

Independent review of company financial statements

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ABSTRACT

One of the provisions in the *Companies Act 2008* which is particularly significant to the auditing profession in South Africa is the introduction of the independent review of financial statements of certain non-public interest companies as an alternative to the conventional audit of financial statements which is currently required for all companies. The *Companies Act 2008* provides for regulations regarding independent reviews to be drawn up by the Minister. This article presents a background study and analysis of what constitutes an independent review in order to provide a better understanding of this alternative to an audit of a company's annual financial statements.

It seems that the Draft Regulations regarding which companies should be audited and which independently reviewed will achieve the Act's primary objective of the protection of the public interest as they are primarily based on a company's activities and not on quantitative thresholds such as turnover and assets. A robust and well designed set of assurance standards for independent reviews is needed to provide the necessary guidance to practitioners who will conduct independent reviews. Contrary to the requirements in the Draft Regulations, it is suggested that an independent review should be performed by a person who is a member in good standing of a professional body accredited by the Independent Regulatory Board for Auditors, and not the International Federation of Accountants.

Key words

Independent review; Companies Act; Draft Regulations to the Companies Act; auditors; accountants

1 INTRODUCTION AND OBJECTIVE OF THE STUDY

According to the *Companies Act 1973* all companies in South Africa, both public and private, have a statutory obligation to appoint an auditor at every annual general meeting and to have their annual financial statements audited annually (South Africa 1973 sect 270 & 300). After the auditor has performed the audit function, he must then report to the shareholders of the company on whether or not the annual financial statements fairly present the financial position of the company and the results of its operations (South Africa 1973 sect 301). The *Companies Act* also states that only persons who qualify in terms of the *Auditing Profession Act 2005* (APA), can be appointed as auditors (South Africa 1973 sect 275).

However, the Department of Trade and Industry in South Africa (DTI) embarked on a process to completely reform the *Companies Act 1973*, which was already more than 30 years old (DTI 2007). The result was the signing into law of the *Companies Act 2008* on 8 April 2009 (South Africa 2009), which is

due to come into effect in 2011 (South African Institute of Chartered Accountants (SAICA) 2010/09/29). This Act is a significant departure from the existing statute and completely reforms the *Companies Act 1973* in line with international trends. The aim of the redrafting of the *Companies Act* was to modernise the legislation, to align it with international best practice, and to promote entrepreneurship and enterprise development. It attempts to achieve this by reducing the costs of registering and maintaining a company and by reducing the regulatory burden on smaller companies (SAICA 2007/04/02).

The *Companies Act 2008* requires that companies other than public companies only need to be audited if it is desirable in the public interest. Otherwise those companies can either be audited voluntarily or independently reviewed. (If it is a private company and securities issued by the company are held by one person, or every person who holds or has a beneficial interest in the securities issued by the company is also a director of the company, it is exempt from statutory audit.) (South Africa 2008 sect 30(2).) However, the *Companies Act 2008* (South Africa 2008 sect 30(7)) provides for regulations to be made

by the Minister regarding:

- the categories of private companies that are required to have their annual financial statements audited (where it is in the public interest, as indicated by its annual turnover, the size of its workforce or the nature and extent of its activities);
- the manner, form and procedures for the conduct of an independent review other than an audit; and
- the professional qualifications of persons who may conduct such reviews.

The Companies Act has as its primary objective, the protection of the “public interest” in the conduct of business in South Africa (Independent Regulatory Board for Auditors (IRBA) 2009/09/08). Hence the regulations to be developed for the Companies Act should also achieve this overarching objective. Within the DTI the Consumer and Corporate Regulation Division (CCRD) is responsible for the drafting of the necessary regulations (DTI 2009/09/08). After consultation with various stakeholders and the receipt of comments on the document from the different role players they issued, ahead of consultations, *Issues for Discussion 7 and 11 August 2009* (DTI 2009/09/08), Draft Regulations to the Companies Act were released for comment on 22 December 2009 (DTI 2009).

This article will, by means of a literature review, investigate international standards, regulations and laws regarding the independent review of the financial statements of a company, in order to provide a better understanding of this alternative to an audit of a company's annual financial statements. The objectives of this article are to find answers to the following questions:

- 1 What is an independent review?
- 2 Which entities should be independently reviewed?
- 3 What are the manner, form and procedures for the conduct of an independent review?
- 4 Who should perform independent reviews?

