

Ref#638801

30 November 2017

Independent Regulatory Board for Auditors (IRBA)

Email: standards@irba.co.za

Dear Sir

SAICA SUBMISSION ON THE IRBA'S PROPOSED SOUTH AFRICAN AUDITING PRACTICE STATEMENT (SAAPS) 2 (REVISED 2017): FINANCIAL REPORTING FRAMEWORKS AND THE AUDITOR'S REPORT

In response to your request for comments on the **Proposed SAAPS 2 (Revised): Financial Reporting Frameworks and the Auditor's Report (Proposed SAAPS 2)**, please find attached comments prepared by The South African Institute of Chartered Accountants (SAICA).

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

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Project Director – Assurance

INTRODUCTION

1. The IRBA has recognised the need to provide guidance to registered auditors (RAs) 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.
2. We welcome and support the initiative and efforts of the IRBA to provide clarity and guidance on this.

SAICA'S APPROACH TO RESPOND

3. A Working Group of SAICA's Assurance Guidance Committee (Working Group) met to provide their views and comments in finalising the SAICA comment letter.
4. Included in this comment letter are the details of the discussions held by the Working Group. The purpose of including such detail is not to provide a definitive conclusion on the matters noted but rather to point out areas of concern for further consideration by the CFAS Task Group.

THE SAICA COMMENT LETTER IS ORGANISED INTO TWO SECTIONS, AS FOLLOWS:

Section 1: Response to Request for Specific Comments; and
Section 2: Response to Request for General Comments.

SECTION 1: RESPONSE TO REQUEST FOR SPECIFIC COMMENTS

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).

5. In considering this question, it became apparent that there was some confusion with regard to referring to National Treasury, and other organisations or bodies in the Proposed SAAPS 2, as "accounting standard setters". In fact, the term "accounting standard setter" is not found anywhere in the ISAs and it is our view that this is what is creating the confusion. In the context of financial reporting and the preparation of financial statements reference is made to "an authorised or recognised standards setting organisation"¹. We believe that this is referring to any organisations that is authorised or recognised to promulgate standards for general purpose financial statement, or for special purpose financial statements as contemplated in

¹ Refer to:

- ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (ISA 200), paragraphs A5; ISA 210.18, A8, A10, A36;
- ISA 800 (Revised), Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks (ISA 800 (Revised)), paragraphs A2, A3;
- ISA 805 (Revised), Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement (ISA 805 (Revised)), paragraphs A7, A9;
- ISA 810 (Revised), Engagements to Report on Summary Financial Statements (ISA 810 (Revised)), paragraph A5

ISA 210, Agreeing the Terms of an Audit Engagement (ISA 210).A8 and ISA 800 (Revised).A6, respectively.

6. To this end, it is suggested that the term *accounting standard setter* that has been used throughout the Proposed SAAPS 2 be reconsidered.
7. In aligning this question to the requirements of the ISAs, it is our view that a more appropriate question is whether the Modified Cash Standard (MCS) as issued by National Treasury can be considered to be an acceptable financial reporting framework.
8. Guidance on this matter was found in ISA 210² and ISA 800 (Revised)³, where it states that financial reporting standards are presumed to be acceptable for general purpose financial statements or for special purpose financial statements, respectively, provided that:
 - They are established by organisations that are authorised or recognised to promulgate standards to be used by certain types of entities; and
 - The organisation must have followed an established and transparent process involving deliberation and consideration of *the views of a wide range of stakeholders* for general purpose financial statements, or involving deliberation and consideration of *the views of relevant stakeholders* for special purpose financial statements.
9. In considering whether the MCS was established by an organisation that is authorised or recognised to promulgate standards as indicated, the following is relevant:

Public Finance Management Act (PFMA)

- Section 40(b): Accounting Officer of a department must prepare annual financial statements in accordance with generally recognised accounting practice (grap).
- Section 89(a)(i): The Accounting Standards Board (ASB) must set standards for departments.

Where they have not set the standard for a specific group of entities, then National Treasury can set such standards, as follows.

