THE COMPANIES ACT, 2015

The Companies Act, 2015 (the Act) was published in September 2015, but most of it, especially those sections relating to accounting, reporting, and audit were not brought into force until 15th June 2016. The Act contained transitional provisions including one that financial statements for accounting periods beginning before these sections were brought into force should continue to comply with the provisions of the previous Companies Act. As a result, we have seen little impact on companies' annual reports, but such reports for periods ending on or after 30th June 2017 will have to comply with all aspects of the Act. Accompanying this newsletter are copies of our specimen financial statements for private companies complying either with full IFRS or the IFRS for SMEs. These illustrate financial statements for the year ending 31st December 2017, but would equally apply to years ending between 30th June 2017 and 31st December 2017, except for some minor changes to full IFRS that only become effective for periods commencing on or after 1st January 2017. We have also summarised below the main changes brought about by the Act relevant to financial statements and directors' reports.

<u>Directors' Reports</u>

As before, directors are required to prepare a report to accompany the financial statements of a company, but there are now additional requirements regarding the contents of the report, including:

- A fair review of the company's business
- A description of the principal risks and uncertainties facing the company
- To an extent necessary for an understanding of the development, performance or position of the business:
    - An analysis using financial key performance indicators
    - An analysis using other key performance indicators
    - References to, and additional explanations of, amounts in the financial statements
- A statement with respect to each director that as far as the director is aware, there is no relevant information of which the auditor is unaware, and that the director has taken all the steps that the director should have taken so as to be aware of any relevant audit information and to establish that the company's auditor is aware of that information.

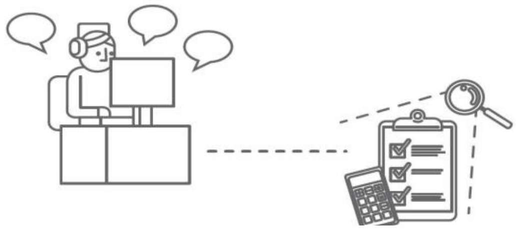
Given that such reports will now be in the public domain, directors will need to spend more time than in the past in drafting their report to meet these requirements.

<u>Terms of appointment of the auditor</u>

The Act requires that the "terms on which the auditor is appointed and remunerated" are disclosed, and that the disclosure shall include "a copy of any terms that are in writing". However, this disclosure does not have to be within the financial statements. Instead, the Act requires that the "place and means of disclosure" be specified in:

- The notes to the financial statements; or
- The Directors' Report; or
- The Auditor's Report.

Regulations in respect of this disclosure are yet to be issued. In the meantime our suggestion is for this to be set out in the Directors' Report, in the form illustrated in our specimen financial statements.



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Report of the independent auditor

While the form of the report of the auditor continues to be determined primarily by International Standards on Auditing (which were revised significantly for accounting periods ending on or after 15th December 2016), the Act has added a requirement that the auditor expresses an opinion on whether the Directors' Report is consistent with the financial statements.

The previous Act required auditors to confirm that the financial statements are in agreement with the accounting records and to express an opinion on whether proper books of account had been kept. Going forward, the auditor only needs to report on this by exception: i.e. only when adequate accounting records have not been kept, or when the financial statements are not in agreement with the accounting records.

Financial statements

Generally, the Act is less prescriptive than the previous Act about the contents of financial statements, recognising instead that they should comply with "the prescribed financial accounting standards".

However, the Act now requires that companies that are parent companies (i.e. have subsidiaries) must produce, and lodge with the Registrar of Companies (see below), audited "individual" financial statements in addition to audited "group" (consolidated) financial statements.

The Act also requires additional disclosures within the Notes to the financial statements about employees including:

- The monthly average number of persons employed under contracts of service (likely to include executive directors) by the company in the financial year, analysed by category. The appropriate categories, such as production, sales, etc., are to be determined by management, "having regard to the manner in which the company's activities are organised".
- The total amounts paid to the above in respect of:
  - Wages and salaries
  - Costs incurred in respect of retirement and other benefits

The Act also contains more detailed requirements regarding dealings with directors (remuneration, benefits, advances, guarantees, etc.) covered in even greater detail in the Companies (General) Regulations, 2015.

Quoted companies are also required to prepare and publish a Directors' Remuneration Report, regulations for which have not yet been issued.

The Small Companies Regime

The Act introduced the concept of a "Small Companies Regime". For a company to qualify to be part of this regime, it must meet two out of the following three criteria:

- Turnover not more than KSh 50 million
- Net assets not more than KSh 20 million
- Not more than 50 employees (average of persons employed under contracts of service)

and cannot be a public or regulated company or part of a group that includes a public or regulated company.

Companies that qualify as subject to the Small Companies Regime do not have to:

- Prepare group (consolidated) financial statements
- Disclose the number of employees
- Disclose details of directors' benefits, advances, guarantees, etc.
- Include a business review and description of principal risks in the directors' report
- Lodge a full set of financial statements with the Registrar – but they must file a balance sheet as a minimum, in which case the balance sheet must include a statement to the effect that the financial statements are prepared in accordance with the provisions applicable to the Small Companies Regime.

A company subject to the Small Companies Regime may be exempt from audit if it satisfies both of the following criteria:

- Turnover not more than KSh 50 million
- Net assets not more than KSh 20 million.

It will be appreciated that these criteria are more stringent than those to qualify as subject to the Small Companies Regime – it is no longer a case of 'two out of three'.

Approval and distribution of the Directors' Report and financial statements

One or more of the directors must sign on the balance sheet once the financial statements have been approved by a resolution of the directors. A copy of the financial statements and reports must be sent to every member, although regulations, yet to be issued, may allow summary financial statements to be sent.

Private companies are no longer required to hold an AGM, although their Articles of Association may require that they still do so.

Private companies must lodge their financial statements with the Registrar of Companies within 9 months of the balance sheet date. Public companies must do this within 6 months.

Caveat

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