



## DECEMBER '11 NEWSLETTER



Every year we say the same thing – “the year has just flown by” – this year is no exception.

At this time last year we communicated on the global economic crisis and felt that any recovery progress would be slow and erratic – how true this has turned out to be.

As we speak the Euro Zone woes have worsened – it appears that nobody has a clear vision as to the way forward. Add to this mix that America and the UK are still in severe difficulty plus all the political turmoil in Egypt, Syria et al and you get a very uncertain and volatile scenario.

To try and predict the direction of economies, share markets and currencies is all but impossible, so let's all have an enjoyable, peaceful and restful festive season and hope and pray that 2012 will deliver a far better outcome in all areas discussed above.

As the implications of the new companies act which became effective from 1 May 2011 are not fully understood by many people, we felt it appropriate to comment thereon in this issue and also to discuss the reporting standards that will now apply in the preparation of annual financial statements.

### YEAR-END CLOSURE

We will as usual be closing our office for 3 weeks. Wednesday, 21 December 2011 will be our last day (at 12h00 to celebrate our year-end function). We re-open on Thursday, 12 January 2012.

### THE NEW COMPANIES ACT

The New Companies Act became effective on 1 May 2011. Although this act does not repeal the Close Corporations Act it does make changes to the way in which Close Corporations are required to prepare their financial statements and have them reported on. These changes enforce the same reporting requirements as those for companies.

Before we can discuss the reporting requirements under this new act we need to understand the concept of the Public Interest Score. Every company and Close Corporation must calculate a public interest score each year and this score will determine, along with the ownership of the entity, its financial reporting framework and whether it requires an audit, a review, an accounting officer's report or no report at all.

The public interest score is a function of staffing, debt, turnover and ownership. The calculation of the score is set out in regulation 26(2)(a),(b),(c) and (d).

- (2)(a) a number of points equal to the average number of employees of the company during the financial year;
- (b) one point for every R1million (or portion thereof) in third party liability for the company, at the financial year end;
- (c) one point for every R1million (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;"

It should be noted that the employees referred to are as defined in the Labour Relations Act, no 66 of 1995 and shareholders/members loans are excluded from the debt figure.

If we assume by way of an example that company X has 50 employees, a bank overdraft of R50 000, trade and other creditors of R1.56million, a mortgage bond of R1million, shareholders loans of R5.3million, turnover of R10.1million and 4 shareholders. This entity's public interest score is calculated as follows:

	Value	Points
Employees	50	50
Debt	2 610 000	3
Bank overdraft	50 000	
Trade and other creditors	1 560 000	
Mortgage bond	1 000 000	
Turnover	10 100 000	11
Ownership	4	4
Public interest score		68

A second point that needs to be considered before we discuss the financial reporting framework that will need to be used in drafting the financial statements or the audit and review is the exemption from audit and review.

This is set out in section 30(2A) of the act and allows certain companies and close corporations to be exempt from the audit and review requirements of the act. In its basic form owner managed entities are exempt from audit, unless they fall into a category that in terms of the regulations requires an audit.

Owner managed is defined as every shareholder has to be a director. This means that companies and close corporations that are held by trusts are not owner managed, nor are companies in groups.

This exemption does not apply to owner managed entities whose public interest score is 350 and above or between 350 and 100 if the financial statements are prepared by the entity itself or another act requires the financial statements to be audited or if the entity holds assets in a fiduciary capacity of R5million.

The public interest score is also important in the determination of the financial reporting framework that the entity has to use in preparing its financial statements., being either International Financial Reporting Standards (IFRS), International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SME) or none.

Thus all entities whose public interest score is above 100 have the choice to apply IFRS or IFRS for SME but entities whose public interest score is below 100 and whose financial statements are prepared by an independent person (external to the entity) are also required to use IFRS or IFRS for SME.

Those entities whose public interest score is below 100 and who prepare the financial statements themselves do not have any prescribed financial reporting framework.

It is important for all entities to start calculating their public interest score to assist in their planning and to help them make decisions for the coming year.

