

Section 179 Annual general meeting

(1) (a) Every company, at such times as are in this subsection prescribed, shall hold general meetings to be known and described in the notices calling such meetings as annual general meetings of that company.

(b) Such meetings shall be held-

- (i) in the case of the first such meeting, within a period of eighteen months after the date of the incorporation of the company concerned; and
- (ii) thereafter within not more than nine months after the end of every ensuing financial year of that company; and
- (iii) within not more than fifteen months after the date of the last preceding such meeting of that company.

(2) The annual general meeting of a company shall deal with and dispose of the matters prescribed by this Act and may deal with and dispose of such further matters as are provided for in the articles of the company and, subject to the provisions of this Act, any matters capable of being dealt with by any general meeting of the company.

(3) The Registrar may, on application to him before, or, for the purposes of subsection (6), also after, the expiration of the period within which an annual general meeting of a company must be held and on good cause shown, and on payment of the prescribed fee, extend the period within which an annual general meeting of the company concerned must be held by a period not exceeding three months, but, notwithstanding any such extension, the date for the holding of the first annual general meeting following the meeting in respect of which the extension is granted, shall be determined as if such meeting had been held on the last day on which it should have been held if the extension had not been granted.

(4) (a) If for any reason an annual general meeting of a company is not or cannot be held as provided in this section or any matter required by this Act to be dealt with and disposed of at such meeting is not dealt with thereat, the Registrar may, on application by the company or any member or its or his legal representative and on payment of the prescribed fee, call or direct the calling of a general meeting of the company which shall be deemed to be an annual general meeting, and may give such ancillary or consequential directions as he may think expedient, including directions modifying or supplementing, in relation to the calling, holding and conduct

of the meeting, the operation of the company's articles, and directions providing for one member or the legal representative of a member or any specified number of members present in person or by proxy, to be deemed to constitute a meeting, and any meeting called, held and conducted in accordance with any such direction shall for all purposes be deemed to be an annual general meeting of the company duly called, held and conducted.

(b) For the purpose of determining the date for the holding of the next succeeding annual general meeting of a company, after a meeting held in pursuance of paragraph (a) of this subsection, the provisions of subsection (3) shall mutatis mutandis apply.

(5) Any company which fails to comply with any provision of subsection (1) or with any direction given by the Registrar under subsection (4), and every director or officer of the company who knowingly is a party to the failure, shall be guilty of an offence.

(6) A company which has failed to hold its annual general meeting within the time or extended time prescribed by subsection (1) or (3), or as directed by the Registrar under subsection (4), shall further be liable to pay to the Registrar additional fees of fifty rand for every day during which the default continues but not exceeding a maximum of one thousand rand.

(7) A company need not hold any particular annual general meeting if all members entitled to attend that meeting agree thereto in writing, and in such event a resolution in writing dealing with and disposing of-

- (a) the matters required by this Act to be dealt with and disposed of at an annual general meeting of a company; and
- (b) such other matters, if any, as may, in terms of subsection (2), be dealt with at such a meeting,

and signed by all members entitled to vote at that meeting, before the expiration of the period within which that meeting is to be held, shall be deemed to be a resolution passed at an annual general meeting of the company held in terms of this section on the date on which the last signature to such resolution is affixed.

Section 180 General meetings

(1) General meetings of a company may, subject to the provisions of its articles, be held from time to time.

(2) Any such meeting may, save in so far as is otherwise provided in the articles of a company and without derogation from any other provisions of this Act, be called by two or more members holding not less than one-tenth of its issued share capital or, in the case of a company not having a share capital, by not less than five per cent in number of the members of the company.

...

CHAPTER XI

ACCOUNTING AND DISCLOSURE (ss 284-310)

Accounting Records (ss 284-287)

...

Section 285 Determination of financial year of company

(1) The financial year of a company shall, subject to the provisions of this section and any other law, be its annual accounting period, the commencing date of which and the date on which it ends in the next succeeding calendar year, shall be determined upon the incorporation of the company: Provided that the first financial year of a company shall, where the commencing date so determined-

(a) is a date more than three months after such incorporation, be the period commencing on such incorporation and ending on the date immediately preceding the commencing date so determined; or

(b) is a date not more than three months after such incorporation, be the period commencing on such incorporation and ending on the date so determined as the end of the financial year in the next calendar year.

(2) A company may at any time before the end of its current financial year on payment of the prescribed fee and on lodgment with the Registrar of the prescribed form-

(a) change the end of that financial year to a date being not more than six months earlier; or

(b) with the approval of the Registrar given on good cause shown, change the end of that financial year to a date being not more than six months later,

and in such a case every subsequent financial year of the company shall end, subject to the provisions of this section, on the date as so changed.

(3) Any reference in this Act to the financial year of a company shall be construed as including a reference to any period which in terms of this section is stated to be a financial year of that company.

Section 285A General requirements for financial statements

(1) A widely held company-

(a) must comply with financial reporting standards;

(b) must comply with the provisions of this Act and Schedule 4 that are applicable to public interest companies;

(c) must prepare financial statements that fairly present the financial position and the results of the operations of the company (and its subsidiaries, if applicable) in accordance with paragraph (a).

(2) A limited interest company-

- (a) must comply with the accounting standards developed for limited interest companies under section 440S (1) (b);
 - (b) must comply with the provisions of this Act and Schedule 4 that are applicable to limited interest companies;
 - (c) must prepare financial statements that fairly present the financial position and the results of operations of the company (and its subsidiaries, if applicable) in accordance with paragraphs (a) and (b).
- (3) Financial statements must clearly state that they have been prepared in accordance with-
- (a) this Act prior to its amendment by the Corporate Laws Amendment Act, 2006;
 - (b) financial reporting standards; or
 - (c) the requirements of subsection (2) (c).

[S. 285A inserted by s. 36 of Act 24 of 2006.]

Section 286 Duty to make out annual financial statements and to lay them before annual general meeting

(1) The directors of a company shall in respect of every financial year of the company cause to be made out in one of the official languages of the Republic annual financial statements and shall lay them before the annual general meeting of the company required to be held in terms of section 179 in respect of that financial year.

- (2) The annual financial statements required to be made out under subsection (1) shall consist of-
- (a) a balance sheet, income statement and additional components required in terms of financial reporting standards;
 - (b) a summary of significant accounting policies and other explanatory notes on the components referred to in paragraph (a);
 - (c) a directors' report complying with the requirements of this Act; and
 - (d) an auditor's report as required by section 301.

(3) *The annual financial statements of a company shall, in conformity with generally accepted accounting practice, fairly present the state of affairs of the company and its business as at the end of the financial year concerned and the profit and loss of the company for that financial year and shall for that purpose be in accordance with and include at least the matters prescribed by Schedule 4, in so far as they are applicable, and comply with any requirements of this Act.* [Subs. (3) deleted by Act 24 of 2006.]

(4) (a) Any director or officer of a company who fails to take all reasonable steps to comply or to secure compliance with the provisions of this section or with any other requirements of this Act as to matters to be stated in annual financial statements, shall be guilty of an offence.

(b) In any proceedings against any director or officer of a company under paragraph (a), the defence referred to in section 284 (4) (b) shall be available to him.

Section 287 Offence to issue incomplete or non-compliant financial statements

If any financial statements of a company which are incomplete in any material particular or otherwise do not comply with the requirements of this Act, are issued, circulated or published, the company and every director or officer thereof who is a party to such issue, circulation or publication, shall be guilty of an offence.

Section 287A False or misleading reports

(1) If any financial report of a company is false or misleading in a material respect, any person who is a party to the preparation, approval, publication, issue or supply of that report and who knows or ought reasonably to suspect that it is false or misleading is guilty of an offence unless subsection (3) applies.

(2) For the purposes of subsection (1), a person shall be regarded as a party to the preparation of a financial report which is false or misleading if-

- (a) the report includes or is otherwise based on a scheme, structure or form of words devised, prepared or recommended by that person; and
- (b) the scheme, structure or form of words is of such a nature that that person knew or ought reasonably to have suspected that its inclusion or other use in connection with the preparation of the report would cause the report to be false or misleading.

(3) If any person is found guilty of an offence under section 287 in respect of a failure to comply with, or an omission from, financial statements, such person shall not also be guilty of an offence under this section in respect of the same failure or omission.

[S. 287A inserted by s. 39 of Act 24 of 2006.]

Accounting by Holding Companies (ss 288-294)**Section 288 Obligation to lay group statements before annual general meeting**

(1) Where at the end of its financial year a company, which is not a wholly owned subsidiary of another company incorporated in the Republic (including an external company which is a subsidiary of a company incorporated in the Republic), has subsidiaries, group annual financial statements shall be made out and shall be laid before the annual general meeting of the company before which its own annual financial statements are so laid under section 286 (1).

(2) ... [Sub-s. (2) deleted by Act 24 of 2006.]

(3) (a) Any director or officer of a company who fails to take all reasonable steps to comply or to secure compliance with the provisions of this section or with any other requirements of this Act as to matters to be stated in group financial statements, shall be guilty of an offence.

[Para. (a) substituted by Act 24 of 2006.]

(b) In any proceedings against any director or officer of a company under paragraph (a), the defence referred to in section 284 (4) (b) shall be available to him.

Section 289 ... [S. 289 repealed by Act 24 of 2006.]

Section 290 Group financial statements for limited interest companies

(1) A limited interest company need not consolidate financial statements, if the directors of the company are of the opinion that the required information about the state of affairs, business and profit or loss of the company and its subsidiaries would be presented more effectively and meaningfully in the manner set out in subsection (2).

(2) If consolidated annual financial statements are not made out, group annual financial statements may consist of-

- (a) one set of consolidated annual financial statements dealing with the company and one group of subsidiaries and one or more sets dealing with other groups of subsidiaries;
- (b) separate annual financial statements dealing with each of the subsidiaries;
- (c) statements annexed to the company's own annual financial statements dealing with subsidiaries and their effect on the financial statements of the company; or
- (d) any combination of the forms described in paragraph (a), (b) or (c).

(3) Group financial statements may be wholly or partly incorporated in the company's own financial statements.

[S. 290 substituted by Act 24 of 2006.]

...

Further Requirements as to Financial Statements (s 298)

Section 298 Approval and signing of financial statements

(1) The annual financial statements of a company other than the auditor's report, shall be approved by its directors and signed on their behalf by two of the directors or, if there is only one director, by that director, and group annual financial statements shall similarly be approved and signed by the directors of the holding company.

(2) If a copy of any annual financial statements, or group annual financial statements which have not been approved and signed as required by subsection (1), is issued, circulated or published, every director or officer of the company concerned who is a party to such issue, circulation or publication thereof, shall be guilty of an offence.

...

Auditor's Duties as to Annual Financial Statements (ss 300-301)

Section 300 Auditor's duties as to annual financial statements and other matters

It shall be the duty of the auditor of a company-

- (a) to examine the annual financial statements and group annual financial statements to be laid before its annual general meeting;
- (b) to satisfy himself that proper accounting records as required by this Act have been kept by the company and that proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- (c) to satisfy himself that the minute books and attendance registers in respect of meetings of the company and of directors and managers have been kept in proper form as required by this Act;
- (d) to satisfy himself that a register of interests in contracts as required by section 240 has been kept and that the entries therein are in accord with the minutes of directors' meetings;
- (e) to examine or satisfy himself as to the existence of any securities of the company;
- (f) to obtain all the information and explanations which to the best of his knowledge and belief are necessary for the purposes of carrying out his duties;
- (g) to satisfy himself that the company's annual financial statements are in agreement with its accounting records and returns;
- (h) to examine group annual financial statements and satisfy himself that they comply with the requirements of this Act;
- (i) to examine such of the accounting records of the company and carry out such tests in respect of such records and such other auditing procedures as he or she considers necessary in order to satisfy himself or herself that the annual financial statements or group annual financial statements fairly present the financial position of the company or of the company and its subsidiaries and the results of its operations and those of its subsidiaries, in conformity with the requirements of section 285A;
- (j) to satisfy himself that statements made by the directors in their reports do not conflict with a fair interpretation or distort the meaning of the annual financial statements and accompanying notes;
- (jA) when he gets to know, or has reason to believe, that the company is not carrying on business or is not in operation and has no intention of resuming operations in the foreseeable future, to report forthwith accordingly by registered post to the Registrar;
- (k) to comply with any other duty imposed on him by this Act; and
- (l) to comply with any applicable requirements of the Auditing Profession Act, 2005 (Act 26 of 2005).

...

Section 301 Auditor's report

(1) When the auditor of a company has complied with the requirements of, and has satisfied himself as to the matters stated in, section 300, and has carried out his audit free from any restrictions whatsoever, he shall make a report to the members of the company to the effect that he has examined the annual financial statements and group annual financial statements and that in his opinion they fairly present the financial position of the company and its subsidiaries and the results of its operations and that of its subsidiaries in the manner required by this Act.

(2) In the event of the auditor being unable to make such a report or to make it without qualification, he shall include in his report a statement to that effect and set forth the facts or circumstances which prevent him from so making his report or from making it without qualification.

(3) The auditor's report under subsection (1) shall, unless all the members present agree to the contrary, be read out at the annual general meeting.

...

CHAPTER XIV**WINDING UP OF COMPANIES (ss 337-426)**

Provisions as to Meetings in Winding-up (ss 412-416)

...

Section 415 Examination of directors and others at meetings

(1) The Master or officer presiding at any meeting of creditors of a company which is being wound-up and is unable to pay its debts, may call and administer an oath to or accept an affirmation from any director of the company or any other person present at the meeting who was or might have been subpoenaed in terms of section 414 (2) (a), and the Master or such officer and any liquidator of the company and any creditor thereof who has proved a claim against the company, or the agent of such liquidator or creditor, may interrogate the director or person so called and sworn concerning all matters relating to the company or its business or affairs in respect of any time, either before or after the commencement of the winding-up, and concerning any property belonging to the company: Provided that the Master or such officer shall disallow any question which is irrelevant or would in his opinion prolong the interrogation unnecessarily.

(2) In connection with the production of any book or document in compliance with a subpoena issued under section 414 (2) (b) or the interrogation of a person under subsection (1) of this section, the law relating to privilege as applicable to a witness subpoenaed to produce a book or document or give evidence in a magistrate's court shall apply: Provided that a banker at whose

bank the company concerned keeps or at any time kept an account, shall be obliged, if subpoenaed to do so under section 414 (2) (b), to produce-

- (a) any cheque in his possession which was drawn by the company within one year before the commencement of the winding-up; or
- (b) if any cheque so drawn is not available, any record of the payment, the date of payment and the amount of the cheque which may be available to him, or a copy of such record, and shall, if called upon to do so, give any other information available to him in connection with any such cheque or the account of the company.

(3) No person interrogated under subsection (1) shall be entitled at such interrogation to refuse to answer any question upon the ground that the answer would tend to incriminate him or her and shall, if he or she does so refuse on that ground, be obliged to so answer at the instance of the Master or officer presiding at such meeting: Provided that the Master or officer presiding at such meeting may only oblige the person in question to so answer after the Master or officer presiding at such meeting has consulted with the Director of Public Prosecutions who has jurisdiction.

[Sub-s. (3) substituted by s. 10 (a) of Act 55 of 2002.]

(4) The Master or officer presiding at any meeting aforesaid shall record or cause to be recorded in the manner provided by the rules of court for the recording of evidence in a civil case before a magistrate's court the statement of any person giving evidence under this section: Provided that if a person who may be required to give evidence under this section, has made to the liquidator or his agent a statement which has been reduced to writing, or has delivered a statement in writing to the liquidator or his agent, that statement may be read by or read over to that person when he is called as a witness under this section and, if then adhered to by him, shall be deemed to be evidence given under this section.

(5) Any incriminating answer or information directly obtained, or incriminating evidence directly derived from, an interrogation in terms of subsection (1) shall not be admissible as evidence in criminal proceedings in a court of law against the person concerned or the body corporate of which he or she is or was an officer, except in criminal proceedings where the person concerned is charged with an offence relating to-

- (a) the administering or taking of an oath or the administering or making of an affirmation;
- (b) the giving of false evidence;
- (c) the making of a false statement; or
- (d) a failure to answer lawful questions fully or satisfactorily.

[Sub-s. (5) substituted by s. 10 (b) of Act 55 of 2002.]

(6) Any person called upon to give evidence under this section may be represented at his interrogation by an attorney with or without counsel.

(7) Any person other than a director or officer of the company concerned subpoenaed to attend a meeting of creditors for the purpose of being interrogated under this section shall be entitled to such witness fees, to be paid out of the funds of the company, as he would be entitled to if he were a witness in civil proceedings in a magistrate's court.

(8) Any director or other officer of a company who is called upon to attend any meeting of creditors held after the second meeting or an adjourned second meeting, shall be entitled to an allowance out of the funds of the company to defray his necessary expenses in connection with such attendance.

Section 416 Application of provisions of Insolvency Act, 1936.

(1) The provisions of sections 66, 67 and 68 of the Insolvency Act, 1936 (Act 24 of 1936), shall, in so far as they can be applied and are not inconsistent with the provisions of this Act, mutatis mutandis apply in relation to-

(a) any person who is in terms of section 414 (1) of this Act required to attend any meeting of a company being wound up and which is unable to pay its debts, as if such person were an insolvent required to attend any meeting referred to in section 64 of the Insolvency Act, 1936; and

(b) any person subpoenaed in terms of section 414 (2) of this Act to attend any meeting of the creditors of such a company or to produce any book or document at any such meeting, and the provisions of section 65 of the Insolvency Act, 1936, shall, in so far as they can be applied and are not inconsistent with the provisions of this Act, mutatis mutandis apply in relation to the production of any book or document or the interrogation of any person under section 415 of this Act, as if such person had been subpoenaed to produce any book or document or were being interrogated under the said section 65 of the Insolvency Act, 1936.

(2) In applying the said sections 66, 67 and 68 of the Insolvency Act, 1936, in terms of subsection (1) of this section, any reference in any of the said sections or in section 64 or 65 of that Act-

(a) to the estate of an insolvent, shall be construed as a reference to the estate of the company concerned;

(b) to the trustee of an insolvent estate, shall be construed as a reference to the liquidator of such company;

(c) to a meeting of the creditors of an insolvent, shall be construed as a reference to a meeting of the creditors of such company;

(d) to a creditor who has proved a claim against an insolvent estate, shall be construed as a reference to a person who has proved a claim against such company;

(e) to the business or affairs or property of an insolvent, shall be construed as a reference to the business or affairs or property of such company;

(f) to any person indebted to an insolvent estate, shall be construed as a reference to a person indebted to such company;

(g) to the sequestration of an insolvent estate, shall be construed as a reference to the commencement of the winding-up of such company.

Section 417 Summoning and examination of persons as to affairs of company

(1) In any winding-up of a company unable to pay its debts, the Master or the Court may, at any time after a winding-up order has been made, summon before him or it any director or officer of the company or person known or suspected to have in his possession any property of the company or believed to be indebted to the company, or any person whom the Master or the Court deems capable of giving information concerning the trade, dealings, affairs or property of the company.

[Sub-s. (1) substituted by s. 9 (a) of Act 29 of 1985.]

(1A) Any person summoned under subsection (1) may be represented at his attendance before the Master or the Court by an attorney with or without counsel.

[Sub-s. (1A) inserted by s. 9 (b) of Act 29 of 1985.]

(2) (a) The Master or the Court may examine any person summoned under subsection (1) on oath or affirmation concerning any matter referred to in that subsection, either orally or on written interrogatories, and may reduce his answers to writing and require him to sign them.

[Para. (a) substituted by s. 9 (c) of Act 29 of 1985.]

(b) Any such person may be required to answer any question put to him or her at the examination, notwithstanding that the answer might tend to incriminate him or her and shall, if he or she does so refuse on that ground, be obliged to so answer at the instance of the Master or the Court: Provided that the Master or the Court may only oblige the person in question to so answer after the Master or the Court has consulted with the Director of Public Prosecutions who has jurisdiction.

[Para. (b) substituted by s. 11 (a) of Act 55 of 2002.]

(c) Any incriminating answer or information directly obtained, or incriminating evidence directly derived from, an examination in terms of this section shall not be admissible as evidence in criminal proceedings in a court of law against the person concerned or the body corporate of which he or she is or was an officer, except in criminal proceedings where the person concerned is charged with an offence relating to-

- (i) the administering or taking of an oath or the administering or making of an affirmation;
- (ii) the giving of false evidence;
- (iii) the making of a false statement; or
- (iv) a failure to answer lawful questions fully and satisfactorily.

[Para. (c) added by s. 11 (b) of Act 55 of 2002.]

(3) The Master or the Court may require any such person to produce any books or papers in his custody or under his control relating to the company but without prejudice to any lien claimed with regard to any such books or papers, and the Court shall have power to determine all questions relating to any such lien.

[Sub-s. (3) substituted by s. 9 (d) of Act 29 of 1985.]

(4) If any person who has been duly summoned under subsection (1) and to whom a reasonable sum for his expenses has been tendered, fails to attend before the Master or the Court at the time appointed by the summons without lawful excuse made known to the Master or the Court at the time of the sitting and accepted by the Master or the Court, the Master or the Court may cause him to be apprehended and brought before him or it for examination.

[Sub-s. (4) substituted by s. 9 (d) of Act 29 of 1985.]

(5) Any person summoned by the Master under subsection (1) shall be entitled to such witness fees as he would have been entitled to if he were a witness in civil proceedings in a magistrate's court.

[Sub-s. (5) added by s. 9 (e) of Act 29 of 1985.]

(6) Any person who applies for an examination or enquiry in terms of this section or section 418 shall be liable for the payment of the costs and expenses incidental thereto, unless the Master or the Court directs that the whole or any part of such costs and expenses shall be paid out of the assets of the company concerned.

[Sub-s. (6) added by s. 9 (e) of Act 29 of 1985.]

(7) Any examination or enquiry under this section or section 418 and any application therefor shall be private and confidential, unless the Master or the Court, either generally or in respect of any particular person, directs otherwise.

[Sub-s. (7) added by s. 9 (e) of Act 29 of 1985.]

Section 418 Examination by commissioners

(1) (a) Every magistrate and every other person appointed for the purpose by the Master or the Court shall be a commissioner for the purpose of taking evidence or holding any enquiry under this Act in connection with the winding-up of any company.

(b) The Master or the Court may refer the whole or any part of the examination of any witness or of any enquiry under this Act to any such commissioner, whether or not he is within the jurisdiction of the Court which issued the winding-up order.

(c) The Master, if he has not himself been appointed under paragraph (a), the liquidator or any creditor, member or contributory of the company may be represented at such an examination or enquiry by an attorney, with or without counsel, who shall be entitled to interrogate any witness: Provided that a commissioner shall disallow any question which is irrelevant or would in his opinion prolong the interrogation unnecessarily.

(d) The provisions of section 417 (1A), (2) (b) and (5) shall apply mutatis mutandis in respect of such an examination or enquiry.

(2) A commissioner shall in any matter referred to him have the same powers of summoning and examining witnesses and of requiring the production of documents, as the Master who or the Court which appointed him, and, if the commissioner is a magistrate, of punishing defaulting or recalcitrant witnesses, or causing defaulting witnesses to be apprehended, and of determining questions relating to any lien with regard to documents, as the Court referred to in section 417.

(3) If a commissioner-

- (a) has been appointed by the Master, he shall, in such manner as the Master may direct, report to the Master; or
 - (b) has been appointed by the Court, he shall, in such manner as the Court may direct, report to the Master and the Court, on any examination or enquiry referred to him.
- (4) Any witness who has given evidence before the Master or the Court under section 417 or before a commissioner under this section, shall be entitled, at his cost, to a copy of the record of his evidence.
- (5) Any person who-
- (a) has been duly summoned under this section by a commissioner who is not a magistrate and who fails, without sufficient cause, to attend at the time and place specified in the summons; or
 - (b) has been duly summoned under section 417 (1) by the Master or under this section by a commissioner who is not a magistrate and who-
 - (i) fails, without sufficient cause, to remain in attendance until excused by the Master or such commissioner, as the case may be, from further attendance;
 - (ii) refuses to be sworn or to affirm as a witness; or
 - (iii) fails, without sufficient cause-
 - (aa) to answer fully and satisfactorily any question lawfully put to him in terms of section 417 (2) or this section; or
 - (bb) to produce books or papers in his custody or under his control which he was required to produce in terms of section 417 (3) or this section,
- shall be guilty of an offence.

[S. 418 substituted by s. 10 of Act 29 of 1985.]

Dissolution of Companies and other Bodies Corporate (ss 419-422)

Section 419 Dissolution of companies and other bodies corporate

- (1) In any winding-up, when the affairs of a company have been completely wound up, the Master shall transmit to the Registrar a certificate to that effect and send a copy thereof to the liquidator.
- (2) The Registrar shall record the dissolution of the company and shall publish notice thereof in the Gazette.
- (3) The date of dissolution of the company shall be the date of recording referred to in subsection (2).
- (4) In the case of any other body corporate the certificate of the Master under subsection (1) shall constitute its dissolution.

...

CHAPTER XVB
FINANCIAL REPORTING STANDARDS (ss. 440O to 440JJ)
[Chapter XVB inserted by s. 53 of Act 24 of 2006.]

Section 440O Definitions and preliminary

(1) For the purposes of this Chapter-

'advertise' includes notification to interested persons;

'exchange' means an exchange licensed in terms of section 10 of the Securities Services Act, 2004 (Act 36 of 2004);

'nominated officer' means the person referred to in section 440V (2); and

'regulator' means a statutory body with powers to regulate or supervise companies or the trading of shares in companies and includes any self-regulatory organisation as defined in section 1 of the Securities Services Act, 2004, having such powers.

(2) Any duty to be performed in terms of this Chapter by a chairperson may in his or her absence be performed by a deputy chairperson.

Section 440P Establishment of Council

(1) There is hereby established a body corporate known as the Financial Reporting Standards Council.

(2) The Council's objective is to establish financial reporting standards which promote sound and consistent accounting practices.

(3) The Council shall consist of-

- (a) four persons registered and practising as auditors;
- (b) two persons responsible for preparing financial statements on behalf of public interest companies;
- (c) two persons responsible for preparing financial statements for limited interest companies;
- (d) four users of financial statements;
- (e) two persons knowledgeable in company law nominated by the Minister;
- (f) one person nominated by the executive officer of the Financial Services Board; and
- (g) one person each nominated by every exchange which imposes adherence to financial reporting standards as a listing requirement.

(4) The Council shall be autonomous and its members shall serve to promote the objective of the Council.

Section 440Q Appointment and removal of Council members

(1) The Minister shall appoint as members of the Council-

- (a) the persons nominated from time to time under section 440P (3) (e) to (g); and
- (b) persons selected in terms of subsection (2).

(2) The Minister shall-

- (a) advertise any vacancies under section 440P (3) (a) to (d) and allow at least one month for nominations;
- (b) select and appoint persons-
 - (i) with the qualifications, knowledge and experience necessary to further the objective of the Council;
 - (ii) who are not full-time employees of the government or of a statutory body;
- (c) appoint the chairperson and deputy chairperson of the Council.

(3) Members appointed in terms of subsection (2) (b) and (c) shall be appointed every three years and may not serve for more than six consecutive years.

(4) For the sake of continuity, the Minister shall ensure that five or more of the persons appointed-

- (a) at the time the Council is established, shall be former members of the Accounting Practices Board; and
- (b) at every subsequent appointment, shall be former members of the Council.

(5) The Minister-

- (a) must remove a member of the Council-
 - (i) who becomes insolvent, is certified as mentally unfit, or is convicted of an offence and sentenced to imprisonment without the option of a fine;
 - (ii) who becomes permanently incapacitated;
 - (iii) who has been absent without the chairperson's leave, or in the case of the chairperson, without the deputy chairperson's leave, from three consecutive meetings of the Council; or
 - (iv) contemplated in section 440P (3) (a) to (d), who ceases to be a user, preparer or auditor of financial statements;
- (b) may remove a member of the Council for-
 - (i) non-performance of duties;
 - (ii) serious misconduct; or
 - (iii) conduct that undermines the integrity or objective of the Council.

(6) A vacancy arising at any time other than the close of a three-year cycle shall be filled in the manner described in subsection (2).

Section 440R Officers and meetings of Council

(1) The Council must-

- (a) determine the procedures to be followed at its meetings;
- (b) meet at least three times a year on dates set by the chairperson.

(2) Each member of the Council shall have one vote and a decision of the majority of the members present at a meeting, where at least three quarters of the members are present, constitutes a decision of the Council.

(3) The Council may establish and appoint members to subcommittees to assist in performing the functions of the Council.

(4) Meetings of the Council shall be open to the public.

Section 440S Functions of Council

(1) The Council shall-

- (a) establish financial reporting standards for public interest companies; and
- (b) develop accounting standards for limited interest companies.

(2) Financial reporting standards mentioned in subsection (1) (a) shall be in accordance with the International Financial Reporting Standards of the International Accounting Standards Board or its successor body.

(3) Standards mentioned in subsection (1) (b) shall be developed in consultation with representatives of limited interest companies.

Section 440T Interested persons in respect of Council

A person wishing to receive notice of vacancies on the Council, advance notice of meetings of the Council or drafts of any prospective amendment to financial reporting standards may register with the Council as an interested person.

Section 440U Approval and publication of standards

(1) The Council must-

- (a) give notice to interested persons of any prospective amendment of financial reporting standards, with at least one month to return comment;
- (b) consider any comments made before voting on an amendment;
- (c) submit financial reporting standards to the Minister.

(2) The Minister shall issue financial reporting standards on the advice of the Council by publication in the Gazette.

Section 440V Monitoring

(1) The Minister may, after consultation with the Financial Services Board, specify, by proclamation in the Gazette, types or categories of public interest companies to be monitored in terms of this section.

(2) The Minister shall nominate a suitably qualified officer who shall-

- (a) monitor the financial reports and accounting practices of public interest companies contemplated in subsection (1) in order to detect non-compliance with financial reporting standards that may prejudice users; and
- (b) where reasonable grounds exist for suspecting such non-compliance:
 - (i) document the incident; and
 - (ii) refer it to the executive officer of the Financial Reporting Investigations Panel referred to in section 440W.

(3) For the purposes of subsection (2), the nominated officer may in writing direct any person believed to have knowledge or information relating to a company mentioned in subsection (1) to-

- (a) deliver or produce information;
- (b) submit written answers to questions;
- (c) appear at a place designated by the nominated officer to be questioned.

(4) The powers conferred by subsection (3) are subject to the law of privilege.

Section 440W Establishment of Panel

(1) There is hereby established a body corporate known as the Financial Reporting Investigations Panel.

(2) The Panel's objective is to contribute to the reliability of financial reports by investigating alleged non-compliance with financial reporting standards and recommending appropriate measures for rectification or restitution.

(3) The Panel shall consist of-

- (a) an executive officer;
- (b) six auditors;
- (c) six chartered accountants that are not registered as auditors;
- (d) four persons qualified in law;
- (e) one person nominated by the executive officer of the Financial Services Board; and
- (f) one person, nominated by the exchange in question, for each exchange that imposes adherence to accounting standards as a listing requirement.

Section 440X Appointment and removal of members of Panel

(1) The Minister shall appoint as members of the Panel-

- (a) the persons nominated under section 440W (3) (e) and (f); and
- (b) persons selected in terms of subsection (2).

(2) The Minister shall-

- (a) advertise vacancies under section 440W (3) (a) to (d) and allow at least one month for nominations;
- (b) select candidates who-
 - (i) have the qualifications, knowledge and experience necessary to further the objective of the Panel;
 - (ii) are not full-time employees of government or of a statutory body;
- (c) appoint a chairperson and deputy chairperson from members nominated under section 440W (c) and (e).

(3) Members appointed under subsection (2) shall be appointed every three years and may not serve for more than six consecutive years.

(4) For the sake of continuity, the Minister shall ensure that five or more of the candidates appointed-

- (a) at the time the Panel is established, shall be members of the GAAP Monitoring Panel of the JSE Limited; and
- (b) at every subsequent appointment, shall be former members of the Panel.

(5) The Minister-

- (a) must remove a member of the Panel who-
 - (i) becomes insolvent;
 - (ii) is certified as mentally unfit;
 - (iii) is convicted of an offence and sentenced to imprisonment without the option of a fine;
 - (iv) fails to disclose a conflict of interests; or
 - (v) is permanently incapacitated; and
- (b) may remove a member of the Panel if the member-
 - (i) regularly declines nomination to an investigation committee;
 - (ii) is not conscientious in the performance of an investigation;
 - (iii) engages in an activity that may undermine the integrity or objective of the Panel.

(6) A vacancy arising at any time other than the close of a three-year cycle shall be filled in the manner described in subsection (2).

Section 440Y Interested persons in respect of Panel

A person wishing to receive notice of vacancies on the Panel may register with the executive officer of the Panel as an interested person.

Section 440Z Officers and meetings of Panel

(1) The Panel shall-

- (a) determine the procedures to be followed at its meetings;
- (b) determine the procedures to be followed by an investigation committee;
- (c) meet at least twice a year on dates set by the chairperson.

(2) The procedures determined under subsection (1) (b) shall be in accordance with the Promotion of Administrative Justice Act, 2000 (Act 3 of 2000).

(3) Each member present at a meeting of the Panel shall have one vote and the decision of a majority of the members at any meeting of the Panel where at least two thirds of the members are present, constitutes a decision of the Panel.

Section 440AA Investigation of non-compliance

(1) Any person who has reason to believe that a financial report of a widely held company failed to comply with a financial reporting standard may refer the matter to the executive officer of the Panel for investigation.

(2) Every matter referred to the executive officer shall be noted and the following information recorded:

- (a) the date of receipt;
- (b) the name of the company suspected of non-compliance;
- (c) the nature of the alleged non-compliance;
- (d) the financial report containing evidence of the alleged non-compliance;
- (e) whether the matter was referred to the chairperson of the Panel under subsection (3) and the reasons therefor; and
- (f) if the matter was investigated, the report of the investigation committee;
- (g) the persons to whom the report mentioned in paragraph (d) was published;
- (h) the date of publication; and
 - (i) if an administrative penalty was agreed to under section 440FF (2), the amount of the penalty agreed upon and how it was calculated.

(3) The executive officer shall within five business days of a matter being referred under subsection (1) assess whether the matter warrants investigation and, if so, submit all relevant information to the chairperson of the Panel, with reference to the financial reporting standards in question.

- (4) The chairperson shall within seven business days of receipt of a recommendation under subsection (3)-
- (a) appoint an investigation committee; and
 - (b) notify the company being investigated.
- (5) Members appointed to an investigation committee shall recuse themselves if-
- (a) they have an interest in the company being investigated or in the outcome of the investigation;
 - (b) serving on the committee would give rise to any other conflict of interest.
- (6) An investigation committee shall consist of-
- (a) one Panel member qualified in law; and
 - (b) two or more Panel members qualified in accounting.
- (7) The investigation committee shall-
- (a) follow the procedures determined from time to time by the Panel;
 - (b) investigate whether there was a failure to comply with financial reporting standards;
 - (c) if necessary, consult with any specialist advisors;
 - (d) assess the materiality of any failure and its prejudice to users;
 - (e) within 18 business days of its commencement, deliver a written report on the findings of its investigation to the executive officer; and
 - (f) if appropriate, make recommendations on how non-compliance may be rectified.
- (8) If the committee has not concluded its investigation within the 18 business days contemplated in subsection (7) (e), the committee shall deliver a provisional report, and the executive officer may then allow additional time or otherwise direct how the investigation should proceed.
- (9) If the members of the committee did not reach consensus on the fact or extent of the alleged non-compliance, the written report mentioned in subsection (7) (e) must record the different opinions.
- (10) The Minister may, in respect of a particular investigation, by proclamation in the Gazette, extend the number of days prescribed in subsections (3), (4) and (7).

Section 440BB Powers of investigation committee

- (1) For the purposes of section 440AA (7), an investigation committee may in writing direct any person believed to have knowledge or information relating to a company under investigation to-
- (a) deliver or produce information;
 - (b) submit written responses to questions posed by the committee;
 - (c) appear at a place designated by the committee to be questioned.
- (2) The powers conferred by subsection (1) are subject to the law of privilege.

Section 440CC Confidentiality

(1) A member of an investigation committee shall keep confidential the names of the other members of the committee and any information disclosed to him or her during the course of an investigation and not publish it to any other person or use it for any purpose other than to discharge duties in terms of this Chapter or to comply with any law.

(2) Any person who contravenes the provisions of subsection (1) shall be guilty of an offence.

Section 440DD Advisors

Section 440AA (5) and section 440CC shall, with the necessary changes, apply also to specialist advisors consulted under section 440AA (7) (c).

Section 440EE Publication

(1) The executive officer shall within five business days of the receipt of a report of an investigation committee issue a copy thereof to the company investigated.

(2) Any response by the company must be submitted to the executive officer in writing within seven business days of receipt of the report, and referred back to the investigation committee.

(3) After due consideration of the response, the investigation committee may amend the report and must within 14 business days of receipt of the company's response resubmit the report to the executive officer.

(4) If no response was received by the date specified in subsection (2), within two business days of that date, or if a response was received, within two business days of the resubmission of the report, the executive officer-

- (a) shall publish the report to-
 - (i) the Registrar; and
 - (ii) any exchange on which shares of the company are listed;
- (b) may, if it is in the interest of users, publish the report to-
 - (i) any other regulator;
 - (ii) any professional body representing accountants or auditors; or
 - (iii) the news media.

(5) The Registrar shall make a report available for inspection by the public within two months after its publication.

Section 440FF Offence and penalty

(1) A widely held company which issues a financial report that fails to comply with a financial reporting standard, and every director of the company who has signed or was party to the preparation or approval of the financial report, shall be guilty of an offence.

(2) A company under investigation may with the agreement of the Minister-

- (a) pay an administrative penalty;
- (b) revise and republish the financial report;
- (c) take any other remedial action; or
- (d) undertake any combination of the measures listed in paragraphs (a) to (c), within a designated time.

(3) The amount and action contemplated in subsection (2) shall be decided by the nominated officer in consultation with the executive officer and the chairperson of the Panel, and be based on-

- (a) the nature, extent and materiality of the failure;
- (b) whether the failure was deliberate or reckless;
- (c) any prospective loss or damage to users as a result of the failure;
- (d) the probable influence of the failure on the economic decisions of users;
- (e) any previous failures of the same company;
- (f) any other relevant factor.

(4) If a company and the Minister do not reach agreement under subsection (2), or if the company fails to pay or take remedial action as agreed, the Minister must refer the matter to the National Director of Public Prosecutions.

(5) A court shall not convict a company or director of an offence under subsection (1) or section 287 if-

- (a) it is satisfied that the company has performed substantially in terms of an agreement under subsection (2); or
- (b) the company or director has been convicted of an offence under section 287A.

Section 440GG Limitation of liability

Neither the Council, the Panel nor their respective members and employees shall be held liable for any loss sustained or damages caused to any person as a result of any bona fide act or omission relating to the performance of their duties under this Chapter, unless gross negligence is proved.

Section 440HH Annual reports

The chairperson of the Council and the executive officer of the Panel shall submit to the Minister an annual report on their respective activities in the preceding calendar year.

Section 440II Administrative support

(1) The Minister, in support of the Council and the Panel, shall-

- (a) provide offices;
- (b) employ staff;
- (c) open and operate banking accounts;
- (d) insure against risk;
- (e) perform other administrative acts;
- (f) perform legal acts and institute or defend any legal action; and
- (g) meet all reasonable expenditure.

(2) The Minister may delegate to each of the executive officers of the Council and the Panel any power necessary for the performance of the acts in subsection (1).

Section 440JJ Remuneration and reimbursements

The Minister shall, from funds appropriated by Parliament for that purpose, remunerate members appointed under sections 440Q (1) (b) and 440X (1) (b) and reimburse reasonable expenses incurred in the performance of their duties.

CHAPTER XVI**PENALTIES FOR OFFENCES (s 441)****Section 441 Penalties for offences**

(1) Any company, director, officer or person convicted of any offence referred to in any of the undermentioned sections shall be liable to be sentenced, in the case of an offence referred to-

- (a) in section 440F (1), to a fine or to imprisonment for a period not exceeding 10 years or to both such fine and such imprisonment;
- (b) in section 132, to a fine or to imprisonment for a period not exceeding 10 years or to both such fine and such imprisonment;
- (bA) in section 440FF (1), to a fine not exceeding R1 000 000;
[Para. (bA) inserted by Act 24 of 2006.]
- (c) in section 440I (2), 440CC (2) or that section as applied by 440DD, to a fine or to imprisonment for a period not exceeding five years or to both a fine and such imprisonment;

[Para. (c) substituted by Act 24 of 2006.]

- (d) in section 37, 140A, 143, 145, 145A, 146, 146A, 147 (2) (a), 148, 149, 153 (4), 156, 162, 169, 218, 219, 255, 256 (5), 260, 284, 287A, 424 or 440D (3) or (4), to a fine or to imprisonment for a period not exceeding two years or to both such fine and such imprisonment;
[Para. (d) substituted by Act 24 of 2006.]
- (e) in section 15A, 38, 141, 153 (3), 165, 222, 226, 234, 237, 238, 249 (1), 250, 251 or 275, to a fine or to imprisonment for a period not exceeding one year or to both such fine and such imprisonment;
- (f) in section 90, 286, 288, 297, 298, 299, 300A, 302, 308, 312 (5), 363, 363A, 365, 414, 418 (5) or 421, to a fine or to imprisonment for a period not exceeding six months or to both a fine and such imprisonment;
[Para. (f) substituted by Act 24 of 2006.]
- (g) in section 242, 268C, 268I or 287 to a fine or to imprisonment not exceeding a period of three months or to both a fine and such imprisonment;
[Para. (g) substituted by Act 24 of 2006.]
- (h) in section 168, 185, 256 (6), 312 (4), 331 (1) or 333 (1), to a fine;
- (i) in section 81, 93, 164, 166, 170, 207, 211 (7), 239, 291 or 295, to a fine;
- (j) in section 112, 113, 131 or 179, to a fine;
- (k) in section 49, 50, 67, 68, 147 (2) (b), 181, 186, 189, 192, 206, 313 or 333 (2), to a fine;
- (l) in section 204 or 245, to a fine for every meeting in respect of which the contravention has taken place;
- (m) in section 171, 200 (5), 268H or 311, to a fine;
- (n) in section 215, to a fine and an additional fine not exceeding R40 for every day during which the contravention continues;
- (o) in section 172, to a fine for every day during which the contravention continues;
- (p) in section 46, 51, 58, 80, 96, 98, 102, 139, 200 (6), 213, 253, 269, 271, 309, 356 or 357, to a fine for every day during which the contravention continues;
- (q) in section 211 (6), 216 (5), 252 or 276 (5), to a fine for every day during which the contravention continues.

(2) The Court convicting any company, director, officer or person for failure to perform any act required to be performed by it or him by or under this Act, may, in addition to any penalty which the Court imposes, order such company, director, officer or person to perform such act within such period as the Court may fix.

...

Section 443 **Short title and date of commencement**

This Act shall be called the Companies Act, 1973, and shall come into operation on the first day of January, 1974, except sections 15 and 18 which shall come into operation on promulgation of this Act, and except such other sections as may be determined by the Minister which shall come into operation on a date fixed by the State President by proclamation in the Gazette.

CONSTITUTION OF THE REPUBLIC OF SOUTH AFRICA, 1996

[ASSENTED TO 16 DECEMBER 1996]

[DATE OF COMMENCEMENT: 4 FEBRUARY 1997]

(English text signed by the President)

as amended by

Constitution Fifteenth Amendment Act of 2008

...

CHAPTER 1

FOUNDING PROVISIONS (ss 1-6)

Section 1 Republic of South Africa

The Republic of South Africa is one, sovereign, democratic state founded on the following values:

...

- (c) Supremacy of the constitution and the rule of law.

...

Section 2 Supremacy of Constitution

This Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled.

...

CHAPTER 2

BILL OF RIGHTS (ss 7-39)

...

Section 8 Application

...

(4) A juristic person is entitled to the rights in the Bill of Rights to the extent required by the nature of the rights and the nature of that juristic person.

Section 9 Equality

(1) Everyone is equal before the law and has the right to equal protection and benefit of the law.

...

Section 14 Privacy

Everyone has the right to privacy, which includes the right not to have-

- (a) their person or home searched;
- (b) their property searched;
- (c) their possessions seized; or
- (d) the privacy of their communications infringed.

Section 25 Property

(1) No one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property.

...

Section 33 Just administrative action

(1) Everyone has the right to administrative action that is lawful, reasonable and procedurally fair.

(2) Everyone whose rights have been adversely affected by administrative action has the right to be given written reasons.

(3) National legislation must be enacted to give effect to these rights, and must-

- (a) provide for the review of administrative action by a court or, where appropriate, an independent and impartial tribunal;
- (b) impose a duty on the state to give effect to the rights in subsections (1) and (2); and
- (c) promote an efficient administration.

Section 34 Access to courts

Everyone has the right to have any dispute that can be resolved by the application of law decided in a fair public hearing before a court or, where appropriate, another independent and impartial tribunal or forum.

...

Section 36 Limitation of rights

(1) The rights in the Bill of Rights may be limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including-

- (a) the nature of the right;
- (b) the importance of the purpose of the limitation;
- (c) the nature and extent of the limitation;
- (d) the relation between the limitation and its purpose; and
- (e) less restrictive means to achieve the purpose.

(2) Except as provided in subsection (1) or in any other provision of the Constitution, no law may limit any right entrenched in the Bill of Rights.

...

CHAPTER 4

PARLIAMENT (ss 42-82)

Section 42 Composition of Parliament

(1) Parliament consists of-

- (a) the National Assembly; and
- (b) the National Council of Provinces.

(2) The National Assembly and the National Council of Provinces participate in the legislative process in the manner set out in the Constitution.

...

The National Assembly (ss 46-59)

...

Section 55 Powers of National Assembly

(1) In exercising its legislative power, the National Assembly may-

- (a) consider, pass, amend or reject any legislation before the Assembly; and
 - (b) initiate or prepare legislation, except money Bills.
- (2) The National Assembly must provide for mechanisms-
- (a) to ensure that all executive organs of state in the national sphere of government are accountable to it; and
 - (b) to maintain oversight of-
 - (i) the exercise of national executive authority, including the implementation of legislation; and
 - (ii) any organ of state.

...

CHAPTER 5

THE PRESIDENT AND NATIONAL EXECUTIVE (ss 83-102)

...