This research could be instrumental in the development of the final regulations. It could also provide practitioners about to perform independent reviews with a better understanding of the independent review concept.

The remainder of this article explains firstly what the differences between an audit and an independent review are, and secondly it investigates which companies should be independently reviewed. Then the manner, form and procedures for independent reviews are examined, taking into account the responses received to the Consultation Paper dealing with Review Engagements, issued by the National Standard Setters (NSS) Task Group in March 2008. Lastly the required professional qualifications enabling practitioners to perform independent reviews are researched.

2 DIFFERENCES BETWEEN AN AUDIT AND AN INDEPENDENT REVIEW

According to the International Framework for Assurance Engagements the objective of any

assurance engagement, be it an audit or a review, is to enhance the degree of confidence users of financial statements have in the statements (International Auditing and Assurance Standards Board (IAASB) 2005a par 7). More specifically the objective of an audit of financial statements is to enable the auditor to express an opinion as to whether the financial statements have been prepared, in all material respects, in accordance with an applicable financial reporting framework (IAASB 2005c par 2) and the objective of a review of financial statements is to enable a practitioner to reach a conclusion as to whether, on the basis of the performance of procedures which do not provide all the evidence that would be required in performing an audit, anything has come to the practitioner's attention that causes the practitioner to believe that the financial statements have not been prepared, in all material respects, in accordance with an applicable financial reporting framework (IAASB 2006b par 3). In the case of an audit, the auditor is required to give positive assurance but in the case of a review the practitioner is required to give negative assurance. In contrast to audits, where a *reasonable level* of assurance that the information subject to audit is free of material misstatement is provided, a review engagement provides a *moderate level* of assurance that the information subject to review is free of material misstatement (IAASB 2005c par 17 & IAASB 2006b par 9). According to the International Federation of Accountants (IFAC) (2008) the main objective of a review is to provide assurance at a lower cost.

Engagement risk pervades all assurance engagements. A review of financial statements is an assurance engagement and the objective of an assurance engagement from the point of view of the practitioner is to reduce assurance engagement risk to an acceptably low level. The level of assurance engagement risk that is deemed “acceptable” to the practitioner is determined with reference to the level of assurance the practitioner can obtain from his procedures and reviews of business and accounting processes. The level of assurance is therefore directly linked to the amount of money the client is prepared to pay for the time the auditor spends on the task. This is then the basis for expressing the conclusion for the engagement (IAASB 2005a par 48). Thus, from the auditor's point of view, the acceptable level of engagement risk for a review is higher than that of an audit, and the nature, timing and extent of procedures implemented to obtain evidence is limited relative to an audit. An *audit* is a reasonable assurance engagement: therefore, reducing audit risk to an acceptable level involves obtaining an understanding of the business; performing a detailed and documented risk assessment, including an assessment of internal control; testing of internal control, and obtaining audit evidence during substantive procedures, before a positive conclusion is expressed in the report (Fédération des Experts Comptables Européens (FEE) 2008:6, IFAC 2008:4 & Institut des Reviseurs d'Entreprises (IRE) 2008:3-4). A *review* is a limited assurance engagement: therefore, the acceptable level of engagement risk is higher than in an audit; the nature, timing and extent

of evidence-gathering procedures is limited when compared to an audit, and this limited basis from which to draw a conclusion is indicated by the expression of a negative review conclusion in the report (IAASB 2005a par 11). The CCRD stresses that an independent review is not simply another name for an audit: a review is something less rigorous, less burdensome, less onerous and less costly to the company (DTI 2009/09/08).

