Inflation eroding benefits intended for small businesses

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Parliament is currently in the process of reviewing comments received from stakeholders on the Companies Amendment Bill, 27 of 2023. While the Bill seeks to address pertinent matters within the South African economic context, there is one particular issue that has not been considered in the proposed amendments; this relates to the Public Interest score (PI Score). The South African Institute of Chartered Accountants (SAICA) made oral and written submissions to Parliament highlighting the need to review the PI score. Thandokuhle Myoli, project director: Audit and Assurance at SAICA, gives more insight on this matter.


Thando Myoli

When the Companies Act, 71 of 2008 (Companies Act) came into effect in May 2011, one of the new concepts introduced was that of the PI score. The PI score is important in the sense that depending on a company's score, certain requirements within the Companies Act may be triggered. For example, a company whose PI score is 350 or higher for a particular financial year is required to have its financial statements audited. In another example; a company whose PI score is 500 or higher, in terms of the Companies Act, is required to establish a Social and Ethics committee.

Audits and independent reviews

When it comes to the requirement to have an audit or an independent review, Companies Regulation 29(4) requires audits in the following instances:

- For companies whose PI score is greater than 350;
- For companies whose PI score is between 100-349, should a company's financial statements be internally compiled.

These requirements imply that small companies that do not meet these thresholds are exempted from audits. Independent reviews are required for:

- Companies whose PI score is between 100-340 and have their financial statements compiled independently.
- Companies whose PI score is less than 100 but have their financial statements internally compiled.

The level of assurance required for an independent review is lower than an audit engagement, meaning that the costs borne by the business may be due to the less intensive work effort. Should a company still wish to have its financial statements audited, the Companies Act gives companies the option to include the audit requirement in its Memorandum of Incorporation should there be an exemption in terms of the PI score thresholds.

It is also important to note that all companies are required to compile and file annual financial statements with the CIPC. Section 30(2A) of the Companies Act does provide exemptions to the audit and independent review requirements for companies whose directors are also beneficial holders of securities issued by the company.

Determining the PI score

What are the factors considered in determining the PI score for a particular financial year? Companies Regulation 26(2) deals with the determinants of the PI score. These include monetary measures such as a company's turnover for a financial year and third-party liabilities; as well as non-monetary measures such as the number of employees and the number of individuals who have beneficial interest in a company's issued shares. The problem highlighted in SAICA's submission to Parliament arises primarily due to the monetary measures as these do not consider the well-known and currently topical concept of inflation.

The value of R100 in May 2011, when the Companies Act came into effect was R187 in September 2023. To illustrate the effect of inflation on the PI score, consider this simple and fictitious example:

A company, suppose it is a farm operation that has an average of 100 employees in a year – mostly seasonal farmworkers. The company has 7 shareholders (mostly family) and generates an annual turnover of R80m and has total third-party liabilities of R50m.

By applying the requirements in the Companies Act and Regulations, in 2011, when the Companies Act came into effect, this company would not have been required to have an audit; rather an independent review would have sufficed. Applying the same requirements in 2023, with all factors remaining the same and adjusting for inflation on the turnover and liabilities, this same company would now be required to have an audit.

In the example above, the benefits that the Companies Act envisaged to provide to the small business are eroded by inflation. Due to the elevated level of assurance required in an audit engagement compared to an independent review, the company would need to expend more financial resources to the assurance provider and spend more precious time to ensure the audit is completed. In a similar vein, there will be companies that were not previously required to establish Social and Ethics Committees but due to inflation are now required to do so.

SAICA Proposal

SAICA in its submission to Parliament has proposed that the PI score should be adjusted on a periodic basis to factor in the impact of inflation on the monetary measures used in the determination of the PI score. One of the benefits of the introduction of the PI score was to promote the ease of doing business in South Africa by ensuring that small businesses are not subjected to unnecessary regulatory burdens. By failing to consider its impact, we are allowing inflation to erode the gains once enjoyed by small businesses. Here is a link to SAICA's written submission to Parliament. SAICA also made a similar submission to the Department of Trade, Industry and Competition in July 2022.

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