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In this Issue

Junk Status Is Now a Reality – How Will It Affect Us?

- Why the muted response?
- The events so far ...
- Now what?
- The man in the street

Frightening Fraud Statistics – Protect Your Business Now!

- In Sub-Saharan Africa
- In global terms

SMMEs and BBBEE Firms: Government Wants To Do Business With You

- New regulations from 1 April -

May 2017

JUNK STATUS IS NOW A REALITY – HOW WILL IT AFFECT US?

Events have moved swiftly – on 31 March the Minister of Finance and the Deputy Minister were axed. Ratings agencies Fitch and S&P downgraded South African debt to junk status the next week.



Why the muted response?

In December last year when Mr. Nene was replaced as Finance Minister, it appeared we had fallen off a cliff – the Rand tumbled and interest rates spiked sharply. Since then there were four attempts to replace Mr. Gordhan and thus the market was not surprised by the events of 31 March.

Yet there have been consequences – interest sensitive stocks have dropped R190 billion, South African bonds have shed R100 billion in value, the Rand is 10% weaker versus the US dollar and the cost of financing South African debt has increased by R1 billion per year.

The events so far ...

how will they work?

### How Many Days A Year Do You Work For The Taxman?

- "Tax Freedom" Day gets later every year....
- Is this good or bad?
- Where to now?

### Aggrieved Minority Shareholders: You Have Plenty of Options

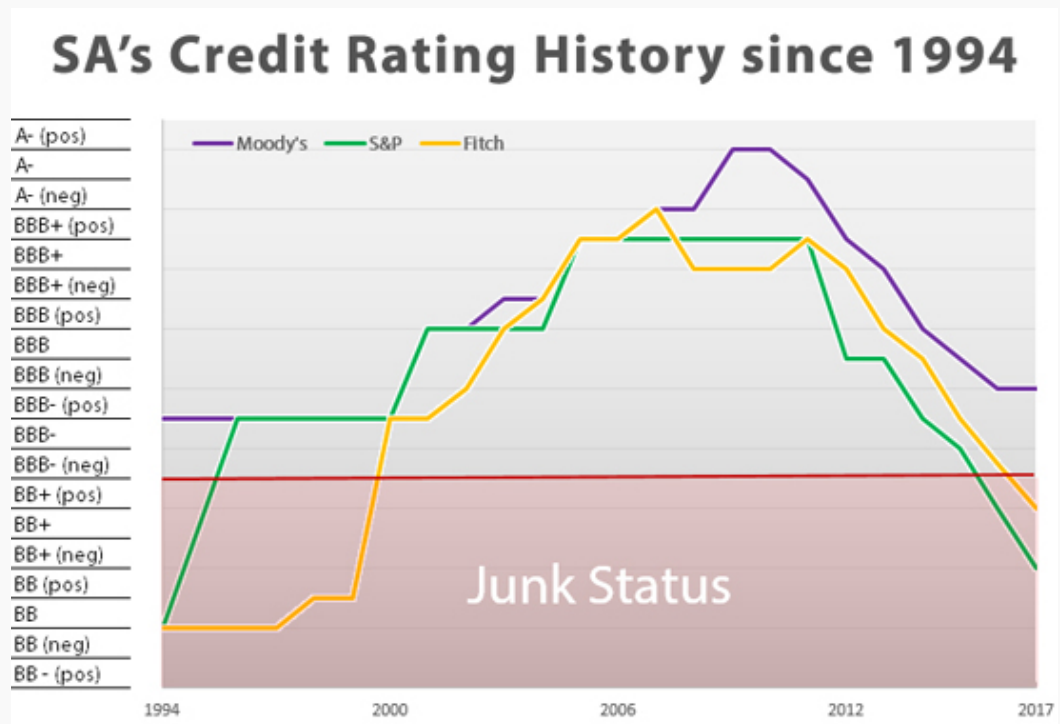
- What remedies are available to you?

### Your Tax Deadlines for May

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Two of the major rating agencies – Fitch and S&P - have downgraded our foreign denominated debt to junk status. Fitch has also downgraded our Rand denominated debt. Usually for rating downgrades to trigger selling of country assets, two of the three agencies need to declare junk status. As our foreign denominated debt is only 10% of our debt, the response has not been as dramatic as many expected. If our local debt receives a downgrade from Moody's (they are deciding how to react to March's events) this will have a much greater impact, particularly as 35% of local debt is owned by foreign investors.

