

The alternatives to audits following the new Companies Act

The Companies Act No. 71 of 2008, which was signed by the President on 8 April 2009, represents the culmination of a corporate law reform programme which was started as far back as 2004. Although gazetted, the new Act will only come into operation on a date still to be fixed by the President; currently this date is widely speculated to be 1 October 2010. Of particular relevance to auditors and companies alike, are the amendments pertaining to the mandatory requirement for an annual audit. The new Act distinguishes between two types of companies, namely profit and non-profit companies, with the former comprising public, private and state owned companies. Under the new Act, with a few exceptions, only public, state owned, certain non-profit and private companies holding assets in a fiduciary capacity will be subject to an annual audit.

But what of the companies that do not fall into these categories? What alternatives are there to a mandatory audit? According to Andrew Pitt, a Director at Moore Stephens South Africa, those companies which do not fall into the categories above will now be subject to either an independent compilation or review, depending on both annual turnover and assets.

“The DTI envisages three types of ‘limited assurance’ engagements under the new Act, namely an independent compilation, independent review in accordance with ISRE 2400 (International Standard on Review Engagements) or an independent review in accordance with ISRS4400 (International Standard on Related Services).”

Pitt explains that these engagements can be undertaken by any independent professional accountant who is a member in good standing of a professional body which in turn is a member of the International Federation of Accountants. This includes members of SAICA, as well as SAIPA (South African Institute of Professional Accountants).

“The implication of the introduction of the concept of an independent professional accountant (IPA) into the new Act is that it is not necessary to be a registered auditor in order to sign off such review/compilation engagements, although registered auditors are currently the only body of professional accountants subject to regulation and practice review by the Independent Regulatory Board of Auditors (IRBA).”

Independent Compilations

Independent Compilations, although likely to be significantly less expensive than that of an audit, do give rise to several concerns, mainly in terms of accountability and transparency of statements.

“The Draft Regulations give no guidelines as to the scope of procedures for an independent compilation, nor do they specify a formal financial reporting framework (such as IFRS for SME’s). Accordingly, there is concern that this will result in inconsistencies amongst compilers, and, since only registered auditors are subject to regulation by IRBA, there will be little regulation as to the standards and quality of financial statements prepared in terms of an independent compilation outside of those prepared by registered auditors. How this will be controlled, given the emphasis in the new Act on accountability and transparency in reporting, thus remains to be seen,” says Pitt.

Independent Review in accordance with ISRE2400

Pitt explains that the objective of a review of financial statements in accordance with ISRE2400 is to enable an auditor to state whether, on the basis of procedures performed (which do not provide all the evidence that would be required in an audit), anything has come to the auditor’s attention that causes them to believe that the financial statements are not prepared in accordance with an identified financial reporting framework.

“A review under ISRE2400 requires that the auditor (or as in the case of the Draft Regulations, the IPA) properly plans the engagement and obtains a sufficient knowledge of the business so as to determine the extent and nature of the review procedures. The procedures performed would typically include inquiries of management, high level balance sheet and income statement analytical procedures and limited high level substantive procedures (such as inspection of reconciliations, aged analyses and review of minutes and company records).”

So while the extent of the procedures might be less than those of an audit, the implicit cost savings are likely to be largely offset by the use of higher level resources by the auditor or IPA. “Accordingly, it is not likely that there will be significant cost savings for companies subject to this type of engagement under the new Act, when compared with an audit,” says Pitt.

Independent Review in accordance with ISRS4400

“The objective of an ISRS4400 agreed-upon procedures engagement is for the auditor to carry out procedures of an audit nature to which the auditor and the company (and any appropriate third parties) have agreed and to report the factual findings thereon. As the auditor simply provides a report of the factual findings of agreed-upon procedures, no assurance is expressed thereon. Instead, users of the report assess for themselves the procedures and findings reported by the auditor and draw their own conclusions from the auditor’s work,” explains Pitt.

“An ISRS4400 engagement will require typical audit type procedures, such as inquiry and analysis, observation, recalculation and obtaining confirmations and the scope of these procedures will be agreed upon between the auditor/IPA and client. As such, it is difficult to compare the cost thereof to an audit in general and such a comparison will have to be done on an individual engagement basis, depending on the scope of procedures agreed upon to be performed.”

Whilst there has been no indication yet that the DTI will in fact review these and other key aspects of the Act itself prior to effecting it, there have been a number of submissions made by the legal and accounting professional bodies to address what appears to be onerous elements of the Draft Regulations which give effect to the Act’s application. In the interim though, uncertainty and confusion appear to be the only certainties amongst auditors and attorneys alike.

“It is difficult for auditors to understand what the implication of the new Act will be on the cost of the preparation and review/compilation of statutory annual financial statements, what the scope of these engagements will entail and even who will be allowed to perform these,” concludes Pitt.

- end -