

CIPC IDENTIFIES AND ACTS ON COVID-19 CONSEQUENCES

WEBINAR MATERIAL: 23 APRIL 2020

Table of Contents

MODULE 1: THE NATIONAL LOCKDOWN	2
1. Introduction	2
Full list of the categories of businesses that should remain open during National Lockdown	2
2. Consequences of the National Lockdown on businesses and their ability to trade	4
MODULE 2: LEGAL REQUIREMENTS.....	5
1. Paragraph 4(1)(b) of the Companies Regulations	5
2. Section 22 of the Companies Act	5
3. Lockdown Regulations (Original & Amended)	5
MODULE 3: CIPC PROVIDES COVID-19 RELIEF TO BUSINESSES.....	7
1. Practice Note 1 of 2020 – Notice to Customers.....	7
2. Impact of CIPC’s actions on companies and businesses unable to trade	7
3. Impact of CIPC’s actions on your Considerations as Auditor/Independent Reviewer/Accountant.....	8
4. Impact of CIPC’s actions on your Reporting Obligations.....	8
MODULE 4: CIPC ISSUES CERTIFICATES TO BUSINESSES PROVIDING ESSENTIAL SERVICES	9
1. Initial Process	9
2. CIPC’s process of Cancelling the Certificates of companies not designated as essential services	9
3. Amended process due to Extended Lockdown – NEW Certificate	10
4. Example of New CIPC Certificate.....	11
MODULE 5: INSOLVENCY CONSIDERATIONS (BONUS SECTION).....	12
1. Commercial vs Factual insolvency.....	12
2. Potential Legal Consequences of Insolvency	12
3. Companies Act Requirements	14
4. Companies Regulation 29.....	15
5. Auditing Profession Act	16
6. Close Corporations Act.....	16
7. CIPC notes on Solvency and Reckless trading	17
8. Your Reporting Obligations (regarding Insolvency)	17
MODULE 6: SOURCE DOCUMENTS.....	18
DISCLAIMER & COPYRIGHT	19
1. Disclaimer	19
2. 2020 Copyright, SA Accounting Academy	19

MODULE 1: THE NATIONAL LOCKDOWN

1. INTRODUCTION

Our national lockdown has caused and continues to cause companies and businesses to go into financial distress. What happens if a company is temporarily insolvent and still carrying on business?

CIPC has to monitor compliance with the Companies Act and Regulations, and would usually see the above as carrying on business recklessly, BUT now, CIPC has issued a Practice Note that provides relief to businesses in this regard. Also related to COVID-19 consequences, CIPC will revoke business permits of certain companies that obtained certificates for use in the lockdown period.

During this webinar we will discuss the above that all accountants and auditors must know of – during and after our national lockdown. This includes the impact of CIPC's actions on companies and businesses unable to trade at this stage – taking into account issues relating to insolvency.

This webinar examines the latest CIPC communications as a direct result of COVID-19, the practical effect on businesses, and the reporting obligations of the accountants and auditors of these businesses.

Full list of the categories of businesses that should remain open during National Lockdown

In his statement of 23 March 2020 to inform the SA nation of the lockdown, President Cyril Ramaphosa stated the following: *“All shops and businesses will be closed, except for pharmacies, laboratories, banks, essential financial and payment services, including the JSE, supermarkets, petrol stations and health care providers.*

Companies that are essential to the production and transportation of food, basic goods and medical supplies will remain open.

We will publish a full list of the categories of businesses that should remain open.”

According to this list, the following services will need to be maintained during the lockdown:

ESSENTIAL INFRASTRUCTURE SERVICES

1. Electricity - stable power supply with no loadshedding

Public and private organisations, their staff and service providers essential to the generation, transmission and distribution of electricity will need to continue to operate. This includes municipalities, and the suppliers of logistics, feedstock and maintenance will be required to continue to operate and provide security of electricity supply.

2. Water supply, sewerage and sanitation

Public and private organisations, their staff and service providers essential to the security of supply of bulk and potable water and sanitation must continue to operate and provide vital water and sanitation services. This includes municipalities and those involved in the supply of materials, chemicals and related equipment.

3. ICT – datacentres, fibre optic infrastructure, towers and antennae

We have extensively engaged with the ICT sector and are satisfied that connectivity will remain stable during this period. In this time industry collaboration will be critical to ensure that society remains connected and functional. The ICT sector including data centres, fibre optic providers, towers and antennae will need to operate at high capacity.

The industry will collaborate and use multiple data sets to provide predictive insights into spread and impact dynamics of the crisis which will enable government and society's ability to be proactive in measures that reduce the curve and social and economic impact of the spread.

Social platforms will allow our people to remain socially included and these platforms remain critical to the dissemination of accurate information. However, our citizens are reminded that cyber security is of the utmost importance and to be vigilant to cyber criminals who will, during this time, try to exploit the public.