Section 85 Executive authority of the Republic

- (1) The executive authority of the Republic is vested in the President.
- (2) The President exercises the executive authority, together with the other members of the Cabinet, by-
- (a) implementing national legislation except where the Constitution or an Act of Parliament provides otherwise;
 - (b) developing and implementing national policy;
 - (c) co-ordinating the functions of state departments and administrations;
 - (d) preparing and initiating legislation; and
 - (e) performing any other executive function provided for in the Constitution or in national legislation.

...

Section 91 Cabinet

- (1) The Cabinet consists of the President, as head of the Cabinet, a Deputy President and Ministers.

(2) The President appoints the Deputy President and Ministers, assigns their powers and functions, and may dismiss them.

...

Section 92 Accountability and responsibilities

(1) The Deputy President and Ministers are responsible for the powers and functions of the executive assigned to them by the President.

(2) Members of the Cabinet are accountable collectively and individually to Parliament for the exercise of their powers and the performance of their functions.

(3) Members of the Cabinet must-

- (a) act in accordance with the Constitution; and
- (b) provide Parliament with full and regular reports concerning matters under their control.

...

Section 101 Executive decisions

(1) A decision by the President must be in writing if it-

- (a) is taken in terms of legislation; or
- (b) has legal consequences.

(2) A written decision by the President must be countersigned by another Cabinet member if that decision concerns a function assigned to that other Cabinet member.

(3) Proclamations, regulations and other instruments of subordinate legislation must be accessible to the public.

(4) National legislation may specify the manner in which, and the extent to which, instruments mentioned in subsection (3) must be-

- (a) tabled in Parliament; and
- (b) approved by Parliament.

...

CHAPTER 8

COURTS AND ADMINISTRATION OF JUSTICE (ss 165-180)

Section 165 Judicial authority

- (1) The judicial authority of the Republic is vested in the courts.
- (2) The courts are independent and subject only to the Constitution and the law, which they must apply impartially and without fear, favour or prejudice.
- (3) No person or organ of state may interfere with the functioning of the courts.
- (4) Organs of state, through legislative and other measures, must assist and protect the courts to ensure the independence, impartiality, dignity, accessibility and effectiveness of the courts.
- (5) An order or decision issued by a court binds all persons to whom and organs of state to which it applies.

Section 166 Judicial system

The courts are-

- (a) the Constitutional Court;
- (b) the Supreme Court of Appeal;
- (c) the High Courts, including any high court of appeal that may be established by an Act of Parliament to hear appeals from High Courts;
- (d) the Magistrates' Courts; and
- (e) any other court established or recognised in terms of an Act of Parliament, including any court of a status similar to either the High Courts or the Magistrates' Courts.

Section 167 Constitutional Court

- (1) The Constitutional Court consists of the Chief Justice of South Africa, the Deputy Chief Justice and nine other judges.
- (2) A matter before the Constitutional Court must be heard by at least eight judges.
- (3) The Constitutional Court-
 - (a) is the highest court in all constitutional matters;
 - (b) may decide only constitutional matters, and issues connected with decisions on constitutional matters; and
 - (c) makes the final decision whether a matter is a constitutional matter or whether an issue is connected with a decision on a constitutional matter.
- (4) Only the constitutional Court may-
 - (a) decide disputes between organs of state in the national or provincial sphere concerning the constitutional status, powers or functions of any of those organs of state;
 - (b) decide on the constitutionality of any parliamentary or provincial Bill, but may do so only in the circumstances anticipated in section 79 or 121;

- (c) decide applications envisaged in section 80 or 122;
- (d) decide on the constitutionality of any amendment to the Constitution;
- (e) decide that Parliament or the President has failed to fulfil a constitutional obligation; or
- (f) certify a provincial constitution in terms of section 144.

(5) The Constitutional Court makes the final decision whether an Act of Parliament, a provincial Act or conduct of the President is constitutional, and must confirm any order of invalidity made by the Supreme Court of Appeal, a High Court, or a court of similar status, before that order has any force.

(6) National legislation or the rules of the Constitutional Court must allow a person, when it is in the interests of justice and with leave of the Constitutional Court-

- (a) to bring a matter directly to the Constitutional Court; or
- (b) to appeal directly to the Constitutional Court from any other court.

(7) A constitutional matter includes any issue involving the interpretation, protection or enforcement of the Constitution.

Section 168 Supreme Court of Appeal

(1) The Supreme Court of Appeal consists of a President, a Deputy President and the number of judges of appeal determined in terms an Act of Parliament.

(2) A matter before the Supreme Court of Appeal must be decided by the number of judges determined in terms of an Act of Parliament.

(3) The Supreme Court of Appeal may decide appeals in any matter. It is the highest court of appeal except in constitutional matters, and may decide only-

- (a) appeals;
- (b) issues connected with appeals; and
- (c) any other matter that may be referred to it in circumstances defined by an Act of Parliament.

Section 169 High Courts

A High Court may decide-

- (a) any constitutional matter except a matter that-
 - (i) only the Constitutional Court may decide; or
 - (ii) is assigned by an Act of Parliament to another court of a status similar to a High Court; and
- (b) any other matter not assigned to another court by an Act of Parliament.

Section 170 Magistrates' Courts and other courts

Magistrates' Courts and all other courts may decide any matter determined by an Act of Parliament, but a court of a status lower than a High Court may not enquire into or rule on the constitutionality of any legislation or any conduct of the President.

Section 171 Court procedures

All courts function in terms of national legislation, and their rules and procedures must be provided for in terms of national legislation.

Section 172 Powers of courts in constitutional matters

(1) When deciding a constitutional matter within its power, a court-

- (a) must declare that any law or conduct that is inconsistent with the Constitution is invalid to the extent of its inconsistency; and
- (b) may make any order that is just and equitable, including-
 - (i) an order limiting the retrospective effect of the declaration of invalidity; and
 - (ii) an order suspending the declaration of invalidity for any period and on any conditions, to allow the competent authority to correct the defect.

(2) (a) The Supreme Court of Appeal, a High Court or a court of similar status may make an order concerning the constitutional validity of an Act of Parliament, a provincial Act or any conduct of the President, but an order of constitutional invalidity has no force unless it is confirmed by the Constitutional Court.

(b) A court which makes an order of constitutional invalidity may grant a temporary interdict or other temporary relief to a party, or may adjourn the proceedings, pending a decision of the Constitutional Court on the validity of that Act or conduct.

(c) National legislation must provide for the referral of an order of constitutional invalidity to the Constitutional Court.

(d) Any person or organ of state with a sufficient interest may appeal, or apply, directly to the Constitutional Court to confirm or vary an order of constitutional invalidity by a court in terms of this subsection.

Section 173 Inherent power

The Constitutional Court, Supreme Court of Appeal and High Courts have the inherent power to protect and regulate their own process, and to develop the common law, taking into account the interests of justice.

...

CHAPTER 10
PUBLIC ADMINISTRATION (ss 195-197)

Section 195 Basic values and principles governing public administration

(1) Public administration must be governed by the democratic values and principles enshrined in the Constitution, including the following principles:

- (a) A high standard of professional ethics must be promoted and maintained.
- (b) Efficient, economic and effective use of resources must be promoted.
- (c) Public administration must be development-oriented.
- (d) Services must be provided impartially, fairly, equitably and without bias.
- (e) People's needs must be responded to, and the public must be encouraged to participate in policy-making.
- (f) Public administration must be accountable.
- (g) Transparency must be fostered by providing the public with timely, accessible and accurate information.
- (h) Good human-resource management and career-development practices, to maximise human potential, must be cultivated.
- (i) Public administration must be broadly representative of the South African people, with employment and personnel management practices based on ability, objectivity, fairness, and the need to redress the imbalances of the past to achieve broad representation.

(2) The above principles apply to-

- (a) administration in every sphere of government;
- (b) organs of state; and
- (c) public enterprises.

(3) National legislation must ensure the promotion of the values and principles listed in subsection (1).

(4) The appointment in public administration of a number of persons on policy considerations is not precluded, but national legislation must regulate these appointments in the public service.

(5) Legislation regulating public administration may differentiate between different sectors, administrations or institutions.

(6) The nature and functions of different sectors, administrations or institutions of public administration are relevant factors to be taken into account in legislation regulating public administration.

...

Section 197 Public Service

(1) Within public administration there is a public service for the Republic, which must function, and be structured, in terms of national legislation, and which must loyally execute the lawful policies of the government of the day.

(2) The terms and conditions of employment in the public service must be regulated by national legislation. Employees are entitled to a fair pension as regulated by national legislation.

(3) No employee of the public service may be favoured or prejudiced only because that person supports a particular political party or cause.

(4) Provincial governments are responsible for the recruitment, appointment, promotion, transfer and dismissal of members of the public service in their administrations within a framework of uniform norms and standards applying to the public service.

...

CHAPTER 14

GENERAL PROVISIONS (ss 231-243)

International Law (ss 231-233)

...

Section 233 Application of international law

When interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.

Other Matters (ss 234-243)

...

Section 239 Definitions

In the Constitution, unless the context indicates otherwise-

'national legislation' includes-

- (a) subordinate legislation made in terms of an Act of Parliament; and

- (b) legislation that was in force when the Constitution took effect and that is administered by the national government;

'organ of state' means-

(a) any department of state or administration in the national, provincial or local sphere of government; or

(b) any other functionary or institution-

(i) exercising a power or performing a function 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,

but does not include a court or a judicial officer;

...

INTERPRETATION ACT 33 OF 1957

[ASSENTED TO 16 MAY 1957]

[DATE OF COMMENCEMENT: 24 MAY 1957]

(English text signed by the Governor-General)

as amended by

Magistrates' Courts Amendment Act 120 of 1993

ACT

To consolidate the laws relating to the interpretation and the shortening of the language of statutes.

PART I

GENERAL (ss 1-17)

Section 1 Application of Act

The provisions of this Act shall apply to the interpretation of every law (as in this Act defined) in force, at or after the commencement of this Act in the Republic or in any portion thereof, and to the interpretation of all by-laws, rules, regulations or orders made under the authority of any such law, unless there is something in the language or context of the law, by-law, rule, regulation or order repugnant to such provisions or unless the contrary intention appears therein.

Section 2 Definitions

The following words and expressions shall, unless the context otherwise requires or unless in the case of any law it is otherwise provided therein, have the meanings hereby assigned to them respectively, namely-

...

'law' means any law, proclamation, ordinance, Act of Parliament or other enactment having the force of law;

...

'person' includes-

- (a) any divisional council, municipal council, village management board, or like authority;
- (b) any company incorporated or registered as such under any law;
- (c) any body of persons corporate or unincorporate;

...

Section 13 Commencement of laws

(1) The expression 'commencement' when used in any law and with reference thereto, means the day on which that law comes or came into operation, and that day shall, subject to the provisions of subsection (2) and unless some other day is fixed by or under the law for the coming into operation thereof, be the day when the law was first published in the Gazette as a law.

(2) Where any law, or any order, warrant, scheme, letters patent, rules, regulations or by-laws made, granted or issued under the authority of a law, is expressed to come into operation on a particular day, it shall be construed as coming into operation immediately on the expiration of the previous day.

(3) If any Act provides that that Act shall come into operation on a date fixed by the President or the Premier of a province by proclamation in the Gazette, it shall be deemed that different dates may be so fixed in respect of different provisions of that Act.

...

Section 16 Certain enactments to be published in Gazette

When any by-law, regulation, rule or order is authorized by any law to be made by the President or a Minister or by the Premier of a province or a member of the Executive Council of a province or by any local authority, public body or person, with the approval of the President or a Minister, or of the Premier of a province or a member of the Executive Council of a province, such by-law, regulation, rule or order shall, subject to the provisions relative to the force and effect thereof in any law, be published in the Gazette.

...

Section 17 List of certain proclamations and notices to be submitted to Parliament and provincial legislatures

When the President, a Minister or the Premier or a member of the Executive Council of a province is by any law authorized to make rules or regulations for any purpose in such law stated, notwithstanding the provisions of any law to the contrary, a list of the proclamations, government notices and provincial notices under which such rules or regulations were published in the Gazette during the period covered in the list, stating in each case the number, date and title of the proclamation, government notice or provincial notice and the number and date of the Gazette in which it was published, shall be submitted to Parliament or the provincial legislature concerned, as the case may be, within fourteen days after the publication of the rules or regulations in the Gazette.

...

PROMOTION OF ADMINISTRATIVE JUSTICE ACT 3 OF 2000

[ASSENTED TO 3 FEBRUARY 2000]

[DATE OF COMMENCEMENT: 30 NOVEMBER 2000]

(English text signed by the President)

as amended by the Judicial Matters Amendment Act 66 of 2008

ACT

To give effect to the right to administrative action that is lawful, reasonable and procedurally fair and to the right to written reasons for administrative action as contemplated in section 33 of the Constitution of the Republic of South Africa, 1996; and to provide for matters incidental thereto.

Preamble

WHEREAS section 33 (1) and (2) of the Constitution provides that everyone has the right to administrative action that is lawful, reasonable and procedurally fair and that everyone whose rights have been adversely affected by administrative action has the right to be given written reasons;

AND WHEREAS section 33 (3) of the Constitution requires national legislation to be enacted to give effect to those rights, and to-

- * provide for the review of administrative action by a court or, where appropriate, an independent and impartial tribunal;
- * impose a duty on the state to give effect to those rights; and
- * promote an efficient administration;

AND WHEREAS item 23 of Schedule 6 to the Constitution provides that the national legislation envisaged in section 33 (3) must be enacted within three years of the date on which the Constitution took effect;

AND IN ORDER TO-

- * promote an efficient administration and good governance; and
- * create a culture of accountability, openness and transparency in the public administration or in the exercise of a public power or the performance of a public function, by giving effect to the right to just administrative action,

BE IT THEREFORE ENACTED by the Parliament of the Republic of South Africa, as follows:

Section 1 Definitions

In this Act, unless the context indicates otherwise-

'**administrative action**' means any decision taken, or any failure to take a decision, by-

- (a) an organ of state, when-
 - (i) exercising a power 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; or
- (b) a natural or juristic person, other than an organ of state, when exercising a public power or performing a public function in terms of an empowering provision,

which adversely affects the rights of any person and which has a direct, external legal effect, but does not include-

- (aa) the executive powers or functions of the National Executive, including the powers or functions referred to in sections 79 (1) and (4), 84 (2) (a), (b), (c), (d), (f), (g), (h), (i) and (k), 85 (2) (b), (c), (d) and (e), 91 (2), (3), (4) and (5), 92 (3), 93, 97, 98, 99 and 100 of the Constitution;
- (bb) the executive powers or functions of the Provincial Executive, including the powers or functions referred to in sections 121 (1) and (2), 125 (2) (d), (e) and (f), 126, 127 (2), 132 (2), 133 (3) (b), 137, 138, 139 and 145 (1) of the Constitution;
- (cc) the executive powers or functions of a municipal council;
- (dd) the legislative functions of Parliament, a provincial legislature or a municipal council;
- (ee) the judicial functions of a judicial officer of a court referred to in section 166 of the Constitution or of a Special Tribunal established under section 2 of the Special Investigating Units and Special Tribunals Act, 1996 (Act 74 of 1996), and the judicial functions of a traditional leader under customary law or any other law;
- (ff) a decision to institute or continue a prosecution;
- (gg) a decision relating to any aspect regarding the nomination, selection or appointment of a judicial officer or any other person, by the Judicial Service Commission in terms of any law;
- (hh) any decision taken, or failure to take a decision, in terms of any provision of the Promotion of Access to Information Act, 2000; or
- (ii) any decision taken, or failure to take a decision, in terms of section 4 (1);

'administrator' means an organ of state or any natural or juristic person taking administrative action;

'Constitution' means the Constitution of the Republic of South Africa, 1996;

'court' means-

- (a) the Constitutional Court acting in terms of section 167 (6) (a) of the Constitution; or
- (b) (i) a High Court or another court of similar status; or

- (ii) a Magistrate's Court, either generally or in respect of a specified class of administrative actions, designated by the Minister by notice in the Gazette and presided over by a magistrate or an additional magistrate designated in terms of section 9A,

within whose area of jurisdiction the administrative action occurred or the administrator has his or her or its principal place of administration or the party whose rights have been affected is domiciled or ordinarily resident or the adverse effect of the administrative action was, is or will be experienced;

'decision' means any decision of an administrative nature made, proposed to be made, or required to be made, as the case may be, under an empowering provision, including a decision relating to-

- (a) making, suspending, revoking or refusing to make an order, award or determination;
- (b) giving, suspending, revoking or refusing to give a certificate, direction, approval, consent or permission;
- (c) issuing, suspending, revoking or refusing to issue a licence, authority or other instrument;
- (d) imposing a condition or restriction;
- (e) making a declaration, demand or requirement;
- (f) retaining, or refusing to deliver up, an article; or
- (g) doing or refusing to do any other act or thing of an administrative nature, and a reference to a failure to take a decision must be construed accordingly;

'empowering provision' means a law, a rule of common law, customary law, or an agreement, instrument or other document in terms of which an administrative action was purportedly taken;

'failure', in relation to the taking of a decision, includes a refusal to take the decision;

'Minister' means the Cabinet member responsible for the administration of justice;

'organ of state' bears the meaning assigned to it in section 239 of the Constitution;

'prescribed' means prescribed by regulation made under section 10;

'public', for the purposes of section 4, includes any group or class of the public;

'this Act' includes the regulations; and

'tribunal' means any independent and impartial tribunal established by national legislation for the purpose of judicially reviewing an administrative action in terms of this Act.

Section 2 Application of Act

(1) The Minister may, by notice in the Gazette-

- (a) if it is reasonable and justifiable in the circumstances, exempt an administrative action or a group or class of administrative actions from the application of any of the provisions of section 3, 4 or 5; or
- (b) in order to promote an efficient administration and if it is reasonable and justifiable in the circumstances, permit an administrator to vary any of the requirements referred to in section 3 (2), 4 (1) (a) to (e), (2) and (3) or 5 (2), in a manner specified in the notice.

(2) Any exemption or permission granted in terms of subsection (1) must, before publication in the Gazette, be approved by Parliament.

Section 3 Procedurally fair administrative action affecting any person

(1) Administrative action which materially and adversely affects the rights or legitimate expectations of any person must be procedurally fair.

(2) (a) A fair administrative procedure depends on the circumstances of each case.

(b) In order to give effect to the right to procedurally fair administrative action, an administrator, subject to subsection (4), must give a person referred to in subsection (1)-

- (i) adequate notice of the nature and purpose of the proposed administrative action;
- (ii) a reasonable opportunity to make representations;
- (iii) a clear statement of the administrative action;
- (iv) adequate notice of any right of review or internal appeal, where applicable; and
- (v) adequate notice of the right to request reasons in terms of section 5.

(3) In order to give effect to the right to procedurally fair administrative action, an administrator may, in his or her or its discretion, also give a person referred to in subsection (1) an opportunity to-

- (a) obtain assistance and, in serious or complex cases, legal representation;
- (b) present and dispute information and arguments; and
- (c) appear in person.

(4) (a) If it is reasonable and justifiable in the circumstances, an administrator may depart from any of the requirements referred to in subsection (2).

(b) In determining whether a departure as contemplated in paragraph (a) is reasonable and justifiable, an administrator must take into account all relevant factors, including-

- (i) the objects of the empowering provision;
- (ii) the nature and purpose of, and the need to take, the administrative action;
- (iii) the likely effect of the administrative action;
- (iv) the urgency of taking the administrative action or the urgency of the matter; and
- (v) the need to promote an efficient administration and good governance.

(5) Where an administrator is empowered by any empowering provision to follow a procedure which is fair but different from the provisions of subsection (2), the administrator may act in accordance with that different procedure.

Section 4 Administrative action affecting public

(1) In cases where an administrative action materially and adversely affects the rights of the public, an administrator, in order to give effect to the right to procedurally fair administrative action, must decide whether-

- (a) to hold a public inquiry in terms of subsection (2);
- (b) to follow a notice and comment procedure in terms of subsection (3);
- (c) to follow the procedures in both subsections (2) and (3);
- (d) where the administrator is empowered by any empowering provision to follow a procedure which is fair but different, to follow that procedure; or
- (e) to follow another appropriate procedure which gives effect to section 3.

(2) If an administrator decides to hold a public inquiry-

- (a) the administrator must conduct the public inquiry or appoint a suitably qualified person or panel of persons to do so; and
- (b) the administrator or the person or panel referred to in paragraph (a) must-
 - (i) determine the procedure for the public inquiry, which must-
 - (aa) include a public hearing; and
 - (bb) comply with the procedures to be followed in connection with public inquiries, as prescribed;
 - (ii) conduct the inquiry in accordance with that procedure;
 - (iii) compile a written report on the inquiry and give reasons for any administrative action taken or recommended; and
 - (iv) as soon as possible thereafter-
 - (aa) publish in English and in at least one of the other official languages in the Gazette or relevant provincial Gazette a notice containing a concise summary of any report and the particulars of the places and times at which the report may be inspected and copied; and
 - (bb) convey by such other means of communication which the administrator considers effective, the information referred to in item (a) to the public concerned.

(3) If an administrator decides to follow a notice and comment procedure, the administrator must-

- (a) take appropriate steps to communicate the administrative action to those likely to be materially and adversely affected by it and call for comments from them;

- (b) consider any comments received;
- (c) decide whether or not to take the administrative action, with or without changes; and
- (d) comply with the procedures to be followed in connection with notice and comment procedures, as prescribed.

(4) (a) If it is reasonable and justifiable in the circumstances, an administrator may depart from the requirements referred to in subsections (1) (a) to (e), (2) and (3).

(b) In determining whether a departure as contemplated in paragraph (a) is reasonable and justifiable, an administrator must take into account all relevant factors, including-

- (i) the objects of the empowering provision;
- (ii) the nature and purpose of, and the need to take, the administrative action;
- (iii) the likely effect of the administrative action;
- (iv) the urgency of taking the administrative action or the urgency of the matter; and
- (v) the need to promote an efficient administration and good governance.

Section 5 Reasons for administrative action

(1) Any person whose rights have been materially and adversely affected by administrative action and who has not been given reasons for the action may, within 90 days after the date on which that person became aware of the action or might reasonably have been expected to have become aware of the action, request that the administrator concerned furnish written reasons for the action.

(2) The administrator to whom the request is made must, within 90 days after receiving the request, give that person adequate reasons in writing for the administrative action.

(3) If an administrator fails to furnish adequate reasons for an administrative action it must, subject to subsection (4) and in the absence of proof to the contrary, be presumed in any proceedings for judicial review that the administrative action was taken without good reason.

(4) (a) An administrator may depart from the requirement to furnish adequate reasons if it is reasonable and justifiable in the circumstances, and must forthwith inform the person making the request of such departure.

(b) In determining whether a departure as contemplated in paragraph (a) is reasonable and justifiable, an administrator must take into account all relevant factors, including-

- (i) the objects of the empowering provision;
- (ii) the nature, purpose and likely effect of the administrative action concerned;
- (iii) the nature and the extent of the departure;
- (iv) the relation between the departure and its purpose;
- (v) the importance of the purpose of the departure; and
- (vi) the need to promote an efficient administration and good governance.

(5) Where an administrator is empowered by any empowering provision to follow a procedure which is fair but different from the provisions of subsection (2), the administrator may act in accordance with that different procedure.

(6) (a) In order to promote an efficient administration, the Minister may, at the request of an administrator, by notice in the Gazette publish a list specifying any administrative action or a group or class of administrative actions in respect of which the administrator concerned will automatically furnish reasons to a person whose rights are adversely affected by such actions, without such person having to request reasons in terms of this section.

(b) The Minister must, within 14 days after the receipt of a request referred to in paragraph (a) and at the cost of the relevant administrator, publish such list, as contemplated in that paragraph.

Section 6 Judicial review of administrative action

(1) Any person may institute proceedings in a court or a tribunal for the judicial review of an administrative action.

(2) A court or tribunal has the power to judicially review an administrative action if-

- (a) the administrator who took it-
 - (i) was not authorised to do so by the empowering provision;
 - (ii) acted under a delegation of power which was not authorised by the empowering provision; or
 - (iii) was biased or reasonably suspected of bias;
- (b) a mandatory and material procedure or condition prescribed by an empowering provision was not complied with;
- (c) the action was procedurally unfair;
- (d) the action was materially influenced by an error of law;
- (e) the action was taken-
 - (i) for a reason not authorised by the empowering provision;
 - (ii) for an ulterior purpose or motive;
 - (iii) because irrelevant considerations were taken into account or relevant considerations were not considered;
 - (iv) because of the unauthorised or unwarranted dictates of another person or body;
 - (v) in bad faith; or
 - (vi) arbitrarily or capriciously;
- (f) the action itself-
 - (i) contravenes a law or is not authorised by the empowering provision; or

- (ii) is not rationally connected to-
 - (aa) the purpose for which it was taken;
 - (bb) the purpose of the empowering provision;
 - (cc) the information before the administrator; or
 - (dd) the reasons given for it by the administrator;
- (g) the action concerned consists of a failure to take a decision;
- (h) the exercise of the power or the performance of the function authorised by the empowering provision, in pursuance of which the administrative action was purportedly taken, is so unreasonable that no reasonable person could have so exercised the power or performed the function; or
- (i) the action is otherwise unconstitutional or unlawful.

(3) If any person relies on the ground of review referred to in subsection (2) (g), he or she may in respect of a failure to take a decision, where-

- (a) (i) an administrator has a duty to take a decision;
- (ii) there is no law that prescribes a period within which the administrator is required to take that decision; and
- (iii) the administrator has failed to take that decision,

institute proceedings in a court or tribunal for judicial review of the failure to take the decision on the ground that there has been unreasonable delay in taking the decision; or

- (b) (i) an administrator has a duty to take a decision;
- (ii) a law prescribes a period within which the administrator is required to take that decision; and
- (iii) the administrator has failed to take that decision before the expiration of that period,

institute proceedings in a court or tribunal for judicial review of the failure to take the decision within that period on the ground that the administrator has a duty to take the decision notwithstanding the expiration of that period.

Section 7 Procedure for judicial review

(1) Any proceedings for judicial review in terms of section 6 (1) must be instituted without unreasonable delay and not later than 180 days after the date-

- (a) subject to subsection (2) (c), on which any proceedings instituted in terms of internal remedies as contemplated in subsection (2) (a) have been concluded; or
- (b) where no such remedies exist, on which the person concerned was informed of the administrative action, became aware of the action and the reasons for it or might reasonably have been expected to have become aware of the action and the reasons.

(2) (a) Subject to paragraph (c), no court or tribunal shall review an administrative action in terms of this Act unless any internal remedy provided for in any other law has first been exhausted.

(b) Subject to paragraph (c), a court or tribunal must, if it is not satisfied that any internal remedy referred to in paragraph (a) has been exhausted, direct that the person concerned must first exhaust such remedy before instituting proceedings in a court or tribunal for judicial review in terms of this Act.

(c) A court or tribunal may, in exceptional circumstances and on application by the person concerned, exempt such person from the obligation to exhaust any internal remedy if the court or tribunal deems it in the interest of justice.

(3) The Rules Board for Courts of Law established by section 2 of the Rules Board for Courts of Law Act, 1985 (Act 107 of 1985), must, before 28 February 2009, subject to the approval of the Minister, make rules of procedure for judicial review.

(4) Until the rules of procedure referred to in subsection (3) come into operation, all proceedings for judicial review under this Act must be instituted in a High Court or another court having jurisdiction.

(5) Any rule made under subsection (3) must, before publication in the Gazette, be approved by Parliament.

Section 8 Remedies in proceedings for judicial review

(1) The court or tribunal, in proceedings for judicial review in terms of section 6 (1), may grant any order that is just and equitable, including orders-

- (a) directing the administrator-
 - (i) to give reasons; or
 - (ii) to act in the manner the court or tribunal requires;
- (b) prohibiting the administrator from acting in a particular manner;
- (c) setting aside the administrative action and-
 - (i) remitting the matter for reconsideration by the administrator, with or without directions; or
 - (ii) in exceptional cases-
 - (aa) substituting or varying the administrative action or correcting a defect resulting from the administrative action; or
 - (bb) directing the administrator or any other party to the proceedings to pay compensation;
- (d) declaring the rights of the parties in respect of any matter to which the administrative action relates;
- (e) granting a temporary interdict or other temporary relief; or
- (f) as to costs.

(2) The court or tribunal, in proceedings for judicial review in terms of section 6 (3), may grant any order that is just and equitable, including orders-

- (a) directing the taking of the decision;
- (b) declaring the rights of the parties in relation to the taking of the decision;
- (c) directing any of the parties to do, or to refrain from doing, any act or thing the doing, or the refraining from the doing, of which the court or tribunal considers necessary to do justice between the parties; or
- (d) as to costs.

Section 9 Variation of time

(1) The period of-

- (a) 90 days referred to in section 5 may be reduced; or
- (b) 90 days or 180 days referred to in sections 5 and 7 may be extended for a fixed period,

by agreement between the parties or, failing such agreement, by a court or tribunal on application by the person or administrator concerned.

(2) The court or tribunal may grant an application in terms of subsection (1) where the interests of justice so require.

Section 9A Designation and training of presiding officers

(1) (a) The head of an administrative region defined in section 1 of the Magistrate's Courts Act, 1944 (Act 32 of 1944), must, subject to subsection (2), designate in writing any magistrate or additional magistrate as a presiding officer of the Magistrate's Court designated by the Minister in terms of section 1 of this Act.

(b) A presiding officer must perform the functions and duties and exercise the powers assigned to or conferred on him or her under this Act or any other law.

(2) Only a magistrate or additional magistrate who has completed a training course-

- (a) before the date of commencement of this section; or
- (b) as contemplated in subsection (5),

and whose name has been included on the list contemplated in subsection (4) (a), may be designated in terms of subsection (1).

(3) The heads of administrative regions must-

- (a) take all reasonable steps within available resources to designate at least one presiding officer for each magistrate's court within his or her area of jurisdiction which has been designated by the Minister in terms of section 1; and
- (b) without delay, inform the Director-General: Justice and Constitutional Development of any magistrate or additional magistrate who has completed a

training course as contemplated in subsections (5) and (6) or who has been designated in terms of subsection (1).

(4) The Director-General: Justice and Constitutional Development must compile and keep a list of every magistrate or additional magistrate who has-

- (a) completed a training course as contemplated in subsections (5) and (6); or
- (b) been designated as a presiding officer of a magistrate's court contemplated in subsection (1).

(5) The Chief Justice must, in consultation with the Judicial Service Commission and the Magistrates Commission, develop the content of training courses with the view to building a dedicated and experienced pool of trained and specialised presiding officers for purposes of presiding in court proceedings as contemplated in this Act.

(6) The Chief Justice must, in consultation with the Judicial Service Commission, the Magistrates Commission and the Minister, implement the training courses contemplated in subsection (5).

(7) The Minister must table a report in Parliament, as prescribed, relating to the content and implementation of the training courses referred to in subsections (5) and (6).

Section 10 Regulations and code of good administrative conduct

(1) The Minister must make regulations relating to-

- (a) the procedures to be followed by designated administrators or in relation to classes of administrative action in order to promote the right to procedural fairness;
- (b) the procedures to be followed in connection with public inquiries;
- (c) the procedures to be followed in connection with notice and comment procedures; and
- (d) the procedures to be followed in connection with requests for reasons.

(2) The Minister may make regulations relating to-

- (a) the establishment, duties and powers of an advisory council to monitor the application of this Act and to advise the Minister on-
 - (i) the appropriateness of publishing uniform rules and standards which must be complied with in the taking of administrative actions, including the compilation and maintenance of registers containing the text of rules and standards used by organs of state;
 - (ii) any improvements that might be made in respect of internal complaints procedures, internal administrative appeals and the judicial review by courts or tribunals of administrative action;
 - (iii) the appropriateness of establishing independent and impartial tribunals, in addition to the courts, to review administrative action and of specialised administrative tribunals, including a tribunal with general jurisdiction over

- all organs of state or a number of organs of state, to hear and determine appeals against administrative action;
- (iv) the appropriateness of requiring administrators, from time to time, to consider the continuance of standards administered by them and of prescribing measures for the automatic lapsing of rules and standards;
 - (v) programmes for educating the public and the members and employee of administrators regarding the contents of this Act and the provisions of the Constitution relating to administrative action;
 - (vi) any other improvements aimed at ensuring that administrative action conforms with the right to administrative justice;
 - (vii) any steps which may lead to the achievement of the objects of this Act; and
 - (viii) any other matter in respect of which the Minister requests advice;
- (b) the compilation and publication of protocols for the drafting of rules and standards;
 - (c) the initiation, conducting and co-ordination of programmes for educating the public and the members and employees of administrators regarding the contents of this Act and the provisions of the Constitution relating to administrative action;
 - (d) matters required or permitted by this Act to be prescribed; and
 - (e) matters necessary or convenient to be prescribed in order to-
 - (i) achieve the objects of this Act; or
 - (ii) subject to subsection (3), give effect to any advice or recommendations by the advisory council referred to in paragraph (a).

(3) This section may not be construed as empowering the Minister to make regulations, without prior consultation with the Minister for the Public Service and Administration, regarding any matter which affects the public service.

(4) Any regulation-

- (a) made under subsections (1) (a), (b), (c) and (d) and (2) (c), (d) and (e) must, before publication in the Gazette, be submitted to Parliament; and
- (b) made under subsection (2) (a) and (b) must, before publication in the Gazette, be approved by Parliament.

(5) Any regulation made under subsections (1) and (2) or any provision of the code of good administrative conduct made under subsection (5A) which may result in financial expenditure for the State must be made in consultation with the Minister of Finance.

(5A) The Minister must, by notice in the Gazette, publish a code of good administrative conduct in order to provide administrators with practical guidelines and information aimed at the promotion of an efficient administration and the achievement of the objects of this Act.

(6) The code of good administrative conduct referred to in subsection (5A) must, before publication in the Gazette, be approved by Cabinet and Parliament and must be made before 28 February 2009.

Section 10A Liability

No person is criminally or civilly liable for anything done in good faith in the exercise or performance or purported exercise or performance of any power or duty in terms of this Act or the rules made under section 7 (3).

Section 11 Short title and commencement

This Act is called the Promotion of Administrative Justice Act, 2000, and comes into operation on a date fixed by the President by proclamation in the Gazette.

REPUBLIC OF SOUTH AFRICA**Government Gazette**

[XXX]

COMPANIES REGULATIONS, 2011**DRAFT FOR PUBLIC COMMENT 29 NOVEMBER 2010**

The Minister of Trade and Industry intends to publish the draft Regulations, 2011 based on the Companies Act 2008 and the Companies Amendment Bill 2010 published in Gazette No 33695 of 27 October 2010. The draft Regulations are released for further stakeholder engagement, and in preparing this draft Regulations the dti took into account the Companies Act, 2008 and Companies Amendment Bill as published. Therefore the Regulations should be read together with Companies Act, 2008 and the Companies Amendment Bill as published. The draft Regulations deal with the functions of the Companies Commission, the Takeover Regulation Panel and the Companies Tribunal, and other matters relating to the regulation of companies, to take effect at the time that the Companies Act, 2008 takes effect.

Note to this Draft

In preparing these draft regulations and forms, the dti provided an early draft of the proposed Companies Amendment Bill, published in Gazette No 33695 of 27 October 2010. When considering these regulations, readers should refer to both the Companies Act 2008, as well as the draft Companies Amendment Bill as published in the Government Gazette on 27 October 2010.

In order to retain the essential harmony of the regulations with the empowering legislation, after the Companies Amendment Bill has been considered by Parliament, these regulations and forms will be re-evaluated, and may need to be revised, to the extent that the Companies Amendment Bill differs from any legislation that Parliament may enact.

Chapter 1 - General Provisions**Part A— Interpretation****1.****Short title**

These Regulations may be cited as the Companies Regulations, 2011.

2.

Definitions

See also s. 1, and Regulation 2: Definitions in section 1 of the Act apply equally to the regulations

In these Regulations, unless the context indicates otherwise

...

(d) “**publish a notice**” means to publicise information to the general public, or to a particular class of persons as applicable in specific circumstances, by any means that can reasonably be expected to bring the information to the attention of the persons for whom it is intended;

(e) “**recording officer**”, when used in relation to a particular matter, means—

(i) the officer of the Commission, Panel, or Tribunal, as the case may be, appointed or designated in terms of Regulation 167; or

(ii) any assistant or acting recording officer having responsibility for the particular matter;

(f) “**Regulation**” includes any Table or Form included within, or referred to in, a Regulation;

(g) “**regulatory agency**” means the Commission, the Panel, or the Companies Tribunal;

(h) “**senior officer**” means, in the case of—

(i) the Commission, the Commissioner;

(ii) the Panel, the chairperson of the Panel, designated in terms of section 198; or

(iii) the Companies Tribunal, the chairperson of the Tribunal, appointed in terms of section 194;

(i) “**the Act**” means the Companies Act, 2008 (Act No. 71 of 2008), as amended from time to time; and

(j) “**Tribunal**” means the Companies Tribunal.

3.

Interpretation

(1) In these Regulations

(a) a reference to a section by number refers to the corresponding section of the Act;

(b) a reference to a Regulation by number refers to the corresponding provision of these Regulations; and

(c) a reference to a sub-regulation or other partial regulation by number refers to the corresponding clause of the regulation in which the reference appears.

(2) A word or expression that is defined in section 1, or elsewhere in the Act to the extent applicable in particular circumstances, bears the same meaning in these Regulations as in the Act.

Part B— Guidelines, Practice Notes, Forms, Notices and other documents

4.

Issuing and Status of Guidelines and Practice Notes

See s. 188 (2)(b) and s. 201 (2)(b)

(1) In this Regulation

(a) “**Guideline**” means a document issued by a regulatory agency with respect to a matter within its authority, which sets out recommended procedures, standards or forms reflecting that regulatory agency’s advice as to what constitutes best practice on a matter; and

(b) “**Practice Note**” means a document issued by a regulatory agency with respect to a matter within its authority, which sets out

(i) a procedure that will be followed by that regulatory agency; or

(ii) a procedure to be followed when dealing with that regulatory agency; or

(iii) that regulatory agency’s interpretation of, or intended manner of applying, a provision of the Act or these Regulations.

(2) The senior officer of a regulatory agency may

(a) issue a Guideline at any time by publishing a notice of the Guideline to the general public in the Gazette, any generally circulated newspaper, on the regulatory agency’s web site, or by any similar means of providing information to the public generally; or

(b) issue a Practice Note at any time by publishing it in the Gazette, and may amend or withdraw any such Practice Note at any time by subsequent notice in the Gazette.

(3) A Guideline or Practice Note must be consistent with the Act and these regulations, and a provision of the Act or these regulations prevails if there is any inconsistency between that provision and any such Guideline or Practice Note.

(4) A regulatory agency must

(a) maintain a notice on its website of the existence of every Guideline or Practice Note that it has published and not withdrawn;

(b) provide for copies of every Guideline or Practice Note to be freely accessed or printed from its website; and

(c) provide a printed copy of any Guideline or Practice Note freely to any person upon request.

5.**Forms and filing requirements**

See s. 223 (1)(b) and (d)(i)

(1) Whenever a document is required

(a) in terms of a section of the Act that is listed in column 1 of Table CR 1, or a provision of these Regulations that is listed in column 1 of Table CR 1; and

(b) for a purpose listed in column 2 of that Table, the document must be substantially in the form of the annexure listed opposite that section number in column 3 of that Table, and must be produced, delivered, or filed as the case may be subject to any conditions or requirements listed opposite that section number in column 4 of that Table.

(2) If a regulatory agency has reasonable grounds for uncertainty whether a copy of a document to be filed is in fact unaltered, as contemplated in section 6 (7), the regulatory agency may require the person seeking to file that document to provide a certified copy of the document.

...

Part C— Transparency, accountability and integrity of companies

...

22.**Company records**

See s. 25

A company must notify the Commission of the location, or of any change in the location, of any company records that are not located at its registered office, by filing Form CoR 22, indicating the date as of which the records will be kept at the relevant location, which must be the date on which the notice is filed, or a later date.

...

25.**Company financial year and accounting records**

See s. 27 and 28

(1) A company must notify the Commission of a change in its financial year end by filing Form CoR 25.

(2) A company must keep accounting records in an official language of the Republic, as necessary to provide an adequate information base sufficient to

(a) enable the company to satisfy all reporting requirements applicable to it, as set out in section 28 (1) read with section 29 (1); and

(b) provide for the compilation of financial statements, and the proper conduct of an audit, or independent review, of its annual financial statements, as applicable for the particular company.

(3) To the extent necessary for a particular company to comply with section 28 (1), read with section 29 (1), the accounting records of that company must include

(a) a record of the company's assets and liabilities including, but not limited to

(i) a record of the company's non-current assets, showing for each such asset or, in the case of a group of relatively minor assets acquired simultaneously, each such group of assets

(aa) the date the company acquired it, and the acquisition cost;

(bb) the date the company re-valued it, if applicable, and the amount of the revaluation and, if it was re-valued after the Act took effect, the basis of, and reason for, the re-valuation; and

(cc) the date the company disposed of or retired it, once it has been disposed of or retired, and the value of the consideration, if any, received for it and, if it was disposed of after the Act took effect, the name of the person to whom it was transferred;

(ii) a record of any loan by the company to a shareholder, director, prescribed officer or employee of the company, or to a person related to any of them, including the amount borrowed, the interest rate, the terms of re-payment, and material details of any breach, default or re-negotiation of any such loan; and

(iii) a record of any liabilities and obligations of the company including, but not limited to

(aa) a record of any loan to the company from a shareholder, director, prescribed officer or employee of the company, or from a person related to any of them, including the amount borrowed, the interest rate, and the terms of re-payment, and material details of any breach, default or renegotiation of any such loan; and

(bb) a record of any guarantee, suretyship or indemnity granted by the company in respect of an obligation to a third party incurred by a shareholder, director, prescribed officer or employee of the company, or by a person related to any of them, including the amount secured, the interest rate, the terms of re-payment, the expiry date, and the circumstances in which the company may be called upon to honour the guarantee, suretyship or indemnity;

- (b) a record of any property held by the company
 - (i) in a fiduciary capacity; or
 - (ii) in any capacity or manner contemplated in section 65 (2) of the Consumer Protection Act, 2008 (Act No. 68 of 2008);
 - (c) a record of the company's revenue and expenditures, including
 - (i) daily records of all money received and paid out, in sufficient detail to enable the nature of the transactions and, except in the case of cash transactions, the names of the parties to the transactions to be identified;
 - (ii) daily records of all goods purchased or sold on credit, and services received or rendered on credit, in sufficient detail to enable the nature of those goods or services and the parties to the transactions to be identified; and
 - (iii) statements of every account maintained in a financial institution in the name of the company, or in any name under which the company carries on its activities, together with vouchers or other supporting documents for all transactions recorded on any such statement; and
 - (d) if the company trades in goods, a record of inventory and stock in trade, statements of the annual stocktaking, and records to enable the value of stock at the end of the financial year to be determined.
- (4) In addition to the requirements set out above, a non-profit company must maintain adequate records of all revenue received from donations, grants, and member's fees, or in terms of any funding contracts or arrangements with any party.
- (5) The accounting records required to be kept by the Act and this regulation must be kept in such a manner as
- (a) to provide adequate precautions against
 - (i) theft, loss or intentional or accidental damage or destruction; and
 - (ii) falsification; and
 - (b) to facilitate the discovery of any falsification; and
 - (c) to comply with any other applicable law dealing with accounting records, access to information, or confidentiality.
- (6) If a company keeps any of its accounting records in electronic form, the company must
- (a) provide adequate precautions against loss of the records as a result of damage to, or failure of, the media on which the records are kept; and
 - (b) ensure that the records are at all times capable of being retrieved to a readable and printable form, including by converting the records from legacy to later systems, storage media, or software, to the extent necessary from time to time.
- (7) For greater certainty, the requirements of this regulation are in addition to, and not in substitution for, any applicable requirements to keep accounting records set out in terms of any other law, or any agreement to which the company is a party.

26.**Interpretation of regulations affecting transparency and accountability**

(1) For the purposes of Regulations 27 to 29

(a) “**IFRS**” means the International Financial Reporting Standards as adopted from time to time by the International Accounting Standards Board or its successor body; and

(b) “**IFRS for SMEs**” means the International Financial Reporting Standards for Small and Medium Enterprises, as adopted from time to time by the International Accounting Standards Board or its successor body;

(c) “**independent accounting professional**” when used with respect to any particular company, means a person who

(i) is

(aa) a registered auditor in terms of the Auditing Profession Act; or

(bb) a member in good standing of a professional body that has been accredited in terms of section 33 of the Auditing Profession Act; or

(cc) qualified to be appointed as an accounting officer of a close corporation in terms of section 60 (1), (2) and (4) of the Close Corporations Act, 1984 (Act No. 69 of 1984); and

(ii) does not have a personal financial interest in the company or a related or interrelated company; and

(iii) is not

(aa) involved in the day to day management of the company’s business, nor has been so involved at any time during the previous three financial years; or

(bb) a prescribed officer, or full-time executive employee, of the company or another related or inter-related company, or have been such an officer or employee at any time during the previous three financial years; and

(iv) is not related to any person who falls within any of the criteria set out in clause (ii) or (iii).

(d) “**independently compiled and reported**” means that the annual financial statements are prepared

(i) by an independent accounting professional;

(ii) on the basis of financial records provided by the company; and

(iii) in accordance with any relevant financial reporting standards.

(e) “**ISRE 2400**” means the International Standard for Review Engagements, as issued from time to time;

(f) “SA GAAP” means the South African Statements of Generally Accepted Accounting Practice, as adopted from time to time by the Accounting Practices Board or its successor body.

(2) For the purposes of Regulations 27 to 30, 43, 127 and 128, every company must calculate its ‘public interest score’ for each financial year, calculated as the sum of the following:

(a) a number of points equal to the maximum number of employees of the company at any one time during the financial year;

(b) one point for every R 1 million (or portion thereof) in outstanding unsecured debt of the company held by creditors at the financial year end;

(c) one point for every R 1 million (or portion thereof) in turnover during the financial year; and

(d) one point for every individual who, at the end of the financial year, is known by the company—

(i) in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company’s issued securities; or

(ii) in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company.

27.

Financial Reporting Standards

See s. 29(4)

(1) A company’s financial statements may be compiled internally or independently.

(2) For all purposes of this regulation and Regulations 28 and 29, a company’s financial statements must be regarded as having been compiled internally, unless they have been ‘independently compiled and reported’, as defined in Regulation 26 (1)(d).

(3) Nothing in this regulation precludes a company

(a) that is required to prepare its financial statements to the standards of IFRS for SMEs, from preparing its financial statements to the standards of IFRS instead; or

(b) that is not subject to any prescribed standards, from preparing its financial statements to the standards of either IFRS or IFRS for SMEs.

