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# INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA (ICPAU)

# INFORMATION PAPER:
# AUDITING OF BRANCHES

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**Institute of Certified Public Accountants of Uganda**
**Plot 42 Bukoto Street, Kololo, P.O. Box 12464, Kampala, UGANDA**
**Tel. 041-4540125, 031-2262333, 031-2265590, Fax: 041-4540389**
**technical@icpau.co.ug or icpau@icpau.co.ug**
**www.icpau.co.ug**

## EXECUTIVE SUMMARY

Foreign Direct Investments (FDI) play an extraordinary and growing role in global business. FDI in Uganda are made through branches, subsidiaries, reciprocal distribution agreements, portfolio investments, licensing and technology transfers, joint ventures and other hybrid strategic alliances.

Despite the sizes and contributions by branches of foreign companies to the Ugandan economy, there appears to be no express guidance on their auditing requirements. The provisions in the laws of Uganda are directed to branches of companies incorporated in Uganda. As a result this paper explores the various regulatory provisions concerning auditing and how they may or may not relate to auditing of branches of foreign companies.

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## 1.0 OVERVIEW

Foreign Direct Investments (FDI) play an extraordinary and growing role in global business. FDI in Uganda are made through branches, subsidiaries, reciprocal distribution agreements, portfolio investments, licensing and technology transfers, joint ventures and other hybrid strategic alliances. This paper largely focuses on FDIs taking the form of branches.

## 2.0 INTRODUCTION

A Branch can be defined as an operation in a foreign country incorporated in the home country or an office of a company that exists and conducts operations in a country other than the one in which the company is headquartered. Whereas the Ugandan Companies Act does not give the definition of a Branch, the Indian Companies Act, 1956 defines the expression “Branch Office” in relation to a company to mean:

a. any establishment described as a branch by the company; or
b. any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company; or
c. any establishment engaged in any production, processing or manufacture, but does not include any establishment specified in any order made by the Central Government of India under section 8.

The Income Tax Act, Cap 340 defines a branch as;

a. a place where a person is carrying on business through an agent, other than a general agent of independent status acting in the ordinary course of business as such;
b. a place where a person has, is using, or installing substantial equipment or substantial machinery for ninety days or more; or
c. a place where a person is engaged in a construction assembly, or installation project for ninety days or more, including a place where a person is conducting supervisory activities in relation to such a project; and

With the Government’s drive to promote FDI, foreign companies have continuously participated in doing business or carrying out non-profit activities in Uganda. These are permitted to operate in the country provided they established a place of business before/after 1st January, 1961, and continued to have a place of business in Uganda. A foreign company doing business through an agent in Uganda, at the place of business of its agent, is deemed not to have a place of business in Uganda.

## 3.0 BRANCH AND SUBSIDIARY COMPARED

A subsidiary company or a foreign owned private limited company in Uganda is seen as a separate legal entity from its parent company. It is an independent entity from the foreign parent company shareholders. In principle, shareholders have no liability for debts or undertakings of the subsidiary. Recourse for the subsidiary's creditors or co–contracting parties being limited to the assets of the subsidiary.

What this means is that since a subsidiary enjoys unique or individual legal status, they can pick and choose things different from the head office. It can have its own organs, registered management, rights and obligations and therefore its own identity memorandum and articles of association and its own business activities separate from the parent company.

A branch is an office through which a foreign company engages in business in Uganda. A branch office is a satellite operation established and maintained by a business enterprise for any various reasons. Firms maintain their headquarters in a single location and will direct the activities through branch offices, so as to establish a physical presence in locations sometimes far from the headquarters.

A branch office is not fully autonomous; although it may often conduct most or all the transactions normally dealt with by the headquarters, a branch office does not hold the authority to change or make policy or otherwise act independently of the headquarters. The branch has no independent legal personality (although it is treated in some respects as though it were independent for tax purposes). It follows that the foreign company is directly and fully responsible for all liabilities and undertakings of its Ugandan branch office.