CRITICAL BUSINESS CONTINUITY SERVICES TO SUPPORT THE HEALTH AND SAFETY OF SOUTH AFRICANS

1. Food & essential products – related manufacturing and processing, and distribution

In order to ensure that people remain well-nourished and apply high personal hygiene to combat the spread of Covid-19, the following operations will continue:

- Manufacturing of health-related products, supplies, devices, equipment, and medicines, including complementary health products; food and essential products, as well as essential inputs thereto.
- Agricultural and food supply related operations, including farming, veterinary and phyto-sanitary provider services, pest control services, and chemical and fertilizer providers.
- Fishing operations
- Forestry and sawmills will remain in production for disposable health and hygiene products, including toilet paper; as well as for the production of packaging for essential health and food supply chains.
- Food, beverages and essential products manufacturing and processing facilities
- Warehousing, transport and logistics for food & essential products, and health related goods
- The Ports, road and rail networks will remain open in order to facilitate the import and export of essential products.
- Food outlets – retail, wholesale, spaza shops and malls for food and essential products.

Essential products include: toilet paper, cleaners, sanitizers and disinfectants, personal hygiene products, bedding and clothing, and essential supplies for those taking care of the sick and in order for people to remain healthy.

2. Enabling Services

To assist in the Covid-19 response, the following services are required to continue operations:

- All healthcare related services be they public or private.
- Call centres providing life and health; energy, food and water supply, social, transactional, communications, law and order and international critical business continuity services.
- Professional and artisan services, to the extent that they are providing support in the Covid19 response, essential and critical business continuity services.
- Cleaning, laundry and hospitality services supporting the Covid-19 response and essential and critical business continuity services.
- Hotels, airlines, stadiums, car rental services, to the extent that they are supporting essential or critical business continuity services and repurposing for
- Financial and insurance services and health funders required to finance and support essential and critical business continuity services in the Covid-19 response, and provide short term bridging finance to people and businesses during this period.
- Anti-poaching and wildlife conservation services.
- Communication and media services on screen, TV, radio, print, broadcast and online.
- Safety and security services protecting people and property.

3. Work from Home

The government encourages people to continue to remain productive and work from home. However, this must be on the basis that it does not require contact with people not residing in the home, and it does not interfere in any manner with the Covid-19 response.

A detailed list will be made available in due course, the statement said.

Other than the above, most businesses had no choice but to follow the Lockdown Regulations and shut down during the lockdown.

2. CONSEQUENCES OF THE NATIONAL LOCKDOWN ON BUSINESSES AND THEIR ABILITY TO TRADE

The world's biggest virus lockdown saves lives, but hurts businesses!

- Most businesses do not have many savings or spare cash lying around. In tough economic times, running a business is difficult enough, and if you don't trade, you don't make money.
- To now be told "you have to close your business" and stay home, has far-reaching and devastating effects on the business, the owners, the employees, the suppliers, all of their families and dependants, and ultimately, the economy suffers.
 - These businesses still have all their usual fixed costs and other running expenses (e.g. rent, salaries, etc.), but they are not earning any income.
 - This could lead to a situation of commercial insolvency (where the company does not have enough funds available to pay the company's debts in the normal course of business).
 - When liabilities exceed assets, factual insolvency exists. This is also commonly referred to as technical insolvency.
- So, through no fault of their own, some businesses might now become commercially and/or technically insolvent (as a result of lockdown).
- Independent Reviewers and Auditors of companies and close corporations that trade whilst insolvent, should normally report this fact accordingly to either CIPC or IRBA, respectively.

MODULE 2: LEGAL REQUIREMENTS

1. PARAGRAPH 4(1)(B) OF THE COMPANIES REGULATIONS

GNR 351 of 26 April 2011 (303 pages)

4. Issuing of Guidelines and Practice Notes

(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. SECTION 22 OF THE COMPANIES ACT

Section 22 of the Companies Act, 71 of 2008 (the Act) empowers the Commission to issue notices, and if necessary, compliance notices to companies, which the Commission has reasonable grounds to believe is trading or carrying on business recklessly, with gross negligence or for a fraudulent purpose.

- An amendment to Section 22(2) makes it clear that this provision is concerned only with commercial insolvency and not with balance sheet insolvency.
- Deals with carrying on business recklessly or fraudulently
- Section 22 of the Companies Act prohibits companies from carrying on their business “... recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose ...”.
- In terms of schedule 5 to the Companies Act, Chapter 14 of the Companies Act, 1973 (the 1973 Companies Act) continues to apply with respect to the winding-up and liquidation of insolvent companies. Chapter 14 of the 1973 Companies Act includes section 424, which provides that where any business of a company is carried on recklessly or with intent to defraud, every person knowingly a party to such conduct is guilty of an offence.
- It is thus unlawful for a company to trade recklessly or with intent to defraud.

