

GS 003
(October 2007)

Guidance Statement GS 003
Audit and Review
Requirements for Australian
Financial Services Licensees
under the Corporations Act
2001

Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

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CONTENTS

AUTHORITY STATEMENT	<i>Paragraphs</i>
Application.....	1
Issuance Date	2
Introduction.....	3-6
Legislative Background	7-8
Regulatory Requirements for AFS Licensees	
<i>Corporations Act Requirements</i>	9-12
<i>Financial Requirements for APRA Regulated Entities, Market and Clearing Participants</i>	13-15
<i>Financial Requirements for all Other AFS Licensees</i>	16-19
<i>FS 71 Auditor Reporting Requirements</i>	20-23
<i>Exemptions from Lodging Form FS 71</i>	24-27
Considerations for the Auditor	
<i>Those Who May Audit the AFS Licensee</i>	28
<i>Agreeing on the Terms of the Engagement</i>	29-31
<i>Planning</i>	32-35
<i>Materiality</i>	36-39
<i>Quality Control</i>	40
<i>Reporting Entity Concept</i>	41-42
<i>Natural Persons</i>	43-44
Reporting Requirements	
<i>Limited Assurance on Certain Statements Made in FS 70 relating to Dealing with Clients' Money and Dealing with Other Property of Clients</i>	45
<i>Statement on Section 990K(2) Matters</i>	46-50
<i>Limited Assurance on Risk Management Systems</i>	51-52
<i>Reasonable Assurance on Certain Provisions in Part 7.8 of the Corporations Act</i>	53-64

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

<i>Financial Requirements</i>	64-65
<i>Cash Needs Requirement</i>	66-75
<i>Inherent Limitations</i>	76-77
The FS 71 Audit Report.....	78-80
Conformity with International Pronouncements.....	81
Appendix 1: Example FS 71 Paragraph 3 Insertions:	
<u>Example 1</u> : Paragraph 3 for a licensee regulated by APRA	
<u>Example 2</u> : Paragraph 3 for a Market or Clearing Participant	
<u>Example 3</u> : Paragraph 3 relying on Option 1 or Option 2	
<u>Example 4</u> : Paragraph 3 relying on licence condition 13(c)(iii) (Option 3)	
<u>Example 5</u> : Paragraph 3 relying on licence condition 13(c)(iv) (Option 4)	
<u>Example 6</u> : Paragraph 3 relying on licence condition 13(c)(v) (Option 5)	
Appendix 2: Example Engagement Letter	
Appendix 3: Example Management Representation Letter	
Appendix 4: Extract from ASIC Pro Forma 209	

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) formulates Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001* as set out in paragraphs 1 to 81 and Appendices 1 to 4, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001*, for the purposes of providing guidance on procedural auditing and assurance matters.

This Guidance Statement provides guidance to assist the auditor to fulfil the objectives of the audit or assurance engagement. It includes explanatory details and suggested procedures on specific matters for the purposes of understanding and complying with AUASB Standards. The auditor exercises professional judgement when using this Guidance Statement.

This Guidance Statement does not prescribe or create mandatory requirements.

Dated 31 October 2007

M H Kelsall
Chairman - AUASB

GUIDANCE STATEMENT GS 003

Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001

Application

- 1 This Guidance Statement has been formulated by the Auditing and Assurance Standards Board (AUASB) to provide guidance to the auditor of an Australian financial services (AFS) licensee reporting in accordance with the requirements of the *Corporations Act 2001* (the Corporations Act).

Issuance Date

- 2 This Guidance Statement is issued on 31 October 2007 by the AUASB and replaces AGS 1068 *Audit Requirements for Australian Financial Services Licensees under the Corporations Act 2001* (issued in October 2004).

Introduction

- 3 The audit of AFS licensees may give rise to a number of special audit considerations. Accordingly, this Guidance Statement has been developed to identify the auditor's responsibilities on such engagements, and to provide guidance to the auditor on additional factors which the auditor may consider when planning, conducting and reporting on the audit of an AFS licensee.
- 4 This Guidance Statement provides guidance on the existing responsibilities of the auditor of an AFS licensee imposed by Auditing Standards (ASAs), Standards on Assurance Engagements (ASAEs), Standards on Review Engagements (ASREs) and the requirements of the Corporations Act and the *Corporations Regulations 2001* (Corporations Regulations) but does not add to the auditor's responsibilities contained therein.
- 5 This Guidance Statement is to be read in conjunction with Standard on Assurance Engagements ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, ASA 800 *The Auditor's Report on Special Purpose Audit Engagements* and relevant Australian Securities and Investments Commission (ASIC) regulatory documents in this area issued from

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

time to time, such as Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) reissued on 25 June 2007 and Pro Forma 209 *Australian financial services licence conditions* (PF 209) reissued on 25 June 2007.

- 6 It is not intended that this Guidance Statement replace the need for the auditor of an AFS licensee to refer to the Corporations Act, Corporations Regulations or other relevant ASIC regulatory documents. This Guidance Statement should not be used as a checklist of issues to be considered by the auditor. Furthermore it is not intended that this Guidance Statement limits or replaces the auditor's professional judgement and initiative or limits the application of AUASB Standards on such engagements. AUASB Standards contain the basic principles and essential procedures to be applied to audit and review engagements. Audit and review programs for each engagement are to be designed to meet the requirements of the particular situation, giving careful consideration to the size and type of AFS licensee and the adequacy of its internal control structure.

Legislative Background

- 7 The *Financial Services Reform Act 2001* (FSR Act) and the overall AFS licensing regulatory regime which is administered by ASIC, formally commenced on 11 March 2002. The full provisions of the FSR Act are operative for all AFS licensees under Chapter 7 of the Corporations Act.
- 8 The FSR Act amendments to the Corporations Act introduced a single licensing regime for financial advice and dealings in relation to financial products. The Corporations Act requires an entity that operates a financial services business to hold an AFS licence or be authorised by a licensee.

Regulatory Requirements for AFS Licensees

Corporations Act Requirements

- 9 Section 989B of Part 7.8 of the Corporations Act requires an AFS licensee to lodge a profit and loss statement, balance sheet and auditor's report with ASIC for each financial year. Regulation 7.8.13(1) of the Corporations Regulations requires that for subsection 989B(3), the auditor's report on the profit and loss statement and balance sheet in respect of a financial year be lodged with ASIC in the prescribed form. ASIC requires the profit and loss statement (Statement of Financial Performance) and balance sheet

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

(Statement of Financial Position) and notes to the Statement of Financial Performance and Statement of Financial Position (the “financial statements”) to accompany Australian financial services licensees: profit and loss statement and balance sheet (FS 70) and Australian financial services licensees: audit report (FS 71). FS 70 and FS 71 can be found on the ASIC website www.asic.gov.au under Download Forms.

- 10 Section 989D(1) of the Corporations Act and regulation 7.8.14A of the Corporations Regulations requires an AFS licensee to lodge FS 70 and FS 71 with ASIC within the following periods:
- (a) if not a body corporate – the day that is 2 months after the end of that financial year;
 - (b) if a body corporate that is a disclosing entity or a registered scheme – the day that is 3 months after the end of that financial year; or
 - (c) if a body corporate that is not a disclosing entity or registered scheme – the day that is 4 months after the end of that financial year.
- 11 Many AFS licensees already lodge annual financial reports and the auditor’s report under Chapter 2M of the Corporations Act (usually within 4 months of the financial year, but within 3 months of the financial year for a disclosing entity or registered scheme) with ASIC. The lodgement requirements under Chapter 2M of the Corporations Act apply to companies in general and are not affected by the FSR Act amendments. The FSR Act requires AFS licensees to lodge FS 70 (which includes the annual financial reports) and FS 71 (auditor’s report) under Part 7.8 of the Corporations Act. The lodgement requirements under Chapter 2M and Part 7.8 of the Corporations Act are independent obligations so it is necessary to lodge financial reports separately under both provisions. Only the financial reports lodged under Chapter 2M are on public record while FS 70 and FS 71 contain information that is not required under Chapter 2M. If an AFS licensee is not required to lodge annual financial reports under Chapter 2M, they are still required to lodge FS 70 and FS 71 with ASIC under Part 7.8 of the Corporations Act.
- 12 An AFS licensee can apply to ASIC for an extension of time to lodge FS 70 and FS 71 under Section 989D(3) of the Corporations Act.

