Audit Committees in South Africa in Terms of the *Companies Act* 71 of 2008: Policy Rationale, Role and Contribution of Audit Committees Towards Financial Reporting

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Abstract

In recent times the world's business community has seen an overwhelming surge of serious corporate governance and financial reporting scandals in both the private and the public sectors. These governance collapses happened despite the fact that the majority of these companies have audit committees. This article critically examines the provisions of the *Companies Act* 71 of 2008 relating to the establishment and maintenance of audit committees in South African companies. The focus is particularly on the policy rationale, and the role and contribution of audit committees towards financial reporting in South Africa. The purpose is to demonstrate that audit committees play a key role in the production of dependable financial statements and reports for the benefit of the company's stakeholder community. This article highlights the relationship between the effectiveness of audit committees and good corporate governance, as well as accurate financial reporting. In other words, where there is a more effective audit committee, there is a high likelihood of accurate and dependable financial statements and other financial reports.

Keywords

History; memory; legal culture; jurisprudence.

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1 Introduction

Audit committees have increasingly become a critically important corporate governance improvement mechanism,[1] especially in the light of the multiplicity of the corporate scandals and financial irregularities that have been widely publicised in South Africa[2] and many other parts of the world. For the South African corporate community, the stakeholders are expected to increasingly become more reliant on the effective performance of the role of the audit committee.[3] The reliance on the audit committees is not only for the provision of oversight on the companies' financial reporting but also for ensuring that the board of directors and board sub-committees do not abuse the powers conferred on them by the *Companies Act* 71 of 2008 (*Companies Act* 2008), the companies' constitutive documents and the relevant corporate governance codes. The devastating financial misstatements and corporate scandals publicised both locally and internationally generally had the following in common: poor corporate governance practices, fraudulent financial reporting, creative accounting and auditor inefficiency and independence issues, despite the fact that audit committees existed at most of these companies.[4] Despite audit committees' stewardship role in respect of the audit function and financial reporting, the widely reported failings of auditing continue to be of grave governance concern to stakeholders. This calls into question the effectiveness of audit committees under the South African corporate law regime. However, the inquiry into the effectiveness of the audit committee under the South African corporate structure requires special attention and therefore falls outside the scope of this article.

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1 Van der Nest, Thornhill and De Jager 2008 *Journal of Public Administration* 549.

2 For an identification of some of the reported corporate scandals and financial irregularities in South Africa, see the discussion in point 2 below.

3 This expectation is drawn from the fact that stakeholders are the consumers of financial reports and that the audit committee provides oversight of the integrity of the financial reporting process. S 94(2) of the *Companies Act* 71 of 2008 makes it mandatory for public companies and state-owned enterprises (SOEs) (and any other company mandated by its Memorandum of Incorporation (MOI)) to establish audit committees. Additionally, the establishment of audit committees is a listing requirement of the Johannesburg Stock Exchange (see Requirements 3.84 of the JSE Listing Requirements - JSE date unknown https://www.jse.co.za/sites/default/files/media/documents/2019-04/JSE%20 Listings%20Requirements.pdf).

4 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 10.

This article critically evaluates the establishment and role of audit committees under the *Companies Act* 2008, with specific focus on the policy rationale and the contribution of audit committees towards financial reporting in South Africa. The objective is to demonstrate that audit committees play a key role in the accuracy and integrity of financial statements and reports for the benefit of the company's stakeholder community.

The article is structured as follows: this introductory segment introduces the subject and sets the tone of the paper. It also sets out the scope and objectives of the article. The discussion proceeds to highlight some few examples of corporate scandals and financial irregularities in South Africa. This will be followed by a detailed assessment of the policy rationale for the establishment of audit committees under the *Companies Act* 2008, with the aid of the historical development in the United Kingdom (UK) and the United States of America (USA). The purpose is to examine the current legislative and regulatory framework which provides for the establishment and role of audit committees against the policy objectives. To achieve this, the article provides a detailed exposition of the composition and functions of audit committees under the *Companies Act* 2008. The article further discusses the effect of audit committees on companies' financial reporting obligations. The last segment provides a conclusion and some recommendations.

2 Some reported corporate scandals and financial irregularities in South Africa

The South African corporate community has recently been and continues to be rocked by overwhelming corporate governance disasters in both the private and the public sectors. The following are some of the examples. The Steinhoff corporate scandal has been labelled as possibly the biggest case of corporate fraud in South African business history,[5] or more aptly, as "South Africa's Enron".[6] With respect to the Steinhoff scandal, its auditor, Deloitte & Touche (Deloitte), had to agree to contribute towards the payment of claims to the Steinhoff shareholders for the economic losses suffered by that company.[7] In the Tongaat Hulett Limited scandal, PriceWaterhouseCoopers' (PwC) investigation into that company's corporate shame found, among other things, that there were a number of governance failures pursuant to which internal policies, guidelines and

5 Naudé *et al* 2018 https://www.researchgate.net/publication/337740231_BUSINESS_PERSPECTIVES_ON_THE_STEINHOFF_SAGA_SPECIAL_REPORT_JUNE_2018 2.

6 Rabkin 2019 https://mg.co.za/article/2019-11-08-00-steinhoff-relies-on-legal-fig-leaf/.

7 Gernetzky 2021 https://www.businesslive.co.za/bd/companies/retail-and-consumer/deloitte-makes-r1bn-move-to-clean-its-steinhoff-stain/.

frameworks were not followed.[8] The PwC investigation into the Tongaat Hulett Limited scandal further found that the governance failures discovered had created an environment in which senior executives could initiate or participate in the financial reporting misstatements.[9] Another example is EOH Holding's corruption scandal. An investigation of corruption at EOH Holding by a law firm, ENSafrica, discovered that there was evidence of serious governance failings and wrongdoing in that company.[10] The state-owned enterprises (SOEs) were not spared. The South African Airways (SAA) has recently concluded a business rescue process and the erstwhile chairperson of its board of directors was declared a delinquent director by the court.[11] Transnet and Eskom were the subjects of crucial testimony at the Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in Public Sector including Organs of State (Zondo Commission).[12] Among many others, these big corporations have encountered grave governance transgressions which have adversely affected the shareholders, creditors, employees and relevant communities, among other stakeholders. This happened even though these corporations and public entities have or had audit committees whose statutory duties include, among other things, addressing concerns and complaints relating to the companies' accounting practices and internal financial controls,[13] as well as the performance of such other oversight functions as may be determined by the corporations' board of directors and governing bodies.[14]

Despite the audit committees' stewardship role, the widely reported failings of the corporations' auditors continue to be of grave governance concern. For example, the shareholders of African Bank Investments Limited (ABIL), which is listed on the Johannesburg Securities Exchange (JSE), instituted a claim for damages against the directors of that company and its auditor, Deloitte.[15] The claim was based on the damage allegedly suffered by the shareholders as a result of the diminution in the value of their shares in

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8 Naudé *et al* 2018 https://www.researchgate.net/publication/337740231_BUSINESS_PERSPECTIVES_ON_THE_STEINHOFF_SAGA_SPECIAL_REPORT_JUNE_2018 2.