(4) For any particular company, any financial statements contemplated in section 28 or 29 must comply with the applicable standards for that category of company as follows:

State owned and Profit companies

State owned companies.

IFRS, but in the case of any conflict with any requirement in terms of the Public Finance Management Act, the latter prevails.

Public companies listed on an exchange.

IFRS, but in the case of any conflict with the applicable listing requirements of the relevant exchange, the latter prevails provided the exchange's listings requirements require compliance with IFRS as issued by the International Accounting Standards Board.

Public companies not listed on an exchange.

One of

(a) IFRS; or

(b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.

Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is at least 750.

One of

(a) IFRS; or

(b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.

Profit companies, other than state-owned or public companies

(a) whose public interest score for the particular financial year is at least 300 but less than 750; or

(b) whose public interest score for the particular financial year is less than 300, and whose statements are independently compiled.

One of

(a) IFRS; or

(b) IFRS for SME's, provided that the company meets the scoping requirements outlined in the IFRS for SME's; or

(c) SA GAAP.

Profit companies, other than state-owned or public companies, whose public interest companies, whose public interest score for the particular financial year is less than 300, and whose statements are internally compiled.

There is no prescribed Financial Reporting Standard.

Non-Profit Companies

Non profit companies that are required in terms of Regulation 28(1)(b) to have their annual financial statements audited.

IFRS, but in the case of any conflict with any requirements in terms of the Public Finance Management Act, the latter prevails.

Non profit companies, other than those contemplated in the first row above, whose public interest score for the particular financial year is at least 750.

One of

(a) IFRS; or

(b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.

Non profit companies, other than those contemplated in the first row above

(a) whose public interest score for the particular financial year is at least 300, but less than 750; or

(b) whose public interest score for the particular financial year is at less than 300, and whose financial statements are independently compiled.

One of

(a) IFRS; or

(b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's; or

(c) SA GAAP

Non profit companies, other than those contemplated in the first row above, whose public interest score for the particular financial year is less than 300, and whose financial statements are internally compiled.

There is no prescribed Financial Reporting Standard.

28.

Categories of companies required to be audited

See s. 30 (2), read with 30 (7)

(1) This regulation applies to a company unless, in terms of section 30 (2A), it is exempt from having its annual financial statements either audited or independently reviewed.

(2) In addition to public companies and state owned companies, any company that falls within any of the following categories in any particular financial year must have its annual financial statements for that financial year audited:

(a) any profit or non-profit company if, in the ordinary course of its primary activities, it holds assets in a fiduciary capacity for persons who are not related to the company, and the aggregate value of such assets held at any time during the financial year exceeds R 5 million;

(b) any non-profit company, if it was incorporated

- (i) directly or indirectly by the state, an organ of state, a state-owned company, an international entity, a foreign state entity or a company; or
 - (ii) primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direct or indirect initiation or direction of an organ of the state, a state-owned company, an international entity, or a foreign state entity, or for a purpose ancillary to any such function; or
- (c) any other company whose public interest score in that financial year, as calculated in accordance with Regulation 26 (2)
- (i) is 750 or more; or
 - (ii) is at least 300, but less than 750, if its annual financial statements for that year were internally compiled.

29.

Independent review of annual financial statements

See s. 30 (2) and (7)

- (1) This regulation applies to a company, with respect to any particular financial year, unless the company
- (a) is exempt, in terms of section 30 (2A), from any requirement to have its annual financial statements for that year audited or reviewed;
 - (b) is required by its own Memorandum of Incorporation, or required in terms of the Act or Regulation 28, to have its annual financial statements for that financial year audited; or
 - (c) has voluntarily had its annual financial statements for that year audited.
- (2) A company to which this regulation applies must have its annual financial statements independently reviewed in accordance with ISRE 2400.
- (3) An independent review of a company's annual financial statements must be carried out
- (a) in the case of a company whose public interest score for the particular financial year was at least 300, by a registered auditor, or a member in good standing of a
 - (b) in the case of a company whose public interest score for the particular financial year was less than 300, by
 - (i) a person contemplated in paragraph (a); or
 - (ii) a person who is qualified to be appointed as an accounting officer of a close corporation in terms of section 60 (1), (2) and (4) of the Close Corporations Act, 1984 (Act No. 69 of 1984).

30.

Company annual returns

See s.33

- (1) A company must file its annual return in Form CoR 30.1 within 30 business days after the anniversary of
 - (a) its date of incorporation, in the case of a company that was incorporated in the Republic; or
 - (b) the date that its registration was transferred to the Republic, in the case of a domesticated company.
- (2) A company that is required by the Act or Regulation 28 to have its annual financial statements audited must file a copy of those audited statements
 - (a) on the date that it files its annual return, if the company's board has approved those statements by that date; or
 - (b) within 20 business days after the board approves those statements, if they had not been approved by the date on which the company filed its annual return.
- (3) A company that is not required in terms of the Act or Regulation 28 to have its annual financial statements audited may, at its option
 - (a) file a copy of its audited or reviewed statements together with its annual return; or
 - (b) undertake to file a copy of its audited or reviewed statements within the time contemplated in sub-regulation (2)(b).
- (4) A company that is not required to file annual financial statements in terms of sub-regulation (2), or a company that does not elect to file, or undertake to file, a copy of its audited or reviewed annual financial statements in terms of sub-regulation (3), must file a financial accountability supplement to its annual return in Form CoR 30.2.
- (5) The Commission
 - (a) must establish a system to select and review a sample of financial accountability supplements that have been filed in terms of sub-regulation (4), with the objective of monitoring compliance with the financial record keeping and financial reporting provisions of the Act; and
 - (b) may issue a compliance notice to any such company setting out changes that are required to the company's practices to better comply with the financial record keeping and financial reporting provisions of the Act.
- (6) An external company must file its annual return in Form CoR 30.3 within 30 business days after the anniversary date of its registration as an external company.

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Chapter 7 - Complaints, Applications and Tribunal Hearings

Part A— Definitions Used in This Chapter

129.**Definitions**

In this Chapter, unless the context indicates otherwise

- (a) “**Answer**” means a document as described in Regulation 143 and filed by a respondent;
- (b) “**applicant**” means a person who submits an application to the Tribunal in terms of the Act or this Chapter;
- (c) “**Application**” means a request submitted to the Tribunal in terms of the Act or these Regulations;
- (d) “**complaint**” means
 - (i) a matter that has been submitted to the Commission in terms of section 168 (1)(b);
 - (ii) a matter initiated by the Commission in terms of section 168 (2); or
 - (iii) a matter that the Minister has directed the Commission to investigate, in terms of section 168 (3).
- (e) “**Complaint Referral**” means an initiating document as described in Regulations 140 (3) and 141 for the purposes contemplated in section 170 (1)(b);
- (f) “**Dispute Referral**” means an initiating document as described in Regulation 132 for the purposes of referring a dispute for alternative resolution to the Tribunal or an accredited entity, as contemplated in section 166 (1);
- (g) “**initiating document**”, depending on the context, means either an Application, Complaint Referral, or a Dispute Referral;
- (h) “**initiating party**”
 - (i) in the case of a Complaint Referral, means the Commission, or other person referred to in Regulation 141;
 - (ii) in the case of a Dispute Referral, means the person who referred the matter to the Tribunal or accredited entity in terms of section 166 (1), read with Regulation 132;
 - (iii) in any other proceedings before the Tribunal, means the Applicant;
- (i) “**intervenor**” means any person who has been granted standing to participate in particular proceedings before the Tribunal in terms of section 181 (c), read with Regulation 159;
- (j) “**presiding member**” means the member of the Tribunal designated by the chair to preside over particular proceedings;
- (k) “**Reply**” means a document as described in Regulation 144 and filed by an initiating party in response to an Answer;
- (l) “**respondent**”, when used in respect of
 - (i) an application to review a notice issued by, or a decision of, the Commission, means
 - (aa) the Commission, and

- (bb) any other person concerned, except the applicant;
- (ii) any other application, means the person against whom the relief is sought;
- (iii) a Complaint Referral, means the person against whom that complaint has been initiated; or
- (iv) a Dispute Referral, means any party to the dispute other than the initiating party;

...

Part B— Forms and Notices with respect to certain remedies

130.

Request for Commission or Panel to act on behalf of complainant

See s. 157 (2).

A complainant may give written authorization to the Commission or the Panel to commence proceedings in the name of the complainant, as contemplated in section 157 (2), by so indicating on Form CoR 135.1 at the time of filing a complaint.

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Part C—Alternative Dispute Resolution

132.

Alternative dispute resolution procedures

See s. 156 (a), 157, 158, 166 (1) and 169 (1)(b)

(1) A person may refer a matter for alternative dispute resolution to the Tribunal or to an accredited entity, as contemplated in section 166 (1) and elsewhere in the Act, by filing a completed Form CTR 132.1 with the Tribunal or the accredited entity.

(2) The Commission or the Panel may refer a complaint to be resolved by alternative dispute resolution, as contemplated in section 169 (1)(b), by delivering a copy of Form CTR 132.2, to the complainant, the respondent and the Tribunal or accredited dispute resolution entity.

(3) A Certificate of Failed Dispute Resolution, as contemplated in section 166 (2), must be in Form CTR 132.3.

133.**Forms of order resulting from alternative dispute resolution procedures**

See s. 167

A consent order, as contemplated in section 167, must be set out in a form satisfactory to the High Court, in terms of its rules.

134.**Accreditation of alternative dispute resolution providers**

See s. 166(4)(a)(iii) and (5)

(1) An application for accreditation as an alternative dispute resolution provider must be made to the Commission in Form CoR 134.1

(2) A certificate accrediting an entity as an alternative dispute resolution provider must be in Form CoR 134.2

Part C— Commission or Panel Complaint and Investigation Procedures**135.****Filing of complaints with the Commission**

See s. 156 (d), 157, 168 and 169 (1).

(1) A complaint filed with the Commission or the Panel must be in Form CoR 135.1.

(2) At any time before the Commission or Panel has concluded its consideration of a complaint, the complainant may withdraw the complaint.

(3) The Commission or the Panel may continue to investigate a complaint after it has been withdrawn, as if the Commission or Panel had initiated it as contemplated in section 168 (2).

(4) A notice of non-investigation of a complaint by the Commission or the Panel, as contemplated in section 169 (1)(a), must be in Form CoR 135.2.

...

137.**Investigation of complaints**

See s. 169 and 176 to 179

(1) A notice to investigate issued by the Commission or the Panel in terms of section 169 (1)(c) must be in Form CoR 137.1

- (2) A summons issued by the Commission or the Panel in terms of section 176 (1) must be in Form CoR 137.2.
- (3) If a person to whom a summons has been issued is required to produce in evidence any document or thing in the witness's possession, the summons must specify the document or thing to be produced.
- (4) After the summons has been issued, it must be served by the sheriff in any manner authorised by the High Court Rules.
- (5) A person who has been required to produce any document or thing to the Commission must hand it over to the recording officer as soon as possible after service of the summons, unless the person claims that the document or thing is privileged.
- (6) At any time during an investigation, the Commission or the Panel, as the case may be, may
- (a) informally request additional information from a party; or
 - (b) require a party to provide additional information, at any time, by delivering to the party a demand in Form 137.3, setting out the specific information that is required.
- (7) If, at any time, the Commission or the Panel has reasonable grounds to believe that a document filed in respect of an investigation contains false or misleading information, the Commission or Panel may issue a Demand for Corrected Information in Form 137.4 to the person who filed that document.
- (8) Within 5 business days after being served with a Demand for Corrected Information, the person concerned may apply to the Tribunal for an order confirming or setting aside the Demand.
- (9) If a person does not apply to the Tribunal within the time allowed by sub-regulation (8) or, if the Tribunal, on hearing the appeal, partially or entirely confirms the Demand, the person concerned must file corrected information.
- (10) If the Tribunal, on hearing an application in terms of sub-regulation (8), sets aside the Demand entirely, the Demand is a nullity.

138.

Resolving complaints by proposed consent order

See s 170 (1)(d) and 173

- (1) If, at any time before concluding its consideration of a complaint, the Commission believes that the respondent may be prepared to agree terms of a proposed order, the Commission may
- (a) notify the complainant, in writing, that a consent order may be recommended; and
 - (b) invite the complainant to inform the Commission in writing within 10 business days after receiving that notice
 - (i) whether the complainant is prepared to accept damages under such an order; and
 - (ii) if so, the amount of damages claimed.

(2) If the Commission and the respondent agree the terms of an appropriate order, the Commission must

(a) refer the complaint to the High Court in accordance with its Rules;

(b) attach to the referral

(i) a draft order in a form consistent with the High Court Rules, and

(aa) setting out each section of the Act or of a company's Memorandum of Incorporation or Rules that has been contravened;

(bb) setting out the terms agreed between the Commission and the respondent, including, if applicable, the amount of damages agreed between the respondent and the complainant; and

(cc) signed by the Commission and the respondent indicating their consent to the draft order; and

(ii) a Consent to Order in Form CoR 138, completed by the complainant, if applicable; and

(c) serve a copy of the referral and draft order on the respondent and the complainant.

(3) The Commission must not include an order of damages in a draft consent order unless the complainant expressly consented that order for damages in Form CoR 138.

(4) A draft consent order may be submitted to the Court in terms of section 173 and this Rule notwithstanding the refusal by a complainant to consent to including an award of damages in that draft order.

139.

Compliance notices and certificates

See s. 170 (1)(g), 171 and 172

(1) A Compliance Notice issued by the Commission, or by the Executive Director of the Panel, as contemplated in section 171, must be in Form CoR 139.1.

(2) A Compliance Certificate issued by the Commission, or by the Executive Director of the Panel, as contemplated in section 171, must be in Form CoR 139.2.

140.

Procedures following investigation

See s. 170

(1) A Notice of Referral by the Commission or the Panel of a complaint to another regulatory agency, as contemplated in section 170 (1) (b), must be in form CoR 140.1 and delivered to the complainant, the respondent, and the other relevant regulatory agency.

(2) A Notice of Non-referral issued by the Commission or the Panel, as contemplated in section 170 (1)(c), must be in Form CoR 140.2.

- (3) A Complaint Referral to the Tribunal must be in Form CTR 140, and
- (a) may allege alternative contraventions of the Act based on the same facts; and
 - (b) must be supported by an affidavit setting out in numbered paragraphs
 - (i) a concise statement of the particulars of the complaint; and
 - (ii) the points of law, or material facts relevant to the complaint; and
 - (c) must be served on each person named as a respondent.

Part D— Initiating Tribunal Procedures

141.

Complaint Referrals to the Tribunal

A complaint proceeding to be adjudicated by the Tribunal may be initiated only by filing a Complaint Referral as contemplated in section 170 (1)(b), and in accordance with Regulation 140.

142.

Applications to the Tribunal in respect of matters other than complaints

- (1) A person may apply to the Tribunal for an order in respect of any matter contemplated by the Act, or these Regulations, by completing and filing with the Tribunal's recording officer
- (a) an Application in Form CTR 142; and
 - (b) a supporting affidavit setting out the facts on which the application is based.
- (2) The applicant must serve a copy of the application and affidavit on each respondent named in the application, within 5 business days after filing it.
- (3) An application in terms of this Regulation must
- (a) indicate the basis of the application, stating the section of the Act or these Regulations in terms of which the Application is made; and
 - (b) depending on the context -
 - (i) set out the Commission's decision that is being appealed or reviewed;
 - (ii) set out the decision of the Tribunal that the applicant seeks to have varied or rescinded;
 - (iii) set out the regulation in respect of which the applicant seeks condonation; or
 - (c) indicate the order sought; and
 - (d) state the name and address of each person in respect of whom an order is sought.

143.**Answer**

(1) Within 20 business days after being served with a Complaint Referral, or an application, that has been filed with the Tribunal, a respondent who wishes to oppose the complaint or application must

(a) serve a copy of an Answer on the initiating party; and

(b) file the Answer with proof of service.

(2) An Answer that raises only a point of law must set out the question of law to be resolved.

(3) Any other Answer must be in affidavit form, setting out in numbered paragraphs

(a) a concise statement of the grounds on which the complaint or application is opposed;

(b) the material facts or points of law on which the respondent relies; and

(c) an admission or denial of each ground, and of each material fact relevant to each ground, set out in the complaint or application.

(4) An allegation of fact set out in an initiating document that is not specifically denied or admitted in an Answer must be regarded as having been admitted.

(5) In an Answer, the respondent must qualify or explain a denial of an allegation, to the extent necessary in the circumstances.

144.**Reply**

(1) Within 15 business days after being served with an Answer that raises issues not addressed in the initiating document, other than a point of law alone, the initiating party may

(a) serve a Reply on the other parties; and

(b) file a copy of the Reply and proof of service.

(2) A Reply must be in affidavit form, setting out in numbered paragraphs

(a) an admission or denial of each new ground or material fact raised in the Answer; and

(b) the position of the replying party on any point of law raised in the Answer.

(3) If the initiating party does not file a Reply, they will be deemed to have denied each new issue raised in the Answer, and each allegation of fact relevant to each of those issues.

145.**Amending documents and Notices of Motion**

- (1) The initiating party may apply to the Tribunal by Notice of Motion at any time before the end of the hearing of the matter for an order authorising them to amend their initiating document as filed.
- (2) If the Tribunal allows an amendment, it must allow any other party affected by the amendment to file additional documents consequential to those amendments within a time period allowed by the Tribunal.
- (3) A Notice of Motion to be made before the Tribunal, for any purpose in terms of the Act and these Regulations, must be in Form CTR 145.

146.**Completion of file**

Subject to any order made by the Tribunal, the filing of documents is complete when a initiating document or Answer has not been responded to within the time allowed.

147.**Late filing, extension and reduction of time**

- (1) A party to any matter may apply to the Tribunal to condone late filing of a document, or to request an extension or reduction of the time for filing a document, by filing a request in form CTR 147.
- (2) Upon receiving a request in terms of sub-regulation (1), the recording officer, after consulting the parties to the matter, must set the matter down for hearing at the earliest convenient date.

148.**Withdrawals and postponements**

- (1) At any time before the Tribunal has determined a matter, the initiating party may withdraw all or part of the matter by
 - (a) serving a Notice of Withdrawal in form CTR 148 on each party; and
 - (b) filing the Notice of Withdrawal with proof of service.
- (2) If the parties agree to postpone a hearing, the initiating party must notify the recording officer as soon as possible.
- (3) Subject to any provision of the Act to the contrary
 - (a) a Notice of Withdrawal may include a consent to pay costs; and
 - (b) if no consent to pay costs is contained in a Notice of Withdrawal the other party may apply to the Tribunal by Notice of Motion for an appropriate order for costs.

Part E – Conduct of Tribunal Proceedings

149. Pre-hearing conferences

(1) Before, or within 20 business days after, the filing of documents is completed, a member of the Tribunal assigned by the Chairperson may convene a pre-hearing conference on a date and at a time determined by that member with

- (a) the initiating party;
- (b) each complainant in the matter;
- (c) each Respondent; and
- (d) any intervenors.

(2) If a point of law has been raised, and it appears to the assigned member of the Tribunal at a pre-hearing conference to be practical to resolve that question before proceeding with the Conference, the member may

- (a) direct the recording officer to set only that question down for hearing by the Tribunal; and
- (b) may adjourn the pre-hearing conference pending the resolution of that question by the Tribunal.

(3) The assigned member of the Tribunal may adjourn a pre-hearing conference from time to time.

(4) Pre-hearing conferences may be conducted in person or by telephone or both, need not follow formal rules of procedure, and are not open to the public.

(5) At a pre-hearing conference, the assigned member of the Tribunal may

- (a) establish procedures for protecting confidential information, including the terms under which participants may have access to that information;
- (b) direct the Commission to investigate specific issues or obtain certain evidence; or
- (c) give directions in respect of
 - (i) technical or formal amendments to correct errors in any documents filed in the matter;
 - (ii) any pending Notices of Motion;
 - (iii) clarifying and simplifying the issues;
 - (iv) obtaining admissions of particular facts or documents;
 - (v) the production and discovery of documents whether formal or informal;
 - (vi) witnesses to be called by the Tribunal at the hearing, the questioning of witnesses and the language in which each witness will testify;
 - (vii) a timetable for

(aa) the exchange of summaries of expert opinions or other evidence that will be presented at the hearing; and

(bb) any other pre-hearing obligations of the parties;

(viii) determine the procedure to be followed at the hearing, and its expected duration;

(ix) a date, time and schedule for the hearing; or

(x) any other matters that may aid in resolving the matter.

(6) At a pre-hearing conference, the assigned member of the Tribunal may require each participant to submit at a date to be determined, but before the hearing, a written statement summarising its argument, if any, with respect to the complaint, and identifying what it believes are the major unresolved issues.

(7) After concluding a pre-hearing conference, the assigned member of the Tribunal must issue an order recording any agreements or rulings arising from matters considered at the pre-hearing conference.

(8) A member of the Tribunal assigned by the Chairperson may schedule a further pre-hearing conference on their own motion, and the provisions of this regulation apply to such a conference.

150.

Settlement conference

At any time before the Tribunal makes a final order in a matter, the Tribunal, on its own initiative or at the request of the participants, may order an adjournment of the proceedings to allow the participants to attempt to reach agreement on any outstanding issue.

151.

Set down of matters

(1) If a matter has been postponed to a date to be determined in the future, any party to the matter may apply to the recording officer for it to be re-enrolled, but no preference may be given to that matter on the roll, unless the Chairperson decides otherwise.

(2) The recording officer must allocate a time, date and place for the hearing and send a Notice of Hearing in form CTR 151 to each party.

(3) If a matter is postponed to a specific date, the recording officer need not send a Notice of Set Down to the parties.

152.

Matters struck-off

(1) The Tribunal member presiding at a hearing may strike a matter off the Roll if the initiating party is not present.

- (2) If a matter is struck off the roll, the matter may not be re-enrolled unless
- (a) the party concerned files an affidavit setting out a satisfactory explanation for the failure to attend the hearing; and
 - (b) a member of the Tribunal assigned by the Chairperson, on considering the explanation offered, orders the matter to be re-enrolled.

153.**Default orders**

- (1) If a person served with an initiating document has not filed a response within the prescribed period, the initiating party may apply to have the order, as applied for, issued against that person by the Tribunal.
- (2) On an application in terms of sub-regulation (1), the Tribunal may make an appropriate order
- (a) after it has heard any required evidence concerning the motion; and
 - (b) if it is satisfied that the notice or application was adequately served.
- (3) Upon an order being made in terms of sub-regulation (2), the recording officer must serve the order on the person described in subsection (1) and on every other party.

154.**Conduct of hearings**

- (1) If, in the course of proceedings, a person is uncertain as to the practice and procedure to be followed, the member of the Tribunal presiding over a matter
- (a) may give directions on how to proceed; and
 - (b) for that purpose, if a question arises as to the practice or procedure to be followed in cases not provided for by these Regulations, the member may have regard to the High Court Rules.
- (2) Subject to these Regulations, the member of the Tribunal presiding over a matter may determine the time and place for the hearing before the Tribunal.
- (3) The Tribunal may condone any technical irregularities arising in any of its proceedings.

155.**Record of hearing**

The recording officer must compile a record of any proceeding in which a hearing has been held, including

- (a) the initiating document, and any answers or replies filed in the matter;
- (b) the notice of any hearing;
- (c) any interlocutory orders made by the Tribunal or a member;

- (d) all documentary evidence filed with the Tribunal;
- (e) the transcript, if any, of the oral evidence given at the hearing; and
- (f) the final decision of the Tribunal and the reasons.

...

160.

Summoning witnesses

- (1) If the Tribunal requires a witness to attend any proceedings to give evidence it may have a summons issued by the recording officer in form CTR 160 for that purpose.
- (2) If a witness is required to produce in evidence any document or thing in the witness's possession, the summons must specify the document or thing to be produced.
- (3) After the summons has been issued, it must be served by the sheriff in any manner authorised by the High Court Rules.
- (4) A witness who has been required to produce any document or thing at the proceedings must hand it over to the recording officer as soon as possible after service of the summons, unless the witness claims that the document or thing is privileged.

...

Part F— Maximum Administrative Fines and Determination of Turnover

163.

Maximum administrative fines

See s. 175

The maximum administrative fine, as contemplated in section 175 (5), is R 1 million.

164.

Manner of calculating assets and turnover

See s. 175 (3) and 223

- (1) Subject to the following provisions of this regulation, for all purposes of the Act other than Chapter 5, and for all purposes of these Regulations other than Chapter 5, the assets and turnover of a company at any particular time must be calculated in accordance with

- (a) the financial reporting standards applicable to that company, as set out in Regulation 27; or
 - (b) SA GAAP, as defined in Regulation 26 (1)(f), in the case of a company in respect of which no financial reporting standards have been prescribed.
- (2) At any particular time, the asset value of
- (a) a company, other than a holding company, is equal to the gross value of the company's assets as shown on the company's balance sheet in its most recent annual financial statements; or
 - (b) a holding company is equal to the gross value of the consolidated assets of the company and its subsidiaries, as shown on the company's balance sheet in its most recent annual financial statements, adjusted in either case in accordance with sub-regulation (3).
- (3) If, between the date of the most recent annual financial statements and the date at which a calculation of a company's asset value is to be calculated, the company has acquired or divested itself of any subsidiary, or has entered into a joint venture not shown on those statements
- (a) the following items must be added to the calculation of the company's asset value, to the extent that any such item would be required to be included in the company's assets on its annual financial statements:
 - (i) the value of each such recently acquired asset; and
 - (ii) any asset received by the company in exchange for a recently divested asset; and
 - (b) the following items may be deducted from the company's asset value, to the extent that any such item was included as an asset on the company's most recent annual financial statements:
 - (i) the value of each such recently divested asset at the date of divestiture; and
 - (ii) any asset that was used by the company to acquire a recently acquired asset.
- (4) At any particular time, the annual turnover of
- (a) a company other than a holding company is the gross revenue of that company from income in, into or from the Republic, arising from the following transactions or events, as recorded on the company's most recent annual financial statements:
 - (i) the sale of goods;
 - (ii) the rendering of services; or
 - (iii) the use by other persons of the company's assets yielding interest, royalties, or dividends; or
 - (b) a holding company is the consolidated gross revenue of that company and each of its subsidiaries from income in, into or from the Republic, arising from the following transactions or events, as recorded on the company's most recent annual financial statements:
 - (i) the sale of goods;

(ii) the rendering of services; or

(iii) the use by other persons of the company's assets yielding interest, royalties, or dividends, adjusted in accordance with sub-regulations (5) and (6), in either case.

(5) In calculating the annual turnover of a company

(a) any amount contemplated in sub-regulation (4) may be excluded to the extent that it is properly excluded from gross revenue in accordance with the applicable financial reporting standards referred to in sub-regulation (1);

(b) taxes, rebates, or similar amounts calculated and paid or to be paid in direct relation to revenue as, for example, sales tax, VAT, excise duties or sales rebates, may be deducted from gross revenue; and

(c) gains arising from non-current assets or from foreign currency transactions may be excluded from gross revenue.

(6) If, between the date of the most recent annual financial statements and the date at which a calculation of a company's annual turnover is to be calculated, the company has acquired or divested itself of any subsidiary, or entered into a joint venture not shown on those statements

(a) the turnover generated by any such newly acquired asset must be included in the calculation of the company's annual turnover, to the extent that any such item would be required to be included in the company's income statements on its annual financial statements; and

(b) the turnover generated in the previous financial year by any such newly divested asset may be excluded in the calculation of the company's annual turnover, to the extent that any such item was included in the company's income statements on its most recent annual financial statements.

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COMPANIES REGULATIONS PURSUANT TO THE ACT:
FOR PUBLIC COMMENT

COMPANIES REGULATIONS, 2010
("Draft Companies Regulations 2010")

Chapter 1 - General Provisions

Part A – Interpretation

1.

Short title

Authority: s. 223 (1)(d)(ii)

These Regulations may be cited as the Companies Regulations, 2010.

2.

Definitions

Authority: s. 223 (1)(d)(ii)

In these Regulations, unless the context indicates otherwise

...

(c) “**initiating document**”, depending on the context, means –

- (i) an application submitted to a regulatory agency;
- (ii) a complaint submitted to the Commission or the Panel;
- (iii) a Complaint Referral by the Commission to the Tribunal; or
- (iv) a Complaint referral directly by a complainant to the Tribunal;

...

(i) “**Regulation**” includes any Table or Form included within or referred to in a Regulation;

- (j) “**regulatory agency**” means the Commission, the Panel, the Tribunal or the Board;
- (l) “**the Act**” means the Companies Act, 2008 (Act No. 71 of 2008), as amended from time to time; and

...

3.

Interpretation

Authority: s. 223 (1)(d)(ii)

(1) In these Regulations

- (a) a reference to a section by number refers to the corresponding section of the Act;
- (b) a reference to a Regulation by number refers to the corresponding provision of these Regulations; and
- (c) a reference to a sub-regulation or other partial Regulation by number refers to the corresponding clause of the Regulation in which the reference appears.
- (2) A word or expression that is defined in section 1, or elsewhere in the Act to the extent applicable in particular circumstances, bears the same meaning in these Regulations as in the Act.

...

Part B – Guidelines, Practice Notes, Forms, Notices and other documents

...

Part C – Transparency, accountability and integrity of companies

...

28.

Financial Reporting Standards

Authority: s. 29(4)

(1) In this Regulation,

- (a) “**IFRS**” means the International Financial Reporting Standards as adopted from time to time by the International Accounting Standards Board or its successor body and approved for use in South Africa from time to time by the Council; and

(b) “**IFRS for SMEs**” means the International Financial Reporting Standards for Small and Medium Enterprises, as adopted from time to time by the International Accounting Standards Board or its successor body and approved for use in South Africa from time to time by the Council.

(2) For any particular company, any financial statements contemplated in section 28 or 29 must comply with the applicable standards for that category of company as follows:

State owned and Profit companies

State owned companies.

IFRS, but in the case of any conflict with any requirements in terms of the Public Finance Management Act, the Public Audit Act, or other applicable national legislation, the latter prevails.

Public companies listed on an exchange.

IFRS, but in the case of any conflict with the applicable listing requirements of the relevant exchange, the latter prevails.

Public companies not listed on an exchange.

IFRS

Profit companies, other than public companies, that are required in terms of Regulation 29 (1)(a) to have their annual financial statements audited.

IFRS

Profit companies that are required in terms of Regulation 30(2)(b) to have their annual financial statements independently reviewed.

IFRS for SMEs

Profit companies that are (a) required in terms of Regulation 30(2)(a) to have their annual financial statements independently compiled and reported, or (b) exempted from having their annual financial statements audited or reviewed.

There is no prescribed Financial Reporting Standard.

Non-Profit Companies

Non Profit Companies that are required in terms of Regulation 29(1)(a) to have their annual financial statements audited.

IFRS, but in the case of any conflict with any requirements in terms of the Public Finance Management Act, the Public Audit Act, or other applicable national legislation, the latter prevails.

Non profit companies that are required in terms of Regulation 29(1)(b) to have their annual financial statements audited.

IFRS

Non profit companies that are required in terms of Regulation 30(2)(b) to have their annual financial statements independently reviewed.

IFRS for SMEs

Non profit companies that are required in terms of Regulation 30(2)(a) to have their annual financial statements independently compiled and reported.

There is no prescribed Financial Reporting Standard.

29.

Categories of companies required to be audited

Authority: s. 30 (2), read with 30 (7)

(1) In addition to public companies and state owned companies, a company that falls within any of the following categories with respect to any particular financial year must have its annual financial statements for that financial year audited:

(a) Any profit or non-profit company if, in the ordinary course of its activities, it holds assets in a fiduciary capacity for a broad group of persons who are not related to the company, whether it does so –

(i) as its primary activity; or

(ii) incidental to its primary activity in any manner contemplated in terms of section 65 (2) of the Consumer Protection Act, 2008.

(b) Any non-profit company, if it –

(i) was incorporated

(aa) directly or indirectly by the state, an organ of state, a state-owned company, an international entity, a foreign state entity or a foreign company; or

(bb) primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direct or indirect initiation or direction of an organ of the state, a state-owned company, an international entity, or a foreign state entity; or

(ii) it solicits or accepts donations from the general public and –

(aa) its assets, as reported on its annual financial statement for the immediately preceding year, exceeded R 60 Million; or

(bb) its current expenditures, as reported on its annual financial statement for the immediately preceding year, exceeded R120 million.

(c) Any profit or non-profit company that is subject to a compliance notice, in accordance with Regulation 32 (5)(b)(ii), requiring it to have its annual financial statement for that particular year audited.

(2) Nothing in this regulation precludes a company

- (a) that is required to prepare its financial statements to the standards of IFRS for SMEs from preparing its financial statements to the standards of IFRS instead; or
- (b) that is not subject to any prescribed standards from preparing its financial statements to the standards of either IFRS or IFRS for SMEs.

30.

Independent reviews of annual financial statements

Authority: s. 30 (7)

(1) This Regulation applies to any company that, with respect to any particular financial year, is neither –

- (a) required, in terms of the Act or Regulation 29, to have its annual financial statements for that financial year audited; or
- (b) exempted, in terms of section 30(2)(b)(ii), read with Regulation 31, from any requirement to have its annual financial statements for that year audited or reviewed.

(2) Unless it is required by its Memorandum of Incorporation, or chooses voluntarily, to have its annual financial statements audited, a company to which this regulation applies must have its annual financial statements for a particular financial year

(a) independently compiled and reported if, on its annual financial statement for the immediately preceding year, –

- (i) it reported assets totalling less than R 5 million; and
- (ii) it reported annual revenue, from its business activities in the case of a profit company, or from donations, grants, membership fees and business activities in the case of a non-profit company, of less than R 20 million; or

(b) reviewed by an independent accounting professional

(i) in accordance with the requirements of ISRE 2400, if –

- (aa) the company's assets, as reported on its annual financial statements for the three immediately preceding financial years, averaged at least R100 million; or
- (bb) the turnover of the company as calculated in accordance with Regulation 175, and as reported on its annual financial statements for the three immediately preceding financial years, averaged at least R200 million; or

(ii) in any other case, in accordance with the requirements of ISRS 4400, as promulgated from time to time.

(3) For the purposes of this regulation

(a) If a company has been existence for a shorter time than contemplated in sub-regulation (2)(b), the calculation of the company's average assets and turnover must be

made on the basis of the number of previous financial years for which the company has produced annual financial statements;

(b) “ISRE 2400” means the International Standards for Review Engagements, as promulgated from time to time;

(c) “ISRS 4400” means the International Standards for Independent Reviews, as promulgated from time to time;

(d) “independent accounting professional” when used with respect to any particular company, means a person who

(i) is a member in good standing of a professional body that is a member of the International Federation of Accountants; and

(ii) does not have a personal financial interest in the company or a related or inter-related company; and

(iii) is not

(aa) involved in the day to day management of the company’s business nor has been so involved at any time during the previous three financial years;

(bb) a prescribed officer, or full-time executive employee, of the company or another related or inter-related company, or have been such an officer or employee at any time during the previous three financial years; or

(cc) a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that professional is compromised by that relationship; and

(iv) is not related to any person who falls within any of the criteria set out in clause (ii) or (iii).

(e) “**independently compiled and reported**” means that the annual financial statements are prepared

(i) by an independent accounting professional;

(ii) on the basis of financial records provided by the company; and

(iii) in accordance with any relevant financial reporting standards.

(4) Section 90 (3), 92, and 93 (1) and (2), each read with the changes required by the context, applies to the conduct of an independent review in terms of this regulation and, for greater certainty, for all purposes of this regulation, a reference in any of those sections to an auditor must be regarded as referring to an independent accounting professional.

31.

General exemption from audit and review

Authority: s. 30 (2)(b)(ii), read with s. 223

(1) Subject to any contrary requirement set out in its Memorandum of Incorporation, or to a compliance notice issued in terms of Regulation 32 (5)(b)(ii), a profit company that falls within the category of companies contemplated in section 30 (2)(b)(ii)(aa) or (bb) is unconditionally exempted in terms of the Act from the requirement to have its annual financial statement either audited or independently reviewed.

(2) For greater certainty, nothing in section 30 (2)(b)(ii)(aa) or (bb), or sub-regulation (1), is to be construed as relieving a company of any obligation arising in terms any law other than this Act, a court order, or an agreement to which the company is a party, to have its annual financial statements audited or reviewed.

32.

Company annual returns

Authority: s.33

(1) If a company's financial year end coincides with the anniversary date of its incorporation, the company must file its annual return in Form CoR 32.1 within 20 business days after the company's board approves its annual financial statements in terms of section 30 (3)(c).

(2) If a company's financial year end does not coincide with the anniversary date of its incorporation

(a) the company must file its annual return in Form CoR 32.1 within 20 business days after the anniversary date of its incorporation; and

(b) if, in terms of section 33 (1)(a) or sub-regulation (3), the company is required to file a copy of its annual financial statements in conjunction with its annual return, that requirement will be satisfied if the company files its next ensuing annual financial statements within 20 business days after the company's board approves those annual financial statements in terms of section 30 (3)(c).

(3) A company that is –

(a) required in terms of Regulation 29 to have its annual financial statements audited in a particular year, must file a copy of those statements as a supplement to its annual return, in accordance with sub-regulation (1) or (2) as applicable; or

(b) not required in terms of the Act or Regulation 29 to have its annual financial statements audited in a particular year, but has nevertheless voluntarily had those statements audited must, at the option of the company, either

(i) file a copy of those audited statements as a supplement to its annual return in accordance with sub-regulation (1) or (2) as applicable; or

(ii) file a financial accountability supplement to its annual return in the relevant form as set out in sub-regulation (4); or

(c) not required in terms of the Act or Regulation 29 to have its annual financial statements audited in a particular year, and has not voluntarily had those statements audited, must file a financial accountability supplement to its annual return in the relevant form as set out in sub-regulation (4).

(4) A company that elects or is required to file a financial accountability supplement to its annual return must file it with the annual return in

- (a) Form CoR 32.2 if the company is exempted from any audit or review requirement as contemplated in Regulation 31;
- (b) Form CoR 32.3 if the company is a non profit company that was required only to have its annual financial statements independently compiled and reported, as contemplated in Regulation 30 (2)(a);
- (c) Form CoR 32.4 if the company was required to have its annual financial statement independently reviewed, as contemplated in Regulation 30 (2)(b).

(5) The Commission

(a) must establish a systematic procedure to select and review a sampling of financial accountability supplements that have been filed in terms of this regulation, with the objects of –

- (i) monitoring compliance with the financial record keeping and financial reporting provisions of the Act; and
- (ii) identifying companies whose annual financial statements for a particular year should be audited; and

(b) may issue a compliance notice to any such company either –

- (i) setting out changes that are required to the company's practices to better comply with the financial record keeping and financial reporting provisions of the Act; or
- (ii) requiring the company to have its most recent annual financial statements audited on the grounds that the activities of the company during the previous year raise a reasonable apprehension of potentially adverse consequences to the public, which cannot be dispelled without such an audit being performed.

(6) A compliance notice issued in terms of this regulation is subject to every provision of the Act respecting compliance notices.

(7) An external company must file its annual return in Form CoR 32.5 within 20 business days after the anniversary date of its registration as an external company.

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Chapter 7 - Complaints, Applications and Tribunal Hearings

Part A – Definitions Used in This Chapter

Definitions

In this Chapter, unless the context indicates otherwise –

- (a) “**Answer**” means a document as described in Regulation 148 and filed by a respondent;
- (b) “**applicant**” means a person who submits an application to the Tribunal in terms of Act or this Chapter;
- (c) “**Application**” means a request submitted to the Tribunal in terms of the Act or these Regulations;
- (d) “**complaint**” means
 - (i) a matter that has been submitted to the Commission in terms of section 168 (1)(b);
 - (ii) a matter initiated by the Commission in terms of section 168 (2); or
 - (iii) a matter that the Minister has directed the Commission to investigate, in terms of section 168 (3).
- (e) “**Complaint Referral**” means an initiating document as described in Regulation 149 for the purposes contemplated in section 170 (1)(b);
- (f) “**Dispute Referral**” means an initiating document as described in Regulation 138 for the purposes of referring a dispute for alternative resolution to the Tribunal or an accredited entity, as contemplated in section 166 (1);
- (g) “**initiating document**”, depending on the context, means either an Application, Complaint Referral, or a Dispute Referral;
- (h) “**initiating party**”, depending on the context, means
 - (i) in the case of a Complaint Referral, the Commission, or other person referred to in Regulation 149;
 - (ii) in the case of a Dispute Referral, the person who referred the matter to the Tribunal or accredited entity in terms of section 166 (1), read with Regulation 138;
 - (iii) in any other proceedings, the Applicant;
- ...
- (l) “**Reply**” means a document as described in Regulation 152 and filed by a respondent;
- (m) “**respondent**”, when used in respect of
 - (i) an application to review a notice issued by, or a decision of, the Commission, means
 - (aa) the Commission, and
 - (bb) the person concerned, if that person is not the applicant;
 - (ii) any other application, means the person against whom the relief is sought;
 - (iii) a Complaint Referral, means the person against whom that complaint has been initiated; or
 - (iv) a Dispute Referral, means any party to the dispute other than the initiating party;

(n) “**sheriff**” means a person appointed in terms of section 2 of the Sheriff’s Act, 1986 (Act 90 of 1986), and includes a person appointed in terms of section 5 and section 6 of that Act as an acting sheriff and a deputy sheriff, respectively.

137.

Accreditation of alternative dispute resolution providers

Authority s. 166(4)(a)(iii) and (5)

(1) An application for accreditation as an alternative resolution dispute provider must be made to the Commission in Form CoR 137.1.

(2) A notice accrediting an entity as an alternative dispute resolution provider must be in form CoR 137.2.

138.

Alternative dispute resolution procedures

(1) A person may refer a matter for alternative dispute resolution to the Tribunal or to an accredited entity, as contemplated in section 166 (1) by filing a completed Form CTR 99.1 with the Tribunal or accredited entity.

(2) A Certificate of Failed Dispute Resolution, as contemplated in section 166 (2), must be in Form CTR 138.2.

(3) A consent order, as contemplated in section 167, must be set out in a form satisfactory to the High Court, in terms of its rules.

Part C – Commission Complaint and Investigation Procedures

139.

Receipt and filing of complaints

(1) A complaint to the Commission must be in form 139.1.

(2) A notice of non-investigation by the Commission must be in Form 139.2.

(3) A notice of referral by the Commission of a matter to alternative dispute resolution, must be in Form 139.3.

140.

Withdrawal of complaints

(1) At any time before the Commission has referred a complaint to the Tribunal, the complainant may withdraw the complaint.

(2) The Commission may continue to investigate a complaint after it has been withdrawn, as if the Commission had initiated it.

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142.

Consent orders

(1) If, at any time before issuing a Notice of Non-referral of a complaint, or referring a complaint to the Tribunal, it appears to the Commission that the respondent may be prepared to agree terms of a proposed order, the Commission –

(a) must notify the complainant, in writing, that a consent order may be recommended to the Tribunal; and

(b) invite the complainant to inform the Commission in writing within 10 business days after receiving that notice –

(i) whether the complainant is prepared to accept damages under such an order; and

(ii) if so, the amount of damages claimed.

(2) If the Commission and the respondent agree the terms of an appropriate order, the Commission must –

(a) refer the complaint to the Tribunal in form CoR 142.1;

(b) attach to the referral

(i) a draft order in Form CTR 142.2

(aa) setting out each section of the Act or of a company's Memorandum of Incorporation or Rules that has been contravened;

(bb) setting out the terms agreed between the Commission and the respondent, including, if applicable, the amount of damages agreed between the respondent and the complainant; and

(cc) signed by the Commission and the respondent indicating their consent to the draft order; and

(ii) a Consent to Order in form CoR 142.3, completed by the complainant, if applicable; and

(c) serve a copy of the referral and draft order on the respondent and the complainant.

(3) The Commission must not include an order of damages in a draft consent order unless it is supported by a completed Consent to Damages, in form CoR 142.4.

(4) A draft consent order may be submitted to the Tribunal in terms of section 173 and this Rule notwithstanding the refusal by a complainant to consent to including an award of damages in that draft order.

143.**Commission investigations**

- (1) A notice to investigate issued by the Commission in terms of section 169 (1)(c) must be in Form 143.1
- (2) A summons issued by the Commission in terms of section. 176 (1) must be in Form CoR 143.2.

144.**Request for additional information**

- (1) At any time during an investigation, the Commission may
 - (a) informally request additional information from a party; and
 - (b) require a party to provide additional information, at any time, by delivering to the party a demand in Form 144.1, setting out the specific information that the Commission requires.
- (2) If, at any time, the Commission has reasonable grounds to believe that a document filed in respect of a investigation contains false or misleading information, the Commission may issue a Demand for Corrected Information in Form 144.2 to the person that filed that document.
- (3) Within 5 business days after being served with a Demand for Corrected Information, the person concerned may appeal to the Tribunal for an order confirming or setting aside the Demand.
- (4) If a person does not appeal a Demand for Corrected Information within the time allowed by sub-regulation (1), or if the Tribunal, on hearing the appeal, confirms the demand in whole or in part the person concerned must file corrected information.
- (5) If the Tribunal, on hearing an application in terms of sub-regulation (2), sets aside the Demand entirely, the Demand is a nullity.

145.**Procedures following investigation**

- (1) A Notice of Non-referral issued by the Commission must be in Form CoR 145.1.
- (2) A Referral of Complaint to the Tribunal in terms of section 170 (1)(b) must be in Form CoR 145.2.

146.**Compliance Notices and certificates**

- (1) A Compliance Notice issued by the Commission in terms of section 171 must be in Form CoR 146.1.
- (2) A Compliance Certificate issued by the Commission must be in Form CoR 146.2.

147.**Initiating applications**

- (1) A person may apply to the Tribunal for an order in respect of any matter contemplated by the Act or these Regulations by completing and filing with the Tribunal's recording officer –
 - (a) an Application in Form CTR 147; and
 - (b) a supporting affidavit setting out the facts on which the application is based.
- (2) The applicant must serve a copy of the application and affidavit on each respondent named in the application, within 5 business days after filing it.
- (3) An application in terms of this Regulation must
 - (a) indicate the basis of the application; or
 - (b) depending on the context
 - (i) set out the Commission's decision that is being appealed or reviewed;
 - (ii) set out the decision of the Tribunal that the applicant seeks to have varied or rescinded;
 - (iii) set out the regulation in respect of which the applicant seeks condonation;
 - (c) indicate the order sought; and
 - (d) state the name and address of each person in respect of whom an order is sought.