**Guidance Statement GS 003 Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001**

Financial Requirements for APRA Regulated Entities, Market and Clearing Participants

- 13 The base level financial requirements and other financial requirement conditions, as set out in ASIC Pro Forma 209 (PF 209), do not apply but FS 70 and FS 71 are still required to be lodged with ASIC if the licensee is either:
- (a) a body regulated by the Australian Prudential Regulation Authority (APRA) as defined in Section 3(2) of the *Australian Prudential Regulation Authority Act 1998*; or
 - (b) a market participant, as defined in the operating rules of ASX Limited (ASX) (other than a principal trader, unless the principal trader is registered as a market maker) who complies with the ASX's operating rules for financial requirements, taking into account any waiver by ASX; or a participant in the licensed market operated by the Sydney Futures Exchange Limited (SFE) that restricts its financial services business to participation in the licensed market and incidental business supervised by SFE and complies with the SFE operating rules for financial requirements, taking into account any waiver by SFE; or
 - (c) a clearing participant in the licensed clearing and settlement facility, as defined in the operating rules of the Licensed Clearing and Settlement Facility (CS Facility), operated by Australian Clearing House Pty Ltd (ACH), that complies with the operating rules of the CS Facility operated by ACH relating to financial requirements, taking into account any waiver by ACH.
- 14 Where a licensee is a body regulated by APRA, PF209 condition 27 requires the audit opinion in FS 71 to state whether for the relevant period, on a reasonable assurance basis, the licensee was a body regulated by APRA at the end of the financial year or for any period of time that ASIC requests. Example 1 in Appendix 1 shows an example FS 71 paragraph 3 for a licensee regulated by APRA.
- 15 Where a licensee is a market participant or clearing participant, ASIC requires the audit opinion in FS 71 to state whether, during any part of the period for which the licensee relied on being a market participant or clearing participant, on a reasonable assurance basis, the licensee was a participant in the market conducted by:
- (a) ASX; or

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- (b) ACH; or
- (c) SFE, that restricted its financial services business to participating in the market and incidental business supervised by SFE.

Example 2 in Appendix 1 shows an example FS 71 paragraph 3 for a market participant or clearing participant.

Financial Requirements for all other AFS Licensees

- 16 All other licensees that are not exempted from the base level financial requirements are required to comply with these requirements under the Corporations Act. The base level financial requirements are that the licensee must:
- (a) be able to pay all its debts as and when they become due and payable; and
 - (b) either:
 - (i) have total assets that exceed total liabilities as shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's total assets would not currently exceed its total liabilities; or
 - (ii) have adjusted assets that exceed adjusted liabilities calculated at the balance date shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's adjusted assets would currently not exceed its adjusted liabilities; and
 - (c) meet the cash needs requirement by complying with one of the following five options:
 - (i) Option 1 (reasonable estimate projection plus cash buffer) - refer to definition of Option 1 in Appendix 4; or
 - (ii) Option 2 (contingency based projection) - refer to definition of Option 2 in Appendix 4; or
 - (iii) Option 3 (financial commitment by an Australian ADI or comparable foreign institution) – refer to

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- Base Level Financial Requirements in Appendix 4;
or
- (iv) Option 4 (expectation of support from an Australian ADI or comparable foreign institution) – refer to Base Level Financial Requirements in Appendix 4; or
 - (v) Option 5 (parent entity prepares cash flow projections on a consolidated basis) – refer to Base Level Financial Requirements in Appendix 4.
- 17 There are also additional financial requirements specified in PF 209 and RG 166 for:
- (a) managed investments and custody services (net tangible assets requirement, refer to PF 209 conditions 14-19 and RG 166 Section C);
 - (b) foreign exchange dealers (tier one capital requirement, refer to PF 209 condition 20 and RG 166 Section G);
 - (c) holding client money or property (tiered surplus liquid funds requirement, refer to PF 209, condition 21 and RG 166 Section E);
 - (d) transacting with clients as principal (adjusted surplus liquid funds requirement, refer to PF 209, condition 22 and RG 166 Section F); and
 - (e) reporting triggers (refer to PF 209, conditions 23-26).
- The auditor has an obligation to consider whether these financial requirements are applicable depending upon the licensee’s licence and business activities. If any of the additional financial requirements are applicable to the licensee, then the FS 71 audit report requires reasonable assurance on those financial requirements.
- 18 If the licensee is authorised to operate an Investor Directed Portfolio Services (“IDPS”), the licensee will need to comply with Class Order 02/294 *Investor directed portfolio services* (CO 02/294). CO 02/294 as amended:
- on 1 June 2004, by Class Order 04/606 *Investor directed portfolio services - amendment* (CO 04/606);

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- on 28 June 2004 by CO 04/734 Investor directed portfolio services - amendment (CO 04/734); and
- on 27 June 2007 by CO 07/480 Investor directed portfolio services, investor directed portfolio-like services and managed discretionary accounts - amendments (CO 07/480).

This class order as amended provides an exemption from certain fundraising, financial product disclosure and managed investments provisions of the Corporations Act for persons who are operating, or are involved in the operation or promotion of, an investor directed portfolio service subject to some conditions and disclosure requirements.

- 19 If the licensee is authorised to operate a Managed Discretionary Account (MDA) Service or act as an external MDA custodian that will directly contract with retail clients, the licensee will need to comply with Class Order 04/194 *Managed Discretionary Accounts*. CO 04/194 was amended on 27 June 2007 by CO 07/480 *Investor directed portfolio services, investor directed portfolio-like services and managed discretionary accounts - amendments* (CO 07/480).

FS 71 Auditor Reporting Requirements

- 20 The FS 71 audit report requires:
- (a) Reasonable assurance on the financial statements.
 - (b) Limited assurance on certain statements made in FS 70 relating to dealing with clients' money and other property of clients.
 - (c) Reasonable assurance that the licensee:
 - (i) is a body regulated by APRA; or
 - (ii) is a market or clearing participant; or
 - (iii) complies with all the financial requirements under the licence other than the cash needs requirement, except for paragraph (e) of the definition of Option 1 if the licensee purports to comply with Option 1.
 - (d) If the licensee is not a body regulated by APRA or a market or clearing participant then the licensee will need to meet

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

the cash needs requirements by complying with one of the following options:

- (i) If the licensee is relying on satisfying the cash needs requirement by Option 1 or Option 2 then ASIC requires the following:
 - Reasonable assurance that the licensee had at all times a projection (covering at least the following 3 months) that purports to, and appears on its face to comply with, paragraph (a) of the definition of Option 1 or paragraph (a) of the definition of Option 2 (depending on which option the licensee purports to be complying with); and
 - Reasonable assurance that the licensee has correctly calculated the projections on the basis of the assumptions the licensee adopted for the projections described) above; and
 - Limited assurance that the licensee is managing the risk of having insufficient financial resources to comply with the conditions of the licence; and
 - Limited assurance over the cash needs requirement using either Option 1 or Option 2 except for paragraphs (a), (c) and (e) of the definition of Option 1 or paragraphs (a) and (c) of the definition of Option 2; and
 - If the licensee relied on Option 1, limited assurance that the assumptions the licensee adopted for its projection were not unreasonable; or
 - If the licensee relied on Option 2, limited assurance that the basis for the selection of assumptions to meet the requirements for the projection adopted was not unreasonable; or

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- (ii) If the licensee is relying on satisfying the cash needs requirement with a financial commitment by an Australian ADI or comparable foreign institution (Option 3) then ASIC requires:
 - Reasonable assurance that the licensee has obtained from an Australian ADI or a foreign deposit-taking institution approved in writing by ASIC as an eligible provider an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee, or the amount for which the licensee is liable to its creditors at the time of demand to the licensee's creditors or a trustee for the licensee's creditors; and
 - Limited assurance that the licensee is managing the risk of having insufficient financial resources to comply with the conditions of the licence; and
 - Limited assurance that the basis for the selection of the assumptions adopted was not unreasonable; or
- (iii) If the licensee is relying on satisfying the cash needs requirement by relying on licence condition 13(c)(iv) (Option 4) then ASIC requires:
 - Reasonable assurance that the licensee is a subsidiary of an Australian ADI or a corporation approved by ASIC in writing; and
 - Reasonable assurance that a responsible officer of the licensee has documented that the officer has the reasonable expectation for at least the following three month period together with the reasons for forming the expectation, the contingencies for which the licensee considers it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; and