Application of Section 22 of the Companies Act on Close Corporations = Refer to the Guidance Note issued by CIPC in this regard

3. LOCKDOWN REGULATIONS (ORIGINAL & AMENDED)

The following can be accessed on <https://www.gov.za/coronavirus/quidelines>

Regulations

- [Lockdown regulations](#), as amended on 20 Apr 2020

- [Lockdown regulations amendment](#), 20 Apr 2020
- [Lockdown regulations amendment](#), 16 Apr 2020
- [Lockdown regulations amendment](#), 2 Apr 2020
- [Lockdown regulations amendments](#), 26 Mar 2020
- [Disaster management regulations](#), 18 Mar 2020

Disaster Management Act

- [Disaster Management Act: Declaration of a National State of Disaster: COVID-19 \(coronavirus\)](#), 15 Mar 2020
- [Disaster Management Act: Classification of a national disaster: COVID-19 \(coronavirus\)](#) , 15 Mar 2020
- [Disaster Management Act 57 of 2002](#), 15 Jan 2003

MODULE 3: CIPC PROVIDES COVID-19 RELIEF TO BUSINESSES

CIPC has certain monitoring responsibilities, i.e. they must monitor compliance with the Companies Act. Let's take a look at which steps CIPC will and will not take at this stage:

1. PRACTICE NOTE 1 OF 2020 – NOTICE TO CUSTOMERS

CIPC issues the following practice note in terms of Paragraph 4(1)(b) of the Companies Regulations (GNR 351 of 26 April 2011):

1. Section 22 of the Companies Act, 71 of 2008 (the Act) empowers the Commission to issue notices, and if necessary, compliance notices to companies, which the Commission has reasonable grounds to believe is trading or carrying on business recklessly, with gross negligence or for a fraudulent purpose.
2. In light of the COVID-19 pandemic and the declaration of a national state of disaster under the Disaster Management Act, 57 of 2002, CIPC will not invoke its powers under section 22 of the Companies Act, in the case of a company which is temporarily insolvent and still carrying on business or trading. This is only applicable where the Commission has reason to believe that the insolvency is due to business conditions, which were caused by the COVID-19 pandemic.
3. This practice note shall lapse within 60 days after the declaration of a national disaster has been lifted.

This notice is available to you as a Source Document

2. IMPACT OF CIPC'S ACTIONS ON COMPANIES AND BUSINESSES UNABLE TO TRADE

Usually, CIPC would do the following in terms of Section 22 of the Companies Act:

CIPC "may" call on the company to show cause why it should be allowed to continue trading.

CIPC has taken the view that trading under insolvent circumstances, may not necessarily be trading recklessly as intended by Section 22 of the Companies Act.

- Where CIPC has reasonable grounds to believe that companies are trading or carrying on business recklessly, with gross negligence or for a fraudulent purpose, CIPC may issue notices, and if necessary, compliance notices to such companies.

Because of the National Lockdown, there are numerous companies that this would normally apply to, because their insolvency is due to business conditions that were caused by the COVID-19 pandemic.

BUT because of this Practice Note, companies that are temporarily insolvent and still carrying on business or trading, would not be prosecuted.

These businesses therefore would not receive any notices or compliance notices from CIPC whilst SA is in lockdown, and for a period of 60 days after the lockdown has formally come to an end.

At least, this is one less headache for companies that are already experiencing hardship and worrying about their continued existence, the ability to continue to pay their employees (who may not be working during lockdown), etc.

There are also numerous other tax and financial relief measures available to financially distressed companies.

3. IMPACT OF CIPC'S ACTIONS ON YOUR CONSIDERATIONS AS AUDITOR/INDEPENDENT REVIEWER/ACCOUNTANT

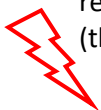
You should still consider (and document) your client's responses to insolvency, e.g. renegotiating payment terms with creditors, use of tax and financial relief measures relating to COVID-19, etc.

CIPC's actions would mean that for the relevant period, the company may still be contravening Section 22 of the Companies Act, but CIPC will not impose any actions upon them, i.e. there would be no material financial loss and it would not be considered reckless trading.

4. IMPACT OF CIPC'S ACTIONS ON YOUR REPORTING OBLIGATIONS

You should still consider (and document) your client's responses to insolvency, e.g. renegotiating payment terms with creditors, use of tax and financial relief measures relating to COVID-19, etc.

- If you are performing an **audit**, you must evaluate whether it is a Reportable Irregularity, then you must report to IRBA – in the prescribed format – within the prescribed timeframes stated in Section 45 of the APA (this will include reporting to management)



- **NOW – the likelihood of it being an unlawful activity and/or reckless trading is NOT eliminated, and you would still need to evaluate whether this is a RI or not. The odds are, because CIPC have decided not to take action, it lessens the possibility of it being a RI, and you would probably not need to report to IRBA.**

- If you are performing an **independent review**, and it is a Reportable Irregularity, then you must report to CIPC – in the prescribed format – within the prescribed timeframes stated in Companies Regulation 29 (this will include reporting to management)



- **NOW – the likelihood of it being a Reportable Irregularity is NOT eliminated, because the company/CC has traded whilst insolvent, and that is an automatic RI.**