Treasury Regulations

Regulation 18(2): In the absence of implementation dates set for standards issued by the ASB, the following reporting standards comprise grap:

- Departments must prepare their financial statement on the modified cash basis in accordance with the format prescribed by National Treasury.
10. It can therefore be concluded that the first requirement with respect to the organisation being authorised or recognised to promulgate standards to be used by certain types of entities has been met.
 11. Proposed SAAPS 2, paragraph 23 presents the MCS as a general purpose framework (as opposed to a special purpose framework). This would require National Treasury to have followed an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders.

² ISA 210, paragraph A8

³ ISA 800 (Revised), paragraph A6

12. With respect to whether such an established and transparent process was followed, the Proposed SAAPS 2 does not contain sufficient information on the reason behind the conclusion reached. To the extent that the required due process was followed and the views of a wide range of stakeholders were considered, we are satisfied that the MCS is acceptable as a general purpose framework.
13. It would be useful for the information relating to these considerations and the reasons behind the conclusion reached to be made available in the form of a Basis for Conclusion. This will also serve as referencing guide should Proposed SAAPS 2 need to be revised again in the future.

SECTION 2: RESPONSE TO REQUEST FOR GENERAL COMMENTS

Consideration 1: Whether the Modified Cash Standard (MCS) is considered to be a fair presentation framework?

14. 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 circumstances⁴.
15. The conjunction used to link the requirements contained in the definition of a fair presentation framework is “or”, implying that only one of the requirements must be met. The MCS⁵ complies with the second requirement contained in the definition, in that it includes acknowledgment that it may be necessary to depart from the standard in order to achieve fair presentation. It is therefore our view that this requirement to be considered a fair presentation framework has been met.

Consideration 2: Are the examples of fair presentation frameworks included under the special purpose financial statement branch of the diagram contained in Appendix 2 of Proposed SAAPS 2 considered to be fair presentation frameworks?

16. In terms of the definitions for a general purpose framework⁶ and a special purpose framework⁷ (respectively), both can be either fair presentation or compliance frameworks. In considering whether a framework is a general purpose or a special purpose framework, consideration is given to the definition of these frameworks, as follows:
 - General purpose framework is a financial reporting framework designed to meet the common financial information needs of a wide range of users⁸; and
 - Special purpose framework is a financial reporting framework designed to meet the financial information needs of specific users⁹.

⁴ IAASB Glossary of Terms (2016)

⁵ MCS, paragraphs 18, 19-20

⁶ IAASB Glossary of Terms (2016)

⁷ IAASB Glossary of Terms (2016); ISA 800 (Revised), paragraph 6(b)

⁸ Extract, IAASB Glossary of Terms (2016)

The question is whether financial reporting frameworks designed for general purpose, such as IFRS, IFRS for SMEs, GRAP or the MCS can be adopted in the preparation of special purpose financial statements. And in answering this question, is the purpose for which the framework was designed, or who the intended users are the overriding consideration.

17. In reading the definitions of a general purpose framework¹⁰ and special purpose framework¹¹ (respectively), we conclude that the purpose for which the financial reporting framework was designed is the important consideration and not who the intended users are.
18. This is supported by the guidance contained in ISA 800 (Revised)¹², which states that financial statements prepared in accordance with a special purpose framework may be the only financial statements that an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be special purpose financial statements for the purpose of the ISAs.
19. IFRS, IFRS for SMEs, GRAP and MCS were designed to be general purpose financial reporting frameworks and it is our view that these cannot be applied in preparing special purpose financial statements. With reference to the guidance contained in ISA 800 (Revised)¹³, which states that it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply full compliance with the financial reporting framework if all the requirements of that framework are not fully complied with, it is unlikely that special purpose financial statements will be fully compliant with IFRS, IFRS for SMEs, GRAP and MCS and if they are, these would then become general purpose financial statements.
20. To this end, it is suggested that all the fair presentation financial reporting frameworks included as examples under the special purpose financial statement branch of the diagram contained in Appendix 2 be removed and replaced with the words *No examples of applied frameworks*.

