



**NATIONAL TREASURY
REPUBLIC OF SOUTH AFRICA**

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**TO : ACCOUNTING OFFICERS OF ALL NATIONAL DEPARTMENTS;
: ACCOUNTING AUTHORITIES OF ALL PUBLIC ENTITIES; AND
: HEADS OF PROVINCIAL TREASURIES**

**PRACTICE NOTE ON APPLICATIONS UNDER SECTION 54 OF THE PUBLIC
FINANCE MANAGEMENT ACT NO.1 OF 1999 (AS AMENDED) ("PFMA") BY
PUBLIC ENTITIES**

1 BACKGROUND

In terms of section 54(2) of the PFMA, before a public entity concludes any of the following transactions, the accounting authority for the public entity must promptly and in writing inform the relevant treasury of the transaction and submit relevant particulars of the transaction to its executive authority for approval of the transaction:

- (a) Establishment or participation in the establishment of a company;
- (b) Participation in a significant partnership, trust, unincorporated joint venture or similar arrangement;
- (c) Acquisition or disposal of a significant shareholding in a company;
- (d) Acquisition or disposal of a significant asset;
- (e) Commencement or cessation of a significant business activity; and
- (f) A significant change in the nature or extent of its interest in a significant partnership, trust, unincorporated joint venture or similar arrangement.

In addition, section 51(1)(g) requires the Accounting Authority for a public entity to promptly inform the National Treasury on any new entity it intends to establish or in the establishment of which it takes the initiative, and allow the National Treasury a reasonable time to submit its decision prior to formal establishment.

Furthermore, in terms of Treasury Regulation 28.3.1 of the PFMA, a public entity must develop and agree a significance framework with that entity's Executive Authority.

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NB This Practice Note is directed at approvals pertaining to section 54(2) and section 51(1)(g) of the PFMA only. Each public entity must still obtain all other legal approvals necessary, for example, the Companies Act and Exchange Control requirements, regulatory approvals, etc.

2 PURPOSE

This document seeks to provide guidance to public entities on the following:

- The development of the aforementioned significance framework;
- The information that should be submitted by an Accounting Authority to its Executive Authority in support of a section 54(2) application.

3 SIGNIFICANCE FRAMEWORK – GUIDING PRINCIPLES

3.1 Section 54(2)(a) [Establishment or participation in the establishment of a company]:

- 3.1.1** Any transaction of this nature that causes any interest (equity or loans) to be taken by the public entity in the company to be established, requires approval from the Executive Authority irrespective of its materiality or significance.
- 3.1.2** Concerning participation in the establishment of a company, where an interest (equity or loans) is to be taken by the public entity in the company to be established, any involvement by a particular public entity in the establishment process will necessitate an application for approval, regardless of the degree of involvement by that public entity.
- 3.1.3** Following from 3.1.1 and 3.1.2 above, where no interest (equity or loans) is to be had by the public entity in the company to be established, for example the public entity is only facilitating the formation on behalf of or with other parties in pursuance of a social objective, such participation need not necessitate an application.
- 3.1.4** It must be noted that the establishment (or participation in the establishment) by a public entity of any company that is domiciled outside the Republic of South Africa also falls under this subsection.
- 3.1.5** For purposes of establishment of an entity as envisaged under section 51(1)(g), the above principles will also apply.

3.2 Section 54(2)(b) [Participation in a significant partnership, trust, unincorporated joint venture or similar arrangement]:

- 3.2.1** Any transaction involving the above that entails incorporation under the Companies Act (or similar foreign legislation) should be dealt with under 3.1 above.
- 3.2.2** For transactions not entailing incorporation, significance is determined by a rand amount derived from the parameters outlined in 3.7 below.
- 3.2.2.1** However, participation in any partnership, trust, unincorporated joint venture or similar arrangement that is located outside the Republic of South Africa is to be regarded as significant, thus necessitating an application for approval, irrespective of the rand amount involved.

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3.2.3 For purposes of establishment of an entity as envisaged under section 51(1)(g), transactions not regarded as significant in terms of 3.2.2. and 3.2.2.1 above need not require an application.

3.3 Section 54(2)(c) [Acquisition or disposal of a significant shareholding in a company]:

3.3.1 Where any of the following occurs, the transaction is to be regarded as significant:

3.3.1.1 Where ownership control is affected; or

3.3.1.2 Where the public entity's right to pass or block a special resolution is affected; or

3.3.1.3 There is a change in shareholding of at least 20%; or

3.3.1.4 For an acquisition, any transaction that results in a shareholding of at least 20% in a company.

The Executive Authority is at liberty to specify a lower percentage on a case-by-case basis where it deems necessary, e.g. where the company concerned is domiciled in a foreign country.