- **The question is now rather: Do you need to report to CIPC?**



- **And the answer is...it feels like we shouldn't, but nothing has changed for us in our capacity as independent reviewer. CIPC have not issued any information to relax our reporting obligations in terms of Regulation 29.**

- **So, until CIPC issues a notice stating that they do not wish to be informed, we have to report the RI to them!!!**

- If you are acting as the **accounting officer to a CC**, then you should report to CIPC – in the prescribed format – within the prescribed timeframes stated in the Close Corporations Act

- **This has not been affected by any CIPC action!**

- If you are compiling the financial statements, then you should ensure that the relevant facts are reported, e.g. subordination of loans, guarantees, going concern issues, etc. in the notes to the AFS, and maybe in the Directors' Report

- In all of the above scenarios, you might need to report to management as well...

All instances of **NOCLAR** must be reported in accordance with your Professional Code of Conduct:

- Remember that this now includes compliance with the Lockdown Regulations!!!

MODULE 4: CIPC ISSUES CERTIFICATES TO BUSINESSES PROVIDING ESSENTIAL SERVICES

1. INITIAL PROCESS

CIPC to grant essential service business operation approval

Thursday, March 26, 2020

All businesses that will be allowed to provide essential services during the 21-day COVID-19 lockdown will be required to seek approval from the Department of Trade, Industry and Competition (the DTIC).

This is in terms of the National State of Disaster gazetted regulations which were published on Wednesday by Cooperative Governance and Traditional Affairs Minister Nkosazana Dlamini-Zuma.

In a statement, DTIC Minister Ebrahim Patel said such businesses are required to apply to the Companies and Intellectual Property Commission (CIPC) Bizportal website at www.bizportal.gov.za.

Here they will obtain a certificate from the Commission that allows them to continue trading. The Bizportal website will contain a menu icon listed as “Essential Service Businesses” through which an application can be made to the CIPC.

“The application will be a simple declaration requiring minimal registration details, type of business/trade involved in, what trading name if any is used and whether it meets the requirements contained in the essential services list, the contact details of the person applying as well as the number of employees that will be working during the lockdown period,” reads the statement.

The CIPC registry will then pre-populate the remaining company information and email a certificate stating that the business is allowed to remain trading.

The certificate can then be used as evidence to authorities requiring same that indeed the business has been given government permission to trade and that its employees are able to have unrestricted movement only in the course of that trade.

The department emphasised that false applications to the CIPC will be taken as a fraudulent application and will render the applicant liable to criminal prosecution and sanction.

This service will be available from 26 March 2020 at the start of business trading hours.

2. CIPC’S PROCESS OF CANCELLING THE CERTIFICATES OF COMPANIES NOT DESIGNATED AS ESSENTIAL SERVICES

Article – 6 April 2020

CIPC to revoke business permits mistakenly awarded, businesses face prosecution

The Companies and Intellectual Property Commission (CIPC) says it has started the process of cancelling the certificates of companies not designated as essential services.

The CIPC discovered several businesses had fraudulently obtained certificates when they initially filed applications on the Bizportal website.

Spokesperson for the Department of Trade and Industry Sidwell Medupe says a large number of businesses had applied illicitly.

“As was made clear when the automated certificate was issued by the CIPC, that the provision thereof was based on information provided by the registered company itself, and that possession thereof does not in itself constitute the right to continue operating during the lockdown period.

“In terms of the applicable regulations during the lockdown, all businesses shall cease operations except for any business involved in the manufacturing, supply or provision of an essential service or goods,” Medupe explains.

He adds **businesses found guilty of wrongdoing will be taken to task.**

“It is a criminal offence for any business to continue operating during the lockdown period if it is not providing an essential service. It is also a criminal offence for any business which misrepresents the nature of its operations in order to obtain a CIPC certificate.

“Businesses in the CIPC database that are not eligible to continue operations during the lockdown have had their certificates cancelled and will be handed over to the South African Police Services for further investigation and potential prosecution.”

Pubs, taverns, restaurants and fast food places are among those who applied for permits to operate during the lockdown, despite the regulations.

It is expected that this process will continue during the extended lockdown.



3. AMENDED PROCESS DUE TO EXTENDED LOCKDOWN – NEW CERTIFICATE

New CIPC certificate required to be open during extended lockdown

You will now need this new certificate to stay open as an essential service during South Africa’s lockdown

Article – 17 April 2020

Companies, which are registered through the Companies and Intellectual Property Commission’s (CIPC) BizPortal to perform essential services during the lockdown period, will be required to have a new certificate for the extended period, the Department of Trade and Industry has announced.

The certificate will be sent via email using the details provided at the time of registration, and will also be available for download from Friday (17 April). The full list of registered companies will have received their certificates by the weekend, the DTI said.

“The new certificate will clearly state that it is for the extended lockdown period, beginning 17 April 2020, and South African Police Service officials will be told which certificates to look for.

