

Executive Summary:

Review Engagements to be conducted in terms of the Companies Act, no. 71 of 2008

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1. Purpose of this document

SAICA has prepared this discussion document to garner the views of a broad range of players that will be impacted by the outcome of the Regulation to be published by the Minister of Trade and Industry in terms of the Companies Act, no. 71 of 2008.

The document has been published on the SAICA website for public comment for a period of 30 days. In addition, SAICA will engage with bodies such as the The Banking Association of South Africa, Business Unity South Africa, National Treasury, the Independent Regulatory Board for Auditors (IRBA) and the South African Revenue Service.

SAICA, jointly with IRBA, will prepare a submission to dti based on the outcomes of this process.

2. Objectives of the Corporate Law review process

The objectives of the Corporate Law review process include *inter alia*:

- A simplified corporate entity that will facilitate the growth and development of small business that will ultimately replace the Close Corporation;
- A low regulatory burden for such small business;
- In line with international best practice, the removal of the full statutory audit for small, privately-owned companies;
- Reducing the cost of compliance, including the reduction/elimination of the cost of assurance providers.

3. Audit thresholds

3.1 Entities required to be audited

According to Section 30 (2) of the Companies Act, no. 71 of 2008 (the Act), the annual financial statements of the following entities must be audited:

- a public company, or
- any other company considered to be desirable in the **public interest**, having regard to the economic or social significance of the company, as indicated by:
 - its annual turnover;
 - the size of its workforce; or
 - the nature and extent of its activities.

It should be noted that the above requirements would also extend to close corporations (CC). Accordingly, a CC that is considered as being in the public interest would also need to be audited.

3.2 What constitutes Public Interest?

Three factors are mentioned in Section 30 (2) of the Act as listed above. Individually or in combination, all three potentially are indicators in determining the level of public interest and impact that a company may have.

3.2.1 Quantitative thresholds (Annual turnover and size of workforce)

In previous research conducted by SAICA it was recognised that the public interest is not necessarily determined by simplistic size measures, such as turnover or workforce. SAICA has correctly asserted that, although turnover is often used in defining small and micro businesses, this is in itself not necessarily a reliable measure of public interest, which may be better measured by size of workforce and possibly balance sheet size. With reference to the latter, the absolute size of the balance sheet may also be unreliable as a public interest determinant.

3.2.2 Qualitative thresholds (Nature and extent of activities)

The nature and extent of a company's operating activities plays a key role in determining public interest. The stakeholders most affected by the nature and extent of the company's activities are its business partners, creditors, investors and environmental beneficiaries.

The nature and extent of a company's activities should take into consideration factors such as the:

- The nature of the industry and the company's relative role;
- The company's relative economic contribution in its geographic location;
- Its contribution to employment relative to the sector;
- National and strategic importance to the country;
- Competitive environment;
- Contribution to transformation goals of the country.

3.2.3 Recommendation for determining Public Interest

The nature and extent of a company's activities should be the central and consistent component of determining the extent of company's public interest. It is recommended that quantitative thresholds (such as turnover, number of employees and/or balance sheet size) only be used

as trigger for the assessment to be made, rather than as an individual determinant of public interest.

It is envisaged that such an assessment be done by the company itself as soon as one of the threshold triggers is reached. In the case of uncertainty or dispute with the dti, an independent assurance provider should review the company's assessment and provide an impartial opinion on the reliability and fairness thereof.

4. Reviews

4.1 Entities subject to annual review

Entities that are not considered to have public interest and entities that are not owner managed are required to have their annual financial statements reviewed.

4.2 Who may conduct the review?

In terms of S 30 (7) (b) the Act, the Minister may prescribe the manner, form and procedures for the conduct of an independent review other than an audit, as contemplated in subsection (2)(b)(ii)(bb), as well as the professional qualifications, if any, of persons who may conduct such reviews.

Option 1:

The Minister could approve a list of professional bodies with which practitioners must be registered in order to perform such a review engagement. Such a list is currently published by the Minister to indicate who may act as Accounting Officer for a close corporation.

Option 2:

A second option is to request that all authorised professional bodies allow for the registration of "Independent Reviewers".

The minister could stipulate what the minimum requirements are for professionals who wish to register as such.

The minimum requirements should include evidence that the professional has had adequate financial reporting experience or training by providing a list of recent assignments and training courses attended. The minimum requirements should also include having sufficient experience or training in assurance type services.

Professionals could address this by proving that they have had experience in providing assurance services or by attending training that deals with assurance type services, in particular applying the ISA Assurance Framework, ISQC 1, and the other standards that would impact the quality of the review.

These requirements will be in addition to the registration requirements already in place for the professional bodies.

4.3 Assurance standards to be used when conducting a review

A review engagement as performed in terms of International Standards on Review Engagements 2400 (ISRE 2400) involves performing audit procedures that are sufficient to provide the practitioner with a level of assurance and this is expressed as negative assurance in the report by the practitioner. Similarly to an audit performed in terms of ISAs, the review involves obtaining an understanding of the client's business and systems of control. It also requires that the practitioner comply with certain quality and ethical procedures. Thus, ISRE 2400 would be the most suitable standard to use when performing a review as envisaged by the Act. (See Appendix 1)

It should be noted that the IAASB's strategy and work program, 2009-2011 includes a plan to revise ISRE 2400 in a manner that would provide a better standard for services that provide acceptable alternatives to an audit of financial statements.

4.4 Users' Needs

Research is being conducted in terms of this discussion paper as to whether the form and content of the report provided in terms of ISRE 2400 for review engagements will satisfy the needs and expectations of major stakeholders.

