THE IMPACT OF THE NEW COMPANIES ACT AND BUSINESS LEGISLATION ON BOARDS AND DIRECTORS – RESPONSIBILITIES AND RISK
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ABSTRACT

2008 was the year of compliance within the law with the enactment of the New Companies Act, the Competition Amendment Act and the Consumer Protection Act. The codification of directors’ duties applies to all companies and is complemented by the final King III code of governance best practices released on 1 September 2009.

This article looks at the directors’ role and duties and the risk and liabilities.

With this new challenge facing directors, the mission of the board is to operate in the best interest of the shareholders and the company is critical. To achieve this objective, directors are both agents of the shareholders and trustees of the company and consequently the need for a balanced board of executive and non-executive directors is fundamental to ensure that the best interest objective is achieved. For the company to be a going concern the board has to ensure that the company meets the new test of solvency and liquidity.

In relation to the New Companies Act, a director has numerous duties of compliance and performance. Some of these are:

- duty to manage the business affairs of the company (section 66(1))
- duty to carry on the business without trading recklessly or under insolvent conditions (section 22)
- duty to comply with chapter 3 of the Act (section 34(1) & 94)
- duty to keep company and accounting records (section 24 & 28)
- duty to prepare annual financial statements (section 29 & 30)
- duty to facilitate a shareholders’ meeting (section 61)

Section 75 and 76 sets out the directors’ liability in terms of the Act.

Finally, we look at the impact of the Competition Amendment Act and the Consumer Protection Act on the duties and liabilities of directors.

SIX KEY WORDS

Codification, Duties, Liabilities
Best interest, Responsibilities, Risk
INTRODUCTION

For businesses to succeed it needs good governance: performance with conformance.

What are the key responsibilities and risks of directors in relation to the New Companies Act (Act 71 of 2008) and other legislation, such as the Competition Amendment Act, the Consumer Protection Act, Protection of Personal Information Bill, Electronic Communications and Transactions Act and the Insolvency Act?

1. BOARD MISSION

The mission of every company, whether a profit company or non-profit company is to survive and succeed by offering products and services that meets the needs of the market. To do so, the company has to have a business model that is sustainable and viable. The goal of every company is to operate in the best interest of the shareholders and to this end, shareholders appoint boards of directors. Because a company is a separate legal entity, boards of profit companies have 2 goals:

i) To operate in the best interest of the shareholders (the owners of the company), viz wealth maximisation; and
ii) To operate in the best interest of the company, viz, value optimisation

To achieve these goals, there has to be a framework of CORPORATE STRATEGY and CORPORATE GOVERNANCE.

The corporate strategy addresses the strategic decisions of choice of business model, legal ownership entity, capital structure and having a strategic plan that will ensure the long-term sustainability of the company.

Corporate governance addresses the implementation and execution of the corporate strategy as managed by the board of directors in terms of conformance and performance standards.

2. DIRECTORS AS AGENTS AND TRUSTEES

Directors have a dual role to play – on the one hand, directors are agents of the shareholders. Their principal responsibility is to act in the best interest of the shareholders and the principal objective is to maximise shareholder wealth – to ensure a return on shareholder investments greater than the cost of capital. On the other hand, directors are trustees of the company. Their principal responsibility is to act in the best interest of the company. They act in a fiduciary capacity in relation to this objective. They are accountable to the shareholders and responsible to the company. This combined role of agent to the shareholder and trustee to the company can only be fulfilled if the best interest of the company is equated with the best interest of the shareholders.

“Structure follows Strategy” – Alfred D. Chandler
3. BOARD STRUCTURE: EXECUTIVE AND NON-EXECUTIVE DIRECTORS

The correct board structure is imperative to ensure the alignment of the interests of the shareholders and the company. Secondly, the operations of the business are to be effectively managed, not in the best interest of the executives and managers, but in the best interest of the shareholders and the company. To this end it is good corporate governance to have a board that consists of both executive and non-executive directors that include independent directors which will ensure a clear separation of ownership from control and related goals, activities and reward structures.

In terms of section 66 of the New Companies Act, every company must appoint a board of directors:
- in the case of a private company or personal liability company, at least one director;
- in the case of a public company or a non-profit company, at least three directors.