148.**Answering and Replying affidavits**

- (1) Within 10 business days after being served with an application for any relief other than condonation, a respondent against whom an order is sought -
 - (a) may serve an answering affidavit on the applicant, and on any other person against whom the order is sought; and
 - (b) must file the affidavit with proof of service.
- (2) Within 10 business days after being served with an answering affidavit that raises issues not addressed in the application or its supporting affidavit, the applicant may -
 - (a) serve a replying affidavit on the respondent, the Commission and on any other person against whom the order is sought; and
 - (b) file a copy of the Replying affidavit and proof of service.

149.

Initiating complaint proceedings

(1) A Complaint Referral may be filed

(a) by the Commission; or

(b) by a complainant in Form CTR 149 within 20 business days after the Commission has issued, or has been deemed to have issued, a Notice of non-referral to that complainant.

(2) If, in respect of a particular matter, more than one person files a Complaint Referral in terms of sub-regulation (1)(b), the recording officer must combine those referrals under a common case number.

(3) The person who files a Complaint Referral must serve a copy of it within 3 business days after filing on

(a) The respondent;

(b) The Commission, if the Commission did not file the Referral; and

(c) On each other person who has previously filed a Complaint Referral in that matter.

150.

Form of Complaint Referral

(1) A complaint proceeding may be initiated only by filing a Complaint Referral in the prescribed form

(2) A Complaint Referral must be supported by an affidavit setting out in numbered paragraphs -

(a) a concise statement of the particulars of the complaint; and

(b) the points of law, or material facts relevant to the complaint and relied on by the respondent.

(3) A Complaint Referral may allege alternative prohibited practices based on the same facts.

151.

Answer

(1) Within 20 business days after being served with a Complaint Referral filed by the Commission, a respondent who wishes to oppose the Complaint Referral must -

(a) serve a copy of their Answer on the Commission; and

(b) file the Answer with proof of service.

(2) Within 20 business days after being served with a Complaint Referral filed by a person other than the Commission, a respondent who wishes to oppose the Complaint Referral must -

- (a) serve a copy of their Answer on the Commission, on the person who filed the Referral, and on each other person who has previously filed a Complaint Referral in that matter; and
 - (b) subject to sub-regulation (4), file the Answer with proof of service.
- (3) An Answer that raises only a point of law must set out the question of law to be resolved.
- (4) Any other Answer must be in affidavit form, setting out in numbered paragraphs
- (a) a concise statement of the grounds on which the Complaint is opposed;
 - (b) the material facts or points of law on which the respondent relies; and
 - (c) an admission or denial of each ground and of each material fact relevant to each ground set out in the Complaint Referral.
- (5) An allegation of fact set out in the Complaint Referral that is not specifically denied or admitted in an Answer will be deemed to have been admitted.
- (6) In an answer, the respondent must qualify or explain a denial of an allegation, if necessary in the circumstances.

152.

Reply

- (1) Within 15 business days after being served with an Answer that raises issues not addressed in the Complaint Referral, other than a point of law alone, the person who filed the Complaint Referral may -
- (a) serve a Reply on the respondent and the Commission, if the Commission did not file the Referral, and on each other person who filed a Complaint Referral in the matter; and
 - (b) file a copy of the Reply and proof of service.
- (2) A Reply must be in affidavit form, setting out in numbered paragraphs -
- (a) an admission or denial of each new ground or material fact raised in the Answer; and
 - (b) the position of the replying party on any point of law raised in the Answer.
- (3) If a person who filed a Complaint Referral does not file a Reply, they will be deemed to have denied each new issue raised in the Answer, and each allegation of fact relevant to each of those issues.

Part E - Tribunal Proceedings

153.

Amending documents

(1) The person who filed a Complaint Referral may apply to the Tribunal by Notice of Motion in form CTR 153 at any time before the end of the hearing of that complaint for an order authorising them to amend their complaint referral as filed.

(2) If the Tribunal allows the amendment, it must allow any other party affected by the amendment to file additional documents consequential to those amendments within a time period allowed by the Tribunal.

154.

Completion of file

Subject to any order made by the Tribunal, the filing of documents is complete when a Complaint Referral or Answer has not been responded to within the time allowed.

155.

Late filing, extension and reduction of time

(1) A party to any matter may apply to the Tribunal to condone late filing of a document, or to request an extension or reduction of the time for filing a document, by filing a request in form CTR 155.

(2) Upon receiving a request in terms of sub-regulation (1), the recording officer, after consulting the parties to the matter, must set the matter down for hearing in terms of section 31(5) at the earliest convenient date.

156.

Pre-hearing conferences

(1) Before, or within 20 business days after, the filing of documents is completed, a member of the Tribunal assigned by the Chairperson may convene a pre-hearing conference on a date and at a time determined by that member with -

- (a) the Commission;
- (b) each complainant who has filed a Complaint Referral;
- (c) intervenors; and
- (d) the Respondent.

(2) If a point of law has been raised, and it appears to the assigned member of the Tribunal at a pre-hearing conference to be practical to resolve that question before proceeding with the Conference, the member may -

- (a) direct the recording officer to set only that question down for hearing by the Tribunal; and
- (b) may adjourn the pre-hearing conference pending the resolution of that question by the Tribunal, and the Court, if applicable.

(3) The assigned member of the Tribunal may adjourn a pre-hearing conference from time to time.

(4) Pre-hearing conferences may be conducted in person or by telephone or both, need not follow formal Regulations of procedure, and are not open to the public.

157.

Other powers of member at pre-hearing conference

(1) At a pre-hearing conference, the assigned member of the Tribunal may -

(a) establish procedures for protecting confidential information, including the terms under which participants may have access to that information;

(b) direct the Commission to investigate specific issues or obtain certain evidence; or

(c) give directions in respect of

(i) technical or formal amendments to correct errors in any documents filed in the matter;

(ii) any pending Notices of Motion;

(iii) clarifying and simplifying the issues;

(iv) obtaining admissions of particular facts or documents;

(v) the production and discovery of documents whether formal or informal;

(vi) witnesses to be called by the Tribunal at the hearing, the questioning of witnesses and the language in which each witness will testify;

(vii) a timetable for

(aa) the exchange of summaries of expert opinions or other evidence that will be presented at the hearing; and

(bb) any other pre-hearing obligations of the parties;

(viii) determine the procedure to be followed at the hearing, and its expected duration;

(ix) a date, time and schedule for the hearing; or

(x) any other matters that may aid in resolving the complaint.

(2) At a pre-hearing conference, the assigned member of the Tribunal may require each participant to submit at a date to be determined, but before the hearing, a written statement summarising its argument, if any, with respect to the complaint, and identifying what it believes are the major unresolved issues.

(3) After concluding a pre-hearing conference, the assigned member of the Tribunal must issue an order recording any agreements or rulings arising from matters considered at the pre-hearing conference.

(4) A member of the Tribunal assigned by the Chairperson may schedule a further pre-hearing conference on their own motion, and the provisions of this rule apply to such a conference.

158.

Settlement conference

At any time before the Tribunal makes a final order in a complaint proceeding, the Tribunal, on its own initiative or at the request of the participants, may order an adjournment of the proceedings to allow the participants to attempt to reach agreement on any outstanding issue.

159.

Initiating consent hearings

(1) If a Complaint Referral is to be proceeded with by way of a consent order

(a) Regulations 150 to 158 inclusive, do not apply to the Complaint Referral; and

(b) the person filing the Complaint Referral must attach the following documents to it:

(i) a Notice of Motion in form CTR 153, for a consent order to be made;

(ii) a copy of each consent to order filed with the Commission in respect of the matter, if any; and

(iii) a draft order in the terms agreed, signed by the Commission and the respondent indicating their consent to the order.

(2) At any time before the Tribunal makes a final order in a complaint proceeding, a party may request the Tribunal to make a consent order by filing a Notice of Motion in form CTR 153 with the documents listed in sub-regulation (1)(b).

(3) A party intending to file a Notice of Motion in terms of sub-regulation (3) –

(a) must notify each complainant, in writing, that a consent order may be proposed to the Tribunal; and

(b) invite the complainant to inform the Commission in writing within 5 business days after receiving that notice –

(i) whether the complainant is prepared to accept damages under such an order; and

(ii) if so, the amount of damages claimed.

(4) A draft order filed in terms of this Rule must meet the requirements set out in Regulation 160, read with the changes required by context.

160.

Consent hearings

- (1) Upon receiving a draft consent order, the recording officer must convene a hearing of the Tribunal at the earliest possible date.
- (2) If the Tribunal refuses to make a consent order as requested, or requires any changes that a party is unwilling to accept
 - (a) The Commission or other complainant, as the case may be, may, as of right, amend the Referral and statement of particulars;
 - (b) The recording officer must serve each party, and complainant, if applicable, with -
 - (i) a notice that the motion for a consent order has been denied; and
 - (ii) a copy of the Complaint Referral and statement of particulars, in their original or amended form, as applicable;
 - (c) the Tribunal must proceed to consider the complaint in accordance with these Regulations as they apply to contested complaints generally, after -
 - (i) the time for an appeal from the decision of the Tribunal in terms of sub-regulation (2) has expired; or
 - (ii) if an appeal has been noted from that decision, after the Court has decided that appeal; and
 - (d) none of the members of the Tribunal who considered the motion for the consent order may participate in any further proceedings relating to that complaint.

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164.

Summoning witnesses

- (1) If the Tribunal requires a witness to attend any proceedings to give evidence it may have a summons issued by the recording officer in form CTR 164 for that purpose.
- (2) If a witness is required to produce in evidence any document or thing in the witness's possession, the summons must specify the document or thing to be produced.
- (3) After the summons has been issued, it must be served by the sheriff in any manner authorised by Rule 4 of the High Court Regulations.
- (4) A witness who has been required to produce any document or thing at the proceedings must hand it over to the recording officer as soon as possible after service of the summons, unless the witness claims that the document or thing is privileged.

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167.

Withdrawals and postponements

- (1) At any time before the Tribunal has determined a matter, the initiating party may withdraw all or part of the matter by
 - (a) serving a Notice of Withdrawal in form CTR 167 on each party; and
 - (b) filing the Notice of Withdrawal with proof of service.
- (2) If the parties agree to postpone a hearing, the initiating party must notify the recording officer as soon as possible.
- (3) Subject to any provision of the Act to the contrary,
 - (a) a Notice of Withdrawal may include a consent to pay costs; and
 - (b) if no consent to pay costs is contained in a Notice of Withdrawal the other party may apply to the Tribunal by Notice of Motion in form CTR 153 for an appropriate order for costs.

168.

Set down of matters

- (1) If a matter has been postponed to a date to be determined in the future, any party to the matter may apply to the recording officer for it to be re-enrolled, but no preference may be given to that matter on the roll, unless the Chairperson decides otherwise.
- (2) The recording officer must allocate a time, date and place for the hearing and send a Notice of Hearing in form CTR 168 to each party.
- (3) If a matter is postponed to a specific date, the recording officer need not send a Notice of Set Down to the parties.

169.

Matters struck-off

- (1) The Tribunal member presiding at a hearing may strike a matter off the Roll if the initiating party is not present.
- (2) If a matter is struck off the roll, the matter may not be re-enrolled unless
 - (a) that party concerned files an affidavit setting out a satisfactory explanation for the failure to attend the hearing; and
 - (b) a member of the Tribunal assigned by the Chairperson, on considering the explanation offered, orders the matter to be re-enrolled.

170.

Default orders

- (1) If a person served with an initiating document has not filed a response within the prescribed period, the initiating party may apply in accordance with Part 4 – Division E to have the order sought issued against that person by the Tribunal.
- (2) On an application in terms of sub-regulation (1), the Tribunal may make an appropriate order
 - (a) after it has heard any required evidence concerning the motion; and
 - (b) if it is satisfied that the notice or application was adequately served.
- (3) Upon an order being made in terms of sub-regulation (2), the recording officer must serve the order on the person described in subsection (1) and on every other party.

171.

Conduct of hearings

- (1) If, in the course of proceedings, a person is uncertain as to the practice and procedure to be followed, the member of the Tribunal presiding over a matter
 - (a) may give directions on how to proceed; and
 - (b) for that purpose, if a question arises as to the practice or procedure to be followed in cases not provided for by these Regulations, the member may have regard to the High Court Regulations.
- (2) Subject to these Regulations, the member of the Tribunal presiding over a matter may determine the time and place for the hearing before the Tribunal.
- (3) The Tribunal may condone any technical irregularities arising in any of its proceedings.

172.

Record of hearing

The recording officer must compile a record of any proceeding in which a hearing has been held, including

- (a) The initiating document;
- (b) the notice of any hearing;
- (c) any interlocutory orders made by the Tribunal or a member;
- (d) all documentary evidence filed with the Tribunal;
- (e) the transcript, if any, of the oral evidence given at the hearing; and
- (f) the final decision of the Tribunal and the reasons.

...

Part F – Maximum Administrative Fines and Determination of Turnover

174.

Maximum administrative fines

The maximum administrative fine, as contemplated in section 175 (5), is R 1 million.

175.

Manner of calculating turnover

For all purposes of the Act, the turnover of a company must be calculated in the manner set out in General Notice 253 of 2001 promulgated in terms of section 6 (1) of the Competition Act, 1998.

...

["Treaty on European Union" ('TEU')]

European Union

Consolidated version of the Treaty on European Union and of the Treaty establishing the European Community as at 29 December 2006

OJ C 321 E/2

INTRODUCTORY NOTE

This publication contains the *Treaty on European Union* and the consolidated version of the *Treaty establishing the European Community*, incorporating the amendments made by the Treaty of Athens, signed on 16 April 2003. It also reproduces all the Protocols annexed to those Treaties, as amended by the 2003 Act of Accession.

This text has been produced for documentary purposes and does not involve the responsibility of the institutions.

THE TREATY ON EUROPEAN UNION

OJ C 321 E/7

TITLE I

COMMON PROVISIONS

...

Article 5

The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty.

...

Article 14

1. The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992, in accordance with the provisions of this Article and of Articles 15, 26, 47(2), 49, 80, 93 and 95 and without prejudice to the other provisions of this Treaty.

2. The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty.

3. The Council, acting by a qualified majority on a proposal from the Commission, shall determine the guidelines and conditions necessary to ensure balanced progress in all the sectors concerned.

...

CHAPTER 3 APPROXIMATION OF LAWS

...

Article 95

1. By way of derogation from Article 94 and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 14. The Council shall, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

...

PART FIVE: INSTITUTIONS OF THE COMMUNITY

TITLE I PROVISIONS GOVERNING THE INSTITUTIONS

CHAPTER 1 THE INSTITUTIONS

...

SECTION 2 THE COUNCIL

Article 202

To ensure that the objectives set out in this Treaty are attained the Council shall, in accordance with the provisions of this Treaty:

- ensure coordination of the general economic policies of the Member States,
- have power to take decisions,
- confer on the Commission, in the acts which the Council adopts, powers for the implementation of the rules which the Council lays down. The Council may impose certain requirements in respect of the exercise of these powers. The Council may also reserve the right, in specific cases, to exercise directly implementing powers itself. The procedures referred to above must be consonant with principles and rules to be laid down in advance by the Council, acting unanimously on a proposal from the Commission and after obtaining the opinion of the European Parliament.

...

SECTION 4 THE COURT OF JUSTICE

Article 220

The Court of Justice and the Court of First Instance, each within its jurisdiction, shall ensure that in the interpretation and application of this Treaty the law is observed.

In addition, judicial panels may be attached to the Court of First Instance under the conditions laid down in Article 225a in order to exercise, in certain specific areas, the judicial competence laid down in this Treaty.

...

Article 222

The Court of Justice shall be assisted by eight Advocates-General. Should the Court of Justice so request, the Council, acting unanimously, may increase the number of Advocates-General.

It shall be the duty of the Advocate-General, acting with complete impartiality and independence, to make, in open court, reasoned submissions on cases which, in accordance with the Statute of the Court of Justice, require his involvement.

...

Article 230

The Court of Justice shall review the legality of acts adopted jointly by the European Parliament and the Council, of acts of the Council, of the Commission and of the ECB, other than recommendations and opinions, and of acts of the European Parliament intended to produce legal effects vis-à-vis third parties.

It shall for this purpose have jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission on grounds of lack of competence, infringement of an essential procedural requirement, infringement of this Treaty or of any rule of law relating to its application, or misuse of powers.

The Court of Justice shall have jurisdiction under the same conditions in actions brought by the Court of Auditors and by the ECB for the purpose of protecting their prerogatives.

Any natural or legal person may, under the same conditions, institute proceedings against a decision addressed to that person or against a decision which, although in the form of a regulation or a decision addressed to another person, is of direct and individual concern to the former.

The proceedings provided for in this Article shall be instituted within two months of the publication of the measure, or of its notification to the plaintiff, or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

Article 231

If the action is well founded, the Court of Justice shall declare the act concerned to be void.

In the case of a regulation, however, the Court of Justice shall, if it considers this necessary, state which of the effects of the regulation which it has declared void shall be considered as definitive.

...

Article 234

The Court of Justice shall have jurisdiction to give preliminary rulings concerning:

- (a) the interpretation of this Treaty;
- (b) the validity and interpretation of acts of the institutions of the Community and of the ECB;
- (c) the interpretation of the statutes of bodies established by an act of the Council, where those statutes so provide.

Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court of Justice to give a ruling thereon.

Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court of Justice.

...

Article 241

Notwithstanding the expiry of the period laid down in the fifth paragraph of Article 230, any party may, in proceedings in which a regulation adopted jointly by the European Parliament and the Council, or a regulation of the Council, of the Commission, or of the ECB is at issue, plead the grounds specified in the second paragraph of Article 230 in order to invoke before the Court of Justice the inapplicability of that regulation.

...

CHAPTER 2 PROVISIONS COMMON TO SEVERAL INSTITUTIONS

Article 249

In order to carry out their task and in accordance with the provisions of this Treaty, the European Parliament acting jointly with the Council, the Council and the Commission shall make regulations and issue directives, take decisions, make recommendations or deliver opinions.

A *regulation* shall have general application. It shall be binding in its entirety and directly applicable in all Member States.

A *directive* shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.

A *decision* shall be binding in its entirety upon those to whom it is addressed.

Recommendations and opinions shall have no binding force.

Article 250

1. Where, in pursuance of this Treaty, the Council acts on a proposal from the Commission, unanimity shall be required for an act constituting an amendment to that proposal, subject to Article 251(4) and (5).

2. As long as the Council has not acted, the Commission may alter its proposal at any time during the procedures leading to the adoption of a Community act.

Article 251

1. Where reference is made in this Treaty to this Article for the adoption of an act, the following procedure shall apply.

2. The Commission shall submit a proposal to the European Parliament and the Council.

The Council, acting by a qualified majority after obtaining the opinion of the European Parliament:

— if it approves all the amendments contained in the European Parliament's opinion, may adopt the proposed act thus amended,

— if the European Parliament does not propose any amendments, may adopt the proposed act,

— shall otherwise adopt a common position and communicate it to the European Parliament.

The Council shall inform the European Parliament fully of the reasons which led it to adopt its common position. The Commission shall inform the European Parliament fully of its position.

If, within three months of such communication, the European Parliament:

(a) approves the common position or has not taken a decision, the act in question shall be deemed to have been adopted in accordance with that common position;

(b) rejects, by an absolute majority of its component members, the common position, the proposed act shall be deemed not to have been adopted;

(c) proposes amendments to the common position by an absolute majority of its component members, the amended text shall be forwarded to the Council and to the Commission, which shall deliver an opinion on those amendments.

3. If, within three months of the matter being referred to it, the Council, acting by a qualified majority, approves all the amendments of the European Parliament, the act in question shall be deemed to have been adopted in the form of the common position thus amended; however, the Council shall act unanimously on the amendments on which the Commission has delivered a negative opinion. If the Council does not approve all the amendments, the President of the Council, in agreement with the President of the European Parliament, shall within six weeks convene a meeting of the Conciliation Committee.

4. The Conciliation Committee, which shall be composed of the Members of the Council or their representatives and an equal number of representatives of the European Parliament, shall have the task of reaching agreement on a joint text, by a qualified majority of the Members of the Council or their representatives and by a majority of the representatives of the European Parliament. The Commission shall take part in the Conciliation Committee's proceedings and shall take all the necessary initiatives with a view to reconciling the positions of the European Parliament and the Council. In fulfilling this task, the Conciliation Committee shall address the common position on the basis of the amendments proposed by the European Parliament.

5. If, within six weeks of its being convened, the Conciliation Committee approves a joint text, the European Parliament, acting by an absolute majority of the votes cast, and the Council, acting by a qualified majority, shall each have a period of six weeks from that approval in which to adopt the act in question in accordance with the joint text. If either of the two institutions fails to approve the proposed act within that period, it shall be deemed not to have been adopted.

6. Where the Conciliation Committee does not approve a joint text, the proposed act shall be deemed not to have been adopted.

7. The periods of three months and six weeks referred to in this Article shall be extended by a maximum of one month and two weeks respectively at the initiative of the European Parliament or the Council.

...

Article 311

The protocols annexed to this Treaty by common accord of the Member States shall form an integral part thereof.

...

["Consolidated version of the Treaty on European Union" ('consTEU')]

European Union

Consolidated version of the Treaty on European Union

OJ C 115/13

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POLICY**

...

TITLE VI FINAL PROVISIONS

...

TITLE I COMMON PROVISIONS

...

Article 5 (*ex Article 5 TEU*)

1. The limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality.
2. Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.
3. Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol.

4. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties. The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality.

...

TITLE III PROVISIONS ON THE INSTITUTIONS

...

Article 16

1. The Council shall, jointly with the European Parliament, exercise legislative and budgetary functions. It shall carry out policy-making and coordinating functions as laid down in the Treaties.

2. The Council shall consist of a representative of each Member State at ministerial level, who may commit the government of the Member State in question and cast its vote.

...

TITLE VI FINAL PROVISIONS

Article 47

The Union shall have legal personality.

...

**[“Consolidated version of the Treaty on the Functioning of the European Union”]
(‘consTFEU’)**

European Union

Consolidated version of the Treaty on the Functioning of the European Union

OJ C 115/47

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PART ONE PRINCIPLES

Article 1

1. This Treaty organises the functioning of the Union and determines the areas of, delimitation of, and arrangements for exercising its competences.
2. This Treaty and the Treaty on European Union constitute the Treaties on which the Union is founded. These two Treaties, which have the same legal value, shall be referred to as ‘**the Treaties**’.

...

CHAPTER 3 APPROXIMATION OF LAWS

Article 114 (*ex Article 95 TEU*)

1. Save where otherwise provided in the Treaties, the following provisions shall apply for the achievement of the objectives set out in Article 26. The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

...

PART SIX INSTITUTIONAL AND FINANCIAL PROVISIONS

TITLE I INSTITUTIONAL PROVISIONS

CHAPTER 1 THE INSTITUTIONS

...

SECTION 5 THE COURT OF JUSTICE OF THE EUROPEAN UNION

...

Article 252 (*ex Article 222 TEU*)

The Court of Justice shall be assisted by eight Advocates-General. Should the Court of Justice so request, the Council, acting unanimously, may increase the number of Advocates-General.

It shall be the duty of the Advocate-General, acting with complete impartiality and independence, to make, in open court, reasoned submissions on cases which, in accordance with the Statute of the Court of Justice of the European Union, require his involvement.

...

Article 263 (*ex Article 230 TEU*)

The Court of Justice of the European Union shall review the legality of legislative acts, of acts of the Council, of the Commission and of the European Central Bank, other than recommendations and opinions, and of acts of the European Parliament and of the European Council intended to produce legal effects *vis-à-vis* third parties. It shall also review the legality of acts of bodies, offices or agencies of the Union intended to produce legal effects *vis-à-vis* third parties.

It shall for this purpose have jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission on grounds of lack of competence, infringement of

an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers.

The Court shall have jurisdiction under the same conditions in actions brought by the Court of Auditors, by the European Central Bank and by the Committee of the Regions for the purpose of protecting their prerogatives.

Any natural or legal person may, under the conditions laid down in the first and second paragraphs, institute proceedings against an act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures.

Acts setting up bodies, offices and agencies of the Union may lay down specific conditions and arrangements concerning actions brought by natural or legal persons against acts of these bodies, offices or agencies intended to produce legal effects in relation to them.

The proceedings provided for in this Article shall be instituted within two months of the publication of the measure, or of its notification to the plaintiff, or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

...

Article 267 (*ex Article 234 TEU*)

The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning:

- (a) the interpretation of the Treaties;
- (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;

Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon.

Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court.

If such a question is raised in a case pending before a court or tribunal of a Member State with regard to a person in custody, the Court of Justice of the European Union shall act with the minimum of delay.

...

Article 277 (*ex Article 241 TEU*)

Notwithstanding the expiry of the period laid down in Article 263, sixth paragraph, any party may, in proceedings in which an act of general application adopted by an institution, body, office or agency of the Union is at issue, plead the grounds specified in Article 263, second paragraph, in order to invoke before the Court of Justice of the European Union the inapplicability of that act.

...

CHAPTER 2 LEGAL ACTS OF THE UNION, ADOPTION PROCEDURES AND OTHER PROVISIONS

SECTION 1 THE LEGAL ACTS OF THE UNION

Article 288 (*ex Article 249 TEU*)

To exercise the Union's competences, the institutions shall adopt regulations, directives, decisions, recommendations and opinions.

A **regulation** shall have general application. It shall be binding in its entirety and directly applicable in all Member States.

A **directive** shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.

A **decision** shall be binding in its entirety. A decision which specifies those to whom it is addressed shall be binding only on them.

Recommendations and opinions shall have no binding force.

Article 289

1. The ordinary legislative procedure shall consist in the joint adoption by the European Parliament and the Council of a regulation, directive or decision on a proposal from the Commission.

This procedure is defined in Article 294.

2. In the specific cases provided for by the Treaties, the adoption of a regulation, directive or decision by the European Parliament with the participation of the Council, or by the latter with the participation of the European Parliament, shall constitute a special legislative procedure.

3. Legal acts adopted by legislative procedure shall constitute legislative acts.

4. In the specific cases provided for by the Treaties, legislative acts may be adopted on the initiative of a group of Member States or of the European Parliament, on a recommendation from the European Central Bank or at the request of the Court of Justice or the European Investment Bank.

Article 290

1. A legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act.

The objectives, content, scope and duration of the delegation of power shall be explicitly defined in the legislative acts. The essential elements of an area shall be reserved for the legislative act and accordingly shall not be the subject of a delegation of power.

2. Legislative acts shall explicitly lay down the conditions to which the delegation is subject; these conditions may be as follows:

(a) the European Parliament or the Council may decide to revoke the delegation;

(b) the delegated act may enter into force only if no objection has been expressed by the European Parliament or the Council within a period set by the legislative act.

For the purposes of (a) and (b), the European Parliament shall act by a majority of its component members, and the Council by a qualified majority.

3. The adjective ‘delegated’ shall be inserted in the title of delegated acts.

Article 291

1. Member States shall adopt all measures of national law necessary to implement legally binding Union acts.
2. Where uniform conditions for implementing legally binding Union acts are needed, those acts shall confer implementing powers on the Commission, or, in duly justified specific cases and in the cases provided for in Articles 24 and 26 of the Treaty on European Union, on the Council.
3. For the purposes of paragraph 2, the European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall lay down in advance the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers.
4. The word 'implementing' shall be inserted in the title of implementing acts.

...

SECTION 2 PROCEDURES FOR THE ADOPTION OF ACTS AND OTHER PROVISIONS

...

Article 294 (*ex Article 251 TEU*)

1. Where reference is made in the Treaties to the ordinary legislative procedure for the adoption of an act, the following procedure shall apply.
2. The Commission shall submit a proposal to the European Parliament and the Council.

First reading

3. The European Parliament shall adopt its position at first reading and communicate it to the Council.
4. If the Council approves the European Parliament's position, the act concerned shall be adopted in the wording which corresponds to the position of the European Parliament.

5. If the Council does not approve the European Parliament's position, it shall adopt its position at first reading and communicate it to the European Parliament.

6. The Council shall inform the European Parliament fully of the reasons which led it to adopt its position at first reading. The Commission shall inform the European Parliament fully of its position.

Second reading

7. If, within three months of such communication, the European Parliament:

(a) approves the Council's position at first reading or has not taken a decision, the act concerned shall be deemed to have been adopted in the wording which corresponds to the position of the Council;

(b) rejects, by a majority of its component members, the Council's position at first reading, the proposed act shall be deemed not to have been adopted;

(c) proposes, by a majority of its component members, amendments to the Council's position at first reading, the text thus amended shall be forwarded to the Council and to the Commission, which shall deliver an opinion on those amendments.

8. If, within three months of receiving the European Parliament's amendments, the Council, acting by a qualified majority:

(a) approves all those amendments, the act in question shall be deemed to have been adopted;

(b) does not approve all the amendments, the President of the Council, in agreement with the President of the European Parliament, shall within six weeks convene a meeting of the Conciliation Committee.

9. The Council shall act unanimously on the amendments on which the Commission has delivered a negative opinion.

Conciliation

10. The Conciliation Committee, which shall be composed of the members of the Council or their representatives and an equal number of members representing the European Parliament, shall have the task of reaching agreement on a joint text, by a qualified majority of the members of the Council or their representatives and by a majority of the members representing the European Parliament within six weeks of its being convened, on the basis of the positions of the European Parliament and the Council at second reading.

11. The Commission shall take part in the Conciliation Committee's proceedings and shall take all necessary initiatives with a view to reconciling the positions of the European Parliament and the Council.

12. If, within six weeks of its being convened, the Conciliation Committee does not approve the joint text, the proposed act shall be deemed not to have been adopted.

Third reading

13. If, within that period, the Conciliation Committee approves a joint text, the European Parliament, acting by a majority of the votes cast, and the Council, acting by a qualified majority, shall each have a period of six weeks from that approval in which to adopt the act in question in accordance with the joint text. If they fail to do so, the proposed act shall be deemed not to have been adopted.

14. The periods of three months and six weeks referred to in this Article shall be extended by a maximum of one month and two weeks respectively at the initiative of the European Parliament or the Council.

Special provisions

15. Where, in the cases provided for in the Treaties, a legislative act is submitted to the ordinary legislative procedure on the initiative of a group of Member States, on a recommendation by the European Central Bank, or at the request of the Court of Justice, paragraph 2, the second sentence of paragraph 6, and paragraph 9 shall not apply.

In such cases, the European Parliament and the Council shall communicate the proposed act to the Commission with their positions at first and second readings. The European Parliament or the Council may request the opinion of the Commission throughout the procedure, which the Commission may also deliver on its own initiative. It may also, if it deems it necessary, take part in the Conciliation Committee in accordance with paragraph 11.

...

Article 297 (*ex Article 254 TEU*)

1. Legislative acts adopted under the ordinary legislative procedure shall be signed by the President of the European Parliament and by the President of the Council.

Legislative acts adopted under a special legislative procedure shall be signed by the President of the institution which adopted them.

Legislative acts shall be published in the *Official Journal of the European Union*. They shall enter into force on the date specified in them or, in the absence thereof, on the twentieth day following that of their publication.

2. Non-legislative acts adopted in the form of regulations, directives or decisions, when the latter do not specify to whom they are addressed, shall be signed by the President of the institution which adopted them.

Regulations and directives which are addressed to all Member States, as well as decisions which do not specify to whom they are addressed, shall be published in the *Official Journal of the European Union*. They shall enter into force on the date specified in them or, in the absence thereof, on the twentieth day following that of their publication.

Other directives, and decisions which specify to whom they are addressed, shall be notified to those to whom they are addressed and shall take effect upon such notification.

...

['The 'foundational' IAS regulation]

**Regulation (EC) No 1606/2002
of the European Parliament and of the Council
of 19 July 2002
on the application of international accounting standards**

OJ L 243, 11/9/02, p. 1-4

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 95(1) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the Economic and Social Committee,

Acting in accordance with the procedure laid down in Article 251 of the Treaty,

Whereas:

(1) The Lisbon European Council of 23 and 24 March 2000 emphasised the need to accelerate completion of the internal market for financial services, set the deadline of 2005 to implement the Commission's Financial Services Action Plan and urged that steps be taken to enhance the comparability of financial statements prepared by publicly traded companies.

(2) In order to contribute to a better functioning of the internal market, publicly traded companies must be required to apply a single set of high quality international accounting standards for the preparation of their consolidated financial statements. Furthermore, it is important that the financial reporting standards applied by Community companies participating in financial markets are accepted internationally and are truly global standards. This implies an increasing convergence of accounting standards currently used internationally with the ultimate objective of achieving a single set of global accounting standards.

(3) Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts, Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of

banks and other financial institutions and Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance companies are also addressed to publicly traded Community companies. The reporting requirements set out in these Directives cannot ensure the high level of transparency and comparability of financial reporting from all publicly traded Community companies which is a necessary condition for building an integrated capital market which operates effectively, smoothly and efficiently. It is therefore necessary to supplement the legal framework applicable to publicly traded companies.

(4) This Regulation aims at contributing to the efficient and cost-effective functioning of the capital market. The protection of investors and the maintenance of confidence in the financial markets is also an important aspect of the completion of the internal market in this area. This Regulation reinforces the freedom of movement of capital in the internal market and helps to enable Community companies to compete on an equal footing for financial resources available in the Community capital markets, as well as in world capital markets.

(5) It is important for the competitiveness of Community capital markets to achieve convergence of the standards used in Europe for preparing financial statements, with international accounting standards that can be used globally, for cross-border transactions or listing anywhere in the world.

(6) On 13 June 2000, the Commission published its Communication on 'EU Financial Reporting Strategy: the way forward' in which it was proposed that all publicly traded Community companies prepare their consolidated financial statements in accordance with one single set of accounting standards, namely International Accounting Standards (IAS), at the latest by 2005.

(7) International Accounting Standards (IASs) are developed by the International Accounting Standards Committee (IASC), whose purpose is to develop a single set of global accounting standards. Further to the restructuring of the IASC, the new Board on 1 April 2001, as one of its first decisions, renamed the IASC as the International Accounting Standards Board (IASB) and, as far as future international accounting standards are concerned, renamed IAS as International Financial Reporting Standards (IFRS). These standards should, wherever possible and provided that they ensure a high degree of transparency and comparability for financial reporting in the Community, be made obligatory for use by all publicly traded Community companies.

(8) The measures necessary for the implementation of this Regulation should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission and with due regard to the declaration made by the Commission in the European Parliament on 5 February 2002 concerning the implementation of financial services legislation.

(9) To adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise — this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives; secondly that, in accordance with the conclusions of the Council of 17 July 2000, it is conducive to the European public good and lastly that it meets basic criteria as to the quality of information required for financial statements to be useful to users.

(10) An accounting technical committee should provide support and expertise to the Commission in the assessment of international accounting standards.

(11) The endorsement mechanism should act expeditiously on proposed international accounting standards and also be a means to deliberate, reflect and exchange information on international accounting standards among the main parties concerned, in particular national accounting standard setters, supervisors in the fields of securities, banking and insurance, central banks including the ECB, the accounting profession and users and preparers of accounts. The mechanism should be a means to foster common understanding of adopted international accounting standards in the Community.

(12) In accordance with the principle of proportionality, the measures provided for in this Regulation, in requiring that a single set of international accounting standards be applied to publicly traded companies, are necessary to achieve the objective of contributing to the efficient and cost-effective functioning of Community capital markets and thereby to the completion of the internal market.

(13) In accordance with the same principle, it is necessary, as regards annual accounts, to leave to Member States the option to permit or require publicly traded companies to prepare them in conformity with international accounting standards adopted in accordance with the procedure laid down in this Regulation. Member States may decide as well to extend this permission or this requirement to other companies as regards the preparation of their consolidated accounts and/or their annual accounts.

(14) In order to facilitate an exchange of views and to allow Member States to coordinate their positions, the Commission should periodically inform the accounting regulatory committee about active projects, discussion papers, point outlines and exposure drafts issued by the IASB and about the consequential technical work of the accounting technical committee. It is also important that the accounting regulatory committee is informed at an early stage if the Commission intends not to propose to adopt an international accounting standard.

(15) In its deliberations on and in elaborating positions to be taken on documents and papers issued by the IASB in the process of developing international accounting standards (IFRS and SIC-IFRIC), the Commission should take into account the importance of avoiding competitive disadvantages for European companies operating in the global marketplace, and, to the maximum possible extent, the views expressed by the delegations in the Accounting Regulatory Committee. The Commission will be represented in constituent bodies of the IASB.

(16) A proper and rigorous enforcement regime is key to underpinning investors' confidence in financial markets. Member States, by virtue of Article 10 of the Treaty, are required to take appropriate measures to ensure compliance with international accounting standards. The Commission intends to liaise with Member States, notably through the Committee of European Securities Regulators (CESR), to develop a common approach to enforcement.

(17) Further, it is necessary to allow Member States to defer the application of certain provisions until 2007 for those companies publicly traded both in the Community and on a regulated third-country market which are already applying another set of internationally accepted standards as the primary basis for their consolidated accounts as well as for companies which have only

publicly traded debt securities. It is nonetheless crucial that by 2007 at the latest a single set of global international accounting standards, the IAS, apply to all Community companies publicly traded on a Community regulated market.

(18) In order to allow Member States and companies to carry out the necessary adaptations to make the application of international accounting standards possible, it is necessary to apply certain provisions only in 2005. Appropriate provisions should be put in place for the first-time application of IAS by companies as a result of the entry into force of the present regulation. Such provisions should be drawn up at international level in order to ensure international recognition of the solutions adopted,

HAVE ADOPTED THIS REGULATION:

Article 1 Aim

This Regulation has as its objective the adoption and use of international accounting standards in the Community with a view to harmonising the financial information presented by the companies referred to in Article 4 in order to ensure a high degree of transparency and comparability of financial statements and hence an efficient functioning of the Community capital market and of the Internal Market.

Article 2 Definitions

For the purpose of this Regulation, ‘international accounting standards’ shall mean International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related Interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB).

Article 3 Adoption and use of international accounting standards

1. In accordance with the procedure laid down in Article 6(2), the Commission shall decide on the applicability within the Community of international accounting standards.

2. The international accounting standards can only be adopted if:

— they are not contrary to the principle set out in Article 2(3) of Directive 78/660/EEC and in Article 16(3) of Directive 83/349/EEC and are conducive to the European public good and,

— they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

3. At the latest by 31 December 2002, the Commission shall, in accordance with the procedure laid down in Article 6(2), decide on the applicability within the Community of the international accounting standards in existence upon entry into force of this Regulation.

4. Adopted international accounting standards shall be published in full in each of the official languages of the Community, as a Commission Regulation, in the Official Journal of the European Communities.

Article 4 Consolidated accounts of publicly traded companies

For each financial year starting on or after 1 January 2005, companies governed by the law of a Member State shall prepare their consolidated accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2) if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

Article 5 Options in respect of annual accounts and of non publicly traded companies

Member States may permit or require:

- (a) the companies referred to in Article 4 to prepare their annual accounts,
- (b) companies other than those referred to in Article 4 to prepare their consolidated accounts and/or their annual accounts,

in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2).

Article 6 Committee procedure

1. The Commission shall be assisted by an accounting regulatory committee hereinafter referred to as 'the Committee'.
2. Where reference is made to this paragraph, Articles 5 and 7 of Decision 1999/468/EC shall apply, having regard to the provisions of Article 8 thereof. The period laid down in Article 5(6) of Decision 1999/468/EC shall be set at three months.
3. The Committee shall adopt its rules of procedure.

Article 7 Reporting and coordination

1. The Commission shall liaise on a regular basis with the Committee about the status of active IASB projects and any related documents issued by the IASB in order to coordinate positions and to facilitate discussions concerning the adoption of standards that might result from these projects and documents.

2. The Commission shall duly report to the Committee in a timely manner if it intends not to propose the adoption of a standard.

Article 8 Notification

Where Member States take measures by virtue of Article 5, they shall immediately communicate these to the Commission and to other Member States.

Article 9 Transitional provisions

By way of derogation from Article 4, Member States may provide that the requirements of Article 4 shall only apply for each financial year starting on or after January 2007 to those companies:

(a) whose debt securities only are admitted on a regulated market of any Member State within the meaning of Article 1(13) of Directive 93/22/EEC; or

(b) whose securities are admitted to public trading in a non-member State and which, for that purpose, have been using internationally accepted standards since a financial year that started prior to the publication of this Regulation in the Official Journal of the European Communities.

Article 10 Information and review

The Commission shall review the operation of this Regulation and report thereon to the European Parliament and to the Council by 1 July 2007 at the latest.

Article 11 Entry into force

This Regulation shall enter into force on the third day following that of its publication in the Official Journal of the European Communities.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

[“The ‘implementing’ IAS regulation 1725/2003”]

**Commission Regulation (EC) No 1725/2003
of 29 September 2003
adopting certain international accounting standards
in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council**

OJ L 261, 13/10/2003, p. 1- 420

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community.

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, and in particular Article 3(3) thereof,

Whereas:

(1) Regulation (EC) No 1606/2002 requires that for each financial year starting on or after 1 January 2005, publicly traded companies governed by the law of a Member State shall under certain conditions prepare their consolidated accounts in conformity with international accounting standards as defined in Article 2 of that Regulation.

(2) The Commission, having considered the advice provided by the Accounting Technical Committee, has concluded that the international accounting standards in existence on 14 September 2002 meet the criteria for adoption set out in Article 3 of Regulation (EC) No 1606/2002.

(3) The Commission has also considered the current improvements projects that propose to amend many existing standards. International accounting standards resulting from the finalisation of these proposals will be considered for adoption once those standards are final. The existence of these proposed amendments to existing standards does not impact upon the Commission's decision to endorse the existing standards, except in the cases of IAS 32 Financial instruments: disclosure and presentation, IAS 39 Financial instruments: recognition and measurement and a small number of interpretations related to these standards, SIC 5 Classification of financial instruments - Contingent settlement provisions, SIC 16 Share capital - reacquired own equity instruments (treasury shares) and SIC 17 Equity - Costs of an equity transaction.

(4) The existence of high quality standards dealing with financial instruments, including derivatives, is important to the Community capital market. However, in the cases of IAS 32 and IAS 39, amendments currently being considered may be so considerable that it is appropriate not to adopt these standards at this time. As soon as the current improvement project is complete and revised standards issued, the Commission will consider, as a matter of priority, the adoption of the revised standards further to Regulation (EC) No 1606/2002.

(5) Accordingly, all international accounting standards in existence on 14 September 2002 except IAS 32, IAS 39 and the related interpretations should be adopted.

(6) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee.

HAS ADOPTED THIS REGULATION,

Article 1

The international accounting standards set out in the **Annex** are adopted.

Article 2

This Regulation shall enter into force on the third day following its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

ANNEX

...

["The 'implementing' Regulation No. 1126/2008"]

**Commission Regulation (EC) No 1126/2008
of 3 November 2008
adopting certain international accounting standards
in accordance with Regulation (EC) No 1606/2002
of the European Parliament and of the Council**

OJ L 320, 29/11/2008, p. 1-481

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, and in particular Article 3(1) thereof,

Whereas:

(1) Regulation (EC) No 1606/2002 requires that for each financial year starting on or after 1 January 2005, publicly traded companies governed by the law of a Member State are, under certain conditions, to prepare their consolidated accounts in conformity with international accounting standards as defined in Article 2 of that Regulation.

(2) By Commission Regulation (EC) No 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, certain international standards and interpretations that were in existence at 14 September 2002 were adopted. The Commission, having considered the advice provided by the Technical Expert Group (TEG) of the European Financial Reporting Advisory Group (EFRAG), has amended that Regulation in order to include all standards presented by the International Accounting Standards Board (IASB) as well as all interpretations presented by the International Financial Reporting Interpretations Committee (IFRIC) and adopted within the Community by 15 October 2008 in full, except for IAS39 (related to recognition and measurement of financial instruments), of which limited parts have been omitted.

(3) The different international standards have been adopted by a number of amending regulations. This causes legal uncertainty and difficulty in correctly applying international

accounting standards in the Community. In order to simplify Community legislation on accounting standards, it is appropriate, for the sake of clarity and transparency, to incorporate in a single text the standards presently contained in Regulation (EC) No 1725/2003 and the acts amending it.

(4) Regulation (EC) No 1725/2003 should therefore be replaced by this Regulation.

(5) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee,

HAS ADOPTED THIS REGULATION:

Article1

The international accounting standards, as defined in Article 2 of Regulation (EC) No 1606/2002, shall be adopted as set out in the Annex hereto.

Article2

Regulation (EC) No 1725/2003 is hereby repealed. References to the repealed Regulation shall be construed as references to this Regulation.