5. Exempt Entities

In terms of Section 30(2)(bb), *An entity is exempt from having an audit and a review if it is:*

(i) a private company and—

(aa) one person holds, or has all of the beneficial interest in, all of the securities issued by the company; or

(bb) every person who is a holder of, or has a beneficial interest in, any securities issued by the company is also a director of the company unless the company has only one director, and that director is a person contemplated in section 69(12).

6. Questions for discussion

1. What do you expect / want from a review engagement?
In other words, what is your understanding of a review in terms of:
 - level of assurance provided (on a scale of 1 to 10)
 - procedures / work performed
 - reliance placed on the financial statements in terms of completeness, accuracy, etc.
 - the reporting framework adopted
 - what is the purpose of your reliance on the review?
2. Should the guidelines adopted for review engagements be based on international standards?
3. If so, would ISRE 2400 be an appropriate standard to use?
4. Who should be permitted to perform review engagements?
5. What level of regulation is expected or should apply to people performing review engagements?
6. Should thresholds used to determine public interest be quantitative, qualitative or both?
 - What quantitative criteria and levels do you deem appropriate?
 - What qualitative criteria and levels do you deem appropriate?
7. Are there any other factors that should be considered when determining public interest?
8. How, when and by whom should the threshold and public interest determination be made?
 - Should this be at company or group level?
 - At a specific date or over a period of time?
9. Should exempt entities be subject to some form of Financial Reporting Standards and assurance?

Appendix 1

Procedures i.t.o. ISRE2400

Procedures for the review of financial statements will ordinarily include the following:

- Obtaining an understanding of the entity's business and the industry in which it operates.
- Inquiries concerning the entity's accounting principles and practices.
- Inquiries concerning the entity's procedures for recording, classifying and summarizing transactions, accumulating information for disclosure in the financial statements and preparing financial statements.
- Inquiries concerning all material assertions in the financial statements.
- Analytical procedures designed to identify relationships and individual items that appear unusual. Such procedures would include:
 - Comparison of the financial statements with statements for prior periods.
 - Comparison of the financial statements with anticipated results and financial position.
 - Study of the relationships of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience or industry norm.

In applying these procedures, the practitioner would consider the types of matters that required accounting adjustments in prior periods.

- Inquiries concerning actions taken at meetings of shareholders, the board of directors, committees of the board of directors and other meetings that may affect the financial statements.
- Reading the financial statements to consider, on the basis of information coming to the practitioner's attention, whether the financial statements appear to conform with the basis of accounting indicated.
- Obtaining reports from other practitioners, if any and if considered necessary, who have been engaged to audit or review the financial statements of components of the entity.
- Inquiries of persons having responsibility for financial and accounting matters concerning, for example:
 - Whether all transactions have been recorded.
 - Whether the financial statements have been prepared in accordance with the basis of accounting indicated.
 - Changes in the entity's business activities and accounting principles and practices.
 - Matters as to which questions have arisen in the course of applying the foregoing procedures.
 - Obtaining written representations from management when considered appropriate.

Appendix 2 to ISRE 2400 provides an illustrative list of procedures which are often used. The list is not exhaustive, nor is it intended that all the procedures suggested apply to every review engagement.

The practitioner should inquire about events subsequent to the date of the financial statements that may require adjustment of or disclosure in the financial statements. The practitioner does not have any responsibility to perform procedures to identify events occurring after the date of the review report.

If the practitioner has reason to believe that the information subject to review may be materially misstated, the practitioner should carry out additional or more extensive procedures as are necessary to be able to express negative assurance or to confirm that a modified report is required.

Appendix 2
Form of Unqualified Review Report

REVIEW REPORT TO ...

We have reviewed the accompanying balance sheet of ABC Company at December 31, 19XX, and the income statement, statement of changes in equity and cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the International Standard on Review Engagements 2400 (or refer to relevant national standards or practices applicable to review engagements). This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with International Accounting Standards.4

PRACTITIONER

Date
Address

Appendix 3

Examples of Review Reports Other than Unqualified

Qualification for a Departure from International Accounting Standards

REVIEW REPORT TO ...

We have reviewed the accompanying balance sheet of ABC Company at December 31, 19XX, and the income statement, statement of changes in equity and cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the International Standard on Review Engagements 2400 (or refer to relevant national standards or practices applicable to review engagements). This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit, and, accordingly, we do not express an audit opinion.

Management has informed us that inventory has been stated at its cost which is in excess of its net realizable value. Management's computation, which we have reviewed, shows that inventory, if valued at the lower of cost and net realizable value as required by International Accounting Standards,⁵ would have been decreased by \$X, and net income and shareholders' equity would have been decreased by \$Y.

Based on our review, except for the effects of the overstatement of inventory described in the previous paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with International Accounting Standards.⁵

PRACTITIONER

Date

Address

Adverse Report for a Departure from International Accounting Standards

REVIEW REPORT TO

We have reviewed the balance sheet of ABC Company at December 31, 19XX, and the income statement, statement of changes in equity and cash flow statement for the year then ended.

These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the International Standard on Review Engagements 2400 (or refer to relevant national standards or practices applicable to review engagements). This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

As noted in footnote X, these financial statements do not reflect the consolidation of the financial statements of subsidiary companies, the investment in which is accounted for on a cost basis. Under International Accounting Standards,6 the financial statements of the subsidiaries are required to be consolidated.

Based on our review, because of the pervasive effect on the financial statements of the matter discussed in the preceding paragraph, the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with International Accounting Standards.6

PRACTITIONER

Date

Address