It is only in relation to audit committees of a public company or state owned company (SOC) that the act prescribes the composition of the Audit Committee, viz, at least three non-executive directors.

4. BOARD RESPONSIBILITIES

In the Companies Act of 1973, the basis of evaluating the company’s financial position was the capital maintenance system. This impacted on whether the company could trade under insolvent conditions, possible liquidation, subordination agreements and the inability of the company to finance the acquisition of its own shares. In the New Companies Act, the existence and longevity of the company is determined by it meeting one test – the solvency and liquidity test. This test brings together the two financial concepts of success and survival, or failure, viz, solvency and liquidity.

Solvency is the total financial state and position of the business. It relates to the net worth or net asset value of the business, where assets are valued on the basis of their market values and realisable values. The balance sheet should reflect the solvency position of the business.

Liquidity is the other side of the solvency coin and is used in the following different ways:

- First, it is used to describe the nature of a company’s asset holdings or mix, i.e. how easily assets can be converted into cash.

- Secondly, it is used to describe the relationship between a company’s liquid assets and its short-term liabilities, i.e. ability of a firm to meet its short-term financial obligations when and as they become due.

“Success is dependent on getting the right people on board”
An insolvency audit or verification has to focus on the big picture of solvency (assets versus liabilities), long-term survival and sustainability and the short-term picture of the firm’s ability to pay its short-term obligations.

The New Companies Act requires the need to have one test that incorporates both solvency and liquidity.

The question is not whether the company will survive for the foreseeable future; it is whether the company has adequately discharged the burden of showing that it can pay all of its debts when they become due and payable over the next 12 months.

Section 4(1) of the Act defines the solvency and liquidity test.

5. DIRECTOR RESPONSIBILITIES

One of the unique features of the New Companies Act is the codification of the general duties of directors. However, this codification is not complete because the Act does not entirely exclude the application of the common law.

The core duties of directors are set out in Section 76:

- While a director must still disclose any conflict of interest he has in relation to a matter before the board (as was previously the case), the concept of a conflict of interest is extended to include a personal financial interest of a person related to the director and the conflicted director may not take part in the board’s consideration of that matter.

- A director must not use his position as director or information gained in that capacity to:
  
  (a) gain any advantage for himself or any person other than the company or one of its wholly-owned subsidiaries; or
  (b) knowingly cause harm to the company or any of its subsidiaries.

- A director must communicate to the company any information that comes to his attention, at the earliest practicable opportunity, unless:
  
  (a) he is bound not to make that disclosure by a legal or ethical obligation; or
  (b) he reasonably believes that the information is immaterial to the company or generally available to the public.

- When acting in his capacity as a director, a director must exercise his powers and perform his functions:

  “Vision, mission and strategies at board level must be matched with tactics, controls, checks and balances at management level”
  
  (a) in good faith and for a proper purpose;
  (b) in the best interests of the company; and
(c) with the degree of care, skill and diligence that may reasonably be expected of a person carrying out those functions and having that director’s general knowledge, skill and experience.

Some of the other specific responsibilities and duties in terms of the Companies Act are as follows:

I CORPORATE STRUCTURE AND STRATEGIC LEADERSHIP

1.1 DUTY TO COMPLY WITH THE ACT IN RELATION TO DIFFERENT TYPES OF COMPANIES (Section 8)

Depending on the type of company formed and incorporated, this will drive the board to meet the applicable administrative requirements in relation to:
- Minimum number of members / shareholders
- Minimum number of directors
- Audit and independent review requirements
- The special chapter 3 requirements for public companies and state owned companies (SOC)
- Shareholder meetings and AGMs
- Company records and Accounting records
- Annual financial statements

Appendix 1 sets out the comparative requirements for the different profit companies and non-profit companies