“Certificates issued before today will no longer be valid and must be disposed of. To provide time for businesses to adjust to the new requirements, the new certificates will be available to be displayed from start of business on Monday (20 April 2020).”

The department said that possession of the CIPC certificate is still subject to the company fully complying with the applicable lockdown regulations and is a record of the company’s details, and does not in itself constitute the right to continue operating during the period.

Only businesses which provide essential services in terms of the regulations may continue their operations during the Covid-19 lockdown, it said.

Only for registered companies

The certificate is a reference to the legal registration of the company in terms of the Companies Act and a record of registration to the CIPC.

This means that the registration portal is only for companies registered in terms of the Companies Act, the DTI said.

“Other essential service providers, like healthcare professionals registered with the Health Professions Council of South Africa, sole proprietors who provide essential goods and services (like small business owners and spaza shops), and small-scale farmers will not register through the Bizportal.

“These businesses will not have a CIPC certificate, but must still comply with the provisions of the lockdown regulations,” it said.


Where the CIPC finds that certificates have been issued to companies which do not meet the definitions of an essential service, such certificate will be revoked, and the company will be referred to the South African Police Services, the DTI said.

“False declaration by the company is a criminal offence and will result in prosecution, in terms of lockdown regulations.”

4. EXAMPLE OF NEW CIPC CERTIFICATE

**Document issued by the Commissioner of
Companies & Intellectual Property Commission**

on Thursday, April 16, 2020 at 19:04



Companies and Intellectual
Property Commission
a member of the dti group

Enterprise Number: [REDACTED]
 Enterprise Name: [REDACTED]
 Business Category: [REDACTED]
 Contact Person Name: [REDACTED]
 Contact Person Surname: [REDACTED]
 Contact Person Email: [REDACTED]
 Contact Person Cell Number: [REDACTED]
 Number of Employee: [REDACTED]
 Physical Address: [REDACTED]
 [REDACTED]
 [REDACTED]
 [REDACTED]

EXTENDED LOCKDOWN PERIOD: CERTIFICATE OF RECORD FROM 17 APRIL 2020

This revised certificate records that the business operating as [REDACTED] is registered in terms of the Companies Act, 2008. The responsible person named above has submitted information to the Companies and Intellectual Property Commission to state that the business performs essential services as indicated in relevant regulations issued as part of the state of disaster declared under the Disaster Management Act, to deal with the Covid-19 crisis.


This CIPC certificate is a record that the company has submitted information to the CIPC. This replaces any other certificate issued by the CIPC prior to 17:30 on April 16, 2020.

The possession of the CIPC certificate is still subject to the company fully complying with the applicable Lockdown Regulations and is a record of the company's details. This certificate does not in itself constitute the right to continue operating during the period, and it is the responsibility of the company to ensure that it complies with the regulations.

Only businesses which provide essential services in terms of the Lockdown Regulations, as amended, issued by the Minister for Cooperative Governance and Traditional Affairs may continue their operations during the COVID-19 lockdown, and only in respect of goods or services defined as essential in the regulations.

False declaration by the company is a criminal offence and will result in prosecution. This certificate may be revoked if there are changes to the regulations or in order to improve implementation of the lockdown.


Yours truly
CIPC Commissioner




Physical Address
the dti Campus - Block F
77 Meintjies Street
Sunnyside 0001

Postal Address: Companies
P O Box 429
Pretoria
0001

Docex: 256
Web: www.cipc.co.za
Contact Centre: 086 100 2472(CIPC)
Contact Centre (International): +27 12 394 9573



1 of 1



MODULE 5: INSOLVENCY CONSIDERATIONS (BONUS SECTION)

1. COMMERCIAL VS FACTUAL INSOLVENCY

Although it is not the norm, it is not uncommon in business for a company's liabilities to exceed its assets.

When liabilities exceed assets, factual insolvency exists. This is also commonly referred to as technical insolvency.

Factual or technical solvency is distinguishable from commercial solvency. Commercial solvency is the ability of an entity to meet its debts as and when these fall due.

The ability of a company to meet its debts as and when these fall due is dependent upon the funds available (and reasonably anticipated to be available) to the company.

To continue operating as a going concern, a company must be commercially solvent. There is thus a link between the factual solvency assessment and commercial solvency, as the asset and liability values may be different if a company is not a going concern.

Factual insolvency = A company is trading whilst factually insolvent, if its total liabilities exceed its total assets.

- For the consideration of factual solvency, assets are normally measured at their fair value (and not only at their carrying value in the financial statements and accounting records) in the ordinary course of business of the company – not in a liquidation or close-down scenario.
- This assessment thus assumes that the company will continue as a going concern in the foreseeable future – which is typically considered as covering the twelve months from the date of the assessment.

Commercial insolvency = not having enough funds available to pay the company's debts in the normal course of business.