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- Limited assurance that the licensee is managing the risk of having insufficient financial resources to comply with the conditions of the licence; and
 - Limited assurance that the basis for the selection of the assumptions adopted was not unreasonable; or
- (iv) If the licensee is relying on satisfying the cash needs requirement by relying on licence condition 13(c)(v) (Option 5), then ASIC requires:
- Reasonable assurance that the cash flows of the licensee and each of its related bodies corporate, other than any body regulated by APRA (“licensee group”), are managed on a consolidated basis and there is a body corporate within the licensee group of which all members of the licensee group are subsidiaries that is not a body regulated by APRA (“parent entity”); and
 - If the licensee is relying on Alternative A, reasonable assurance that the parent entity has provided an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee or to meet the licensee’s liabilities; or
 - If the licensee is relying on Alternative B:
 - ◇ Limited assurance that the licensee is managing the risk of having insufficient financial resources to comply with the conditions of the licence; and
 - ◇ Limited assurance that the basis for the selection of the assumptions adopted was not unreasonable.
- (e) Reasonable assurance on the following matters as stated in Regulation 7.8.13(2) of the Corporations Regulations:

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- (i) the effectiveness of internal controls used by an AFS licensee to comply with:
 - Divisions 2, 3, 4, 5 and 6 of Part 7.8 of the Corporations Act; and
 - Division 7 of Part 7.8 of the Corporations Act other than section 991A; and
 - (ii) whether each account required by sections 981B and 982B of the Corporations Act to be maintained by the AFS licensee has been operated and controlled in accordance with those sections; and
 - (iii) whether all necessary records, information and explanations were received from the AFS licensee.
- (f) A statement that there are no matters that should have been reported to ASIC in accordance with section 990K of the Corporations Act during or since the financial year that have not previously been reported to ASIC, other than the matters detailed in FS 71.

21 FS 71 is a prescribed form, however, paragraph 3 of FS 71 has been left blank for the auditor to insert their opinions and/or statements required under the licensee's licence. Appendix 1 contains examples of paragraph 3 to be included in different circumstances.

22 The AFS financial requirements are complex and ASIC reissued *Regulatory Guide 166 Licensing: Financial requirements* (RG 166) on 25 June 2007. This regulatory guide sets out the financial requirements for holders of an AFS licence.

23 In addition, ASIC *Pro Forma 209 Australian Financial Services Licence Conditions* (PF 209), reissued on 25 June 2007, sets out the standard licence conditions which subject to individual circumstances, will usually be applied to licences authorising a person to provide financial services under an AFS licence. It is important that the individual AFS licence conditions are examined carefully so that the appropriate reporting and auditing obligations are met.

Exemptions From Lodging Form FS 71

24 A foreign Authorised Deposit-taking Institution ("ADI") which holds an AFS licence that has relief under Class Order 03/823 *Relief from licensing, accounting and audit requirements for foreign*

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- authorised deposit-taking institutions*, is not required to lodge FS 71 with ASIC. It is exempt from the requirements of section 989B of the Corporations Act, where equivalent reports prepared for the overseas regulator of the foreign ADI are lodged with ASIC at least once in every calendar year and at intervals of not more than 15 months.
- 25 Where the foreign ADI is also regulated by APRA and the AFS licence contains condition 27 in PF 209, then it is necessary for the foreign ADI to lodge an audit report (even if the foreign ADI is exempt under Class Order 03/823), that states whether for the relevant period, on a reasonable assurance basis, the licensee was a body regulated by APRA at the end of the financial year or for any period of time that ASIC requests. This is because the APRA regulation confirmation requirement is in addition to Section 989B or Class Order 03/823. The format of this audit report does not need to be in accordance with FS 71. To avoid any processing problems, ASIC requires the audit report to be lodged and accompanied by a letter identifying the licensee, licence number and financial year, and clearly stating the reasons why FS 71 has not been lodged. ASIC requires this letter to include reference to the class order and to the requirement for a report pursuant to the relevant licence condition.
- 26 Class Order 06/68 *Conditional relief for foreign licensees from financial reporting and record keeping obligations*, issued 3 February 2006 provides that a foreign company AFS Licence holder (other than a foreign ADI) can lodge accounts prepared for their home regulator with ASIC to meet their AFS Licence requirements. As a result the foreign company does not have to comply with regulations made for the purposes of sections 989B and 989C and hence is not required to lodge FS 70 or FS 71.
- 27 RG 166.8 also states that if the licensee is prudentially regulated overseas, they can apply to ASIC for relief from the financial requirements. ASIC will give this relief on a case-by-case basis if they are satisfied that the applicant is regulated in a way that is comparable to regulation by APRA for entities of that kind. If applicable, ASIC will consider the extent to which the relevant foreign prudential regulation is consistent with the Basel Committee guidelines for regulating deposit-taking institutions.

Considerations for the Auditor

Those Who May Audit the AFS Licensee

- 28 Section 990B(1) of the Corporations Act, requires the AFS licensee to ensure that at all times a registered company auditor is engaged to audit the licensee's financial statements.

Agreeing on the Terms of the Engagement

- 29 The auditor and the AFS licensee agree on the terms of the AFS licensee engagement in writing. Such terms may be outlined in an engagement letter¹, an example of which is provided in Appendix 2 to this Guidance Statement. The auditor has regard to the requirements of ASA 210 *Terms of Audit Engagements* when agreeing on the terms of the engagement.
- 30 The auditor may also use the engagement letter to clarify the respective roles of the AFS licensee and the auditor. In particular, it is important to highlight in the engagement letter the AFS licensee's obligation to establish and maintain effective internal controls in relation to compliance with the requirements of the Corporations Act. It is the responsibility of the AFS licensee to comply with all the conditions under its licence, including all the financial requirements. The auditor obtains acknowledgment of this obligation from the directors of the AFS licensee when obtaining agreement on the terms of the engagement.

Planning

- 31 ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* requires that, the auditor obtains an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial report whether due to fraud or error, and sufficient to design and perform further audit procedures which may also impact on the FS 71 audit report.
- 32 The auditor plans the engagement in accordance with ASA 300 *Planning an Audit of a Financial Report*. In planning the engagement the auditor considers comparison of actual amounts to budgets, for example, when considering the projection of the licensee's cash flows over the next 3 months to the actual cash flows.

¹ Or other suitable form of audit contract.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- 33 The auditor of the AFS licensee considers:
- (a) key responsibilities and risks identified;
 - (b) processes established by the AFS licensee to implement the licence conditions; and
 - (c) processes established by the licensee to monitor adherence to the licence conditions and the Corporations Act requirements.
- 34 When evaluating the licensee's adherence to the licence conditions and the ongoing adequacy of its processes, the auditor will need to obtain from management a copy of the licence conditions, together with a written description of the procedures and structures which the licensee has established to ensure compliance with those licence conditions.
- 35 In planning the audit or review, the auditor considers various matters including:
- The licence conditions.
 - The nature and extent of any recent changes to the licence conditions and whether any detected breaches are deemed to be material in light of the revised licence conditions.
 - The nature of and extent of any changes to, the operations of the licensee itself.
 - Changes to the Corporations Act and Corporations Regulations.
 - Reports and other documents submitted to the board of the licensee regarding the operation of the licence and its compliance functions.
 - Previous auditor's reports, including the auditor's report on financial statements of the licensee, and related management letters.

Materiality

- 36 The auditor considers materiality when determining the nature, timing and extent of audit and review procedures.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- 37 Materiality is addressed in the context of the AFS licensee's objectives, which are developed having regard to the protection of the interests of clients as a whole. Materiality considerations are therefore viewed within the context of setting out adequate measures that the licensee is to apply in operating to ensure compliance with the Corporations Act and the licence conditions.
- 38 The meaning and application of the concept of materiality contained in ASA 320 *Materiality and Audit Adjustments* is adapted by the AFS licensee auditor, as appropriate, to the task of judging adherence to the AFS licence and conformity with the relevant provisions in Part 7.8 of the Corporations Act. However, it is not possible to give a definitive view on what may constitute material, other than to suggest that the auditor exercises appropriate professional judgement having regard to the AFS licensee's obligations to clients, together with the size, complexity and nature of an AFS licensee's activities.
- 39 As identified in ASA 320, when assessing materiality, the auditor considers qualitative factors as well as quantitative factors. The following are examples of qualitative factors that may be relevant:
- The specific requirements of the terms of the engagement.
 - The significance of identified weaknesses or breaches in compliance measures.
 - The cost of alternative compliance measures relative to their likely benefit.
 - Public perceptions and/or interest.

