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Reflections on the Botswana Law of Company Accounts in the aftermath of the Benco Crash

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1. Introduction

The events surrounding the insolvency of BENCO INTERNATIONAL'S holding company is BENCOFIN HOLDING LTD based in Luxembourg subsidiaries in Botswana and Lesotho have cast doubt on the effectiveness of existing company law rules regarding corporate accounting and their enforcement both in Botswana and Lesotho. When BENCO's subsidiary in Botswana, the Botswana Engineering and Construction Company, collapsed in January 1982 it was in debt to the tune of P3 million and it left 430 employees jobless and without terminal benefits. The subsidiary in Lesotho was also liquidated at about the same time.

According to the liquidator of BENCO in Lesotho the directors who had since fled the country operated the company with minimal account. The liquidator reported that the company collapsed into a state of insolvency because of a shortage of working capital, inadequate management and lack of progress on contracts. The company left a number of projects worth P10 million incomplete (most of which were government contracts) Other creditors included 800 employees claiming salary and terminal benefits and suppliers many of whom are now unwilling to supply materials and equipment to Lesotho.

The Botswana liquidator found evidence of massive mismanagement. The company had not, like its counterpart in Lesotho, published accounts for two years and that the last audited balance sheet was for 1979. The liquidator reported that there had been large-scale misuse of the company's financial and material resources by its directors. Luxurious residences were constructed for the directors in Gaborone and Randburg (South Africa). The auditors of the company reported that a major proportion of the costs incurred were paid for by BENCO's sister company in Lesotho and were charged through inter-company accounts to BENCO.

The basic problem presented by BENCO is the real possibility that the existing regulatory strategies are no longer appropriate for the present economic and business environment in Botswana. The present Botswana Companies Act is based on the premise that the growth of a free enterprise system is a progression through two different stages characterised by distinct legal rules and roles. The first stage is the epoch of the entrepreneur - promoter - investor - manager. The second stage is the time when the entrepreneurial function is split into ownership and control. According to Clark, while the legal correlate of the "first stage" is the enactment of a general incorporation statute like the Botswana Companies Act the characteristic institution of the "second stag" is to define the relationship between professional managers and public investors (shareholders) with a view to rendering the former accountable to the latter and to placing control of business decisions in the professionals' hands.
From the standpoint of regulation, the function of company law under "stage one" is to protect the entrepreneurs from one another. This function is fulfilled by prescribing and enforcing rules of fair play among the members of the relatively small entrepreneurial associations which characterise "stage one". The informing principle is that there is an equality of power based on equal access to relevant information and a reasonable ability to enter into "consensual" legal relationships with each other. The Botswana Companies Act and the relevant case law represents this model of company law.

The function of company law under "stage two" is to facilitate the increased aggregation of capital through the public company and the growth of efficient stock exchanges. In contrast to "stage one", it is recognised that the participants' access to relevant information is unequal. The legal response is to impose fiduciary duties upon the professional managers (who are deemed to be endowed with superior information).

Some might argue that the current company law in Botswana which is based largely on the British 1948 Act is adequate since entrepreneurial activity in Botswana is still limited to the "stage one" mode of operation. In this they would, to a certain extent, be supported by the statistics on company registration in Botswana. To date, there is a total of 3884 registered companies in Botswana. Prior to independence there were only 270 (8% of the present total). After independence a total of 3614 (90% of the current total) have been registered. The overwhelming majority of the post-independence registrations have occurred in the last ten years. Out of the total of 3884 companies, 3818 (approximately 98%) are private and public companies account for approximately 2% (66 in all). On the basis of these statistics, there would seem to be no need for a revision of the legal mechanism in Botswana since the registration figures tend to confirm the view that Botswana is still firmly in the "stage one" league. However, with the arrival of the multi-national companies like BENCO and the increasing significance of the company (whether private or public and whether local or international) on the overall economic scene in Botswana, especially in the post-independence era, there is a need for a shift in the orientation of the regulatory function beyond facilitating fair play to protection of the public against economic calamities similar to the BENCO debacle. The necessity for a review of the existing framework is rendered even more urgent by evidence suggesting that in terms of sectoral participation in the Botswana economy, companies are active virtually in all the sectors of the economy including mining (43), farming and livestock (38), manufacturing (21), tourism (33), wholesale and retail (335), import/export (67), finance and investment (67), property development (204), transport (80), professional services (300), cultural and scientific (39), insurance (30), banking (4), garages (91), general services (248) and general trading. In terms of capital structure and aggregation, the registered companies range from such "giants" as De Beers Mining Company (Pty) Ltd (P161 million), Bamangwato Concessions Ltd (P122 million), Botswana RST Ltd (P80 million), Standard Bank (P20.6 million), Barclays Bank (P5 million) at one end of the spectrum to companies with a share capital of less than P1000 (totalling roughly 248).