3 WHICH COMPANIES SHOULD BE INDEPENDENTLY REVIEWED?

In South Africa, up to now, the audit has been a statutory requirement for all companies. However, the *Companies Act 2008* has introduced exemptions from audit to entities that would previously have been required to have an audit (South Africa 2008 sect 30(2)(b)). According to the Act the regulations should determine which companies, other than public companies and state-owned companies, should have their annual financial statements audited (i.e. where it is in the public interest, as indicated by its annual turnover, the size of its workforce or the nature and extent of its activities). As the Companies Act has the protection of the public interest as its overarching objective the regulations that determine if a company should be audited or independently reviewed should also achieve this objective. Research conducted by the SAICA (2009/09/08) indicated that public interest is not necessarily determined by size measures, such as turnover or workforce. The nature and extent of a company's operating activities play a key role in determining public interest. Quantitative thresholds, such as turnover, number of employees and balance sheet size should therefore only be used as triggers for the assessment to be made, rather than as an individual determinant of public interest. The SAICA (2009/08/27) recommend that a model similar to that used in the United Kingdom (UK) be adopted where the determination of whether or not an audit is required is made on the basis of whether or not a company exceeds at least two of three thresholds, namely turnover, total assets and number of employees. The IRBA (2009/09/08) also supports regulations which are based on qualitative measures such as level of accountability, as opposed to regulations which are based on quantitative measures, to ensure protection of the public interest. Quantitative thresholds, such as turnover or size of workforce, will create complexities for companies to determine whether or not they meet them and are likely to encourage manipulation by owners to deliberately fall below the thresholds (IRBA 2009/09/08).

The Draft Regulations to the Companies Act (DTI 2009) firstly use activity as a basis to regulate which companies, except for public companies and state-owned companies, should be audited. Companies (profit and non-profit companies) *holding assets in a fiduciary capacity* should be audited (sect 29). The Draft Regulations (DTI 2009) then distinguish, on the basis of thresholds (turnover and assets), which companies that need not be audited, or choose voluntarily to be audited, or are exempt from being audited or reviewed, should be independently

reviewed. Companies with assets greater than R100 million or turnover greater than R200 million per annum should be independently reviewed (sect 30(1)&(2)). It thus seems that the regulations regarding which companies should be audited and which independently reviewed will achieve the overarching objective of the protection of the public interest as they are primarily based on a company's activities and not on quantitative thresholds such as turnover and assets. However, it seems that this is an area that should be further researched.

Despite the exemption from being audited, experience in other countries shows that many companies continue to have their financial statements audited (Hickey 2007). The IFAC (2008) stresses the fact that reviews should be very clearly distinguishable from audits, as well as being cost-effective, in order for them to be taken up by markets. According to a study by the UK's DTI in 2003 the factors which influenced the directors' decisions whether to have their financial statements audited or not, were (Collis 2003):

- the size of the company in terms of turnover;
- the positive impact of the audit report on the company's credit rating; and
- the bank and other finance providers' need for a copy of the audited financial statements.

In South Africa bankers have indicated that they are likely to continue to require audited annual financial statements from entities as they do not understand the level of assurance they might obtain from a review report, as opposed to an audit report (IRBA 2009/09/08).

On the other hand the main reason why directors of private companies might decide to take up the audit exemption was to save on audit fees and the administrative burden of an audit (Collis 2003 & FEE 2008:2). A study by the Auditing Practices Board in the United Kingdom (APB UK) (2001:iv) confirmed that the independent review could, in some circumstances, give rise to significant cost savings when compared to an audit.

Internationally the development of the review as an alternative to the audit shows great variety (NSS Task Group 2008:6). In some countries, for example the United States and Canada, reviews have gained wide acceptance (NSS Task Group 2008:5&11). Until now, reviews have not been widely used in many European jurisdictions because their regulatory structures have not required it; there are low statutory audit exemption thresholds, and because of perceptions that it is not relevant to their circumstances. The increases in the audit exemption thresholds in various European Union Member States, with more expected in the future, will result in fewer smaller entities being subject to a statutory audit, and this is likely to increase the demand for alternative assurance services, pitched somewhere between an audit and a compilation (FEE 2008:2&4). In the UK review engagements are not that common. However, many small charities are subject to independent examinations which are similar to

reviews (APB UK 2008).

It seems that companies want some form of assurance on their financial statements but also want to save on costs. Review engagements can fill this gap. The Regulations which determine which companies, other than public and state-owned companies, should be audited seem to have taken into account the protection of the public interest on the one side and affordable assurance for small companies on the other side.