Article3

This Regulation shall enter into force on the third day following its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

ANNEX

INTERNATIONALACCOUNTING STANDARDS

IAS1 Presentation of financial statements

IAS2 Inventories

IAS7 Cash-flow statements

IAS8 Accounting policies, changes in accounting estimates and errors

IAS 10 Events after the balance sheet date

IAS 11 Construction contracts

IAS 12 Income taxes

IAS 16 Property, plant and equipment

IAS 17 Leases

IAS 18 Revenue

IAS 19 Employee benefits

IAS 20 Accounting for government grants and disclosure of government assistance

IAS 21 The effects of changes in foreign exchange rates

IAS 23 Borrowing costs

IAS 24 Related party disclosures

IAS 26 Accounting and reporting by retirement benefit plans

IAS 27 Consolidated and separate financial statements

IAS 28 Investments in associates

IAS 29 Financial reporting in hyperinflationary economies

IAS 31 Interests in joint ventures

IAS 32 Financial instruments: presentation

IAS 33 Earnings per share

IAS 34 Interim financial reporting

IAS 36 Impairment of assets

IAS 37 Provisions, contingent liabilities and contingent assets

IAS 38 Intangible assets

IAS 39 Financial instruments: recognition and measurement

IAS 40 Investment property

IAS 41 Agriculture

IFRS1 First-time adoption of international financial reporting standards

IFRS2 Share-based payment

IFRS3 Business combinations

IFRS4 Insurance contracts

IFRS5 Non-current assets held for sale and discontinued operations

IFRS6 Exploration for and evaluation of mineral resources

IFRS7 Financial instruments: disclosures

IFRS8 Operating segments

IFRIC1 Changes in existing decommissioning, restoration and similar liabilities

IFRIC2 Members' shares in co-operative entities and similar instruments

IFRIC4 Determining whether an arrangement contains a lease

IFRIC5 Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds

IFRIC6 Liabilities arising from participating in a specific market — waste electrical and electronic equipment

IFRIC7 Applying the Restatement Approach under IAS 29 Financial reporting in hyperinflationary economies

IFRIC8 Scope of IFRS2

IFRIC9 Reassessment of embedded derivatives

IFRIC 10 Interim financial reporting and impairment

IFRIC 11 IFRS2 — Group and treasury share transactions

SIC-7 Introduction of the euro

SIC-10 Government assistance — no specific relation to operating activities

SIC-12 Consolidation — special purpose entities

SIC-13 Jointly controlled entities — non-monetary contributions by venturers

SIC-15 Operating leases — incentives

SIC-21 Income taxes — recovery of revalued non-depreciable assets

SIC-25 Income taxes — changes in the tax status of an entity or its shareholders

SIC-27 Evaluating the substance of transactions involving the legal form of a lease

SIC-29 Disclosure — service concession arrangements

SIC-31 Revenue — barter transactions involving advertising services

SIC-32 Intangible assets — website costs

["The Fourth Council Directive"]

**Fourth Council Directive
of 25 July 1978
based on Article 54 (3) (g) of the Treaty
on the annual accounts of certain types of companies
(78/660/EEC)**

OJ L 222, 14/8/1978, p. 11–31

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 54 (3) (g) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas the coordination of national provisions concerning the presentation and content of annual accounts and annual reports, the valuation methods used therein and their publication in respect of certain companies with limited liability is of special importance for the protection of members and third parties;

Whereas simultaneous coordination is necessary in these fields for these forms of company because, on the one hand, these companies' activities frequently extend beyond the frontiers of their national territories and, on the other, they offer no safeguards to third parties beyond the amounts of their net assets; whereas, moreover, the necessity for and the urgency of such coordination have been recognized and confirmed by Article 2 (1) (f) of Directive 68/151/EEC;

Whereas it is necessary, moreover, to establish in the Community minimum equivalent legal requirements as regards the extent of the financial information that should be made available to the public by companies that are in competition with one another;

Whereas annual accounts must give a true and fair view of a company's assets and liabilities, financial position and profit or loss ; whereas to this end a mandatory layout must be prescribed for the balance sheet and the profit and loss account and whereas the minimum content of the notes on the accounts and the annual report must be laid down ; whereas, however, derogations may be granted for certain companies of minor economic or social importance;

Whereas the different methods for the valuation of assets and liabilities must be coordinated to the extent necessary to ensure that annual accounts disclose comparable and equivalent information;

Whereas the annual accounts of all companies to which this Directive applies must be published in accordance with Directive 68/151/EEC ; whereas, however, certain derogations may likewise be granted in this area for small and medium-sized companies;

Whereas annual accounts must be audited by authorized persons whose minimum qualifications will be the subject of subsequent coordination ; whereas only small companies may be relieved of this audit obligation;

Whereas, when a company belongs to a group, it is desirable that group accounts giving a true and fair view of the activities of the group as a whole be published ; whereas, however, pending the entry into force of a Council Directive on consolidated accounts, derogations from certain provisions of this Directive are necessary;

Whereas, in order to meet the difficulties arising from the present position regarding legislation in certain Member States, the period allowed for the implementation of certain provisions of this Directive must be longer than the period generally laid down in such cases,

HAS ADOPTED THIS DIRECTIVE:

Article 1

1. The coordination measures prescribed by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to the following types of companies:

- in Germany:

die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien, die Gesellschaft mit beschränkter Haftung;

- ...

- in France:

la société anonyme, la société en commandite par actions, la société à responsabilité limitée;

- in Ireland:

public companies limited by shares or by guarantee, private companies limited by shares or by guarantee;

...

- in the Netherlands:

de naamloze vennootschap, de besloten vennootschap met beperkte aansprakelijkheid;

- in the United Kingdom:

public companies limited by shares or by guarantee, private companies limited by shares or by guarantee

...

The coordination measures prescribed by this Directive shall also apply to the Member States' laws, regulations and administrative provisions relating to the following types of company:

(a) in Germany:

die offene Handelsgesellschaft, die Kommanditgesellschaft;

...

(d) in France:

la société en nom collectif, la société en commandite simple;

...

(g) in Ireland:

partnerships, limited partnerships, unlimited companies;

...

(j) in the Netherlands:

de vennootschap onder firma, de commanditaire vennootschap;

...

(l) in the United Kingdom:

partnerships, limited partnerships, unlimited companies;

...

where all members having unlimited liability are companies of the types set out in the first subparagraph or companies which are not governed by the laws of a Member State but which have a legal form comparable to those referred to in Directive 68/151/EEC.

This Directive shall also apply to the types of companies or firms referred to in the second subparagraph where all members having unlimited liability are themselves companies of the types set out in that or the first subparagraph.

2. Pending subsequent coordination, the Member States need not apply the provisions of this Directive to banks and other financial institutions or to insurance companies.

SECTION 1 General provisions

Article 2

1. The annual accounts shall comprise the balance sheet, the profit and loss account and the notes on the accounts. These documents shall constitute a composite whole.

2. They shall be drawn up clearly and in accordance with the provisions of this Directive.

3. The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit or loss.

4. Where the application of the provisions of this Directive would not be sufficient to give a true and fair view within the meaning of paragraph 3, additional information must be given.

5. Where in exceptional cases the application of a provision of this Directive is incompatible with the obligation laid down in paragraph 3, that provision must be departed from in order to give a true and fair view within the meaning of paragraph 3. Any such departure must be disclosed in the notes on the accounts together with an explanation of the reasons for it and a statement of its effect on the assets, liabilities, financial position and profit or loss. The Member States may define the exceptional cases in question and lay down the relevant special rules.

6. The Member States may authorize or require the disclosure in the annual accounts of other information as well as that which must be disclosed in accordance with this Directive.

SECTION 2 General provisions concerning the balance sheet and the profit and loss account

...

SECTION 3 Layout of the balance sheet

...

SECTION 4 Special provisions relating to certain balance sheet items

...

SECTION 5 Layout of the profit and loss account

...

SECTION 6 Special provisions relating to certain items in the profit and loss account

...

SECTION 7 Valuation rules

Article 31

1. The Member States shall ensure that the items shown in the annual accounts are valued in accordance with the following general principles:

- (a) the company must be presumed to be carrying on its business as a going concern;
 - (b) the methods of valuation must be applied consistently from one financial year to another;
 - (c) valuation must be made on a prudent basis, and in particular:
 - (aa) only profits made at the balance sheet date may be included,
 - (bb) account must be taken of all foreseeable liabilities and potential losses arising in the course of the financial year concerned or of a previous one, even if such liabilities or losses become apparent only between the date of the balance sheet and the date on which it is drawn up,
 - (cc) account must be taken of all depreciation, whether the result of the financial year is a loss or a profit;
 - (d) account must be taken of income and charges relating to the financial year, irrespective of the date of receipt or payment of such income or charges;
 - (e) the components of asset and liability items must be valued separately;
 - (f) the opening balance sheet for each financial year must correspond to the closing balance sheet for the preceding financial year.
2. Departures from these general principles shall be permitted in exceptional cases. Any such departures must be disclosed in the notes on the accounts and the reasons for them given together with an assessment of their effect on the assets, liabilities, financial position and profit or loss.

Article 34

1. (a) Where national law authorizes the inclusion of formation expenses under "Assets", they must be written off within a maximum period of five years.
- (b) In so far as formation expenses have not been completely written off, no distribution of profits shall take place unless the amount of the reserves available for distribution and profits brought forward is at least equal to that of the expenses not written off.
2. The amounts entered under "Formation expenses" must be explained in the notes on the accounts.

...

Article 37

1. Article 34 shall apply to costs of research and development. In exceptional cases, however, the Member States may permit derogations from Article 34 (1) (a). In that case, they may also provide for derogations from Article 34 (1) (b). Such derogations and the reasons for them must be disclosed in the notes on the accounts.
2. Article 34 (1) (a) shall apply to goodwill. The Member States may, however, permit companies to write goodwill off systematically over a limited period exceeding five years provided that this period does not exceed the useful economic life of the asset and is disclosed in the notes on the accounts together with the supporting reasons therefore.

...

Article 62

This Directive is addressed to the Member States.

[“The 7th Council Directive”]

Seventh Council Directive
of 13 June 1983
based on the Article 54 (3) (g) of the Treaty
on consolidated accounts
(83/349/EEC)

OJ L 193, 18/7/1983, p. 1–17

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 54 (3) (g) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas on 25 July 1978 the Council adopted Directive 78/660/EEC on the coordination of national legislation governing the annual accounts of certain types of companies; whereas many companies are members of bodies of undertakings; whereas consolidated accounts must be drawn up so that financial information concerning such bodies of undertakings may be conveyed to members and third parties; whereas national legislation governing consolidated accounts must therefore be coordinated in order to achieve the objectives of comparability and equivalence in the information which companies must publish within the Community;

Whereas on 25 July 1978 the Council adopted Directive 78/660/EEC on the coordination of national which the power of control is based on a majority of voting rights but also of those in which it is based on agreements, where these are permitted; whereas, furthermore, Member States in which the possibility occurs must be permitted to cover cases in which in certain circumstances control has been effectively exercised on the basis of a minority holding; whereas the Member States must be permitted to cover the case of bodies of undertakings in which the undertakings exist on an equal footing with each other;

Whereas the aim of coordinating the legislation governing consolidated accounts is to protect the interests subsisting in companies with share capital; whereas such protection implies the principle of the preparation of consolidated accounts where such a company is a member of a body of undertakings, and that such accounts must be drawn up at least where such a company is a parent undertaking; whereas, furthermore, the cause of full information also requires that a subsidiary undertaking which is itself a parent undertaking draw up consolidated accounts; whereas, nevertheless, such a parent undertaking may, and, in certain circumstances, must be exempted from the obligation to draw up such consolidated accounts provided that its members and third parties are sufficiently protected;

Whereas, for bodies of undertakings not exceeding a certain size, exemption from the obligation to prepare consolidated accounts may be justified; whereas, accordingly, maximum limits must be set for such exemptions; whereas it follows therefrom that the Member States may either provide that it is sufficient to exceed the limit of one only of the three criteria for the exemption not to apply or adopt limits lower than those prescribed in the Directive;

Whereas consolidated accounts must give a true and fair view of the assets and liabilities, the financial position and the profit and loss of all the undertakings consolidated taken as a whole; whereas, therefore, consolidation should in principle include all of those undertakings; whereas such consolidation requires the full incorporation of the assets and liabilities and of the income and expenditure of those undertakings and the separate disclosure of the interests of persons outwith such bodies; whereas, however, the necessary corrections must be made to eliminate the effects of the financial relations between the undertakings consolidated;

Whereas a number of principles relating to the preparation of consolidated accounts and valuation in the context of such accounts must be laid down in order to ensure that items are disclosed consistently, and may readily be compared not only as regards the methods used in their valuation but also as regards the periods covered by the accounts;

Whereas participating interests in the capital of undertakings over which undertakings included in a consolidation exercise significant influence must be included in consolidated accounts by means of the equity method;

Whereas the notes on consolidated accounts must give details of the undertakings to be consolidated;

Whereas certain derogations originally provided for on a transitional basis in Directive 78/660/EEC may be continued subject to review at a later date,

HAS ADOPTED THIS DIRECTIVE:

SECTION 1

Conditions for the preparation of consolidated accounts

Article 1

1. A Member State shall require any undertaking governed by its national law to draw up consolidated accounts and a consolidated annual report if that undertaking (a parent undertaking):

(a) has a majority of the shareholders' or members' voting rights in another undertaking (a subsidiary undertaking); or

(b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another undertaking (a subsidiary undertaking) and is at the same time a shareholder in or member of that undertaking; or

(c) has the right to exercise a dominant influence over an undertaking (a subsidiary undertaking) of which it is a shareholder or member, pursuant to a contract entered into with that undertaking or to a provision in its memorandum or articles of association, where the law governing that subsidiary undertaking permits its being subject to such contracts or provisions. A Member State need not prescribe that a parent undertaking must be a shareholder in or member of its subsidiary undertaking. Those Member States the laws of which do not provide for such contracts or clauses shall not be required to apply this provision; or

(d) is a shareholder in or member of an undertaking, and:

(aa) a majority of the members of the administrative, management or supervisory bodies of that undertaking (a subsidiary undertaking) who have held office during the financial year, during the preceding financial year and up to the time when the consolidated accounts are drawn up, have been appointed solely as a result of the exercise of its voting rights; or

(bb) controls alone, pursuant to an agreement with other shareholders in or members of that undertaking (a subsidiary undertaking), a majority of shareholders' or members' voting rights in that undertaking. The Member States may introduce more detailed provisions concerning the form and contents of such agreements.

The Member States shall prescribe at least the arrangements referred to in (bb) above.

They may make the application of (aa) above dependent upon the holding's representing 20 % or more of the shareholders' or members' voting rights.

However, (aa) above shall not apply where another undertaking has the rights referred to in subparagraphs (a), (b) or (c) above with regard to that subsidiary undertaking.

2. Apart from the cases mentioned in paragraph 1 above and pending subsequent coordination, the Member States may require any undertaking governed by their national law to draw up consolidated accounts and a consolidated annual report if that undertaking (a parent undertaking) holds a participating interest as defined in Article 17 of Directive 78/660/EEC in another undertaking (a subsidiary undertaking), and:

(a) it actually exercises a dominant influence over it; or

(b) it and the subsidiary undertaking are managed on a unified basis by the parent undertaking.

...

SECTION 2

The preparation of consolidated accounts

Article 16

1. Consolidated accounts shall comprise the consolidated balance sheet, the consolidated profit-and-loss account and the notes on the accounts. These documents shall constitute a composite whole.

2. Consolidated accounts shall be drawn up clearly and in accordance with this Directive.

3. Consolidated accounts shall give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included therein taken as a whole.

4. Where the application of the provisions of this Directive would not be sufficient to give a true and fair view within the meaning of paragraph 3 above, additional information must be given.

5. Where, in exceptional cases, the application of a provision of Articles 17 to 35 and 39 is incompatible with the obligation imposed in paragraph 3 above, that provision must be departed from in order to give a true and fair view within the meaning of paragraph 3. Any such departure must be disclosed in the notes on the accounts together with an explanation of the reasons for it and a statement of its effect on the assets,

liabilities, financial position and profit or loss. The Member States may define the exceptional cases in question and lay down the relevant special rules.

6. A Member State may require or permit the disclosure in the consolidated accounts of other information as well as that which must be disclosed in accordance with this Directive.

...

Article 19

1. The book values of shares in the capital of undertakings included in a consolidation shall be set off against the proportion which they represent of the capital and reserves of those undertakings:

(a) That set-off shall be effected on the basis of book values as at the date as at which such undertakings are included in the consolidations for the first time. Differences arising from such set-offs shall as far as possible be entered directly against those items in the consolidated balance sheet which have values above or below their book values.

(b) A Member State may require or permit set-offs on the basis of the values of identifiable assets and liabilities as at the date of acquisition of the shares or, in the event of acquisition in two or more stages, as at the date on which the undertaking became a subsidiary.

(c) Any difference remaining after the application of (a) or resulting from the application of (b) shall be shown as a separate item in the consolidated balance sheet with an appropriate heading. That item, the methods used and any significant changes in relation to the preceding financial year must be explained in the notes on the accounts. Where the offsetting of positive and negative differences is authorized by a Member State, a breakdown of such differences must also be given in the notes on the accounts.

2. However, paragraph 1 above shall not apply to shares in the capital of the parent undertaking held either by that undertaking itself or by another undertaking included in the consolidation. In the consolidated accounts such shares shall be treated as own shares in accordance with Directive 78/660/EEC.

...

Article 29

1. Assets and liabilities to be included in consolidated accounts shall be valued according to uniform methods and in accordance with Articles 31 to 42 and 60 of Directive 78/660/EEC.

2. (a) An undertaking which draws up consolidated accounts must apply the same methods of valuation as in its annual accounts. However, a Member State may require or permit the use in consolidated accounts of other methods of valuation in accordance with the abovementioned Articles of Directive 78/660/EEC.

(b) Where use is made of this derogation that fact shall be disclosed in the notes on the consolidated accounts and the reasons therefore given.

3. Where assets and liabilities to be included in consolidated accounts have been valued by undertakings included in the consolidation by methods differing from those used for the consolidation, they must be revalued in accordance with the methods used for the consolidation, unless the results of such revaluation are not material for the purposes of Article 16 (3). Departures from this principle shall be permitted in exceptional cases. Any such departures shall be disclosed in the notes on the consolidated accounts and the reasons for them given.

4. Account shall be taken in the consolidated balance sheet and in the consolidated profit-and-loss account of any difference arising on consolidation between the tax chargeable for the financial year and for preceding financial years and the amount of tax paid or payable in respect of those years, provided that it is probable that an actual charge to tax will arise within the foreseeable future for one of the undertakings included in the consolidation.

5. Where assets to be included in consolidated accounts have been the subject of exceptional value adjustments solely for tax purposes, they shall be incorporated in the consolidated accounts only after those adjustments have been eliminated. A Member State may, however, require or permit that such assets be incorporated in the consolidated accounts without the elimination of the adjustments, provided that their amounts, together with the reasons for them, are disclosed in the notes on the consolidated accounts.

Article 30

1. A separate item as defined in Article 19 (1) (c) which corresponds to a positive consolidation difference shall be dealt with in accordance with the rules laid down in Directive 78/660/EEC for the item "goodwill".

2. A Member State may permit a positive consolidation difference to be immediately and clearly deducted from reserves.

...

Article 51

This Directive is addressed to the Member States.

["The 2nd Comitology Decision"]

Council Decision

of 28 June 1999

**laying down the procedures for the exercise of implementing powers conferred on the Commission
(1999/468/EC)**

OJ L 184, 17/7/1999, p. 23–26

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular the third indent of Article 202 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Whereas:

(1) in the instruments which it adopts, the Council has to confer on the Commission powers for the implementation of the rules which the Council lays down; the Council may impose certain requirements in respect of the exercise of these powers; it may also reserve to itself the right, in specific and substantiated cases, to exercise directly implementing powers;

(2) the Council adopted Decision 87/373/EEC of 13 July 1987 laying down the procedures for the exercise of implementing powers conferred on the Commission; that Decision has provided for a limited number of procedures for the exercise of such powers;

(3) declaration No 31 annexed to the Final Act of the Intergovernmental Conference which adopted the Amsterdam Treaty calls on the Commission to submit to the Council a proposal amending Decision 87/373/EEC;

(4) for reasons of clarity, rather than amending Decision 87/373/EEC, it has been considered more appropriate to replace that Decision by a new Decision and, therefore, to repeal Decision 87/373/EEC;

(5) the first purpose of this Decision is, with a view to achieving greater consistency and predictability in the choice of type of committee, to provide for criteria relating to the choice of committee procedures, it being understood that such criteria are of a non-binding nature;

(6) in this regard, the management procedure should be followed as regards management measures such as those relating to the application of the common agricultural and common fisheries policies or to the implementation of programmes with substantial budgetary implications; such management measures should be taken by the Commission by a procedure ensuring decision-making within suitable periods; however, where non-urgent measures are referred to the Council, the Commission should exercise its discretion to defer application of the measures;

(7) the regulatory procedure should be followed as regards measures of general scope designed to apply essential provisions of basic instruments, including measures concerning the protection of the health or

safety of humans, animals or plants, as well as measures designed to adapt or update certain non-essential provisions of a basic instrument; such implementing measures should be adopted by an effective procedure which complies in full with the Commission's right of initiative in legislative matters;

(8) the advisory procedure should be followed in any case in which it is considered to be the most appropriate; the advisory procedure will continue to be used in those cases where it currently applies;

(9) the second purpose of this Decision is to simplify the requirements for the exercise of implementing powers conferred on the Commission as well as to improve the involvement of the European Parliament in those cases where the basic instrument conferring implementation powers on the Commission was adopted in accordance with the procedure laid down in Article 251 of the Treaty; it has been accordingly considered appropriate to reduce the number of procedures as well as to adjust them in line with the respective powers of the institutions involved and notably to give the European Parliament an opportunity to have its views taken into consideration by, respectively, the Commission or the Council in cases where it considers that, respectively, a draft measure submitted to a committee or a proposal submitted to the Council under the regulatory procedure exceeds the implementing powers provided for in the basic instrument;

(10) the third purpose of this Decision is to improve information to the European Parliament by providing that the Commission should inform it on a regular basis of committee proceedings, that the Commission should transmit to it documents related to activities of committees and inform it whenever the Commission transmits to the Council measures or proposals for measures to be taken;

(11) the fourth purpose of this Decision is to improve information to the public concerning committee procedures and therefore to make applicable to committees the principles and conditions on public access to documents applicable to the Commission, to provide for a list of all committees which assist the Commission in the exercise of implementing powers and for an annual report on the working of committees to be published as well as to provide for all references to documents related to committees which have been transmitted to the European Parliament to be made public in a register;

(12) the specific committee procedures created for the implementation of the common commercial policy and the competition rules laid down by the Treaties that are not currently based upon Decision 87/373/EEC are not in any way affected by this Decision,

HAS DECIDED AS FOLLOWS:

Article 1

Other than in specific and substantiated cases where the basic instrument reserves to the Council the right to exercise directly certain implementing powers itself, such powers shall be conferred on the Commission in accordance with the relevant provisions in the basic instrument. These provisions shall stipulate the essential elements of the powers thus conferred.

Where the basic instrument imposes specific procedural requirements for the adoption of implementing measures, such requirements shall be in conformity with the procedures provided for by Articles 3, 4, 5 and 6.

Article 2

The choice of procedural methods for the adoption of implementing measures shall be guided by the following criteria:

(a) management measures, such as those relating to the application of the common agricultural and common fisheries policies, or to the implementation of programmes with substantial budgetary implications, should be adopted by use of the management procedure;

(b) measures of general scope designed to apply essential provisions of basic instruments, including measures concerning the protection of the health or safety of humans, animals or plants, should be adopted

by use of the regulatory procedure; where a basic instrument stipulates that certain non-essential provisions of the instrument may be adapted or updated by way of implementing procedures, such measures should be adopted by use of the regulatory procedure;

(c) without prejudice to points (a) and (b), the advisory procedure shall be used in any case in which it is considered to be the most appropriate.

Article 3

Advisory procedure

1. The Commission shall be assisted by an advisory committee composed of the representatives of the Member States and chaired by the representative of the Commission.
2. The representative of the Commission shall submit to the Committee a draft of the measures to be taken. The committee shall deliver its opinion on the draft, within a time-limit which the chairman may lay down according to the urgency of the matter, if necessary by taking a vote.
3. The opinion shall be recorded in the minutes; in addition, each Member State shall have the right to ask to have its position recorded in the minutes.
4. The Commission shall take the utmost account of the opinion delivered by the committee. It shall inform the committee of the manner in which the opinion has been taken into account.

Article 4

Management procedure

1. The Commission shall be assisted by a management committee composed of the representatives of the Member States and chaired by the representative of the Commission.
2. The representative of the Commission shall submit to the committee a draft of the measures to be taken. The committee shall deliver its opinion on the draft within a time-limit which the chairman may lay down according to the urgency of the matter. The opinion shall be delivered by the majority laid down in Article 205(2) of the Treaty, in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States within the committee shall be weighted in the manner set out in that Article. The chairman shall not vote.
3. The Commission shall, without prejudice to Article 8, adopt measures which shall apply immediately. However, if these measures are not in accordance with the opinion of the committee, they shall be communicated by the Commission to the Council forthwith. In that event, the Commission may defer application of the measures which it has decided on for a period to be laid down in each basic instrument but which shall in no case exceed three months from the date of such communication.
4. The Council, acting by qualified majority, may take a different decision within the period provided for by paragraph 3.

Article 5

Regulatory procedure

1. The Commission shall be assisted by a regulatory committee composed of the representatives of the Member States and chaired by the representative of the Commission.
2. The representative of the Commission shall submit to the committee a draft of the measures to be taken. The committee shall deliver its opinion on the draft within a time-limit which the chairman may lay down according to the urgency of the matter. The opinion shall be delivered by the majority laid down in Article

205(2) of the Treaty in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States within the Committee shall be weighted in the manner set out in that Article. The chairman shall not vote.

3. The Commission shall, without prejudice to Article 8, adopt the measures envisaged if they are in accordance with the opinion of the committee.

4. If the measures envisaged are not in accordance with the opinion of the committee, or if no opinion is delivered, the Commission shall, without delay, submit to the Council a proposal relating to the measures to be taken and shall inform the European Parliament.

5. If the European Parliament considers that a proposal submitted by the Commission pursuant to a basic instrument adopted in accordance with the procedure laid down in Article 251 of the Treaty exceeds the implementing powers provided for in that basic instrument, it shall inform the Council of its position.

6. The Council may, where appropriate in view of any such position, act by qualified majority on the proposal, within a period to be laid down in each basic instrument but which shall in no case exceed three months from the date of referral to the Council.

If within that period the Council has indicated by qualified majority that it opposes the proposal, the Commission shall re-examine it. It may submit an amended proposal to the Council, re-submit its proposal or present a legislative proposal on the basis of the Treaty.

If on the expiry of that period the Council has neither adopted the proposed implementing act nor indicated its opposition to the proposal for implementing measures, the proposed implementing act shall be adopted by the Commission.

Article 6

Safeguard procedure

The following procedure may be applied where the basic instrument confers on the Commission the power to decide on safeguard measures:

(a) The Commission shall notify the Council and the Member States of any decision regarding safeguard measures. It may be stipulated that before adopting its decision, the Commission shall consult the Member States in accordance with procedures to be determined in each case;

(b) Any Member State may refer the Commission's decision to the Council within a time-limit to be determined within the basic instrument in question;

(c) The Council, acting by a qualified majority, may take a different decision within a time-limit to be determined in the basic instrument in question. Alternatively, it may be stipulated in the basic instrument that the Council, acting by qualified majority, may confirm, amend or revoke the decision adopted by the Commission and that, if the Council has not taken a decision within the abovementioned time-limit, the decision of the Commission is deemed to be revoked.

Article 7

1. Each committee shall adopt its own rules of procedure on the proposal of its chairman, on the basis of standard rules of procedure which shall be published in the Official Journal of the European Communities.

Insofar as necessary existing committees shall adapt their rules of procedure to the standard rules of procedure.

2. The principles and conditions on public access to documents applicable to the Commission shall apply to the committees.

3. The European Parliament shall be informed by the Commission of committee proceedings on a regular basis. To that end, it shall receive agendas for committee meetings, draft measures submitted to the committees for the implementation of instruments adopted by the procedure provided for by Article 251

of the Treaty, and the results of voting and summary records of the meetings and lists of the authorities and organisations to which the persons designated by the Member States to represent them belong. The European Parliament shall also be kept informed whenever the Commission transmits to the Council measures or proposals for measures to be taken.

4. The Commission shall, within six months of the date on which this Decision takes effect, publish in the Official Journal of the European Communities, a list of all committees which assist the Commission in the exercise of implementing powers. This list shall specify, in relation to each committee, the basic instrument(s) under which the committee is established. From 2000 onwards, the Commission shall also publish an annual report on the working of committees.

5. The references of all documents sent to the European Parliament pursuant to paragraph 3 shall be made public in a register to be set up by the Commission in 2001.

Article 8

If the European Parliament indicates, in a Resolution setting out the grounds on which it is based, that draft implementing measures, the adoption of which is contemplated and which have been submitted to a committee pursuant to a basic instrument adopted under Article 251 of the Treaty, would exceed the implementing powers provided for in the basic instrument, the Commission shall re-examine the draft measures. Taking the Resolution into account and within the time-limits of the procedure under way, the Commission may submit new draft measures to the committee, continue with the procedure or submit a proposal to the European Parliament and the Council on the basis of the Treaty.

The Commission shall inform the European Parliament and the committee of the action which it intends to take on the Resolution of the European Parliament and of its reasons for doing so.

Article 9

Decision 87/373/EEC shall be repealed.

Article 10

This Decision shall take effect on the day following that of its publication in the Official Journal of the European Communities.

Commission Decision 2006/505/EC setting up SARG

Commission Decision

of 14 July 2006

**setting up a Standards Advice Review Group (SARG)
to advise the Commission on the objectivity and neutrality
of the European Financial Reporting Advisory Group's (EFRAG's) opinions
(2006/505/EC)**

OJL 199, 21/7/2006, p. 33-35

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Whereas:

(1) The high level of transparency and comparability of financial reporting for all publicly traded Community companies is necessary for building an integrated capital market which operates effectively, smoothly and efficiently.

(2) In order to contribute to a better functioning of the internal market Regulation (EC) No 1606/2002 of the European Parliament and of the Council (1) provides that the companies listed on regulated market are required to prepare their consolidated accounts in accordance with a single set of global accounting standards, commonly referred to as International Financial Reporting Standards (IFRS). The Regulation, in its recital 10, foresees the creation of an accounting technical committee to provide support and expertise to the Commission in the assessment of international accounting standards.

(3) The European Financial Reporting Advisory Group (EFRAG) was founded in March 2001 by the organisations representing preparers, users and accountancy professions involved in the financial reporting process; EFRAG provides opinions on whether the standard or interpretation to be endorsed complies with the Community law and, in particular, the requirements of Regulation (EC) No 1606/2002 as regards understandability, relevance, reliability and comparability as well as the true and fair principle as set out in Council Directives 78/660/EEC (2) and 83/349/EEC (3).

(4) As EFRAG is a private body it is important for the high quality, transparency and credibility of the endorsement process to establish appropriate institutional infrastructure ensuring that its endorsement advice is objective and well-balanced.

(5) In this context, the Commission considers that a Standards Advice Review Group composed of independent experts and high level representatives from National Standard Setters should therefore be established to serve as a body to reflect on the endorsement advice submitted by the EFRAG with a view to assessing whether its content is well-balanced and objective,

HAS ADOPTED THIS DECISION:

Article 1

A group of non-governmental experts in accounting, hereinafter referred to as ‘the group’, is hereby established.

Article 2

Task

The role of the group shall be to advise the Commission, before it takes a decision on endorsement, on whether EFRAG's opinions on endorsement of International Financial Reporting Standards (IFRS) and Interpretations by the International Financial Reporting Committee (IFRICs) are well-balanced and objective.

Article 3

Membership — Appointment

1. The group shall comprise of maximum seven members.
2. The Commission shall appoint the members of the group from independent experts whose experience and competence in the accounting area, in particular in financial reporting issues, are widely recognised at Community level. The members shall be selected on the basis of eligible proposals submitted following the call for applications published on the website of DG Internal Market and Services.
3. The Commission will take the following criteria into account when assessing applications:
 - proven competence and high level technical experience, including at European and/or international level, in the accounting area, in particular in financial reporting issues,
 - independence,
 - the need for balanced composition in terms of geographical origin, gender (1), the functions and size of businesses or bodies concerned.

4. The members shall be appointed in a personal capacity and shall advise the Commission independently of any outside influence. The members shall not participate in the work of EFRAG either before the appointment to the group or during their term of office.
5. Members shall each year sign an undertaking to act in the public interest and a declaration indicating the absence or existence of any interest which may undermine their independence and objectivity.
6. Members of the group are appointed for a 3-year renewable term of office. The rules of procedure of the group may foresee partial replacement of the members every year in groups of 2 or 3.
7. In the event of resignation of a member of the group during the term of office as well as when a member is no longer capable of contributing effectively to the group's deliberations or does not comply with the conditions set out in paragraphs 3 and 4, or Article 287 of the Treaty, the Commission shall appoint a new member of the group in accordance with paragraphs 3 and 4 for the remainder of his/her term of office.
8. The names of members appointed by the Commission shall be published on the Internet website of the DG Internal Market and Services. The names of members shall be collected, processed and published in accordance with Regulation (EC) No 45/2001 of the European Parliament and of the Council.

Article 4

Operation

1. The group shall be chaired by one of its members. The chairman will be selected by a simple majority for a period of one year.
2. The representative of the Commission will assist in the meetings of the group and may take part in the debates. Other Commission officials interested in the matters discussed by the group may also attend its meetings.
3. Upon receiving EFRAG's opinion on endorsement of IFRS or IFRICs, the group shall give its advice on whether the opinion of EFRAG is objective and well-balanced.
4. The group shall deliver its advice to the Commission within a short time, which should not be longer than three weeks from the date of receiving EFRAG's opinion. In exceptional circumstances, in particular when the issue is complex, this period may be extended to four weeks.
5. The final advice of the group shall be published on the Internet website of the Commission.
6. When the group identifies a particular concern, the chairman of the group shall enter into a dialog with EFRAG with a view to resolve the matter, before the group issues its final advice. The Commission may assist in the discussions between the group and EFRAG with the aim to establish a balanced solution.

7. The Chairman of Technical Expert Group (TEG) of EFRAG may attend the meetings of the group as an observer. The chairman or the representative of the Commission may also ask other experts or observers with specific competence on a subject on the agenda to participate in the group's deliberations if this is useful and/or necessary.

8. Information obtained by participating in the deliberations of the group shall not be divulged if, in the opinion of the Commission, that information relates to confidential matters.

9. The group shall adopt its rules of procedure on the basis of the standard rules of procedure adopted by the Commission.

10. In addition to documents mentioned in this Article, the Commission may publish on the Internet, in the original language of the document concerned, any summary, conclusion, or partial conclusion or working document of the group.

Article 5

Meeting expenses

The Commission shall reimburse travel and, where appropriate, subsistence expenses for members, experts and observers in connection with the group's activities in accordance with the Commission's rules on the compensation of external experts. The members, experts and observers shall not be remunerated for the services they render. Meeting expenses are reimbursed within the limits of the annual budget allocated to the group by the responsible Commission services.

Article 6

Applicability

The decision shall take effect on the day of its publication in the Official Journal of the European Union. It shall apply until 13 July 2009. The Commission shall decide on a possible extension before that date.

[“The 2006 amendments to the 2nd Comitology Decision”]

Council Decision

of 17 July 2006

**amending Decision 1999/468/EC laying down the procedures for the exercise of
implementing powers conferred on the Commission**

(2006/512/EC)

OJ L 200, 22/7/2006, p. 11-13

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular the third indent of Article 202 thereof,

Having regard to the proposal from the Commission,

Having regard to the Opinion of the European Parliament,

Whereas:

(1) The Council adopted Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission. That Decision provided for a limited number of procedures for the exercise of such powers.

(2) That Decision should be amended in order to introduce a new type of procedure for the exercise of implementing powers, the regulatory procedure with scrutiny, which allows the legislator to oppose the adoption of draft measures where it indicates that the draft exceeds the implementing powers provided for in the basic instrument, or that the draft is incompatible with the aim or the content of that instrument or fails to respect the principles of subsidiarity or proportionality.

(3) It is necessary to follow the new regulatory procedure with scrutiny for measures of general scope designed to amend non-essential elements of a basic instrument adopted in accordance with the procedure referred to in Article 251 of the Treaty, including by deleting some of those elements or by supplementing the instrument by the addition of new non-essential elements.

(4) In this same framework, it should be ensured that the European Parliament receives better information on the work of committees,

HAS DECIDED AS FOLLOWS:

Article 1

Decision 1999/468/EC is hereby amended as follows:

1. at the end of recital 5, the following shall be added: ‘with the exception of those governing the regulatory procedure with scrutiny’;
2. after recital (7), the following recital shall be inserted: ‘(7a) It is necessary to follow the regulatory procedure with scrutiny as regards measures of general scope which seek to amend non-essential elements of a basic instrument adopted in accordance with the procedure referred to in Article 251 of the Treaty, inter alia by deleting some of those elements or by supplementing the instrument by the addition of new nonessential elements. This procedure should enable the two arms of the legislative authority to scrutinise such measures before they are adopted. The essential elements of a legislative act may only be amended by the legislator on the basis of the Treaty.’;
3. recital (10) shall be replaced by the following: ‘(10) The third purpose of this Decision is to improve information to the European Parliament by providing that the Commission should inform it on a regular basis of committee proceedings, that the Commission should transmit to it documents related to activities of committees and inform it whenever the Commission transmits to the Council measures or proposals for measures to be taken; particular attention will be paid to the provision of information to the European Parliament on the proceedings of committees in the framework of the regulatory procedure with scrutiny, so as to ensure that the European Parliament takes a decision within the stipulated deadline.’;
4. in Article 1: **‘5a’ shall be inserted** between ‘5’ and ‘and 6’ in the last line;
5. in Article 2: (a) in the first paragraph the words ‘1. Without prejudice to paragraph 2,’ shall be inserted at the beginning of the text; (b) the following paragraph shall be added: ‘2. Where a basic instrument, adopted in accordance with the procedure referred to in Article 251 of the Treaty, provides for the adoption of measures of general scope designed to amend non-essential elements of that instrument, inter alia by deleting some of those elements or by supplementing the instrument by the addition of new non-essential elements, those measures shall be adopted in accordance with the regulatory procedure with scrutiny.’;
6. in Article 4(2) and Article 5(2), the terms ‘and (4)’ shall be added after ‘Article 205(2)’;
7. after Article 5, the following Article shall be inserted:

‘Article 5a Regulatory procedure with scrutiny

1. The Commission shall be assisted by a Regulatory Procedure with Scrutiny Committee composed of the representatives of the Member States and chaired by the representative of the Commission.

2. The representative of the Commission shall submit to the Committee a draft of the measures to be taken. The Committee shall deliver its opinion on the draft within a time-limit which the chairman may lay down according to the urgency of the matter. The opinion shall be delivered by the majority laid down in Article 205(2) and (4) of the Treaty in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States within the Committee shall be weighted in the manner set out in that Article. The chairman shall not vote.

3. If the measures envisaged by the Commission are in accordance with the opinion of the Committee, the following procedure shall apply:

(a) the Commission shall without delay submit the draft measures for scrutiny by the European Parliament and the Council;

(b) the European Parliament, acting by a majority of its component members, or the Council, acting by a qualified majority, may oppose the adoption of the said draft by the Commission, justifying their opposition by indicating that the draft measures proposed by the Commission exceed the implementing powers provided for in the basic instrument or that the draft is not compatible with the aim or the content of the basic instrument or does not respect the principles of subsidiarity or proportionality;

(c) if, within three months from the date of referral to them, the European Parliament or the Council opposes the draft measures, the latter shall not be adopted by the Commission. In that event, the Commission may submit to the Committee an amended draft of the measures or present a legislative proposal on the basis of the Treaty;

(d) if, on expiry of that period, neither the European Parliament nor the Council has opposed the draft measures, the latter shall be adopted by the Commission.

4. If the measures envisaged by the Commission are not in accordance with the opinion of the Committee, or if no opinion is delivered, the following procedure shall apply:

(a) the Commission shall without delay submit a proposal relating to the measures to be taken to the Council and shall forward it to the European Parliament at the same time;

(b) the Council shall act on the proposal by a qualified majority within two months from the date of referral to it;

(c) if, within that period, the Council opposes the proposed measures by a qualified majority, the measures shall not be adopted. In that event, the Commission may submit to the Council an amended proposal or present a legislative proposal on the basis of the Treaty;

(d) if the Council envisages adopting the proposed measures, it shall without delay submit them to the European Parliament. If the Council does not act within the two month period, the Commission shall without delay submit the measures for scrutiny by the European Parliament;

(e) the European Parliament, acting by a majority of its component members within four months from the forwarding of the proposal in accordance with point (a), may oppose the adoption of the measures in question, justifying their opposition by indicating that the proposed measures exceed the implementing powers provided for in the basic instrument or are not compatible with the aim or the content of the basic instrument or do not respect the principles of subsidiarity or proportionality;

(f) if, within that period, the European Parliament opposes the proposed measures, the latter shall not be adopted. In that event, the Commission may submit to the Committee an amended draft of the measures or present a legislative proposal on the basis of the Treaty;

(g) if, on expiry of that period, the European Parliament has not opposed the proposed measures, the latter shall be adopted by the Council or by the Commission, as the case may be.

5. By way of derogation from paragraphs 3 and 4, a basic instrument may in duly substantiated exceptional cases provide:

(a) that the time-limits laid down in paragraphs 3(c), 4(b) and 4(e) shall be extended by an additional month, when justified by the complexity of the measures; or

(b) that the time-limits laid down in paragraphs 3(c), 4(b) and 4(e) shall be curtailed where justified on the grounds of efficiency.

6. A basic instrument may provide that if, on imperative grounds of urgency, the timelimits for the regulatory procedure with scrutiny referred to in paragraphs 3, 4 and 5 cannot be complied with, the following procedure shall apply:

(a) if the measures envisaged by the Commission are in accordance with the opinion of the Committee, the Commission shall adopt the measures, which shall immediately be implemented. The Commission shall without delay communicate them to the European Parliament and to the Council;

(b) within a time-limit of one month following that communication, the European Parliament, acting by a majority of its component members, or the Council, acting by a qualified majority, may oppose the measures adopted by the Commission, on the grounds that the measures exceed the implementing powers provided for in the basic instrument or are not compatible with the aim or the content of the basic instrument or do not respect the principles of subsidiarity or proportionality;

(c) in the event of opposition by the European Parliament or the Council, the Commission shall repeal the measures. It may however provisionally maintain the measures in force if warranted on health protection, safety or environmental grounds. In that event, it shall without delay submit to the Committee an amended draft of the measures or a legislative proposal on the basis of the Treaty. The provisional measures shall remain in force until they are replaced by a definitive instrument.’

8. In Article 7(3) at the end of the first sentence, the following shall be added: ‘following arrangements which ensure that the transmission system is transparent and that the information forwarded and the various stages of the procedure are identified.’

Article 2

This Decision shall take effect on the day following that of its publication in the Official Journal of the European Union.

“Tomberger”

Judgment of the Court (Fifth Chamber) of 27 June 1996.

Waltraud Tomberger v Gebrüder von der Wettern GmbH.

Reference for a preliminary ruling: Bundesgerichtshof - Germany.

Directive 78/660/EEC - Annual accounts - Balance sheet - Date at which profit is made.

Case C-234/94.

European Court Reports 1996 Page I-03133

Keywords

Freedom of movement for persons - Freedom of establishment - Companies - Directive 78/660 - Annual accounts of certain types of companies - Principle of the true and fair view - Requirement that only profits made at the balance-sheet date may be included - Circumstances of the case - Council Directive 78/660, Art. 31(1)(c)(aa)

Summary

In order to coordinate the content of annual accounts, the Fourth Directive 78/660 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, as amended by the Seventh Directive 83/349 on consolidated accounts, lays down the principle of the “true and fair view”, compliance with which is the primary objective of that directive. Application of that principle must, as far as possible, be guided by the general principles contained in Article 31 of the directive, particularly in Article 31(1)(c), (aa) and (bb), and (d). It is clear from those provisions that taking account of all elements which actually relate to the financial year in question ensures observance of the principle of a true and fair view.

Where

- one company (the parent company) is the sole shareholder in another company (the subsidiary), and controls it,
- under national law, the parent company and the subsidiary form a group,
- the financial years of the two companies coincide,
- the subsidiary’s annual accounts for the financial year in question were adopted by the general meeting before completion of the audit of the parent company’s annual accounts for that year,
- the subsidiary’s annual accounts for the financial year in question, as adopted by its general

meeting, show that on the subsidiary's balance-sheet date - namely the last day of that financial year - the subsidiary appropriated profits to the parent company, and

- the national court is satisfied that the subsidiary's annual accounts for the financial year in question give a true and fair view of its assets and liabilities, financial position and profit or loss, it is not contrary to the rule laid down in Article 31(1)(c)(aa) of the directive according to which, for the purpose of valuing the items shown in the annual accounts, only profits made at the balance-sheet date may be included for the national court to consider that the profits in question must be entered in the parent company's balance sheet for the financial year in respect of which they were appropriated by the subsidiary.

Parties

In Case C-234/94,

REFERENCE to the Court under Article 177 of the EC Treaty by the Bundesgerichtshof for a preliminary ruling in the proceedings pending before that court between

Waltraud Tomberger

and

Gebrueder von der Wettern GmbH,

on the interpretation of Articles 31(1) and 59 of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (OJ 1978 L 222, p. 11), as amended by the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts (OJ 1983 L 193, p. 1),

THE COURT (Fifth Chamber),

composed of: D.A.O. Edward (Rapporteur), President of the Chamber, J.-P. Puissechet, J.C. Moitinho de Almeida, C. Gulmann and M. Wathelet, Judges,

Advocate General: G. Tesauro,

Registrar: H. von Holstein, Deputy Registrar,

after considering the written observations submitted on behalf of:

- Mrs Tomberger, by Hansjuergen Herrmann, Rechtsanwalt, Cologne,
- Gebrueder von der Wettern GmbH, by Adelgund Hofmeister, Rechtsanwalt, Cologne,
- the German Government, by Alfred Dittrich, Regierungsdirektor in the Federal Ministry of Justice, and Bernd Kloke, Oberregierungsrat in the Federal Ministry for the Economy, acting as Agents,
- the Commission of the European Communities, by Antonio Caeiro and Juergen Grunwald, Legal Advisers, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Mrs Tomberger, represented by Klaus Heinemann, Rechtsanwalt, Cologne, Gebrueder von der Wettern GmbH, represented by Adelgund Hofmeister, the German Government, represented by Alfred Dittrich, the United Kingdom, represented by David Anderson, Barrister, and the Commission, represented by Juergen Grunwald, at the hearing on 16 November 1995,

after hearing the Opinion of the Advocate General at the sitting on 25 January 1996,

gives the following

Judgment:

Grounds

1 By order of 21 July 1994, received at the Court on 18 August 1994, the Bundesgerichtshof (Federal Court of Justice) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty a question on the interpretation of Articles 31(1) and 59 of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (hereinafter “the Fourth Directive”), as amended by the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts.

2 That question was raised in proceedings between Mrs Tomberger (hereinafter “the plaintiff”) and Gebrueder von der Wettern GmbH (hereinafter “the defendant”), a company governed by German law and established in Germany.

3 Article 2(3) of the Fourth Directive provides, in the same terms as the fourth recital of the preamble, as follows:

“The annual accounts shall give a true and fair view of the company' s assets, liabilities, financial position and profit or loss.”

4 Article 2(5) lays down that:

“Where in exceptional cases the application of a provision of this directive is incompatible with the obligation laid down in paragraph 3, that provision must be departed from in order to give a true and fair view within the meaning of paragraph 3.”

5 Article 31(1) of the Fourth Directive provides:

“(1) The Member States shall ensure that the items shown in the annual accounts are valued in accordance with the following general principles:

(...)

(c) valuation must be made on a prudent basis, and in particular:

(aa) only profits made at the balance-sheet date may be included;

(bb) account must be taken of all foreseeable liabilities and potential losses arising in the course of the financial year concerned or of a previous one, even if such liabilities or losses become apparent only between the date of the balance sheet and the date on which it is drawn up;

(...)

(d) account must be taken of income and charges relating to the financial year, irrespective of the date of receipt or payment of such income or charges;

(...)"