We have been in junk status before following a debt default in the mid 1980s and we came out of junk status in 1999. See this chart of our grading history since 1994 –



Source: Adapted from a Nedbank chart

### Now what?

The new Finance Minister and his team need to rapidly re-establish credibility in the Treasury. The path of only paying what the nation can afford should remain in place and controls over State-owned entities (such as Eskom) should also be built on.

Mr. Gordhan had the confidence of offshore investors and both Fitch and S&P made it clear they feared that South Africa would not stick to current Treasury policies.

We can go one of two ways:

- Move along the path feared by ratings agencies which will lead to further bailouts of State businesses and increased government spending, e.g. on the nuclear program. This way will lead to lower or no economic growth and a steady downward spiral which could end up in further downgrades and an IMF bailout.
- Maintain the fiscal stance of the last twenty years which could prevent further downgrades and see the country in a year or two emerging from junk status.

### The man in the street

There will be less disposable income as petrol price hikes, a declining currency, more interest rate rises and stagnant economic growth curb our ability to improve living standards.

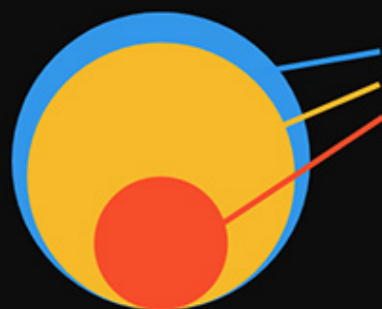
What is concerning is that surveys show that 30% of even "well-off" South Africans (i.e. they live comfortably and can cover future unplanned expenses) would struggle with an unexpected bill of R20,000. More and more people live at the margin and will be at even greater risk from the downgrade.

We can also expect unemployment to rise and investment to drop (particularly as foreign investment will substantially reduce). Considering GDP per head has not grown since 2013, you have to question how long the social fabric can hold.

Fin24's powerful Infographic "How Junk Status Will Affect You" below says it all -

# How junk status will affect you

With SA's sovereign credit rating now at junk status, or sub-investment grade, life for ordinary South Africans just got worse.



SA's 2017 budget is R1.56trn. Tax payers contribute R1.41trn towards this, while the remainder – R149bn – is borrowed.

The cost of borrowing will now increase as a result of the ratings downgrade, as government will have to pay more on debt costs. Treasury expects to pay R162.4bn in debt costs this year.

Government in R2.2trn debt = **50.7% of GDP**

For every R1 collected in tax, 13c must be diverted to service debt.



## How does junk status impact our economy?



South Africa will pay more towards interest on debt.



Borrowing costs will increase which means there will be less funds for infrastructure spending.



The rand may decline



Inflation may go up



The country's economy – which was predicted to only grow at just over 1% this year - will likely slow down due to the downgrade.



Possible repo and prime lending rate increase



## This is how it would impact you:



Your salary will likely not get increased, while inflation will continue to climb from 6.4%, meaning you will have less money to pay for items that will cost more.



Jobs will be at risk, meaning there could be job losses in various sectors.



Business and consumer confidence will decline, resulting in lower investments and spending. This will affect your own investments.