This article argues that though Botswana's industrial and commercial system has not arrived at "stage two" (that is to say that large-scale corporate groups and a major secondary financial market have not developed), the relatively rapid expansion of company floatation in the post-independence era and a significant participation of multi-national enterprises in major sectors of the economy should justify the application of regulatory strategies which are normally associated with economies and legal systems at "stage two" typified by such institutions and roles as professional management, large public companies and the large numbers context. Though the
The Botswana Disclosure System

Under the Botswana Companies Act, it is compulsory for every economy, once in every calendar year, to hold an annual general meeting and to make and file with the Registrar within forty two days after the date of such a meeting, an annual return consisting of particulars regarding:

2.1. shareholders
2.2. directors
2.3. situation of registered company office
2.4. place where the share register is kept
2.5. share capital

In terms of the Act, there shall be annexed to the annual return:

2.6. a certified copy of every balance sheet laid before the company in general meeting during the period to which the annual return relates (including the accounts and the auditor's report).

2.7. a certified copy of the directors' report accompanying the aforesaid balance sheet.

The Act lays down detailed legal requirements regarding the form and content of company accounts. The Act has a general provision which requires every company to keep books of accounts with respect to:

2.8. all sums of money received and expended by the company
2.9. all sales and purchases of goods by the company

2.10. and the assets and liabilities of the company in order to give a true and fair view of the state of affairs and to explain its transactions.

More specifically, the Act requires the production and preparation of the following documents:

2.11. profit and loss accounts (eighteen months after incorporation and subsequently once at least in every calendar year)\(^{21}\)

2.12. a balance sheet\(^{22}\)

2.13. consolidated accounts in respect of holding companies\(^{23}\)

2.14. a directors' report (to be attached to the balance sheet in the case of a public company)\(^{24}\)

2.15. an auditor's report (which together with the accounts are required to be attached to the signed balance sheet)\(^{25}\)

In order to facilitate and ensure a professional audit, the Act mandates the appointment and remuneration of an independent auditor\(^{26}\) whose position the Act seeks to entrench and protect. The legislation lays down the qualifications for appointment as an auditor. Apart from being an outsider, the auditor must be a member of a body of accountants.

1. established by statute in any part of the Commonwealth;

2. established by statute in any country outside the Commonwealth designated by the Minister, by notice published in the Gazette, for the purposes of this paragraph; or

3. established in the United Kingdom and for the time being recognised by the Department of Trade and Industry for the purposes of the qualification of auditors of companies incorporated in the United Kingdom;

Persons who do not satisfy the above qualifications may be appointed as auditors if authorised by the Minister\(^{28}\).

The auditor in his report must state:\(^{29}\)

4. whether he has examined the securities, books, accounts and vouchers of the company and is satisfied with their existence;

5. whether he has obtained all the information he required;

6. whether proper and adequate accounts have been kept;

7. whether the company's balance sheet and profit and loss accounts are in agreement with the books of accounts and returns;

8. whether the accounts give a true and fair view regarding the state of the company's affairs and of the profit or loss for the relevant financial year;
9. and in case of a holding company whether the consolidated accounts have been properly prepared.

The Act grants the auditor somewhat extensive powers. These include:

10. the right of access to the books etc., including all current and former accounts of any subsidiary.

11. and the right to attend any general meeting and the right to be heard on any part of the business of the meeting which concerns him as auditor.

The Act requires the presentation of the auditor's report at the annual general meeting and furthermore the shareholders are granted the right to inspect it.

3. The Shortcomings of the Botswana System

The crucial role of the disclosure approach cannot be over-emphasised. It is the technique by which the public, investors and shareholders are protected from fraud. The relevant legal provisions in Botswana provide some degree of protection but such protection falls short of what would be considered to be sufficient this day and age.

The Botswana legal provisions are based upon the 1948 British Companies Act. The 1948 legislation formally recognised the shift from the pre-existing doctrine of capital maintenance (whereby companies were prohibited from distributing dividends in excess of the surplus of net assets over the amount of the paid up capital of the company) to the solvency test whereby the emphasis is placed on the calculation and presentation of the profit figure. The shift in focus meant that a company had to prepare a balance sheet and profit and loss account which had to conform to the format prescribed by the Act. An additional change was the requirement that a company with subsidiaries had to submit a consolidated balance sheet and profit and loss account. At the heart of the disclosure system are the financial statements. The fundamental problem in the Botswana context and elsewhere in English-speaking Africa is that the data as required by the 1948 Act in such statements is not full enough and moreover it is based on historic cost.

