

**Exposure Draft**

**September 2010**

**Comments are requested by 12 November 2010**



**Proposed Revised South African Auditing Practice Statement (SAAPS) 2  
Financial Reporting Frameworks and the Auditor's Report**

## REQUEST FOR COMMENTS

The Committee for Auditing Standards (CFAS), a statutory committee of the Independent Regulatory Board for Auditors (IRBA) approved the release of the Proposed Revised South African Auditing Practice Statement (SAAPS) 2, *Financial Reporting and the Auditor's Report* at its meeting in August 2010, now issued for public comment. To ensure that all relevant stakeholders are consulted and to streamline the consultation process, interested and affected stakeholders are invited to submit **written** comments to the IRBA. All comments will be considered a matter of public record.

Please submit written comments, preferably by e-mail, or on a computer disc to:

The Director-Standards  
Independent Regulatory Board for Auditors  
P O Box 751595  
Garden View  
2047  
**For Attention: Mrs. S D van Esch**

E-mail: [svanesch@irba.co.za](mailto:svanesch@irba.co.za)

Fax: +27 86 575 6535

Enquiries should be directed to Mrs. S D van Esch

Tel: +27 87 940 8871

Fax: +27 86 575 6535

E-mail [svanesch@irba.co.za](mailto:svanesch@irba.co.za)

or

Mr. B Jantjies

Tel; +27 87 940 8862

Fax: +27 86 575 8645

E-mail [bjantjies@irba.co.za](mailto:bjantjies@irba.co.za)

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**EXPOSURE DRAFT  
PROPOSED REVISED  
SOUTH AFRICAN AUDITING PRACTICE STATEMENT (SAAPS) 2  
FINANCIAL REPORTING FRAMEWORKS AND THE AUDITOR'S REPORT**

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## **Explanatory Memorandum**

This memorandum provides background to, and explanation of, the proposed revised South African Practice Statement (SAAPS) 2, now titled *Financial Reporting Frameworks and the Auditor's Report*.

This proposed revision was prompted by the changes that came about in International Standards on Auditing which were approved for audits of financial statements for periods beginning on or after 15 December 2009 (the clarified ISAs) and the need for auditors to understand the interaction, rather than the difference, between general and special purpose financial statements, general and special purpose frameworks, and fair presentation and compliance frameworks that are a feature of the clarified ISAs. At the same time there have been revisions to the modifications requirements and the requirements for the emphasis of matter and other matter paragraphs. The risk for an auditor lies in applying the wrong framework in the wrong circumstance and getting his report 'wrong' because the application of the clarified ISAs and their interaction is not understood.

This proposed revision additionally deals with the requirements of public sector reporting as contributed by the Auditor-General and the title has also been changed from Financial Reporting Frameworks and Audit Opinions to Financial Reporting Frameworks and the Auditor's Report, thus indicating a more comprehensive application than previously. In these circumstances it is inevitable that this revision is longer than the version it replaces – some 51 paragraphs against 31 paragraphs, together with its appendices. This revised SAAPS 2 is expected to require further revision when the Companies Act 2008 and its Regulations are approved.

The Committee for Auditing Standards approved this proposed revision of SAAPS 2 at its August 2010 meeting for exposure for public comment.

## Proposed Revised South African Auditing Practice Statement (SAAPS) 2

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

#### Purpose

1. The purpose of this South African Auditing Practice Statement (SAAPS) is to provide guidance to the auditor 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 audit<sup>1</sup> is present; and
  - The effect of the financial reporting framework applied on the auditor's report in South Africa.<sup>2</sup>
2. The guidance contained in this SAAPS does not establish new requirements for, or exemptions from, the requirements of the ISAs and should be read in conjunction therewith. The auditor exercises professional judgement to determine the extent to which any of the guidance provided in this SAAPS may be appropriate in the light of the requirements of the ISAs and the auditor's particular circumstances.

#### Scope

3. This SAAPS is based on the ISAs which were approved for audits of financial statements for periods beginning on or after 15 December 2009 (the clarified ISAs). The ISAs that have particular reference to financial reporting frameworks and the auditor's report dealt with in this SAAPS are:
  - ISA 200, Overall Objective of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing (ISA 200)
  - ISA 210, Agreeing the Terms of Audit Engagements (ISA 210)
  - ISA 700, Forming an Opinion and Reporting on Financial Statements (ISA 700)
  - ISA 705, Modifications to the Opinion in the Independent Auditor's Report (ISA 705)
  - ISA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (ISA 706)
  - ISA 800, Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks (ISA 800)
4. This SAAPS does not incorporate the requirements of:
  - ISA 805, Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement (ISA 805). The principles dealt with in this SAAPS may, however, be applied to ISA 805 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, Engagements to Report on Summary Financial Statements (ISA 810), as the 'applied criteria' referred to in ISA 810 is not the 'applicable financial reporting framework' as contemplated in the preparation of financial statements.
5. This SAAPS does not extend to:
  - An engagement to review financial statements in accordance with

