AGENDA

- Accounting records
- Prepare financial statements
- Analysis of financial statements by FAIS Supervision
- Financial Soundness requirements
- Proposed exemptions and amendments
FINANCIAL SOUNDNESS REQUIREMENTS

- Solvency and Liquidity requirements - Section 9 of the Determination of Fit and Proper Requirements for Financial Services Providers (BN 106 of 2008)
- Preparation and maintenance of accounting records - Section 19 of the Act.
- FSPs must prepare monthly accounting records and subject them to annual audit where required (Companies Act new requirements dealt with a bit later on).
- Financial statements must be submitted to the Registrar within 4 months of the FSPs’s year end
MONTHLY ACCOUNTING RECORDS

- FSP must maintain full and proper accounting records on a continuous basis - (sect 19(1)(a) of Act)
- Brought up to date monthly - (sect 19(1)(a) of Act)
- FSB may request the accounting records in terms of - section 4(2)
- To manage a business properly, management need financial performance tracking tools, financial reporting mechanisms and proper financial processes and controls
PREPARATION OF FINANCIAL STATEMENTS
PREPARATION OF FINANCIAL STATEMENTS

- A set of financial statements must include:
  - Balance sheet
  - Income statement
  - Cash flow statement
  - Statement of changes in equity
  - Notes to the financial statements

- The financial statements must:
  - Fairly represent the state of affairs of FSP’s business - Sect 19(2)(b)(ii)
  - Refer to any material matter which has affected or is likely to affect the financial affairs of the FSP - Sect 19(2)(b)(iii)
# Preparation of Financial Statements

<table>
<thead>
<tr>
<th>Type of FSP</th>
<th>Preparation of Financial Statements</th>
<th>Audit reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category I FSP that does not receive client funds or premium</td>
<td>Not in accordance with South African Generally Accepted Accounting Practices (“GAAP”) or International Financial Reporting Standards (“IFRS”)</td>
<td>No audit required, exempted in terms of Board Notice 96 of 2003.</td>
</tr>
<tr>
<td>Category I FSP receives client funds or premium</td>
<td>In accordance with SA GAAP or IFRS</td>
<td>Audit report in terms of section 19(2)(a) and 19(3) of Act.</td>
</tr>
<tr>
<td>Category I FSP receives premiums in relation to long-term insurance category A (assistance business policies) only</td>
<td>Not in accordance with SA GAAP or IFRS</td>
<td>No audit is required, exempted in terms of Board Notice 85 of 2004, provided that an ‘accounting officers’ report must be submitted.</td>
</tr>
</tbody>
</table>
FINANCIAL STATEMENTS NOT IN CONFORMANCE WITH GAAP OR IFRS

- State the accounting framework according to which the financial statements were prepared
- Accounting frameworks e.g. SA GAAP or IFRS and IFRS for SME's are used by management to prepare and present financial statements
- A summary of accounting policies followed must be clearly stated where there is non-conformance with GAAP
- Explanatory notes on the financial statements must accompany such financial statements
AUDITOR REQUIREMENTS

○ An FSP must appoint an external auditor* who is registered with the Independent Regulatory Board for Auditors.

○ The external auditor must be approved by the registrar:
  - We consider the external auditor’s reputation as a result of prior dealings with the registrar.
  - The auditor’s audit approach must be up to date with changes and developments in standards.
  - The auditor’s report must consist of scope and a clear expression of audit opinion on the financial statements taken as a whole.

○ If an FSP terminates the auditor’s services:
  - The external auditor must submit a statement of what the auditor believes to be the reasons for that termination by the FSP

*(refer to slide on exemption from auditor requirements)
EXEMPTION FROM APPOINTING AUDITOR

- **Who is affected:**
  - Category 1 FSP that does not receive client funds or premiums and
  - Category 1.1 and/or 1.19 FSPs only

- **What is exempted:**
  - If no other law requires an audit, then don’t need to audit the financial statements

- **Applies to:**
  - Sole proprietors, Trusts, Partnerships & Close corporations

- **Excludes:**
  - Companies obliged to have their financial statements audited in terms of the Companies Act.