Quality Control

- 40 The auditor needs to adopt quality control policies and procedures in accordance with ASA 220 *Quality Control for Audits of Historical Financial Information*. Quality control policies and procedures apply at two levels. Quality control policy and procedures relate to the overall policies and procedures for all engagements, such as procedures in relation to client acceptance, and also to the direction, supervision and review of work delegated to personnel involved in a specific engagement.

Reporting Entity Concept

- 41 AFS licensees are required to lodge annual financial statements attached to FS 70 and FS 71. Where licensees have not previously

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

prepared financial statements or, in very rare situations, have previously prepared special purpose financial statements, then the auditor considers whether the licensee is a reporting entity. Guidance as to what constitutes a reporting entity is contained in Statement of Accounting Concepts SAC 1 'Definition of the Reporting Entity' and Miscellaneous Professional Statement APS 1 'Conformity with Accounting Standards and UIG Consensus Views'. The decision as to whether an entity is a reporting entity needs to be made on a case by case basis in accordance with SAC 1 and APS 1. A requirement to prepare and/or lodge a financial report with ASIC pursuant to the Corporations Act does not, of itself, deem that entity to be a reporting entity.

- 42 Whilst the current legislation allows for a non-reporting entity to prepare "special purpose" financial statements, in most circumstances an AFS licensee will be a reporting entity and hence lodge "general purpose" financial statements (i.e. adopt all of the Australian Accounting Standards). FS 71 requires a statement as to whether the licensee is a reporting entity or not.

Natural Persons

- 43 ASIC has issued class order CO 03/748 on reporting requirements for AFS licensees who are natural persons. A natural person is defined as an individual, as opposed to a company, partnership or trustee. CO 03/748 states that where the licensee is a natural person, the licensee may exclude from the profit and loss statement, the revenue and expense that do not relate to any business of the licensee or all the revenue and expenses that do not relate to a financial services business of the licensee.
- 44 Alternatively, a natural person licensee can choose not to rely on CO 03/748 and instead include in a profit and loss statement all of their revenues and expenses, whether personal or business. The relief under CO 03/748 is confined to the preparation of the profit and loss statement. ASIC requires a natural person licensee to still prepare a balance sheet that discloses all of his or her assets and liabilities, including his or her personal assets and liabilities and the assets and liabilities of any other business.

Reporting Requirements

Limited Assurance on Certain Statements Made in FS 70 relating to Dealing with Clients' Money and Dealing with Other Property of Clients

- 45 The FS 71 audit report requires limited assurance on certain statements at paragraphs 6 (has the licensee received client monies),

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

7 (has the licensee received client property) and 8 (has the licensee received a loan from a client) of FS 70. The auditor considers the licensee's statements on FS 70 and through performing other evidence gathering procedures including, knowledge of the client and corroborative enquiry, concludes as to the reasonableness of the statements.

Statement on Section 990K(2) Matters

- 46 FS 71 requires a statement about any matter referred to in subsection 990K(2) of the Corporations Act and covers the year under audit and up until the date the FS 71 auditor's report is signed. This 990K(2) statement only deals with those matters that have not already been reported by the auditor as required under 990K(1). The section 990K(2) statement is no longer part of the opinion section on FS 71. Section 990K(2) requires a report to be given in relation to any matter that, in the opinion of the auditor:
- (a) has adversely affected, is adversely affecting or may adversely affect the ability of the licensee to meet the licensee's obligations as a licensee; or
 - (b) constitutes or may constitute a contravention of:
 - (i) a provision of Subdivision A or B of Division 2 (or a provision of regulations made for the purposes of such a provision); or
 - (ii) a provision of Division 3 (or a provision of regulations made for the purposes of such a provision); or
 - (iii) a provision of Subdivision B or C of this Division (or a provision of regulations made for the purposes of such a provision); or
 - (iv) a condition of the licensee's licence; or
 - (c) constitutes an attempt to unduly influence, coerce, manipulate or mislead the auditor in the conduct of the audit.
- 47 The auditor's obligation is to report on the above relevant matters (a) - (c), if they have become aware of them during the course of the audit of the financial statements, performing work on FS 71 or undertaking other audit work (e.g. Managed investments compliance plan audits). However, if the auditor becomes aware of a 990K(2)

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

matter that is outside the Corporations Act sections under audit, then the auditor would report on these section 990K(2) matters but has no obligation to look for matters outside the sections under audit.

48 As this statement specifically covers both the financial year and the period between the end of the financial year and the date of signing the FS71 auditor's report (unlike the other reporting requirements in FS71), the auditor is obliged to formally consider the existence of relevant matters up to the date of signing the report. To determine the existence of such matters, the auditor considers matters including:

- Reading minutes of the meetings of those charged with governance, and compliance, audit and executive committees, held after the reporting date, and enquiring about matters discussed at meetings for which minutes are not yet available.
- Examining the licensee's breach registers up to the date of signing.
- Obtaining copies of all correspondence with ASIC up to the date of signing.
- Enquiring of management as to whether any subsequent events have occurred which might represent matters referred to under section 990K(2).

49 To determine whether the licensee is meeting its obligations as a licensee, the auditor considers matters including:

- A compliance manual exists and whether it has been distributed.
- The licensee monitors the conduct of its representatives.
- Procedures exist to ensure all staff are appropriately qualified and receive ongoing training.
- Recruitment procedures assess the competence of candidates.
- The licensee has a documented complaints and dispute resolution policy.
- The licensee is a member of an approved external dispute resolution scheme.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- The licensee has written approval from ASIC of its compensation arrangements for retail clients.
- Any non-compliance with ASIC directions or ASIC requests for information exists.
- There has been any business changes that may impact on the licence conditions eg: has the licensee either become or ceased to be a participant in a licensed market or a licensed clearing settlement facility.
- Due diligence procedures exist for client documents such as financial services guides, product disclosure statements and other public documents.
- Copies of all correspondence with ASIC during the period have been received.
- The licensee's breach registers have been obtained to determine whether any breaches identified by the licensee are required to be reported in FS 71.

50 Apart from the requirement to report section 990K(2) breaches in FS 71, section 990K(1) requires auditors to report such breaches to ASIC (and any relevant market or clearing authority e.g. ASX for stockbrokers) within 7 days of becoming aware of the matter. Auditors consider this obligation at all times of the year, but particularly during the planning, interim and final stages of their audits. The licensee will have already reported any such breaches within 5 business days of them becoming aware of the matter as required by section 912D(1). However, there is potential conflict between the auditor's obligation to report any breaches and the licensee's obligation to only report significant breaches to ASIC.

Limited Assurance on Risk Management Systems

- 51 FS 71 requires limited assurance on risk management systems in relation to compliance with financial requirements. Section 912A(1)(h) requires an AFS licensee to have adequate risk management systems. To satisfy this obligation, ASIC expects that the risk management systems will specifically deal with the risk that the licensee's financial resources will not be adequate to ensure that they are able to carry on their business in compliance with their licence obligations.
- 52 The auditor considers enquiry of management as to the processes by which they manage these risks. The auditor considers whether a

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

formal documented risk management system exists, although the formality and extent of the processes required will depend on the size, nature and complexity of the business. Aside from periodic calculations of compliance with financial requirements, the auditor considers processes that also exist to identify and address matters that may arise between these periodic calculations that have the potential to cause non-compliance with the financial requirements, although the extent of these processes will depend on how much of a buffer the licensee has above the requirements and the sensitivity of these buffers to fluctuations in the performance and financial position of the licensee.

Reasonable Assurance on Certain Provisions in Part 7.8 of the Corporations Act

53 The FS 71 audit report requires reasonable assurance on compliance with the requirements of Divisions 2, 3, 4, 5 and 6 of Part 7.8 of the Corporations Act and Division 7 of Part 7.8 other than section 991A. These provisions include:

- Dealing with clients' money.
- Dealing with other property of clients.
- Special provisions relating to insurance.
- Obligations to report.
- Financial records, statements and audit.
- Other rules about conduct (i.e.: giving priority to client orders, transmission of instructions through licensed markets, maintaining records of instruction, dealing with non-licensees and employees).