- ISA 570 identifies net current liabilities as a condition which may cast doubt about the going concern assumption.
- The funds available to a company include inter alia its bank balances, liquid assets, borrowing facilities and committed funding from related parties (such as a holding company or fellow-sub subsidiary). Sometimes, the relationship between current assets and current liabilities is considered as a potential indicator of commercial insolvency.

2. POTENTIAL LEGAL CONSEQUENCES OF INSOLVENCY

If a company is considered not to be a going concern, then the assets should be considered at their realisable amounts, and the measurement of liabilities should include all liabilities that arise in a liquidation or close-down scenario.

- *When the fair value of an asset is different from the carrying value in the financial statements and accounting records, then when taking into account the fair value of that asset in the factual solvency assessment, it is also necessary to take into account the tax consequences that follow from the notional revaluation of the asset (or a revaluation processed in the books of account and financial statements).*

Summary of certain relevant principles (from Case Law)

- There is no prohibition against a company continuing to trade whilst its liabilities exceed its assets i.e. whilst it is factually insolvent.
- However, trading whilst factually insolvent does raise the potential for possible recklessness, or even fraud.

- Continuing to trade whilst factually insolvent does not itself amount to reckless or fraudulent trading, but trading under such circumstances raises a “flag” in relation to potential reckless or fraudulent trading. Continuing to incur debt whilst factually insolvent raises the inevitable questions as to whether the debt incurred will be paid as and when due, and whether it is reasonable and responsible for the company to continue trading and incurring new debt in those circumstances.
- If a factually insolvent company incurs new debt, that does not, of itself, constitute reckless trading. However, when a company is factually insolvent, that should cause the directors to have an elevated level of regard to the interests of creditors.
- If a company continues to incur debt where there is no reasonable prospect of the creditors being paid when due, then in general, the proper inference is that the business is being carried on recklessly. This is objectively measured in the context of the notional reasonable person in business, but subjectively to postulate this person with similar knowledge and background to the actual directors.
- An honest belief by the directors as to prospects of payment to creditors when due is critical in assessing fraudulent trading, but not in itself a determinant of reckless trading.
- A genuine belief as to prospects of payment of creditors when due is not relevant if objective considerations establish recklessness.
- If a company continues to incur credit when to the knowledge of the directors the debts will not be paid as and when due, that will typically amount to an intent to defraud and fraudulent trading – which would be a breach of the common law (in addition to applicable legislation), and hence unlawful conduct.
- **The legal test for recklessness involves a consideration inter alia of:**
 - the scope of operations of the company;
 - the role, functions and powers of the directors;
 - the amount of the debts;
 - the extent of the financial difficulties; and
 - the prospects (if any) of recovery.
- **The ordinary meaning of “reckless” includes gross negligence**, with or without consciousness of risk-taking. Gross negligence includes an entire failure to give consideration to the consequences of one’s actions – an attitude of reckless disregard of such consequences.
- Recklessness is present when the conduct is grossly unreasonable. Although business involves entrepreneurial risks, if credit is incurred when there is an objectively strong chance (falling short of a virtual certainty) that creditors will not be paid when due, that indicates reckless trading.
- **Recklessness is distinguishable from mere negligence** – which is indicated when the incurrence of debt in particular circumstances creates a material, but not high risk of non-payment of creditors, and which risk reasonable businessmen would refrain from running in the particular circumstances.
- **In a group scenario (which may also have application in other contexts), the following is relevant in assessing recklessness:**
 - the ability of a company to pay its creditors without group support;
 - the extent of the company’s dependence on support from its holding company (or group companies);
 - if a company is unable to pay its debts without group support, clarity on basic questions is required before incurring debt for the continued operation of the business, namely:
 - what financial support will the group provide?

- for how long will that support be available?
- Without clarity and commitment on the questions above, it is neither reasonable nor responsible to take the risk, knowingly or not, that trade creditors might not be paid.
- Clarity and commitment are required not only where a company relies solely on a shareholder to provide funding, but also where shareholder funding is essential for the company to survive even though other funding is available.
- **Other relevant matters to be considered in an assessment of potential reckless trading include the following:**
 - the litmus test of factual solvency of a company is the shareholders’ interest in the company i.e. assets versus liabilities;
 - revaluations of assets, especially when conducted by the directors, should be considered with caution in assessing the factual solvency of a company;
 - the profit (or loss) after interest is illustrative of profitability and the ability to pay debts;
 - although as a matter of law an overdraft is repayable on demand, it is not reckless for a director to assume that the bank will not unexpectedly call it up before the term – in circumstances when the bank, after due consideration, had granted and increased the overdraft for a fixed term.
- The issues above are not the only matters to be considered by an auditor, who includes all relevant facts in the consideration.