4 MANNER, FORM AND PROCEDURES OF INDEPENDENT REVIEWS

The IAASB of the IFAC is responsible for the issuing of International Standards on Auditing (ISAs) and International Standards on Review Engagements (ISREs). Since 2005 the entire suite of International Standards has had to be applied by all Registered Auditors (RAs) in South Africa (IRBA 2009/09/08). Included in the ISREs is ISRE 2400 *Engagements to Review Financial Statements*, which has been effective for reviews of financial statements beginning on or after 15 December 2006. The most suitable standard to use when performing an independent review of annual financial statements of companies that are deemed to be exempt from an audit, and do not choose to have a voluntary audit, is thus ISRE 2400. The Draft Regulations (DTI 2009 sect 30(3)) indeed state that an independent review should be performed according to ISRE 2400. This is in line with the DTI's objective to bring South Africa's corporate law in line with international best practice. However, according to ISRE 2400 (IAASB 2006b par 2) practitioners should get guidance in the ISAs when applying ISRE 2400.

In response to the anticipated international increase in demand for independent reviews, the IAASB decided to revise ISRE 2400 in order to provide a better standard for services that provide an acceptable alternative to an audit of financial statements (IAASB 2008:8). A NSS Task Group, which comprises New Zealand, Canada and South Africa, was formed. The NSS Task Group issued a Consultation Paper in 2008 with the aim to get feedback on a number of significant matters pertinent to the IAASB's planned revision of ISRE 2400 (Fischer 2008:29 & NSS Task Group 2008). Responses were received from nine NSS namely: Auditing and Assurance Standards Board in Canada (AASB Canada), IRE (Luxembourg), Institute of Chartered Accountants in England and Wales (ICAEW), Association IEC (International), APB UK, IFAC, IRBA, FEE and Compagnie Nationale des Commissaires aux Comptes (CNCC) and Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC) (France). These responses formed the bases of the document entitled, *ISRE 2400 Engagements to Review Financial Statements - Issues and IAASB Task Force Proposals*, submitted to the IAASB in June 2009 (IFAC 2009).

From the responses to the NSS Task Group Consultation Paper it appeared that most of the respondents were in favour of the proposal that the

standards on review engagements should stand alone (AASB Canada 2008:9, Association IEC 2008, CNCC & CSOEC 2008:6, FEE 2008:10, ICAEW 2008:15, IFAC 2008, IRBA 2009/02/04 & IRE 2008:7). A separate set of review standards would avoid the need for practitioners who only perform reviews to refer to and understand auditing standards in order to perform a review. A stand-alone set of standards is likely to enhance the quality of reviews because they would be simple to refer to and would obviate the need to analyse the ISAs (AASB Canada 2008:9). A stand-alone set of standards would also clearly distinguish a review from an audit. The IAASB agreed to this proposal during their meeting in June 2009 (IFAC 2009).

Some of the main issues that should be addressed in the revised review standard should be: the level of assurance; the nature, scope and extend of the procedures, and reporting.

4.1 Level of assurance

According to a study by the IAASB in 2002, conducted amongst more than fifty firms from around the world, the level of assurance in the case of an audit was found to be between 55% and 98%, while in the case of a review it was between 10% and 88% (IAASB 2002). These are similar to the results of a survey conducted in 1993 in Canada where the level of assurance in the case of an audit was between 60% and 100% and in the case of a review it was between 0% and 90% (NSS Task Group 2008:10). These results indicate that practitioners are not sure about the level of assurance they are providing, most dramatically in the case of a review, which can result in significant differences in the procedures they perform. The IRBA (2008:3) is also of the opinion that the concept of a moderate level of assurance is not well understood by either practitioners or users of a review engagement report. The IFAC (2008) confirms that there is confusion amongst practitioners as well as users with respect to the scope and nature of reviews.

Besides the fact that the level of assurance which a practitioner is giving is based on his professional judgement, an obvious reason for the apparent uncertainty about the required level of assurance in the case of reviews might be that the term *moderate assurance* is undefined. ISRE 2400 does not give a definition of the term. Additionally, the Glossary of Terms and the International Framework for Assurance Engagements (IAASB 2005a par 11&48 & IAASB 2006a), as well as International Standard on Assurance Engagements (ISAE) 3000 (IAASB 2005b par 2), use the term *limited assurance* and not *moderate assurance*.