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<sup>1</sup>ISA 210, paragraph 6(a)

<sup>2</sup>ISAs 700, 705, 706 and 800

International Standards on Review Engagements (ISREs). It is nevertheless 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 is nevertheless 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 SAAPS 2 the following terms defined in the ISAs and reflected in the Glossary of Terms (February 2009) have the same meanings attributed to them:<sup>3</sup>
  - ‘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’;
  - ‘criteria’ and ‘applied criteria’.
7. The ‘applicable financial reporting framework’ referred to in the ISAs, for all practicable purposes, is the same as the ‘identified financial reporting framework’ referred to in the definition of ‘audit’ in the Auditing Profession Act, No. 26 of 2005.<sup>4</sup>
8. The term ‘basis of accounting’ used in this SAAPS is used in the context of 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.

### **Purpose of an audit of financial statements**

10. The purpose of an audit is to enhance the degree of confidence of the intended users in the financial statements and 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.<sup>5</sup> Accordingly an audit is an assurance engagement.

### **Determining the acceptability of the financial reporting framework**

11. The *International Framework for Assurance Engagements* 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.

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<sup>3</sup>These definitions are provided in Appendix 1 of this SAAPS.

<sup>4</sup>The Auditing Profession Act (2005) section 1.

<sup>5</sup>ISA 200, paragraph 3.

## **Intended users**

12. The intended users<sup>6</sup> 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 the following:
- A wide range of users for which general purpose financial statements are prepared. These include:
    - Those established by statute, such as the members in the case of the Companies Act, No. 61 of 1973 as amended to whom the auditor's report is addressed;
    - Those established in terms of common law, such as financial institutions, regulatory authorities, the South African Revenue Service and creditors; and
    - Those in the public sector, such as Parliament, Provincial Legislatures, elected officials, National / Provincial Treasuries, donors, institutional and individual lenders, special interest groups and the general public.
  - Specific users for which special purpose financial statements are prepared. These include:
    - Those established by agreement between the auditor, the responsible party (usually, but not necessarily, the client) and those engaging the auditor (the client);
    - Those established 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 the parents of learners in a school.

## **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:<sup>7</sup>
- **Relevance:** relevant criteria contribute to conclusions that assist decision-making by the intended users.
  - **Completeness:** criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
  - **Reliability:** reliable criteria allow reasonably consistent evaluation or measurement of the subject matter (other historical financial information) including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
  - **Neutrality:** neutral criteria contribute to conclusions that are free from bias.
  - **Understandability:** understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

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<sup>6</sup> ISA 210, paragraphs A2 – A10 provide further guidance, ISA 800, paragraphs 8(b) and A5.

<sup>7</sup> Framework, paragraph 36, ISA 200, Appendix 2 and ISA 800, paragraph A8.

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 judgement, 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. In order 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 framework<sup>8</sup> to be applied 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.<sup>9</sup>
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:<sup>10</sup>
  - The nature of the entity;
  - The purpose of the financial statements;
  - The nature of the financial statements; and
  - Whether law or regulation prescribes the applicable financial reporting framework.

Additional factors to be considered for special purpose financial statements include:<sup>11</sup>

- The intended users; and
- The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

### **General purpose and special purpose frameworks**

18. In order to determine 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. At present there is no objective and authoritative basis that has been generally recognised globally for determining the acceptability of general purpose financial reporting frameworks and 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, provided the organisations follow an established and transparent process involving deliberation

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<sup>8</sup>ISA 210, paragraph 6(a), A2 – A10 and Appendix 2.

<sup>9</sup>ISA 800, paragraph 10.

<sup>10</sup>ISA 210, paragraph A4.

<sup>11</sup>ISA 800, paragraph 8.



and consideration of the views of a wide range of stakeholders.<sup>12</sup>

20. Law and regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such entity.<sup>13</sup>
21. The recognised accounting standard setters in South Africa are the Accounting Practices Board (APB) and the Accounting Standards Board (ASB). The auditor relies on the processes followed by these standard setters in developing frameworks acceptable for general purpose financial statements. A body authorised by statute to prescribe financial reporting frameworks to be applied in preparation of financial statements by certain entities does not constitute a recognised accounting standard setter.
22. The framework to be applied by particular entities may be prescribed by law or regulation. The following, for example, contain prescribed requirements:
  - The Companies Act;<sup>14</sup>
  - The JSE Listings Requirements;
  - The Public Finance Management Act, No. 1 of 1999 (PFMA).

The Public Audit Act, No. 25 of 2004 (PAA) empowers the Auditor-General to prescribe the financial reporting framework to be applied by a public sector entity in the absence of any requirement regarding the financial reporting framework in the legislation applicable to that entity.

In addition to the prescription in the PFMA, the PFMA also empowers the National Treasury to prescribe the accounting standards for public sector entities in the absence of implementation dates of GRAP.

23. The following are examples of general purpose frameworks:
  - Standards approved by the APB
    - International Financial Reporting Standards (IFRS)
    - South African Statements of Generally Accepted Accounting Practice (SA GAAP / GAAP)
    - International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs)<sup>15</sup>
  - Standards approved by the ASB
    - Standards of Generally Recognised Accounting Practice (GRAP)
  - The Departmental Financial Reporting Framework prescribed by the National Treasury
24. The following are examples of special purpose frameworks:
  - Where management does not have a choice in the application of the framework:
    - The financial reporting framework approved by the Financial Services Board for the financial statements of retirement funds is an

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<sup>12</sup>ISA 210, paragraph A8 and ISA, 200 paragraph A7.

<sup>13</sup>ISA 800, paragraph A6.

<sup>14</sup>Refer to Appendix 3 in this SAAPS for further guidance.

<sup>15</sup>South African Statement of GAAP for SMEs may still be applied by entities for financial periods ending on or before 31 August 2010.

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 that comprises a set of criteria used in preparing financial statements which applies to all material items and which 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 acknowledgements in the definition of a fair presentation framework. It should be noted that the departures referred to in the acknowledgements are only to achieve fair presentation.
27. The following financial reporting frameworks approved and issued by standard setters in South Africa are recognised as fair presentation frameworks:
  - International Financial Reporting Standards (IFRS);
  - South African Statements of Generally Accepted Accounting Practice (GAAP);
  - International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs);<sup>16</sup>
  - Standards of Generally Recognised Accounting Practice (GRAP).
28. A financial reporting framework, whether prescribed by law or regulation or management, which 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.
29. When a departure from the prescribed financial reporting framework is granted by the body or entity who prescribed the framework, the auditor determines whether that framework is still a fair presentation framework and whether the framework is still acceptable.<sup>17</sup>
30. Where management has selected a compliance framework or basis of accounting where it has a choice, the auditor determines the acceptability of the basis of accounting<sup>18</sup> given 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 especially 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 stipulation in that entity's founding document, for example, a trust deed.

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<sup>16</sup>South African Statement of GAAP for SMEs may still be applied by entities for financial periods ending on or before 31 August 2010.

<sup>17</sup>ISA 800, paragraph A3.

<sup>18</sup>ISA 800, paragraph 8.

The specified basis of accounting may be a fair presentation framework or a compliance framework.

### **The effect of the financial reporting framework or basis of accounting on the auditor's report**

33. 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. 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.
34. The requirements of the applicable financial reporting framework and any legislative requirements determine the form and content of a set of financial statements and affects the wording in the auditor's *Report on the Financial Statements*. Law or regulation may impose additional reporting responsibilities on the auditor which have no effect on the financial reporting framework applied in the preparation of the financial statements. These are dealt with in the auditor's *Report on Other Legal and Regulatory Requirements*.
35. The auditor's report on a company's financial statements refers to the applicable fair presentation financial reporting framework followed by '... and in the manner required by 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 Schedule 4. The reference to the Companies Act also indicates that the financial statements are that company's statutory financial statements and is omitted when the financial statements are not a company's statutory financial statements.
36. In the case of a public sector entity, which may also be a company, the auditor's report also refers to the PFMA, Local Government: Municipal Finance Management Act, No. 56 of 2003 (MFMA), the Division of Revenue Act (DORA) or any specific enabling legislation which prescribes the financial reporting framework and any additional financial reporting requirements, additional to those contained in the applicable financial reporting framework.  
  
For example, in the case of a company which is a public entity as defined in the PFMA, the auditor's report refers to the applicable fair presentation financial reporting framework followed by '... and in the manner required by the Public Finance Management Act of South Africa, and in the manner required by 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.
37. The financial reporting framework referred to in the financial statements and auditor's report must be available to the intended users to 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 in the case of a compliance framework.
38. Legislation, regulatory requirements and legal agreements often refer to 'generally accepted accounting practice (gaap)', which is neither an identified fair presentation financial reporting framework nor a description of a compliance framework in accordance with International Standards on Auditing. In such circumstances the compliance framework referred to in the auditor's report is described as '...the basis of accounting described in Note X...to the financial statements'.

39. 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 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 better able to 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.<sup>19</sup>
40. 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.
41. 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*]'
42. The auditor issues an appropriately modified auditor's opinion in accordance with ISA 705:
- 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 the aim of the departure is not to achieve fair presentation.
43. 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, 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'.
44. 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.

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<sup>19</sup>ISA 800, paragraphs 14, A14 and A15.

### **When a financial reporting framework is not acceptable**

45. If it is determined that the financial reporting framework is not acceptable, and the preconditions for an audit have not been met, the auditor refers to ISA 210, paragraph 8, for guidance.
46. 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 refers to ISA 210, paragraphs 19 and 20, for guidance.
47. If the auditor has 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 evaluates the effect of the misleading nature of the financial statements on the auditor's report and modifies the auditor's opinion accordingly.<sup>20</sup>
48. It is unlikely that a fair presentation framework, approved and issued by a standard setter in South Africa (see paragraph 23 above), may 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 may be unacceptable. It is more likely that where management has a choice in the application of the framework, such framework may be unacceptable.

### **Other matters**

49. The application of the financial reporting frameworks dealt with in this SAAPS is presented by way of a diagram in Appendix 2.
50. Illustrative auditor's reports on financial statements are contained in SAAPS 3.

### **Effective date**

51. This SAAPS provides guidance for the implementation of the International Standards on Auditing (ISAs) that became effective for audits of financial statements for periods beginning on or after 15 December 2009.

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<sup>20</sup>ISA 210, paragraph 20

## Proposed Revised South African Auditing Practice Statement (SAAPS) 2

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

#### Appendix 1

##### Definitions<sup>21</sup>

- 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) *Applied criteria* (in the context of ISA 810) are the criteria applied by management in the preparation of summary financial statements.
- c) *Compliance framework* refers to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in the definition of a fair presentation framework.
- d) *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 judgement.
- e) *Fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and:
  - Acknowledges explicitly 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 provide disclosures beyond those specifically required by the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.
- f) *General purpose financial statements* are financial statements prepared in accordance with a general purpose framework
- g) *General purpose framework* is a financial reporting framework designed to meet the common information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework
- h) *Special purpose financial statements* are financial statements prepared in accordance with a special purpose framework
- i) *Special purpose framework* is a financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.

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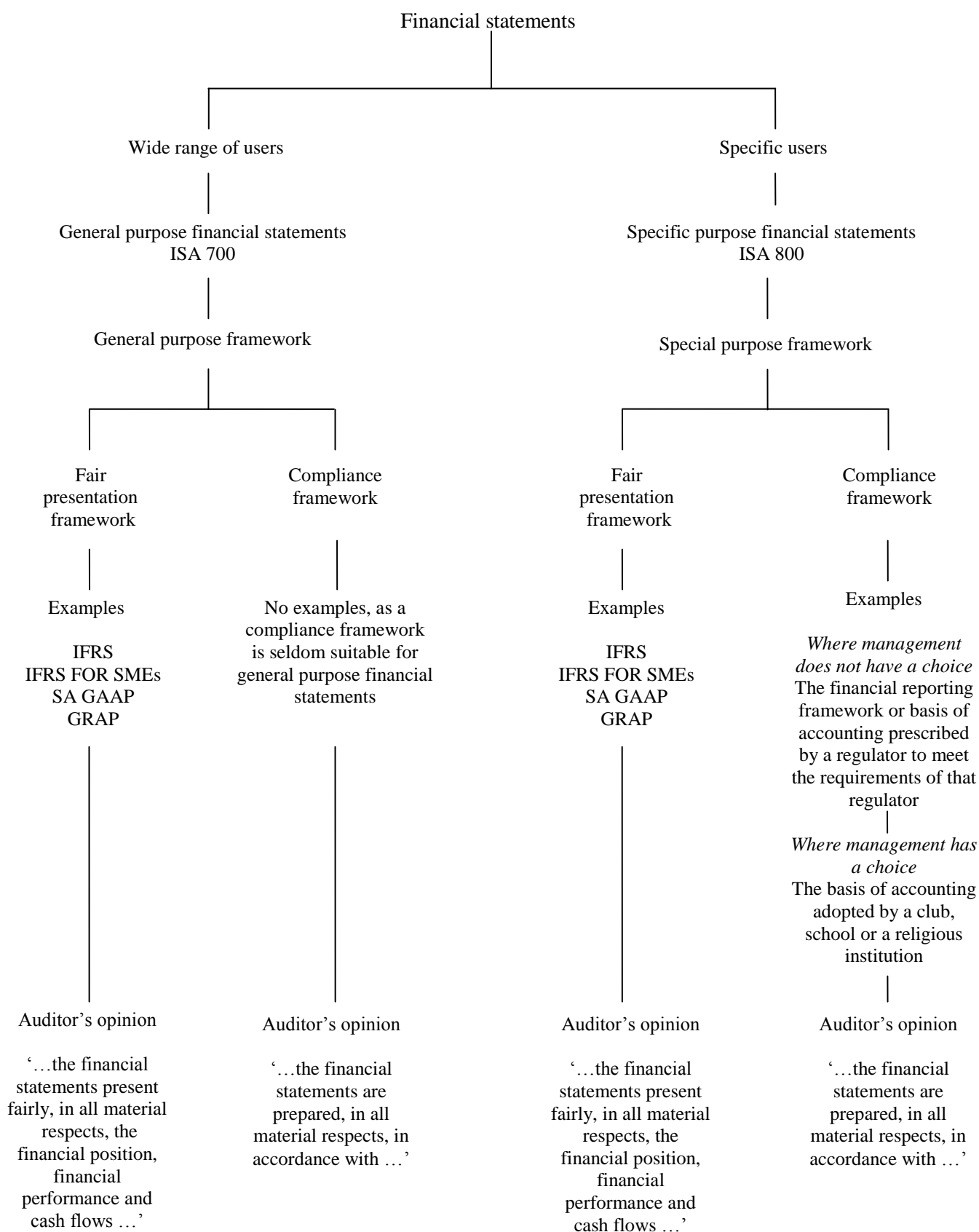
<sup>21</sup>Refer to paragraph 6 – These definitions referred to in SAAPS 2 are terms defined in the ISAs and reflected in the Glossary of Terms (February 2009) and have the same meanings attributed to them.

# Proposed Revised South African Auditing Practice Statement (SAAPS) 2

## Financial Reporting Frameworks and the Auditor's Report

### Appendix 2

#### Diagram of the financial reporting frameworks



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

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

#### **Appendix 3**

##### **Financial reporting frameworks and the Companies Act**

- a) The Companies Act, 2008 provides that the Minister, after consulting with the Financial Reporting Standards Council, which is still to be established, may make regulations regarding financial reporting standards. Until such regulations are promulgated, the authority for general purpose frameworks is the Accounting Practices Board (APB).
- b) The Companies Act, 2008 defines financial reporting standards as Statements of Generally Accepted Accounting Practice adopted by the APB prior to the establishment of the Financial Reporting Standards Council (FRSC). At present the financial reporting standards adopted by the APB apply.
- c) The financial statements of a widely held company comply with financial reporting standards and the provisions of the Companies Act, 1973 and Schedule 4 that are applicable to public interest companies. The financial reporting frameworks that may be applied by a widely held company are IFRS and SA GAAP. A company listed on the JSE Limited (JSE) is a widely held company and, additionally, complies with the JSE Listings Requirements which require that the financial statements of JSE listed entities be prepared in accordance with IFRS, which includes certain South African interpretations in the AC 500 statements issued by the APB.
- d) The financial statements of a limited interest company comply with the accounting standards developed by the FRSC for limited interest companies and the provisions of the Act and Schedule 4 of the Companies Act, 1973 that are applicable to limited interest companies. At the time of issuance of this SAAPS, such accounting standards have not been developed. Accordingly, the financial reporting frameworks that may be applied by a limited interest company in the transitional period are IFRS, SA GAAP or IFRS for SMEs. However, the latter may only be applied by a limited interest company if it does not have public accountability as defined in the Standard.
- e) Paragraph 5 of Schedule 4 to the Companies Act, 1973 which permitted departures from any of the accounting concepts stated in SA GAAP approved by the APB if it appears to the directors that there were reasons for doing so, has been deleted by the Corporate Laws Amendment Act. A departure still permitted by the Companies Act, 1973 relates to section 290(1) which states that, "a limited interest company need not consolidate financial statements if the directors are of the opinion that the required information about the state of affairs, business and profit or loss of the company and its subsidiaries would be presented more effectively and meaningfully in the manner set out in section 290(2)". Group annual financial statements in a form other than consolidated financial statements are subject to the disclosure requirements of paragraph 61 of Schedule 4.