3. COMPANIES ACT REQUIREMENTS

There are numerous sections to the Companies Act that apply:

Section 4

- Consideration of the solvency and liquidity test in Section 4 of the Companies Act
 - and making the connection to the evaluation thereof on the new CIPC Compliance Checklist
- **Refer to Guidance issued by CIPC below**

Section 22

- Deals with carrying on business recklessly or fraudulently
- Section 22 of the Companies Act prohibits companies from carrying on their business “... recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose ...”.
- In terms of schedule 5 to the Companies Act, Chapter 14 of the Companies Act, 1973 (the 1973 Companies Act) continues to apply with respect to the winding-up and liquidation of insolvent companies. Chapter 14 of the 1973 Companies Act includes section 424, which provides that where any business of a company is carried on recklessly or with intent to defraud, every person knowingly a party to such conduct is guilty of an offence.
- It is thus unlawful for a company to trade recklessly or with intent to defraud.

Application of Section 22 of the Companies Act on Close Corporations

- Refer to the Guidance Note issued by CIPC in this regard.
- CCs have new duties such as having to meet the **solvency & liquidity test** of Section 4 of the Companies Act.
- CCs have to comply with the relevant sections of the Companies Act as well as the Close Corporations Act.

This Guidance Note is available to you as a Source Document

Section 129

- Deals with “financially distressed companies”
- Section 128(1)(f) of the Companies Act defines “financially distressed” in relation to a company as meaning that:
 - (i) *“it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or*
 - (ii) *it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months ...”*
- Section 129(7) of the Companies Act provides that if a company is financially distressed as defined and the board has not resolved that the company voluntarily begin business rescue proceedings, the board must deliver a written notice to shareholders, creditors and representatives of the employees of the company, explaining that the company is financially distressed as contemplated in section 128(1)(f), and provide the reasons for not adopting the resolution to begin business rescue proceedings.
- If a company is factually insolvent, then it falls within the definition of “financially distressed” in section 128(1)(f), and the company is required to act in the manner set out in section 129(7).

Section 128

Interpretation of Section 128(1)(f) of the Companies Act

There is room for interpretation on the application of section 128(1)(f) of the Companies Act.

We have not provided for alternative interpretations of “insolvent” in section 128(1)(f)(ii) and Regulation 29(1)(b)(iii) which are contrary to its plain meaning. There is a possibility, such that reporting of a reportable irregularity in terms of the Auditing Profession Act is not automatically the default action of the registered auditor in all instances.

4. COMPANIES REGULATION 29

Companies Regulation 29 dealing with reportable irregularities in the context of a review in terms of the Companies Act.

Regulation 29(6)(a) provides that an independent reviewer that is satisfied or has reason to believe that a “reportable irregularity” has taken place (or is taking place) must, without delay, send a written report to the Companies and Intellectual Property Commission (the Commission) giving particularities of the reportable irregularity.

Regulation 29(1)(b) defines a reportable irregularity as meaning “any act or omission committed by any person responsible for the management of a company, which –

(i) *unlawfully has caused or is likely to cause material financial loss to the company or to any member, shareholder, creditor or investor of the company in respect of his, her or its dealings with that entity; or*

(ii) *is fraudulent or amounts to theft; or*

(iii) *causes or has caused the company to trade under insolvent circumstances.”*

The definition of “reportable irregularity” in the Regulations is *not* the same as the definition of “reportable irregularity” in the APA.

The independent reviewer is alert to the possibility of the existence of a reportable irregularity in terms of the Regulations, and the independent reviewer’s obligation to report in such circumstances.

Regulation 29(1)(b)(iii) is considered to deal with factual insolvency.

Thus, in terms of Regulation 29(1)(b)(iii), if a company whose annual financial statements are subject to a review (and not an audit), has traded, or is trading whilst factually insolvent, that conduct itself constitutes a reportable

irregularity. Consequently, the reporting obligations of the independent reviewer of that company in terms of the Regulations would apply.

If a company whose annual financial statements are subject to review (and not an audit) is factually solvent, but is, or appears to be, trading recklessly or fraudulently, then the independent reviewer should consider whether there is a reportable irregularity in terms of Regulation 29(1)(b) (i) or (ii) i.e. whether trading under such circumstances has caused, or is likely to cause material financial loss to any or all of the parties identified in the Regulation, or is fraudulent or amounts to theft.

If an independent reviewer is satisfied or has reason to believe that the circumstances in Regulation 29(1)(b)(i) or (ii) exist, then the report in terms of the Regulations should be made to the Commission.

An illustrative example of the required reports to the Commission in terms of Regulation 29 are available in Bonus Documents, as well as the SAICA Circular in Source Documents.

5. AUDITING PROFESSION ACT

Section 45 of the APA dealing with reportable irregularities in the context of an audit of an entity.

Where an entity appoints a registered auditor that is a firm to perform an audit, the firm must decide as to the individual registered auditor/s within the firm that is/are to be responsible and accountable for that audit.

Section 45(1) of the APA imposes a statutory duty on the individual registered auditor of an entity that is satisfied or has reason to believe that a “reportable irregularity” has taken place or is taking place in respect of the entity, to report to the IRBA.

The definition of reportable irregularity in the APA is different to that in the Regulations.