From the responses to the NSS Task Group Consultation Paper it appears that the use of the terms *moderate* and *limited assurance* varies from one jurisdiction to another. Some respondents prefer the term *limited assurance* (Association IEC 2008, ICAEW 2008:6, IFAC 2008, IRBA 2008:3 & IRE 2008:2). The IFAC (2008) is of the opinion that the use of the term *moderate assurance* is likely to create

an expectation gap, however the term is used and preferred in France (CNCC & CSOEC 2008:2). According to the AASB Canada (2008:1) the term *limited assurance* is too vague. They favour the term *review level assurance*. However the respondents indicated a significant preference for use of the term *limited assurance* to indicate the required level of assurance for a review of financial statements. The reason offered for this was that *moderate assurance* implies a degree of precision in the level of assurance that is not obtained in a review. The term *limited assurance* is seen as being a more accurate descriptor of the level of assurance actually obtained (IFAC 2009). The diversity of responses to the NSS Task Group Consultation Paper emphasises the necessity to streamline and standardise the terminology.

4.2 Nature, scope and extent of procedures

Amongst the European jurisdictions the approaches to reviews and the scope and extent of review procedures varies considerably (FEE 2008:4). Some jurisdictions are in favour of a risk-based approach (CNCC & CSOEC 2008:4, FEE 2008:6, ICAEW 2008:9, IFAC 2008:5, IRBA 2008:6 & IRE 2008:4) while some are in favour of a procedure-based approach (APB UK 2008, Association IEC 2008 & FEE 2008:4). The NSS Task Group (2008:14) confirms that in jurisdictions where reviews have been performed for many years there is a longstanding controversy among practitioners about whether or not reviews should be risk-based. Practitioners in favour of a procedure-based approach feel that the risk-based approach would require greater work effort and would therefore increase costs. Those in favour of a risk-based approach believe that it can be followed without an escalation of costs, and that the quality of reviews will be increased.

The NSS Task Group (IFAC 2009 sect C) is of the opinion that the practitioner should, based on his understanding of the industry, the entity and its environment, focus inquiries and analytical procedures in those areas where the practitioner believes there is increased risk of inconsistency between the financial statements and the practitioner's understanding.

Some of the respondents to the NSS Task Group Consultation Paper (CNCC & CSOEC 2008:3 & IRE 2008:5) asked for further guidance than what is at present in ISRE 2400 regarding the procedures to be performed by practitioners. Most of the respondents to the NSS Task Group Consultation Paper agree that the procedures contained in Appendix 2 of ISRE 2400 should be used as a guide or as application material, and not be treated as mandatory procedures (Association IEC 2008, CNCC & CSOEC 2008:4, FEE 2008:5, IFAC 2008 & IRE 2008:3). Some respondents to the NSS Task Group Consultation Paper warned that providing too much detail in a review standard and an over-regulation of work to be conducted by a review, which will lead to increasing demands for documentation of the process, will reduce flexibility and cost-effectiveness (Association IEC 2008 & ICAEW 2008:5). The ICAEW (2008:8)

supported principle-based guidance because a detailed work programme does not encourage the exercise of professional judgement, which is important in performing reviews. According to a study the ICAEW (2008) performed, practitioners expressed concerns about prescriptive guidance and standards as these might result in the performance of procedures irrelevant to the objective of the engagement. The use of professional judgement appears to be fundamental to the review's need to be flexible and cost effective.

Unless practitioners are consistent in their approach to the procedures to be performed in a review, the extent of work performed is likely to vary substantially from one practitioner to another, resulting in different levels of assurance and disparate costs reflecting the diversity of the work performed.

4.3 Reporting

In some European jurisdictions the negative form of the conclusion is widely used and accepted while in others such reporting is poorly understood (FEE 2008:3). The IAASB (2002) also raised concerns as to whether the negative form of assurance contained in the review report is the best way to communicate the level of assurance that has been derived from the engagement. Some respondents to the NSS Task Group Consultation Paper (CNCC & CSOEC 2008:8, ICAEW 2008:14 & IRBA 2008:10) were of the opinion that the negative form of expressing a conclusion is appropriate because this limited assurance is in clear contrast with the reasonable (positive) assurance provided by an audit. According to ICAEW (2008:6&14) users appear to be reasonably familiar with negative conclusions and stakeholders do not appear to have difficulties in understanding the negative form of assurance. However, the IAASB agreed that the NSS Task Group should explore the possible use of a positive form of expression of the review conclusion which would signal more clearly the limitations of the review engagement (IFAC 2009).

Although the IRBA (2008:10) favours a flexible format for the review report, most respondents to the NSS Task Group Consultation Paper were not in favour of a flexible report as they believed it would make it more complex (AASB Canada 2008:9, CNCC & CSOEC 2008:8, ICAEW 2008:14 & IFAC 2008). It would also reduce the consistency of review reports, thus potentially misleading and confusing the market with respect to the extent of work performed and the extent of comfort given by this form of work (AASB Canada 2008:9 & ICAEW 2008:14). The IFAC (2008) confirms that flexible reports would lead to further inconsistencies in practice and more confusion in the marketplace.

Thus the review report should describe the scope of the engagement so that it is clear that an audit has not been performed, that the procedures undertaken provide less assurance than those of an audit, and therefore that an audit opinion has not been expressed. There should be proper guidance on the format of the review report and the statement of the negative form of assurance expressed in the review

report. Users of review reports should also be educated as to the level of assurance provided in a review report.

5 PRACTITIONERS PERMITTED TO PERFORM INDEPENDENT REVIEWS

According to the Draft Regulations (DTI 2009 sect 30(2)(b)) independent reviews should be performed in accordance with ISRE 2400. ISRE 2400 (IAASB 2006b) lists the following attributes or abilities required of practitioners performing reviews [emphasis added]:

- The review should be planned and performed with an attitude of *professional scepticism* (par 6).
- *Judgement* should be applied in determining the nature, timing and extent of review procedures (par 18).
- *Judgement* should be applied as to what is material; the same materiality considerations apply as in the case of an audit (par 19).
- Based on the work performed, an *assessment* should be made as to whether there is any evidence that the financial statements are not presented fairly and in accordance with the identified financial reporting framework (par 24).

ISRE 2400 (par 2) further states that guidance in the ISAs may be useful to practitioners when applying ISRE 2400. However, this will only be possible if a practitioner has a working knowledge of the ISAs. As assurance is expressed if the financial statements have been prepared in accordance with a specific financial reporting framework (IAASB 2006b par 3), the practitioner should also have the requisite competence to review financial statements prepared according to different financial reporting frameworks (IFAC 2009).

Thus the first requirement that should be met by a practitioner in order to be permitted to perform independent reviews is the possession of an adequate level of training and experience to support his professional scepticism and judgement. He further needs a working knowledge of the ISAs to provide him with an understanding of the underlying principles. (This requirement will fall away if the review standards are prescriptive and stand-alone.)

Furthermore, the practitioner performing a review has to comply with the Code of Ethics for Professional Accountants issued by the IAASB (2006b par 4). The same ethical principles governing auditors therefore apply, namely independence, integrity, objectivity, professional competence and due care, confidentiality, professional behaviour, technical standards, scepticism and evidence.

As the public is dependent on the competence and professional conduct of practitioners performing independent reviews, procedures should be in place to monitor compliance with standards, and non-compliance should be disciplined. Thus the second requirement that should be met by a practitioner in order to be allowed to perform independent reviews is membership of a body which has adequate

monitoring and disciplining processes in place.

In order to perform an independent review, the practitioner should therefore be a member of a body which only registers practitioners who have achieved an adequate level of training and experience appropriate to the performance of independent reviews, and which has adequate monitoring and disciplinary processes in place to ensure compliance with the required standard(s) regarding independent reviews and ethical conduct.

No legislation, or regulations provided for in legislation, can be drafted in isolation. Knowledge of the context of the broader legislative framework is an obvious prerequisite, and it is thus important to take note of existing legislation which might influence the regulations of the Companies Act (IRBA 2009/09/08). The APA (South Africa 2005) is one such piece of legislation that should be taken into account.

