

# Companies Act reform

## Accountability versus governance

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The *Companies Act*, Act 61 of 1974 came into effect on 1 January 1974, more than thirty years ago. Although the Act has been amended a few dozen times since then, the basic principles that established the accountability arrangements between the providers and stewards of capital have remained essentially unchanged.

These fundamental arrangements are based on English law dating back to the Victorian era. There is no dispute that company law is in urgent need of reform – it is a widely accepted fact. Not only has the South African Constitution changed fundamentally, but corporate failures have exposed the current structures as incapable of effectively and efficiently dealing with irresponsible and self-serving company directors and officers. In South Africa we now live in a society where openness and transparency, inclusivity and accountability are the established societal norms. The *Companies Act* was not designed to support these principles.

### Introducing company law reform

Against this background, in June this year the Department of Trade & Industry published a position paper that provides guidelines for South African company law reform. This document is now open to public scrutiny and the Department of Trade & Industry has requested comment from all affected and interested parties.

The consultative document entitled “*South African Company Law for the 21<sup>st</sup> Century – Guidelines for Corporate Law Reform*” discusses the objectives of the proposed new company law, its purpose and scope as well as the general principles underpinning the framework.

The objectives given in the position paper demonstrate high aspirations as the Department of Trade & Industry strives to create a regulatory framework that “promotes growth, employment, innovation, stability, good governance, confidence and international competitiveness”. It adds that elements of “flexibility” should also be incorporated into the proposed new Act, and “unnecessary artificial preferences and distortions” should be avoided.

Although these broad objectives at first glance seem to be all encompassing, closer examination and analysis reveals a disappointing omission. This omission mirrors trends set by the corporate world to create an environment that is designed to suit corporate objectives whilst marginalizing the public interest. *Accountability* is not a sought after objective – instead, the term *governance* has taken its place.

### Accountability versus governance

The concept of *accountability* seems to have fallen out of fashion and favour. The volume and tone of pronouncements produced, distributed and promoted by organised business and self-regulating accounting bodies world-wide have educated and conditioned the public to accept new terminology and its accompanying marginalisation of the accountability concept. The “in” concept is now “corporate governance”. Corporate governance has not only remodeled business “norms”, it has also created itself as a new, highly profitable industry. All business “partners” have benefited from its birth and phenomenal growth, growth that was fuelled by combined efforts to shape a new creation that would marginalize the public interest whilst pretending to be almost altruistic in its motives.

Big business has cleverly helped “itself” to achieve the necessary recognition of the new-born concept. Self-appointed, self-regulating bodies have generated their own self-serving standards and guidelines to protect self-interests. Accountability was discarded and replaced by corporate governance in these

standards. Business applauded their own self-regulators for developing and extending this unique concept. The self-regulators applauded each others' involvement and endorsed it because the other regulator had also done so. It was then introduced into the syllabi of professional bodies because it had become the norm in business. This gave business more reason to use it as it had become the educational norm. Before long, its origins faded and all that remained was an undisputed concept.

And so self-interests have been legitimized in statute and regulatory standards. Now corporate governance is there for all to use. The consulting arms of business use it to assist businesses to become "corporate governance compliant", and earn huge fees in the process. Business uses it to claim ultimate stewardship: "We are corporate governance compliant – what more do you expect us to do?" Decisions are justified by referring to the fact that they were taken within corporate governance frameworks and when something goes wrong, directors claim innocence and hide behind the fact that they have stuck to corporate governance principles. Corporate governance has become a precious product and the corporate propaganda machine now not only sustains it, but has in fact endowed it with an almost hallowed status.

And no-one dares to mention that the infamous Enron won "excellence in corporate governance" awards, and that corporate governance compliance neither prevented nor lessened the impact of fraud, shareholder exploitation, corporate and audit failure.

In South Africa, the *King Report* (and now the so-called *King II report*) describes and epitomises corporate governance. But whilst *King II* nobly warns against the loss of auditor independence, it still allows external auditors to provide unlimited non-audit services to companies and then to audit and to express an opinion on their own work.

Unfortunately, South African corporate governance has cultivated a checklist approach to management – you become "King compliant". If you have an audit committee, if a non executive director is chairing it, if they meet with the external auditors once a year, and if they have written terms of reference and state this in their annual report, they already score important points. No-one assesses the impact these aspects have on advancing accountability. How are the agendas of the meetings drawn up? How inclusive and transparent is this process? How are the meetings being conducted? Are all role-players allowed to attend? Are all role-players allowed to present their views without intimidation? Are accurate minutes kept? Do they reflect all issues discussed and are they distributed efficiently? Are processes in place to correct misstatements in these minutes, especially if pointed out by minorities? How are decisions taken? What is the quality of their terms of reference?

And if the audit committee has set out the principles for using the external auditors to provide non-audit services, do these principles actually safeguard auditor independence? And if they do, are they being adhered to in fact?

These issues currently fall beyond corporate governance's sphere of interest. They do, however, matter in the realm of accountability.

Our large companies have all arrived at the corporate governance objectives. They score full points on the King-scorecard and their corporate governance consultants are there to prove it, their glossy annual reports are there to pronounce it. They are perfect companies with perfect directors and of course perfect corporate governance compliance records.

Like the many perfect husbands and fathers, who buy their wives flowers at least once every week, never forget to transfer their kids' pocket moneys and spend at least one hour per week "quality time" with them. They phone home once a day when away, and always bring something expensive home from their business trips. Their checklist score is 100%, for outward form, but this approach has not prevented their family lives from falling apart.

Because you either have it on paper or you have it in your heart.

Just like being a good husband or father is really judged from what is in the heart, accountability is not about checklists – it also comes from the heart. You can never arrive, cross your arms and sit back and relax. You strive your whole life to improve, eliminate errors, anticipate pitfalls, be more accountable.

I have a dream...

The essential difference between private sector and public sector management focuses on this very point. The *Public Finance Management Act* (PFMA) for example requires Accounting Officers to put in place an effective, efficient and transparent system of financial risk management and internal control. These public sector managers therefore never arrive and are continually striving to be better – because you can always be more effective and efficient – you can always become more obviously transparent. The PFMA also requires public entities to disclose *all* losses written off, denying them the chance their private sector counterparts have to play with the concept of materiality to hide crucial information and avoid embarrassment.

The PFMA is packed with examples showing that accountability, not governance, is the foundation of good management and business. This concise legislation already holds the key to achieving most of the ambitious objectives set by the Department of Trade & Industry in respect of company law reform. It is the ideal blueprint on which to mold the new Companies Act.

At this watershed in company law reforms, I appeal to all involved in drafting this new Act that we bid farewell to the corporate governance concept and its lustrous self-serving support industry, discard the checklist approach and re-introduce the true concept of accountability.

In 1963 Dr Martin Luther King told the American people that he dreamed of a country that would live out the true meaning of its creed: "All men are created equal". Since then, both America and South Africa have changed while attempting to fulfill this dream. I hope that we too can give rise to a similar dream: a dream of a South African business sector that honestly embraces *accountability* ...