Financial statements such as the balance sheet if based on historic cost accounting principles may give a misleading picture of the real current value of the company's assets. This problem was, in the post-1948 era, recognised by the British Institute of Chartered Accounts. As part of the recommendations on Accounting principles the Institute conceded that:

The primary purpose of the annual accounts of a business is to present information to the proprietors showing how their funds have been utilised and the profits derived from such use. It has long been accepted in accounting practice that a balance sheet prepared for this purpose is an historic record and not a statement of current worth.

The irrelevance of the historic approach in assessing the current worth of an enterprise is particularly highlighted by the problem of rapid inflation, which is quite high in Botswana. This is more so in the process of determining profits in a given trading year. Enterprises in Botswana import a substantial portion of their raw materials and machinery from South Africa and abroad. The cost of these items has risen substantially and the indications are that this trend is likely to continue. In
these circumstances, the employment of the historic cost approach would mean that
the profit on the stock-in-trade and work-in-progress would be exaggerated since much
of the "profit" upon the sale of the goods will have to be used to procure new
machinery and raw materials at rapidly rising prices unless the business is to be wound
up.

The historic cost approach is also a drawback regarding the question of depreciation.
The normal practice in Botswana is to make provision for depreciation by charging a
fixed percentage of the original cost of the machinery against a given year's revenue.
Given the rising cost of imported machinery and plant, the prudent thing to do is to
base the percentage for depreciation on the anticipated replacement cost as opposed
to the original cost.

The overall effect of the historic cost methodology may be that companies in
Botswana may declare profits they have not earned, which, as the experience was in
the United Kingdom, may lead to major cash flow problems and thus cast doubt on the
efficacy of the disclosure system as an effective remedy. In the case of BENCO the
liquidators and auditors strongly hinted that the company had major cash flow
problems.38 Though they did not specifically attribute that problem to the use of an
inappropriate accounting methodology, the overall impression one gets is that such
might have been a partial cause.

In the United Kingdom as a response to the problems posed by the historic cost
accounting principles, a committee was appointed in 197439 to consider "whether, and
so how, companies should allow for changes... in costs and prices having regard to
established accounting conventions based on historic costs".40 The Committee in its
report argued that since accounts based on the historic costs do not reflect the
inflation factor, they are misleading to the investor and the investment analyst.41
The Committee therefore recommended the abandonment of the historic cost approach
and the adoption of the current cost approach.42 The Committee's recommendations
have not been translated into legislation though they have been accepted in principle
by the Institute of Chartered Accountants.43 The result is that in the United
Kingdom the balance sheet and the profit and loss accounts are now based on current
accounting principles.

In addition to the balance sheet and profit and loss account, British companies which
use the new system, produce for each year a statement of source and application of
funds and an appropriation account.44 The function of the former is to indicate the
flow of funds during the accounting period which affords more insight into the
relationship between the income statement (profit and loss) and the balance sheet at
the beginning and end of the accounting period45 whereas the latter indicates what
proportion of current cost profit and "holding gains" the directors consider should be
retained in the business having regard to their assessment of its needs.46

When the liquidator of BENCO's Lesotho operations was asked how BENCO went
bankrupt he said: "whether they were genuinely under-capitalised or whether they
were milking it is not clear because their records are a mess."47 It is submitted that
if BENCO had not been operated as a family concern (akin to a "stage one"
enterprise) but rather subjected to less open-ended controls by use of "stage two"
techniques such as more affirmative disclosure requirements (for example, the
requirement for the preparation of a statement of source and application of funds)
both Botswana and Lesotho would probably have been spared the economic
embarrassment precipitated by the BENCO crash.

Furthermore, United Kingdom companies may prepare a voluntary statement of share-
holders' net equity interest whose function is to reveal the net increase or decrease in
the net worth of the company from the standpoint of the shareholders after allowing for changes in the value of money.48

The South African disclosure system also seeks to reveal more information regarding the profitability and liquidity of the business. In addition to the production of the profit and loss accounts, the balance sheet and the directors' report, companies have to prepare a statement of source and application of funds.