9 See PwC 2019 https://www.tongaat.com/wp-content/uploads/2019/11/Key-findings-of-PwC-Investigations-29-Nov-2019.pdf.

10 See McKane 2019 https://mybroadband.co.za/news/business/313465-major-corruption-unearthed-at-eoh.html.

11 See *Organisation Undoing Tax Abuse v Myeni* (15996/2017) [2020] ZAGPPHC 169 (27 May 2020) para 285.

12 Proc 3 in GG 41403 of 25 January 2018 (Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in Public Sector Including Organs of State).

13 Section 94(7)(g) of the *Companies Act* 71 of 2008.

14 Section 94(7)(i) of the *Companies Act* 71 of 2008.

15 *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* (1423/2018) [2020] ZASCA 83 (3 July 2020) (hereafter *Hlumisa Investment Holdings*).

ABIL.[16] The shareholders argued that Deloitte was tasked by ABIL to audit and report on the financial standing of ABIL and its wholly owned subsidiary company, African Bank Limited (African Bank). The ABIL shareholders further argued that Deloitte had reported that African Bank's annual financial statements fairly presented the bank's financial position.[17] Although the claim failed,[18] it demonstrates the failures of the audit function under the stewardship of the audit committee. The KPMG[19] scandal provides another example of failings of the auditing function despite the existence of the audit committee in these corporations. KPMG is currently being sued by the liquidators of one of its former clients, the Venda Building Society Mutual Bank (VBS Bank), for an amount more than R800 million. This claim is based on the firm's alleged failure, as the VBS Bank's auditor, to report on the financial irregularities and alleged corruption within the VBS Bank.[20] KPMG's alleged failure to report the financial irregularities and alleged corruption happened under the stewardship of the VBS Bank audit committee. It is said that the scandals of both African Bank and VBS "revealed similar causes of the collapses, namely corporate governance failures; poor or corrupt corporate practices; reckless lending in one case and reckless conducting of the business of banking in both [cases]."[21]

3 Historical development and policy rationale

The concept of an audit committee is not new.[22] It is a global phenomenon.[23] The concept was introduced as early as in the nineteenth century by the Great Western Railway Company in the UK.[24] In the USA the concept dates back to the late 1930s[25] but it was the promulgation of the *Sarbanes-Oxley Act* of 2002 (SOX Act) in that country that saw the amplification of the need for audit committees in both the private and the public sectors.[26] A fundamental feature of an effective audit committee is its independence from the company's management.[27]

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16 *Hlumisa Investment Holdings* para 3.
17 *Hlumisa Investment Holdings* para 7.
18 *Hlumisa Investment Holdings* para 74.
19 KPMG is one of the big accounting and audit firms globally.
20 See Koko 2021 https://mg.co.za/business/2021-02-24-in-a-bizarre-twist-vbs-liquidators-sue-kpmg-for-r863mn/.
21 Mupangavanhu 2021 *Interdisciplinary Journal of Economics and Business Law* 35.
22 Marx and Du Toit 2009 *Journal of Economic and Financial Sciences* 116.
23 Akwenye, Chata and Benedict 2016 *Risk Governance and Control* 282.
24 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 1. Also see Marx and Du Toit 2009 *Journal of Economic and Financial Sciences* 116.
25 Akwenye, Chata and Benedict 2016 *Risk Governance and Control* 282.
26 Akwenye, Chata and Benedict 2016 *Risk Governance and Control* 282.
27 Global Institute of Internal Auditors 2014 https://www.theiia.org/globalassets/documents/standards/independent-audit-committees-in-public-sector-organizations.pdf 12.

Although the concept of audit committees has been in existence for decades, it has endured a number of challenges globally.[28] This is evinced by the introduction and revision of corporate governance codes in a number of countries to enhance transparency and accountability.[29] For example, the UK has gone through a number of corporate governance challenges, which resulted in the development and publication of a series of governance reports and codes[30] such as the Cadbury Report[31] in 1992, the Smith Report[32] in 2003, the Combined Code in 1998, 2003, 2006 and 2008,[33] and the UK Corporate Governance Code in 2010, 2012, 2014, 2016 and 2018.[34] Similarly, the corporate governance scandals and financial reporting irregularities in the USA have led to the promulgation of the SOX Act in that country.[35]

While the USA's SOX Act has had an influence on corporate governance in many countries, including South Africa, South African company law has a rich English law heritage.[36] The enduring influence of English law in South Africa dates back to the middle of the nineteenth century.[37] The previous company law framework,[38] and to some extent the current company legislation,[39] are founded on the principles of English company law.[40] It is thus not surprising that South Africa has faced corporate governance challenges similar to those of the UK and the USA.

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28 Over the years the world has been rocked by an assortment of shocking financial irregularities and corporate governance scandals despite the existence of audit committees. This includes, among many others, the Enron and WorldCom scandals in the USA, the challenges faced by the Barings Bank and Carillion PLC in the UK, Securency in Australia, Olympus Corporation in Japan, Petrobras in Brazil, and Steinhoff, Tongaat Hulett Limited, SAA and VBS Bank in South Africa. See Mallin *Corporate Governance* 2-8.

29 Mallin *Corporate Governance* 30.

30 Mallin *Corporate Governance* 31.

31 Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance*.

32 Smith *Audit Committees.*

33 FRC *Combined Code*.

34 FRC *UK Corporate Governance Code*. See a brief discussion of various UK governance codes in Mallin *Corporate Governance* 31-44.

35 Smith 2006 *International Journal of Accounting, Auditing and Performance Evaluation* 240-241.

36 Gen N 1183 in GG 26493 of 23 June 2004 (South African Company Law for the 21st Century, Guidelines for Corporate Law Reform) 12.

37 Gen N 1183 in GG 26493 of 23 June 2004 (South African Company Law for the 21st Century, Guidelines for Corporate Law Reform) 12.

38 Under the *Companies Act* 46 of 1926 and later under the *Companies Act* 61 of 1973.

39 The *Companies Act* 71 of 2008.

40 Gen N 1183 in GG 26493 of 23 June 2004 (South African Company Law for the 21st Century, Guidelines for Corporate Law Reform) 12. Also see Botha 2009 *Obiter* 704.

