The difference between having your annual financial statements reviewed as opposed to audited

By Wiehann Olivier

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With the current state of the national and global economy, companies are trying to better manage their expenses. Audit fees tend to make up a significant portion of a company's annual expenses and therefore some businesses specifically focus on audit fees when they need to tighten their belts.

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However, if a company does decide to cut its spend on audit fees, directors and shareholders should make a cost vs benefit assessment to determine the value that an audit may add, compared to possible alternatives.

Depending on a company's public interest score (PIS) and who the compiler of the annual financial statements (AFS) are, the Companies Act of South Africa allows a company to either have its AFS audited or independently reviewed.

The directors of a company can decide if they want to internally compile their AFS or have them independently compiled. However, companies with a PIS of between 100 and 350 need to bear in mind that this decision will also influence the type of assurance required, in accordance with the Companies Act.

The PIS of a company is calculated by taking a number of factors into consideration, such as the number of individuals with beneficial interests (shareholders), turnover for the financial year, third party liability at the end of the financial year and the average number of employees.

Should a company have a PIS of more than 350, the AFS will need to be audited in terms of the Companies Act. If a company has a PIS of below 350 and its AFS are compiled independently, the directors of that company may elect to have the AFS undergo an independent review as opposed to an audit. With that said, if a company has a PIS of above 100 and the directors prefer to internally compile its AFS, the company is required to have its AFS audited.

Certain businesses can also be exempt from having their AFS audited or independently reviewed according to Section 30(2A) of Companies Act. For this exemption to apply, the company must have a PIS lower than 350 and all of the shareholders must be directors of the company. In certain instances a company's memorandum of incorporation (MOI) may also require it to be audited, irrespective of its PIS.

There is a number of differences between an audit and an independent review. The most significant of these include the level of assurance that one obtains, and the procedures performed by the persons conducting the audit or independent review. By comparing an audit report opinion and an independent review conclusion the significant difference is that an audit opinion provides reasonable assurance on the AFS while an independent review conclusion provides limited assurance.

An audit report states that reasonable assurance has been obtained that the AFS as a whole is free from material misstatement, while an independent review states that (based on the work performed) nothing has come to the reviewers' attention that causes them to believe that the AFS are not fairly presented.

The differences

An independent review primarily consists of making inquiries of management and others within the company, applying analytical procedures and evaluating the evidence obtained. An audit is a much more in depth investigation where various techniques are used to obtain the assurance required to enable the auditor to issue an audit opinion. For an independent review engagement, more experienced staff are usually made use of due to the higher complexity of the interpretations and evaluations of the results. An audit engagement uses a variety of staff with different experience due to the nature of the work. The amount of work to be performed by the auditor or independent reviewer, as well as the experience of the staff used for the engagements, will therefore have a direct impact on the fees applicable to the different assurance engagements and therefore making a review engagement less expensive compared to that of an audit.

Should the directors decide to have the company's AFS independently reviewed, several factors need to be considered. Firstly, they need to ensure that there are no requirements from either the shareholders or any third party requiring the AFS to be audited. After that, they must ensure that the legal requirements of the MOI and the Companies Act are being adhered to.

The directors also need to be aware that they cannot move from an audit to an independent review and back to an audit in subsequent years without repercussions. When an auditor issues an opinion on a set of AFS, the opinion is applicable to balances and transactions included in the current year, the comparative balances and transactions of the previous year, as well as the closing retained earnings of the year before the previous year. If any of these prior years' balances and transactions were not subject to an audit (i.e. an independent review), it will result in a qualification of the audit report as the auditor is unable to issue an opinion on these unaudited balances and transactions due to only limited assurance having been obtained.

It should also be noted that these types of qualifications to the audit report will also be carried forward for two consecutive years.

This qualification can be avoided if an audit is completed on the previous years' AFS (which was initially only subject to an independent review). However, this would be inefficient and costly - seeing as it would result in the previous year's AFS being both audited and independently reviewed.

In light of the above, it is vital that the shareholders and directors consult with their companies' auditors to ensure that all of the current and future implications are understood before decisions regarding a change in the type of assurance engagement is made.

ABOUT THE AUTHOR

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