

## MEDIA COLUMN

*Issued by:*



### **Audit relief is at hand – provided you are sure you want it**

**By Theashen Vandiar**

Perhaps the most far-reaching of the new Companies Bill provisions is its removal of the requirement for all companies to be audited. Only public companies are obliged to be audited.

Entities that are not public companies have the option of an audit or an independent review. The decision is determined by public interest, the determining factors being the entity's economic or social significance, its turnover, size of workforce or the nature and extent of its activities.

The new audit dispensation, which grants businesses the option of avoiding the audit, thereby removes the administrative and cost burdens on non-public companies. Yet while such burdens may be removed, it is nevertheless imperative that non-public entities fully understand the options that are available to them and the pros and cons of each option.

There are two basic types of financial oversights that must be contracted from outside sources as envisioned by the proposed Companies Bill – a review or an audit. Each has its own pros and cons, with the significance lying in the value added by their performance.

A review assurance requires inquiry and analytical procedures. The review can be performed by a practitioner, who, however, need be a registered auditor.

The practitioner must:

- Comply with certain basic requirements of the professional standards;
- Have a basic knowledge of the client's business and industry, although not to the extent required for an audit; and
- Be able to determine whether there are any obvious departures from generally accepted accounting practice from reading the financial statements.

There should be a clear understanding between the practitioner and the client as to the services that are being provided.

The result of a review engagement is a report stating that a review has been performed in accordance with the Bill's stipulations, that a review is less in scope than an audit, and that the practitioner did not become aware of any requisite material modifications for the statements to conform with generally acceptable accounting standards or, if applicable, another comprehensive basis of accounting.

This is known as "Limited Assurance."

Unlike a review engagement, an audit provides the highest level of assurance. The audit must be performed by registered auditors and accountants, and requires the performance of verification and substantiation procedures, which may include direct correspondence with creditors or debtors to verify details of amounts owed, physical inspection of inventories or investment securities, inspection of minutes and contracts and other similar steps.

The result of an audit is a standard audit report that states an audit was performed in accordance with International standards on auditing, and expresses an opinion that the financial statements fairly present the entity's financial position and results of operations.

This is known as the expression of "Positive Assurance."

The pros and cons of each type of assurance are reflected in the accompanying tables.

### Review

<u>Pros</u>	<u>Cons</u>
Not as costly as an audit	Provides limited assurance
Provides an objective assessment of areas of interest or concern	Does not provide a basis for the expression of an opinion
Assists on investigations into possible frauds and irregularities	Provides limited legal protection against misstatements or errors in the financial records
	Most bank covenants require an annual audit; hence a review is not sufficient

### Audit

<u>Pros</u>	<u>Cons</u>
Positive assurance is issued	The performance of an audit is costly
Extensive enough to allow the auditor to form an opinion	Due to the extent of procedures, the audit extends over a longer period
Increased reliance can be placed on financial records by investors	High level of assistance required from client staff may result in distraction from daily duties
Provides an extent of legal protection against misstatements or errors in financial records	
Ensures credible financial reporting	

Improves internal controls	
Provides best practice advice	

Even though not compelled to have the financial statements audited, the board of directors of non-public companies should adhere to and invest appropriate funds for an annual audit, rather than trying to initially save money with a review. A recent UK survey found that of companies exempt from being audited, some 80% chose to have their financials audited.

Hopefully, non-public South African companies will also appreciate that the benefits and value derived from an audit far exceed the cost savings of a review engagement.

***Theashen Vandiar is the Project Director: Auditing at the South African Institute of Chartered Accountants (SAICA).***



Ashley Vandair