### Home loan

1 million over 20 years

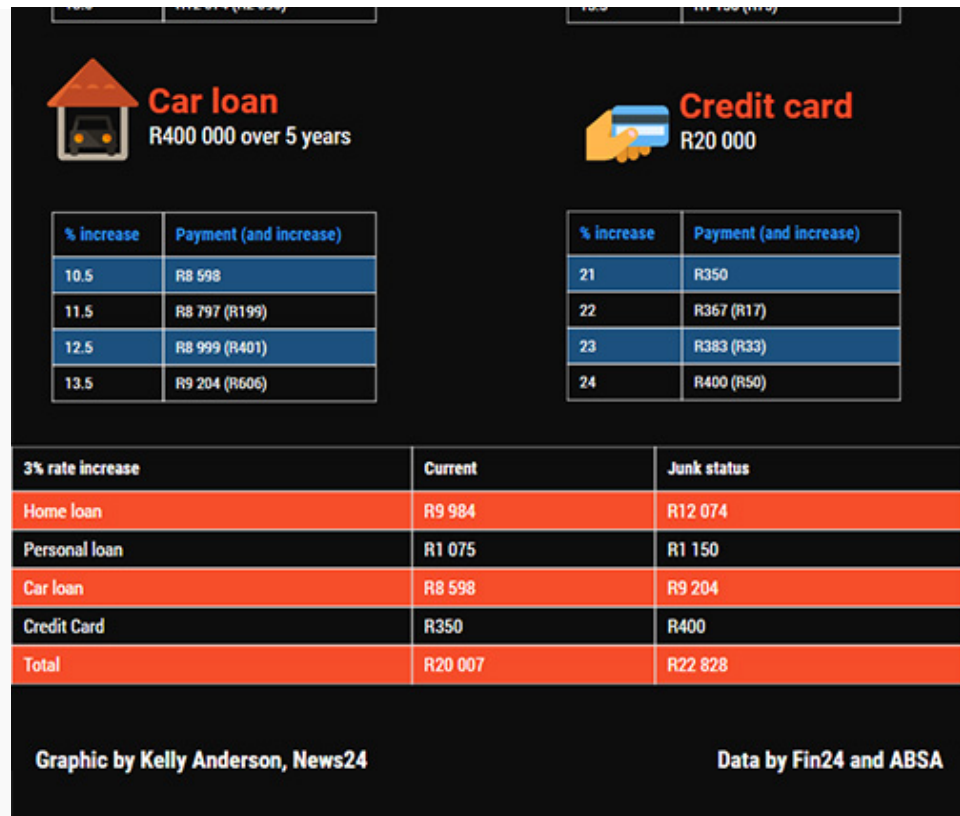
% increase	Payment (and increase)
10.5	R9 984
11.5	R10 664 (R680)
12.5	R11 361 (R1 377)
13.5	R12 074 (R2 090)



### Personal loan

R50 000 over 5 years

% increase	Payment (and increase)
10.5	R1 075
11.5	R1 100 (R25)
12.5	R1 125 (R50)
13.5	R1 150 (R75)



Source: Fin24

## FRIGHTENING FRAUD STATISTICS – PROTECT YOUR BUSINESS NOW!

A global organisation which focuses on internal (i.e. management, owners and staff) fraud, recently released some sobering findings. **Understanding them is your first step in protecting your business from serious loss.**



### In Sub-Saharan Africa

- Over 60% of frauds were committed by people with a degree (in view of the large number of fake degrees consider carefully checking qualifications when hiring).
- 82% of perpetrators were male with an average age of 38.
- 18% came from the accounting department, 17% from operations and 11% from purchasing.

### In global terms

- 5% of revenues are lost due to fraud. This applies to large and small entities but clearly will have a greater impact on small entities.
- The best method of fraud detection is by tip-off (approximately 30% of cases), followed by management review (15%), internal audit (12%) and account reconciliation (just under 10%). If you don't have a tip-off or whistle blower policy, now is the time to do it. Most of the other detection methods come from active management control.
- Most frauds come from asset theft and the largest (by value) from financial mis-statement.
- 90% of background checks did not pick up any indication of malfeasance and 82% of fraudsters had not been punished by their organisations. Something also to consider – and check with

previous employers - when recruiting.

- Fraud losses were detected much faster and the loss was 34% less in entities with strong controls.
- Those committing fraud typically showed some of these characteristics:
  - “Wheeler dealer” personalities
  - Financial problems
  - Living beyond their means
  - Control issues
  - Strong relationship with a vendor
  - Family difficulties such as divorce.

**Don't become a “fraud statistic” – analyse the risk factors listed above and take preventative action now!**

## **SMMES AND BBBEE FIRMS: GOVERNMENT WANTS TO DO BUSINESS WITH YOU**

The government spends over R500 billion annually on goods and services. Promises have been made for several years that government would promote small and medium-sized businesses (SMEs). Government has also promised to help emerging Black business through its Broad Based Black Economic Empowerment (BBBEE) program.



Now it has taken steps to follow through on this. From 1 April, new preferential procurement regulations have come into effect that favour SMMEs and BBBEE firms. The aim of these regulations is to channel R150 billion in procurement spend to these entities.

### ***New regulations from 1 April - how will they work?***

State and parastatal tenders depend mainly on price. In terms of the new regulations the percentage of points awarded for a tender that depend on price is 80% for tenders of R50 million or less, and 90% for tenders over R50 million.