## **CONVERSION TO THE INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES**

In terms of regulation 27 of the Companies Act 71 of 2008 all companies and close corporations who have their financial statements prepared by an independent accounting professional have to have the financial statements prepared using either International Financial Reporting Standards (IFRS) or the International Financial reporting Standard for Small and Medium-sized Entities (IFRS for SME). Only entities whose public interest score is below 100 and who prepare their financial statements themselves do not have to use IFRS or IFRS for SME.

Thus should clients who are close corporations continue to have their financial statements prepared externally, there is going to be a change in the manner in which the financial statements are prepared.

So what are the implications?

There is going to have to be a restatement of the financial statements to take into account the measurement and recognition requirements of IFRS or IFRS for SME. Effectively the financial statements for the past two years need to be re-drafted and any change in the first period will be accounted for in the retained income or loss for that period.

For most clients the biggest impact is going to be in property, plant and equipment, operating and finance leases and deferred taxation.

If we now move on to an example and only look at property plant and equipment:

The entity has a year end of 29 February 2012 with a summarised income statement and balance sheet as follows before taking into account the conversion to IFRS for SME.

**XYZ CC**

**Balance sheet as at 29 February 2012**

	2010 R	2011 R	2012 R
<b>Non-current assets</b>			
Property plant and equipment			
Cost	100 000	100 000	100 000
Accumulated depreciation	(40 000)	(60 000)	(80 000)
Carrying value	60 000	40 000	20 000
<b>Equity and reserves</b>			
Members interest	100	100	100
Retained income	59 900	39 900	19 900
	60 000	40 000	20 000

**XYZ CC**

**Income statement for the year ended 29 February 2012**

	2011 R	2012 R
<b>Operating expenses</b>		
Depreciation	20 000	20 000

In this example the entity has used the tax rates to calculate depreciation thus the tax value and the accounting values are the same therefore there is no deferred tax.

Let us now apply the requirements of the IFRS for SME. The transition provision allows us to take the fair value of the asset at the transition date as the deemed cost. If we assume that the entity will be presenting IFRS for SME financial statements for the first time in February 2012 the transition date is 1 March 2010. At that date the fair value of the motor vehicle is R80 000 while the carrying value is R60 000.

If for the purpose for the example we assume that the residual value is nil and the useful life of the motor vehicle is a further 5 years, depreciation is calculated as the deemed cost less the residual value of nil divided by the useful life of 5 years - thus depreciation is calculated as R16 000.

**XYZ CC****Balance sheet as at 29 February 2012**

	<b>2010</b>	<b>2011</b>	<b>2012</b>
	<b>R</b>	<b>R</b>	<b>R</b>
<b>Non-current assets</b>			
Property plant and equipment			
Cost	80 000	80 000	80 000
Accumulated depreciation	-	(16 000)	(32 000)
Carrying value	80 000	64 000	48 000

**Equity and reserves**

Members interest	100	100	100
Retained income	74 300	57 180	40 060
	74 400	57 280	40 160
Deferred taxation	5 600	6 720	7 840
	80 000	64 000	48 000

**XYZ CC****Income statement for the year ended 29 February 2012**

	<b>2011</b>	<b>2012</b>
	<b>R</b>	<b>R</b>
<b>Operating expenses</b>		
Depreciation	16 000	16 000
Taxation		
Deferred taxation	1 120	1 120

From the above it can be seen that there is going to be an impact on the entity, as there are going to be a number of additional workings as well as additional notes.

**AUDIT REQUIREMENT**

Most private companies registered under the Companies Act of 1973, utilised Table B as their standard for their Articles of Association. These Articles of Association remain in force under the new Companies Act of 2008 unless replaced by a Memorandum of Incorporation.

Table B requires a company to be audited and even if, under the new Companies Act of 2008, a company is not compelled to be audited, it will have to be so audited.

In cases where a company is no longer compelled to be audited, in order to avoid this being required, the Articles of Association must be amended to remove this requirement.

Please contact your contact person or Wendy from our secretarial department about this matter.

***All of us here at Wilder Lockitch  
wish you a very enjoyable, peaceful and  
restful festive season and  
a great 2012!***