3.4 Section 54(2)(d) [Acquisition or disposal of a significant asset]:

3.4.1 Although the acquisition or disposal of shares or of an interest in an unincorporated vehicle, as envisaged by sections 54(2)(b), (c) and (f), would also be an acquisition or disposal of an asset, such transactions are more appropriately dealt with under the guidelines for those subsections.

3.4.2 Assets classified as current assets according to generally accepted accounting practice need not be regarded as falling under this subsection.

3.4.3 The acquisition / disposal of all assets other than those referred to in **3.4.1** and **3.4.2** above should be regarded as significant if its rand value falls within the parameters outlined in **3.7** below.

3.4.4 Regarding the acquisition of assets through a finance lease, the principles in both **3.4.2** and **3.4.3** will apply.

3.5 Section 54(2)(e) [Commencement or cessation of a significant business activity]:

3.5.1 A business activity that falls within a public entity's core business need not be regarded as falling under this subsection.

3.5.2 A business activity that falls outside of a public entity's core business should be regarded as significant if its rand value falls within the parameters outlined in **3.7** below.

3.6 Section 54(2)(f) [A significant change in the nature or extent of its interest in a significant partnership, trust, unincorporated joint venture or similar arrangement]:

3.6.1 The significance of a change in interest as envisaged in this subsection, and thus the guidance per **3.6.2** to **3.6.4** below, should only be considered if the participation in the partnership, trust, unincorporated joint venture or similar arrangement was originally regarded as significant per **3.2** above.

3.6.2 Any change in interest the rand value of which exceeds the significance limits as determined per **3.7** below, should be regarded as significant.

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- 3.6.3 Where the nature changes between any of the vehicles (that is, between a partnership, trust, unincorporated joint venture or similar arrangement), this should be regarded as significant.
- 3.6.4 Any transaction that results in a cumulative interest of at least 20% in the vehicle (partnership, trust, unincorporated joint venture or similar arrangement) should be regarded as significant.
- 3.6.4.1 Any subsequent transaction that results in an increase of the cumulative interest by at least 10% in the vehicle (partnership, trust, unincorporated joint venture or similar arrangement) should be regarded as significant.

The Executive Authority is at liberty to specify a lower percentage on a case-by-case basis where it deems necessary, e.g. where the operations of the vehicle concerned is in a foreign country.

3.7 Guidance on setting the parameters for the rand value determination of significance for purposes of 3.2.2, 3.4.3, 3.5.2 and 3.6.2 above

It should be noted that in terms of Treasury Regulation 28.3.1, acceptable levels of significance must be agreed with the Executive Authority. In arriving at acceptable levels of significance, the guiding principles set out below should be applied.

- 3.7.1 The parameters are derived from the rand values of certain elements of the individual public entity's audited annual financial statements, as follows:

Element:	% range to be applied against R value
Total Assets	1% - 2%
Total Revenue	0,5% - 1%
Profit after tax	2% - 5%

The finalised rand amount to be applied for purposes of determining the significance threshold for each public entity will require sound judgment:

- The rand value of the above elements will differ from one public entity to the next;
 - The most appropriate % chosen within the range is also entity-specific;
 - The rand amounts calculated per element may require averaging in the interests of prudence;
 - Qualitative factors, for example, where the transaction is likely to result in large-scale retrenchments should also be taken into account.
- 3.7.2 The latest available audited financial statements should be used to calculate the above.
- 3.7.3 The elements as well as % range selected should be consistent from one year to the next.
- 3.7.4 The finalised rand amount should be reviewed at least annually.

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4 APPLICATIONS FOR APPROVAL

- 4.1** A public entity should address an application in terms of section 54(2) (and section 51(1)(g) if applicable) directly to its Executive Authority (accountable Minister), and to the Minister of Finance, who is the head of National Treasury.
- 4.2** Applications per **4.1** must be submitted simultaneously.