1.2 DUTY TO COMPLY WITH THE COMPANY’S MEMORANDUM OF INCORPORATION (Section 13)

1.3 DUTY TO MANAGE THE BUSINESS AFFAIRS AT THE COMPANY (Section 66(1))

1.4 DUTY TO CARRY ON THE BUSINESS WITHOUT TRADING RECKLESSLY OR UNDER INSOLVENT CONDITIONS (Section 22)

II BOARD STRUCTURE AND CORPORATE ADMINISTRATION

2.1 DUTY TO APPOINT BOARD COMMITTEES, where appropriate (Section 72)

2.2 DUTY TO APPOINT AN AUDIT COMMITTEE in the case of a public company and state owned company (Section 94)

Solvency and liquidity are the two sides of the same coin of financial and economic sustainability

2.3 DUTY TO APPOINT A COMPANY SECRETARY in the case of a public company and state owned company (Section 84 & 86)
III ACCOUNTABILITY AND ASSURANCE

3.1 DUTY TO KEEP COMPANY RECORDS (Section 24)

3.2 DUTY TO KEEP ACCOUNTING RECORDS (Section 28)

3.3 DUTY TO COMPLY WITH CHAPTER 3 OF THE ACT (Section 34(1) & 94) in respect of public companies and state owned companies, viz:

   a) Appoint a company secretary
   b) Appoint an auditor
   c) Establish an audit committee

3.4 DUTY TO PAY DIRECTORS REMUNERATION IN TERMS OF MEMORANDUM OF INCORPORATION AND GET IT APPROVED BY SHAREHOLDERS BY SPECIAL RESOLUTION (Section 66(8) & 66(9))

3.5 DUTY TO APPOINT AUDITORS in case of public company, state owned company and private company (Section 90 & 92):
   - The auditor must be in the first instance be acceptable to the audit committee (in terms of qualifications and independence) and in the second instance, approved by the shareholders at the company’s annual meeting. In respect of an audit of companies operating in the public interest space, section 30(2) sets out the guidelines.

3.6 DUTY TO OBTAIN AN INDEPENDENT REVIEW OF THE FINANCIAL STATEMENTS, if they have not been audited* (Section 30)

   * The manner, form and procedures for the conduct of any independent review other than an audit as well as the professional qualifications if any of persons who may conduct such reviews will be determined by regulation.

IV DISCLOSURE AND TRANSPARENCY

4.1 DUTY TO PREPARE ANNUAL FINANCIAL STATEMENTS (Section 29 & 30)

   “Risk, return and responsibility are the three sides of the business opportunity”
   - Within 6 months after the financial year end;
   - In compliance with the financial reporting standards;
- To be approved by the board, prior to presentation to the shareholders’ meeting.

4.2 **DUTY TO PREPARE A DIRECTOR’S REPORT** which will form part of the Annual Financial Statements *(Section 30(3))*

4.3 **DUTY TO ISSUE A PROSPECTUS** in relation to a public offering by a public company *(Section 100)*

4.4 **DUTY TO DISCLOSE DIRECTOR’S REMUNERATION INFORMATION**, where the Annual Financial Statements is required to be audited *(Section 30)*

4.5 **DUTY TO FILE AN ANNUAL RETURN** *(Section 33)*

V **SHAREHOLDER TREATMENT**

What are some of the main sections of the New Companies Act in relation to the directors operating in the best interest of the shareholders?

5.1 **DUTY TO ENSURE THAT SHAREHOLDERS CAN EXERCISE THEIR VOTING POWER AND RIGHTS** *(Section 2(2) & 58)*

5.2 **DUTY TO FACILITATE A SHAREHOLDERS MEETING** *(Section 61)*

5.3 **DUTY TO OPERATE WITHIN THE FRAMEWORK OF THE COMPANY’S MEMORANDUM OF INCORPORATION** *(Section 15(3) & (4) & 36)*

5.4 **DUTY TO OPERATE IN THE BEST INTEREST OF THE SHAREHOLDERS** *(Section 20(6) & (7)) AND THE COMPANY *(Section 76(3))*

6. **LIABILITIES OF DIRECTORS**

The extent of directors’ liability has also been set out in the Act. In addition to explaining the liability for any breach of the abovementioned duties, the Act states that a director will be liable for losses suffered by the company as a result of the director having taken or failed to act against certain unauthorised or unlawful actions and situations.

6.1 **BREACH OF DUTIES**

   a) A director will be liable in accordance with the principles of the

   “There can be no responsibility without accountability”
common law relations to breach of fiduciary duty for any loss, damages or costs sustained by the company as a consequence of any breach of duty by him:

- to disclose a personal financial interest (section 75); or
- to avoid a conflict of interest (section 76(2)); or
- to act:
  - in good faith and for a proper purpose; or
  - in the best interests of the company (section 76(3)(a) – (b))

Liability for any breach by the director of:

- the duty to act with the required degree of care, skill and diligence (section 76(3)(c)); or
- any provision of this Act not otherwise mentioned in this section; or
- any provision of the company’s MOI;

is in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence thereof.

b) A director is liable to the company for any loss, damage or costs arising as a direct or indirect consequence of him:

- acting for an on behalf of the company despite knowing that he lacked authority to do so; or
- agreeing to carrying on the business of the company while knowing that it is prohibited under section 22; or
- being a party to an act or omission by the company despite knowing that it was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose; or
- having signed, or consented to the publication of a financial statement that was false or misleading in a material respect, or publication of a prospectus, or a written statement contemplated in section 101, that contained an “untrue statement” as defined in section 95, knowing that, or with reckless disregard as to whether the statement was false, misleading or untrue, as the case may be.

If the director took part in a meeting (formal or informal) and failed to vote against:

“One of the biggest failings in corporate governance has been the failure of shareholders to behave like owners” – Joseph Healy
● the issuing of any unauthorised shares or options on those shares, despite knowing that those shares had not been authorised under section 36; or

● the issuing of any authorised securities without shareholder approval under section 41; or

● the provision of financial assistance to any person in the acquisition of securities of the company, knowing that the financial assistance is in contravention of section 44 of the company’s MOI, to the extent that the resolution or agreement has been declared void in terms of section 218(1); or

● the provision of financial assistance to a director under section 45, knowing that it was in contravention of the Act or the company’s MOI, to the extent that the resolution or agreement has been declared void in terms of section 218(1); or

● a resolution approving a distribution, despite knowing that the distribution was contrary to section 46; or

● the acquisition by the company of any it shares, or the shares of its holding company, despite knowing that the acquisition was contrary to sections 46 or 48; or

● an allotment by the company despite knowing that the allotment was contrary to any provision of chapter 4, to the extent that the allotment or an acceptance is declared void under section 109(1) read with section 218(1).

(c) LIABILITY FOR FAILURE OF ACCOUNTABILITY (Section 213 & 214)

(d) OTHER LIABILITY (Section 20)

Each shareholder of a company has a claim for damages against any person, including a director, who fraudulently or due to gross negligence causes the company to do anything inconsistent with the Act or a limitation, restriction or qualification in terms of section 20, unless the action has been ratified by the shareholders.

6.2 CIVIL LIABILITY FOR RECKLESS TRADING

A company must not:

Eternal vigilance, looking ahead and constantly reviewing all aspects of the company’s activities: Here are the reasons why a board director is essential for a company” – Jonas Ridderstrale
● carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose; or
● trade under “insolvent circumstances” (“prohibited conduct”).

6.3 PROSPECTUS LIABILITY

Prospectus liability (for untrue statements) follows the structure of the 1973 Companies act. Directors who authorise the issue of the prospectus are liable to pay compensation for any loss or damage sustained by any person who acquired securities on the strength of the prospectus, as a result of any untrue statement in the prospectus, or any report or memorandum appearing on the face of, issues with, or incorporated by reference into the prospectus. This liability is in addition to any other liability under “public regulation” or the common law.

Delictual liability under common law for the director(s) and / or experts and / or the company therefore remains and the innocent party can claim recission (if the misrepresentation is material) and / or damages from the director(s) and / or experts and / or the company.

6.4 LIABILITY UNDER THE INSOLVENCY ACT

With regard to insolvent companies, Chapter IX of the Companies Act 61 of 1973 continues to apply with respect to the winding-up and liquidation of companies under the New Act as if the 1973 Act had not been repealed. This means that section 424, 425 and 426 still applies and ties in with the Insolvency Act.

Section 424 liability of directors and others for fraudulent conduct of business

SECTION 424(1)

“When it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct”.

Directors should ensure that they do not fall foul of the above section.