Tenders may now be subject to pre-qualifying criteria which may contain any one of the following:

- A minimum BBBEE (Broad Based Black Economic Empowerment) status
- An Exempt Micro Enterprise (EME) status – turnover of R10 million or less; or a Qualifying Small Enterprise (QSE) status – turnover of R50 million or less
- If it is feasible to subcontract a tender of more than R30 million then the business that is awarded the tender must allocate 30% of the tender to
  - EMEs and/or QSEs
  - EMEs and/or QSEs with at least a 51% Black shareholding
  - A cooperative which is at least 51% Black owned
  - Any combination of the above.

**In essence this excludes companies that do not have the above criteria.** Thus, the state has put in the conditions for a large slice of its procurement to go to SMMEs and BBBEE businesses. It is now up to government and parastatal entities to use these new regulations.

SMMEs and BBBEE organisations should now follow tenders closely to see if they are eligible for a slice

of this R500 billion spend.

### HOW MANY DAYS A YEAR DO YOU WORK FOR THE TAXMAN?

In the last few years in particular we have been aware of tax increases. The Free Market Foundation measures how many days in a year it takes to pay our taxes (taking total taxes over total earnings – obviously in reality we pay taxes monthly, or twice-yearly for provisional taxpayers).

Compared to last year, it will take us two more days to pay tax – on 22 May we will have settled our owing to SARS and **only from the 23rd will we work for ourselves.** That's 142 days (4 months and 22 days) we've worked for the taxman.



#### ***"Tax Freedom" Day gets later every year ...***

Since 1994, the number of days taken to pay tax has risen by 29 days – if we stick with the current trends, it means that each successive generation will work one extra month to pay tax.

#### ***Is this good or bad?***

It depends how government is spending its money. If the money is going on infrastructural projects that will increase productivity, this will increase economic growth over the medium term. In South Africa's case the major trend has been the increase in the number of civil servants employed. Since 2009 our debt to Gross Domestic Product (GDP) has doubled which has put the country under unnecessary pressure and is one of the factors that alarms rating agencies.

#### ***Where to now?***

One of the issues that worried former Finance Minister Gordhan was the sudden decline in "tax buoyancy" which measures how revenue collections respond to changes in national income. For example, tax buoyancy would be positive if GDP rose by 1% and revenue collections increased by 2%. In the 2016/17 year SARS fell R30 billion short of its collection target for the first time since 2009.

Potentially this can mean that taxpayers are taxed to the hilt (remember 4% of the population pay the bulk of our tax) or perhaps more worryingly, what amounts to a tax revolt is beginning. The people who pay most of our tax have the resources to avoid tax (remember that whilst "tax evasion" is illegal, "tax avoidance" using tax laws legally is allowed) or to find work in another country.

### AGGRIEVED MINORITY SHAREHOLDERS: YOU HAVE PLENTY OF OPTIONS

The Companies Act gives directors substantial leeway to run a company and gives them considerable powers to do this. So how does it protect minority shareholders who disagree with how the directors operate the business?

#### ***What remedies are available to you?***

- A shareholder may seek court relief when there is "an unconscionable abuse" of the company's separate legal persona
- Shareholders may "demand" that the company purchase their shares at "fair value" in the event



of a:

- Change in the company's Memorandum of Incorporation (MOI)
  - Disposal of a large part of the company's assets
  - Merger with another business
  - Scheme of arrangement being entered into by the company.
- A shareholder may ask the court to protect his/her/its rights in matters affecting the MOI, company rules and company debt.
  - A shareholder may apply to court to have one or more directors declared delinquent.
  - If shareholders are being treated in an "oppressive" or unfair manner which prejudices their rights, the courts are given wide discretion. Inter alia, they can appoint new directors, restrain behaviour, change the MOI, award compensation to the prejudiced shareholder, issue shares, set aside transactions or require a trial be held.

The Supreme Court of Appeal in 2013 found in favour of a minority shareholder under this section.

- Shareholders may institute a derivative action by demanding the company take legal action against wrongdoers who have acted in a manner harmful to the company.

Whilst we are often told the Companies Act favours directors, there are numerous avenues sanctioned by the Companies Act to address grievances of minorities.

**Ask your accountant for help in doubt.**

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#### YOUR TAX DEADLINES FOR MAY

Your Employer Annual Reconciliation (EMP501) is due on 31 May.

Don't underestimate the amount of work involved in preparing and submitting this form, and ask your accountant for help in any doubt.



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