



IN THE COMPANIES TRIBUNAL OF SOUTH AFRICA

Case No: CT008APRIL2017

In the matter between:

JOHN FREDERICK ODDY

APPLICANT

and

COMPANIES AND INTELLECTUAL

PROPERTY COMMISSION (CIPC)

RESPONDENT

Presiding Member of the Companies Tribunal: ISHARA BODASING

Date of Decision: 31 AUGUST 2017

DECISION

1. INTRODUCTION

1.1 The Applicant, **JOHN FREDERICK ODDY** is the Managing Director of **WELFIT ODDY INDUSTRIES (PTY) LTD.** (the Company), a private company incorporated in terms of the company laws of South Africa, with registration number 1987/004045/07, and with its registered address at Kurland Road, Perseverance, Port Elizabeth. The company manufactures a range of tank containers, which are used for the transportation of hazardous liquids throughout the world by rail, road and sea.

1.2 Applicant brought an application in terms of S172 (2) of the Companies Act 71/2008 ("the Act") for cancellation of the Compliance Notice issued by the Respondent on 15 February 2017. A founding affidavit in the CTR142 form is deposed to by Applicant ("Deponent").

1.3 Respondent filed an answering affidavit, deposed to by Ms Khutso Maboya who is a Senior Investigator in the Corporate Compliance and Disclosure Regulations ("CCDR") unit within the CIPC. Deponent replied thereto.

2. BACKGROUND

2.1 During July 2016, Respondent received a report that was sent to the Independent Regulatory Board of Auditors (IRBA), concerning a reportable irregularity on the part of the Company. Such reports are sent to IRBA by the auditors in terms of S45(3) of the Auditing Profession Act 26/2005.

2.2 The report came in the form of two letters dated 7 June 2016 and 8 July 2016 from Deloitte and Touche, the then auditors of the Company. The letters suggested that the Company had contravened S29 of the Act.

2.3 On 15 February 2017, Respondent issued a Compliance Notice to Applicant, in terms of which Applicant was required within 40 days, to correct any action in contravention of the Act, specifically:

2.3.1 The Board of Directors of the entity should comply with all the requirements of the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SME's). An entity can not state in their annual financial statement that they comply with IFRS for SME's, unless it complies with all the requirements of the applicable standards;

2.3.2 The audit opinion on the annual financial statements of Welfit Oddy Industries (Pty) Ltd for the year ended 31 December 2015 stated that they do not present fairly the financial position of the entity, in that the entity applies hedge accounting with the sales orders as hedged item, even though it does not meet the requirements for hedge accounting. In order to apply hedge accounting, the Board of Directors must

designate and document the hedging relationship from the inception of the hedge in accordance with paragraph 12.16(a) of the IFRS for SME's. This documentation must clearly identify the risk being hedged, the hedging instrument and the hedged item;

2.3.3 The Board of Directors for Welfit Oddy Industries (Pty) Ltd must avoid the recurrence of a similar non-compliance and/or reportable irregularity. The investigator reviewed the prior year's annual financial statements (31 December 2013) and it was observed that a similar non-compliance was noted. Any person who is repeatedly guilty of an offence in terms of the Act, including the offence of failure to satisfy a compliance notice, may be placed on probation as a director, or declared a delinquent director, and disqualified from serving as a director, in terms of S162;

2.3.4 To provide reasons to the Commission why the Board of Directors of the company never rectified the abovementioned reportable irregularity and/or non-compliance of the IFRS for SME's, even though they were persistently informed by their auditors.

2.4 On 7 March 2017 Applicant filed an application with the Companies Tribunal for cancellation of the Compliance Notice.

3. ISSUES

3.1 Respondent relies on the records of the auditors (Deloitte and Touche), who, in their report to IRBA, contend that the Company committed a Reportable Irregularity as defined in the Auditing Professions Act, because it did not adhere to IFRS for SME's in respect of hedge accounting.

3.2 The crux of the auditors concern is based on the fact that the Company applies Fair Value Hedging. As a result of this: not only are the Forward Exchange Contracts (FEC's), being the hedging instruments, re-valued to year-end spot rate, but the hedged contract, being the hedged sales order, is also re-valued to the same year-end spot rate.

3.3 IFRS for SME's rules require an exact, specific and ongoing match between the hedging instrument and the hedged contract, which must be done at the hedging instrument level and not the more fundamental level of spot rate and date, and the forward points earnings over time thereafter.

3.4 Applicant admits that in applying Fair Value Hedge Accounting, it failed to comply with IFRS for SME's; but claims that this has to be done in order to prepare financial statements that fairly present the financial results of the company, which is one of the statutory duties of the Directors of a company.

3.5 However, Applicant submits that its non-compliance is not material because it is fully disclosed, explained and the impact is set out. Hence, there is no misrepresentation and no material breach of the fiduciary duties owed by the Directors to a company.