## 4.0 AUDITING LEGISLATIVE FRAMEWORK OF UGANDA

### 4.1 The Accountants Act, 2013

The Accountants Act empowers the ICPAU to regulate and maintain the country's standards of accountancy, and it is a legal function of the ICPAU Council to promote the usage of internationally accepted accounting and related standards in Uganda.

### 4.2 The Companies Act, 2012

The Companies Act provides basic requirements for accounting and reporting applicable to all private and public companies in Uganda. The Act requires public companies to file annual returns with the Registrar of Companies, including a balance sheet, profit and loss account, group accounts and auditor's report.

### 4.3 Financial Institutions

The Bank of Uganda (BOU) is empowered to regulate banks under the Financial Institutions Act (2004) and financial reporting by nonbanking financial institutions under the Micro-Finance Deposit Taking Institutions Act (2003). Both Acts require compliance with IFRS/IAS in preparation of and maintenance of "financial ledgers and financial records," and specify certain financial statements disclosure requirements (such as insider loans).

The Act further requires every financial institution to nominate for appointment annually, from a pre-qualified list published by the BOU, a firm of qualified auditors who shall perform an audit of the financial statements of the financial institution and to give an opinion in accordance with the Act, the Companies Act, and International Standards on Auditing as adopted in Uganda.

### 4.5 Insurance Institutions

The Insurance Act (as amended by the Insurance (Amendment) Act No. 13 of 2011) and Insurance Regulations (2002) facilitate compliance with international accounting and auditing standards by insurance companies. The Insurance Regulatory Authority regulates financial reporting practices by insurance companies. The Insurance Act requires compliance with IFRS/IAS. The Act requires every risk manager, loss assessor, loss adjuster, insurance surveyor and claim settling agent to maintain books of accounts (Income and Expenditure records), in accordance with IFRSs adopted by ICPAU.

The Act further requires every insurer within one hundred and twenty days after the end of each financial year to prepare and furnish to the Authority in the prescribed form a balance sheet and profit and loss account duly audited by an auditor approved by the commission, showing the financial position of the insurance business at the close of that year.

## 5.0 BRANCH AUDITS

### 5.1 Insurance Act (As Amended)

Section 51 requires that the accounts of every insurer to be audited annually by an auditor approved by the commission. This literally implies that the accounts of the insurer (head office and their branch extensions) shall be audited. No provision is available for those foreign companies that may wish to join the insurance services in Uganda in form of a branch since the act clearly requires each insurer to maintain a head office in Uganda (section 13).

### 5.2 Financial Institutions Act, 2004

The Act defines the term “branch” to mean a place of business which forms a legally dependent part of a financial institution and which conducts directly all or some of the operations inherent in the business of the financial institution;

The same Act considers a branch located within Uganda of a company, firm or other enterprise whose principal place of business is located outside of Uganda to be a resident of Uganda.

Therefore the Act tends to treat branches as part and parcel of their parent companies and hence treated as one for example in computing the minimum amount of liquid assets to be held by a financial institution operating in Uganda and elsewhere, all offices or branches of that financial institution in Uganda are deemed to constitute one institution (Section 28(4)).

### 5.3 The Companies Act, 2012

The Companies Act requires every company (meaning a company formed and registered under this Act or an existing company) to keep books of accounts in respect to:

a. all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;
b. all sales and purchases of goods by the company;
c. the assets and liabilities of the company

Whereas the Companies Act requires all incorporated companies to be audited and which requirement subsidiaries need to fulfill, audit of branches is not explicitly implied anywhere within the auditing provisions of Ugandan legislation. Branches of foreign companies are simply required to present certified copies of their parent company documents when they seek for registration in Uganda. The practice by URA in the recent past was to require branches of foreign companies to file returns accompanied by audited financial statements. However, with the inception of the e-tax system, the authenticity of the amounts on which the returns are based may be doubtable. This may be attributed to the fact the foreign branches in essence may simply use their management accounts especially where the parent company does not insist on the branch to be audited.