3.1 Historical overview of audit committees in the United Kingdom

As already pointed out,[41] the first audit committee was introduced as far back as in 1872 by the Great Western Railway Company in the UK.[42] However, it was the widely reported financial scandals and general decline of confidence in the financial reporting process of many UK companies which resulted in the establishment of a committee on the Financial Aspects of Corporate Governance in 1991.[43] The committee was set up by the Financial Reporting Council (FRC), the London Stock Exchange (LSE) and the accountancy profession to address the financial aspects of corporate governance in the UK.[44] At the conclusion of its work in 1992 this committee produced a report called the Cadbury Report, which was named after the chairperson of that committee, Sir Adrian Cadbury. The Report contained a recommended Code of Best Practice with which the UK companies had to comply.[45] In particular, the recommended Code of Best Practice made recommendations in respect of audit committees.[46] After the publication of the Cadbury Report, the audit committee became a standard feature of corporate governance in the UK, principally among listed companies.[47]

In 2002 the FRC, which is the UK's independent audit regulator, set up a committee to review the institution of the audit committee. This committee, the purpose of which was to assist in the development of the then existing audit committee guidelines, was chaired by Sir Robert Smith, and it became known as the Smith Committee.[48] The Committee was formed as the UK's response to the reported corporate scandals which had been discovered in the USA.[49] At the conclusion of its work in 2003 the Smith Committee produced a report titled the "Audit Committees - Combined Code

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41 See the discussion under point 3 above.

42 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 1. Also see Marx and Du Toit 2009 *Journal of Economic and Financial Sciences* 116.

43 The reasons for setting up this committee are set out in the Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance* paras 2.1-2.4. The purpose of the committee was, among others, to review aspects of the UK's corporate governance specifically relating to financial reporting and accountability, and its recommendations focussed on the control and reporting functions of boards and the role of auditors (see paras 1.2 of the Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance*).

44 Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance* para 2.1.

45 Mallin *Corporate Governance* 33.

46 See Appendix 4 of the Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance*.

47 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 31.

48 AccoutingWeb 2003 https://www.accountingweb.co.uk/business/financial-reporting/smith-report-on-audit-committees-a-summary.

49 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 104. The corporate governance failures in the USA were reported in the highly publicised scandals in Enron, WorldCom and McKesson & Robbins Incorporated.

Guidance", which Report is commonly known as the Smith Report. The Report described the importance of the audit committee thus:

> While all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal controls.[50]

The recommendations of the Cadbury Report and the Smith Report and other various governance codes are consolidated into a governance code titled UK Governance Code issued by the FRC, with the latest version released in July 2018.[51]

3.2 Historical overview of audit committees in the United States of America

Like the UK, the USA jurisdiction has suffered a number of corporate governance challenges for many years. While the highly publicised Enron and WorldCom corporate catastrophes have exposed weaknesses in the USA corporate governance model, financial and auditing systems, it was the corporate scandals in the case of McKesson & Robbins Incorporated in the 1930s which resulted in the recommendation of the establishment of audit committees.[52] The scandals at McKesson & Robbins Incorporated are best described by Shinde *et al*[53] as "impactful" on auditing standards. In other words, these scandals necessitated the adoption of a different perspective and approach to auditing practice in the USA. After an intensive investigation of the McKesson & Robbins Incorporated corporate scandal, the Securities and Exchange Commission (SEC) recommended the

> establishment of a committee to be selected from non-officer members of the board of directors which shall make all company or management nominations of auditors and shall be charged with the duty of arranging the details of the engagement.[54]

The aftermath of McKesson & Robbins Incorporated and the resultant SEC recommendations is that the appointment of audit committees became a listing requirement for listed companies in the USA.[55]

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50 Smith *Audit Committees Combined Code Guidance* para 1.5. Also see Mallin *Corporate Governance* 35.

51 FRC 2018 https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-Final.PDF.

52 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 121-122.

53 Shinde *et al* 2015 *Journal of Accounting and Finance* 40.

54 United States, Securities and Exchange Commission 1940 https://egrove.olemiss.edu/acct_fed/107.

55 Lutzy 2003 *DePaul Business and Commercial Law Journal* 99-100. Also see Marx *Analysis of the Development, Status and Functioning of Audit Committees* 122.

In its effort to impose higher levels of responsibility on audit committees, working with New York Stock Exchange (NYSE) and National Association of Securities Dealers Automated Quotations (NASDAQ), in 1998 the SEC established a committee called the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit committees (BRC).[56] The BRC was tasked with the responsibility of investigating and recommending mechanisms which could strengthen audit committees in respect of their role of overseeing the financial reporting process.[57]

The BRC released its report called "Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees" in February 1999 (BRC Report).[58] For the purpose of the improvement of the financial reporting oversight role of audit committees, the BRC Report made a number of recommendations regarding the composition and functions of an audit committee.[59] Consequently, the SEC amended its rules, and both the NYSE and NASDAQ amended their listing requirements.[60] While the BRC recommendations were not mandatory and were applicable only to listed companies of over a specific size, the BRC encouraged all companies, regardless of size, to make an attempt to implement its recommendations.[61]

The BRC viewed the implementation of the recommendations of the BRC Report as a way to help improve the effectiveness of audit committees and maintain investors' confidence.[62] To achieve this, the individual members of an audit committee must not only be independent but must also possess certain individual characteristics, integrity and a sense of accountability.[63] The BRC Report was said to be a very important milestone in the USA.[64] However, the continued major corporate and financial reporting scandals of the early 2000s, notably the Enron and WorldCom disasters, resulted in the promulgation of the SOX Act.[65]

56 Abbott, Parker and Peters 2000 https://www.researchgate.net/publication/228742552_The_Effectiveness_of_Blue_Ribbon_Committee_Recommendations_in_Mitigating_Financial_Misstatements_An_Empirical_Study 1.

57 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 134.

58 Smith 2006 *International Journal of Accounting, Auditing and Performance Evaluation* 240.

59 Smith 2006 *International Journal of Accounting, Auditing and Performance Evaluation* 243.

60 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 137.

61 Blue Ribbon Committee 1999 *Business Lawyer* 1071.

62 Blue Ribbon Committee 1999 *Business Lawyer* 1077.

63 Blue Ribbon Committee 1999 *Business Lawyer* 1078.

64 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 137.

