

**GS 018**  
(October 2010)

**Guidance Statement GS 018**  
*Franchising Code of Conduct*  
*– Auditor's Reports*

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



**Australian Government**

---

**Auditing and Assurance Standards Board**

## **Obtaining a Copy of this Guidance Statement**

This Guidance Statement is available on the AUASB website:  
[www.auasb.gov.au](http://www.auasb.gov.au)

### **Contact Details**

Auditing and Assurance Standards Board    Phone: (03) 8080 7400  
Level 7, 600 Bourke Street                    Fax: (03) 8080 7450  
Melbourne Victoria 3000                      E-mail: [enquiries@auasb.gov.au](mailto:enquiries@auasb.gov.au)  
AUSTRALIA

**Postal Address:**  
PO Box 204  
Collins Street West  
Melbourne Victoria 8007  
AUSTRALIA

## **COPYRIGHT**

© 2010 Auditing and Assurance Standards Board (AUASB). The text, graphics and layout of this Guidance Statement are protected by Australian copyright law and the comparable law of other countries. Reproduction within Australia in unaltered form (retaining this notice) is permitted for personal and non-commercial use subject to the inclusion of an acknowledgment of the source. Requests and enquiries concerning reproduction and rights for commercial purposes within Australia should be addressed to the Executive Director, Auditing and Assurance Standards Board, PO Box 204, Collins Street West, Melbourne Victoria 8007. Otherwise, no part of the Guidance Statement may be reproduced, stored or transmitted in any form or by any means without the prior written permission of the AUASB except as permitted by law.

ISSN 1833-7600

## CONTENTS

### AUTHORITY STATEMENT

*Paragraphs*

Application.....	1
Issuance Date .....	2
Introduction.....	3-4
Nature and Extent of the Audit Engagement .....	5-10
Audit Approach.....	11-15
Auditor's Report .....	16-20
Conformity with International Pronouncements .....	21
Appendix 1: Example Unmodified Auditor's Report	

### **AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) formulates Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports*, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001*, for the purposes of providing guidance on 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 material on specific matters for the purposes of understanding and complying with AUASB Standards. The auditor exercises professional judgement when using this Guidance Statement.

The Guidance Statement does not prescribe or create new requirements.

Dated: 28 October 2010

M H Kelsall  
Chairman - AUASB

## GUIDANCE STATEMENT GS 018

### *Franchising Code of Conduct – Auditor's Reports*

#### **Application**

- 1 This Guidance Statement has been formulated by the Auditing and Assurance Standards Board (AUASB) to assist auditors to interpret, discharge and report under Item 20 of Annexure 1 to the Franchising Code of Conduct<sup>1</sup> (the “Franchising Code”).

#### **Issuance Date**

- 2 This Guidance Statement is issued on 28 October 2010 by the AUASB and replaces AGS 1040 *Franchising Code of Conduct – Auditor's Reports* issued in November 2002.

#### **Introduction**

- 3 Item 20 of Annexure 1<sup>2</sup> to the *Franchising Code* imposes mandatory disclosure requirements in relation to financial details, which must be provided by franchisors to franchisees when entering into a new franchise agreement on or after 1 October 1998, as follows:
  20. Financial details
    - 20.1 A statement as at the end of the last financial year, signed by at least one director of the franchisor, whether in its directors' opinion there are reasonable grounds to believe that the franchisor will be able to pay its debts as and when they fall due.
    - 20.2 Financial reports for each of the last two completed financial years in accordance with sections 295 to 297 of

---

<sup>1</sup> The *Franchising Code of Conduct* came into operation on 1 July 1998 and was last amended on 3 June 2010. A copy of the Code is available from the Australian Competition and Consumer Commission (ACCC) website (<http://www.accc.gov.au>).

<sup>2</sup> Annexure 1 to the *Franchising Code* sets out the content requirements of the franchising disclosure document when the expected annual turnover of a franchised business is \$50,000 or more. Annexure 2 to the *Franchising Code* sets out the content requirements of the franchising disclosure document when the expected annual turnover of a franchised business is less than \$50,000. For the purpose of this Guidance Statement, the guidance applicable to the auditing requirements of the solvency statements under Annexure 1 and Annexure 2 is the same.

**Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports***

---

the *Corporations Act 2001*, or a foreign equivalent of that Act applicable to the franchisor, prepared by the franchisor.

20.2A If:

(a) the franchisor is part of a consolidated entity that is required to provide audited financial reports under the *Corporations Act 2001*, or a foreign equivalent of that Act applicable to the consolidated entity; and

(b) a franchisee requests those financial reports;

financial reports for each of the last two completed financial years, prepared by the consolidated entity.

20.3 Item 20.2 and 20.2A do not apply if:

(a) the statement under item 20.1 is supported by an independent audit [report specifically relating to that statement] provided by:

(i) a registered company auditor; or

(ii) if the franchisor is a foreign franchisor – a foreign equivalent for that franchisor;

within 12 months after the end of the financial year to which the statement relates; and

(b) a copy of the independent audit [report] is provided with the statement under item 20.1.

4 Generally, the financial report of the franchisor needs to be accompanied by an independent audit report addressed to the directors of the franchisor entity for the specific purpose of being provided to franchisees as part of the disclosure document. However, as indicated in Item 20.3, a franchisor will not be required to provide a financial report where the directors' statement relating to solvency which is provided pursuant to Item 20.1 is supported by an independent audit report provided by a registered company auditor.

## **Nature and Extent of the Audit Engagement**

- 5 The directors' statement required by Item 20.1 of Annexure 1 to the *Franchising Code* contains their opinion on "solvency" as at the end of the last financial year in respect of recorded liabilities as at the end of that year, and which relates to the ability to meet those liabilities over the 12 month period from the end of the last financial year. The auditor's direct responsibility is to form and express an opinion on the directors' statement made pursuant to Item 20.1 of Annexure 1 to the *Franchising Code*. The substance of this responsibility is similar to that assumed by a company auditor in relation to the "solvency" statement by directors which forms part of the directors' declaration under Section 295(4) of the *Corporations Act 2001* (the "Act"), and on which the auditor forms an opinion and reports, as a component of the financial report, under the *Corporations Act*. For audits under the *Act*, the auditor's opinion on the directors' solvency statement is derived from, and is integral to, the audit process related to forming an opinion on the financial report and the appropriateness of the going concern basis in accordance with ASA 570 *Going Concern*.<sup>3</sup>
- 6 In the case of an audit under the *Act*, the auditor's responsibility is to consider the appropriateness of the going concern basis (defined for financial reporting purposes) in the context of the audit of a financial report. The auditor therefore considers the going concern assumption (including solvency) for the "relevant period", being the period from the date of the auditor's current report to the expected date of the next auditor's report on the financial report for the next period. Due to the specific nature of the engagement under the *Franchising Code* which generally occurs outside the annual financial reporting process, the *Franchising Code* specifies that the directors' statement must be provided within a 12 month period from the end of the financial year to which it relates.
- 7 Whilst recognising that for entities subject to audit under the *Act*, there is an interrelationship between the opinion under the *Act* and that required under Item 20.3 of Annexure 1 to the *Franchising Code*, the audit report issued under Item 20.3 is undertaken as a separate audit engagement. It is acknowledged, however, that in situations where the reports are to be provided by the same auditor, much of the evidence to support the opinion under Item 20.3 will be derived from the financial report audit under the *Act*.

---

<sup>3</sup> The Australian Auditing Standards (ASAs) referred to in this Guidance Statement are those ASAs issued by the AUASB in October 2009, which apply to audits of financial reports with reporting periods commencing on or after 1 January 2010.

**Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports***

---

- 8 For engagements under Item 20.3 of Annexure 1 to the *Franchising Code*, the auditor considers the risks inherent in issuing an audit report without the support of an accompanying financial report. For example, unlike the auditor's opinion on solvency under the *Act*, which is one element of the information reported on by the auditor, the Item 20.3 opinion is a specific report on solvency and stands in its own right.
- 9 In situations where no audit has been conducted as at the end of the last financial year, the nature and extent of the audit procedures to be undertaken by an auditor on an entity's financial information, may be similar to those required to express an opinion under the *Act*, before being able to report under Item 20.3. Whilst the audit process need not be directed to supporting an opinion on a complete financial report, but rather on the directors' assertion in their statement, the auditor may, for example need to have obtained sufficient appropriate audit evidence under ASA 500 *Audit Evidence* about the assets, liabilities, revenues, expenses, cash flows, budgets and projections etc. of the entity in order to assess the basis for the directors' "solvency" statement.
- 10 The audit procedures performed are likely to include analysis and assessment of prospective information in relation to cash flows, revenue and payment streams and reflects assumptions that are dependent upon future events which may be subject to risks inherent in the business and future economic conditions. The auditor applies professional judgement in auditing any assumptions to determine their reasonableness as such evidence is future oriented and speculative in nature.