- **Purpose:**
  - This board notice was designed to provide a relief to these FSPs from financial or other hardships that may be experienced relating to the appointment of an auditor.
CLOSE CORPORATION

- Appoint an accounting officer in terms of section 62 of the Close Corporation Act, 1984 to prepare financial statements
- The accounting officer must be approved by the Registrar

Financial statements:
- Prepared in accordance with the requirements of GAAP or IFRS.
- Signatures of:
  - members
  - the accounting officer.
- A complete set of financial statements such as accounting officer’s report, balance sheet, income statement, cash flow statement and notes.
- Clearly show:
  - The close corporation’s registration number
  - The nature of the business of the provider
TRUST

- Financial statements can be prepared by registered bookkeepers, accountants, auditors, etc.
- Financial statements:
  - Prepared in accordance with the requirements of GAAP or IFRS.
  - Signatures of:
    - trustees
    - the person that prepared statements.
  - A complete set of financial statements:
    - bookkeeper, accountant or auditor’s report,
    - balance sheet,
    - income statement,
    - cash flow statement and notes.
- Clearly show:
  - the Trust’s registration number
  - the nature of the business of the provider
They should be prepared:
- by external auditors
- in accordance with the requirements of GAAP or IFRS

Signatures:
- the board of directors
- the auditor

It should be a complete set of financial statements:
- auditor’s report - section 19(2)
- director’s report,
- balance sheet,
- income statement,
- cash flow statement,
- statement of changes in equity,
- notes to the financial statements.

Clearly show:
- The company’s registration number
- The nature of the business of the provider

Ensure that the auditor has been approved by the Registrar.
SOLE PROPRIETORS

- Prepared by:
  - bookkeepers, accountants, auditors, or
  - according to the guideline provided on the FSB’s website.
- Nothing stops preparation in accordance with the requirements of GAAP or IFRS although it may be difficult to comply.
- Must be signed by the sole proprietor.
- It should be a complete set of financial statements:
  - balance sheet,
  - income statement,
  - cash flow statement and
  - notes.
- Currently the statement of assets and liabilities, income and expenditure are either typed, hand written or using the format posted on internet.
PARTNERSHIP

- Prepared by bookkeepers, accountants or auditors
- Nothing stops preparation in accordance with the requirements of GAAP or IFRS although it may be difficult to comply.
- Must be signed by the partners.
- It should be a complete set of financial statements:
  - balance sheet,
  - income statement,
  - cash flow statement and
  - notes.
- Clearly show the nature of the business of the provider
**Para 10 of the General Code of Conduct - Custody of Financial Products and Funds**

- Paragraph 10 applies to:
  - all FSPs that are involved in the collection of clients’ funds or premiums
  - But excludes short-term insurance brokers that must have an IGF guarantee and comply with S45 of the STIA

- A separate banking account should be opened and maintained

- The records relating to separate accounts are subject to an audit in terms of s19(3) of the Act
IGF - IMPLICATIONS

- If an FSP collects short term insurance premiums:
  - STIA:
    - S45 of the STIA
    - Must have a valid IGF
  - In terms of FAIS:
    - don’t need:
      - the separate account or
      - submit the Section 19(3) report
    - BUT they still need audited financials
AUDIT OF SEPARATE ACCOUNT
SECTION 19(3)(A),(B) AND (C)

- Applies to any FSP required to open a separate account as specified in terms of Paragraph 10 of the General Code of Conduct
  - Category 1.1 and/or 1.19 only FSPs excluded but must submit a similar report prepared by accounting officer
- The auditor is required to report on the money and assets held by the FSP.
- The format of the report is published in Board Notice 85 of 2008
- Separate accounts i.e. bank accounts opened in the name of the FSP to hold money on behalf of clients should not be disclosed on the balance sheet of the FSP as assets.
If an auditor believes that a material irregularity has taken place or is likely to take place or is taking place he/she should notify the Registrar.

Must report even if Management has fixed or is willing to fix

The irregularities need not to be a proven occurrence; it can be a suspected irregularity as long as it is in the auditor’s opinion material and significant enough to be reported.
HOW DOES THE FSB ASSESS FINANCIAL STATEMENTS?
What is financial analysis?

Also referred to as analysis and interpretation of financial statements.

Purpose:

- Establish meaningful relationship between various items of the financial statements
- It determines financial strength and weaknesses of the FSP.
- Attempts to assess the efficiency and performance of an FSP.
- Measure the efficiency, profitability, financial soundness and future prospects of the FSP.
WHY DO WE ANALYSE FINANCIAL STATEMENTS?

- It provides the basis upon which the Registrar can be satisfied that the licensee meets the FAIS Financial Soundness requirements as required by section 8 of the Act read with the Determination of Fit and Proper Requirements for Financial Services Providers and Representatives, 2008.
PURPOSE OF FINANCIAL SOUNDNESS ASSESSMENTS

- Collective view of FSPs:
  - the overall financial stability of FSPs

- Individual FSP view:
  - Evaluate the profitability and financial soundness of the FSP.