54 Division 2 of Part 7.8 subdivision A and Corporations Regulations 7.8.01 – 7.8.05 relates to handling of client money including:

- What constitutes client money?
- Establishing an approved trust account.
- Payment of client money into the trust account within one business day.
- Circumstances where money can be withdrawn from the trust account.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- Treatment of interest on client money.
- 55 The auditor establishes whether the licensee holds client money, and then the auditor performs procedures including:
- Determining whether a trust account has been appropriately established for the financial period.
 - Sample testing to establish whether client money received has been appropriately paid into the trust account.
 - Sample testing to establish whether withdrawals from the trust account are in accordance with Corporations Regulation 7.8.02. If a licensee does hold client money, the auditor considers whether they also have to comply with the Surplus Liquid Funds requirement.
- 56 Division 2 of Part 7.8 subdivision B and Corporations Regulations 7.8.06 relates to monies paid to a licensee by way of a loan from a client, including:
- What constitutes a loan from a client (excludes deposit and debenture payments)?
 - Establishing an approved trust account.
 - Payment of money lent into the trust account within 1 business day.
 - Statement required to be given to the client setting out terms and conditions of use of the loan and purpose for which funds will be used.
 - Requirement to only use funds for specified purpose outlined in the terms and conditions or subsequently agreed to in writing.
- 57 The auditor establishes whether the licensee has received a loan from a client, and then the auditor performs procedures including:
- Determining whether a trust account has been appropriately established for the financial period;
 - Sample testing to establish whether money received has been appropriately paid into the trust account;

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- Testing to establish whether clients have been given the appropriate statements;
 - Sample testing to establish whether money lent has been used for an agreed purpose.
- 58 Division 3 of Part 7.8 and Corporations Regulation 7.8.07 relates to the handing of property other than money given to the licensee, including:
- What constitutes client property?
 - How the licensee deposits or registers that client property.
 - Circumstances in which a licensee can hold property as security.
 - The requirement to return secured property to the client within one business day of the client settling their obligation to the licensee.
 - The requirement to provide clients with statements of property held as security every 3 months.
- 59 The auditor establishes whether the licensee handles client property, and then the auditor performs procedures including:
- Sample testing to establish whether property received has been appropriately deposited or registered;
 - Establishing whether property is received as security;
 - Sample testing to establish whether the licensee has complied with the requirements relating to property received as security.
- 60 Division 4 of Part 7.8 and Corporations Regulations 7.8.08 relates to the receipt of monies by licensees who are insurance brokers and agents of general and life insurance contracts but not the actual insurer. Auditors consider the applicable legislation and design appropriate tests to determine whether the licensee has designed and is operating effective internal controls in order to comply with the relevant requirements.
- 61 Division 5 of Part 7.8 makes provision for the regulations to impose reporting requirements in relation to money to which Division 2 or 3

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

applies, or to a licensee dealing in derivatives. Currently, there are no regulations relating to this Division.

- 62 Division 6 of Part 7.8 relates to financial records, statements and audit. Auditors consider the applicable legislation and design appropriate tests to determine whether the licensee has complied with the relevant requirements.
- 63 Division 7 of Part 7.8 (other than section 991A) relates to other rules about conduct in licensed markets. The auditor considers firstly whether the legislation is applicable to the licensee. If the legislation is applicable, the auditor then designs appropriate tests to determine whether the licensee has designed and is operating effectively internal controls in order to comply with the relevant requirements.

Financial Requirements

- 64 When auditing compliance with the AFS Licensee requirements throughout the period, it is important for the auditor to:
- (a) understand how the licensee derives their calculations, so the auditor can conclude as to whether this method is in accordance with the requirements
 - (b) ascertain whether all the calculations prepared during the period demonstrate a compliant position; and
 - (c) sample test a number of calculations for accuracy based on underlying financial information.
- 65 The auditor considers the relevant financial requirements by referring to the licence conditions and the client's documented procedures for monitoring compliance with the financial requirements.

Cash Needs Requirement

- 66 ASIC requires a reasonable assurance opinion on the entity's compliance with the financial licensee requirements for the entire year, not just year end. Hence, evidence-gathering procedures will need to include an understanding of the processes adopted by the licensee to ensure compliance throughout the year, such as formal policies, monthly calculations, use of standard calculation templates and monitoring by the licensee's board or appropriate delegate. The auditor considers testing to be performed on a sample basis depending on the assessment of effectiveness of controls.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- 67 If the licensee has adopted Option 1 for the cash needs requirement, the auditor considers compliance throughout the period with the cash holding requirement in Part (e) of the Option 1 definition.
- 68 The auditor considers obtaining the cash flow projections throughout the relevant period and determining whether the cash flow projections are either:
- (a) a projection of the licensee's cash flows over at least the next 3 months based on the licensee's reasonable estimate of what is likely to happen over this term (Option 1); or
 - (b) a projection of the licensee's cash flows over at least the next 3 months based on the licensee's estimate of what would happen if the licensee's ability to meet its liabilities over the projected term (including any liabilities the licensee might incur during the term of the projection) is adversely affected by commercial contingencies taking into account all contingencies that are sufficiently likely for a reasonable licensee to plan how they might manage them (Option 2).
- The auditor considers establishing how often and when the cash flow projection is updated to ensure it continuously covers at least the next 3 months.
- 69 The auditor considers obtaining the licensee's documented assumptions used to prepare the cash flow projections and checking whether the assumptions have been correctly applied in preparing the projections. This may include ensuring that the documented assumptions on the timing of cash flows have been correctly applied to budgeted revenues, expenses and capital expenditure.
- 70 Based on the cash flow projections already obtained, the auditor considers whether there is evidence that the cash flow assumptions are not appropriately documented or that the projections do not demonstrate that the licensee had access as needed to sufficient financial resources at all times in compliance with paragraphs (b) and (d) of either the Option 1 or Option 2 definitions throughout the period. The auditor considers whether the documentation is sufficient to enable the auditor to ascertain whether the assumptions have been correctly applied in preparing the projections. This may involve reviewing the documentation of budget assumptions if the cash flow documentation does not stand alone.
- 71 If the licensee relied on Option 1, then based on reviewing the assumptions in line with the auditor's knowledge of the business and

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- on enquiries of management, the auditor considers whether there is evidence that the assumptions used are unreasonable. This may involve obtaining an understanding of the licensee's budgeting process if budgets are used to prepare the cash flow projections, or considering the historical accuracy of the assumptions in predicting actual cash flows.
- 72 If the licensee relies on Option 2, then based on reviewing the basis of selecting the assumptions in line with the auditor's knowledge of the business and on enquiries of management, the auditor considers determining whether there is evidence that the basis for selecting the assumptions is unreasonable. For Option 2, there is no requirement to consider whether the assumptions themselves are reasonable, unlike for Option 1.
- 73 Where the licensee uses group cash flow projections to meet the cash needs requirement, on the basis of alternative A (under licence condition 13(c)(v)), the auditor is required to include an audit opinion on whether there is an enforceable and unqualified commitment to pay on demand an unlimited amount to the licensee, or to meet the licensee's liabilities (including any additional liabilities that the licensee might incur while the commitment applies). In addition, the report is required to contain a statement on whether the auditor has any reason to believe that the documented basis for selecting the assumptions, on which the licensee's expectation concerning the period during which the commitment will apply, is unreasonable.
- 74 Where the licensee relies on alternative B (under licence condition 13(d)(v)), the audit report is required contain a statement about whether the auditor has any reason to believe that the documented basis for selecting the assumptions, on which the licensee's expectation concerning the adequacy of the resources required under alternative B, is unreasonable.
- 75 Where the licensee is a subsidiary of an Australian ADI or ASIC-approved prudentially regulated body that does not prepare cash flow projections, on the basis of its expectation concerning the adequacy of resources (under licence condition 13(c)(iv)), the audit report is required to contain a statement about whether the auditor has any reason to believe that the basis for selecting the assumptions documented by the licensee in forming the expectation is unreasonable.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

Inherent Limitations

- 76 Due to the nature of audit testing and other inherent limitations of an audit, together with the inherent limitations of an AFS licensee and its related licence conditions, there is a possibility that a properly planned and executed audit will not detect all deficiencies in a licensee's licence conditions. Accordingly, the audit opinion under section 989B(3) is expressed in terms of reasonable assurance and cannot constitute a guarantee that the AFS licensee is completely free from any deficiency, or that all compliance breaches have been detected.
- 77 There are also practical limitations in requiring an auditor to perform a continuous examination of the AFS licensee, and form an opinion that the entity has complied at all times with the Corporations Act during the period covered by the AFS licensee audit report. However, the auditor performs tests periodically throughout the financial year to obtain evidence and have reasonable assurance that the measures complied with the written descriptions and were adequate throughout the period under examination.