**Audit Approach**

- 11 The nature, timing and extent of the audit procedures appropriate to achieve reasonable assurance are a function of the circumstances of each engagement, and will depend on:
- (a) whether the auditor is a new or continuing auditor;
  - (b) the proximity of the most recent audited financial report;
  - (c) the extent and nature of changes in the entity's activities and/or industry/industries in which it operates since the issue of the most recent audited financial report; and



**Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports***

---

- (d) the nature, timing and extent of the audit procedures conducted since the issue of the most recent audited financial report.

*Continuity in Auditor*

- 12 For the continuing auditor where an audited financial report has recently been issued under the *Act*, the audit process may be limited to a consideration of any changes in the entity's circumstances since the audit of the directors' opinion on solvency included in the directors' declaration is already required under the *Act*. This may involve the auditor:
- (a) enquiring of management/directors as to the basis on which they have formed their opinion on solvency under Item 20.1, and evaluating the appropriateness of any new assumptions underlying their opinion;
  - (b) updating knowledge of the entity's business and industry, to evaluate whether there have been any significant changes to the appropriateness of significant assumptions underlying the previous solvency opinion. Procedures to be applied in this regard could include, for example, those identified in Appendix 1 of ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*. Particular emphasis may need to be given to any changes in expectations concerning cash flow, trading conditions, financial commitments, financing arrangements etc;
  - (c) enquiring as to any changes to the entity's internal control structure in relation to cash flow and management of debt; and
  - (d) applying appropriate analytical review procedures, for example comparing the latest management accounts with budgets and cash flow forecasts.

In the absence of evidence contrary to the representations made by the directors in their Item 20.1 solvency statement, and for the auditor to report under Item 20.3, ASA 700 *Forming an Opinion and Reporting on a Financial Report* states that the auditor shall form an unmodified opinion.

**Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports***

---

- 13 Significant changes in fundamental assumptions and/or conditions, for example changes in the nature of the entity's business, plans for significant acquisitions and disposals may require application of more extensive procedures.

*Initial Engagement – New Auditor*

- 14 For a new auditor, and/or a situation where there has been a significant time lag since the issue of the latest audited financial report, and limited audit procedures applied in relation to forming an audit opinion on the financial report in the current financial period, the nature, timing and extent of the audit procedures may need to be more extensive. This may involve the auditor placing further emphasis on certain areas of the audit, but is not limited to, the following:
- (a) Understanding the entity and its environment and assessing the risks of material misstatement under ASA 315.
  - (b) Obtaining sufficient appropriate audit evidence under ASA 500 to support the solvency statement by Directors:
    - (i) enquiring of management as to the basis on which they have formed their opinion on solvency and evaluating the appropriateness of the assumptions on which this is based;
    - (ii) reviewing procedures and controls over cash flows, trading conditions, financial commitments etc that may affect cash flow and budgetary forecasts and the ability of the entity to pay its debts as and when they fall due;
    - (iii) appropriateness of management's use of the going concern assumption in the preparation of the solvency statement under ASA 570 *Going Concern*; and
    - (iv) obtaining written representations under ASA 580 *Written Representations* from management based on the assertions made throughout the engagement.
  - (c) Consideration of subsequent events under ASA 560 *Subsequent Events* that may have the potential to affect the solvency statement by Directors.

**Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports***

---

- 15 In any of the situations described above where the audit procedures create doubts as to the directors' representations concerning solvency, additional audit procedures may need to be undertaken to enable an opinion to be expressed.