65 Smith 2006 *International Journal of Accounting, Auditing and Performance Evaluation* 241.

An empirical study by Smith[66] has found that the implementation of the BRC recommendations has improved audit committee effectiveness in the USA. However, following the persistent corporate governance and financial reporting challenges in the USA despite the recommendations of the BRC, the US Congress agreed to a reform, which resulted in the promulgation of the Public Company Accounting Reform and Investor Protection Act in July 2002. This Act became known as the *Sarbanes Oxley Act* 2002.[67] The SOX Act sought to enhance the independence of external auditors and audit committees.[68] The SOX Act has wide-reaching implications, not only for USA companies but also for foreign companies listed in the USA.[69] It requires the SEC to adopt rules which compel the NYSE and NASDAQ to prohibit the listing of a company's securities unless that company has an audit committee consisting entirely of independent directors and meeting certain requirements pertaining to its responsibility and operation.[70]

The SOX Act provides a clear definition of the term audit committee. Section 2(3) of the SOX Act defines an audit committee as

> a committee or equivalent body established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer and if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

Section 205(a) of the SOX Act amended section 58 of the *Securities Exchange Act* of 1934 which includes the definition of an audit committee. From this definition it is apparent that an audit committee is a committee of the board of directors under the SOX Act and *Securities Exchange Act* of 1934. This is confirmed by the provisions of section 301 of the SOX Act and section 10A(m) of the *Securities Exchange Act* of 1934. It is a committee of, appointed by and answerable to the board of directors of the company.[71]

3.3 Historical overview of audit committees in South Africa

In South Africa the establishment of audit committees by large companies was by and large a voluntary exercise.[72] However, with the amendment of the *Companies Act* 61 of 1973[73] (*Companies Act* 1973) and later the introduction of the *Companies Act* 2008, it has since become mandatory for

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66 Smith 2006 *International Journal of Accounting, Auditing and Performance Evaluation* 249-250.

67 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 139; Mallin *Corporate Governance* 62.

68 Mallin *Corporate Governance* 62.

69 Hendrikse and Hefer 2019 *Corporate Governance Handbook* 113.

70 Hendrikse and Hefer 2019 *Corporate Governance Handbook* 114. See s 301 of the *Sarbanes Oxley Act* of 2002 and s 10A(m) of the *Securities Exchange Act* of 1934.

71 Johnson 2005 *S Tex L Rev* 30.

72 Marx *Analysis of the Development, Status and Functioning of Audit Committees* 6.

73 See s 24 of *Corporate Laws Amendment Act* 24 of 2006.

certain categories of companies to establish and maintain audit committees.[74]

An audit committee under the *Companies Act* 2008 is an essential governance enhancement mechanism and a remarkable improvement from the *Companies Act* 1973, which until 2007 did not require companies to appoint an audit committee. Before 2007 the provisions spanning from section 269 to section 276 of the *Companies Act* 1973 had only set out the requirements and procedure for the appointment of the company's auditors; what had to happen if and when the company failed to appoint auditors; and the categories of persons who were disqualified from being appointed as the company's auditors. Section 24 of the *Corporate Laws Amendment Act* 24 of 2006 amended the *Companies Act* 1973 to make provision for the appointment of audit committees for public interest companies. Similar provisions are now outlined in Part C in Chapter 3 of the *Companies Act* 2008.

The Companies Act 2008 is a creation of the *South African Company Law for the 21st Century, Guidelines for Corporate Law Reform*, the Department of Trade and Industry (DTI) policy paper, Notice 1183 of 2004, in Government Gazette 26493 (the DTI policy paper). The DTI policy paper sets out the policy objectives of the South African company law reform as, among others, to encourage transparency and high standards of corporate governance within South African corporations.[75] Accordingly this policy objective has been carried over into the *Companies Act* 2008 as one of the purposes of that Act.[76] In its policy paper the DTI recognised the global financial reporting calamities which had acutely affected the entire business community, including both investor confidence and the audit profession globally.[77] For this reason the DTI adopted the attitude that the reformed company laws must "ensure maximum possible transparency in regard to the administration of companies and the maximum possible disclosure of information concerning their affairs."[78]

The DTI's policy paper intervention with respect to transparency and accountability is mirrored in the *Companies Act* 2008. Specifically, the heading of Chapter 3 of the *Companies Act* 2008 reads: Enhanced Accountability and Transparency. This part of the *Companies Act* 2008 sets

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74 Section 84(4)(c) of the *Companies Act* 71 of 2008.

75 See Gen N 1183 in GG 26493 of 23 June 2004 (South African Company Law for the 21st Century, Guidelines for Corporate Law Reform) 9.

76 Section 7(b)(iii) of the *Companies Act* 71 of 2008.

77 Gen N 1183 in GG 26493 of 23 June 2004 (South African Company Law for the 21st Century, Guidelines for Corporate Law Reform) 10-11.

78 Gen N 1183 in GG 26493 of 23 June 2004 (South African Company Law for the 21st Century, Guidelines for Corporate Law Reform) 39.

out the provisions which regulate the appointment of auditors,[79] and the establishment, composition and duties of audit committees.[80]

4 The composition, appointment, functions and removal of members of audit committees in South Africa

4.1 Composition of the audit committee

As pointed out above, South African audit committees are regulated in terms of section 94 of the *Companies Act* 2008. In terms of section 94(2) an audit committee must consist of at least three members. The *Companies Act* 2008 does not prescribe any maximum number of members of a company's audit committee. However, the *Companies Act* 2008 prescribes that all members of a company's audit committee must be directors of the company[81] who meet the requirements set out in section 94(5). The provisions of section 94(5) give the Minister the powers to prescribe the minimum qualification requirements for members of a company's audit committee to ensure that the committee, viewed as a whole, has adequate knowledge and experience to perform its statutory functions. Accordingly Regulation 42 of the Companies Regulations 2011 prescribes that at least one-third of the members of a company's audit committee must at any given time have academic qualifications or experience in the field of economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resources management. Recommended practice 55 under Principle 8 of the King IV Code[82] further recommends that, when considering the qualifications of the audit committee, members should when viewed as a whole have the necessary financial literacy, skills and experience to execute their duties effectively.[83] The provisions of section 94(5) of the *Companies Act* 2008, read with Regulation 42 of the Companies Regulations 2011, appear to be aimed at the enhancement of the effectiveness of audit committees. They do this by evaluating the audit committee as a whole, to determine whether it has the capacity (the knowledge and experience) to discharge its legislative responsibilities.

With the only statutory requirement seemingly being that of compliance with the provisions of section 94(5) of the *Companies Act* 2008 and Regulation 42 of the Companies Regulation 2011, it would appear that members of an audit committee need not be registered auditors. It therefore follows that the provisions of the *Auditing Profession Act* 26 of 2005 (the *Auditing Profession Act*) do not apply to members of a company's audit committee. However,

79 Part C of ch 3 of the *Companies Act* 71 of 2008.
80 Part D of ch 3 of the *Companies Act* 71 of 2008.
81 Section 94(4)(a) of the *Companies Act* 71 of 2008.
82 IoDSA *King IV Report*.
83 Also see Delport *Henochsberg on the Companies Act* 358.

there is no doubt that, where an individual member of a company's audit committee is a registered auditor as defined in the *Auditing Profession Act*,[84] such a registered auditor is regulated as contemplated in that Act.