The FS 71 Audit Report

- 78 Prior to issuing the FS 71 audit report, the auditor considers obtaining a written representation from the directors of the AFS licensee which contains their assertions that the AFS licensee has complied with the licence conditions during the financial year and up to the date the FS71 audit report is signed, and that the AFS licensee continues to meet the requirements of Part 7.8 of the Corporations Act.
- 79 The FS 71 audit report is an ASIC prescribed form and can be found on the ASIC web site www.asic.gov.au under Download Forms. ASIC requires form FS 71 to be lodged in the prescribed form and that no modifications or deletions be made, unless consented to by ASIC.
- 80 It is important to check the ASIC website to ensure that the latest version of FS71 is adopted.

Conformity with International Pronouncements

- 81 There is no equivalent International Standard on Auditing or International Auditing Practice Statement to this Guidance Statement.

APPENDIX 1

EXAMPLE FS 71 PARAGRAPH 3 INSERTIONS

Example 1: Paragraph 3 for a Licensee regulated by APRA

This suggested example paragraph 3 is to be included on ASIC's Form FS 71 and applies where the licensee is a body regulated by APRA for the entire financial year. This example also applies if the licensee is both a body regulated by APRA and a market participant or clearing participant.

3. Except as stated at paragraph 7, the licensee relied on being a body regulated by the Australian Prudential Regulation Authority ("APRA") for the financial year and in my/our opinion the licensee was a body regulated by APRA at the end of the financial year.

Example 2: Paragraph 3 for a Market or Clearing Participant

This suggested example paragraph 3 is to be included on ASIC's Form FS 71 and applies where the licensee was a market participant or clearing participant for the entire financial year and is not a body regulated by APRA.

3. Except as stated at paragraph 7, based on the definitions under the licensee's licence, the licensee relied on being a market participant or a clearing participant for the financial year, and in my/our opinion, the licensee was a participant in the market conducted by [ASX Limited (ASX)], [the Australian Clearing House Pty Ltd (ACH)] or [Sydney Futures Exchange Limited (SFE) that restricted its financial services business to participating in the market and incidental business supervised by SFE] for the financial year.

Example 3: Paragraph 3 relying on Option 1 or Option 2

This suggested example paragraph 3 is to be included on ASIC's Form FS 71 and is for licensees not regulated by APRA or market participants or clearing participants and where the licensee is relying on satisfying the cash needs requirement by Option 1 or Option 2. The licence conditions specified have been taken from PF 209 reissued on 25 June 2007, however the auditor is expected to use the actual licence conditions of the licensee.

3. Except as stated at paragraph 7,
 - (i) in my/our opinion, for the financial year, the licensee:
 - (A) complied with all the financial requirements under conditions 13 to 26 (inclusive) of this licence, other than paragraph 13(c) of this licence, [except

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- for paragraph (e) of the definition of Option 1 under this licence if the licensee purports to comply with Option 1]; and
- (B) had at all times a projection (covering at least the following 3 months) that purported to, and appears on its face to comply with, [paragraph (a) of the definition of Option 1] *or* [paragraph (a) of the definition of Option 2]; and
 - (C) correctly calculated the projections on the basis of the assumptions the licensee adopted for the projections described in subparagraph 4(i)(B) above; and
- (ii) based on my/our review, following an examination of the documents the licensee relied on in complying with Option 1 or Option 2, we have no reason to believe that:
- (A) the licensee did not satisfy the requirements of subsection 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions of this licence; or
 - (B) the licensee failed to comply with the cash needs requirement using either Option 1 or Option 2 (as applicable) except for paragraphs (a), (c) and (e) of the definition of Option 1 or paragraphs (a) and (c) of the definition of Option 2; or
 - (C) if the licensee relied on Option 1, the assumptions the licensee adopted for its projections were unreasonable; or
 - (D) if the licensee relied on Option 2, the basis for the selection of assumptions to meet the requirements for the projections adopted was unreasonable.

Example 4: Paragraph 3 relying on licence condition 13(c)(iii) (Option 3)

This suggested example paragraph 3 is to be included on ASIC's Form FS 71 and is for licensees not regulated by APRA or market participants or clearing participants and where the licensee is relying on satisfying the cash needs requirement with PF 209 licence condition 13(d)(iii). The licence conditions specified have been taken from PF 209 reissued on 25 June 2007, however the auditor is expected to use the actual licence conditions of the licensee.

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

3. Except as stated at paragraph 7,
- (i) in my opinion the licensee has complied with all the financial requirements under conditions 13 to 26 (inclusive) of this licence, other than paragraph 13(c) of this licence for the financial year; and
 - (ii) in my/our opinion, for the financial year when the licensee relied on subparagraph 13(c)(iii), the licensee has obtained from [an Australian ADI] *or* [a foreign deposit-taking institution] approved in writing by ASIC as an eligible provider an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee, or the amount for which the licensee is liable to its creditors at the time of demand to the licensee's creditors or a trustee for the licensee's creditors; and
 - (iii) based on my/our review, for the financial year, following an examination of the documented assumptions that the licensee relied on in forming the reasonable expectation referred to in licence condition 13(c)(iii), we have no reason to believe that:
 - (A) the licensee did not satisfy the requirements of subsection 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions of this licence; or
 - (B) the basis for the selection of the assumptions adopted was unreasonable.

Example 5: Paragraph 3 relying on licence condition 13(c)(iv) (Option 4)

This suggested example paragraph 3 is to be included on ASIC's Form FS 71 and is for licensees not regulated by APRA or market participants or clearing participants and where the licensee is relying on satisfying the cash needs requirement with PF 209 licence condition 13(c)(iv). The licence conditions specified have been taken from PF 209 reissued on 25 June 2007, however the auditor is expected to use the actual licence conditions of the licensee.

3. Except as stated at paragraph 7:
- (i) in my opinion the licensee has complied with all the financial requirements under conditions 13 to 26 (inclusive) of this licence, other than paragraph 13(c) of this licence for the financial year; and

**Guidance Statement GS 003 Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001**

- (ii) in my opinion, for the financial year when the licensee relied on subparagraph 13(c)(iv), following an examination of the documents prepared for subparagraphs 13(c)(iv)(C), the licensee complied with subparagraphs 13(c)(iv)(A) and subparagraph 13(c)(iv)(C) for the period to which the report relates; and
- (iii) based on my/our review, for the financial year when the licensee relied on subparagraph 13(c)(iv), following an examination of the documents prepared for subparagraph 13(c)(iv)(C), we have no reason to believe that:
 - (A) the licensee did not satisfy the requirements of subsection 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions of this licence; and
 - (B) the basis for the selection of the assumptions adopted was unreasonable.

Example 6: Paragraph 3 relying on licence condition 13(c)(v) (Option 5)

This suggested example paragraph 3 is to be included on ASIC's Form FS 71 and is for licensees not regulated by APRA or market participants or clearing participants and where the licensee is relying on satisfying the cash needs requirement with PF 209 licence condition 13(c)(v). The licence conditions specified have been taken from PF 209 reissued on 25 June 2007, however the auditor is expected to use the actual licence conditions of the licensee.

3. Except as stated at paragraph 7,:
- (i) in my opinion the licensee has complied with all the financial requirements under conditions 13 to 26 (inclusive) of this licence, other than paragraph 13(c) of this licence for the financial year; and
 - (ii) in my opinion, for the financial year when the licensee relied on subparagraph 13(c)(v), the licensee complied with licence condition 13(c)(v)(A) and (B); and
 - (iii) in my opinion, when the licensee relied on Alternative A in subparagraph 13(c)(v)(E), the parent entity has provided an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee or to meet the licensee's liabilities;

or

**Guidance Statement GS 003 *Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001***

- (iii) based on my/our review, for the financial year when the licensee relied on subparagraph 13(c)(v) under Alternative B, following an examination of the documents prepared for Alternative B, we have no reason to believe that:
 - (A) the licensee did not satisfy the requirements of subsection 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions of this licence; or
 - (B) the basis for the selection of the assumptions adopted was unreasonable.

