

TECHNICAL MEMORANDUM COMPANIES ACT, 2008

AUDIT COMMITTEE REPORT AND REPORT OF THE COMPANY SECRETARY TO BE INCLUDED IN THE ANNUAL FINANCIAL STATEMENTS

This memorandum does not deal with the requirements for appointing an audit committee or a company secretary in accordance with Chapter 3, Parts D and B of the Companies Act (the Act), respectively. For this refer to Section 84 that addresses the application of Chapter 3 of the Act. The purpose of this memorandum is to deal with the requirements that, when applicable, a company must include an audit committee report and/or company secretary report as part of its annual financial statements.

Report of the audit committee

Section 94(7)(f) of the Act determines the duties of an audit committee of a company; which include to prepare a report, to be included in the annual financial statements for that financial year describing how the audit committee carried out its functions, stating whether the audit committee is satisfied that the auditor was independent of the company and commenting in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company.

Report of the company secretary

Section 88(2)(e) of the Act determines that a company secretary's duties include, but are not restricted to, certifying in the company's annual financial statements whether the company has filed required returns and notices in terms of the Act, and whether all such returns and notices appear to be true, correct and up to date.

Complete set of general purpose financial statements and its components

1. There can be little doubt that the following financial reporting standards identified in regulation 27 to the Act each satisfies the requirements of an "acceptable financial reporting framework" and that of a "general purpose financial reporting framework" (compare ISA 210, ISA 700 and SAAPS 2):
 - International Financial Reporting Standards (IFRSs)
 - The International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)
 - South African Statements of Generally Accepted Accounting Practice (SA GAAP).
2. In terms of IFRSs, IFRS for SMEs and SA GAAP, the components of a complete set of financial statements are:

- A statement of financial position
- A statement of comprehensive income
- A statement of cash flows
- A statement of changes in equity
- A summary of significant accounting policies
- Other explanatory information to the financial statements

3. Section 30 of the ~~companies~~ **Companies** Act prescribes additional requirements in relation to what is regarded, under the Act, to be part of a complete set of *annual financial statements*. This includes, for example, a report by the directors [section 30(3)(b)].

4. ISA 210 anticipates this type of eventuality in par. 18: “If financial reporting standards established by an authorized or recognized standards setting organization are supplemented by law or regulation, the auditor shall determine whether there are any conflicts between the financial reporting standards and the additional requirements.”

For further clarification, ISA 210.A34 states that in “some jurisdictions, law or regulation may supplement the financial reporting standards established by an authorized or recognized standards setting organization with additional requirements relating to the preparation of financial statements. In those jurisdictions, the applicable financial reporting framework for the purposes of applying the ISAs encompasses both the identified financial reporting framework and such additional requirements provided they do not conflict with the identified financial reporting framework ...” (own emphasis added).

Hence, ~~is~~ **in** South Africa the applicable financial reporting framework will typically be referred to as, for example, “International Financial Reporting Standards and the requirements of the Companies Act of South Africa” (compare guidance provided in SAAPS 2).

5. However, the Companies Act identifies other reports/components that also form part of the annual financial statements of a company [refer to section 94(7)(f) and section 88(2)(e)]:

- Report of the audit committee
- Report of the company secretary

It follows that these components are part of a complete set of financial statements in accordance with the applicable financial reporting framework described as, for example, “International Financial Reporting Standards and the requirements of the Companies Act of South Africa”.

6. “**Financial statements**” is accepted to be a structured representation of the financial position, financial performance and cash flows of an entity; i.e. a structured representation of historical financial information, including related notes, intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. It is intended to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs (Refer to IAASB Glossary of terms, ISA 210 and ISA 700).

Comment [HH1]: This is the correct definition in terms of ISA, but not what the Companies Act intends. It intends to include the other reports.

7. The requirements of the report of the audit committee are specified in section 94(7)(f) of the Act and deal with the audit committee reporting on the carrying out of its functions, reporting on the independence of the auditor and commenting, as it sees fit, on the financial statements of the company and/or the company's internal financial control.