In addition to the requirement to comply with the provisions of section 94(5) of the *Companies Act* 2008 and Regulation 42 of the Companies Regulations 2011, all members of an audit committee are required to be directors of the company.[85] Moreover, such members of the audit committee should be independent non-executive directors[86] who are not involved in the day to day management of the company's business and have not been so involved at any time during the preceding financial year.[87] As directors of the company, members of an audit committee, like the rest of the directors, are required to act in the best interests of the company[88] and their conduct must be consistent with the statutory provisions set out in sections 75 and 76 of the *Companies Act* 2008, as well as their common law fiduciary duties. It must be noted that directors, including members of the audit committee, may be held personally liable in terms of the *Companies Act* 2008[89] when they fail to observe and uphold the statutory provisions and/or their common law fiduciary duties, the duty of care, skill and diligence and/or any other rules as set out in the company's Memorandum of Incorporation (MOI).

The provisions of section 94(4)(b) of the *Companies Act* 2008 prohibit certain persons from serving as members of audit committees. This prohibition includes prescribed officers or full time employees of a company or its related or inter-related company or anyone having been such a prescribed officer or full time employee at any time during the previous three financial years.[90] It is rather strange, though, that the *Companies Act* 2008 precludes from serving as members of the audit committee only full time employees, whereas "part time employees" and "independent consultants" who do not necessarily provide services to the company or its related or inter-related company on a full time basis could equally have direct or indirect influence on or directly or indirectly be influenced by the management and/or the governing body of the company or its related or inter-related company. It is also uncertain from the reading of the provisions of section 94(4)(b)(ii) of the *Companies Act* 2008 whether the full-time employees referred to in that subsection are only full-time employees who

84 Section 1 of the *Auditing Profession Act* 26 of 2005.

85 Section 94(4)(a) of the *Companies Act* 71 of 2008.

86 Recommended practices 56 and 57 of Principle 8 of the IoDSA *King IV Report*. Also see Delport *Henochsberg on the Companies Act* 359.

87 Section 94(4)(b)(i) of the *Companies Act* 71 of 2008.

88 Section 76(3)(b) of the *Companies Act* 71 of 2008; Cassim *et al Contemporary Company Law* 515.

89 Section 77 of the *Companies Act* 71 of 2008.

90 Section 94(4)(b)(ii) of the *Companies Act* 71 of 2008.

have executive authority, though Delport[91] appears to suggest quite correctly that to be the case. The fact that a member of an audit committee must be an independent non-executive director of the company who is not involved in the day to day management of the company suggests that a member cannot be a full-time employee with executive powers. Only directors involved in the day-to-day management of the company are full time employees of the company vested with executive authority. The lawmakers should perhaps reconsider the wording of section 94(4)(b)(ii) to include all types of employees, including any person who, although he or she is not classified as an employee, nevertheless provides services to the company as if he or she was an employee.

Section 94(4)(b)(iii) of the *Companies Act* 2008 disqualifies from serving as a member of a company's audit committee any person who is a material supplier or customer of the company in the circumstances where a reasonable and informed third party could be led to conclude that the integrity, impartiality or objectivity of that material supplier or customer is compromised by his or her relationship with the company. This therefore means that the provisions of section 94(4)(b)(iii) necessitate a two-staged enquiry. The first question is whether the director is a material supplier or customer of the company. If the answer is in the affirmative, then the second question arises, that is whether, objectively viewed, a reasonable and informed third party would conclude that the director's integrity, impartiality or objectivity is compromised. It would appear that the fact that a director is a material supplier or customer of the company (that is the first question) does not *per se* preclude such a director from appointment as a member of the company's audit committee.[92] It is clear that both the first and the second questions must be answered in the affirmative. Finally the *Companies Act* 2008 also excludes from appointment as member of the company's audit committee any person who is related to any of the persons prohibited in terms of section 94(4)(b).[93]

4.2 Appointment and removal of members and functions of the audit committee

First it must be noted that members of a company's audit committee are generally not appointed by the company's board of directors,[94] except pursuant to the provisions of section 94(3)(b) or section 94(6) of the *Companies Act* 2008. However, as will be demonstrated below, it makes no difference in some cases whether the members of an audit committee are appointed by the company's board of directors or its shareholders. It is

91 Delport *New Entrepreneurial Law* 189.
92 Delport *Henochsberg on the Companies Act* 358.
93 Section 94(4)(c) of the *Companies Act* 71 of 2008.
94 Delport *Henochsberg on the Companies Act* 357.

argued that, although the audit committee is accountable to the company's board of directors, it is not a committee of the board.[95] It is an independent structure of the company.[96]

For start-up companies the first members of an audit committee may be appointed by the company's incorporators[97] or by the board within 40 days after the incorporation of the company.[98] The board of directors is also empowered to appoint a person who satisfies the requirements of section 94(4)(a) of the *Companies Act* 2008 to fill a vacancy on the company's audit committee within 40 days after such vacancy arose.[99] It is, however, conceivable that where a public company or any other company[100] whose MOI requires the company to appoint an audit committee has only the prerequisite minimum number of directors comprising of only non-executive directors, all such non-executive directors could be appointed into the audit committee either by the incorporators or the board of directors, at least until the company's first or next annual general meeting. This may present a situation where all the members of the company's board of directors, including its chairperson,[101] serve as the only members of the company's audit committee. In such instances, the difficulty may arise where members of the audit committee individually and/or collectively fail to separate their duties and responsibilities as members of the audit committee from their duties and responsibilities in their capacity as members of the board of directors. This is in the light of the controversial idea that an audit committee is an independent stand-alone organ of a company. For this reason it is submitted that the decisions of the audit committee must be clear and separate from the decisions of the board. For example, the decisions in respect of the nomination of the auditor, the determination of the audit fees

95 Delport *Henochsberg on the Companies Act* 356.

96 Delport *Henochsberg on the Companies Act* 356.

97 Section 94(3)(a) of the *Companies Act* 71 of 2008.

98 Section 94(3)(b) of the *Companies Act* 71 of 2008.

99 Section 94(6) of the *Companies Act* 71 of 2008.

100 A private or personal liability company may have only one director. However, if such a company's MOI prescribes that the company has to appoint an audit committee, then that company must have a minimum of three directors. See Delport *Henochsberg on the Companies Act* 357.