6 Article 59(1) of the Fourth Directive, as amended by the Seventh Directive, provides as follows:

"A Member State may require or permit that participating interests, as defined in Article 17, in the capital of undertakings over the operating and financial policies of which significant influence is exercised, be shown in the balance sheet in accordance with paragraphs (2) to (9) below, as sub-items of the items 'shares in affiliated undertakings' or 'participating interests', as the case may be."

7 Article 59(2) to (9), as amended, lays down two methods of valuing the holdings referred to in paragraph (1).

8 The plaintiff, a shareholder in the defendant company, challenges that company's annual accounts for the financial year 1 January 1989 to 31 December 1989 as approved on 19 October 1990 by the general meeting of the company.

9 The defendant, in particular, has a 100% shareholding in the companies Technische Sicherheitssystem GmbH and Gesellschaft fuer Bauwerksabdichtungen mbH (hereinafter "TSS and GfB").

10 On 29 June 1990 the annual accounts of TSS and GfB, likewise for the financial year 1 January 1989 to 31 December 1989, were approved by resolutions of their respective general meetings. Those accounts showed that certain profits had been appropriated to the defendant for the financial year 1989 but had not yet been paid to it.

11 The defendant's annual accounts for 1989 showed the profits distributed to it by TSS and GfB for the financial year 1988 but not those appropriated to it for the financial year 1989.

12 The plaintiff considered that under the Fourth Directive the defendant's annual accounts for the financial year 1989 should have included the profits appropriated to it by TSS and GfB for that same year; she therefore brought an action before the Landgericht (Regional Court) for annulment of the resolution of the general meeting approving the defendant's annual accounts for 1989. The action was dismissed at first instance and on appeal, whereupon the plaintiff appealed to the Bundesgerichtshof on a point of law.

13 The Bundesgerichtshof considers that the entitlement of an undertaking (the parent company) which is the sole or majority shareholder of another company (the subsidiary) to the profits of the subsidiary is sufficiently certain at the balance-sheet date for it to be regarded as forming part of the assets of the parent company. It follows, in its view, that the debt receivable by the parent company from its subsidiary company must be included in the annual accounts of the parent company as from the date when the corresponding liability of the subsidiary company came into

being. However, the Bundesgerichtshof is in doubt as to the compatibility of that view with the requirements of the Fourth Directive.

14 The Bundesgerichtshof therefore decided to stay proceedings pending a ruling from the Court of Justice on the following question:

“Is there an infringement of Article 31(1)(c)(aa) of the Fourth Directive 78/660/EEC of 25 July 1978, according to which only profits made at the balance-sheet date may be included, and of the principles laid down in Article 59 of that directive on the ‘equity method’, if the profit entitlement of an undertaking, as against a private limited company in which it is the sole or majority shareholder and in respect of which the presumptions of dependency within the meaning of Paragraph 17(2) of the Aktiengesetz (Law on Private Companies) and of belonging to a single group within the meaning of the third sentence of Paragraph 18(1) of that Law have not been rebutted, is regarded as forming part as from the balance-sheet date of the subsidiary company of the assets of the undertaking which is the sole or majority shareholder and must therefore be shown as an asset of the latter ‘as from that date’, on the assumption that the financial years of the two undertakings coincide and the meeting of shareholders in the private limited company controlled by the other resolves to adopt the annual accounts and appropriate the profits at a time when the auditing of the annual accounts of the undertaking which is the sole shareholder has not yet been completed?”

15 It should be emphasized at the outset that, as appears from the terms of the question referred and the order for reference, the question arises in the context of a highly specific set of circumstances:

- the parent company is the sole shareholder in the subsidiary, and controls it,
- under national law, the parent company and the subsidiary form a group,
- the financial years of the two companies coincide,
- the subsidiary’s annual accounts for the financial year in question were adopted by its general meeting before completion of the audit of the parent company’s annual accounts for that year,
- the subsidiary’s annual accounts for the financial year in question, as adopted by its general meeting, show that on the subsidiary’s balance-sheet date namely the last day of that financial year the subsidiary appropriated profits to the parent company, and
- in the light of the presumptions of national law as to the relationship between the parent company and its subsidiary, the national court considers that the parent company’s entitlement to the profits in question is sufficiently certain at the balance-sheet date of the two companies for it to be regarded as forming, at that date, part of the assets of the parent company.

16 As regards Article 59 of the Fourth Directive, as amended, to which the national court refers, it is sufficient to note, as the Advocate General has done at point 12 of his Opinion, that this provision can have no bearing on the resolution of the dispute in the main proceedings since the German legislature has not exercised the option made available to it under that article, so that the methods of valuation there provided for do not apply in Germany.

17 With regard to Article 31 of the Fourth Directive, it should be borne in mind that the Fourth Directive seeks to coordinate national provisions concerning the presentation and content of annual accounts of certain types of companies (see the first recital of the preamble). In order to coordinate the content of annual accounts, the directive lays down the principle of the “true and

fair view”, compliance with which is the primary objective of the directive. According to that principle, the annual accounts of the companies to which the Fourth Directive applies must give a true and fair view of their assets and liabilities, financial position and profit or loss (see the fourth recital in the preamble to the Fourth Directive and Article 2(3) and (5) thereof).

18 Application of that principle must, as far as possible, be guided by the general principles contained in Article 31 of the Fourth Directive. In this case, the principles set out in Article 31(1)(c)(aa) and (bb) and (d) are of particular importance.

19 First, Article 31(1)(c)(aa) provides that only profits made at the balance-sheet date may be included in the balance sheet.

20 Second, Article 31(1)(d) provides that account must be taken in the balance sheet for a financial year of all income and charges relating to that year, irrespective of the date of receipt or payment of such income or charges.

21 Third, in accordance with Article 31(1)(c)(bb), account must be taken of liabilities and losses arising in the course of a financial year even if they become apparent only between the end of the financial year and the date on which the balance sheet for that year is drawn up.

22 It is clear from those provisions that taking account of all elements - profits made, charges, income, liabilities and losses - which actually relate to the financial year in question ensures observance of the requirement of a true and fair view.

23 In the present case, according to the subsidiary’s annual accounts, the profits in question were made by that company during the financial year 1989 and were appropriated by it to the parent company as at 31 December 1989, that is to say before the end of that financial year. Before examining the parent company’s accounts, the national court must be satisfied that there is no reason to question that that presentation of the subsidiary’s financial position complies with the principle of the true and fair view.

24 It follows from all the foregoing that, if the subsidiary’s accounts themselves comply with the principle of the true and fair view, it is not contrary to the rule laid down in Article 31(1)(c)(aa) of the Fourth Directive for the national court to consider that, in the circumstances described, the profits in question must be entered in the parent company’s balance sheet for the financial year in respect of which the subsidiary appropriated them.

25 The answer to the question referred by the national court must therefore be that, where

- one company (the parent company) is the sole shareholder in another company (the subsidiary), and controls it,
- under national law, the parent company and the subsidiary form a group,
- the financial years of the two companies coincide,
- the subsidiary’s annual accounts for the financial year in question were adopted by the general meeting before completion of the audit of the parent company’s annual accounts for that year,
- the subsidiary’s annual accounts for the financial year in question, as adopted by its general meeting, show that on the subsidiary’s balance-sheet date - namely the last day of that financial year - the subsidiary appropriated profits to the parent company, and
- the national court is satisfied that the subsidiary’s annual accounts for the financial year in

question give a true and fair view of its assets and liabilities, financial position and profit or loss, it is not contrary to the rule laid down in Article 31(1)(c)(aa) of the Fourth Directive for the national court to consider that the profits in question must be entered in the parent company's balance sheet for the financial year in respect of which they were appropriated by the subsidiary.

Decision on costs

Costs

26 The costs incurred by the German Government and the United Kingdom, and by the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

Operative part

On those grounds,

THE COURT (Fifth Chamber),

in answer to the question referred to it by the Bundesgerichtshof by order of 21 July 1994, hereby rules:

Where

- one company (the parent company) is the sole shareholder in another company (the subsidiary), and controls it,
- under national law, the parent company and the subsidiary form a group,
- the financial years of the two companies coincide,
- the subsidiary's annual accounts for the financial year in question were adopted by the general meeting before completion of the audit of the parent company's annual accounts for that year,
- the subsidiary's annual accounts for the financial year in question, as adopted by its general meeting, show that on the subsidiary's balance-sheet date ; namely the last day of that financial year - the subsidiary appropriated profits to the parent company, and
- the national court is satisfied that the subsidiary's annual accounts for the financial year in question give a true and fair view of its assets and liabilities, financial position and profit or loss, it is not contrary to the rule laid down in Article 31(1)(c)(aa) of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, as amended by the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts, for the national court

to consider that the profits in question must be entered in the parent company's balance sheet for the financial year in respect of which they were appropriated by the subsidiary.

Conclusions No. 10491/00 of the ECOFIN-Council of 17 July 2000

Conclusions of the Council No. 10491/00 of 17 July 2000



COUNCIL OF THE EUROPEAN UNION						
DG MARCHÉ INTERIEUR						
3109/00						
DG	DGA	ASX	CF	RES	BUD	
A	B	C	D	E	F	PAR

Brussels, 17 July 2000

10491/00

LIMITE

ECOFIN 213

OUTCOME OF PROCEEDINGS

of: ECOFIN Council

on: 17 July 2000

Subject: **Regulation of European Securities Markets****- Terms of reference for the Committee of Wise Men**

The introduction of the euro and the resulting structural changes have speeded up integration of the European financial market. To deliver the full prospective benefits to European business and the EU economy, to compete in the global market for financial services and to help European business to compete in the global market for goods and services, EU capital markets need to be dynamic, competitive and innovative. They need to embrace new technology and new opportunities. To support this, regulation of capital markets needs to support the Lisbon vision of a dynamic knowledge-driven economy, with good access to capital in order for businesses to invest, grow and create jobs.

A single market in securities must be achieved rapidly to allow:

- more competitive financing on the markets of EU enterprises, including SMEs
- increased liquidity and
- greater competitiveness between intermediaries and infrastructures, in order to achieve better provision of services at lower cost.

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However, growth and competitiveness will be hampered unless the administrative, regulatory or other types of obstacles which in practice impede cross-border securities transactions are eliminated.

Regulation of the markets and of financial reporting in Europe is based primarily on European directives which have established standards for regulation of a broad range of financial activities. This legislation, which was drawn up in the context of fragmented national markets, may need to be adjusted in the light of market developments. The Financial Services Action Plan is designed to make progress in these areas and remove the most significant barriers to the single market.

However, given the scope of the changes taking place on the market, it seems clear that an appropriate response is also required from national regulators.

It is therefore necessary to follow up the Action Plan with discussion on the conditions for practical implementation of the directives by the competent national authorities so as to meet the expectations of dealers and brokers, issuers and investors who wish to be able to deal with one another throughout the European Union in an effective, entirely secure and informed manner.

Taking into account the existing institutional framework, the need to respond effectively to the challenges of integrating the financial markets makes it necessary to set up a committee of independent persons, to be assisted by the Commission. The Committee will therefore focus its discussion on the practical arrangements for implementation of the Community rules concerning the areas identified by the Action Plan and will propose various approaches to adjusting the practice of regulation and cooperation between regulators in response to current developments. Without prejudice to the work being done in the framework of the Financial Services Action Plan and taking into account the measures being undertaken by securities market regulators within FESCO, the Committee will consider how to achieve a more effective approach towards transposition and implementation, in particular in the following areas of regulation : the listing of enterprises, the public offer of securities and requirements relating to reporting by issuers, the conduct of cross-border financial operations, the day-to-day operation of the regulated markets, the protection of consumers and investors in the provision of investment services, and the integrity of the market.

In this context, the Committee will have to :

1. assess the current conditions for implementation of the regulation of the securities markets in the European Union.

In addition, the Council invites the Commission to identify a priority -related critical path to achieving the relevant parts of the Lisbon target of Financial Services Action Plan, and the implementation, by 2003, of the Risk Capital Action Plan. The Commission will propose possible indicators of progress in realising economic benefits. The Commission will report to the Council on November 27th.

2. assess how the mechanism for regulating the securities markets in the European Union can best respond to developments under way on the securities markets, including the creation of markets resulting from either the alliance of European (and non-European) stock exchanges or from technical innovation (ATS), while still guaranteeing the effective and dynamic operation of markets throughout the European Union to achieve a level playing field.
3. in order to eliminate barriers and obstacles, propose as a result scenarios for adapting current practices in order to ensure greater convergence and co-operation in day-to-day implementation and take into account new developments on the markets.

It will not, however, deal with the prudential supervision.

The Committee should be able to present an initial report to the ECOFIN Council early in November 2000. This report will present the state of play and initial approaches to solutions. The final report will be presented to ECOFIN during the first six months of 2001.



The Council appointed the following members of the Committee :

- Alexandre Lamfalussy
- Cornélis Herkströter
- Luis Angel Rojo
- Bengt Rydén
- Luigi Spaventa
- Norbert Walter
- Sir Nigel Wicks

European Commission Comments 2003

COMMISSION OF THE EUROPEAN COMMUNITIES
Brussels, November 2003
Comments

Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, November 2003

Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting

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1. INTRODUCTION

1. The Regulation (EC) No 1606/2002 of the European Parliament and the Council of 19 July 2002 on the application of international accounting standards¹ (IAS Regulation) harmonises the financial information presented by public listed companies in order to ensure a high degree of transparency and comparability of financial statements.

2. The Fourth Council Directive 78/660/EEC of 25 July 1978² and the Seventh Council Directive 83/349/EEC of 13 June 1983³ are the main harmonization instruments in the accounting field within the European Union.

3. In this paper, the Commission comments on topics where authoritative clarification appears to be required. The topics have been chosen after taking into account discussions in the Accounting Regulatory Committee set up pursuant to Article 6 of the IAS Regulation as well as discussions in the Contact Committee set up pursuant to Article 52 on the Fourth Council Directive.

4. The views expressed in this paper do not necessarily represent the views of the Member States and should not, in themselves impose any obligation on them. They do not prejudice the interpretation that the Court of Justice, as the final instance responsible for interpreting the Treaty and secondary legislation, might place on the matters at issue.

5. Both the Accounting Regulatory Committee and the Contact Committee consist of representatives of the Member States and the Commission. The Accounting Regulatory Committee assists the Commission in the endorsement of international accounting standards, while the Contact Committee has an important function to facilitate a harmonized application of the Accounting Directives through regular meetings, dealing in particular with practical problems arising in connection with their application.

6. The International Accounting Standards (IASs) and the Interpretations of the Standing Interpretations Committee (SICs) referred to in this paper are those that were adopted by the International Accounting Standards Board (IASB) in April 2001, when the IASB endorsed the body of IASs issued by its predecessor, the International Accounting Standards Committee (IASC). The accounting standards that the IASB will develop will be called International Financial Reporting Standards (IFRSs) and the interpretations of IFRSs will be published as interpretations of the International Financial Reporting Interpretations Committee (IFRICs).

7. For the purpose of this paper, IASs and IFRSs are referred to as either IASs or IFRSs; SICs and IFRICs are referred to as either SICs or IFRICs.

¹ OJ L 243, 11.9.2002, p. 1

² OJ L 222, 14.8.1978, p. 11, Directive as last amended by Directive 2003/51/EC of the European Parliament and of the Council (OJ L 178, 17.07.2003, p.16

³ OJ L 193, 18.7.1983, p. 1, Directive as last amended by Directive 2003/51/EC of the European Parliament and of the Council (OJ L 178, 17.07.2003, p.16

2. THE IAS REGULATION

2.1. Article 3: Adoption and use of international accounting standards

2.1.1. Endorsement criteria of IASs

Whether a standard is suitable for application in the EU will depend on that standard meeting certain criteria set out in the IAS Regulation. These criteria require that IASs:

- are not contrary to the principle set out in Article 16(3) of Council Directive 83/349/EEC and in Article 2(3) of Council Directive 78/660/EEC and
- are conducive to the European public good and,
- meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

In considering whether the application of a standard results in a true and fair view of the financial position and performance of an enterprise, this principle is considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives.

2.1.2. Languages and availability of IASs

Adopted IASs and SICs will be freely available (via the Official Journal) in all Community languages. Adopted standards and interpretations will be published in the Official Journal of the European Union. These standards will also be available on our web site:

http://europa.eu.int/comm/internal_market/accounting/index_en.htm

2.1.3. IASs not yet endorsed and IASs rejected by the EU

Where it applies, the IAS Regulation requires that accounts be prepared in accordance with endorsed IASs i.e. IASs adopted by the EU further to the IAS Regulation. Accordingly, if a standard is not endorsed it is not required or in certain instances not permitted to be applied by a company preparing its accounts further to the IAS Regulation.

To the extent that a standard which has not yet been endorsed by the EU is not inconsistent with endorsed standards and is consistent with the conditions set out in IAS 1 paragraph 22⁴ it may be used as guidance.

⁴ In the absence of a specific International Accounting Standard and an Interpretation of the Standing Interpretations Committee, management uses its judgement in developing an accounting policy that provides the most useful information to users of the enterprise's financial statements. In making this judgement, management considers:

To the extent that a standard has been rejected by the EU but is not inconsistent with endorsed standards and is consistent with the conditions set out in IAS 1 paragraph 22, it may be used as guidance.

To the extent that a rejected standard conflicts with a standard which has been endorsed – for example where an endorsed standard is amended – the rejected standard may not be applied. The company must continue to apply fully the standard endorsed by the EU.

IAS 1 requires that the notes to the financial statements present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied. These requirements will necessitate clear disclosure of both the standards applied and of any other standards or guidance applied by the company further to paragraphs 20 and 22 of IAS 1.

2.1.4. Statement in the accounting policies

The legal requirement in the IAS Regulation is for the accounts to be prepared in accordance with *adopted* IASs i.e. IASs endorsed by the EU. It is therefore appropriate that this should be made clear in the accounting policies. Following the change of name from International Accounting Standards to International Financial Reporting Standards and consistent with the guidance contained in the ‘Preface to Statements of International Accounting Standards’, such a statement should refer to the financial statements having been prepared ‘... in accordance with all International Financial Reporting Standards adopted for use in the European Union’. However, if the application of adopted IFRSs results in financial statements that also comply with all IFRSs, because no standards have been rejected and all standards issued by the IASB have been endorsed, then it would not be necessary to state "adopted for use in the European Union", but simply ‘... in accordance with all International Financial Reporting Standards’.

2.1.5. Status of the IASB Framework, the Appendices to IASs and the Implementation Guidance to IASs

IAS 1 states that the application of International Accounting Standards (IASs) and Interpretations of the Standing Interpretations Committee (SICs) (Interpretations), with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation. IAS 1 states further that financial statements shall not be described as complying with IASs and Interpretations unless they comply with all the requirements of each applicable Standard and Interpretation.

(a) the requirements and guidance in International Accounting Standards dealing with similar and related issues;
(b) the definitions, recognition and measurement criteria for assets, liabilities, income and expenses set out in the IASC Framework; and
(c) pronouncements of other standard setting bodies and accepted industry practices to the extent, but only to the extent, that these are consistent with (a) and (b) of this paragraph.'

IASs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. IASs are based on the *Framework for the Preparation and Presentation of Financial Statements* (“the Framework”), which addresses the concepts underlying the information presented in general purpose financial statements. The objective of the Framework is to facilitate the consistent and logical formulation of IASs.

However, the Framework itself is not an IAS or Interpretation and therefore does not need to be adopted into Community law. Nevertheless, it does provide the basis for the use of judgement in resolving accounting issues. This is of particular relevance in situations where there is no particular Standard or Interpretation that specifically applies to an item in the financial statements. In such situations, IASs require management to use their judgement in developing and applying an accounting policy that results in information that is relevant and reliable. In making such judgements, IASs require management to consider, inter alia, the definitions, recognition criteria and measurement concepts set out in the Framework.

Similarly, when an IAS or Interpretation does apply to an item in the financial statements, management is required to select the accounting policy to be applied to that item by considering also any Appendices to the Standard that do not form a part of the IAS (such as the Basis for Conclusions) and any Implementation Guidance issued in respect of the IAS.

In view of its importance to the resolution of accounting issues, the IASB Framework has been annexed to this paper. Users of IASs should, in addition, consult individual IASs and Interpretations in order to ensure that any Appendices and Implementation Guidance are properly considered in determining the appropriate application of IASs.

2.2. Article 4: Consolidated accounts of publicly traded companies

2.2.1. Definition of "companies"

Articles 4 and 5 of the IAS Regulation refer to ‘companies’. Companies are defined by the Treaty of Rome, Article 48 (ex Article 58) as follows:

Article 48 (ex Article 58) second paragraph:

...

"Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

This definition is reflected in the scope of each of the following related Accounting Directives, which have as their legal base the Treaty's Article 54 (new Treaty, Article 44), which makes a reference to Article 58 of the Treaty (new Treaty, Article 48),:

- The Fourth Council Directive (78/660/EEC) of 25 July 1978 based on Article 54(3)(g) of the Treaty (new Treaty version 44(2)(g) on the annual accounts of certain types of companies sets out the requirements in respect of the preparation of the annual accounts of companies⁵.
- The Seventh Council Directive (83/349/EEC) of 13 June 1983 based on Article 54(3)(g) of the Treaty (new Treaty version 44(2)(g) on consolidated accounts sets out the requirements in respect of the preparation of consolidated accounts⁶.
- Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions deals with those matters specific to such institutions⁷ (having regard to Article 54(3)(g) of the Treaty (new Treaty version 44(2)(g); and
- Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings sets out the specific requirements relevant to the preparation of accounts of such entities⁸ (having regard to Article 54 of the Treaty (new Treaty, Article 44).

The IAS Regulation is addressed only to EU companies. It does not set out requirements for non-EU companies.

2.2.2. Definition of "consolidated accounts"

As the IAS Regulation only applies to ‘consolidated accounts’, it only takes effect where such consolidated accounts are otherwise required.

The determination of whether or not a company is required to prepare consolidated accounts will continue to be made by reference to national law transposed from the Seventh Council Directive. For the avoidance of doubt, the following Articles of the Seventh Council Directive are relevant to the existence of such a requirement: Articles 1, 2, 3(1) 4, 5-9, 11, and 12.

These requirements are considered further below.

a) General requirement

Subject to certain exemptions (see (b) below), the Seventh Council Directive (83/349/EEC) sets out the circumstances when a company is required to prepare consolidated accounts.

Where these circumstances (as transposed into national law), require the preparation of consolidated accounts, the requirements of the IAS Regulation apply to those accounts.

⁵ OJ No L222, 14.8.1978, p. 11, Directive as last amended by Directive 2003/51/EC (OJ No L178, 17.07. 2003, p. 16)

⁶ OJ No L193, 18. 7. 1983, p. 1, Directive as last amended by Directive 2003/51/EC (OJ No L178, 17. 07. 2003, p. 16)

⁷ OJ No L372, 31. 12. 1986, p. 1, Directive as last amended by Directive 2003/51/EC (OJ No L178, 17.07. 2003, p. 16)

⁸ OJ No L374, 31. 12. 1991, p. 7, Directive as last amended by Directive 2003/51/EC (OJ No L178, 17.07. 2003, p. 16)

b) Exemptions from the preparation of consolidated accounts

Exemptions from the general requirement to prepare consolidated accounts are set out in Articles 5, 7-11 of the Seventh Council Directive (83/349/EEC). In addition, Article 6 of the Seventh Council Directive provides an exemption on the grounds of size alone.

Where a company is not required to prepare consolidated accounts as a result of an exemption contained in national law derived from the Accounting Directives, the requirements of the IAS Regulation in respect of consolidated accounts do not apply – as there are no ‘consolidated accounts’ to which to apply those requirements.

c) Exclusions from consolidation

Certain exclusions from the scope of the consolidation are provided for in Articles 13 to 15 of the Seventh Directive.

As noted above, it is the national law derived from the Accounting Directives that determines whether or not consolidated accounts are required. However, if consolidated accounts are so required, it is the requirements of endorsed IASs that will dictate the scope of consolidation and, therefore, which entities should be included in those consolidated accounts and how they should be included.

Accordingly, the exclusions from the scope of the consolidation derived from the Accounting Directives are not relevant – the consolidated accounts are prepared in accordance with endorsed IASs.

2.2.3. Interim reporting requirements

There is no direct impact upon interim reporting requirements as the scope of the IAS Regulation covers only annual and consolidated accounts.

To the extent that a company is required to prepare an interim report and where that report is prepared on a basis consistent with the annual (or consolidated) accounts, it is clear that there is an indirect impact of the change to IASs.

It should be noted that the Commission has recently made a proposal for a directive on the harmonisation of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC. This directive establishes requirements in relation to the disclosure of periodic and ongoing information about issuers whose securities are already admitted to trading on a regulated market situated or operating within a Member State. Further information can be found at the web site: http://europa.eu.int/comm/internal_market/en/finances/mobil/transparency/index.htm

CESR (Committee of European Securities Regulators) has issued for public consultation a draft recommendation for additional guidance regarding the transition to IFRS in 2005. This recommendation articulates a number of proposals to ensure a smooth transition to IAS through proper interim information in 2005. CESR recommends that market participants be provided

during 2005 with financial information consistent with the IAS-based information they will receive relating to the full year ending on or after 31 December 2005. Listed companies are therefore encouraged to use the same IAS measurement and recognition principles for preparing interim financial reports as for their year-end reporting under IAS. Further information can be found on the web site of CESR: www.europefesco.org.

2.3. Use of IASs before 2005

In terms of listed companies⁹, the IAS Regulation is directly applicable to their consolidated accounts. Article 4 of the IAS Regulation contains no requirements prior to 2005 and envisages no voluntary early adoption.

This would suggest that, solely on the basis of the IAS Regulation, adopted (i.e. endorsed) IASs would not be permitted or required prior to 2005.

However, on 13 June 2000, the Commission adopted its Communication *The EU's Financial Reporting Strategy: the Way Forward* (COM (2000)359, 13.06.2000). The Communication proposed that all EU listed companies should be required to prepare their consolidated accounts in accordance with a single set of accounting standards, namely International Accounting Standards (IASs), from 2005 at the latest. This strategy has been endorsed by the Commission and Member States through the IAS Regulation.

Consequently, it would not be inconsistent with this strategy for Member States to permit or require listed companies to prepare their consolidated accounts for a year prior to 2005 in accordance with IASs under national law.

In terms of private companies (and annual accounts), the IAS Regulation applies via the Member State option in Article 5. This article does not have any time reference. Member States may therefore permit or require consolidated accounts of unlisted companies and annual accounts to be prepared in accordance with endorsed IASs as soon as they choose.

2.4. Clarification of Article 9

Where a Member State exercises the option in Article 9(b) of the IAS Regulation, the extension until 2007 applies only in respect of companies that are using internationally accepted standards as the basis for their primary statements in their statutorily required consolidated accounts, for the purposes of a non-EU listing. It does not apply where national GAAP is used, even if reconciliation to internationally accepted standards is provided either within or separate to the statutory consolidated accounts. Similarly, there is no extension to 2007 where separate, non-statutory accounts are prepared on the basis of internationally accepted standards.

The extension is also unavailable where required compliance with national GAAP happens to lead to compliance with internationally accepted standards also. Such coincidence may be

⁹ 'Listed Companies' means those companies whose securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

transitory – the appropriate test is whether internationally accepted standards are permitted as the basis for the preparation of the primary statements and have been so adopted.

3. THE INTERACTION BETWEEN THE IAS REGULATION AND THE ACCOUNTING DIRECTIVES

3.1. Annual and consolidated accounts of listed EU companies

Article 5 of the IAS Regulation sets out an option, allowing Member States to permit or require the application of adopted IASs in the case of annual accounts of listed EU companies.

In respect of the consolidated accounts of listed EU companies, the IAS Regulation is directly applicable to the company drawing up accounts. The Accounting Directives apply to companies through their transposition into national law.

Accordingly, there is no direct interaction between a Directive and a Regulation as only one is directly applicable to companies. Accordingly, the issue properly concerns the interaction of national law and the IAS Regulation.

The issue of interaction is only relevant to the extent that national law deals with the same subject matter as the IAS Regulation. Some aspects of national law transposed from the Accounting Directives deal with matters outside the scope of the IAS Regulation and will continue to apply, for example the annual report (Fourth Directive, Article 46). In this instance, the IAS Regulation deals solely with ‘consolidated accounts’ (together with certain options in respect of annual accounts). It follows that the additional information in or accompanying the annual (and consolidated annual) report falls outside the scope of the IAS Regulation.

Other matters which are dealt with in the Accounting Directives, which are outside the scope of the IAS Regulation and will continue to apply include:

- Publication: Article 47 of the Fourth and Article 38 of the Seventh Directives;
- Audit matters: Articles 48 and 51 of the Fourth and Article 37 of the Seventh Directives,
- Other matters: Article 53 of the Fourth Directive.

To the extent that the scope is the same (i.e. with respect to the consolidated or annual accounts themselves), the interaction is as follows:

No transposed provision of the Accounting Directives may restrict or hinder a company’s compliance with (or choice under) adopted IASs, further to the IAS Regulation. In other words, a company applies endorsed IASs irrespective of any contrary, conflicting or restricting requirements in national law. As such, Member States are not able to restrict explicit choices contained in IASs.

In a principles-based system such as IASs there will always exist transactions or arrangements that are not covered by explicit rules. In such circumstances IASs specifically require

management to use its judgement to determine the most appropriate accounting treatment (IAS 1, paragraph 22). This judgement does not amount to a free choice, as IASs require that it is exercised having regard to the IASB Framework, definitions, other standards and best practice. Consistent with the application of adopted IASs further to the IAS Regulation, national law may not, by specifying particular treatments, restrict or hinder this requirement to apply judgement in the manner envisaged.

As the IAS Regulation is directly applicable, Member States will ensure that they do not seek to apply to the company any additional elements of national law that are contrary to, conflict with or restrict a company's compliance with adopted IASs, further to the IAS Regulation.

3.2. Annual and consolidated accounts of unlisted companies

Article 5 of the IAS Regulation sets out an option, allowing Member States to permit or require the application of adopted IASs in the case of annual accounts and/or the consolidated accounts of unlisted EU companies.

Where a Member State so requires the use of IASs, further to Article 5 of the IAS Regulation, IASs become directly applicable to those accounts of the company.

Accordingly, the same interaction applies in respect of the annual accounts and the consolidated accounts of unlisted companies that are prepared further to the implementation of the Member State option in Article 5 of the IAS Regulation as applies in the case of the consolidated accounts of listed EU companies.

This interaction is the same irrespective of whether the accounts are prepared in accordance with IASs as a result of a *requirement* that they be so prepared, or as a result of a choice given to the company by national law further to Article 5.

3.3. Articles of the transposed Accounting Directives still applying to companies after the IAS Regulation

The general interaction of the IAS Regulation and the transposed Accounting Directives is discussed under paragraphs 3.1 and 4.1. The specific interaction concerning the entities to be included in consolidated accounts prepared in accordance with endorsed IASs is considered in paragraph 2.2.2.

A company which is required to prepare **consolidated accounts** and which falls within the scope of the IAS Regulation as a result of either the application of Article 4 or of Article 5 of the IAS Regulation, is required to comply with national law transposed from those Articles in the Fourth and Seventh Directives that deal with the audit, consolidated annual report and certain disclosures that are beyond the scope of International Accounting Standards. For the avoidance of doubt, the

following Articles in the Fourth and Seventh Council Directives continue to be relevant to such consolidated accounts:

- (a) In the case of the Fourth Council Directive, Article 58(c); and
- (b) In the case of the Seventh Council Directive, Articles 34(2)-(5), 34(9), 34(12), 34(13), 35(1), 36, 37, and 38.

A company which is required to prepare **annual accounts** and which falls within the scope of the IAS Regulation as a result of the application of Article 5 of the IAS Regulation, is required to comply with national law transposed from those Articles in the Fourth and Seventh Directives that deal with the audit, annual report and certain disclosures that are beyond the scope of International Accounting Standards. For the avoidance of doubt, the following Articles in the Fourth and Seventh Council Directives continue to be relevant to such annual accounts:

- (a) In the case of the Fourth Council Directive, Articles 11, 12, 27, 43(1)(2), 43(1)(9), 43(1)(12), 43(1)(13), 45(1), 46, 47(1), 47(1a), 47(2) last sentence, 48, 49, 51, 51a, 53, 56(2), 57 and 58.
- (b) In the case of the Seventh Council Directive, Article 9(2)

3.4. IASs as part of national accounting law

Companies which are not subject to the IAS Regulation continue to have national accounting requirements derived from the Accounting Directives as the basis for their accounts.

Provided that a given IAS is consistent with a transposition of the Accounting Directives, Member States may require that IAS to be applied by such companies. Clearly, such a requirement could be extended to cover all IASs and their interpretations.

In such instances, the company remains under the requirements of national law and the restriction upon additional measurement or disclosure requirements as part of that national law referred to in paragraphs 3.1 and 4.1 do not apply.

4. DISCLOSURE ISSUES

4.1. Member State requirements of additional disclosures above IASs

The maximum benefits of the application of a single financial reporting framework as envisaged in the IAS Regulation, whereby all relevant accounts are directly comparable, will be achieved where Member States do not seek disclosure, in the annual or consolidated accounts prepared in accordance with adopted IASs further to the IAS Regulation, of qualitative or quantitative disclosures that are not relevant to such general purpose financial statements or of information that would more appropriately be reported separately.

Consistent with the interaction of national law and IASs considered in paragraph 3.1, additional disclosure requirements included in national law, whether transposed from the Accounting Directives or at the initiative of the Member State itself, may continue to apply where they are relevant to such general purpose financial statements and are outside the scope of endorsed IASs.

Additional disclosure may still be required by e.g. supervisory authorities or securities regulators of matters which:

- are to be given outside the annual (or consolidated) accounts to which the IAS Regulation applies – say in the annual report or in a separate schedule annexed to the accounts; or
- are to be given within the notes to the annual (or consolidated) accounts to which the IAS Regulation applies when the subject matter is perceived as highly relevant to those general purpose accounts (for example, certain corporate governance related disclosures such as management remuneration by individual) but falls outside the scope of IASs as it is not necessary for the presentation of a true and fair view in accordance with IASs.

4.2. IASs formats and a chart of accounts

IASs describe the manner in which the items disclosed on the face of the profit and loss account and the balance sheet should be determined.

In respect of the profit and loss account, IASs permit two approaches, disclosure by *function* or by *nature*. Where disclosure by function is adopted, certain additional information by nature is required. Disclosure by function or nature follows the same principles that determine the alternative formats set out in the Fourth Council Directive.

In respect of the balance sheet, assets are presented either in order of their liquidity or on the basis of a current/non-current distinction. These presentations are very similar to those envisaged by the Fourth Council Directive which requires distinctions between fixed and current assets and between short- and long term liabilities.

As IASs are only relevant to external, general purpose financial reporting, there are no explicit requirements in IASs concerning the structure of the internal management information (or chart of accounts) which must be maintained by the company; though clearly such internal information must be at least sufficient to support the preparation of the information required for external financial reporting.

As the IAS Regulation applies directly to individual companies, Member States cannot impose their own formats and therefore endorsed IASs shall be applied.

5. ANNEX

Framework for the Preparation and Presentation of Financial Statements

The IASB Framework was approved by the IASC Board in April 1989 for publication in July 1989, and adopted by the IASB in April 2001.

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Preface

Financial statements are prepared and presented for external users by many enterprises around the world. Although such financial statements may appear similar from country to country, there are differences which have probably been caused by a variety of social, economic and legal circumstances and by different countries having in mind the needs of different users of financial statements when setting national requirements.

These different circumstances have led to the use of a variety of definitions of the elements of financial statements; that is, for example, assets, liabilities, equity, income and expenses. They have also resulted in the use of different criteria for the recognition of items in the financial statements and in a preference for different bases of measurement. The scope of the financial statements and the disclosures made in them have also been affected.

The International Accounting Standards Committee (IASC) is committed to narrowing these differences by seeking to harmonise regulations, accounting standards and procedures relating to the preparation and presentation of financial statements. It believes that further harmonisation can best be pursued by focusing on financial statements that are prepared for the purpose of providing information that is useful in making economic decisions.

The Board of IASC believes that financial statements prepared for this purpose meet the common needs of most users. This is because nearly all users are making economic decisions, for example, to:

- (a) decide when to buy, hold or sell an equity investment;
- (b) assess the stewardship or accountability of management;
- (c) assess the ability of the enterprise to pay and provide other benefits to its employees;
- (d) assess the security for amounts lent to the enterprise;
- (e) determine taxation policies;
- (f) determine distributable profits and dividends;
- (g) prepare and use national income statistics; or
- (h) regulate the activities of enterprises.

The Board recognises, however, that governments, in particular, may specify different or additional requirements for their own purposes. These requirements should not, however, affect financial statements published for the benefit of other users unless they also meet the needs of those other users.

Financial statements are most commonly prepared in accordance with an accounting model based on recoverable historical cost and the nominal financial capital maintenance concept. Other models and concepts may be more appropriate in order to meet the objective of providing information that is useful for making economic decisions although there is presently no consensus for change. This Framework has been developed so that it is applicable to a range of accounting models and concepts of capital and capital maintenance.

Introduction

Purpose and Status

1. This Framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. The purpose of the Framework is to:
 - (a) assist the Board of IASC in the development of future International Accounting Standards and in its review of existing International Accounting Standards;
 - (b) assist the Board of IASC in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by International Accounting Standards;
 - (c) assist national standard-setting bodies in developing national standards;
 - (d) assist preparers of financial statements in applying International Accounting Standards and in dealing with topics that have yet to form the subject of an International Accounting Standard;
 - (e) assist auditors in forming an opinion as to whether financial statements conform with International Accounting Standards;
 - (f) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with International Accounting Standards; and
 - (g) provide those who are interested in the work of IASC with information about its approach to the formulation of International Accounting Standards.
2. This Framework is not an International Accounting Standard and hence does not define standards for any particular measurement or disclosure issue. Nothing in this Framework overrides any specific International Accounting Standard.
3. The Board of IASC recognises that in a limited number of cases there may be a conflict between the Framework and an International Accounting Standard. In those cases where there is a conflict, the requirements of the International Accounting Standard prevail over those of the Framework. As, however, the Board of IASC will be guided by the Framework in the development of future Standards and in its review of existing Standards, the number of cases of conflict between the Framework and International Accounting Standards will diminish through time.
4. The Framework will be revised from time to time on the basis of the Board's experience of working with it.

Scope

5. The Framework deals with:
 - (a) the objective of financial statements;
 - (b) the qualitative characteristics that determine the usefulness of information in financial statements;
 - (c) the definition, recognition and measurement of the elements from which financial statements are constructed; and
 - (d) concepts of capital and capital maintenance.
6. The Framework is concerned with general purpose financial statements (hereafter referred to as "financial statements") including consolidated financial statements. Such financial statements are prepared and presented at least annually and are directed toward the common information needs of a wide range of users. Some of these users may require, and have the power to obtain, information in addition to that contained in the financial statements. Many users, however, have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in

view. Special purpose financial reports, for example, prospectuses and computations prepared for taxation purposes, are outside the scope of this Framework. Nevertheless, the Framework may be applied in the preparation of such special purpose reports where their requirements permit.

7. Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, an income statement, a statement of changes in financial position (which may be presented in a variety of ways, for example, as a statement of cash flows or a statement of funds flow), and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about industrial and geographical segments and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report.
8. The Framework applies to the financial statements of all commercial, industrial and business reporting enterprises, whether in the public or the private sectors. A reporting enterprise is an enterprise for which there are users who rely on the financial statements as their major source of financial information about the enterprise.

Users and Their Information Needs

9. The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs for information. These needs include the following:
 - (a) *Investors*. The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the enterprise to pay dividends.
 - (b) *Employees*. Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.
 - (c) *Lenders*. Lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.
 - (d) *Suppliers and other trade creditors*. Suppliers and other creditors are interested in information that enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuation of the enterprise as a major customer.
 - (e) *Customers*. Customers have an interest in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.
 - (f) *Governments and their agencies*. Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises, determine taxation policies and as the basis for national income and similar statistics.
 - (g) *Public*. Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.
10. While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As investors are providers of risk capital to the enterprise, the provision of financial

statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy.

11. The management of an enterprise has the primary responsibility for the preparation and presentation of the financial statements of the enterprise. Management is also interested in the information contained in the financial statements even though it has access to additional management and financial information that helps it carry out its planning, decision-making and control responsibilities. Management has the ability to determine the form and content of such additional information in order to meet its own needs. The reporting of such information, however, is beyond the scope of this Framework. Nevertheless, published financial statements are based on the information used by management about the financial position, performance and changes in financial position of the enterprise.

The Objective of Financial Statements

12. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.
13. Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.
14. Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management.

Financial Position, Performance and Changes in Financial Position

15. The economic decisions that are taken by users of financial statements require an evaluation of the ability of an enterprise to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines, for example, the capacity of an enterprise to pay its employees and suppliers, meet interest payments, repay loans and make distributions to its owners. Users are better able to evaluate this ability to generate cash and cash equivalents if they are provided with information that focuses on the financial position, performance and changes in financial position of an enterprise.
16. The financial position of an enterprise is affected by the economic resources it controls, its financial structure, its liquidity and solvency, and its capacity to adapt to changes in the environment in which it operates. Information about the economic resources controlled by the enterprise and its capacity in the past to modify these resources is useful in predicting the ability of the enterprise to generate cash and cash equivalents in the future. Information about financial structure is useful in predicting future borrowing needs and how future profits and cash flows will be distributed among those with an interest in the enterprise; it is also useful in predicting how successful the enterprise is likely to be in raising further finance. Information about liquidity and solvency is useful in predicting the ability of the enterprise to meet its financial commitments as they fall due. Liquidity refers to the availability of cash in the near future after taking account of financial commitments over this period. Solvency refers to the availability of cash over the longer term to meet financial commitments as they fall due.
17. Information about the performance of an enterprise, in particular its profitability, is required in order to assess potential changes in the economic resources that it is likely to control in the future. Information about variability of performance is important in this respect. Information about performance is useful in predicting the capacity of the enterprise to generate cash flows from its existing resource base. It is also useful in forming judgements about the effectiveness with which the enterprise might employ additional resources.

18. Information concerning changes in the financial position of an enterprise is useful in order to assess its investing, financing and operating activities during the reporting period. This information is useful in providing the user with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. In constructing a statement of changes in financial position, funds can be defined in various ways, such as all financial resources, working capital, liquid assets or cash. No attempt is made in this Framework to specify a definition of funds.
19. Information about financial position is primarily provided in a balance sheet. Information about performance is primarily provided in an income statement. Information about changes in financial position is provided in the financial statements by means of a separate statement.
20. The component parts of the financial statements interrelate because they reflect different aspects of the same transactions or other events. Although each statement provides information that is different from the others, none is likely to serve only a single purpose or provide all the information necessary for particular needs of users. For example, an income statement provides an incomplete picture of performance unless it is used in conjunction with the balance sheet and the statement of changes in financial position.

Notes and Supplementary Schedules

21. The financial statements also contain notes and supplementary schedules and other information. For example, they may contain additional information that is relevant to the needs of users about the items in the balance sheet and income statement. They may include disclosures about the risks and uncertainties affecting the enterprise and any resources and obligations not recognised in the balance sheet (such as mineral reserves). Information about geographical and industry segments and the effect on the enterprise of changing prices may also be provided in the form of supplementary information.

Underlying Assumptions

Accrual Basis

22. In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

Going Concern

23. The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

Qualitative Characteristics of Financial Statements

24. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

25. An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

Relevance

26. To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.
27. The predictive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the enterprise to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the enterprise would be structured or the outcome of planned operations.
28. Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, security price movements and the ability of the enterprise to meet its commitments as they fall due. To have predictive value, information need not be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the income statement is enhanced if unusual, abnormal and infrequent items of income or expense are separately disclosed.

Materiality

29. The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. For example, the reporting of a new segment may affect the assessment of the risks and opportunities facing the enterprise irrespective of the materiality of the results achieved by the new segment in the reporting period. In other cases, both the nature and materiality are important, for example, the amounts of inventories held in each of the main categories that are appropriate to the business.
30. 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. Thus, 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.

Reliability

31. To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.
32. Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action are disputed, it may be inappropriate for the enterprise to recognise the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

Faithful Representation

33. To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.
34. Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that enterprises generally would not recognise them in the financial statements; for example, although most enterprises generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement.

Substance Over Form

35. If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an enterprise may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the enterprise continues to enjoy the future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

Neutrality

36. To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

37. The preparers of financial statements do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

Completeness

38. To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

39. Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises.
40. An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those policies and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same enterprise from period to period and by different enterprises. Compliance with International Accounting Standards, including the disclosure of the accounting policies used by the enterprise, helps to achieve comparability.
41. The need for comparability should not be confused with mere uniformity and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an enterprise to leave its accounting policies unchanged when more relevant and reliable alternatives exist.
42. Because users wish to compare the financial position, performance and changes in financial position of an enterprise over time, it is important that the financial statements show corresponding information for the preceding periods.

Constraints on Relevant and Reliable Information**Timeliness**

43. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the economic decision-making needs of users.

Balance between Benefit and Cost

44. The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Furthermore, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared; for example, the provision of further information to lenders may reduce the borrowing costs of an enterprise. For these reasons, it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this constraint.

Balance between Qualitative Characteristics

45. In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

True and Fair View/Fair Presentation

46. Financial statements are frequently described as showing a true and fair view of, or as presenting fairly, the financial position, performance and changes in financial position of an enterprise. Although this Framework does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.

The Elements of Financial Statements

47. Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the income statement are income and expenses. The statement of changes in financial position usually reflects income statement elements and changes in balance sheet elements; accordingly, this Framework identifies no elements that are unique to this statement.
48. The presentation of these elements in the balance sheet and the income statement involves a process of sub-classification. For example, assets and liabilities may be classified by their nature or function in the business of the enterprise in order to display information in the manner most useful to users for purposes of making economic decisions.

Financial Position

49. The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:
 - (a) An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.
 - (b) A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
 - (c) Equity is the residual interest in the assets of the enterprise after deducting all its liabilities.
50. The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet. Thus, the definitions embrace items that are not recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for recognition discussed in paragraphs 82 to 98. In particular, the expectation that future economic benefits will flow to or from an enterprise must be sufficiently certain to meet the probability criterion in paragraph 83 before an asset or liability is recognised.
51. In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form. Thus, for example, in the case of finance leases, the substance and economic reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its useful life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge. Hence, the finance lease gives rise to items that satisfy the definition of an asset and a liability and are recognised as such in the lessee's balance sheet.
52. Balance sheets drawn up in accordance with current International Accounting Standards may include items that do not satisfy the definitions of an asset or liability and are not shown as part of equity. The definitions set out in paragraph 49 will, however, underlie future reviews of existing International Accounting Standards and the formulation of further Standards.

