



Article (Internal Newsletter) – Prepared by Converg

The Companies Act, Companies Regulations and the Public Interest Score

Background

South Africa was introduced to The Companies Act 71 of 2008 and The Companies Regulations 2011 that became effective on 1 May 2011. This legislation set to bring about many changes including the dilemma that business owners are now faced with, including the choice between an audit or an independent review for some entities. This choice seems easy at first, due to the seemingly enticing cost saving of an Independent Review over an audit. However there is more extensive thought that needs to be put into making this decision.

This article deals with the following matters:

- The Public Interest Score
- Basis of preparation of annual financial statements
- Compilation of annual financial statements
- The auditing standards that govern audits and reviews
- Memorandum of incorporation

The Public Interest Score

The starting point to ascertain whether an audit or an Independent review is required by the Act and Regulations is the calculation of the entity's Public Interest Score (PIS). This score is required to be determined at the end of each financial year and the Regulations (Section 26(2)) set out the manner in which it should be calculated.

Public Interest Score – Calculation (S 26(2))

A Company's or Close Corporation's score will be the sum of the following:

- One point for every employee, taking the average **number of employees** during the financial year.
- One point for every R 1 million (or portion thereof) in **third party liability** of the company, at the financial year end.
- One point for every R 1 million (or portion thereof) in **turnover** during the financial year.
- One point **for every individual** who, at the end of the financial year, is known by the company
 - in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities or
 - in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company.

It is important to note that as an assurance firm, the calculation of the PIS should every year form part of the acceptance and/or continuance procedures.

Basis of preparation of Annual Financial Statements

The determination of the above score is pertinent, as it determines the level of assurance required and enables the business owners and the assurance providers to identify the basis on which the annual financial statements (AFS) should be prepared. Regulation 27 sets out guidelines on the basis on which AFS can be prepared and when the PIS has an effect on this decision. This Regulation has been included in the Appendix to this article.

Compilation of Annual Financial Statements

Now that the score has been calculated and the basis on which AFS are to be prepared has been determined, a further complication arises. This is whether the AFS is **internally** or **externally** compiled. This factor is very important as it could determine whether an audit or Independent Review is required. Although certain companies, such as public and state owned entities, require an annual audit, according to the Regulation 28 certain other companies only require an audit if they meet certain criteria during a particular financial year. These criteria are set out in the following tables which illustrate when a statutory audit or review is required:

Statutory Audit

The PIS is equal to or greater than 350	The company is subject to a Statutory Audit of its AFS.
The PIS is more than 100, but less than 350 AND the AFS is prepared internally	The company is subject to a Statutory Audit of its AFS.

Review

The PIS is more than 100, but less than 350 AND the AFS is prepared independently	The company is subject to a Review. A CA (SA) or Registered Auditor must carry out this Review.
The PIS is less than 100	The company is subject to a Review. Anyone who qualifies as an "Accounting Officer" of a CC may carry out this Review.

The Act provides an exemption to the above rule for owner-managed entities that have less than 350 points. Such owner-managed entities are exempt from the requirements to have their AFS audited or Independently reviewed. Sections 30(2A) of the Act has altered this exemption by stating owner managed entities are only exempt from a review if they fit in between 100 and 350. If their AFS are internally prepared and their score is between 100 and 350, they will still require an audit.

The auditing standards that govern Audits and Reviews

Audit

An audit has to be performed in line with the requirements set out by the International Standards on Auditing (ISAs)

Independent Review

There are currently two standards that govern independent reviews, ISRE 2400 (just over 15 pages) and ISRE 2410 (interim independent reviews). The current ISRE 2400 is under revision and an Exposure Draft(ED) (just over 85 pages) has been issued. The IAASB will consider and evaluate the comments received on the ED at their December 2011 meeting.

IAASB communication suggests that finalisation of the ED will only be by mid 2012, making a likely effective date for periods ending on/after 31 December 2013.

Memorandum of Incorporation (MOI)

It is important to note that although a statutory audit may not be required by what has been covered in this article, entities may elect to be audited. This is a consideration business owners should take into account before reaching a decision as to whether an audit or an Independent review should be performed. The assurance given may well outweigh the costs. Examples of situations that may influence a business owner`s decision include :

- If your entity has requested a loan or overdraft facility, the banks or lenders may still want to review the entity's audited AFS.
- If there is intention to sell the entity, the prospective buyer may want to review audited AFS.
- The desire to establish and uphold good governance.

A company that may not require an audit, but elects to be audited, has the option of including this election in the company's MOI. If this election has been included in the MOI, the company is required to be audited annually.

The MOI may subsequently be amended in terms of the steps required by the Companies Act should the company choose no longer to be audited. If the company does not include this election in the MOI, the company has the option to consider an audit annually and is not bound by any legal requirements.

Conclusion

It is also important to note that where the client has a choice of being audited or having an Independent review, as auditors we should be able to advise the client based on fact. However, the ultimate decision should be left to the client to avoid future challenges arising from the client's perception that we have advised one way or the other.

Acknowledgements and Sources

- Parliament of the Republic of South Africa – The Companies Act 71 of 2008
- Parliament of the Republic of South Africa – The Companies Regulations 2011

Appendix

Regulation 27

State owned and Profit companies

Category of Companies	Financial Reporting Standard
State owned companies.	IFRS, but in the case of any conflict with any requirement in terms of the Public Finance Management Act, the latter prevails.
Public companies listed on an exchange.	IFRS
Public companies not listed on an exchange.	Either: (a) IFRS or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.
Profit companies, other than state-owned or public companies, whose PIS for the particular financial year is at least 350 .	Either: (a) IFRS or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.
Profit companies, other than state-owned or public companies: (a) whose PIS for the particular financial year is at least 100 but less than 350 or (b) whose PIS for the particular financial year is less than 100 , and whose statements are independently compiled.	Either: (a) IFRS or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's or (c) SA GAAP.
Profit companies, other than state-owned or public companies, whose PIS for the particular financial year is less than 100 , and whose statements are internally compiled .	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed.



Precise. Proven. Performance.

MOORE STEPHENS

Non- Profit Companies

Category of Companies	Financial Reporting Standard
Non profit companies that are required in terms of regulation 28 (2) (b) to have their AFS audited.	IFRS, but in the case of any conflict with any requirements in terms of the Public Finance Management Act, the latter prevails.
Non profit companies, other than those contemplated in the first row above, whose PIS for the particular financial year is at least 350.	Either: (a) IFRS or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's.
Non profit companies, other than those contemplated in the first row above: (a) whose PIS for the particular financial year is at least 100, but less than 350 or (b) whose PIS for the particular financial year is less than 100, and whose financial statements are independently compiled.	Either: (a) IFRS or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's or (c) SA GAAP
Non profit companies, other than those contemplated in the first row above, whose PIS for the particular financial year is less than 100, and whose financial statements are internally compiled.	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed.