

Proposed SAAPS 2 (Revised 2017)

Comments due: 30 November 2017



*Proposed South African Auditing Practice Statement (SAAPS) 2
(Revised 2017)*

**Financial Reporting Frameworks
and the Auditor's Report**

WARNING TO READERS

*The content of this proposed SAAPS 2 (Revised 2017) should under no
circumstances be used or relied upon until it is issued as a pronouncement by the
IRBA*

REQUEST FOR COMMENTS

The Independent Regulatory Board for Auditors' (IRBA) Committee for Auditing Standards (CFAS) approved this proposed South African Auditing Practice Statement (SAAPS) 2 (Revised 2017), *Financial Reporting Frameworks and the Auditor's Report* (the proposed SAAPS 2 (Revised 2017)) in August 2017 for exposure for **30 November** for comment. Before being issued in its final form, the proposed SAAPS 2 (Revised 2017) may be modified depending on comments received.

This proposed SAAPS 2 (Revised 2017) has been prepared by a CFAS Task Group, which comprised technical staff representatives from auditing firms, the public sector, a consulting firm, SAICA and the IRBA.

The IRBA's Legislative Mandate

The objects of the Auditing Profession Act, 2005 (Act No. 26 of 2005) (the Act), are set out in Section 2 and include, inter alia:

- (c) *"to approve the development and maintenance of internationally comparable ethical standards and auditing standards for auditors that promote investment and as a consequence employment in the Republic; and*
- (d) *to set out measures to advance the implementation of appropriate standards of competence and good ethics in the auditing profession".*

To give effect to the objects of the Act, Section 4 sets out the general functions of the Regulatory Board and these include that *"the Regulatory Board must, in addition to its other functions provided for in this Act"*, take steps to meet certain specific requirements. These include Section 4(1), which specifies that the IRBA must:

- (e) *"prescribe standards of professional competence, ethics and conduct of registered auditors;" and*
- (f) *"prescribe auditing standards".*

To enable the IRBA to meet these requirements, Section 4(2)(a) states that *"the IRBA may participate in the activities of international bodies whose main purpose it is to develop and set auditing standards and to promote the auditing profession"*.

Statutory Responsibility of the CFAS

The statutory responsibility of the CFAS is set out in Section 22(2), which requires that it *"must assist the IRBA to:*

- (a) *develop, maintain, adopt, issue or prescribe auditing pronouncements;*
- (b) *consider relevant international changes by monitoring developments by other auditing standard-setting bodies and sharing information where requested; and*
- (c) *promote and ensure the relevance of auditing pronouncements.*

The proposed SAAPS 2 (Revised 2017) may be downloaded free-of-charge from the IRBA website at www.irba.co.za.

Comments should be submitted by **30 November 2017**.

Respondents are requested to submit their comments electronically in a Word or PDF format to the Director Standards, Imran Vanker, at IVanker@irba.co.za or standards@irba.co.za. All comments will be considered a matter of public record and will be posted on the IRBA website at www.irba.co.za.

Should you have any queries, or experience any technical difficulties with downloading the documents, please e-mail the Standards Department at standards@irba.co.za or contact:

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Introduction

This memorandum provides the background to and an explanation regarding this proposed South African Auditing Practice Statement (SAAPS) 2 (Revised 2017), *Financial Reporting Frameworks and the Auditor's Report* (the proposed SAAPS 2 (Revised 2017)). This proposed SAAPS 2 (Revised 2017) replaces the previous SAAPS 2, *Financial Reporting Frameworks and the Auditor's Report* (Revised November 2013).

The proposed SAAPS 2 (Revised 2017) provides guidance to registered auditors on the application of International Standards on Auditing (ISAs) in determining the acceptability of the financial reporting framework applied in the preparation of a set of financial statements.

The Committee for Auditing Standards (CFAS) approved this proposed SAAPS 2 (Revised 2017) in August 2017 for exposure for a period of 90 days.

Conforming Amendments to SAAPS 2 (Revised 2017)

The proposed SAAPS 2 (Revised 2017) contains:

- Conforming amendments arising from the withdrawal of the application of Statements of GAAP called the "GAAP Reporting Framework" from 1 April 2018.
- Conforming amendments arising from the introduction of the Modified Cash Standard by the National Treasury in January 2015.
- An update of the reference from the *International Framework for Assurance Engagements* (the *Framework*) to ISA 210, *Agreeing the Terms of Audit Engagements*, regarding characteristics of suitable criteria for a financial reporting framework. This is as a result of the *Framework* having been revised to encapsulate assurance engagements other than audits or reviews of historical financial information.
- Conforming amendments, where considered necessary, arising from the revision of the following ISAs:
 - ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*;
 - ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*;
 - ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*;
 - ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; and
 - ISA 800 (Revised), *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*.

These are effective for audits of financial statements for periods ending on or after 15 December 2016.

Project Timetable

Subject to comments received on exposure of this proposed SAAPS 2 (Revised 2017), the CFAS intends to finalise the SAAPS in the first quarter of 2018.

Effective Date

The final SAAPS is effective for audits of financial statements for periods ending on or after 1 April 2018.

Guide for Respondents

The CFAS welcomes comments on all matters addressed in the exposure draft. Comments, however, will be most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to the wording. Also, when a respondent agrees with the proposals in this exposure draft, it will be helpful for the CFAS to be made aware of this view.

Request for specific comments

While the CFAS welcomes comments on all matters addressed in the exposure draft, the CFAS is seeking comments on the following specific matter:

1. Whether you agree that in the case of public sector entities, the National Treasury is a recognised accounting standard setter in South Africa as a result of its introduction of the Modified Cash Standard? This is in addition to the Accounting Standards Board (ASB), which was already recognised in the extant SAAPS 2 (Revised November 2013).

**SOUTH AFRICAN AUDITING PRACTICE STATEMENT 2
(REVISED 2017)**

FINANCIAL REPORTING FRAMEWORKS AND THE AUDITOR'S REPORT

(Effective for audits of financial statements for periods ending on or after 1 April 2018)

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This South African Auditing Practice Statement (SAAPS) 2 (Revised 2017), *Financial Reporting Frameworks and the Auditor's Report*, provides guidance to registered auditors on the application of International Standards on Auditing (ISA) in determining the acceptability of the financial reporting framework applied in the preparation of a set of financial statements.

South African Practice Statements are developed and issued by the IRBA to provide practical assistance to auditors in the implementation of relevant International or South African *Standards on Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*. South African Practice Statements do not impose requirements on auditors beyond those included in the International or South African Standards or South African regulatory requirements. Also, they do not change the auditor's responsibility to comply, in all material respects, with the requirements of the International or South African Standards or with South African regulatory requirements relevant to the audit, review, other assurance or related services engagement.

An auditor is required to have an understanding of the entire text of every South African Practice Statement to enable the auditor to assess whether any particular South African Practice Statement is relevant to an engagement, and if so, to enable the auditor to apply properly the requirements of the particular International or South African Standard/s to which the South African Practice Statement relates.

In terms of Section 1 of the Auditing Profession Act, No. 26 of 2005 (the Act), a South African Practice Statement is included in the definition of "auditing pronouncements". In terms of the Act, the auditor must, in the performance of an audit, comply with those standards, practice statements, guidelines and circulars developed, adopted, issued or prescribed by the Regulatory Board.

Introduction

Scope

1. This SAAPS provides guidance to registered auditors on the application of International Standards on Auditing (ISAs) in determining the acceptability of the financial reporting framework applied in the preparation of a set of financial statements, thereby establishing:
 - Whether this precondition for an audit¹ is present; and
 - The effect of the financial reporting framework applied by management on the auditor's report in South Africa.²
2. The guidance contained in this SAAPS does not establish new requirements or contain exemptions from the requirements of the ISAs and should be read with the ISAs, as applicable. The auditor exercises professional judgment to determine the extent to which any of the guidance provided in this SAAPS may be appropriate in light of the requirements of the ISAs and the particular circumstances of the engagement.
3. The ISAs that have particular reference to financial reporting frameworks and the auditor's report dealt with in this SAAPS are, inter alia:
 - ISA 200, *Overall Objective of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing*;
 - ISA 210, *Agreeing the Terms of Audit Engagements*;
 - ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*³;
 - ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*⁴;
 - ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*⁵;
 - ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*⁶; and
 - ISA 800 (Revised), *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*⁷.

¹ ISA 210, paragraph 6(a).

² ISAs 700 (Revised), 705 (Revised), 706 (Revised) and 800 (Revised).

³ This is effective for audits of financial statements for periods ending on or after 15 December 2016.

⁴ This is effective for audits of financial statements for periods ending on or after 15 December 2016.

⁵ This is effective for audits of financial statements for periods ending on or after 15 December 2016.

⁶ This is effective for audits of financial statements for periods ending on or after 15 December 2016.

4. This SAAPS does not incorporate the requirements of:
- ISA 805 (Revised), *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*⁸ (ISA 805 (Revised)). The principles dealt with in this SAAPS may, however, be applied to ISA 805 (Revised) in determining the acceptability of the financial reporting framework and the effect that the financial reporting framework has on the auditor's report.
 - ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*⁹ (ISA 810 (Revised)), as the "applied criteria" referred to in ISA 810 (Revised) is not the "applicable financial reporting framework" as contemplated in the preparation of a set of financial statements.
5. This SAAPS does not extend to:
- An engagement to review financial statements in accordance with *International Standards on Review Engagements* (ISREs). It may, nevertheless, be considered by a reviewer in determining the acceptability of the financial reporting framework applicable to a review engagement; and
 - An assurance engagement in accordance with *International Standards on Assurance Engagements other than Audits or Reviews of Historical Financial Information* (ISAEs). It may, nevertheless, be considered by the assurance provider in determining the suitability of the criteria applicable to the provision of assurance in an engagement of this nature.

Terms Used in this SAAPS

6. For purposes of this SAAPS, the following terms defined in the ISAs and reflected in the *Glossary of Terms* (December 2016) have the same meanings attributed to them:¹⁰
- "Applicable financial reporting framework";
 - "General purpose financial statements" and "special purpose financial statements";
 - "General purpose framework" and "special purpose framework";
 - "Fair presentation framework" and "compliance framework"; and
 - "Criteria".
7. The "applicable financial reporting framework" referred to in the ISAs, for all practical purposes, is the same as the "identified financial reporting framework"

⁷ This is effective for audits of financial statements for periods ending on or after 15 December 2016.

⁸ This is effective for audits for periods ending on or after 15 December 2016.

⁹ This is effective for engagements to report on summary financial statements for periods ending on or after 15 December 2016.

¹⁰ These definitions are provided in Appendix 1 of this SAAPS.

referred to in the definition of “audit” in the Auditing Profession Act, No. 26 of 2005.¹¹

8. The term “basis of accounting” is used in the context of the basis of preparation of a set of financial statements selected or used by the management of an entity, for example, the going concern basis of accounting as per the International Financial Reporting Standards (IFRS) and certain special purpose frameworks.
9. The term “management” used in this SAAPS refers to the person(s) or body with executive responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework or basis of accounting, for example, the directors of a company, the trustees of a trust, an accounting officer or accounting authority in the public sector.

The Purpose of an Audit of Financial Statements

10. The purpose of an audit is to enhance the intended users’ degree of confidence in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.¹² Accordingly, an audit meets the description of an assurance engagement as contained in the *International Framework for Assurance Engagements (the Framework)*¹³.

Determining the Acceptability of the Financial Reporting Framework

11. The *Framework* defines and describes the elements of an assurance engagement and, in particular, provides guidance in determining the intended users of an assurance report and the characteristics of suitable criteria against which the financial reporting framework should be assessed.

Intended users

12. The intended users¹⁴ of the auditor’s report on the financial statements are the person, persons or class of persons for whom the auditor prepares the auditor’s report. Examples of intended users are:
 - A wide range of users for whom general purpose financial statements are prepared, and these include:
 - Those identified by statute, and these include:

¹¹ The Auditing Profession Act (2005), Section 1.

¹² ISA 200, paragraph 3.

¹³ The *Framework*, paragraph 10.

¹⁴ ISA 210, paragraphs A2-A10 provide further guidance; ISA 800 (Revised), paragraphs 8(b) and A5.

- The shareholders or members, in the case of the Companies Act, No. 71 of 2008 (the Companies Act), to whom the auditor's report is addressed;
- Regulatory authorities and the South African Revenue Service (SARS); and
- Those in the public sector, such as parliament, provincial legislatures, municipal councils, national/provincial treasuries.
- Those who might find the financial statements useful, such as existing or potential investors; institutional and individual lenders; financial institutions; creditors; and the general public.
- Specific users for whom special purpose financial statements are prepared. These include:
 - Those identified by agreement between the auditor, the responsible party (usually, but not necessarily, the client) and those engaging the auditor (the client), such as donors;
 - Those identified by a founding document, such as the trustees of a trust; and
 - Those specific to the circumstances of the entity, such as the members of a club or religious institution and special interest groups.

Characteristics of suitable criteria

13. The auditor considers whether, in the context of the engagement circumstances, a financial reporting framework exhibits the following characteristics of suitable criteria:¹⁵
- **Relevance:** In that the information provided in the financial statements is relevant to the nature of the entity and the purpose of the financial statements.
 - **Completeness:** In that transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are not omitted.
 - **Reliability:** In that the information provided in the financial statements:
 - Where applicable, reflects the economic substance of events and transactions and not merely their legal form; and
 - Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances.
 - **Neutrality:** In that it contributes to information in the financial statements that is free from bias.

¹⁵ ISA 210, Appendix 2, paragraph 3 and ISA 800 (Revised), paragraph A8.

- Understandability: In that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretations.
14. The evaluation or measurement of a subject matter on the basis of the auditor's own expectations, judgments and individual experience would not constitute suitable criteria.
15. The relative importance of each of these characteristics to a particular engagement is a matter of judgment, and depends on the engagement circumstances. For example, even though a financial reporting framework designed for a special purpose may not result in the preparation of historical financial information that is neutral, that framework may still be acceptable in the engagement circumstances.

Preconditions for an audit

16. To establish whether in the context of engagement acceptance the preconditions for an audit are present, the auditor, inter alia, determines the acceptability of the financial reporting framework¹⁶ to be applied by management in the preparation of financial statements. The auditor further obtains an understanding of the entity's selection and application of accounting policies as part of obtaining an understanding of the entity and its environment.¹⁷
17. Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of financial statements include:¹⁸
- The nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not-for-profit organisation);
 - The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users);
 - The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
 - Whether law or regulation prescribes the applicable financial reporting framework.

In addition, key factors to be considered for special purpose financial statements include the following:¹⁹

- The intended users; and
- The steps taken by management to determine that the applicable financial

¹⁶ ISA 210, paragraph 6(a), A2-A10 and Appendix 2.

¹⁷ ISA 800 (Revised), paragraph 10.

¹⁸ ISA 210, paragraph A4.

¹⁹ ISA 800 (Revised), paragraph 8 and paragraph A5.

reporting framework is acceptable in the circumstances.

General purpose and special purpose frameworks

18. To decide on the acceptability of the financial reporting framework, the auditor determines whether the financial statements are prepared to meet the common financial information needs of a wide range of users (general purpose financial statements) or the financial information needs of specific users (special purpose financial statements).

General purpose financial statements are prepared in accordance with a general purpose framework; and special purpose financial statements are prepared in accordance with a special purpose framework.

19. Presently, there is no objective and authoritative basis that has been generally recognised globally for determining the acceptability of general purpose financial reporting frameworks. So, in the absence of such a basis, financial reporting standards established by organisations that are authorised or recognised to promulgate such standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities. This, however, is provided the organisations follow an established and transparent process involving the deliberation and consideration of the views of a wide range of stakeholders.²⁰ The auditor relies on the processes followed by these organisations to develop general purpose financial reporting frameworks that are acceptable for general purpose financial statements.
20. The International Accounting Standards Board (IASB) is a recognised accounting standard setter whose standards are applied in South Africa. In the case of entities in the public sector in South Africa, the recognised accounting standard setters are the Accounting Standards Board (ASB) and the National Treasury.
21. Law and regulation may prescribe the financial reporting framework to be used in the preparation of general purpose financial statements for certain types of entities. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for general purpose financial statements prepared by such entities.²¹
22. The following laws and regulations, for example, contain prescribed applicable financial reporting frameworks:
- The Companies Act and Regulations;²²
 - The JSE Listings Requirements;²³

²⁰ ISA 210, paragraph A8, and ISA, 200 paragraph A7.

²¹ ISA 210, paragraph A9, and ISA 800 (Revised), paragraph A6.

²² Refer to Appendix 3 in this SAAPS for further guidance.

²³ The JSE is a holder of an exchange licence and issues JSE Listings Requirements in terms of Section 10(2) of the Financial Markets Act, No. 19 of 2012.

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FINANCIAL REPORTING FRAMEWORKS AND THE AUDITOR'S REPORT

- The Public Finance Management Act, No. 1 of 1999 (PFMA) and Regulations;
- The Municipal Finance Management Act, No. 56 of 2003 (MFMA); and
- Directives as issued by the ASB²⁴.

The Companies Act empowers the minister responsible for companies, the Minister of Trade and Industry, after consulting with the Financial Reporting Standards Council (FRSC), to make regulations establishing financial reporting standards for companies and close corporations subject to certain requirements²⁵.

The PFMA empowers the ASB to set standards of generally recognised accounting practice²⁶; it also empowers the Minister of Finance, after consulting the Auditor-General, to prescribe the implementation of these standards. The PFMA also empowers National Treasury to prescribe the accounting standards for public sector entities in the absence of implementation dates for the standards of generally recognised accounting practice. The Public Audit Act, No. 25 of 2004 (PAA), empowers the Auditor-General to prescribe the format and content of the financial statements of a public sector entity, in the absence of any requirement regarding the financial reporting framework in the legislation applicable to that entity.

The MFMA refers to the PFMA regarding the process to prescribe the financial reporting framework to be used by municipalities in the preparation of their financial statements.²⁷

However, a body authorised by statute to prescribe financial reporting frameworks to be applied in the preparation of financial statements by certain entities does not automatically constitute a recognised accounting standard setter.

23. The following are examples of general purpose frameworks:
- International Financial Reporting Standards (IFRS);
 - International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs);
 - Standards of Generally Recognised Accounting Practice (GRAP); and
 - The Modified Cash Standard.
24. The following are examples of special purpose frameworks:
- Where management does not have a choice in the application of the framework:
 - The Regulatory Reporting Requirements for Retirement Funds in South

²⁴ Section 89(1)(b) of the PFMA requires the ASB to prepare and publish directives and guidelines concerning standards of GRAP as set out in section 89(1)(a) of the PFMA.

²⁵ Companies Act, 2008, sections 204(c) and 29(5).

²⁶ PFMA, Section 89(1)(a).

²⁷ Section 122(3) of the MFMA refers to Section 91(1)(b) of the PFMA.

Africa, approved by the Financial Services Board, is an example of a special purpose framework established by a regulator to meet the requirements of that regulator.

- Where management has a choice in the application of the framework:
 - A basis of accounting, applied by an entity, which comprises a set of criteria used in preparing financial statements and that applies to all material items and has been designed specifically for the intended users of the financial statements of the entity.

Fair presentation and compliance frameworks

25. A financial reporting framework, whether a general purpose framework or a special purpose framework, may be classified as either a fair presentation framework or a compliance framework.
26. In considering whether a framework may be classified as a fair presentation framework, the auditor considers whether it contains the acknowledgments in the definition of a fair presentation framework. It should be noted that the departures referred to in the acknowledgments are only to achieve fair presentation, and for no other reason.
27. The following financial reporting frameworks approved and issued by standard setters in South Africa are recognised as fair presentation frameworks:
 - IFRS;
 - IFRS for SMEs;
 - GRAP; and
 - The Modified Cash Standard.²⁸
28. When management departs from the prescribed financial reporting framework, whether this departure is granted by the body or entity that prescribed the framework or not, the auditor determines whether that framework is still a fair presentation framework and is still acceptable.²⁹
29. A financial reporting framework, whether prescribed by law or regulation or management, that is not a recognised financial reporting framework established by a standard setter and where the entity may not deviate from its prescribed form and content is a compliance framework. When the financial statements are prepared in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation.
30. Where management has selected a compliance framework or basis of accounting

²⁸ National Treasury issued the Modified Cash Standard in 2015 (Instruction No. 6 of 2014/2015) for national and provincial departments and other entities that are required to apply it as determined by National Treasury.

²⁹ ISA 800 (Revised), paragraph A3.

where it has a choice, the auditor determines the acceptability of the basis of accounting³⁰ after considering the factors referred to in paragraph 17 above.

31. In determining the acceptability of a compliance framework for general purpose financial statements, the auditor should consider whether such financial statements may be suitable for general purposes, as the users may not understand the basis of accounting.
32. The financial reporting framework applied by an entity such as a school, club, religious institution, farming operation, trust, partnership and body corporate in the preparation of its financial statements may be a requirement of law or regulation, an agreement or a stipulation in that entity's founding document, for example, a trust deed. The specified basis of accounting may be a fair presentation framework or a compliance framework.
33. Management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter, in light of the fact that the matter will be communicated in the auditor's report. Such new or enhanced disclosures, for example, may be included to provide more robust information about the sensitivity of key assumptions used in accounting estimates or the entity's rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework.³¹ A decision by an entity to provide such additional disclosures has no bearing on the description and application of the chosen financial reporting framework. However the auditor considers whether the financial statements, with the additional disclosures, still achieve fair presentation in the case of a fair presentation framework or do not result in the financial statements being misleading in the case of a compliance framework.

The Effect of the Financial Reporting Framework, or Basis of Accounting, on the Auditor's Report

34. The auditor's report on general purpose financial statements, whether prepared in accordance with a fair presentation framework or a compliance framework, follows the guidance in ISA 700 (Revised). When the financial statements are special purpose financial statements, whether prepared in accordance with a fair presentation framework or a compliance framework, the auditor's report additionally follows the guidance in ISA 800 (Revised).
35. The requirements of the applicable financial reporting framework and any legislative requirements determine the form and content of a set of financial statements and affect the wording in the auditor's report on the financial

³⁰ ISA 800 (Revised), paragraph 8.

³¹ ISA 701, paragraph A37.

statements. Law or regulation may impose additional reporting responsibilities on the auditor that have no effect on the financial reporting framework applied in the preparation of the financial statements. These are dealt with in the *Report on Other Legal and Regulatory Requirements* section of the auditor's report.

36. The auditor's report on a company's financial statements refers to the applicable fair presentation financial reporting framework followed by "... and the requirements of the Companies Act of South Africa". The latter refers to the financial reporting requirements additional to those contained in the identified financial reporting framework, which include the requirements of the Companies Act, such as those contained in Section 30, *Annual Financial Statements*. The reference to the Companies Act also indicates that the financial statements are that company's statutory financial statements, and it is omitted when the financial statements are not a company's statutory financial statements.
37. In the case of a public sector entity, which is also a company, the auditor's report also refers to the PFMA, MFMA or any specific enabling legislation that prescribes the financial reporting framework and any other or extra financial reporting requirements, additional to those contained in the applicable financial reporting framework.

For example, in the case of a company that is a public entity as defined in the PFMA, the auditor's report refers to the applicable fair presentation financial reporting framework followed by "... the requirements of the Public Finance Management Act of South Africa, and the requirements of the Companies Act of South Africa". Reference is made to the PFMA because the entity has financial reporting requirements additional to the identified financial reporting framework and those in the Companies Act.

38. The financial reporting framework referred to in the financial statements and auditor's report must be available to the intended users. This will allow them to understand how the financial position, financial performance and cash flows have been evaluated or measured in the case of a fair presentation framework, or whether the financial statements have been prepared in accordance with the applicable basis of accounting or financial reporting requirements in the case of a compliance framework.
39. Legislation, regulatory requirements and legal agreements often refer to "generally accepted accounting practice", "generally recognised accounting practice" and "financial reporting standards". These terms are used to describe financial reporting frameworks in general terms and are therefore not identified as general purpose financial reporting frameworks in accordance with the ISAs.
40. Special purpose financial statements prepared in accordance with a compliance framework should indicate their purpose and, if necessary, identify the intended users. Consequently:

- The basis of preparation paragraph in the notes to the financial statements should adequately describe the basis of accounting.
 - Where the basis of accounting is based on a fair presentation framework with certain departures (where the aim is not to achieve fair presentation), it is preferable to describe the basis of accounting, for example, “IFRS except for those identified standards (or components of identified standards) that have not been complied with”, as the user is able to better understand the described basis of accounting than when the description simply refers to the accounting policies set out in the financial statements.
 - Where management has a choice in the basis of accounting, it is recommended that the financial statements include a statement that management considers the basis of accounting applied to be suitable for the intended users.
 - The auditor’s report refers to the purpose of the financial statements and contains an “emphasis of matter” paragraph alerting users of the auditor’s report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.³²
41. When the auditor expresses an unmodified opinion in accordance with a fair presentation framework, the auditor’s opinion, unless otherwise required by law or regulation, includes the phrase “the financial statements present fairly, in all material respects, the financial position, financial performance and cash flows, in accordance with” and refers to one of the financial reporting frameworks identified in paragraph 27 above.
42. When the auditor expresses an unmodified opinion in accordance with a compliance framework, the opinion states that “the financial statements are prepared, in all material respects, in accordance with the *[describe applicable financial reporting framework]*”.
43. The auditor issues an appropriately modified auditor’s opinion in accordance with ISA 705 (Revised):
- When the auditor concludes that the financial statements do not adequately describe or refer to the applicable financial reporting framework or basis of accounting.
 - When an entity departs materially from the applicable or prescribed financial reporting framework and in the case of a fair presentation framework the aim of the departure is not to achieve fair presentation, and in the case of a

³² ISA 800 (Revised), paragraphs 14, A20 and A21.

compliance framework the departure leads to the financial statements being misleading.

44. Where the auditor is obliged by law or regulation to use the phrase “present fairly” in the auditor's opinion and the financial reporting framework is not a fair presentation framework but is still acceptable, the auditor's report contains an “*Other matters*” paragraph when the auditor concludes that an explanation is required to mitigate any possible misunderstanding of the phrase “present fairly”.
45. When the auditor concludes that an explanation in the “*Other matters*” paragraph cannot mitigate any possible misunderstanding, the auditor evaluates the effect of the misleading nature of the financial statements and modifies the auditor's opinion accordingly.

When a Financial Reporting Framework is Not Acceptable

46. If it is determined that the financial reporting framework is not acceptable, and the preconditions for an audit have not been met, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.³³
47. If it is determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present:³⁴
 - Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and
 - It is recognised in the terms of the audit engagement that:
 - The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with ISA 706 (Revised); and
 - Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases “present fairly, in all material respects” or “give a true and fair view”, in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.
48. If the conditions outlined in paragraph 47 are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor evaluates the effect of the misleading nature of the financial statements on the

³³ ISA 210, paragraph 8.

³⁴ ISA 210, paragraph 19 and paragraph A37.

auditor's report and modifies the auditor's opinion accordingly.³⁵

49. It is unlikely that a fair presentation framework, approved and issued by a standard setter in South Africa (see paragraph 23 above), could be unacceptable in the circumstances of the engagement. It is also unlikely that where management does not have a choice in the application of a "compliance framework", such as that required by a regulator, such framework could be unacceptable. It is more likely that where management has a choice in the application of the framework, such framework could be unacceptable.

Additional Information

50. The definitions dealt with in this SAAPS are provided in Appendix 1.
51. The application of the financial reporting frameworks dealt with in this SAAPS is presented by way of a diagram in Appendix 2.
52. The financial reporting frameworks in accordance with Regulation 27 of the Companies Act, which are dealt with in this SAAPS, are summarised in Appendix 3.
53. For public sector entities also refer to Directives issued by the ASB regarding the appropriate reporting frameworks for public sector entities.
54. Illustrative auditor's reports on financial statements are contained in SAAPS 3 (Revised November 2015), *Illustrative Reports*.

³⁵ ISA 210, paragraph 20.

Appendix 1

Definitions³⁶

- a) *Applicable financial reporting framework* is the financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of financial statements that is acceptable in view of the nature of the entity and the objective of financial statements, or that is required by law or regulation.
- b) *Compliance framework* refers to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgments included in the definition of a fair presentation framework.
- c) *Criteria* are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. There can be different criteria for the same subject matter. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.
- d) *Fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and:
 - Acknowledges explicitly or implicitly that to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
 - Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.
- e) *General purpose financial statements* are financial statements prepared in accordance with a general purpose framework.
- f) *General purpose framework* is a financial reporting framework designed to meet the common financial information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.
- g) *Special purpose financial statements* are financial statements prepared in accordance with a special purpose framework.
- h) *Special purpose framework* is a financial reporting framework designed to meet the financial information needs of specific users. The financial reporting

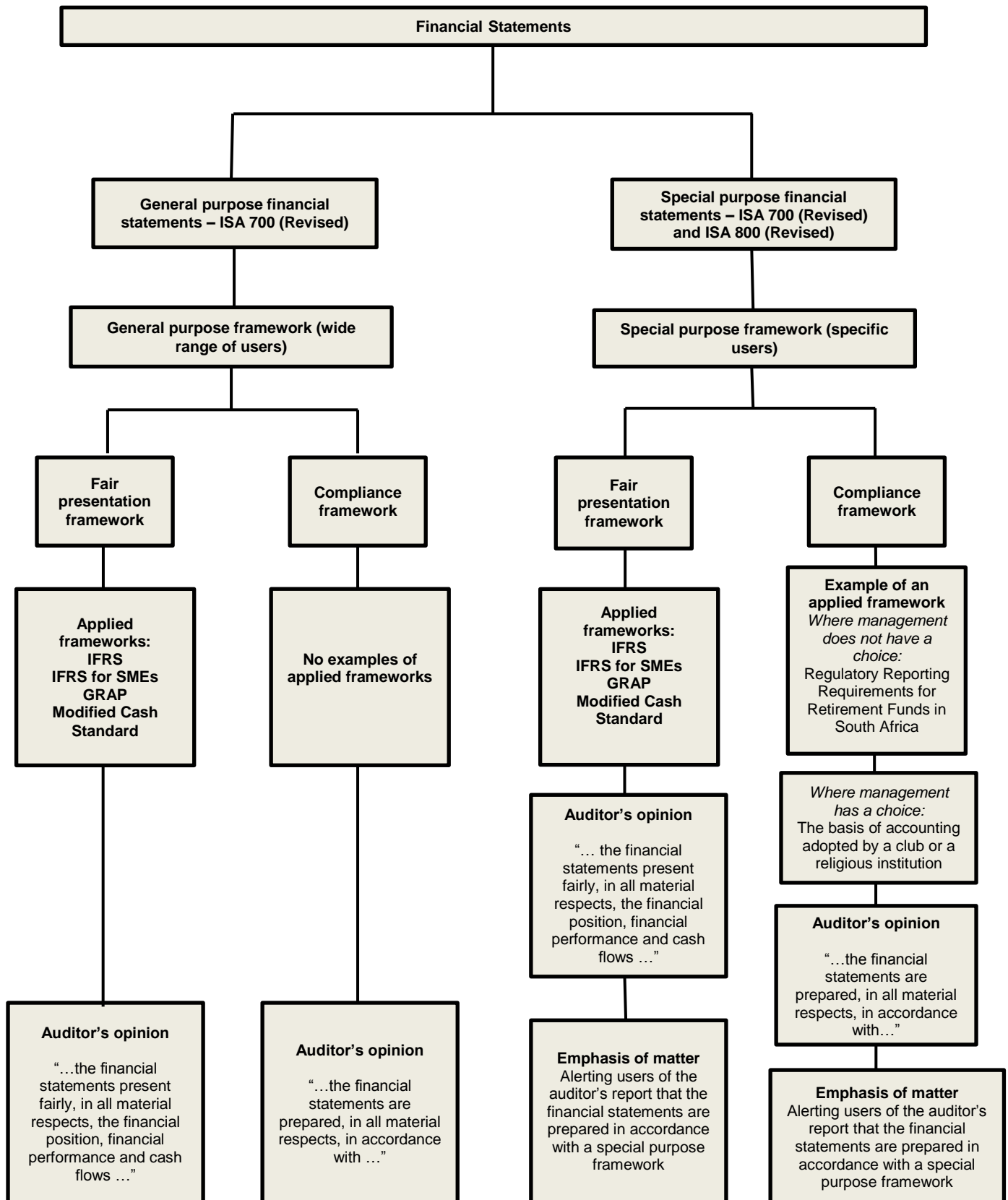
³⁶ Refer to paragraph 6 – The definitions referred to in SAAPS 2 are terms defined in the ISAs and reflected in the *Glossary of Terms* (December 2016) and they have the same meanings attributed to them.

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framework may be a fair presentation framework or a compliance framework.

Appendix 2

Diagram of the financial reporting frameworks



Appendix 3

Financial Reporting Frameworks in Accordance with Regulation 27 of the Companies Act³⁷

Type of Company	Sub-categories (Note 1)	Financial Statements	Financial Reporting Framework
State-Owned Company			IFRS or GRAP
Public Company	Listed		IFRS
Public Company	Unlisted		IFRS or IFRS for SMEs
Private Company – including Close Corporations	Fiduciary assets >R5m		IFRS or IFRS for SMEs
Private Company – including Close Corporations	Public interest score >350		IFRS or IFRS for SMEs
Private Company – including Close Corporations	Public Interest Score >=100 <350	Independently compiled	IFRS or IFRS for SMEs
Private Company – including Close Corporations	Public interest score >=100 <350	Internally compiled	IFRS or IFRS for SMEs
Private Company – including Close Corporations	Public interest score <100	Independently compiled	IFRS or IFRS for SMEs
Private Company – including Close Corporations	Public interest score <100	Internally compiled	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed
Personal Liability Company	Fiduciary assets >R5m		IFRS or IFRS for SMEs
Personal Liability Company	Public Interest score >350		IFRS or IFRS for SMEs
Personal Liability Company	Public interest score >=100 <350	Independently compiled	IFRS or IFRS for SMEs
Personal Liability Company	Public interest score >=100 <350	Internally compiled	IFRS or IFRS for SMEs
Personal Liability Company	Public interest score <100	Independently compiled	IFRS or IFRS for SMEs
Personal Liability Company	Public interest score <100	Internally compiled	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed

³⁷ Companies Act, Regulation 27.

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Type of Company	Sub-categories (Note 1)	Financial Statements	Financial Reporting Framework
Non-Profit Company	Linked to state or foreign company or statutory/regulatory function		IFRS or GRAP
Non-Profit Company	Fiduciary assets >R5m		IFRS or IFRS for SMEs
Non-Profit Company	Public Interest Score >350		IFRS or IFRS for SMEs
Non-Profit Company	Public interest score >=100 <350	Independently compiled	IFRS or IFRS for SMEs
Non-Profit Company	Public interest score >=100 <350	Internally compiled	IFRS or IFRS for SMEs
Non-Profit Company	Public interest score <100	Independently compiled	IFRS or IFRS for SMEs
Non-Profit Company	Public interest score <100	Internally compiled	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed

Note 1: Fiduciary Assets: Regulation 28 of the Pension Funds Act, No. 24 of 1956 – assets held at any time during the year in the ordinary course of primary activities in a fiduciary capacity for persons not related to the company.

Public interest score: Regulation 26 of the Companies Act – calculated at financial year-end.