The fate in regard to audit of branches seems to rest with the parent company and as such, where there is no guidance on such a subject, the increasing number of branches in the country may consider it a lee way to avoid audits.

Section 256 of the Companies Act states that, "Every foreign company shall, in every calendar year, make out a balance sheet and profit and loss account and, if the company is a holding company, group accounts, in such form, and containing such particulars and including such documents, as under this Act, subject, however, to any prescribed exceptions, it would, if it had been a Company within the meaning of this Act, have been required to make out and lay before the company in general meeting, and deliver copies of those documents to the registrar for registration.

The nexus of the above statement being that a foreign company (used to mean a subsidiary other than branch office) would be required to make out a balance sheet and profit and loss account and in such a form, and containing such particulars and including such documents, as under the Companies Act as if it had been a Company within the meaning of this Act.

Paragraph 2 of the fifth schedule regarding Matters to be expressly stated in the auditors' report only requires the auditors to state whether, in their opinion, proper books of account were kept by the company, so far as their examination of those books were concerned, and that proper returns adequate for the purposes of their audit were received **from branches** not visited by them. This tends to refer to the term 'branches' to mean branches of companies incorporated in Uganda and not those branches that relate to foreign companies.

## 6.0 ELSEWHERE IN THE WORLD

### 6.1 United Kingdom

The Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations (the 'Regulations') were published on 11 September 2012 and came into force on 1 October 2012.

The Regulations create a number of new exemptions and widen certain existing exemptions in relation to the requirements for companies to prepare, file and audit annual accounts under Part 15 of the Companies Act 2006. For small UK businesses and subsidiary companies they will be allowed to dispense with an audit where they meet specified conditions.

The Act and regulations do not give any guidance regarding the audit of branches of foreign companies.

### 6.2 India

Section 228 of the Indian Companies Act 1956 requires that where a company, whether a public or a private limited, has a branch office, its accounts should also be audited. The audit of the accounts of branch office can be done **either** by:

a. the company's auditor; or
b. by any other person who is qualified to act as the company's auditor

This tends to relate to branches of companies incorporated in India.

For foreign companies, section 591 (2) requires that, where not less than fifty per cent. of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of this Act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India. This is taken to refer to establishments in form of subsidiary.

### 6.3 South Africa

The South African Companies Act 2008 defines a "company'' to mean a juristic person incorporated in terms of this Act, or a juristic person that, immediately before the effective date—
(a) was registered in terms of the—
(i) Companies Act, 1973 (Act No. 61 of 1973), other than as an external company as defined in that Act; …

South African legislation provides for a branch of an Offshore Company – also termed as an External Company and a subsidiary that is a Local Branch South African Company Owned by an International Company.

In this case, a branch is registered within the jurisdiction of South Africa; provided the shareholding and directors are situated in the country of origin. It is a requirement for such a firm to have an auditor appointed. The scope of the audit is however, limited to the income statement of the South African operations, since there is no balance sheet required. The audit is mainly for income tax purposes although it can also be used by the international company's auditors.

By implication therefore, an external company- a branch may not be tied by the requirements of the Companies Act 2008 a case in point is Section 23. This section gives more clarity on external companies but it only highlights registration requirements, and the procedures of conducting business in South Africa. The section is silent about the audit requirements and it is also imperative to note that branches of foreign companies are accorded legal status in South Africa by virtue of their registration as external companies but are not recognised as separate legal entities – except for exchange control purposes.

## 7.0 CONCLUSION

Whereas branches of companies incorporated in Uganda are impliedly required to be audited along with their main offices, the audit of branches for foreign companies in Uganda, like it is elsewhere, is not clearly catered for in Ugandan legislation.

The Institute recommends for clarification of requirements in Ugandan legislation relating to registration and auditing of branches operating in Uganda.