- The auditor cannot report on the opinion of the audit committee regarding his/her independence. This conflicts with the Code of Professional Conduct for registered auditors and the Auditing Profession Act.
- The functions of the audit committee are statutory matters.
- The report of the audit committee does not serve to provide financial information *that presents* the company's financial position, financial performance and cash flows, but rather *to report on or provide comments on* the financial statements.

Comment [HH2]: I agree that the auditor can't do that, but I don't think the auditor is expected to comment whether their opinion is right or wrong, he needs to conclude whether the report fairly represents the audit committee's opinion. That he can and should do.

Comment [HH3]: I don't follow this – where exactly does the Code say the auditor can't do this?

8. The requirements of the report of the company secretary are specified in section 88(2)(e) of the Act and involve certifying whether the company has filed required returns and notices in terms of the Act, and whether all such returns and notices appear to be true, correct and up to date.

The above is in essence a statement of compliance and provides no financial information *that presents* the company's financial position, financial performance and cash flows.

9. It follows that there exists a number of *conflicts* between the report of the audit committee and the report of the company secretary compared to the other components of a complete set of financial statements in accordance with the applicable financial reporting framework, before being supplemented by these requirements of law.

Comment [HH4]: I think this is where we disagree, I don't see this as a conflict as defined by ISA210. So I don't think this is applicable.

This situation is addressed in ISA 210.18 (continuing from #4, above): "...If such conflicts exist, the auditor shall discuss with management the nature of the additional requirements and shall agree whether: (a) The additional requirements can be met through additional disclosures in the financial statements; or (b) The description of the applicable financial reporting framework in the financial statements can be amended accordingly. If neither of the above actions is possible, the auditor shall determine whether it will be necessary to modify the auditor's opinion in accordance with ISA 705."

10. If a company is required in terms of the Act to include a report of the audit committee and report of the company secretary (taking cognisance of the category of company and in accordance with the requirements of its Memorandum of Incorporation, as applicable), what additional disclosure would be required to prevent any conflict; or alternatively to prevent misleading the users of the financial statement?

Answer: In line with the intention of the Act in section 29(1)(e), stating clearly that these reports have not been audited.

Comment [HH5]: I don't think this reference is applicable – it refers to statements that are not audited because there was no audit requirement.

11. The arguments presented above establish that the report of the audit committee and the report of the company secretary are not wholly consistent (are in conflict) with the other components of a complete set of financial statements in so far as purpose and contents. An audit conducted in accordance with ISAs, resulting in an audit report issued in accordance with ISA 700, is not designed and cannot be expected to encompass these reports.

Comment [HH6]: I don't think it's established.

12. Although not "supplementary information" in the annual financial statements of a company (in actual fact, the reports are part of the financial statements), it may be relevant to refer to the principles established in ISA 700, par. 46 and 47:

Comment [HH7]: Agreed

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- "If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether such supplementary information is clearly differentiated from the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall explain in the auditor's report that such supplementary information has not been audited."
- "Supplementary information that is not required by the applicable financial reporting framework but is nevertheless an integral part of the financial statements because it cannot be clearly differentiated from the audited financial statements due to its nature and how it is presented shall be covered by the auditor's opinion."

The report of the audit committee and the report of the company secretary are integral parts of a company's annual financial statements. However, they *can be clearly differentiated* from the other components of the audited financial statements, because of their very nature, presentation and contents.

13. Therefore, the auditor will not include these reports in the first paragraph of the auditor's report which identify the financial statements subject to audit.

The auditor considers including the following paragraph, after the opinion paragraph in the auditor's report:

Report of the audit committee and report of the company secretary

Without qualifying our opinion, we draw attention to the fact that the report of the audit committee (on pages X to X) and the report of the company secretary (on page Y) are included as part of the annual financial statements in accordance with the requirement of the Companies Act in South Africa, but did not form part of the financial statements subject to audit, as identified in the first paragraph of this report. We have not audited these reports and accordingly we do not express an opinion on them.

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14. The above is also consistent with the requirements in ISA 706 as it relates to other matter paragraphs.

15. To further prevent any misunderstanding, I would agree with SAICA's view that these reports should be included as part of the annual financial statement, before the auditor's report and other components of the financial statements.

16. It would be interesting to find out whether it was the ~~intension~~-intention of the legislator that the report of the audit committee and the report of the company secretary be subject to audit.