- Helps to identify:
  - various dimensions of risks
  - the capacity of the system to cope with and manage these risks
  - weaknesses at an early stage
ANALYSIS OF FINANCIAL STATEMENTS

Objective of financial statements:
- Provision of information on the:
  - financial position,
  - performance, and
  - cash flow information of an entity.

Main issue with financial statements:
- Fair presentation with accurate information
- For the functional benefit of the users of the financial statements.

Achieve fair presentation:
- Prepare the financial statements in terms of Generally Accepted Accounting Practice (GAAP)
- Incorporating compliance with the International Financial Reporting Standards (IFRS).

An entity whose financial statements comply with IFRS shall make an explicit and unreserved statement of such compliance in its notes to the financial statements.

Where there is a deviation or aberration from IFRS the above statement should not be included and full disclosure of the financial impact of the departure is required.
FINANCIAL SOUNDNESS INDICATORS

- **Capital.**
  - Capital adequacy ultimately determines how well financial institutions can cope with shocks to their balance sheets.

- **Assets.**
  - The solvency of financial institutions typically is at risk when their assets become impaired, so it is important to monitor indicators of the quality of their assets in terms of overexposure to specific risks.

- **Management.**
  - Sound management is key to FSP performance but is difficult to measure. It is primarily a qualitative factor applicable to individual institutions. Several indicators, however, can jointly serve—as, for instance, efficiency measures do—as an indicator of management soundness.

- **Earnings.**
  - Chronically unprofitable FSPs risk insolvency.

- **Liquidity.**
  - Initially solvent financial institutions may be driven toward closure by poor management of short-term liquidity.

- **Sensitivity to market risk.**
  - FSPs that are very sensitive to market risk may be at bigger risk when there is a financial crisis.

- **Source - IMF**
ELEMENTS OF ANALYSIS

- Measuring the profitability
  - Determine whether adequate profits are being earned on the capital invested in the business or not.
  - Establish the capacity to pay the interest and dividend.

- Indicating the trend of Achievements
  - Trend analysis on various expenses, purchases, sales, gross profits and net profit etc
  - Compare value of assets and liabilities
  - Predict future prospects of the business

- Assessing the growth potential of the business
  - The trend and other analysis of the business - growth potential of the business.

- Assess overall financial strength
  - Is internal funding available for expenses and expansion?
  - How much funds have been received from external sources.

- Assess solvency of the firm
  - Sufficient funds to meet its short term and long term liabilities?
Purpose of the FSB for analysing the financial statements of FSPs

- Compliance with the financial soundness requirement (solvency) in terms of the Fit and Proper requirements
- Indicate whether the FSP will be able to meet its financial obligations
- Business continuity (going concern aspect) of the entity which ensures protection of clients
- Ability of FSPs to pay its expenses
- Subsequent events
WHAT DO WE CONSIDER:

- Audit report
- Is the Income sustainable to support FSP in future
- Financial soundness requirements
- Notes to the financial statements
- Do the financial statements make sense compared with other information received relating to the FSP
FINANCIAL SOUNDNESS REQUIREMENTS

- An FSP must not be an:
  - unrehabilitated insolvent (sole proprietor) or
  - under liquidation or provisional liquidation (legal entity)

- If FSP is authorised for multiple categories:
  - comply with the most onerous financial soundness requirements as it applies to the multiple categories.
FINANCIAL SOUNDNESS: ALL FSPs STATUTORY SOLVENCY REQUIREMENT

- **Assets** excluding:
  - Goodwill
  - Other intangible assets
  - Investments in related parties (International Accounting Standard 24 definition)

- **Must exceed Liabilities**
  - Excluding subordinated loans
    - Subordination must be indicated in the notes to the financial statements; and
    - A copy of the subordination must be provided to the FSB on request
CATEGORY I FSPs: hold clients assets or receive money or premiums

1. Assets exceed liabilities (refer to previous slide)
2. Maintain current assets which are at least sufficient to meet current liabilities
3. Maintain liquid assets equal to or greater than 4 weeks of annual expenditure
CAT II AND IV FSPs:

1. Assets exceed liabilities (refer to previous slide)
2. Maintain current assets which are at least sufficient to meet current liabilities
3. Maintain liquid assets equal to or greater than 8 weeks of annual expenditure.
CAT IIA AND III FSPs:

1. Assets exceed liabilities by R3 million (refer to previous slide)
2. Maintain current assets which are at least sufficient to meet current liabilities
3. Maintain liquid assets equal to or greater than 13 weeks of annual expenditure.
WHAT IS EXPECTED FROM FSPs RELATING TO MONITORING OF FINANCIAL STATEMENTS

- Key individuals:
  - manage compliance with financial soundness requirements
- FSB expects the compliance officer to monitor compliance with financial soundness requirements:
- Key financial processes to be in place.
- Ongoing review of accounting records to ensure ongoing compliance with the Fit and Proper requirements.
PROPOSED EXEMPTIONS AND AMENDMENTS

Issues to consider
**PROPOSED EXEMPTION: NEW COMPANIES ACT**

- **The FAIS Act:**
  - S19(1): an FSP must maintain proper accounting records and prepare the conventional annual financial statements.
  - S19(2)(a): The financial statements prepared in terms of s19(1) must be audited.
  - S19(4) to (6) deals with irregularity reporting and the appointment of an auditor.

- **The Companies Act, 2008:**
  - Different requirements regarding the submission of financial statements for different types of companies.
  - The extent to which annual financial statements of private companies will have to be professionally reviewed or audited depends on the company’s “Public Interest Score” (a measure of “economic or social significance”).
PROPOSED EXEMPTION: NEW COMPANIES ACT

- **Not apply:**
  - where an FSP is otherwise obliged by law to cause financial statements to be audited and reported on, or otherwise prepared, in which case section 19 applies.

- **Applies:**
  - If no other law requires audited financial statements
  - FSP who receives or holds clients’ money or assets must appoint an accounting officer approved by the registrar.

- **Duties accounting officer:**
  - certify and report on the financial statements
  - conformity with the practices of the accounting officer's profession.
  - S 19(2) to (6) of the Act applies with the necessary changes to the accounting officer, any certification and report by the officer and termination of appointment.

- **Registration of FSP:**
  - FSP registers within three months after publication of the Notice or
  - upon application for authorisation in case of an unauthorised FSP.
POSSIBLE AMENDMENTS TO SECTION 9 OF F&P

‘annual expenditure’, means the expenditure set out in-
a) the latest set of financial statements; or
b) in the case of an applicant commencing business, the budgeted expenditure as expressed in its budget or other accounts less-
i. staff bonuses;
ii. sharing in profits by employees, directors, partners and members;
iii. emoluments of directors, members, partners and a sole proprietor;
iv. other appropriation of profits to directors, members and partners; and
v. fifty percent of the commission of representatives not forming part of their salary.
**LIQUID ASSETS**

‘liquid assets’, means cash and other assets equivalent to cash that can be liquidated without realising a loss on liquidation: Provided-

a) 25% of the assets must be capable of being liquidated in seven days;

b) a further 25% of the assets must be capable of being liquidated in 30 days; and

c) the remaining 50% of the assets must be capable of being liquidated in 60 days.
WHAT IS NOT LIQUID ASSETS (ILLIQUID ASSETS)

- Illiquid assets are assets that are not easily and quickly converted into money.
- Some examples:
  - Shares
  - Real estate
  - Antiques
  - Collectibles
  - Some types of debt instruments
  - Private company interests
PROBLEMS FSPS FACE IF THEY DO NOT MEET REQUIREMENTS

- Must apply for individual exemption as licence will be suspended for non compliance
- Due to day-to-day business may face a situation that they can’t meet requirements in full for short period of time
- New businesses have difficulty to immediately meet requirements
- Difficult to monitor if accounting records are not up to date
INCLUDING NEW PARAGRAPH – GIVE REGISTRAR DISCRETION ON APPLICATION TO REDUCE REQUIREMENTS

a) An FSP may apply to the Registrar to hold half of the assets in paragraph 9(3), (4) and (5) for a period not exceeding 24 months.

b) The FSP must submit management accounts within 15 days after each month end.

c) The approval lapses in case of non-compliance with paragraph (b)
**MANAGEMENT ACCOUNTS**

‘management accounts’, means a set of financial statements which-

a) is prepared from the accounting records contemplated in section 19(1)(a) of the Act;

b) reflects the financial position of the FSP at month end;

c) is prepared in accordance with the accounting policies summarised as contemplated in section 19(1)(b)(iv);

d) fairly represents the state of affairs of the FSP’s business; and

e) refers to any material matter which has affected or is likely to affect the financial affairs of the FSP.”.
THE END