

Audit requirements relating to the business accounts of legal practitioners now clarified

By [Hayley Barker Hoogwerf](#), issued by [SAICA](#)

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In October 2019, the Companies and Intellectual Property Commission (CIPC) issued a notice of the withdrawal of the non-binding opinion ("this" or "the" "opinion") pertaining to Regulation 28(2)(a) of the Companies Regulations, 2011 (the Companies Regulations) to the Companies Act, 2008 (the Companies Act). This opinion applied to legal practitioners who are registered as companies in terms of the Companies Act. This opinion considered whether the holding of assets in the legal practitioners' trust accounts is regarded as part of the ordinary course of the legal practitioner's primary business. As a result of the withdrawal of the opinion, the business accounts of legal practitioners who are subject to the Companies Act, i.e. are registered companies, and who hold assets in trust in excess of R5m at any time during the financial year, are now required to be audited.



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Overview of legislative requirements

The South African Legal Practice Council Rules ("the Rules") issued in terms of Sections 95(1), 95(3) and 109(2) of the Legal Practice Act, No. 28 of 2014 ("the Act") require an audit engagement to be undertaken on the compliance of the legal practitioner's trust accounts with the Act and the Rules. Currently, there is no requirement in the Act or the Rules for a legal practitioner's financial statements to be audited, as they relate to the business accounts of the firm. Such requirement may however emanate from another Act, such as the Companies Act.

Regulation 28(2) of the Companies Regulations provides that, in addition to public companies and state owned companies (SOC), where the audit of any other company is desirable in the public interest, as indicated by prescribed criteria in any particular financial year, the Annual Financial Statements (AFS) of that company must be audited. One of the prescribed criteria (among others), is *that an audit is required if in the ordinary course of its primary activities, a profit or non-profit company holds assets in a fiduciary capacity for people who are not related to the company, and the aggregate value of such assets held at any time*

during the financial year exceeds R5m.

The terms, *ordinary course of its primary activities* and *fiduciary capacity*, are however not defined, which has resulted in different interpretations of the requirements. The South Africa Institute of Chartered Accountants' (SAICA) Guide to the Companies Act outlines SAICA's view on the meaning of *ordinary course of its primary activities* and *fiduciary capacity*, as follows:

Assets held in a fiduciary capacity must be held in the ordinary course of the company's primary business, not incidental to it, on behalf of third parties not related to the company. Fiduciary capacity implies decision-making capability over the application of the assets and that the third parties have the right to reclaim the assets. These assets may be financial or non-financial assets.

Whether a company holds assets in the ordinary course of its primary activities depends on the nature of the company, viz. whether the activity is part of the core business or is incidental to it. Incidental activities will not be included in a company's primary activities, for example the holding of deposits.

In applying the requirements of the Companies Regulations, the first step is to determine what the primary activities of the

business are. The second step is to determine what comprises the activities in the ordinary course of the primary activities. If any of the activities in steps 1 and 2 involve the holding of funds, then the criterion of holding assets in a fiduciary capacity in the ordinary course of its primary activities on behalf of an unrelated party could potentially apply.

SAICA is of the view that the operation of the trust account is part of the core business of a legal practitioner and therefore does form part of the primary activities of the business. With regards to the issue of holding assets in a fiduciary capacity, SAICA is of the view that the keeping of funds in a trust account by a legal practitioner meets the definition of holding assets in a fiduciary capacity. Certain legal practitioners however do not share this view, with the argument being that primary business activity of a legal practitioner is to provide legal services and not to hold assets in a fiduciary capacity.

Recent developments

To aid in clarifying this matter, CIPC issued a non-binding opinion in 2013 on Regulation 28(2)(a) of the Companies Regulations, specifically as it relates to the operation of trust accounts by legal practitioners (then attorneys) in the ordinary course of the legal practitioner's firm's primary activities. In this non-binding legal opinion, CIPC concluded that, while they agree that the assets held by the legal practitioner firm are held in fiduciary capacity, the conclusion that the operation of trust accounts by legal practitioner firms is in the ordinary course of the firm's primary activities is far-fetched, as the primary activities of the legal practitioner's firm is the provision of legal services. The non-binding opinion continued to state that whether, in the provision of such services, another piece of legislation requires these firms to operate a trust account is a completely different matter.

In October 2019, CIPC issued a notice that they have subsequently withdrawn the above mentioned non-binding opinion. In this notice, CIPC draws attention to Regulation 28(2)(a) of the Companies Regulations and specifically highlights the fact that a company that holds assets in a fiduciary capacity, and the aggregate value of such assets held at any time during the financial year exceeds R5 million must have its annual financial statements audited for that financial year. The notice specifically identifies legal practitioners as an example of such a company requiring audit.

Implications for legal practitioners

In withdrawing the non-binding legal opinion, CIPC has made it clear that legal practitioners that are subject to the Companies Act, for example as incorporated companies, do in fact hold assets in a fiduciary capacity as part of the ordinary course of the firm's primary business. If the aggregate value of assets held in trust exceeds R5m, an audit of the business accounts of the legal practitioner is now required.

Legal practitioners who have interpreted the legislation differently in the past are now faced with complying with the requirements from the date of withdrawal of the opinion. Legal practitioners and their auditors will have to evaluate and agree on the way forward. This will include evaluating the independence of the auditors in terms of the IRBA Code of Professional Conduct as well as identifying other sections of the Companies Act that may be applicable to the legal practitioner who are subject to the Companies Act.

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