Other General Comments

21. Paragraph 8:
 - With reference to the words “selected or used”, it is not clear whether the use of these two words carry different meanings. To avoid confusion, we suggest that these be replaced with “adopted by”;
 - We suggest adding “(such as the examples referred to in paragraph 24 below)” to the end of the paragraph.
22. Paragraph 16, Footnote 17 – Since ISA 800 (Revised) is a special consideration standard, we suggest changing this reference to ISA 315 (Revised).11(c)
23. Paragraph 29 – This paragraph states that *A financial reporting framework, whether prescribed by law or regulation or management, that is not a recognised financial reporting*

⁹ Extract, IAASB Glossary of Terms (2016); Extract, ISA 800 (Revised), paragraph 6(b)

¹⁰ IAASB Glossary of Terms (2016)

¹¹ IAASB Glossary of Terms (2016); ISA 800 (Revised), paragraph 6(b)

¹² ISA 800 (Revised), paragraph A4

¹³ ISA 800 (Revised), paragraph A2-A3

framework established by a standard setter and where the entity may not deviate from its prescribed form and content is a compliance framework. Since the intention of the Proposed SAAPS 2 is not to establish new requirements, it would be useful to include a reference to the source of this information. Alternatively, we suggest that the SAAPS includes the definition of, or describes a compliance framework as in the ISAs. The last sentence of paragraph 29 should remain as is.

24. Paragraph 34 – With reference to the comment made in paragraphs 16-20 of this comment letter, it is suggested that this is an appropriate place to explain that compliance frameworks will rarely be adopted in the preparation of general purpose financial statements, and that a fair presentation framework will rarely be adopted in the preparation of special purpose financial statements.

25. Paragraph 36 - With reference to the following extract:

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.

During the Working Group's deliberations, it was clear that there was not consensus with respect to the reference to a company's "statutory financial statements". This term is not used or defined in the Companies Act. In terms of its plain English meaning, it would refer to a company's financial statements prepared in accordance with statutory requirements applicable to the company. The Companies Act prescribes requirements for a company's financial statements in section 29 (i.e. in relation to any financial statements, including any annual financial statements), in section 30 (i.e. in relation to a company's annual financial statements as described in that section) and in the related Companies Regulations. There were views expressed that it is uncertain whether the Proposed SAAPS 2 should be indicating that the reference to "... and the requirements of the Companies Act of South Africa" should be omitted in certain instances and if so, what these instances would be. Guidance on this matter was found in SAAPS 3 (Revised)¹⁴. In order to eliminate confusion and align this with the guidance contained in SAAPS 3 (Revised), paragraph 36 could be reworded as follows:

"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". When the financial reporting framework is supplemented by legal or regulatory requirements, reference must be made to the legislation concerned [footnote: ISA 210, paragraph 18 and ISA 700 (Revised), paragraph A24]; in this case the additional financial reporting requirements of the Companies Act."

26. Paragraph 40 – With reference to the following extract:

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.

ISA 800 (Revised).A2 states the following (our emphasis):

¹⁴ SAAPS 3 (Revised), Part A, note N10

There may be circumstances where a special purpose framework is based on a financial reporting framework established by an authorized or recognized standards setting organization or by law or regulation, **but does not comply with all the requirements of that framework**. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of the Financial Reporting Standards of Jurisdiction X. When this is acceptable in the circumstances of the engagement, **it is inappropriate** for the description of the applicable financial reporting framework in the special purpose financial statements to imply full compliance with the financial reporting framework established by the authorised or recognised standards setting organisation or by law or regulation. In the above example, **the description of the applicable financial reporting framework may refer to financial reporting provisions of the contract, rather than make any reference to Financial Reporting Standards of Jurisdiction X**.

We suggest that the guidance contained in paragraph 40 be aligned to the requirements contained in ISA 800 (Revised).A2.

27. Paragraph 49 – This includes a reference to paragraph 23 and we suggest that a reference to paragraph 27 is more appropriate.
28. Appendix 3 - It is suggested that Appendix 3 can be shortened by combining some of the line items in the table. This is in light of the fact that most instances IFRS or IFRS for SMEs is the prescribed financial reporting framework.