101 The recommended practice 36(a) under Principle 7 of IoDSA *King IV Report* recommends that the chairperson of the board of the company should not be a member of the company's audit committee. However, the King Code is a code which employs the principle of "apply and explain". In this context it is submitted that a chairperson of the board may only not be a member of the company's audit committee if the company can explain as to how such a move would be in the best interest of the company. The reason for this is that the company cannot employ what is referred to as a "tick-box" approach, by applying recommended practice 36(a) only for compliance purposes, while it cannot explain how such a move is beneficial to the company.

and the auditor's terms of reference can only be the decisions of the audit committee as contemplated in section 94(10) of the *Companies Act* 2008.

At its first and every other subsequent annual general meeting the company must elect members to serve on its audit committee,[102] except where the provisions of section 94(2)(a) and (b) of the *Companies Act* 2008 apply. To be clear, this is the annual general meeting of the company's shareholders and not that of the company's board of directors,[103] as there is no separate annual general meeting of the board of directors only. Nevertheless, where all shareholders of the company also serve as and sit on the company's board of directors it is submitted that the statutory requirement to elect members of the audit committee at the company's annual general meeting of shareholders would become a mere academic exercise (the author’s own deduction). The reason for this is that the legislative intention of section 94(2), read with subsection (4), of the *Companies Act* 2008 is presumably to safeguard the independence of a company's audit committee. It would therefore make no difference that the shareholders, where all of them are directors of the company, would cast a vote at the annual general meeting which they would in any case have cast at a meeting of the company's board of directors. The foregoing presents circumstances where the independence of the company's audit committee may be deeply eroded. It would mean that members of the audit committee would be appointed by the board of directors as opposed to the shareholders as contemplated in section 94(2).

It is worrying that the *Companies Act* 2008 does not make any provisions for the removal of members of an audit committee. Consequently, it is not clear whether the powers to remove members of the committee are vested in the board of directors or the shareholders. What is not doubtful, though, is that by virtue of the provisions of section 94(4)(a) of the *Companies Act* 2008 a member of the audit committee ceases to be such a member when he or she voluntarily resigns or is removed as a director of the company in terms of section 71 of the same Act. Thus, the only ambiguity is whether the board of the company has the powers to create a vacancy on the audit committee, just as it has the powers to fill any such vacancy in terms of section 94(6) of the *Companies Act* 2008. It is submitted, however, that by virtue of its powers to appoint, the board of directors has analogous powers to remove members of the audit committee. The power to appoint presupposes the right and/or power to remove or dismiss.[104] It is therefore

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102 Section 94(2) of the *Companies Act* 71 of 2008.

103 Delport *Henochsberg on the Companies Act* 357.

104 *Masetlha v President of the Republic of South Africa* 2008 1 SA 566 (CC) para 68, where it is stated the power to remove or dismiss is necessary in order to exercise the power to appoint. The dictum in *Masetlha* was cited in a number of subsequent judgments, notably in *MEC: Free State Provincial Government: Tourism, Economic*

submitted that the powers of the board of directors to remove or dismiss members of the audit committee are implied in terms of the provisions of sections 94(3)(b) and 94(6) of the *Companies Act* 2008.

Section 94(7) of the *Companies Act* 2008 outlines the duties of an audit committee of a company. In terms of this section an audit committee is responsible for the nomination of an independent registered auditor to be appointed by the company[105] and the determination of the audit fees payable in respect of audit work,[106] among other things. It must be noted that the audit committee of the company does not appoint the company's auditor but rather only nominates an independent auditor who may be appointed at an annual general meeting of shareholders. The first auditor of the company[107] is appointed by the company's incorporators at the time of the incorporation of the company and subsequently at its annual general meetings.[108] Further, the *Companies Act* 2008 also permits the appointment of an independent auditor other than the auditor who was nominated by the company's audit committee, provided that the audit committee is satisfied that the auditor so appointed is independent.[109] Section 94(9) ensures that the powers to appoint the company's auditor are firmly ingrained in the shareholders of the company, so as to enhance the independence of the auditor. The provisions of the *Companies Act* 2008 governing the determination of whether an auditor is independent fall outside the scope of this article and will therefore not be discussed.

Evidently, the *Companies Act* 2008 gives the audit committee broad yet ambiguous powers and responsibilities in terms of sections 94(7)(g) and (h). In particular, section 94(7)(g) empowers the company's audit committee to deal appropriately with any concerns and/or complaints relating to the company's accounting practices and the auditing of financial statements and the company's internal financial controls. The phrase "deal appropriately with" may be problematic in so far as it does not unequivocally define what it means and to what extent or level of appropriateness the audit committee is empowered to deal with the matters referred to in that subsection. It may be difficult to establish a reasonably suitable test to determine objectively whether the audit committee would have appropriately dealt with the matter referred to it. In some instances, an audit committee whose members also serve on the company's board of directors

and Environmental Affairs v Moeko (JR 2582/07) [2013] ZALCJHB 15 (8 February 2013) para 35 and *South African Broadcasting Corporation (Soc) Ltd v Keevy* (J1652-19) [2020] ZALCJHB 31 (7 February 2020) para 49.

105 Section 94(7)(a) of the *Companies Act* 71 of 2008.

106 Section 94(7)(b) of the *Companies Act* 71 of 2008.

107 A public company or a state-owned company or any company referred to in s 84(1)(c)(i) of the *Companies Act* 71 of 2008.

108 Section 90(1) of the *Companies Act* 71 of 2008.

109 Section 94(9) of the *Companies Act* 71 of 2008.

may be confronted with a matter which implicates some of or the entire board of directors. This may create a corporate governance dilemma in so far as the audit committee would be expected to deal appropriately with a matter in which all or some of its members are implicated. The difficulty may be heightened by the fact that, though the members of the committee who have conflict of interests may recuse themselves, the *Companies Act* 2008 is silent on whether the board of directors or the shareholders have the powers to appoint temporary replacement members of an audit committee. The *Companies Act* 2008 prescribes that an audit committee must be constituted with a minimum of three members. Further, the *Companies Act* 2008 only makes provisions for appointment of members of the audit committee by shareholders in terms of section 94(2) or board of directors in terms of sections 94(3) and 94(6). It is submitted that, where a member of the audit committee temporarily recuses himself or herself on the basis of conflict of interests, no vacancy on the audit committee is given rise to by such a recusal, and therefore subsection (6) will not apply.

The duties of a company's audit committee include the determination of the fees to be paid to the company's registered auditor and the terms of the auditor's engagement.[110] Despite the fact that the business and affairs of the company are managed by or under the stewardship of the company's board of directors,[111] the duty to determine the audit fees and the scope of the audit engagement are the sole responsibility of the company's audit committee.[112] This inference may be drawn from the provision of section 94(10), which states that neither the appointment nor the duties of an audit committee reduce the functions and duties of the board or the directors of the company, except with respect to the appointment, fees and terms of engagement of the company's auditor. From the foregoing it would appear that the board of directors does not have the power to interfere with the duty of the company's audit committee in the determination of the terms of the audit work to be undertaken by the company's auditor and the fees to be paid.