APPENDIX 2

EXAMPLE AUDIT ENGAGEMENT LETTER

The following example audit engagement letter is for use as a guide only, in conjunction with the considerations described in GS 003, and will need to be varied according to individual requirements and circumstances.

To [Board of Directors]

Engagement Letter for Australian Financial Services Licensee

Australian Auditing Standards require that there be a clear understanding in writing, between the auditor and the client as to the extent of audit duties. Accordingly, we set out below details of our responsibilities as auditor and our understanding of the services you require us to perform.

Our Role

Section 989B of the *Corporations Act 2001* (the “Corporations Act”) requires an Australian Financial Services Licence (“AFSL”) holder (“Licensee”) to lodge the auditor’s report on the Licensee together with a profit and loss statement and balance sheet (being the audited financial statements). This letter outlines the scope for the auditor’s report for the year ending [*year-end*].

The Corporations Act and Corporations Regulations determine the scope of the auditor’s report. Reference to the auditor’s report is also made in the conditions of the AFSL. Currently the required format of the auditor’s report is set out in ASIC Form 71.

Audit Scope and Approach

The audit scope is summarised as follows:

- Audit of the financial statements (covered by a separate engagement letter);
- Audit of compliance with specified provisions of Part 7.8 of the Corporations Act (being Divisions 2 to 7, except for section 991A);
- Audit of compliance with sections 981B and 982B of the Corporations Act (relating to the control and operation of trust accounts);
- Audit of compliance with specific AFSL conditions relating to financial requirements, including internal procedures used by the

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

Licensee to comply with the financial requirements under the Licence;

- Review of projections required under the cash needs requirements conditions of the AFSL; and
- Consideration of Guidance Statement GS 003 *Audit Requirements for Australian Financial Services Licensees under the Corporations Act 2001* and section 990K of the Corporations Act. These procedures will be limited primarily to inquiries of Licensee management, review of minutes and related documents, review of correspondence with regulatory bodies and observation of the operation of the internal compliance controls. These procedures will not constitute an audit of the overall internal compliance structure and framework.

Audit procedures will be conducted in accordance with Australian Auditing Standards, and accordingly will include such tests and procedures as we consider necessary in the circumstances. This will involve an examination of the internal control procedures used by the Licensee to comply with the financial requirements of the AFSL, the specified provisions of Part 7.8 and the control and operation of each account maintained for section 981B or section 982B of the Corporations Act.

Our review of the projections required under the cash needs requirements conditions of the AFSL will be conducted in accordance with Australian Auditing Standards applicable to review engagements in order to state whether anything has come to our attention, which causes us to believe that the Licensee did not satisfy the cash needs requirements. A review is substantially less in scope than an audit examination conducted in accordance with Australian Auditing Standards. A review of this nature provides less assurance than an audit.

Inherent Limitations

cause of the inherent limitations of any internal control structure it is possible that errors or irregularities may occur and not be detected. We will not audit the overall internal control structure (including procedures that do not relate to the financial requirements) and no opinion will be expressed as to its effectiveness.

The projections prepared by the Directors in accordance with the cash needs requirements conditions of the AFSL are based upon the achievement of certain economic, operating and developmental assumptions about future events and actions that have not yet occurred and may not necessarily occur. There is a considerable degree of subjective judgement involved in the

**Guidance Statement GS 003 Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001**

preparation of projections. Actual results may vary materially from those projections and the variation may be materially positive or negative.

Directors' Responsibilities

The Licensee is responsible for maintaining effective internal control procedures, including control procedures in relation to compliance with the requirements of Part 7.8 of the Corporations Act, the conditions of the AFSL and the provisions of the financial services laws. These duties are imposed on the Licensee by the Corporations Act and the AFSL.

Fees

We look forward to full cooperation from your staff and we trust that they will make available to us whatever records, documentation and other information we request in connection with our audit.

[Insert additional information here regarding fee arrangements and billings, as appropriate]

Other

This letter will be effective for future years unless we advise you of its amendment or replacement, or the engagement is terminated.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our audit of [Name of the AFS Licensee] as required by Section 989(B) of the Corporations Act.

Yours faithfully,

(signed)

.....

Name and Title

Date

Acknowledged on behalf of [entity] by (signed)

.....

Name and Title

Date

APPENDIX 3

**EXAMPLE MANAGEMENT REPRESENTATION
LETTER**

[Client Letterhead]

[Addressee – Auditor]

[Date]

This representation letter is provided in connection with your audit of the Australian Financial Services Licence (“AFSL”) of [Name of the AFS Licensee] (Licence No: [xx]) as required by Section 989(B) of the Corporations Act 2001 for the financial year ended [balance date]. We confirm, to the best of our knowledge and belief, the following representations:

1. We have made available to you, and your representatives:
 - (a) all financial records and related data, other information, explanations and assistance necessary for the conduct of the audit; and
 - (b) minutes of all meetings of (*shareholders, directors, and committees of directors*).
2. There:
 - (a) has been no knowledge of any fraud, error or non-compliance with laws and regulations involving management or employees who have a significant role in the internal control structure;
 - (b) has been no knowledge of any fraud, error or non-compliance with laws and regulations that could have a material effect on the either the financial reports for [Name of the AFS Licensee], or ongoing compliance with the AFSL; and
 - (c) has been no communications from regulatory agencies concerning non-compliance with, or deficiencies in, financial reporting or compliance practices that that could have a material effect on the financial report of [Name of the AFS Licensee] or our ongoing ability to comply with financial services laws or conditions of the AFSL.

**Guidance Statement GS 003 Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001**

3. We have disclosed to you:
- (a) all significant facts relating to any frauds or suspected frauds which are known to us that may have affected the respective entities; and
 - (b) the results of our assessment of the risk that the financial report may be materially misstated as a result of fraud.
4. There has been no matter during or since the end of the year/period ended **[selected date]** which has adversely affected, is adversely affecting or may adversely affect our ability to meet our obligations as a licensee or constitutes a contravention of :
- (a) a provision of Subdivision A or B of Division 2 of Part 7.8 of the Act (or a provision of regulations made for the purposes of such a provision); or
 - (b) a provision of Division 3 of Part 7.8 of the Act (or a provision of regulations made for the purposes of such a provision); or
 - (c) a provision of Subdivision B or C of Division 6 of the Part 7.8 of the Act (or a provision of regulations made for the purposes of such a provision); or
 - (d) a condition of the licence.
5. We have reported any significant breaches to ASIC as required under:
- (a) section 912D of the Act; and
 - (b) section 601FC(1)(l) of the Act *[delete if licensee is not a responsible entity of a managed investment scheme]*
- and have provided you with details of all breaches, reported and unreported, of the Licence or the Act that occurred during or since the end of the year/period.
6. We have complied with all the financial requirements under the Licence throughout the year/period.
7. We acknowledge our responsibility for the preparation of cash flow projections and the assumptions underpinning those projections, and confirm that the assumptions adopted for the projections were reasonable/the basis for the selection of assumptions to meet the

**Guidance Statement GS 003 Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001**

requirements for the projections adopted was reasonable. *[delete as applicable depending on whether the licensee is complying with Option 1 or Option 2]*

8. We confirm that we have access as needed to enough financial resources to meet our liabilities over the next 3 months, including any additional liabilities that we project we will incur during that term/we might incur during that term. *[delete as applicable depending on whether the licensee is complying with Option 1 or Option 2]*
9. We have maintained adequate risk management systems throughout the year/period to manage the risk of having insufficient financial resources to comply with the conditions of the Licence. *[delete if APRA-regulated]*
10. We have maintained effective controls to ensure that we comply with Divisions 2, 3, 4, 5, 6 and 7 of Part 7.8 of the Act (other than section 991A);
11. We have operated and controlled each account required by sections 981B and 982B in accordance with those sections;
12. In relation to forecast financial information provided to you for the purpose of your report (in particular the cash needs requirements prescribed by Option 1 or Option 2 as referred to in your AFSL and ASIC Form FS 71), it is confirmed, to the best of our knowledge and belief, that:
 - (a) the financial position and operating results for the forecast period reflect the best judgement of our directors and management based on expected future market conditions and the likely course of action to be taken;
 - (b) the accounting principles used in the preparation of the forecast data are consistent with those used in our historical financial statements and are the same as those expected to be used in the eventual preparation of the historical financial statements come the end of the forecast period;
 - (c) there are no contingent liabilities, unusual contractual obligations or substantial commitments which would materially affect the financial forecast except as otherwise specifically disclosed to you;
 - (d) the key assumptions have been consistently applied during the forecast period; and

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- (e) no factors that may be relevant have been omitted.
13. We understand that your examination was made in accordance with Australian Auditing Standards and was, therefore, designed primarily for the purpose of expressing an opinion to the Australian Securities and Investments Commission for the financial year ended [balance date] and that your tests of the financial records and other auditing procedures were limited to those which you considered necessary for that purpose.
14. We have established and maintained an adequate compliance structure to ensure compliance with the conditions applicable to in the AFSL.