“Where there is risk, there will be failure and success; Where there is dishonesty, there will only be failure”
6.5 PERSONAL LIABILITY COMPANY

A personal liability company is a company which meets the criteria for a private company and its MOI provides that the directors and past directors are jointly and severally liable, together with the company, for any debts and liabilities of the company that were contracted during their respective terms of office.

7. RESPONSIBILITIES UNDER OTHER LEGISLATION

COMPETITIONS AMENDMENT ACT

The Act aims to regulate fair competition practices in South Africa and to strengthen the existing provisions of the Competitions Act. The primary purpose of the Competition Act is to improve the economic efficiencies of companies, hereby allowing consumers to enjoy lower prices, increased choice and improved product quality.

7.1 CRIMINAL LIABILITY

Perhaps the most significant proposed amendment to the Competition Act is the introduction of criminal sanctions against individuals and directors who participate in cartel conduct. The Act will introduce jail sentences of up to 10 years, or fines of R500 000 or both, for directors and managers who are responsible for, or knowingly acquiesce in cartel conduct as regulated by section 4(1)(b) of the Competition Act. This specifically includes:

- the fixing of prices and trading conditions;
- market division; or
- collusive tendering.

This sanction will apply to any person “engaged or purporting to be engaged by a firm in a position-having management authority within the firm”, who either “caused” the firm to engage in such a prohibited practice, or who “knowingly agreed to” contravening this section of the Act.

An individual can only be charged if the company involved has been found to have contravened the Act by the Competition Tribunal, or it has admitted a contravention in a formal consent order.

7.2 RISK

This amendment poses a risk in the context of mergers and acquisitions, because directors or managers appointed to target companies may find themselves caught in the very wide net these

“Corporate governance is a partnership of shareholders, directors and management – to provide wealth creation and economic well-being to the wider community of stakeholders and society”
amendments cast – if, for example, a target company is engaging in price fixing or market division and the new management continue this practice (even if they don’t realise it), they may be liable for “causing” a contravention of section 4(1)(b). If new management perceive that there is a contravention, but fail to act to stop it immediately upon acquiring control of the business, they are potentially liable for having “knowingly agreed to” a violation of section 4(1)(b).

7.3 MITIGATING THE RISKS

It is essential to manage the increased risk of exposure to liability, as well as to protracted and costly competition litigation, created by these new provisions in the context of mergers and acquisitions. Most importantly, a competition law review should be conducted as part of the due diligence investigation prior to merger agreements being signed. The recent Sasol wax case illustrates the value of this kind of inquiry. For the purchaser’s perspective, it may be wise to require that appropriate warranties and indemnities pertaining to competition law contraventions be built into the merger agreement.

In addition, a number of measures should be taken as a standard part of integration planning:

(a) A suitable competition law compliance programme should be implemented to provide an early warning system to detect potential contraventions and safeguard against contraventions in future.

(b) In particular, staff should be educated to exercise care when responding to requests for information from the Commission, both in the context of formal market inquiries and in the course of investigations involving cartel conduct, abuses of dominance and complex monopoly conduct.

(c) Reporting procedures need to be established so that staff know who to report a possible contravention of the Act to, and what procedure to follow.

(d) Since search and seizure proceedings are increasingly a favourite weapon in the Commission’s arsenal, staff need to be trained on how to react to a dawn raid.

(e) Procedures should also be established for the regular internal review of all agreements entered into by your business units, as well as their business practices, particularly in the context of industry associations where your staff interact with their competitors.

A duty of the company is a duty of the directors”
THE CONSUMER PROTECTION ACT (ACT 68 of 2008)

The Act introduces general principles of consumer protection and serves as an over-arching governing statement on consumer protection matters in South Africa.

Seeks to create and promote an economic environment that supports and strengthens a culture of consumer rights and responsibilities.
It seeks to promote fair, efficient and transparent marketing practices for consumers and businesses.

Examples of some of the far-reaching provisions are:

- **Marketing**
The Act prohibits discriminatory marketing (i.e. excluding persons from accessing any goods or services or targeting particular communities for exclusive supply of goods or services). The Act deals with the consumer’s right to select suppliers; the expiry and renewal of fixed-term agreements; pre-authorisation of repair or maintenance services; providing consumers with estimates; the right to choose or examine goods; the right to return goods and so-called unsolicited goods.