For the purpose of completeness it must be stated that the directors of the company, including the members of an audit committee, are obliged to act with integrity, in good faith and in the best interests of the company[113] and must disclose any conflict of interests, including personal financial interests.[114] The Recommended practice 26 under Principle 7 of King IV Code further recommends that directors must declare their interests in

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110 Section 94(7)(b) of the *Companies Act* 71 of 2008.
111 Section 66(1) of the *Companies Act* 71 of 2008.
112 Section 94(7)(b), read with subs (10) of the *Companies Act* 71 of 2008.
113 Section 76(3) of the *Companies Act* 71 of 2008.
114 Section 75 of the *Companies Act* 71 of 2008.

respect of matters before them and any conflict of interests must be managed proactively and within the legal provisions.

5 The audit committee and financial reporting in South Africa

5.1 Accounting records and financial statements

South African companies are statutorily required to keep accounting records.[115] This is to enable companies to satisfy the obligations under the *Companies Act* 2008 and any other law in respect of the preparation of the companies' financial statements.[116] The *Companies Act* 2008 defines accounting records as information in written or electronic form concerning the financial affairs of a company as required in terms of that Act, including but not limited to purchase and sales records, general and subsidiary ledgers and other documents and books used in the preparation of financial statements.[117] The importance of keeping accounting records is accentuated by the provisions of section 28(3) of the *Companies Act* 2008, which create an offence for companies which, with an intention to deceive or mislead any person, fail to keep accurate and complete accounting records[118] and/or fail to keep records other than in the prescribed manner and form.[119] It is also an offence for the company to falsify its accounting records[120] or for any person to falsify the company's accounting records.[121]

From the foregoing it is clear that accounting records are essential for the preparation of the company's financial statements. The financial statements of the company include annual financial statements and provisional annual financial statements; interim or preliminary reports; group and consolidated financial statements in the case of a group of companies; and 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.[122] The heading of Part C in Chapter 2 of the *Companies Act* 2008 reads as follows: Transparency, accountability and integrity of companies. This suggests that the purpose of Part C in Chapter 2, which encompasses, among other things, the provisions dealing with accounting records and financial statements, is to give effect to one of the purposes of the *Companies Act* 2008 as contemplated in section 7 of that Act,

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115 Section 28(1) of the *Companies Act* 71 of 2008.
116 Section 28(1)(a) of the *Companies Act* 71 of 2008.
117 See s 1 of the *Companies Act* 71 of 2008.
118 Section 28(3)(a)(i)(aa) of the *Companies Act* 71 of 2008.
119 Section 28(3)(a)(i)(bb) of the *Companies Act* 71 of 2008.
120 Section 28(3)(a)(ii) of the *Companies Act* 71 of 2008.
121 Section 28(3)(b) of the *Companies Act* 71 of 2008.
122 See s 1 of the *Companies Act* 71 of 2008.

specifically with respect to "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."[123] The financial statements of companies are regulated in terms of the provisions of sections 29-31 of the *Companies Act* 2008.[124]

5.2 Auditing of annual financial statements and financial reporting

The annual financial statements of companies are regulated in terms of the provisions of section 30 of the *Companies Act* 2008. Of particular importance for the purpose of this discussion is that public companies are obliged to have their annual financial statements audited.[125] The annual financial statements of any other profit or non-profit company must be audited, provided the criteria set out in sections 30(b)(i) or 30(b)(ii)(aa) of the *Companies Act* 2008 are satisfied, or be independently reviewed in terms of provisions of subsection 30(b)(ii)(bb). Further, the audited annual financial statements of the company must include the auditor's report.[126] This is to ensure that the reports, including the annual financial statements, issued by companies enable stakeholders to make informed assessments of the companies' performance, and their short, medium and long-term prospects.[127]

Section 34 of the *Companies Act* 2008 creates additional accountability requirements for certain companies. Notably, public companies and SOEs are required to comply with the extended accountability requirements set out in Chapter 3 of the *Companies Act* 2008.[128] Among other things, Chapter 3 of the *Companies Act* 2008 encompasses provisions which deal with the appointment of auditors[129] and audit committees.[130] Of particular significance is the interaction between the auditors and the audit committee from the perspective of the appointment of auditors and the oversight of the audit function, the auditing of financial statements for the purpose of financial reporting and the duties of the audit committee as they relate to the

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123 Section 7(b)(iii) of the *Companies Act* 71 of 2008.

124 It is important to note that ss 24 to 28 of the *Companies Act* 71 of 2008 are also very relevant to financial statements and a company's financial reporting standards. S 24 for example deals with the form of and standards for company records; s 25 deals with the location of company records; s 26 provides for access to company records; s 27 provides for the financial year of the company, and s 28 deals with the accounting records.

125 Section 30(2)(a) of the *Companies Act* 71 of 2008.

126 Section 30(3)(a) of the *Companies Act* 71 of 2008.

127 See Principle 5 under Part 5.3 of the IoDSA *King IV Report*.

128 Section 34(1) of the *Companies Act* 71 of 2008. Private companies, personal liability companies or non-profit companies are generally not required to comply with the provisions set out in ch 3, except to the extent contemplated in s 84(1)(c), or as set out in the company's MOI (see s 34(2) of the *Companies Act* 71 of 2008).

129 Part C of ch 3 of the *Companies Act* 71 of 2008.

130 Part D of ch 3 of the *Companies Act* 71 of 2008.

auditors, as set out in section 94(7) of the *Companies Act* 2008. The importance of the audit committee flows from Part C of Chapter 2 of the *Companies Act* 2008 and is entrenched in section 94 of the same Act.

