

Requirements for annual financial statements to be independently reviewed or audited



The primary purpose of annual financial statements is to measure and communicate two aspects of an entity's activities, namely its financial position and financial performance.

The financial position and financial performance of an entity are communicated to stakeholders or users.

In this way, the stakeholders can make a judgement as to how the management performs the stewardship duty assigned to them and can make rational business decisions on the basis of the financial statements.

In a previous blog we discussed *the importance of filing Annual Returns*, in this blog we look at the requirements for annual financial statements.

Who are the stakeholders and users of financial statements?

- **Investors:** Owners or potential owners of the entity and their financial advisers or brokers provide the necessary capital to run the business and therefore require information regarding the risks involved and the return they can earn on their investment.
- **Employees and trade unions** want information regarding the profitability and stability of the entity in order to assess their own position.
- **Financial institutions** want to know whether the funds they lent to the entity can be repaid and whether the interest can be paid on time.
- **Suppliers and other creditors** would like to know whether the money owed to them will be paid on time.
- **Customers** want to know whether the entity can operate sustainably, especially if they are dependent on the entity's products or services.
- **The government and statutory bodies** require the information for purposes of determining macro-economic policy and to compile statistics and collect taxes.

What are the elements of financial statements?

- **Assets:** Assets are resources that are controlled by the entity as a result of past events and from which the entity is expected to receive future economic benefits.
- **Liabilities:** Liabilities are current responsibilities of an entity that arose from previous events and whose settlement is expected to result in the outflow of resources from the entity.
- **Equity:** Equity is the difference between the entity's assets and liabilities. In the case of a company, equity could be in various forms such as share capital, retained earnings and reserves.
- **Income:** Income is defined as an inflow of economic benefits during the accounting period which results in an increase in equity through an increase in assets and/or a decrease in liabilities excluding contributions by shareholders.

- **Expenses:** Expenditure is defined as an outflow of economic benefits during the accounting period which results in a decrease in equity through a decrease in assets and/or an increase in liabilities excluding distributions to owners.

What are the legal requirements for financial statements?

If a company provides any financial statements in terms of section 29 of the Companies Act to any person for any reason, such statements-

- must satisfy the financial reporting standards in terms of form and content, if any such standards are prescribed;
- must reflect the date on which the statements were produced, and the accounting period to which the statements apply;
- must, on the first page, indicate whether the statements have been audited in compliance with any applicable requirements of this Act;
- must, if not audited, have been independently reviewed in compliance with any applicable requirements of this Act;
- may not have been audited or independently reviewed;
- must reflect the name and professional designation, if any, of the individual who prepared or supervised the preparation of those statements;
- may not be materially false or misleading.

Section 30 of the Companies Act provides that a company must prepare annual financial statements within six months after the end of the financial year.

The annual financial statements must include-

- an auditor's report if an audit was required;
- a directors' report pertaining to the state of affairs of the business and the profit and loss of the company or a group of companies, including any matter considered material in enabling the shareholders to appreciate the company's state of affairs, as well as any prescribed information.

The annual financial statements must be approved by the Board and signed by an authorised director and presented to the shareholders.

How to determine what type of financial statements should be prepared:

A private or personal liability company is subject to an Independent Review or audit, provided that it is not managed by its owners, if-

- it compiles its financial statements internally and its Public Interest Score is less than 100;
- it has its financial statements compiled independently and its Public Interest Score is between 100 and 349;
- a score of 350 points or more is required for an audit to be conducted.

A company's Public Interest Score is calculated as follows:

- 1 point for every employee (average number of employees during any given financial year);
- 1 point for every R1 million in third party liability of the company at the financial year-end;
- 1 point for every R1 million in turnover during the financial year;
- 1 point for every individual who, at the end of the financial year, has a beneficiary interest either directly or indirectly in any of the company's securities. In the case of a non-profit company, 1 point for every person who is a member of the company or a member of an association that is a member of the company.

Conclusion

Annual financial statements must therefore always be in a format that all stakeholders can understand and should include all five elements over a certain measuring period. This will ensure that all users make informed decisions. Any private company with a Public Interest Score of less than 100 is not required to be audited and an independent review will suffice unless the company has opted to have its financial statements audited or is required by its Memorandum of Incorporation (MOI) to do so.

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