The APA (sect 1) defines an audit as follows:

"... the examination of, in accordance with prescribed or applicable auditing standards –

- (a) financial statements with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements; or
- (b) financial and other information, prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information"

This definition of an audit only refers to the opinion that an auditor is expressing and not to the assurance to be provided in the opinion. It therefore seems that it includes both reasonable (in the case of an audit) and limited (in the case of a review) assurance. The definition of an audit in the APA is thus applicable to both audit and independent review opinions expressed on annual financial statements (IRBA 2009/09/08).

The APA (sect 1) defines the terms *public practice* and *registered auditor* as follow:

Public practice "... the practice of a registered auditor who places professional services at the disposal of the public for reward"

Registered auditor "... an individual or firm registered as an auditor with the Regulatory Board"

The APA further regulates public practice by stating that "Only a registered auditor may engage in public practice" (sect 41(1)) and further stating that "A person who is not registered in terms of this Act may not ... perform any audit" (sect 41(2)(a)&(a)(i)).

If the APA means that the definition of an audit includes a review, a review can then only be performed by a registered auditor. That implies that only individuals or firms registered by the IRBA can perform reviews (IRBA 2009/09/08). (If this is not the case, clarity should be provided in the APA.)

However, according to the CCRD it is contemplated that an independent review may also be performed by persons other than auditors (DTI 2009/09/08). The Draft Regulations (DTI 2009) identify the practitioner who is to perform independent reviews as an *independent accounting professional* (sect 30(2)(b)). The Draft Regulations further require that such a person should be a member in good standing of a professional body that is a member of the IFAC and should be independent from the entity to be reviewed (sect 30(3)(d)). (The IFAC, founded in 1977, is the global organisation for the accountancy profession. It comprises 159 member and associate organisations in 124 countries and jurisdictions, representing 2.5 million accountants employed in public practice, industry and commerce, government and academia (IFAC 2010)). The regulations do not limit the performing of independent reviews to South African practitioners, with the result that international practitioners may be permitted to be appointed to perform independent reviews in South Africa. This might be a problem as such practitioners will not necessarily have any knowledge of South African legislation (SAICA 2010). Taking into consideration that the overarching objective of the Companies Act is the protection of the public interest in the conduct of business in South Africa, and the view of the CCRD that a review is something less rigorous, less burdensome, less onerous and less costly to the company than an audit, the regulations regarding who should perform independent reviews should strike a balance between protecting the public interest and being less financially burdensome than an audit.

The APA (South Africa 2005 sect 3) established the IRBA as the statutory regulator to protect the public by regulating audits performed by registered auditors

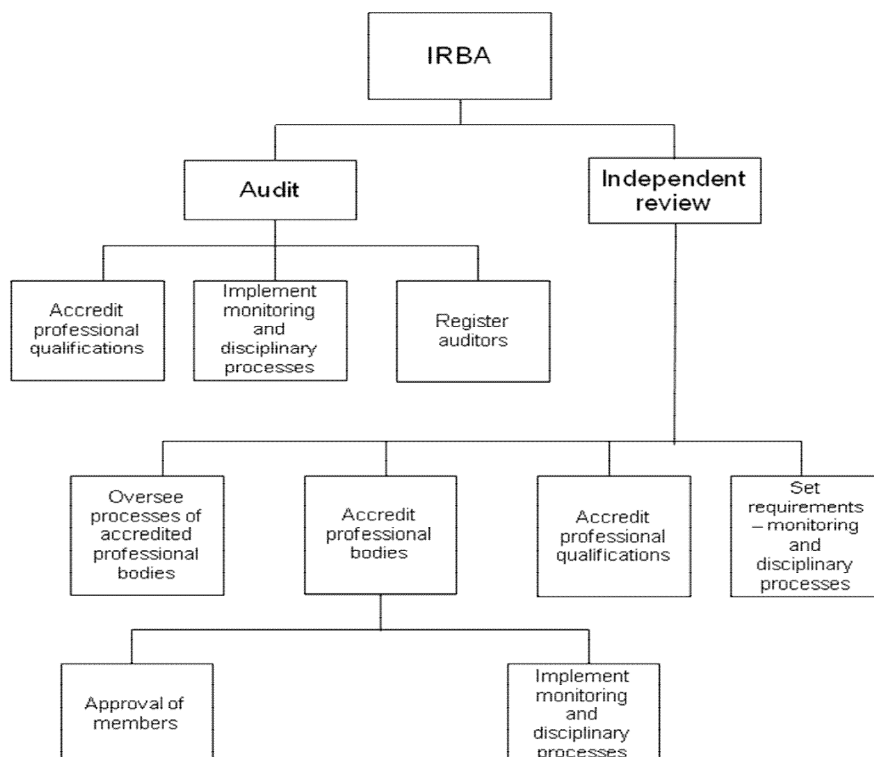
in South Africa. Even if an independent review is not included in the definition of an audit, it should be regulated by the IRBA as it is also an assurance service provided to the public in South Africa. But taking into account that a review should be less rigorous, less burdensome, less onerous and less costly to the company than an audit, and that it provides a lower level of assurance, a co-regulatory system might be acceptable. The IRBA could accredit educational qualifications at educational institutions (sect 7) necessary to perform reviews, set requirements for monitoring and specify the disciplinary processes in respect of improper conduct of practitioners performing reviews (sect 2), and accredit professional bodies (sect 5) whose members are permitted to perform reviews.

