SAICA advises SMEs to know where they stand

Johannesburg, Thursday, 12 July 2012 - Owners of Small and Medium Enterprises (SMEs) have been obliged to bear the cost of an audit for years. The criteria changed with the implementation of the new Companies Act and now they may not have to.

Ashley Vandiar, Project Director, South African Institute of Chartered Accountants (SAICA) says while there are several factors to consider, the decision ultimately depends on the newly introduced Public Interest Score which is calculated in terms of Regulation 26 of the Companies Act.

"Under this system, a company is allocated points according to the number of its employees, its annual turnover, its stakeholders and the level of third party liabilities at the end of the financial year", Vandiar added.

The Public Interest Score is calculated thus:

- 1 point for each employee or the average number of employees throughout the year.
- 1 point per million rand of third party liability. This is the money owed in terms of loans, debentures, and other financing.
- 1 point for each million rand of turnover during the financial year. If the turnover is half a million rand, score ½ point.
- 1 point for every individual who, at the end of the year, is known to have a direct or indirect beneficial interest in the company. This will include shareholders, beneficiaries of a trust where a trust is a shareholder and other stakeholders.

Companies scoring 350 points or more are required to have an audit.

Any company, whatever its points score, that holds funds of R5 million or more for a client in a fiduciary capacity, at any time during the year, is also required to have an audit.

Companies scoring between 100 - 350 points must have an independent review conducted by a registered auditor or a chartered accountant.

Companies scoring less than 100 points are required to have an independent review conducted by anyone who qualifies as an accounting officer, unless circumstances indicate otherwise.

Vandiar confirms that Close Corporations are treated the same way as companies when it comes to the audit requirement, since the Close Corporations Act has been amended to the extent that a Close Corporation would require an audit. They have to comply with the new Act which may make the process of reporting more expensive, depending on their points score.

In addition to the information about the Public Interest Score, Vandiar has a warning for small entities. "SMEs wanting to exercise their option to elect an independent review as an alternative to an audit should ensure that their financial statements are compiled by an independent accounting professional and in accordance with an applicable financial reporting framework. In other words, entities with a Public Interest Score between 100 and 350 points should have their financials independently compiled and reported. If they are compiled internally, then entities within this Public Interest Score range will be scoped into an audit."

The new system sounds complicated but knowing where the SME fits into the points system simplifies matters. So does knowing the difference between the two options.

An audit is a thorough examination of a company's financial status executed by a registered auditor. It involves tests of internal controls and substantive procedures and carries far more weight than a review in that it would result in the auditor expressing the highest level of assurance. This is referred to as 'reasonable assurance.' Companies seeking loans may be required by their bank to have an audit before their application is considered. Thus, the decision to not have an audit may very well impair an entity's ability to obtain external funding.

A review on the other hand provides a lower level of assurance that a company's financial statements do not have any known errors or misstatements. It must be undertaken by an independent accounting professional who can be but doesn't have to be a qualified chartered accountant, unless otherwise required under the points system.

The costs between the two options vary and Vandiar agrees that it's early days for the points system in this country. "In Australia, where a similar system has been in progress for longer, a review by a chartered accountant generally costs up to 25% less than an audit, depending on the complexity of the engagement."

One thing is clear. SMEs with a Public Interest Score of less than 100, which are no longer required to have an audit, will save money. While an audit provides incredible value to any entity and is undoubtedly an investment that will yield growth and improved managerial control, the cost of performing audits for entities with a Public Interest Score less than 100 exceeds the benefits in most instances. The lower level of assurance that an independent review provides would be sufficient for these entities. The cost savings from this reduction in the more onerous audit requirement could be ploughed back into the business or used to reduce debt. The end result is in line with the intention of the legislators in that the option permitted to small entities would promote entrepreneurship.

Vandiar confirms that as individuals who have studied and written in-depth financial and auditing exams, chartered accountants and auditors are professionals bound by the SAICA code of professional conduct. This ensures that they act in accordance with high ethical standards that are aligned with international best practices. "They are required in terms of the auditing and review standards to have a detailed understanding of their clients' businesses and can thus be depended upon to give good, impartial and confidential advice, Vandiar concludes.