Assets

53. The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the enterprise. The potential may be a productive one that is part of the operating activities of the enterprise. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

54. An enterprise usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the enterprise. Cash itself renders a service to the enterprise because of its command over other resources.
55. The future economic benefits embodied in an asset may flow to the enterprise in a number of ways. For example, an asset may be:
 - (a) used singly or in combination with other assets in the production of goods or services to be sold by the enterprise;
 - (b) exchanged for other assets;
 - (c) used to settle a liability; or
 - (d) distributed to the owners of the enterprise.
56. Many assets, for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits are expected to flow from them to the enterprise and if they are controlled by the enterprise.
57. Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the enterprise controls the benefits which are expected to flow from the property. Although the capacity of an enterprise to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an enterprise controls the benefits that are expected to flow from it.
58. The assets of an enterprise result from past transactions or other past events. Enterprises normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an enterprise from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.
59. There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when an enterprise incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet; for example, items that have been donated to the enterprise may satisfy the definition of an asset.

Liabilities

60. An essential characteristic of a liability is that the enterprise has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an enterprise decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.
61. A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an enterprise to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the enterprise enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a

substantial penalty, leave the enterprise with little, if any, discretion to avoid the outflow of resources to another party.

62. The settlement of a present obligation usually involves the enterprise giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:
 - (a) payment of cash;
 - (b) transfer of other assets;
 - (c) provision of services;
 - (d) replacement of that obligation with another obligation; or
 - (e) conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

63. Liabilities result from past transactions or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance or on delivery) and the receipt of a bank loan results in an obligation to repay the loan. An enterprise may also recognise future rebates based on annual purchases by customers as liabilities; in this case, the sale of the goods in the past is the transaction that gives rise to the liability.
64. Some liabilities can be measured only by using a substantial degree of estimation. Some enterprises describe these liabilities as provisions. In some countries, such provisions are not regarded as liabilities because the concept of a liability is defined narrowly so as to include only amounts that can be established without the need to make estimates. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.

Equity

65. Although equity is defined in paragraph 49 as a residual, it may be sub-classified in the balance sheet. For example, in a corporate enterprise, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the enterprise to distribute or otherwise apply its equity. They may also reflect the fact that parties with ownership interests in an enterprise have differing rights in relation to the receipt of dividends or the repayment of capital.
66. The creation of reserves is sometimes required by statute or other law in order to give the enterprise and its creditors an added measure of protection from the effects of losses. Other reserves may be established if national tax law grants exemptions from, or reductions in, taxation liabilities when transfers to such reserves are made. The existence and size of these legal, statutory and tax reserves is information that can be relevant to the decision-making needs of users. Transfers to such reserves are appropriations of retained earnings rather than expenses.
67. The amount at which equity is shown in the balance sheet is dependent on the measurement of assets and liabilities. Normally, the aggregate amount of equity only by coincidence corresponds with the aggregate market value of the shares of the enterprise or the sum that could be raised by disposing of either the net assets on a piecemeal basis or the enterprise as a whole on a going concern basis.
68. Commercial, industrial and business activities are often undertaken by means of enterprises such as sole proprietorships, partnerships and trusts and various types of government business undertakings. The legal and regulatory framework for such enterprises is often different from that applying to corporate enterprises. For example, there may be few, if any, restrictions on the distribution to owners or other beneficiaries of amounts

included in equity. Nevertheless, the definition of equity and the other aspects of this Framework that deal with equity are appropriate for such enterprises.

Performance

69. Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements directly related to the measurement of profit are income and expenses. The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the enterprise in preparing its financial statements. These concepts are discussed in paragraphs 102 to 110.
70. The elements of income and expenses are defined as follows:
 - (a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
 - (b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.
71. The definitions of income and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognised in the income statement. Criteria for the recognition of income and expenses are discussed in paragraphs 82 to 98.
72. Income and expenses may be presented in the income statement in different ways so as to provide information that is relevant for economic decision-making. For example, it is common practice to distinguish between those items of income and expenses that arise in the course of the ordinary activities of the enterprise and those that do not. This distinction is made on the basis that the source of an item is relevant in evaluating the ability of the enterprise to generate cash and cash equivalents in the future; for example, incidental activities such as the disposal of a long-term investment are unlikely to recur on a regular basis. When distinguishing between items in this way consideration needs to be given to the nature of the enterprise and its operations. Items that arise from the ordinary activities of one enterprise may be unusual in respect of another.
73. Distinguishing between items of income and expense and combining them in different ways also permits several measures of enterprise performance to be displayed. These have differing degrees of inclusiveness. For example, the income statement could display gross margin, profit from ordinary activities before taxation, profit from ordinary activities after taxation, and net profit.

Income

74. The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an enterprise and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.
75. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an enterprise. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in this Framework.
76. Gains include, for example, those arising on the disposal of non-current assets. The definition of income also includes unrealised gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.
77. Various kinds of assets may be received or enhanced by income; examples include cash, receivables and goods and services received in exchange for goods and services supplied. Income may also result from the settlement

of liabilities. For example, an enterprise may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan.

Expenses

78. The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the enterprise. Expenses that arise in the course of the ordinary activities of the enterprise include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.
79. Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the enterprise. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this Framework.
80. Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses, for example, those arising from the effects of increases in the rate of exchange for a foreign currency in respect of the borrowings of an enterprise in that currency. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Losses are often reported net of related income.

Capital Maintenance Adjustments

81. The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. These concepts of capital maintenance are discussed in paragraphs 102 to 110 of this Framework.

Recognition of the Elements of Financial Statements

82. Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 83. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals. Items that satisfy the recognition criteria should be recognised in the balance sheet or income statement. The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.
83. An item that meets the definition of an element should be recognised if:
- (a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
 - (b) the item has a cost or value that can be measured with reliability.
84. In assessing whether an item meets these criteria and therefore qualifies for recognition in the financial statements, regard needs to be given to the materiality considerations discussed in paragraphs 29 and 30. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.

The Probability of Future Economic Benefit

85. The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the enterprise. The concept is in keeping with the uncertainty that characterises the environment in which an enterprise operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared. For example, when it is probable that a receivable owed by an enterprise will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognise the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognised.

Reliability of Measurement

86. The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability as discussed in paragraphs 31 to 38 of this Framework. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the balance sheet or income statement. For example, the expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition; however, if it is not possible for the claim to be measured reliably, it should not be recognised as an asset or as income; the existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.
87. An item that, at a particular point in time, fails to meet the recognition criteria in paragraph 83 may qualify for recognition at a later date as a result of subsequent circumstances or events.
88. An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered to be relevant to the evaluation of the financial position, performance and changes in financial position of an enterprise by the users of financial statements.

Recognition of Assets

89. An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the enterprise and the asset has a cost or value that can be measured reliably.
90. An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the enterprise beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the enterprise or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the enterprise beyond the current accounting period is insufficient to warrant the recognition of an asset.

Recognition of Liabilities

91. A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

Recognition of Income

92. Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).
93. The procedures normally adopted in practice for recognising income, for example, the requirement that revenue should be earned, are applications of the recognition criteria in this Framework. Such procedures are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty.

Recognition of Expenses

94. Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).
95. Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events; for example, the various components of expense making up the cost of goods sold are recognised at the same time as the income derived from the sale of the goods. However, the application of the matching concept under this Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.
96. When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated

with the using up of assets such as property, plant, equipment, goodwill, patents and trademarks; in such cases the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

97. An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.
98. An expense is also recognised in the income statement in those cases when a liability is incurred without the recognition of an asset, as when a liability under a product warranty arises.

Measurement of the Elements of Financial Statements

99. Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.
100. A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:
- (a) *Historical cost.* Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.
 - (b) *Current cost.* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
 - (c) *Realisable (settlement) value.* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.
 - (d) *Present value.* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.
101. The measurement basis most commonly adopted by enterprises in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some enterprises use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

Concepts of Capital and Capital Maintenance

Concepts of Capital

102. A financial concept of capital is adopted by most enterprises in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the enterprise. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the enterprise based on, for example, units of output per day.
103. The selection of the appropriate concept of capital by an enterprise should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the enterprise, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

Concepts of Capital Maintenance and the Determination of Profit

104. The concepts of capital in paragraph 102 give rise to the following concepts of capital maintenance:
 - (a) *Financial capital maintenance*. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.
 - (b) *Physical capital maintenance*. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the enterprise (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.
105. The concept of capital maintenance is concerned with how an enterprise defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an enterprise's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a net loss.
106. The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the enterprise is seeking to maintain.
107. The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the enterprise. In general terms, an enterprise has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.
108. Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

109. Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the enterprise are viewed as changes in the measurement of the physical productive capacity of the enterprise; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.
110. The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. This Framework is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the Board of IASC to prescribe a particular model other than in exceptional circumstances, such as for those enterprises reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments.

Working Arrangement

**Working Arrangement
between the European Commission and EFRAG
from 23 March 2006**

**WORKING ARRANGEMENT BETWEEN EUROPEAN
COMMISSION AND EFRAG**

WORKING ARRANGEMENT BETWEEN EUROPEAN COMMISSION AND EFRAG

This Working Arrangement sets out the scope of the work of the European Financial Reporting Advisory Group (EFRAG) and its relationship with the European Commission. It could be reviewed by both signatories after 3 years of implementation.

BACKGROUND

On 19 July 2002 the EU adopted Regulation 1606/2002 which provides that as from 1 January 2005 companies listed on a regulated market are required to prepare their consolidated accounts in accordance with a single set of accounting standards, namely International Accounting Standards now commonly referred to as International Financial Reporting Standards (IFRS).

With the encouragement of the European Commission, EFRAG was created by organisations representing preparers, users and accountancy professions involved in the financial reporting process. Through the provision of the required technical expertise it has fulfilled the important role of advising the Commission of its views on IFRS.

1- Role of EFRAG

EFRAG will provide advice to the Commission on all issues relating to the application of IFRS in the EU.

In this regard, EFRAG:

- a) Provides its opinions in order for the Commission to take a view on endorsement of any IFRS [for application in the EU] and as requested on IFRS interpretations.
- b) Provides its opinions in order for the Commission to take a view on issues related to the development and the improvement of the standards and their effective implementation in the European area.

2- EFRAG's duties

EFRAG is a body independent of the Commission and the International Accounting Standards Board (IASB).

2.1 Technical Expert Group

EFRAG maintains a Technical Expert Group (EFRAG-TEG)¹, composed of highly qualified experts. In addition, the Commission supports the further integration efforts between EFRAG and national standard setters in order to make efficient use of available know-how within the EU.

¹ EFRAG has constituted this group to be independent of the stakeholders and to carry out its work independently of each of the European organisations involved in EFRAG.

EFRAG will consult the Commission before adopting a new Statement of Due Process.

2.2 Opinions in support of the process for endorsement of IFRS standards and interpretations

EFRAG-TEG's opinions will assess whether the standard to be endorsed complies with Community law and in particular, the requirements of Regulation 1606/2002 as regards understandability, relevance, reliability and comparability as well as the true and fair principle as set out in the 4th Directive 78/660 and the 7th Directive 83/349.

In supporting the process of endorsement of IFRS standards, EFRAG will issue, for each Standard or International Financial Reporting Interpretations Committee (IFRIC) Interpretation, an opinion within a maximum period of two months from notification of a request from the European Commission. Where EFRAG is unable to reach unanimous agreement on a given opinion it will transmit to the Commission the opinion which has the support of the majority as well as any written dissenting views provided in accordance with its governance rules.

Opinions will be based on a wide consultation, prior to the issue of opinions, of interested parties in the European area, in accordance with the Statement of Due Process.

In expressing its opinions, EFRAG-TEG will justify how it reached those particular conclusions. Where EFRAG-TEG members do not concur with the endorsement advice, the dissenting opinions will be set out in writing.

2.3 EFRAG-TEG's opinions on upcoming financial reporting issues

EFRAG will participate in the IASB's due process.

In close consultation with the European Commission, EFRAG will participate in the early phases of debate on all issues related to the standard setting process. In such a role, EFRAG will, when requested by the European Commission attend working groups of IASB, liaise with national standard setters and hold Advisory fora.

The objectives of the work are:

- To provide reports as requested to the European Commission reflecting, particularly, European perspectives, giving reasoned opinions on upcoming financial reporting issues, and help identifying issues that need to be addressed by the IASB.
- To provide technical input on exposure drafts, possible consequences of proposed accounting solutions or proposed standards for companies operating in the European environment with the objective that the European concerns and practice are properly taken into account. EFRAG may publish its contributions.

2.4 Work programme

EFRAG publishes a work programme, regularly updated, and an annual activity report and will transmit the annual report to the Commission.

2.5 Future of EFRAG

EFRAG will secure assurance from its members that the necessary resources will be available for EFRAG to perform the tasks described in this Working Arrangement for the next three years.

EFRAG will advise the Commission at least twelve months in advance of any developments which are likely to significantly reflect on the structure of EFRAG or impact on its tasks as set out in this Working Arrangement.

3- Relationship between EFRAG and the European Commission and representation at the IASB

3.1 EFRAG will invite a European Commission observer to its Supervisory Board and to its TEG and any other group.

The chair of EFRAG-TEG and an advisor together with the Chair of the High-Level Group will be invited to the meetings of the Accounting Regulatory Committee.

3.2 The Commission will determine the Community's position on any given issue and formally communicate it to the IASB.

The Commission will keep EFRAG informed of the outcome of the discussions from its bilateral meetings with the IASB.

The Commission will keep EFRAG informed of the outcome of the discussions at meetings of IFRIC. When attending such meetings, the Commission could choose to be accompanied by a suitable expert, which on occasions could be somebody from EFRAG, depending on the matter to be discussed.

EFRAG will keep the Commission informed of the outcome of the discussions from any other meetings, including working groups, between stakeholders and the IASB.

The Commission is willing to make its best efforts for an EFRAG representative to attend meetings of the IASB's Standards Advisory Council (SAC). In any event, the Commission will inform EFRAG on all relevant issues arising from SAC.

EFRAG will treat information given by the Commission on matters of public policy making as confidential.

4- The High-Level Group

The Commission intends to create a High-Level Group (the Group) composed of a small team of independent experts and high level representatives from national standard setters. These individuals will not already be personally involved in EFRAG's work.

This Group will review opinions on endorsement submitted by EFRAG to the Commission with a view to assessing whether the content is well-balanced and objective advice. The members of this Group will not participate in the actual work of EFRAG.

5- Other work by EFRAG

EFRAG may carry out, on its own initiative, other work on the understanding that EFRAG will:

- inform the Commission well in advance of any such initiative, and
- take full account of the Commission's view on the need for such an initiative, and,
- consult the Commission on its work programme.

Done at Brussels on 23 March 2006

Paragraphs 11 and 18(b) of IAS 32 (2003)

This version includes amendments resulting from IFRSs issued up to 31 December 2003.

Paragraph 11:

The following terms are used in this Standard with the meanings specified:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

- (a) a contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

- (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Paragraph 18:

The substance of a financial instrument, rather than its legal form, governs its classification on the entity's balance sheet. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial instruments. For example:

(a) ...

(b) ¹ a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability. ² This is so even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease, or when the legal form of the puttable instrument gives the holder a right to a residual interest in the assets of an issuer. ³ The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability. ⁴ For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash equal to their proportionate share of the asset value of the issuer. ⁵ However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' on the face of the financial statements of an entity that has no contributed equity (such as some mutual funds or unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).

Paragraphs 16-18(b) of IAS 32 (2008)

This version includes amendments resulting from IFRSs issued up to 31 December 2008.

Paragraph 16:

When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

- (a) The instrument includes no contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

Puttable instruments***Paragraph 16A:***

A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

- (i) dividing the entity's net assets on liquidation into units of equal amount; and*

- (ii) *multiplying that amount by the number of the units held by the financial instrument holder.*
- (b) *The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:*
 - (i) *has no priority over other claims to the assets of the entity on liquidation, and*
 - (ii) *does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.*
- (c) *All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.*
- (d) *Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.*
- (e) *The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).*

Paragraph 16B:

For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

- (a) *total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and*
- (b) *the effect of substantially restricting or fixing the residual return to the puttable instrument holders.*

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16A that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

Paragraph 16C:

Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

- (a) *It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:
 - (i) *dividing the net assets of the entity on liquidation into units of equal amount; and*
 - (ii) *multiplying that amount by the number of the units held by the financial instrument holder.**
- (b) *The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
 - (i) *has no priority over other claims to the assets of the entity on liquidation, and*
 - (ii) *does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.**
- (c) *All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.*

Paragraph 16D:

For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

- (a) *total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and*
- (b) *the effect of substantially restricting or fixing the residual return to the instrument holders.*

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16C that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Reclassification of puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

...

Paragraph 18:

The substance of a financial instrument, rather than its legal form, governs its classification on the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial instruments. For example:

(a) ...

(b) ¹ a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, *except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D.* ² *The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease.* ³ The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, *except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D.* ⁴ For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, *which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D.* ⁵ However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity (such as some mutual funds or unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).

**BASIS FOR CONCLUSIONS ON IAS 32 FINANCIAL INSTRUMENTS:
PRESENTATION BC1–BC74**

Amendments for some puttable instruments and some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

Amendment for puttable instruments

BC50:

As discussed in paragraphs BC7 and BC8, puttable instruments meet the definition of a financial liability and the Board concluded that all such instruments should be classified as liabilities. However, constituents raised the following concerns about classifying such instruments as financial liabilities if they represent the residual claim to the net assets of the entity:

- (a) On an ongoing basis, the liability is recognised at not less than the amount payable on demand. This can result in the entire market capitalisation of the entity being recognised as a liability depending on the basis for which the redemption value of the financial instrument is calculated.
- (b) Changes in the carrying value of the liability are recognised in profit or loss. This results in counter-intuitive accounting (if the redemption value is linked to the performance of the entity) because:
 - (i) when an entity performs well, the present value of the settlement amount of the liabilities increases, and a loss is recognised.
 - (ii) when the entity performs poorly, the present value of the settlement amount of the liability decreases, and a gain is recognised.
- (c) It is possible, again depending on the basis for which the redemption value is calculated, that the entity will report negative net assets because of unrecognised intangible assets and goodwill, and because the measurement of recognised assets and liabilities may not be at fair value.
- (d) The issuing entity's statement of financial position portrays the entity as wholly, or mostly, debt funded.
- (e) Distributions of profits to shareholders are recognised as expenses. Hence, it may appear that profit or loss is a function of the distribution policy, not performance.

Furthermore, constituents contended that additional disclosures and adapting the format of the statement of comprehensive income and statement of financial position did not resolve these concerns.

BC51:

The Board agreed with constituents that many puttable instruments, despite meeting the definition of a financial liability, represent a residual interest in the net assets of the entity. The Board also agreed with constituents that additional disclosures and adapting the format of the entity's financial statements did not resolve the problem of the lack of relevance and understandability of that current accounting treatment. Therefore, the Board decided to amend IAS 32 to improve the financial reporting of these instruments.

BC52:

The Board considered the following ways to improve the financial reporting of instruments that represent a residual interest in the net assets of the entity:

- (a) to continue to classify these instruments as financial liabilities, but amend their measurement so that changes in their fair value would not be recognised;
- (b) to amend IAS 32 to require separation of all puttable instruments into a put option and a host instrument; or
- (c) to amend IAS 32 to provide a limited scope exception so that financial instruments puttable at fair value would be classified as equity, if specified conditions were met.

Amend the measurement of some puttable financial instruments so that changes in their fair value would not be recognised

BC53:

The Board decided against this approach because:

- (a) it is inconsistent with the principle in IAS 32 and IAS 39 that only equity instruments are not remeasured after their initial recognition;
- (b) it retains the disadvantage that entities whose instruments are all puttable would have no equity instruments; and
- (c) it introduces a new category of financial liabilities to IAS 39, and thus increases complexity.

Separate all puttable instruments into a put option and a host instrument

BC54:

The Board concluded that conducting further research into an approach that splits a puttable share into an equity component and a written put option component (financial liability) would duplicate efforts of the Board's longer-term project on liabilities and equity. Consequently, the Board decided not to proceed with a project at this stage to determine whether a puttable share should be split into an equity component and a written put option component.

Classify as equity instruments puttable instruments that represent a residual interest in the entity

BC55:

The Board decided to proceed with proposals to amend IAS 32 to require puttable financial instruments that represent a residual interest in the net assets of the entity to be classified as equity provided that specified conditions are met. The proposals represented a limited scope exception to the definition of a financial liability and a short-term solution, pending the outcome of the longer-term project on liabilities and equity. In June 2006 the Board published an exposure draft proposing that financial instruments puttable at fair value that meet specific criteria should be classified as equity.

...

BC65:

In the exposure draft published in June 2006, the Board proposed to exclude from the definition of a financial liability a contractual obligation that entitles the holder to a pro rata share of the net assets of the entity only on liquidation of the entity. The liquidation of the entity may be:

- (a) certain to occur and outside the control of the entity (limited life entities); or
- (b) uncertain to occur but at the option of the holder (for example, some partnership interests).

...

German Commercial Code [“HGB”]

Handelsgesetzbuch¹

of 10 May 1897 as amended by the Act of 31 July 2009

...

Part Six: Financial Reporting Enforcement Panel

Section 342b Financial Reporting Enforcement Panel

(1) The Federal Ministry of Justice may in consultation with the Federal Ministry of Finance contractually recognise an institution organised under private law to examine infringements of financial reporting requirements (enforcement panel) and transfer to it the duties stipulated in the following subsections.

Such an institution may only be recognised if, by virtue of its constitution, its members and the rules of procedure it has submitted, it can ensure that enforcement will be independent, competent, confidential and in compliance with a defined procedure.

Amendments to the constitution and the rules of procedure must be approved by the Federal Ministry of Justice in consultation with the Federal Ministry of Finance.

The enforcement panel may use the services of other person in the persons in the performance of its duties.

The Federal Ministry of Justice shall announce its recognition of an enforcement panel and the termination of its recognition in the official section of the electronic Federal Gazette.

¹ Translation into English as per Fey & Fladt (2006).

(2) The enforcement panel shall examine whether the most recently adopted annual financial statements and the associated management report, or the most recently approved consolidated financial statements and the associated group management report, of a company within the meaning of sentence 2 below comply with the legal requirements, including German accepted accounting principles or other accounting standards permitted by law.

The enforcement panel shall examine the financial statements and management reports of companies whose securities within the meaning of section 2(1) sentence 1 of the German Securities Trading Act have been admitted to trading on the official or regulated market of a German stock exchange.

The enforcement panel shall conduct its examination:

1. if there are concrete indications of an infringement of financial reporting requirements;
2. at the request of the Federal Financial Supervisory Authority; or
3. without any particular reason (sampling).

No examination under sentence 3 no. 1 shall be conducted if it is evidently not in the public interest to conduct such an examination.

Sampling shall be conducted in accordance with principles to be defined by the enforcement panel in consultation with the Federal Ministry of Justice and the Federal Ministry of Finance.

The Federal Ministry of Finance may transfer the authority to issue its approval to the Federal Financial Supervisory Authority.

(3) The annual financial statements and the associated management report shall not be examined by the enforcement panel if an action has been filed under section 256(7) of the German Stock Corporation Act to declare the adopted financial statements void.

Neither shall an examination be conducted if a special auditor has been appointed in accordance with section 142(1) or (2) or section 258(1) of the German Stock Corporation Act to the extent that the subject is dealt with by the special audit, the audit report or a court ruling on the findings on the special auditor in accordance with section 260 of the German Stock Corporation Act.

(4) If the company cooperates with the enforcement panel in an examination, the legal representatives of the company and the other persons assisting the legal representatives in their cooperation with the enforcement panel's examination shall be obliged to provide accurate and complete information and to submit accurate and complete documents.

The provision of information and the submission of documents may be refused if this would expose the obliged persons or one of their related parties as defined in section 52(1) of the German Code of Criminal Procedure to the risk of criminal prosecution or proceedings under the German Act on Administrative Offences.

The obliged persons shall be advised of their right of refusal.

(5) The enforcement panel shall notify the company of the findings of its examination. If the examination indicates that the financial reporting contains errors, it shall justify its decision and give the company an opportunity to state within a reasonable period whether it accepts the enforcement panel's findings.

(6) The enforcement panel shall notify the Federal Financial Supervisory Authority of:

1. its intention to commence and examination;
2. refusal by the company concerned to cooperate with the enforcement panel in an examination;
3. the findings of the examination and, if applicable, whether the company accepts the findings of the examination.

The notification may not be appealed.

(7) The enforcement panel and its employees are obliged to conduct their examinations conscientiously and impartially; they shall be liable for loss or damages incurred as a result of examinations only in cases of intent.

(8) The enforcement panel shall notify the authority responsible for prosecution of facts justifying the suspicion of a criminal offence relating to the financial reporting of a company.

It shall notify the Chamber of German Public Auditors (*Wirtschaftsprüferkammer*) of acts indicating the infringement of professional duties by an auditor.

German Securities Trading Act [“WpHG”]

Wertpapierhaftungsgesetz

of 9 September 1998 as amended by the Act of 5 January 2007

Part 1: Scope of application, definitions

Section 1 Scope of application

(1) This Act shall apply to the provision of investment services and non-core investment services, to on and off-exchange trading in financial instruments, to the conclusion of financial futures transactions, to financial analyses and to changes in the percentage of voting rights held by shareholders of listed companies.

(2) The provisions in parts 3 and 4, as well as sections 34b and 34c are also applicable to actions and omitted actions performed outside of Germany, to the extent that they relate to financial instruments traded on a stock exchange within the country.

(3) The provisions of parts 3 and 4, as well as sections 34b and 34c shall not apply to transactions carried out as functions of monetary or exchange rate policy or within the framework of public debt management by the European Central Bank, the German Federal Government or one of its special funds, a Federal State, the Deutsche Bundesbank, a foreign country or its central bank or another body commissioned to conduct such transactions or any person acting for their account.

Section 2 Definitions

(1) Securities within the meaning of this Act, whether or not represented by a certificate, are

1. shares,
2. investment securities which are comparable to shares and certificates representing shares, and
3. debt securities, in particular bearer bonds and order bonds including profit-participation certificates, warrants and certificates representing debt securities,

if they can be traded on a market. Investment fund units issued by a German investment company or a foreign investment company are also deemed to be securities.

(1a) Money market instruments within the meaning of this Act are receivables which do not come under the provisions of subsection (1) and are usually traded on the money market.

(2) Derivatives within the meaning of this Act are forward transactions in the form of futures or option contracts whose price depends directly or indirectly on

1. the stock exchange or market price of securities;
2. the stock exchange or market price of money market instruments;
3. interest rates or other returns;
4. the stock exchange or market price of commodities or precious metals or
5. currency prices.

(2a) Financial futures transactions within the meaning of this Act are derivatives within the meaning of subsection (2) and warrants.

(2b) Financial instruments within the meaning of this Act are securities within the meaning of subsection (1), money market instruments within the meaning of subsection (1a), derivatives within the meaning of subsection (2) and securities subscription rights. Additionally, other instruments admitted to trading on an organised market within the meaning of subsection (5) in Germany or another member state of the European Union, or for which such admission has been requested, are also deemed financial instruments.

(3) Investment services within the meaning of this Act are

1. the purchase and sale of financial instruments in one's own name for the account of others;
2. the purchase and sale of financial instruments on an own-account basis for others;
3. the purchase and sale of financial instruments in the name of a third party for the account of others;
4. the brokering or documentation of transactions involving the purchase and sale of financial instruments;
5. the underwriting of financial instruments at one's own risk for placement in the market or the assumption of equivalent guarantees or
6. the management of individual assets invested in financial instruments for others on a discretionary basis.

(3a) Non-core investment services within the meaning of this Act are

1. the safekeeping and management of securities on behalf of third parties, provided the German Safe Custody Act (*Depotgesetz*) does not apply;
2. the granting of credit or loans to others for the carrying out of investment services by the credit or loan granting enterprise;
3. the provision of advice with respect to investments in financial instruments or
4. the activities referred to in subsection (3) nos. 1 to 4, to the extent that they are concerned with foreign exchange transactions and are related to investment services.

(4) Investment services enterprises within the meaning of this Act are credit institutions, financial services institutions and enterprises operating under section 53 (1) sentence 1 of the German Banking Act (*Kreditwesengesetz*) which provide investment services alone or in connection with non-core investment services on a commercial basis or on a scale which requires commercially organised business operations.

(5) An organised market within the meaning of this Act is a market which is regulated and supervised by state-approved bodies, is held on a regular basis and is directly or indirectly accessible to the public.

(6) Issuers whose home country is the Federal Republic of Germany are

1. issuers of debt securities the denomination per unit of which is less than 1,000 euros or the value of such denomination per unit in another currency as at the date of issue, or of shares,
 1. who are domiciled in Germany and whose securities are admitted to trading on an organised market in Germany or in another member state of the European Union or another signatory to the Agreement on the European Economic Area; or
 2. who are domiciled in a country which is neither a member state of the European Union nor a signatory to the Agreement on the European Economic Area (third country) and whose securities are admitted to trading on an organised market in Germany or in another member state of the European Union or another signatory to the Agreement on the European Economic Area, if the annual document within the meaning of section 10 of the Securities Prospectus Act (*Wertpapierprospektgesetz*) is to be filed with the Supervisory Authority;
2. issuers who do not issue financial instruments within the meaning of no. 1, if they are domiciled in Germany or a third country and whose financial instruments are admitted to trading on an organised market in Germany but not in another member state of the European Union or another signatory to the Agreement on the European Economic Area;
3. issuers who do not issue financial instruments within the meaning of no. 1 and who do not fall within the scope of no. 2
 1. if they are domiciled in Germany and their financial instruments are admitted to trading on an organised market also, or exclusively, in one or several other

member states of the European Union or in one or several other signatories to the Agreement on the European Economic Area; or

2. if they are domiciled in another member state of the European Union or in another signatory to the Agreement on the European Economic Area and their financial instruments are admitted to trading on an organised market also, or exclusively, in Germany; or
3. if they are domiciled in a third country and their financial instruments are admitted to trading on an organised market in Germany and in one or several other member states of the European Union or one or several other signatories to the Agreement on the European Economic Area, and if they have chosen the Federal Republic of Germany as their home country pursuant to section 2b. The Federal Republic of Germany shall be deemed the home country for issuers who fall within the scope of (a) but have not made a choice; the same applies to issuers who fall within the scope of (c) but have not chosen a home country, if the annual document within the meaning of section 10 of the Securities Prospectus Act (*Wertpapierprospektgesetz*) is to be filed with the Supervisory Authority.

(7) Domestic issuers are.

1. issuers whose home country is the Federal Republic of Germany, with the exception of those issuers whose securities are not admitted in Germany but only in another member state of the European Union or another signatory to the Agreement on the European Economic Area, to the extent that they are subject to the disclosure and notification requirements pursuant to Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ EU no. L 390 p. 38); and
2. issuers whose home country is not the Federal Republic of Germany but another member state of the European Union or another signatory to the Agreement on the European Economic Area, but whose securities are only admitted to trading on an organised market in Germany.

...

Section 4 Functions and powers

(1) The Federal Financial Supervisory Authority (Supervisory Authority) shall exercise supervision in accordance with the provisions of this Act. Within the framework of the functions assigned to it, the Supervisory Authority shall counteract undesirable developments which may adversely affect the orderly conduct of trading with financial instruments or the provision of investment services or non-core investment services or which may result in serious

disadvantages for the capital market. It may issue orders that are appropriate and necessary to eliminate or to prevent such undesirable developments

(2) The Supervisory Authority monitors compliance with the prohibitions and requirements of this Act, and may issue orders appropriate and necessary for its enforcement. It may temporarily suspend trading with individual or several financial instruments or order trading with individual or several financial instruments suspended in markets on which financial instruments are traded, to the extent that this is necessary for the enforcement of the prohibitions pursuant to section 14 or section 20a or for the elimination or prevention of undesirable developments in accordance with subsection (1).

(3) The Supervisory Authority may require the provision of information, submission of documentation and surrender of copies from anyone, as well as summon and question persons, to the extent that these measures are necessary based on evidence for monitoring compliance with the prohibitions and requirements of this Act. In particular, it may require details concerning changes in holdings of financial instruments as well as information about the identities of other persons, especially the principal and the persons acquiring rights or incurring liabilities from transactions. Statutory rights to provide or refuse to provide information as well as statutory obligations to confidentiality remain unaffected.

(4) During normal business hours, employees of the Supervisory Authority and the persons commissioned by it shall be permitted to enter the property and business premises of persons required to provide information pursuant to subsection (3) insofar as this is necessary for the performance of their functions. Outside of normal business hours or if the business premises are located in residential property, entry without permission shall be allowed and must be tolerated only to the extent that this is necessary to prevent imminent danger to public safety and order and if there is evidence indicating contravention of a prohibition or requirement of this Act by the person required to provide information. The basic right granted by Article 13 of the German Basic Law (*Grundgesetz*) is, to this extent, restricted.

(5) The Supervisory Authority must without undue delay report facts giving rise to suspicion of a criminal offence pursuant to section 38 to the competent public prosecutor's office. It may communicate to the public prosecutor's office the personal data of any persons suspected of the offence or persons who may be required to act as witnesses, to the extent that this is necessary for criminal prosecution. The public prosecutor's office shall decide on the necessary investigatory measures to be pursued, especially with regard to searches, in accordance with the provisions of the German Code of Criminal Procedure (*Strafprozessordnung*). The powers of the Supervisory Authority pursuant to subsections (2) to (4) shall remain unaffected, to the extent that this is necessary for the implementation of administrative measures or the fulfilment of requests by foreign agencies in accordance with section 7 (2) or section 7 (7) and if this does not present a threat to the purpose of investigations by prosecuting authorities or the courts responsible for criminal cases.

(6) The Supervisory Authority may make publications or notifications in accordance with the provisions of this Act at the expense of the entity subject to the publication or notification requirement if it fails to comply with the requirement or complies with it incorrectly,

incompletely or not in the prescribed form.

(7) Objections and actions to annul measures in accordance with subsections (1), (4) and (6) shall have no suspensory effect.

(8) Addressees of measures pursuant to subsections (2) to (4) which are taken by the Supervisory Authority in reaction to a possible contravention of a prohibition pursuant to section 14 or section 20a are prohibited from informing persons other than state agencies and such persons who, based on their profession, are subject to a statutory obligation to confidentiality, of the measures or of any investigation begun in relation to them.

(9) A person obliged to furnish information may refuse to do so in respect of any questions, the answers to which would place himself or one of his relatives as designated in section 383 (1) nos. 1 to 3 of the German Code of Civil Procedure (*Zivilprozessordnung*) at risk of criminal prosecution or proceedings under the German Act on Breaches of Administrative Regulations (*Gesetz über Ordnungswidrigkeiten*). Persons obliged to furnish information shall be informed of the right to refuse and instructed that, in accordance with the Act, they are at all times free, including prior to questioning, to consult with a defence counsel of their choosing.

(10) The Supervisory Authority may only store, edit and use the personal data submitted to it for the purposes of fulfilling its supervisory functions and for international cooperation purposes in accordance with section 7.

Section 5 Securities Council

(1) A Securities Council is established at the Supervisory Authority. It comprises representatives of the Federal States. Membership shall not be held in a personal capacity. Each Federal State shall appoint one representative. Representatives of the Federal Ministries of Finance, of Justice and of Economics and Technology, as well as the Deutsche Bundesbank shall be entitled to attend the meetings of the Securities Council. The Securities Council may consult experts, particularly from the stock exchanges, from amongst market participants, from business and from academics. The Securities Council shall draw up standing orders.

(2) The Securities Council shall assist with supervision. It shall advise the Supervisory Authority, in particular

1. on issuing Ordinances and establishing guidelines for the supervisory activity of the Supervisory Authority;
2. concerning the effects of supervisory issues on stock exchange and market structures and on competition in trading with financial instruments and
3. on the demarcation of responsibilities between the Supervisory Authority and the stock exchange supervisory authorities as well as on issues of cooperation.

The Securities Council may submit proposals to the Supervisory Authority concerning the general development of supervisory practice. The Supervisory Authority shall report to the Securities Council at least once per year on its supervisory activities, on the development of supervisory practice and on international cooperation

(3) The Securities Council shall be convened at least once each year by the President of the Supervisory Authority. It shall also be convened at the request of one third of its members. Any member shall be entitled to put forward proposals for consultation.

...

Part 11: Monitoring of company financial statements, publication of financial reports

Sub-part 1 Monitoring of company financial statements

Section 37n Auditing of company financial statements and reports

Pursuant to the provisions set forth in this part, subject to section 342b (2) sentence 3 nos. 1 and 3 of the Commercial Code, the Supervisory Authority is responsible for auditing the annual financial statements and corresponding management report or the consolidated financial statements and the corresponding group management report as well as the condensed set of financial statements and the corresponding interim management report of companies whose securities within the meaning of section 2 (1) sentence 1 are admitted for trading in the official or regulated market (*Geregelter Markt*) of a stock exchange in Germany, to ensure that they comply with the legal requirements including the German Accepted Accounting Principles or other accounting standards permitted by law.

Section 37o Ordering of an accounting audit and the investigatory powers of the Supervisory Authority

(1) The Supervisory Authority orders an audit of accounting if specific evidence exists of a violation against accounting regulations; no order is issued if it is apparent that clarification of the case does not serve the public interest. The Supervisory Authority can also order an audit of accounting procedures without immediate cause (spot check). The scope of each individual audit shall be defined in the audit order. Only on the most recent approved annual financial statements and the corresponding management report or the most recent approved consolidated financial statements and the corresponding group management report as well as the most recent published condensed set of financial statements and the corresponding interim management report are subject to the audit; without prejudice to this, in the case of section 37p (1) sentence 2, the

Supervisory Authority may audit the financial statements which were the subject of the examination by the enforcement panel within the meaning of section 342b (1) of the Commercial Code (enforcement panel). If the Supervisory Authority orders an accounting audit after receiving a report from the enforcement panel pursuant to section 37p (1) sentence 2 no. 1, it may make publicly known the order and the grounds pursuant to section 37p (1) sentence 2 no. 1 in the electronic Federal Gazette (*elektronischer Bundesanzeiger*). Sentence 2 shall not apply to the audit of the condensed set of financial statements and the corresponding interim management report.

(2) The annual financial statements and the corresponding management report are not audited by the Supervisory Authority if action to annul within the meaning of section 256 (7) of the Stock Corporation Act is pending. If in accordance with section 142 (1) or (2) or section 258 (1) of the Stock Corporation Act a special auditor has been appointed, no audit is performed as well, provided that the subject of the special audit, the audit report or a court decision concerning the ultimate findings by the special auditor are adequate pursuant to section 260 of the Stock Corporation Act.

(3) In conducting the audit, the Supervisory Authority may make use of the enforcement panel as well as other institutions or persons.

(4) The company as defined in section 37n, the members of its bodies, its employees and its auditors are required to furnish, upon request, information and documentation to the Supervisory Authority and persons used by the Supervisory Authority in conducting its activities, to the extent that this is required for the audit; the auditors' obligation to provide information is restricted to facts disclosed within the context of the audit. Sentence 1 also applies to subsidiaries that are to be included in the consolidated financial statements in accordance with the provisions of the Commercial Code. For the right of refusal to furnish information and the obligation to inform affected persons of this right, section 4 (9) applies *mutatis mutandis*.

(5) Persons obliged to furnish information and documentation as set out in subsection 4 are required to grant employees of the Supervisory Authority and persons commissioned by it access to their property and business premises during normal business hours, insofar as this is necessary for the performance of the functions of the Supervisory Authority. Section 4 (4) sentence 2 applies *mutatis mutandis*. The inviolability of the home (Article 13 of the Basic Law) shall be restricted accordingly.

Section 37p The Supervisory Authority's powers in the case of recognition of an enforcement panel

(1) If an enforcement panel is recognised pursuant to section 342b (1) of the Commercial Code (*Handelsgesetzbuch*), spot check examinations are only carried out upon initiation by the enforcement panel. Furthermore, the Supervisory Authority is only granted the powers as defined in section 37o if

1. it is informed by the enforcement panel that a company has refused to cooperate in an audit or does not agree with the result of the audit, or
2. substantial uncertainty arises with regard to the accuracy of the audit result arrived at by the enforcement panel or with the proper conduct of the audit by the enforcement panel.

At the request of the Supervisory Authority, the enforcement panel must explain the result and the execution of the audit and furnish an audit report. Without prejudice to sentence 2, the Supervisory Authority may take over the audit at any time if it is also conducting or has conducted an audit pursuant to section 44 (1) sentence 2 of the Banking Act (*Kreditwesengesetz*) or section 83 (1) no. 2 of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) and the audits concern the same subject.

(2) Subject to the provisions in section 37o (1) sentence 1, the Supervisory Authority can request that the enforcement panel commences an audit.

(3) The Supervisory Authority informs the enforcement panel of notifications pursuant to section 142 (7), section 256 (7) sentence 2 and section 261a of the Stock Corporation Act (*Aktiengesetz*) if the enforcement panel intends to or has commenced an audit of a company that is affected by such a notification.

Section 37q Results of the audit by the Supervisory Authority or the enforcement panel

(1) If the audit by the Supervisory Authority establishes that accounting is faulty, the Supervisory Authority states that an error has been made.

(2) The Supervisory Authority orders the company to make publicly known the error established by the Supervisory Authority or the enforcement panel in agreement with the company, together with the primary grounds for stating the error. The Supervisory Authority waives the order pursuant to sentence 1 if the publication does not serve the public interest. Upon request by the company, the Supervisory Authority may waive the order pursuant to sentence 1, if the publication is likely to damage the legitimate interests of the company. The publication must be made without undue delay in the electronic Federal Gazette (*elektronischer Bundesanzeiger*) as well as in either a national official stock exchange gazette or by way of an electronic system for the dissemination of information which is broadly used by credit institutions, enterprises operating under section 53 (1) sentence 1 of the Banking Act, other enterprises domiciled in Germany which are admitted to trading on a German stock exchange and insurance undertakings.

(3) The Supervisory Authority informs the company in the event that the audit conducted by it results in no findings of fault.

Section 37r Notifications to other authorities

(1) The Supervisory Authority must report facts giving reason to suspect a criminal offence in relation to the company's accounting to the competent prosecuting authority. It may communicate to these authorities the personal data of persons suspected of the offence, or persons who may be required to act as witnesses.

(2) The Supervisory Authority communicates all facts indicating the violation of professional obligations by the auditor to the German Chamber of Public Accountants (*Wirtschaftsprüferkammer*). The Supervisory Authority communicates all facts indicating a violation by the company of exchange law provisions to the competent exchange supervisory authority. Subsection (1) sentence 2 applies *mutatis mutandis*.

Section 37s International cooperation

(1) The Supervisory Authority is responsible for cooperation with foreign authorities charged with investigating possible violations of accounting regulations by companies whose securities are admitted to trading on an organised market. To meet this obligation, it may communicate information to these authorities in accordance with section 7 (2) sentences 1 and 2, also in conjunction with subsection (7). Section 37o (4) and (5) applies *mutatis mutandis*, with the proviso that the powers regulated therein shall extend to all companies covered by the cooperation referred to in sentence 1, as well as all entities included in the consolidated financial statements of such companies.

(2) The Supervisory Authority may cooperate with the competent authorities of other member states of the European Union or signatories to the Agreement on the European Economic Area in order to guarantee uniform implementation of international accounting standards. To this end, it may provide these authorities with transcripts of decisions that it or the enforcement panel have made in individual cases. The transcripts of decisions may only be made available in anonymous form.

(3) The Supervisory Authority's cooperation with international authorities as described in subsections (1) and (2) is carried out in consultation with the enforcement panel.

Section 37t Objection procedure

(1) Before a complaint is filed, an objection procedure is required to review the legality and suitability of orders issued by the Supervisory Authority pursuant to the provisions of this part. Such a review is not required if the remedial decision or the ruling on the objection contain an additional burden for the first time. Sections 68 to 73 and 80 (1) of the German Code of

Administrative Court Procedure (*Verwaltungsgerichtsordnung*) apply mutatis mutandis to the objection procedure, unless otherwise provided for in this part.

(2) Objections against measures by the Supervisory Authority pursuant to section 37o (1) sentence 1, 2 and 5 as well as (4) and (5), section 37p (1) sentence 3 and 4 as well as (2), and section 37q (1) as well as (2) sentence 1 shall have no suspensory effect.

Section 37u Complaints

(1) Complaints may be filed against orders by the Supervisory Authority pursuant to this part. Complaints shall have no suspensory effect.

(2) Sections 43 and 48 (2) to (4), section 50 (3) to (5) and sections 51 to 58 of the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) apply mutatis mutandis.

Sub-part 2 Publication and transmission of financial reports to the company register

Section 37v Annual financial report

(1) A company which issues securities as a domestic issuer shall prepare an annual financial report as per the end of each financial year and make such report available to the public at the latest four months after the end of each financial year if the company is not required pursuant to the provisions under commercial law to disclose the accounting documents specified in subsection (2). Prior to making the accounting documents specified in subsection (2) publicly available for the first time, any company which issues securities as a domestic issuer shall make a publication concerning the time at which and the website on which the accounting documents specified in subsection (2) will be publicly available in addition to their availability in the company register. Simultaneously with the publication of such announcement, the company shall notify the Supervisory Authority thereof and transmit the announcement without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. Furthermore, the company shall transmit without undue delay, but not before the publication of the announcement pursuant to sentence 2, the accounting documents specified in subsection (2) to the company register in order to be stored there, unless the transmission is effected pursuant to section 8b (2) no. 4 in conjunction with subsection (3) sentence 1 no. 1 of the Commercial Code.

(2) The annual financial report shall at least contain

1. the annual financial statements prepared and audited in accordance with the national law

of the member state in which the company is registered;

2. the management report; and
3. a statement made in accordance with the provisions of section 264 (2) sentence 3, section 289 (1) sentence 5 of the Commercial Code.

(3) In agreement with the Federal Ministry of Justice, the Federal Ministry of Finance may, by means of an Ordinance not requiring the consent of the Bundesrat, issue more detailed provisions concerning

1. the minimum content, nature, language, scope and form of the publication pursuant to subsection (1) sentence 2;
2. the minimum content, nature, language, scope and form of the notification pursuant to subsection (1) sentence 3;
3. how long the information specified in subsection (2) must generally remain available in the company register and when it is to be deleted; and
4. a coordinated procedure according to which the annual financial report and the annual document pursuant to section 10 of the Securities Prospectus Act (*Wertpapierprospektgesetz*) shall be made known to the Supervisory Authority.