3.6 Applicant finally contends that the substance, but not the form, of IFRS for SME's Fair Value Hedging Rules, are being complied with. To support this contention, Applicant's papers include a letter from their current auditors, to this effect.

4. APPLICABLE LAW

4.1 Section 33(1) of the Constitution entitles everyone the right to administrative action that is lawful, reasonable and procedurally fair.

4.2 Section 29(1) of the Act states the following:

If a company provides any financial statements, including any annual financial statements, to any person for any reason, those statements must-

(a) satisfy the financial reporting standards as to form and content, if any such standards are prescribed;

(b) present fairly the state of affairs and business of the company, and explain the transactions and financial position of the business of the company; (my emphasis)

(c) show the company's assets, liabilities and equity, as well as its income and expenses, and any other prescribed information.

4.3 Companies Regulation 30(5)(b) of 2011 states that the CIPC may issue a Compliance Notice to any such company setting out changes that are required to the company's practices to better comply with the financial record keeping and financial reporting provisions of the Act. In this case, these are in terms of the IFRS for SME's.

4.4 Companies Regulation 143(4) of 2011 states: *An allegation of fact set out in an initiating document that is not specifically denied or admitted in an Answer must be regarded as having been admitted.*

4.5 Section 172(2) of the Act states: *After considering any representations by the applicant and any other relevant information, the Companies Tribunal, ... may confirm, modify or cancel all or part of a compliance notice.*

4.6 Section 204 of the Act makes provision for The Financial Reporting Standards Council, which must-
Receive and consider any relevant information relating to the reliability of, and compliance with, financial reporting standards and adapt international reporting standards for local circumstances and consider information from the Commission as contemplated in section 187(3)(b).

5. EVALUATION

5.1 At the outset, I must point out that the Respondent failed to address in its Answering papers, any of the material issues raised by the Applicant, and which form the basis of this application. Applicant's contentions are supported by an opinion from Senior Counsel, which forms part of Applicant's papers. However, Respondent has not seen fit to investigate further, or even to answer Applicant's submissions.

5.2 Compliance with IFRS for SME's is not an end in itself, but a means to an end. Hence the recognition in domestic legislation of the fair presentation override, as per S29(1)(b) of the Act. Even though the relevant requirements for IFRS for SME's has been embedded in our domestic law, there is no evidence that Respondent investigated circumstances in which departure from IAS's IFRS for SME's is permissible.

5.3 Practically, as financial reporting standards have become more detailed, and departure from them has become harder to justify, the scope for arguing that financial statements which do not comply with relevant standards achieve a fair presentation, has become quite limited. Concomitantly, there has been an increase in the scope for arguing that compliance with relevant financial reporting standards does give fair presentation.

5.4 In making the above observation, I simply comment on a historical trend which has been evident for some years, and which is unsurprising. However, it does not follow from this that the preparation of financial statements can now be reduced to a mechanical process of following the relevant standards without applying objective professional judgement to ensure that the statements achieve a fair presentation.

5.5 That a particular standard is appropriate may be unquestionable, but there may be complicated issues of judgement in applying that standard, which could affect, perhaps crucially, the resultant quantification or appearance of items in the financial statements. Such judgement is not given in a vacuum, but to achieve fair presentation.

5.6 Even though the preceding three paragraphs are included as *obiter dicta*, they serve to emphasise that a proper investigation of Applicant's submissions could possibly lead the Respondent to a different conclusion. If this is in fact so, I encourage the Respondent to invoke the provisions of S204 of the Act.

6. FINDINGS

6.1 It appears that Respondent has mechanically applied the IFRS for SME's standards in deciding that the form must strictly be adhered to, thereby confusing outcome with the need for due process.

6.2 I find that the provisions of the Act have served to underline and reinforce the centrality of the true and fair requirement to the preparation of financial statements. However, Respondent did not apply its mind to this question: under what circumstances can departure from a relevant standard be contemplated, particularly if it is alleged that compliance therewith would be inconsistent with the objective of true and fair view?

6.3 Furthermore, given that Respondent's answering papers do not deny the submissions made by Applicant, one has to presume that they are admitted (Companies Regulation 143(4) of 2011).

6.4 In light of the above, I find that Respondent did not act in a manner that was reasonable or procedurally fair by issuing Applicant with a Compliance Notice. The Tribunal is satisfied that Applicant has shown good cause for the Compliance Notice to be cancelled.

7. ORDER

7.1 The application for cancellation of the Compliance Notice is hereby granted.

7.2 The Registrar of the CIPC is directed to re-consider the reports from IRBA, along with Applicant's submissions, bearing in mind the observations of this decision.

ADV. ISHARA BODASING