**5 GUIDANCE ON THE PROCESS TO BE FOLLOWED BY SUBSIDIARIES
WHEN MAKING A SUBMISSION FOR SECTION 54(2) OF THE PFMA
APPROVAL**

- 5.1** Where transactions envisaged under sections 54(2)(a) and 54(2)(c) occur, the guidelines under **3.1** and **3.3** should be followed.
- 5.2** Regarding transactions envisaged under sections 54(2)(b)(d)(e) and (f), the top-most holding company should agree a significance framework with each of its subsidiaries, by applying the parameters provided in **3.7** above to determine the rand value of the significance limit applicable to that subsidiary.
- 5.2.1** For any such transaction that exceeds the significance limit of a subsidiary, an application to the Executive Authority must be made, which application must be accompanied by approval from the board of the top-most holding company.
- 5.2.2** The top-most holding company may make an application to the Executive Authority on behalf of its subsidiary, provided that this is supported by a resolution to that effect by the board of that subsidiary.
- 5.3** Subsidiaries of subsidiaries should follow the same guidelines above.

**6 POST-APPLICATION: PRINCIPLES REGARDING THE 30-DAY
ASSUMPTION IN TERMS OF SECTION 54(3)**

- 6.1** The 30-day period commences from the date of receipt by the Executive Authority.
- 6.2** The offices of the Executive Authority as well as National Treasury should confirm the receipt of the application to the public entity in writing.
- 6.3** It must be noted that in terms of section 54(3), a longer period may be agreed to between the public entity and the Executive Authority, in which case the office of the latter must communicate its request in writing to the public entity within the 30-day period.

**7 GUIDELINES ON INFORMATION TO BE SUBMITTED TO THE
EXECUTIVE AUTHORITY IN SUPPORT OF AN APPLICATION IN TERMS
OF SECTION 54(2) OF THE PFMA**

These are provided in Annexure A.

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8 ACCOUNTING OFFICERS

In the case of national departments, it would be appreciated if the contents of this Practice Note are also brought to the attention of all public entities reporting to the Executive Authority responsible for your Department.

I trust that this arrangement will facilitate the easier conclusion of section 54(2) applications.



PHAKAMANI HADEBE
HEAD: ASSET AND LIABILITY MANAGEMENT
DATE 13/07/2006

(ANNEXURE A)

9 GUIDELINES ON INFORMATION TO BE SUBMITTED TO THE EXECUTIVE AUTHORITY IN SUPPORT OF AN APPLICATION IN TERMS OF SECTION 54(2) OF THE PFMA

Information required	Sec 54(2)(a)	Sec 54(2)(b)	Sec 54(2)(c)	Sec 54(2)(d)	Sec 54(2)(e)	Sec 54(2)(f)
	Generic Information ¹					
Transaction description and rationale: <ul style="list-style-type: none"> Public entity's objectives in wanting to pursue the transaction and its relation to the core business of the entity. 	✓	✓	✓	✓	✓	✓
Assessment of the entity's ability to execute the transaction: <ul style="list-style-type: none"> Financial and socio-economic objectives² of the transaction and its impact on government and the entity. Financial viability, i.e. cash flow analysis, estimates of future revenue, etc. Details of how the transaction will be funded. Identification of risks pertaining to the proposed transaction and strategies to mitigate those risks. Indicate whether an assessment was made of whether the proposed transaction is not in conflict with another public entity's core business. An indication of whether other alternatives 	✓	✓	✓	✓	✓	✓

¹ Information applicable to all transactions

² Emphasis being on the implication of the transaction on BEE, labour, poverty alleviation, Nepad objectives and skills development

"✓" Means that information has to be provided by that public entity making an application and "X" means that information is not required.

(ANNEXURE A)

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Information required	Sec 54(2)(a)	Sec 54(2)(b)	Sec 54(2)(c)	Sec 54(2)(d)	Sec 54(2)(e)	Sec 54(2)(f)
were considered. <ul style="list-style-type: none">An indication of how the success of the proposed transaction will be measured.Human capital capacity						
Transaction Approvals: <ul style="list-style-type: none">Board approvals i.e. extract of board resolution that gave effect to the proposed transaction. The Chairperson, the Chief Executive or the duly delegated official should sign the submission on behalf of the Board.Third party approvals and consultation, i.e. this section should identify all required approvals and consultation of all key stakeholders including regulatory authorities, labour and affected communities.	✓	✓	✓	✓	✓	✓
Transaction specifics information						
Country Profile Analysis³: <ul style="list-style-type: none">Economic overview of that country.Political overview and socio demographics of that countryCredit Risk profile of that country.Legal and regulatory framework for conducting business in that country.	✓	✓	X	X	X	X

³ Any transaction that involves a participation in any partnership, trust, unincorporated joint venture or similar arrangement that is located outside the Republic of South Africa,