**Auditor's Report**

- 16 The auditor is concerned with obtaining sufficient appropriate audit evidence that the opinion stated in the directors' solvency statement is reasonable, based on the foreseeable commercial circumstances facing the entity and which the auditor can reasonably perceive to exist.
- 17 If, as a result of applying the appropriate level of audit procedures, the auditor forms the opinion that there is sufficient and appropriate audit evidence obtained to support the representation made by the directors in their solvency statement, the auditor issues an unmodified auditor's report under ASA 700. An example report is provided in Appendix 1 to this Guidance Statement.
- 18 If the auditor is of the opinion that the audit evidence is inconsistent with the representation made by the directors, the auditor issues a modified report under ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*.
- 19 If the auditor is of the opinion that there is sufficient and appropriate audit evidence to support the representation made by the directors that events exist that put into doubt the ability of the entity to pay its debts as and when they fall due, the auditor expresses an unqualified opinion but adds an emphasis of matter section. *ASA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* may provide the auditor with some further guidance in this area.
- 20 Item 20.3(b) of Annexure 1, requires the copy of the independent audit [report] to be provided with the directors' statement before distribution of that report to any franchisee or prospective franchisee.

**Conformity with International Pronouncements**

- 21 There is no equivalent International Auditing Practice Statement (IAPS) or Auditing Standard to this Guidance Statement.

## **Appendix 1**

### **Example of An Unmodified Auditor's Report**

#### **INDEPENDENT AUDITOR'S REPORT**

[Appropriate Addressee]

#### **Report on Solvency**

We have audited the statement by directors (“the statement”) of [name of entity] dated [insert date] made for the purposes of fulfilling the requirements of Item 20 of Annexure 1<sup>4</sup> to the *Franchising Code of Conduct*.

#### *Directors' Responsibility for the Statement*

The [name of entity] directors are responsible for the preparation and fair presentation of the statement which has been prepared as at [date of financial year end] to reflect the debts of the entity at that date, and the ability of [name of entity] to meet these debts as and when they fall due over the 12 month period from that date. This responsibility includes establishing, designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the statement that is free from material misstatement, whether due to fraud or errors; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the statement based on our audit. We conducted our audit in accordance with Australian Auditing and Assurance Standards. These standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the statement is free from material misstatement.

Our audit, in accordance with Australian Auditing and Assurance Standards, involved such tests and procedures as we considered necessary in the circumstances. Our procedures included examination, on a test basis, of evidence supporting the reasonableness of assumptions and procedures used by the directors in forming their opinion as at [date of financial year end]

---

<sup>4</sup> The requirements of Item 20 Of Annexure 1 are the same as those of Item 10 of Annexure 2 to the *Franchising Code*. Therefore the phrase ‘Item 20 of Annexure 1’ in the auditor’s report may be replaced with “Item 10 of Annexure 2”, as applicable to the relevant franchised business.

**Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Reports***

---

whether there are reasonable grounds to believe [name of entity] will be able to pay its debts as and when they fall due over the 12 month period from [date of financial year end].

Because of the subjective nature of prospective information required to fulfil the requirements of Item 20 of Annexure 1<sup>4</sup> to the *Franchising Code*, the persuasiveness of the evidence available is limited. Prospective information relates to events and actions that have not yet occurred and may not occur, and reflect assumptions that are dependent upon future events and subject to the risks inherent in the business and future economic conditions. Whilst evidence is available to support the assumptions on which the directors' opinion is based, such evidence is future orientated and speculative in nature. As a consequence, actual results are likely to be different from the information on which the opinion is based, since anticipated events frequently do not occur as expected or assumed and the variations between the prospective opinion and the actual outcome may be significant.

The statement has been prepared pursuant to Item 20 of Annexure 1<sup>4</sup> to the *Franchising Code of Conduct* for distribution to the franchisees and prospective franchisees of [name of entity]. We disclaim any assumption of responsibility for any reliance on this audit report or on the statement to which it relates to any other party, or for any purpose other than that for which it was prepared.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the statement by directors dated [insert date], presents fairly, in all material respects, the directors' opinion pursuant to Item 20 of Annexure 1<sup>4</sup> to the *Franchising Code of Conduct*, that there are reasonable grounds to believe that [name of entity] will be able to pay its debts as and when they fall due.

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

---

<sup>4</sup> The requirements of Item 20 of Annexure 1 are the same as those of Item 10 of Annexure 2 to the *Franchising Code*. Therefore the phrase 'Item 20 of Annexure 1' in the auditor's report may be replaced with "Item 10 of Annexure 2", as applicable to the relevant franchised business.