Section 37w Half-yearly financial report

(1) A company which, as a domestic issuer, issues shares or debt securities within the meaning of section 2 (1) sentence 1 shall prepare a half-yearly financial report covering the first six months of each financial year and make such report available to the public without undue delay, but at the latest two months after the end of the relevant reporting period, unless the admitted securities are debt securities that fall within the scope of section 2 (1) sentence 1 no. 2, or that grant at least a contingent right to acquire securities pursuant to section 2 (1) sentence 1 no. 1 or 2. Furthermore, prior to making the half-yearly financial report publicly available for the first time, the company shall publish an announcement concerning the time at which and the website on which the report will be available to the public in addition to its availability in the company register. Simultaneously with the publication of such announcement, the company shall notify the Supervisory Authority thereof and transmit the announcement without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. Moreover, the company shall transmit without undue delay, but not before the publication of the announcement pursuant to sentence 2, the half-yearly financial report to the company register in order to be stored there.

(2) The half-yearly financial report shall at least contain

1. the condensed set of financial statements;
2. an interim management report; and
3. a statement made in accordance with section 264 (2) sentence 3, section 289 (1) sentence 5 of the Commercial Code.

(3) The condensed set of financial statements shall at least contain a condensed balance sheet, a condensed profit and loss account and explanatory notes. The condensed set of financial statements shall be prepared in accordance with the accounting standards applicable to the annual financial statements. Where, in the case of publication, the annual financial statements are replaced by separate financial statements within the meaning of section 325 (2a) of the Commercial Code, the condensed set of financial statements shall be prepared in accordance with the international accounting standards and provisions specified in section 315a (1) of the Commercial Code.

(4) The interim management report shall at least include an indication of important events that have occurred during the reporting period in the issuer's company and their impact on the condensed set of financial statements as well as a description of the principal opportunities and risks for the six months of the financial year following the reporting period. In respect of companies that issue shares as domestic issuers, the interim management report shall include major related parties transactions; such data may be provided in the notes to the half-yearly financial report instead.

(5) The condensed set of financial statements and the interim management report may be reviewed by auditors. The provisions concerning the appointment of the auditor shall apply *mutatis mutandis* to the auditors' review. The auditors' review shall be effected in such way that, when conscientiously exercising the profession, it can be excluded that the condensed set of financial statements and the interim management report are inconsistent with the applicable accounting standards in material aspects. The auditor shall summarise the findings of his review in a certification in respect of the half-yearly financial report and publish such certification together with the half-yearly financial report. If the condensed set of financial statements and the interim management report have been audited in accordance with section 317 of the Commercial Code, the auditors' report or the non-affirmative auditors' report shall be reproduced in full and published together with the half-yearly financial report. If the condensed set of financial statements and half-yearly financial report have not been reviewed by auditors or audited in accordance with section 317 of the Commercial Code, a statement to that effect shall be made in the half-yearly financial report. Sections 320 and 323 of the Commercial Code shall apply *mutatis mutandis*.

(6) In agreement with the Federal Ministry of Justice, the Federal Ministry of Finance may, by means of an Ordinance not requiring the consent of the Bundesrat, issue more detailed provisions concerning

1. the content and the auditors' review of the half-yearly financial report;
2. the minimum content, nature, language, scope and form of the publication pursuant to subsection (1) sentence 2;
3. the minimum content, nature, language, scope and form of the notification pursuant to subsection (1) sentence 3; and
4. how long the half-yearly financial report must remain publicly available in the company register and when it is to be deleted.

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Section 37y Consolidated financial statements

If a parent enterprise has the obligation to prepare consolidated financial statements and a group management report, sections 37v to 37x shall apply subject to the following proviso:

1. The annual financial report shall also contain the audited consolidated financial statements prepared in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC No. L 243, p. 1), the group management report and a statement made in accordance with the provisions set forth in section 297 (2) sentence 3, section 315 (1) sentence 6 of the Commercial Code (*Handelsgesetzbuch*).
2. The statutory representatives of the parent enterprise shall prepare and publish the half-yearly financial report for the parent enterprise and the subsidiaries to be included in the consolidation taken as a whole. Section 37w (3) shall apply mutatis mutandis if the parent enterprise has the obligation to prepare the consolidated financial statements in accordance with the international accounting standards and provisions specified in section 315a (1) of the Commercial Code.
3. The information provided in the interim management statement of a parent enterprise pursuant to section 37x (2) sentence 2 shall refer to the parent enterprise and the subsidiaries to be included in the consolidation taken as a whole.

Section 37z Exemptions

(1) Sections 37v to 37y shall not apply to companies that exclusively issue debt securities admitted to trading on an organised market, the denomination per unit of which is at least 50,000 euros or the value of such denomination per unit in another currency at the date of the issue.

(2) Section 37w shall not apply to credit institutions that issue securities as domestic issuers if their shares are not admitted to trading on an organised market and if they have, in a continuous or repeated manner, exclusively issued debt securities whose total nominal amount remains below 100 million euros, and for which a prospectus under the Securities Prospectus Act has not been published.

(3) Section 37w shall also not apply to companies that issue securities as domestic issuers if they already existed on 31 December 2003 and exclusively issue debt securities admitted to trading on an organised market which are unconditionally and irrevocably guaranteed by the Federal or one of the Länder Governments, or by one of the regional or local authorities.

(4) The Supervisory Authority may exempt a company domiciled in a third country that issues securities as a domestic issuer from the requirements set forth in sections 37v to 37y, also in conjunction with an Ordinance pursuant to section 37v (3), section 37w (6) or section 37x (4), if such issuers are subject to equivalent rules of a third country or if they submit to such rules. However, the information to be prepared pursuant to the provisions of a third country shall be made available to the public, published and simultaneously notified to the Supervisory Authority in the manner prescribed in section 37v (1) sentences 1 and 2, section 37w (1) sentences 1 and 2, and section 37x (1) sentences 1 and 2, each of which also in conjunction with an Ordinance pursuant to section 37v (3), section 37w (6) or section 37x (4). Furthermore, the information shall be transmitted to the company register within the meaning of section 8b of the Commercial

Code (*Handelsgesetzbuch*) without undue delay, however not before its publication, in order to be stored there. The Federal Ministry of Finance may, by means of an Ordinance not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the equivalence of a third country's rules and the exemption of companies under sentence 1.

(5) By way of derogation from subsection (4), companies domiciled in a third country shall be exempted from preparing their annual financial statements in accordance with sections 37v and 37w prior to the financial year starting on or after 1 January 2007 if such companies prepare their annual financial statements in accordance with the internationally accepted standards referred to in Article 9 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC No. L 243, p. 1).

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FREP 2009

**DPR (FREP)
Annual Activity Report 2009**

Dr. Herbert Meyer

Berlin, 4 February 2010

Annual Activity Report 2009

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Appendices

1. Overview

- The number of instances involving accounting errors reduced with an error rate of some 20% (previous year: some 27%)
- The scope and complexity of IFRSs as well as the financial and economic crisis are seen as the main drivers that cause errors
- For the first time there were also larger companies with a high error rate
- Case-related pre-clearance enquiries are now possible

In 2009, the FREP completed a total of 118 examinations (previous year: 138), of which 103 were sampling examinations and 14 were indication-based examinations; 5 of these in turn being examinations of half-yearly financial reports as well as one examination which was requested by the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin – German Federal Financial Supervisory Authority). The examinations made in the past year were significantly more complex, particularly as a result of the financial and economic crisis; nevertheless, in 2009 we also remained within our target corridor for examinations to be performed.

The percentage of cases involving accounting errors reduced to some 20% (previous year: some 27%). However, for the first time larger firms were also to be found in the higher error rate level as compared to the overall average for all firms. This effect is mainly due to the financial and economic crisis, which particularly resulted in errors in risks and forecast reports.

Following many discussions with concerned parties, it is now possible for the first time to make case-related pre-clearance enquiries with the FREP, which companies can use to clarify queries involving complex accounting issues with the FREP before compiling their financial statements. In this manner, a further important instrument has been authorised to support the FREP's preventive function.

2. Examinations in 2009

2.1 Completed examinations

In 2009, the FREP completed a total of 118 examinations (previous year: 138; see Figure 1) of which 103 were sampling examinations (prior year: 118). We are thus within our target corridor of approximately 110 – 140 examinations per year, which is based on the FREP's code of procedures; this provides that all companies listed in a stock market index are examined every 4 to 5 years and all other publicly trade companies are examined every 8 to 10 years.

In addition to the sampling examinations, we conducted 14 indication-based examinations of which 5 cases related to half-yearly financial reports. Furthermore, one examination was conducted at the request of the BaFin (see Figure 2).

2.2 Results of the examinations

The massive economic and financial crisis that lasted throughout 2008 impacted both consolidated and single-entity financial statements and also the work performed by the FREP in 2009. The main focus areas for examinations of financial statements ending at the end of 2008, which had already been defined by the FREP in October 2008, were significantly influenced by the risks in the financial statements that were expected to arise from the financial crisis. These included the impairment of asset values, the measurement of financial instruments as well as the reporting of risks.

First– an overview of the results:

At the end of an examination, FREP must assess whether the company's financial statements it has examined comply with the applicable accounting standards or whether they are erroneous. Accounting errors are defined as material infringements of financial reporting requirements or immaterial departures from such standards that were made intentionally.

For the first time in two years, the number of cases with accounting errors decreased to 23 (previous year: 37; see Figure 1). As a result, the error rate decreased to some 20% (previous year: some 27%). It remains to be seen in the next 2 - 3 years whether this improvement can be sustained. Truly reliable reasons for any such improvement can normally only be determined after such a time period.

For the 14 indication-based examinations that were completed in 2009 (previous year: 19; see Figure 2), at 79%, the error rate still continued to be at a similar level as that of the previous year (error rate: 84%). For the sampling examinations, the error rate was 12%; this illustrates the improvement against the previous year mentioned above (error rate: 18%).

When differentiation is made by company size, a considerably different picture appears in comparison to the previous year : in previous years, the error rate for larger companies, determined by their belonging to a stock market index (see Figure 3), was significantly lower than for small and medium-sized companies which did not belong to a stock market index. This situation changed for examinations that were completed in 2009: The larger companies, particularly those included in the MDAX and SDAX, with an error rate each of 27%, exhibit a significantly higher error rate than in previous years and compared to the average for all companies (some 20%), whereas the smaller companies which were not included in a stock market index are slightly below the average at 19%. The reasons for this relate to the impact of the financial crisis: for the first time we identified errors in the reporting of forecast data also for larger companies as well as higher error rates in the area of risk reporting. Even though it is understandable that companies become cautious when reporting in these areas, the minimum legal reporting requirements should still be fulfilled.

Special factors relating to the examination of financial institutions and the results thereof

The financial crisis has led to uncertainties in the financial statements of financial institutions, particularly in the area of structured securities in the so-called credit substitute transaction sector. In many cases, individual sub-markets had broken down and measurement models conforming to standards had to be developed. Generally, the parameters of the models could only be produced with a high level of uncertainty and with a high degree of subjective measurement latitude. In addition, at short notice in October 2008, the IASB introduced new possibilities for the re-designation of financial instruments. Under these, securities that had been required to be measured at fair value could be re-designated to categories which are accounted for at amortised cost; however, this possibility involved significant documentation requirements and strict pre-conditions.

These uncertainties, which arose quasi “overnight”, presented the preparers and auditors of financial statements, and also the FREP, with special challenges in relation to the 2008 financial statements and their examination. Accordingly, our examinations in 2009 were sig-

nificantly more complex than in previous years. For this reason, we purchased additional external examination capacity for a number of examinations as foreseen in the budget.

Such partially unclear surrounding constraints for the preparation of financial statements can quickly result in accounting procedures that do not conform to standards. We noted this particularly:

- in the determination of “inactive” markets, which at times occurred prematurely and without performing the necessary test steps
- in the re-designation of securities, particularly relating to the related documentation
- in the performance of impairment tests for various assets (securities, receivables, goodwill) in cases where the deterioration in business development was not given sufficient consideration when measuring future-oriented cash flows that were used as the basis for measurement
- debatable classification of certain forms of hybrid capital as equity
- inadequate level of disclosure with regard to risks associated with financial instruments (IFRS 7)

The error rate for the 18 examinations that were completed for financial institutions, at 17%, was approximately the same as the average for all examinations (some 20%). However, we provided guidance in twice as many cases (28) as in the previous year (14) on indications of variances from standards relating to financial instruments.

When we identify an accounting error, we ask the company whether it accepts the error. This official enquiry is normally preceded by a very intensive discussion with the company. We believe that it is important to give the company and its auditors the opportunity to present their views and arguments and enter into open discussions with them. The percentage of companies that accept the errors that we have identified, approximately 80% (see Figure 4), continues at the high level experienced in the previous two years. We see this as important evidence of the quality of our work.

We refer all cases in which we have identified errors to the BaFin, irrespective of whether the companies have accepted our error findings or not. The cases in which our findings are not accepted are subjected to a further examination by the BaFin itself. In 2009, the result of this process was that the error identification was confirmed in all cases (see Figure 5). Of the 36

cases completed either by the FREP, or in the second stage by the BaFin, 35 cases were published (= 97%).

2.3 Types of error and analysis of errors

The 23 cases involving accounting errors included an average of 3 individual errors per company. In order to enable suitable measures to be developed to reduce the number of errors, these errors need to be analysed by type, frequency and cause. Accordingly, as in previous years, we defined certain categories of errors to which frequently recurring individual errors are assigned. The ranking list of the most frequently identified errors is shown in Figure 6.

Errors related to the financial and economic crisis

In comparison to the two previous years, we identified two significant changes:

- errors relating to forecast reporting were identified for the first time and there was a higher error rate in the area of risk reporting
- there was a significant increase in the incorrect treatment of financial instruments

The significant increase in these two areas is caused by the consequences of the financial and economic crisis and the complexity of the financial instruments that are required to be reported as well as the complex provisions under IAS 39. One of the leading groups in which the highest number of errors was identified was for the area of “Reporting disclosures”, which cannot really be directly attributed to the underlying figures (see Figure 6). The most important source of error included herein was the section of the group management report dealing with risk and forecast reporting.

Risk reporting

In general, the risks relating to further business development have increased due to the crisis. However, our examinations in this area revealed an increasing reluctance of companies to specify the concrete risks that make it possible for investors to obtain an appropriate picture of the risks associated with future development of the group of companies. The same applies to the reporting of risks that relate to financial instruments. In this area, the non-banking sector is affected to a great extent by financial covenants; as soon as a high probability exists that such covenants will be breached, with corresponding possible consequences for liquidity, then this risk must be reported. In such cases, our examinations also

revealed deficiencies in the quality of reporting. In many cases, with non-material deficiencies, we have accordingly issued guidance to the companies. We treat cases as errors when significant risks which would have a high importance to investors' decision-making are completely omitted.

Forecast reporting

In turbulent times, the uncertainties surrounding future business development increase considerably. This makes it more difficult for companies to prepare reliable forecasts and to make a prognosis about future development. On the other hand, especially in such times, future-related information and management's assessment of future business development are particularly important for investment-related decisions made by investors. For this reason, corresponding qualitative assessments – at a minimum – of future developments are required, together with comments on the most important factors of influence and assumptions and an assessment of the significant opportunities and risks.

In some companies, our examinations revealed a strong tendency towards caution when reporting forecast information. In cases where only individual elements were missing from the forecasts, we again limited ourselves to issuing related guidance. If, however, a report of forecast information was intentionally omitted, then we considered this to be unacceptable and this led to classifying such omission as an error. Accordingly, this resulted in our identifying an error in the area of forecast reporting for the first time in 2009. The identification of this error was confirmed in the second stage by the BaFin and the case was subsequently argued before the *Oberlandesgericht* (OLG - Higher Regional Court) in Frankfurt am Main, which then confirmed the joint opinion expressed by the FREP and the BaFin.

The scope and complexity of IFRS as a source of error

In addition to the types of errors which occurred as a consequence of the financial and economic crisis, the same errors that had occurred with great frequency in previous years were again identified in 2009. This is particularly the case for those areas which are especially impacted by the scope and complexity of IFRSs.

Firstly, such cases include the accounting treatment of business acquisitions, which - with 11 cases - continues to take first place. These represent fewer cases than the previous year (24 cases), but we identified a further 36 cases (previous year: 27) of departures from the stan-

dard, which were, however, below the materiality threshold and for which it thus sufficed for us to issue guidance to the company.

Most of the departures, as in previous years, particularly occur when allocating the purchase price to intangible assets. In such cases - as reported in the previous activity report – the standard requires separation of the contribution to earnings made by individual intangible assets such as, for example, brand names and customer lists, which for the most part can rarely be done objectively and reliably in practice. The many instances of departures from the standard provide evidence of the weakness of the regulations covering purchase price allocation.

The second most common source of departures in this area occurs during the measurement of goodwill. Particularly the test for impairment of goodwill in subsequent years is complex and includes many subjective elements: allocation of the goodwill to independent business units, determination of capitalised earnings values based on complicated, future-oriented cash flow plans and derivation of suitable discounting rates, as well as very extensive disclosure requirements. This trend toward more departures from the standard may increase in times of economic difficulty, if attempts are made to influence results by possibly reducing impairment losses related to goodwill. The total goodwill disclosed by the 130 largest companies in Germany had increased to **EUR 200 thousand million** by the beginning of the crisis, as a result of many transactions with correspondingly high purchase prices (and goodwill) due to very optimistic business prospects. The long-term prospects have since become partially clouded due to the crisis, so that widespread impairment of goodwill was to be expected. Our examinations in this respect - and also other analyses performed - have, however, revealed that goodwill has only been written down in relatively few cases. This was achieved by using very high future planned earnings figures for measurement purposes - compared to realistic circumstances.

Further, errors arose due to the scope and complexity of IFRSs, as was the case in previous years, due to deficiencies in the required, very detailed note disclosures in the complicated area of deferred taxation as well in the consolidation area. In summary, the results of the examinations in 2009, as in previous years, illustrate that errors particularly arise in those areas in which the IFRSs show special complexity (see Figure 7). A further driver for the increased incidence of departures from IFRSs in 2009 was the difficult economic situation experienced by many companies as a consequence of the recession.

The results of long-term analysis also show that the scope and complexity of IFRS is the main driver for the errors that have been found. For the period from July 1, 2005 onwards, we have completed a total of more than 500 examinations; that is more than half of the publicly traded companies. Errors in the area of “Business acquisitions and disposals” clearly take the overall lead with a total of 58 individual errors, followed by errors in the area of “Reporting disclosures” with a total of 52 individual errors.

3. Preventive measures

3.1 Providing feedback on results of examinations to standard-setters

The preceding analysis shows that the most important measure to be taken to reduce the high error rate identified in enforcement examinations would be to simplify IFRSs. To this end, we have forwarded the results of our examinations for 2008, with the relevant explanatory comments, both to the national standard-setter *Deutscher Standardisierungsrat* (DSR – German Standardisation Board) and also to the ultimately responsible and authoritative international standard-setter in London (IASB). However, to date, no concrete steps can be perceived to have been taken in the direction of reducing the complexity of IFRSs. Due to massive pressure resulting from the financial crisis, there have been some initial steps taken solely in the area of financial instruments; the final results of this process still have to be forthcoming.

3.2 Guidance issued in 2009 and main focus areas for examinations in 2010

Even though no formal errors are identified in the course of an examination, during the course of many examinations we do provide guidance to companies relating to identified immaterial errors, which might become material for future financial reporting purposes. In so doing, errors can be avoided in future financial statements. The frequency with which such guidance is provided (see Figure 8) shows that the departures from standards also particularly arise in those areas where IFRSs are highly complex.

Before the beginning of a new calendar year, we define the main focus areas for our examinations in the new year, which will in principle be addressed during each of our sampling examinations. As in previous years, these main focus areas are significantly impacted by the continuing financial and economic crisis (see Figure 9) and were published in October 2009

so that the preparers and auditors of financial statements can adapt their procedures for financial statements prepared as at the end of 2009 accordingly.

3.3 Pre-clearance enquiries

From November 2009 onwards, the FREP has been able to answer questions relating to specific accounting problems of publicly traded companies. This desire for so-called pre-clearance had been requested of the FREP by preparers of financial statements for a long time. A pre-clearance enquiry must be in writing and include an adequately formulated description of the specific circumstances, the company's suggested accounting treatment and a position paper prepared by the auditors providing their opinion on the matter.

In those cases in which the FREP accepts a pre-clearance enquiry, a discussion process with the company normally occurs. Following this process, the FREP provides the company with its opinion. Even though, for legal reasons, the reply from the FREP cannot be regarded as binding, this procedure offers a good opportunity to pass on to companies the enforcement panel members' experience from more than 500 examinations of financial reporting. Use of this procedure helps to avoid errors before financial statements are prepared and thus strengthens the FREP's preventive function.

4 FREP's impact

The most important goal of enforcement is to improve the quality of financial reporting. The decisive prerequisite for achieving this goal is a high level of acceptance of the FREP by preparers of financial statements and auditors within the capital markets as well as within the general public.

4.1 Impact on the preparers of financial statements

Insight into the impact of the FREP on the preparers of financial statements is provided by the joint survey carried out by the *Deutsches Aktieninstitut* [a German Association of publicly traded companies] and PricewaterhouseCoopers in 2009. Overall, this summary shows that there is a high level of acceptance by preparers of financial statements for the work performed by the FREP and the results achieved. In detail: 89% of those surveyed confirmed a high level of acceptance for the FREP and the results achieved with supporting assessments such as "highly professional" and "constructive approach to work"; 87% saw a potentially sig-

nificant loss of reputation if errors are made public. This illustrates the high effectiveness of this legal form of sanction for errors made. 34% of those surveyed make necessary adjustments to their financial reporting following a FREP examination; this figure, compared to an error rate of 27% in the previous year, also shows how seriously the results of the FREP's examinations are taken.

4.2 Impact on the capital market

Investors consider published errors detected by the FREP to be a negative signal – this statement also gives an indication that the error sanctions that have been foreseen by the legislators are effective.

In the short-term (within 3 days of publication of the error) the impacts of an identified error on the quoted share price tend to be small: in a survey, average downward share price notations of 1.1% were observed. This is hardly remarkable, as many of the deficiencies that are made known in the published error report are already communicated in advance by the company itself and are corrected.

According to this same survey, in the longer term (within 150 days of publication) more significant downward share price notations of up to 25% have been observed, which provides a clearer signal of the impact of identified errors on the capital markets.

4.3 Impact on the general public

As in previous years, we have presented and disseminated information relating to the work of the FREP and the results thereof through appearances at many relevant events relating to business administration and financial reporting (overall more than 50 presentations made by FREP representatives). In addition, we published the results of the FREP's most recent examination findings and our most important plans through two press conferences held in January and October of the year - with a very good resonance in the business press and the relevant specialised press.

5 International cooperation

Up to now, enforcement bodies have been established at a national level; however, global capital markets and globally active companies demand corresponding trans-nationally struc-

tured and co-ordinated enforcement bodies. Even in Europe, we are a very long way from achieving this.

Within the context of the CESR, “European Enforcement Coordination Sessions“ (EECS) are held at which enforcement experts representing all European countries meet approximately every two months. In this forum, cases of trans-national interest concerning the application of IFRS are discussed. The objective is to reach uniform interpretation of IFRSs and to exchange initial experience gathered in connection with the application of new IFRSs within Europe.

Work in the extensive area involving harmonisation of enforcement processes and structures has, however, not commenced. The EECS was not set up with this intention and it remains to be seen whether the agreed decision to establish European enforcement agencies can produce harmonisation in the performance of enforcement procedures. The structures of the enforcement bodies vary considerably within Europe; in addition to purely government institutions (i.e. in France), there are also combined civil-law-/government-based bodies (i.e. Germany) and purely civil-law based structures (i.e. UK) in place. These structures are based on completely different national enforcement legislation, which has led to completely different processes and scopes for activity to control the content of financial statements at national level. This can lead to significant disadvantages for companies listed on stock exchanges in a number of countries. In order to limit these disadvantages, and in order to achieve a more intensive exchange of information concerning enforcement processes, we, together with the BaFin, continue to engage in bilateral discussions with the individual enforcement bodies in, for example, the UK, Spain and Switzerland.

6. FREP resources

The costs of the two-stage enforcement procedure were budgeted at EUR 7.7 million for 2009, of which EUR 6.0 million was designated for the FREP. We operated under budget by approximately EUR 1 million at an actual level of EUR 4.9 million. Admittedly, the amount for the FREP increased in comparison to the previous year (EUR 4.5 million) by some EUR 0.4 million. This was mainly caused by the previously mentioned highly complex examinations that were carried out in this year, in which we purchased additional external examination capacity for the first time.

In the past year, we have had to manage the first planned, larger scale fluctuation of employees of the enforcement panel, as many of the 4-year contracts with members of the enforcement panel expired in 2009. Five members of the enforcement panel out of 16 (calculated on a full-time basis) left us; two of these retired and three moved on to challenging positions in business. In order to maintain our staff capacity, we therefore have hired five new employees with limited-term contracts. The new colleagues have been quickly and successfully integrated into the organisation.

7. Outlook

Our intention is to strengthen the prevention-oriented tasks of the FREP. The new procedure for case-related pre-clearance enquiries will be helpful in this regard. In addition to this, we want to make our findings and analyses available to the standard-setters to an increased extent with the clear objective of simplifying IFRSs as the standards continue to be developed in the future.

The financial and economic crisis will continue to have a significant impact on 2009 single-entity and consolidated financial statements. We have taken account of the anticipated financial reporting-related risks in defining the focus areas for our examinations in 2010 (see Figure 9).

In addition, we intend to continue our bilateral discussions with other European enforcers in order to gradually move forward the harmonisation of processes and structures in this manner.

Our work continued successfully in 2009 because we were again able to count on effective support from many sources. In this connection, we would like to take the opportunity here to extend our special thanks to the companies that we examined, to the members of the FREP association, its Executive Board and Nominating Committee, as well as to our advisory group, to the responsible bodies at the German Federal Ministries of Justice and Finance, and in particular to the BaFin, the *Deutsches Rechnungslegungs Standards Committee* (DRSC - Accounting Standards Committee of Germany), the audit firms, the *Institut der Wirtschaftsprüfer* (IDW – the Institute of Public Auditors in Germany) and the *Wirtschaftsprüferkammer* (WPK – German Chamber of Public Accountants). Particular thanks go to the panel members and to our office staff for their consistently dedicated and exceptionally professional work.

**DEUTSCHE PRÜFSTELLE FÜR RECHNUNGSLEGUNG
FINANCIAL REPORTING ENFORCEMENT PANEL**

Appendices to the Annual Activity Report 2009

4 February 2010

Dr. Herbert Meyer

Figure 1: Completed FREP examinations, error ratio trend (%)

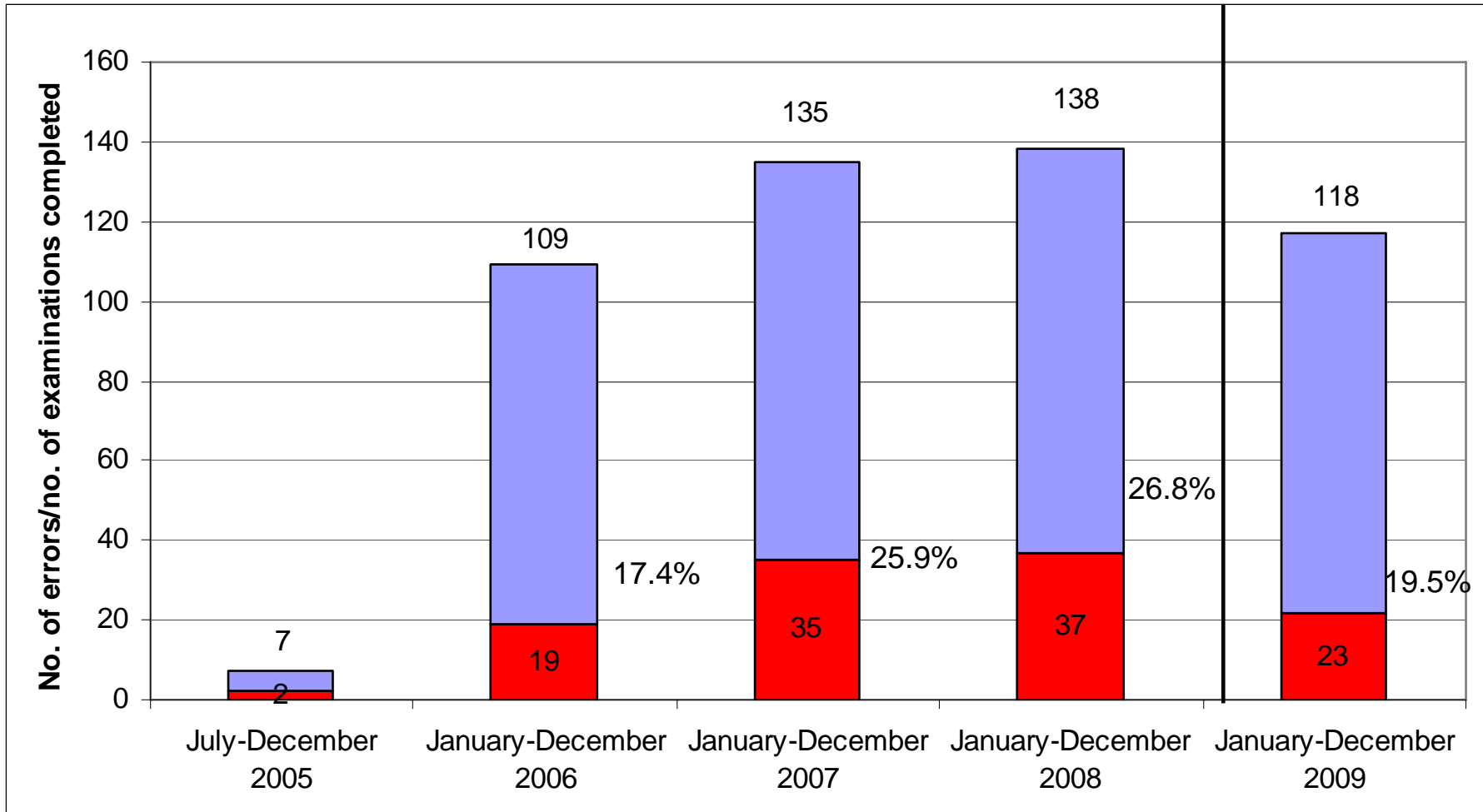


Figure 2: Completed FREP examinations by type of examination and error ratio (%) (2009)

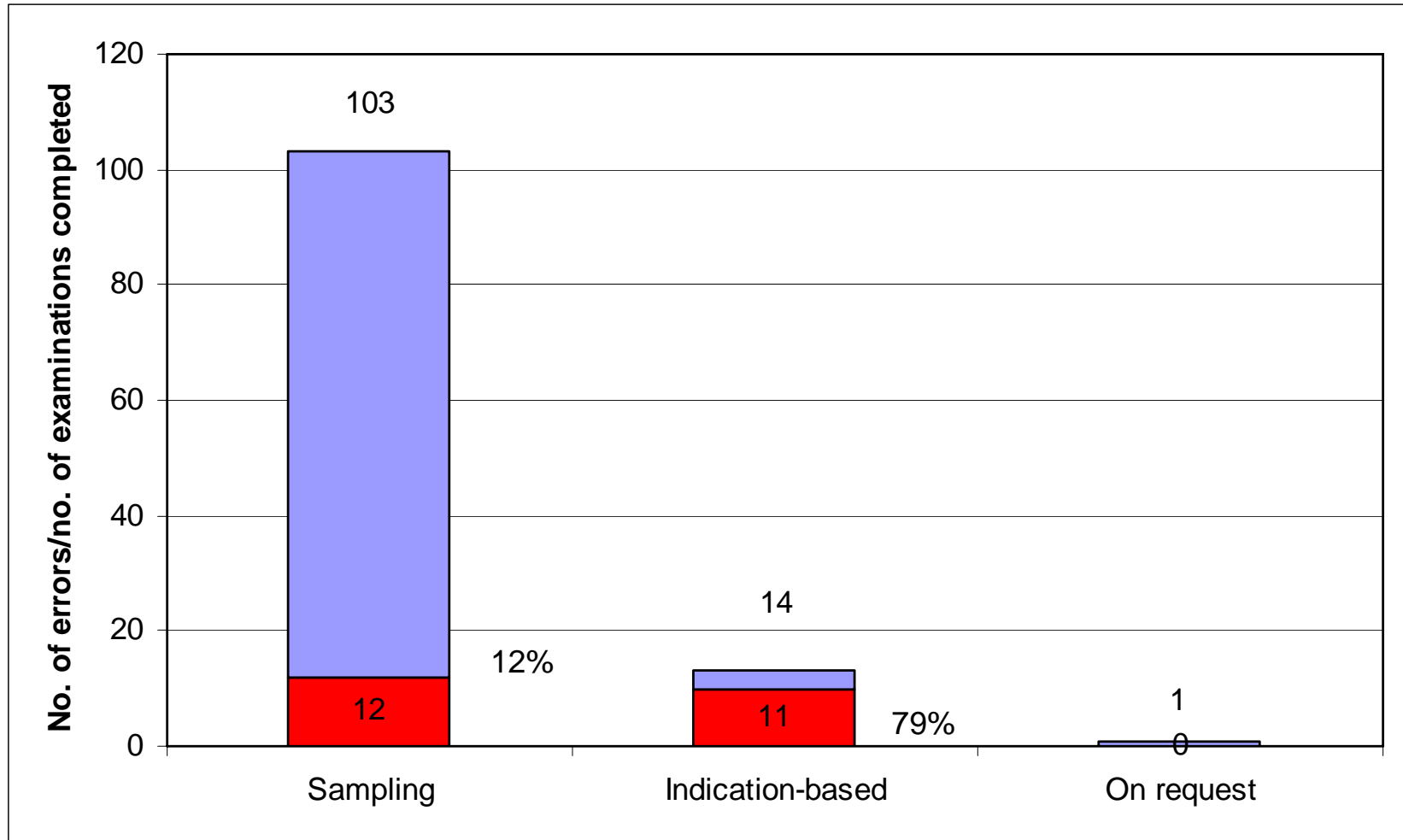
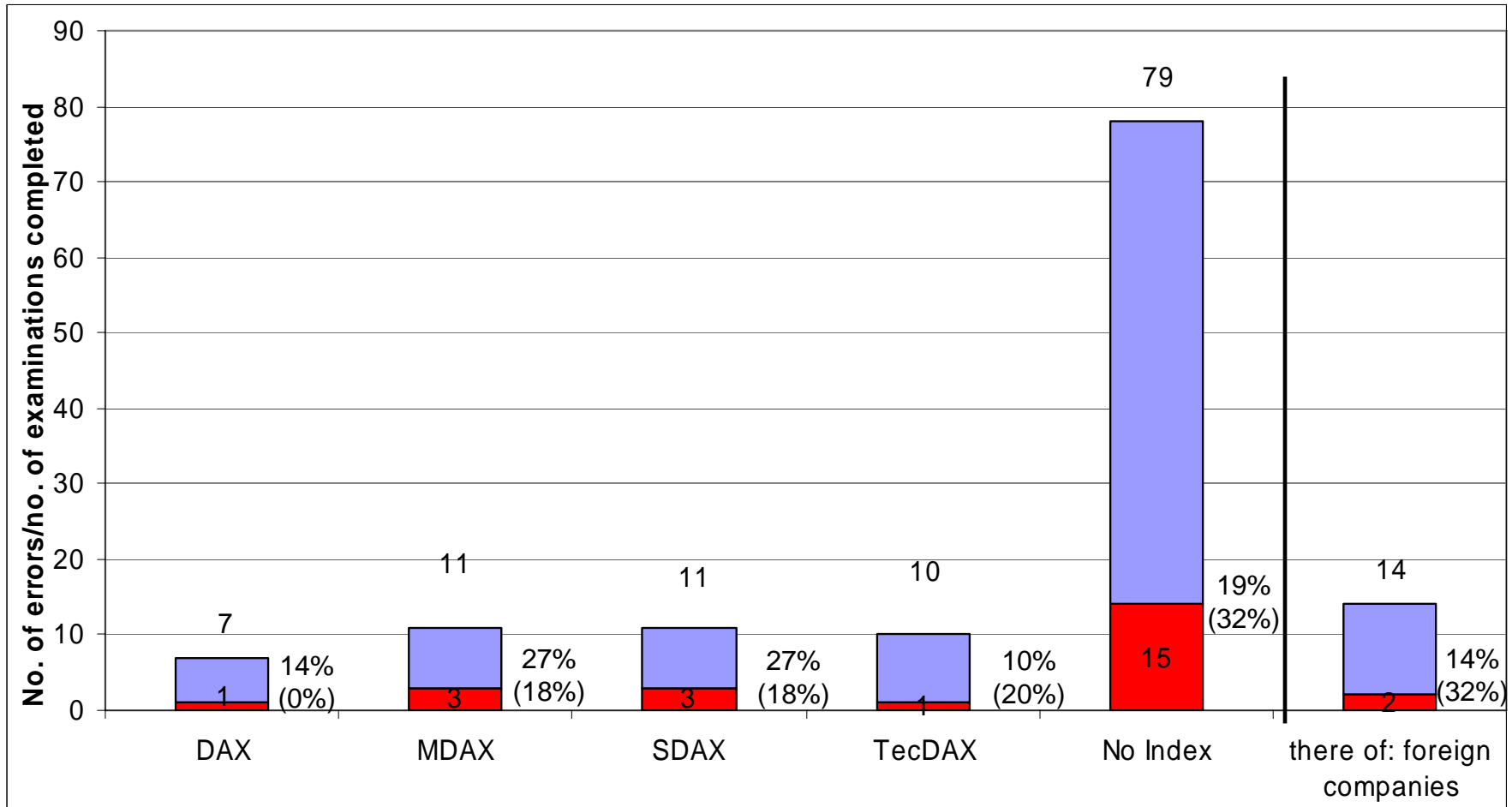


Figure 3: Completed FREP examinations by stock market index, error ratio (%) (2009)



() = Prior year ratio

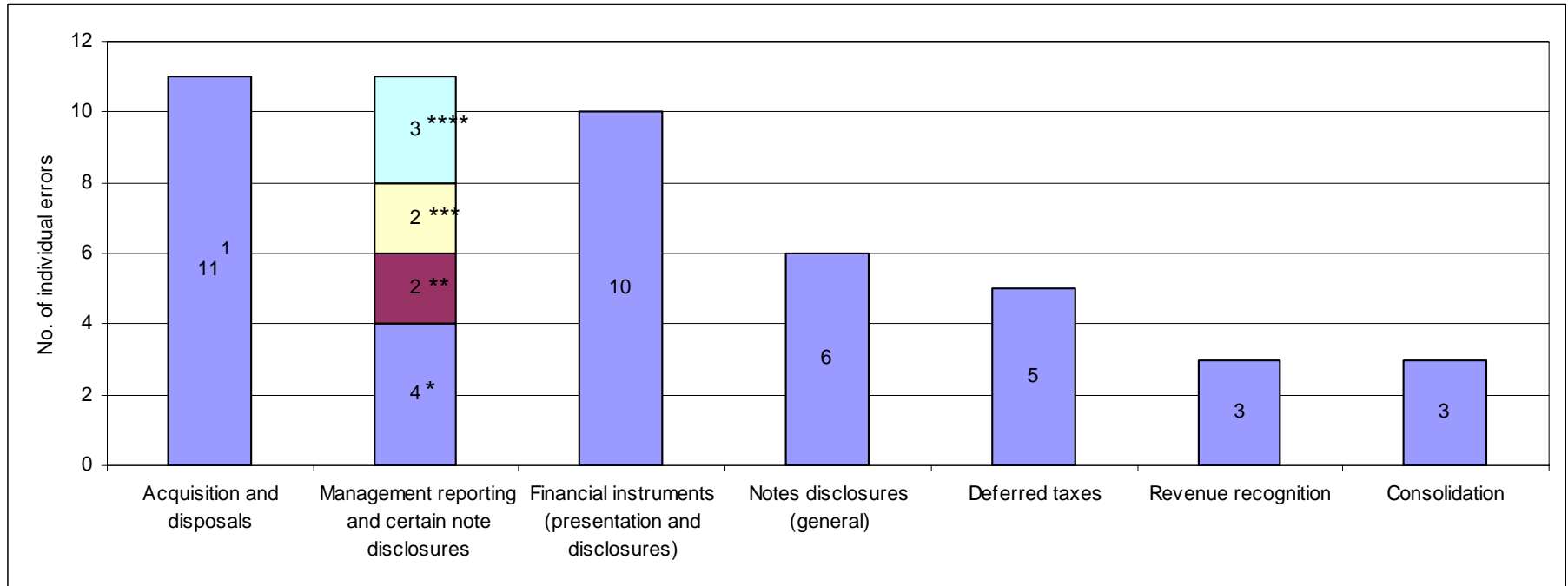
Figure 4: Change in acceptance ratio for errors identified by the FREP

	2006	2007	2008	2009
Acceptance ratio of companies as % of errors identified by the FREP	52	80	82	78

Figure 5: Results of stage 2 (BaFin) in 2009

- o Procedures completed by the BaFin: 36
(excluding cases, in which cooperation was refused)
- o of which: same assessment as the FREP 36 (= 100%)
- o of which: published 35 (= 97%)

Bild 6: Most common types of errors (2009)



1 PPA, Goodwill, Information, Discontinued Operations, Impairment Test

**** Segment reporting

*** Related party disclosures

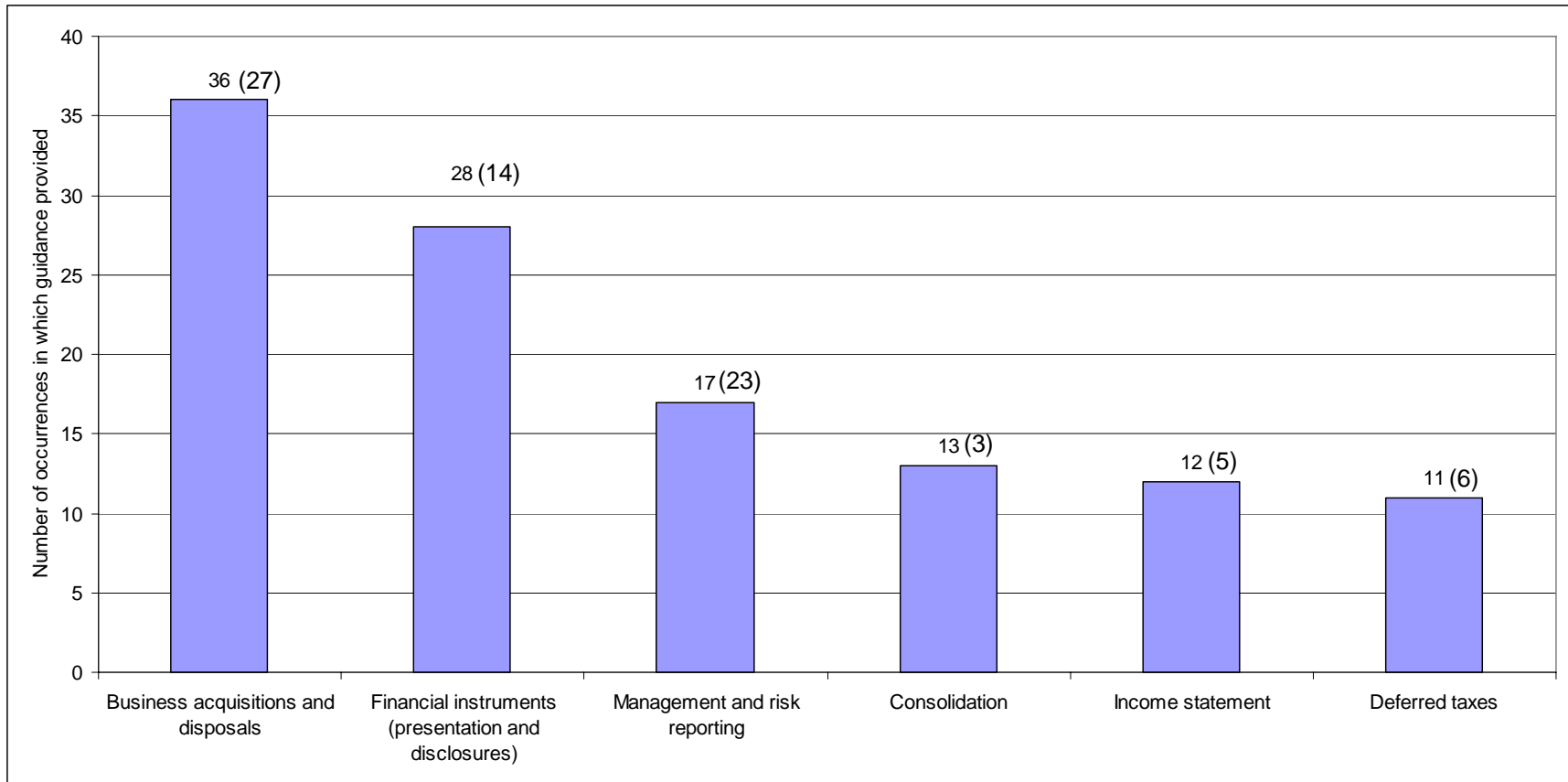
** Statement of changes in equity and tax reconciliation

* Risk and forecast reporting

Figure 7: Main causes of errors

- o **Scope and complex nature of IFRSs**
- o Economic situation of the companies
- o Occasional lack of knowledge of standards
- o A small number of “black sheep”

Figure 8: Most common topics for guidance given to companies (2009)



() = Prior year figure

Figure 9: Examination Areas of Emphasis 2010

1. Business combinations and the related purchase price allocation, measurement and note disclosures
2. Impairment testing of tangible and intangible assets including goodwill in light of the economic situation (including supporting documentation, note disclosures)
3. Recognition and measurement of financial instruments, note disclosures on measurement assumptions and changes in carrying amounts, as well as IFRS 7 disclosures
4. (Group) management report including risk reporting and reporting on expected developments (in particular taking into account the GASB Advice dated 27 March 2009)
5. Segment reporting in accordance with IFRS 8
6. Note disclosures on measurement assumptions used in estimating carrying amounts in financial reporting and the related uncertainty in financial statements; for example, when measuring the fair value of investment property (IAS 40.75d) and when measuring pension obligations (IAS 19.120 A)
7. Presentation and description of key financial risks relating to financial covenants (section 315(1) of the HGB (German Commercial Code), GAS 15, GAS 5; IFRS 7.18 et seq. and IFRS 7.31)