- **A cooling-off period following direct marketing**
Consumers are afforded a period of five business day to rescind transactions resulting from direct marketing, provided that they notify the supplier in writing or another recorded manner and form.

- **Cancellation of advance reservations, bookings or orders**
Consumers are allowed, subject to a reasonable cancellation charge, to cancel advance reservations, bookings and orders.

- **Disclosure and Information**
Consumers are entitled to information in plain and understandable language.

- **Fair and honest dealing with consumers**
The Act deals extensively with so-called unconscionable conduct; false or misleading representations; fraudulent schemes and offers; pyramid schemes and auctions.

- **Over-booking and over-selling**
A supplier must not accept payment or consideration for goods / services if the supplier has no reasonable basis to asset an intention to supply such goods / services which are materially different from those in respect of which payment was accepted.

“The performance of top management is crucial to the bottom-line success of the company”
• **Consumer Agreements**
  Unfair, unreasonable or unjust contract terms are not allowed; notice to the consumer is required for certain contractual terms, such as when the supplier intends to limit his liability; written consumer agreements are required in certain instances, and the Act prescribes the content of theses agreement. The Act also provides for so-called prohibited transactions, agreements, terms or conditions.

• **Fair value, good quality and safety**
  The Act deals with the right to demand quality service; the right to safe, good quality goods; implied warranties of quality; warranties on repaired goods and warnings concerning the fact and nature of risks pertaining to activities or facilities.

• **Liability for damage caused by goods**
  The imposition of strict liability for damage caused by goods is one of the most controversial provisions contained in the Act.

• **Franchise Agreements**
  The Act contains various provisions in relation to franchise agreements, i.e. the agreement has to be in writing, include prescribed information and comply with the plain and understandable language requirement.

• **Business Names**
  The Act proposes a significant change in the current registration scheme by making the registration of business names mandatory.

• **Class Actions**
  The Act class actions in the form of accredited consumer protection groups, which groups may act to protect the interest of a consumer individually or of consumers collectively.

**ELECTRONIC COMMUNICATIONS AND TRANSACTIONS ACT (ACT 25 OF 2002)**

The advent of electronic commerce practices has created a marketplace without conventional rules, not only nationally but also globally. The ECT Act aims to provide for the development of an e-strategy for South Africa, the regulation of electronic communications and e-transactions and the promotion of access to e-commerce. The most important aspects addressed by the Act are the legal recognition of electronic messages and records for evidential purposes; the legal force of electronically concluded contracts and their time and place of conclusion; consumer protection, including the introduction of a seven day cooling off period in respect of goods and services ordered; safe harbour protection for service providers; and the introduction of statutory criminal offences relating to information systems.

“Ethics has nothing to do with rules, but everything to do with attitude”

The Consumer’s Choice
CAVEAT VENDITOR

For directors of all companies, with the codification of corporate duties in the Companies Act, the Act creates significant new areas of responsibilities and risk for all directors; both executive and non-executive.

This has been further implicated by the Competitions Act and Consumer Protection Act, which collectively has introduced criminal liability to go with the civil actions for malpractices by the companies, their directors and managers.

For directors to perform and conform, they have to operate with honesty, integrity, caution, competence and expertise and make sure that every manager and employee in the company is committed to an uncompromising code of conduct of the highest ethical standards.

For directors it is no longer caveat emptor – buyer beware, but caveat venditor – director beware!

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“Do what is right and just and fair” Proverb 1:3
### APPENDIX 1

#### TYPES OF COMPANIES AND COMPLIANCE
(New Companies Act, Act 73 of 2008)

<table>
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<th>Compliance Requirements</th>
<th>Public Companies</th>
<th>State Owned Companies (SOC)</th>
<th>Private Companies (in public interest)</th>
<th>Other Private Companies</th>
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<td>Annual Return</td>
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<td>YES</td>
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<tr>
<td>Annual General Meeting</td>
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<td>NO</td>
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<tr>
<td>Deadline for AFS (after financial year end)</td>
<td>6 months</td>
<td>6 months</td>
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