4. Conclusion

The Botswana Companies Act is based upon the assumption that the major role of company law is to deal with the internal power structure of the company and to protect entrepreneurs from one another as opposed to the protection of the public including consumers, creditors and employees. The BENCO debacle eloquently points out that the need for the regulation of entrepreneurial activity in Botswana though still carried on within relatively small groups has moved beyond considerations of fair play as between entrepreneurs to requirements for the protection of the economy including the government, employees, creditors and consumers in general. It might be argued that since Botswana is a developing country, it has no need for complex rules such as those requiring inflation accounting and the source and application of funds. However, against the background of increased multi-national activity in the country and a rapid expansion in the rate of company floatation, there is a growing need for an effort to create public countervailing power as a mode of preventive cure for unbridled company operations without necessarily changing the existing internal power structure of the company. The focus should not be on the size and absolute number of companies operating in Botswana but rather on the fact that some of the problems normally presented to a legal system under "stage two" and beyond are objective correlates of the arrival of the multi-national firm on the business scene of an African country and the rather fast growth in relative terms of company floatation. The point to be emphasised is that though the number of companies may be small, their influence on the economy may not be inconsiderable.

While it is difficult to state the precise nature of the necessary changes, one can however at this stage suggest that the minimum content of a reform package should include the recognition that the traditional open-ended fiduciary duties of the directors are insufficient from the point of view of adequate policing of entrepreneurial activity in Botswana. In the United States and to a certain extent in the United Kingdom by virtue of the 1967, 1980 and 1981 Companies Acts the shift from the open-ended approach was marked by the enactment of securities laws. There is no necessity for such laws in a country like Botswana which is still a "stage one" economy. However in the United Kingdom securities regulations have been accompanied by efforts of professional bodies to regulate themselves and thereby influence corporate behaviour by prescribing inflation accounting and the preparation though not required by statute of a statement of source and application of funds as professional standards. An investigation of the effectiveness of a similar approach in the African context in general and Botswana in particular would be a timely exercise. In carrying out this exercise, two key issues would have to be clarified and determined. First it will have to be decided whether the additional accounting requirements though not required by statute should be governmentally imposed hence entailing the amendment of the Companies Act or whether prescription and enforcement should be through professional self-regulation by auditors and accountants. Secondly, the investigation should deal with the question of the added costs to the company if it is subjected to further governmentally imposed or voluntary affirmative disclosure requirements, for example, the preparation of a statement of source and application of funds.
Improvements in company reporting, however defined, undoubtedly require institutional reforms within the government machinery particularly those agencies responsible for enforcing company law. Ways to actualise the Companies Act [whether reformed or not] have to be found, and ways to improve the professional ability of the staff of the Companies Registry must be discovered. As stated earlier, when Benco collapsed in Botswana, it had not published accounts for two years. Nevertheless the company had had its trading licence renewed despite the non-publication of accounts as required by the licensing law. The shift to "stage two type" controls as a regulatory strategy over entrepreneurial activity is therefore no substitute for administrative efficiency. Indeed the imposition of greater governmental surveillance over entrepreneurial activity will place additional burdens on the administrators which will call for greater vigilance and efficiency. An interim solution may be as the case has been in the United Kingdom, to phase the imposition of stricter accounting standards over time. Initially only the major concerns, which are of strategic importance in the national economy of Botswana should be required to switch to the new standards. The smaller companies which have minor implications to the national economy can be subject to the new system at a much later stage.

Footnotes

4. Ibid.
5. Ibid.
6. Ibid, p.34
8. Police under Fire, supra note 2.
10. Ibid. p.570
11. Ibid.
12. Ibid.
13. The figures and other data were obtained from the Registry of Companies, Ministry of Commerce and Industry, Gaborone, Botswana. These figures represent the position as of 15/8/1982.
14. Ibid.
15. Ibid.
16. Ibid.
17. Ibid.
19. Ibid. s.96
20. Ibid. s.112
21. Ibid. s.113
22. Ibid.
23. Ibid. s.116
24. Ibid. s.119
25. Ibid. s.118
26. Ibid. s.122
27. See p.2 of the Companies (Amendment) Act, 1982
28. Supra note 18 s.24
29. Ibid
30. Ibid. s.125
31. Ibid. s.126
32. Ibid. s.123
34. Ibid.
35. Ibid.
37. Institute of Chartered Accountants in England and Wales: Recommendations on Accounting Principles, 1960 (cited by Tom Haden. Ibid.
38. See Tom Haden supra note 35.
39. Supra Note 1.
40. The Sandilands Committee on Inflation Accounting.
41. Tom Haden supra note 35 at p.134.

44. Haden, Tom, supra note 35, p.135.


48. Supra note 1.

49. (a) Henry Lunt supra note 44. (b) Haden, Tom, Supra note 35, pp.135-136.