These professional bodies could be responsible for

- the registration of members permitted to perform the review function, taking into account the member's academic and practical training and ongoing professional development; and
- the establishment of monitoring and disciplinary processes in compliance with the requirements set by the IRBA, ensuring that the conduct of their members is in accordance with ISRE 2400 and with the Code of Ethics for Professional Accountants issued by the IAASB, and ensuring the quality of independent reviews.

The IRBA could then oversee the registration, monitoring and disciplinary processes of the accredited professional bodies to provide protection to the public who would rely on independent reviews. This regulatory structure is presented in Figure 1.

Figure 1: Schematic presentation of the regulation of assurance services



Thus when determining who can perform review engagements, the main considerations should be that such a person should be a member in good standing of a professional body; the body being accredited by the IRBA, and its members thereby being enabled to perform reviews, and the practitioner should be independent from the entity to be reviewed.

6 CONCLUSION

This article investigated, by means of a literature review, international standards, regulations and laws regarding the independent review of the financial statements of a company in order to provide a better understanding of this alternative to an audit of a company's annual financial statements.

In the first place, it described what an independent review is, highlighting the differences from an audit, and emphasising that a review is something less rigorous, less burdensome, less onerous and less costly to the company.

Secondly, it investigated which companies, except for public and state-owned companies, should be audited. The Draft Regulations firstly use activity as a basis to regulate which companies should be audited. Then they distinguish on the basis of thresholds (turnover and assets) which companies that need not be audited, choose voluntarily to be audited, or are exempted from being audited or reviewed, should be independently reviewed. It thus seems that the regulations regarding which companies should be audited and which independently reviewed will achieve the overarching objective of protecting the public interest as they are primarily based on a company's activities and not on quantitative thresholds such as turnover and assets.

This article further researched the manner and form of, and procedures for the conduct of an independent review. The Draft Regulations state that an

independent review should be performed according to ISRE 2400 which is in line with the DTI's objective to bring South Africa's corporate law in line with international best practice. However, according to ISRE 2400, practitioners should get guidance in the ISAs when applying ISRE 2400. The IAASB's revised standard(s) on independent reviews is eagerly awaited, as a robust and well designed set of assurance standards for independent reviews is essential to provide the necessary guidance to practitioners intending to conduct independent reviews. Without this guidance the risk is that the work performed will either be insufficient to support a useful opinion, or the level and intensity of the work performed will be similar to that required by an audit, resulting in audit-size costs, but with a much lower assurance level opinion.

Lastly, this article investigated who will be deemed qualified to perform independent reviews. The Draft Regulations state that such a person should be a member in good standing of a professional body that is a member of the IFAC. However, it is suggested that an independent review should be performed by a person who is a member in good standing of any professional association or body accredited by the IRBA as a body whose members can perform reviews.

It is hoped that this study has provided a better insight into the use of independent reviews as an alternative to traditional audits of financial statements. This research could be instrumental in the CCRD developing the final regulations prescribing the performance of independent reviews of companies' financial statements, and who should perform these reviews in South Africa.

This literature review was used to design questionnaires in order to obtain the perceptions of the key role players with regard to performing independent reviews.

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