5.3 Audit committee and financial reporting

An audit committee has an important financial oversight responsibility in relation to financial reporting.[131] Its main objective is to improve the quality of the financial reporting process and the accuracy, integrity and reliability of the financial statements.[132] It is therefore essential that members of the audit committee have the necessary understanding, experience and expertise regarding financial reporting, controls and aspects of auditing.[133]

An audit committee's role in overseeing the financial reporting process cannot be separated from the independence of its members[134] and the committee as a whole. As the cornerstone of an audit committee's efficacy, its independence makes such a committee more autonomous and free from any vested interests.[135] The effectiveness of an audit committee's financial reporting function and the reduction of the extent of the manipulation of financial reporting would be possible only if the committee is independent and enjoys freedom from the influence of the company's board of directors and management.[136]

Beasley *et al*[137] undertook a study to examine the question whether audit committees appear to provide substantive oversight of financial reporting, or whether they appear to be primarily ceremonial bodies designed to create legitimacy.[138] In answering this question the study established that many audit committee members strive to provide effective monitoring of financial reporting and seek to avoid serving on ceremonial audit committees.[139] Avoiding or even refusing to serve in a ceremonial capacity, the individual members of an audit committee might be exposed to possibly unbearable levels of hostility from the company's board of directors, a possibility which amplifies the need for sufficient independence and protection of an audit committee from the governing bodies of the relevant companies. Notwithstanding, the King IV Code recommends that an audit committee should disclose significant matters in relation to the company's annual

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131 Marx and Du Toit 2009 *Journal of Economic and Financial Sciences* 121.
132 Marx and Els 2009 *African Journal of Business Ethics* 8.
133 Marx and Els 2009 *African Journal of Business Ethics* 8.
134 Chariri and Januarti 2017 *European Research Studies Journal* 308.
135 Chariri and Januarti 2017 *European Research Studies Journal* 308.
136 Chariri and Januarti 2017 *European Research Studies Journal* 309.
137 Beasley *et al* 2009 *Contemporary Accounting Research* 122.
138 Beasley *et al* 2009 *Contemporary Accounting Research* 66.
139 Beasley *et al* 2009 *Contemporary Accounting Research* 66.

financial statements and how such matters were addressed by the committee.[140]

6 Conclusion and recommendations

This paper has provided a synopsis of the genesis and historical developments of audit committees. It has been demonstrated that the notion of audit committees was birthed as a response to grave corporate governance catastrophes and financial irregularities, particularly in the UK and the USA. The USA responded with the promulgation of the SOX Act and the UK released a series of governance codes to enhance accountability and transparency in the financial reporting process.

With respect to South Africa, this article has outlined the configuration and maintenance of the company's audit committee under the *Companies Act* 2008. The article has demonstrated that audit committees are meant to play a critical role in enhancing accountability and transparency in the South African corporate governance and financial reporting model. The duties of an audit committee as discussed in this article represent the centrality of its role in the governance of corporations globally. It is submitted that it is not necessary to stretch one's imagination to see the audit committee as a mechanism through which corporate fraud and financial misstatements within companies could be eradicated.

The policy rationale behind the legislative requirements for the creation of accountability and transparency mechanisms in South African company law is highlighted in the DTI policy paper, as discussed in this article. It is against this background that the *Companies Act* 2008 dedicated a chapter[141] to enhancing accountability and transparency in South African companies. The importance of the audit committee flows from Part C of Chapter 2 of the *Companies Act* 2008 and is entrenched in section 94 of the same Act. Part C of Chapter 2 of the *Companies Act* 2008 demands transparency, accountability and integrity from South African companies through the keeping of accounting records, the preparation of financial statements (including annual financial statements) and financial reporting. It is in terms of this policy rationale that the South African corporate law framework attempts to improve the integrity of the financial reporting process for the benefit of the stakeholder community.

The highly publicised financial misstatements and corporate scandals at big corporations such as Steinhoff, Tongaat Hulett Limited, EOH Holding, SAA, Transnet, Eskom, African Bank and VBS discussed in point 2 above have

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140 Recommended practice 59.b. under Principle 8 of Part 5.3 of the IoDSA *King IV Report.*

141 Chapter 3 of the *Companies Act* 71 of 2008, which encompasses the provisions which deal with the appointment of auditors and audit committees.

put into question the effectiveness of audit committees in South Africa in both private companies and SOEs. These reported financial and corporate scandals have made it doubtful that audit committees have been able to drive the government's policy rationale, which is to promote accountability and transparency in South African companies, particularly in the past decade. As demonstrated in this article, audit committees are aimed at providing oversight over the financial reporting process. In other words, it is the role of an audit committee to ensure the integrity of the financial information, including the integrity of the financial reports and annual financial statements.

The reported financial misstatements and irregularities in South Africa suggest one or both of the following: that audit committees fail to discharge their legislative responsibility under the *Companies Act* 2008 or that they do so but with favour or prejudice. This stimulates the need for further investigation of the effectiveness of audit committees under the *Companies Act* 2008 with reference to the independence of such committees and the protection thereof. Such an in-depth investigation falls outside the scope of this article.

In the light of the policy rationale for the establishment of audit committees,[142] their role[143] and their contribution to financial reporting[144] as discussed above, the legislator should consider making the following amendments:

- An amendment of the provisions of section 94(3) of the *Companies Act* 2008, to make provision for the first members of the audit committee to be elected and appointed only by shareholders at a special shareholders meeting within the 40 business days of the date of incorporation. This would be consistent with the idea that audit committees are established and appointed at the annual general meeting of the company's shareholders as contemplated in section 94(2) of the *Companies Act* 2008. This recommended amendment would address any urgency to establish an audit committee before the company's first annual general meeting.

- An amendment of the provisions of section 94(6) of the *Companies Act* 2008 to strip the board of directors of the power to appoint members of the audit committee to fill a vacancy in the committee. The member of an audit committee should be elected and appointed

142 See the discussion in point 3 above, particularly point 3.3 as the discussion relates to the South African position.
143 See the discussion in point 4.2 above.
144 See the discussion in point 5 above.

only by shareholders at a special shareholders meeting within 40 business days after a vacancy has arisen or at the annual general meeting.

- An insertion of a new subsection under 94 of the *Companies Act* 2008 to make an express statement that an audit committee established in terms of the provisions of the section 94 of the *Companies Act* 2008 must report to the company's board of directors but account to the company's shareholders in a general meeting.

- It is recommended that a new subsection should be inserted under section 94 of the *Companies Act* 2008 to make an express provision on how members of an audit committee may be removed from that committee before the expiration of their term of office. Importantly, the recommended subsection should protect the independence of members of an audit committee and the committee as a whole by prescribing that the members of an audit committee may be removed or dismissed from that committee only by shareholders in a duly constituted special meeting.

These recommendations could improve the quality of financial reporting and encourage greater accountability and transparency in South Africa companies.

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List of Abbreviations

ABIL	African Bank Investments Limited
BRC	Blue Ribbon Committee
DTI	Department of Trade and Industry
FRC	Financial Reporting Council
IoDSA	Institute of Directors in Southern Africa
JSE	Johannesburg Stock Exchange
LSE	London Stock Exchange
MOI	Memorandum of Incorporation
NASDAQ	National Association of Securities Dealers Automated Quotations

NYSE	New York Stock Exchange
PELJ	Potchefstroom Electronic Law Journal
PwC	PriceWaterhouseCoopers
S Tex L Rev	South Texas Law Review
SAA	South African Airways
SEC	Securities and Exchange Commission
SOE	state-owned enterprises
SOX	Sarbanes-Oxley
UK	United Kingdom
USA	United States of America
VBS	Venda Building Society