The phrase “reportable irregularity” is defined in section 1 of the APA thus:

“reportable irregularity” means any unlawful act or omission committed by any person responsible for the management of an entity which –

- (a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or*
- (b) is fraudulent or amounts to theft; or*
- (c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof.”*

The two most important differences between the definition of “reportable irregularity” in the APA and that in the Regulations are:

- in the Regulations, the mere act of trading under insolvent circumstances is a reportable irregularity, but not in terms of the APA;
- in the APA, a material breach of a fiduciary duty is a reportable irregularity, but not in terms of the Regulations.

6. CLOSE CORPORATIONS ACT

As the accounting officer, you should still report when the liabilities exceed the assets, as the CC’s Act has not changed in this regard.

7. CIPC NOTES ON SOLVENCY AND RECKLESS TRADING

[Home](#) » [Maintain your Business](#) » [Maintain your Company](#) » [Maintain a Private or Personal Liability Company](#) » [Compliance Obligations](#) » [Solvency and Reckless Trading](#)

The Companies Act, 2008, states that a company must not carry on its business recklessly, with gross negligence, with intent to defraud or trade under insolvent circumstances. (Sect 22) If a company trades in such circumstances, the Commission may require the company to cease carrying on business.

Although “trading under insolvent circumstances” is not defined in the Act, it is accepted to mean that a company does not meet the “solvency and liquidity test” criteria. There are many trading companies which are liquid, meaning they can pay their debts as they become due, but not necessarily solvent as defined in the solvency and liquidity test.

In terms of the “solvency and liquidity test”, solvency relates to the assets of the company, fairly valued, being equal or exceeding the liabilities of the company. Liquidity relates to the company being able to pay its debt as they become due in the ordinary course of business for a period of 12 months.

The [solvency and liquidity test](#) applies to the following:

- financial assistance for the subscription of securities (sect 44)
- loans or other financial assistance to directors (sect 45)
- distributions to shareholders authorized by the board (sect 46)
- capitalization of shares (sect 47)
- company or subsidiary acquiring company’s shares (buy backs or buy ins) (sect 48)
- amalgamations or mergers (sect 113)

8. YOUR REPORTING OBLIGATIONS (REGARDING INSOLVENCY)

This will depend on the outcome of your considerations of the various factors in the previous sections:

- If you are performing an audit, and it is a Reportable Irregularity, then you must report to IRBA – in the prescribed format – within the prescribed timeframes stated in Section 45 of the APA (this will include reporting to management)
- If you are performing an independent review, and it is a Reportable Irregularity, then you must report to CIPC – in the prescribed format – within the prescribed timeframes stated in Companies Regulation 29 (this will include reporting to management)
- If you are acting as the accounting officer to a CC, then you should report to CIPC – in the prescribed format – within the prescribed timeframes stated in the Close Corporations Act
- If you are compiling the financial statements, then you should ensure that the relevant facts are reported, e.g. subordination of loans, guarantees, going concern issues, etc. in the notes to the AFS, and maybe in the Directors’ Report
- In all of the above scenarios, you might need to report to management as well...

You need to decide what your report should include – by referring to the results of your evaluations.

All instances of NOCLAR must be reported in accordance with your Professional Code of Conduct.

MODULE 6: SOURCE DOCUMENTS

The following Source Documents will be uploaded to your profile, for future reference purposes:

1. CIPC_Practice Note 1 of 2020
2. CIPC new certificate EXAMPLE
3. CIPC_Notice re Services during SA lockdown
4. CIPC_Notice 14 of 2020 CIPC Call centre on corona virus
5. CIPC_Notice 15 re platforms
6. CIPC_Notice 19 of 2020_Lockdown
7. CIPC_Notice 21 of 2020_Lockdown ext
8. GN Application_of_Section_22_Co_Act_on CCs_June_2015 INSOLVENT

DISCLAIMER & COPYRIGHT

1. DISCLAIMER

This work or the webinars and/or seminars related thereto are not intended to constitute professional advice. The views expressed are those of the author and the presenter. While reasonable care has been taken to ensure the accuracy of this publication and the presentation thereof, the author and the presenter expressly disclaim any liability to any person relating to anything done or omitted to be done, or to the consequences thereof, in reliance upon this work or the views expressed by the presenter. Webinar and/or seminar material is for the sole use of the participant and is the copyright of **SA Accounting Academy**.

2. 2020 COPYRIGHT, SA ACCOUNTING ACADEMY

This work and any webinar related thereto are protected by copyright laws and international treaties. This work includes, but is not limited to, webinar and/or seminar content, images, illustrations, designs, icons, photographs, audio clips, video clips, articles, documents, plans and other materials and is the exclusive property of **SA Accounting Academy**. You may not copy, reproduce, republish, upload, display, prepare derivative works, report, post, transmit or distribute materials in any form, whether electronic or otherwise without **SA Accounting Academy's** prior written consent. A party infringing such copyright may be liable to a civil claim and/or criminal proceedings in certain circumstances.