Yours faithfully

Name of signing officer and title]

APPENDIX 4

EXTRACT FROM ASIC PRO FORMA 209

Base Level Financial Requirements

13. The licensee must:
- (a) be able to pay all its debts as and when they become due and payable; and
 - (b) either:
 - (i) have total assets that exceed total liabilities as shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's total assets would not currently exceed its total liabilities; or
 - (ii) have adjusted assets that exceed adjusted liabilities calculated at the balance date shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's adjusted assets would currently not exceed its adjusted liabilities; and
 - (c) meet the cash needs requirement by complying with one of the following five options:
 - (iv) Option 1 (reasonable estimate projection plus cash buffer) - refer to definition of "Option 1" under this licence; or
 - (v) Option 2 (contingency based projection) – refer to definition of "Option 2" under this licence; or
 - (vi) Option 3 (financial commitment by an Australian ADI or comparable foreign institution) – a requirement that an Australian ADI or a foreign deposit-taking institution approved in writing by ASIC as an eligible provider gives the licensee an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee, or the amount for which the licensee is liable to its creditors at the time of the demand to the licensee's creditors or a trustee for the licensee's creditors, that the licensee

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- reasonably expects will apply for at least three months, taking into account all commercial contingencies for which the licensee should reasonably plan; or
- (vii) Option 4 (expectation of support from an Australian ADI or comparable foreign institution) – a requirement that the licensee:
- (A) is a subsidiary of an Australian ADI or a corporation approved by ASIC in writing for the purpose of this condition; and
 - (B) reasonably expects that (based on access to cash from its related bodies corporate) it will have adequate resources (when needed) to meet its liabilities for at least the next three months (including any additional liabilities that the licensee might incur during that period), taking into account all adverse commercial contingencies for which the licensee should reasonably plan; and
 - (C) ensures that a responsible officer of the licensee has documented that the officer has the reasonable expectation for at least the following three month period together with the reasons for forming the expectation, the contingencies for which the licensee considers it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; or
- (viii) Option 5 (parent entity prepares cash flow projections on a consolidated basis) – a requirement that the licensee ensures that:
- (A) the cash flows of the licensee and each of its related bodies corporate, other than any body regulated by APRA (“licensee group”), are managed on a consolidated basis; and
 - (B) there is a body corporate within the licensee group of which all members of

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

- the licensee group are subsidiaries that is not a body regulated by APRA (“parent entity”); and
- (C) the parent entity complies with Option 1 or Option 2 as if it were the licensee, cash flows of any member of the licensee group were cash flows of the licensee and any cash held by a member of the licensee group, other than as trustee or as trustee of a relevant trust, were so held by the licensee; and
- (D) a report by the parent entity’s auditor that is a registered company auditor is given to ASIC with the licensee’s annual audit report under condition 28 of this licence, in relation to each financial year of the licensee and for any other period that ASIC requests, by a date that ASIC requests, with respect to compliance by the parent entity with Option 1 or Option 2 as they would apply in accordance with subparagraph (C), reflecting the report that would be required from the auditor of a licensee, for that period purporting to comply with Option 1 or Option 2; and
- (E) either of the following applies:
- Alternative A – the parent entity has provided an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee or to meet the licensee’s liabilities which the licensee reasonably expects will apply for at least the next three months taking into account all adverse commercial contingencies for which the licensee should reasonably plan; or
- Alternative B – the licensee reasonably expects that (based on access to cash from members of the licensee group), it will have adequate resources to meet its liabilities (including any additional

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

liabilities that the licensee might incur while the commitment applies) for at least the next three months taking into account all adverse commercial contingencies for which the licensee should reasonably plan and a responsible officer of the licensee has documented that the officer has the reasonable expectation in respect of at least the following three months together with the reasons for forming the expectation, the contingencies for which the licensee considers it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; and

- (F) the licensee has no reason to believe that the parent entity has not complied with the requirement at subparagraph (C) or has failed to comply in a material respect with its obligations under Chapter 2M of the Corporations Act or, if the parent entity is not a company, under any other laws (whether law in Australia or not) relating to financial reporting that apply to it.

For 5 years after the end of the last financial year that includes a part of the period to which any document prepared for subparagraph (c)(iv)(C) or Alternative B in subparagraph (c)(v)(E) relates, the licensee must keep the document and give it to ASIC if ASIC requests.

Option 1 means the reasonable estimate projection plus cash buffer basis where the licensee is required to:

- (a) prepare a projection of the licensee's cash flows over at least the next 3 months based on the licensee's reasonable estimate of what is likely to happen over this term; and
- (b) document the licensee's calculations and assumptions, and describe in writing why the assumptions relied upon are the appropriate assumptions; and
- (c) update the projection of the licensee's cash flows when those cash flows cease to cover the next 3 months or if the licensee has reason

**Guidance Statement GS 003 Audit and Review Requirements for
Australian Financial Services Licensees under the Corporations Act 2001**

- to suspect that an updated projection would show that the licensee was not meeting paragraph (d) of this definition; and
- (d) demonstrate, based on the projection of the licensee's cash flows, that the licensee will have access when needed to enough financial resources to meet its liabilities over the projected term of at least 3 months, including any additional liabilities the licensee projects will be incurred during that term; and
 - (e) hold (other than as trustee) or be the trustee of a relevant trusts that holds, in cash an amount equal to 20% of the greater of:
 - (i) the cash outflow for the projected period of at least 3 months (if the projection covers a period longer than 3 months, the cash outflow may be adjusted to produce a 3-month average, or
 - (ii) the licensee's actual cash outflow for the most recent financial year for which the licensee has prepared a profit and loss statement, adjusted to produce a 3-month average.

For the purposes of this definition, references to the licensee's cash flow include the licensee's own cash flow and any cash flow of a relevant trust but do not include cash flows of any other trust.

For the purposes of paragraph (e) of this definition, "cash" means:

- (A) current assets valued at the amount of cash for which they can be expected to be exchanged within 5 business days; or
- (B) a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least a month;

but does not include any cash in a relevant trust if the licensee has reason to believe that the cash will not be available to meet all of the projected cash flows of the licensee.

(This definition is imposed where the licensee is not a body regulated by APRA.)

Option 2 means the cash needs requirement on the contingency-based projection basis where the licensee is required to:

- (a) prepare a projection of the licensee's cash flows over at least the next 3 months based on the licensee's estimate of what would happen if the licensee's ability to meet its liabilities over the

Guidance Statement GS 003 *Audit and Review Requirements for Australian Financial Services Licensees under the Corporations Act 2001*

projected term (including any liabilities the licensee might incur during the term of the projection) was adversely affected by commercial contingencies taking into account all contingencies that are sufficiently likely for a reasonable licensee to plan how they might manage them; and

- (b) document the licensee's calculations and assumptions, and describe in writing why the assumptions relied upon are the appropriate assumptions; and
- (c) update the projection of the licensee's cash flows when those cash flows cease to cover the next 3 months or if the licensee has reason to suspect that an updated projection would show that the licensee was not meeting paragraph (d) of this definition; and
- (d) demonstrate, based on the projection of the licensee's cash flow, that the licensee will have access when needed to enough financial resources to meet its liabilities over the projected term of at least 3 months, including any additional liabilities the licensee might incur during that term.

For the purposes of this definition references to the licensee's cash flow include any cash flow of a relevant trust.

(This definition is imposed where the licensee is authorised to provide financial services in the capacity of a Principal Trader only).