

**GS 018**  
(June 2015)

# **Guidance Statement GS 018**

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

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

Draft

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Guidance Statements are designed to provide assistance to auditors and assurance practitioners to assist them in fulfilling the objective(s) of the audit or other assurance engagement. Accordingly, Guidance Statements refer to, and are written in the context of specific AUASB Standard(s); and where relevant, legislation, regulation or other authoritative publication. Guidance Statements are not aimed at providing guidance covering all aspects of the audit or other assurance engagement. Further, Guidance Statements do not establish or extend the requirements under an existing AUASB Standard(s).

Guidance Statement *Franchising Code of Conduct – Auditor's Report* is not, and is not intended to be, a substitute for compliance with the relevant AUASB Standard(s) and auditors and assurance practitioners are required to comply with the relevant AUASB Standard(s) when conducting an audit or other assurance engagement.

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**AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) formulates Guidance Statement GS 018 *Franchising Code of Conduct – Auditor's Report* 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.

This Guidance Statement does not prescribe or create new requirements.

Dated: <TypeHere>

M H Kelsall  
Chairman - AUASB

## GUIDANCE STATEMENT GS 018

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

#### **Application**

1. This Guidance Statement has been formulated by the Auditing and Assurance Standards Board (AUASB) to provide guidance to auditors to interpret, discharge and report under Item 21 of Annexure 1 to the Franchising Code of Conduct<sup>1</sup> (the “Franchising Code”).

#### **Issuance Date**

2. This Guidance Statement is issued on 18 June 2015 by the AUASB and replaces GS 018 *Franchising Code of Conduct – Auditor's Report*, issued in October 2010.

#### **Introduction**

3. Item 21 of Annexure 1<sup>2</sup> to the *Franchising Code* (Annexure 1) imposes mandatory disclosure requirements on the franchisor in relation to financial details, which must be provided to franchisees or prospective franchisees when entering into a new franchise agreement on or after 1 January 2015.
4. Audit engagements undertaken in relation to the financial details as required under Item 21 of Annexure 1 are performed under ASA 805 *Special Considerations-Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*. This standard states that when forming an opinion and reporting on a single financial statement or on a specific element of a financial statement, the auditor shall apply the requirements in ASA 700 *Forming an Opinion and Reporting on a Financial Report* as necessary in the circumstances of the engagement.
5. In undertaking audit engagements under Item 21 of Annexure 1, the auditor is required to provide the audit report to the franchisor within four months after the end of the financial year to which the statement of the franchisor’s solvency (directors’ statement) relates.

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

##### *Item 21.1 of Annexure 1*

6. The directors’ statement required by Item 21.1 of Annexure 1 includes the directors’ opinion on “solvency” as at the end of the last financial year as to whether there are reasonable grounds to believe that the franchisor will be able to pay its debts as and when they fall due.
7. The auditor’s responsibility is to form and express an opinion on the directors’ statement made pursuant to Item 21.1 of Annexure 1. 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 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*.

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<sup>1</sup> The *Franchising Code of Conduct* came into operation on 1 July 1998 and the revised *Competition and Consumer (Industry Code – Franchising) Regulation 2014* (issued Oct 2014) is applicable from 1 January 2015. A copy of the Code is available from the Australian Competition and Consumer Commission (ACCC) website (<http://www.accc.gov.au>).

<sup>2</sup> Refer to Appendix 1 which sets out the Financial details under Item 1 of Annexure 1 to the *Franchising Code*, to be included in the franchisor’s Disclosure document prepared for a franchisee or prospective franchisee looking to enter into a franchise agreement from 1 January 2015.

8. 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 under ASA 570 (including solvency) for the "relevant period"<sup>3</sup>, 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.

*Item 21.2 and 21.3 of Annexure 1*

9. If requested by the franchisee and they are available the franchisor should provide to the franchisee or prospective franchisees as part of the Disclosure documents under Item 21.2 or 21.3 of Annexure 1, the financial reports of the franchisor for each of the last 2 completed financial years or as part of the consolidated entity (or foreign equivalent) which are accompanied by an independent audit report addressed to the directors of the franchisor.

*Item 21.4 and 21.5 of Annexure 1*

10. In the event that clause 21.4 or 21.5 of Annexure 1 applies and the auditor (either a registered company auditor or for foreign franchisors, a foreign equivalent) is engaged to provide an independent audit report on the directors' statement under Item 21.1 of Annexure 1, the audit report is required to be provided within four months of the end of the financial year to which the directors' statement relates. The implication for the auditor will be on managing workflow, client expectations and meeting all reporting requirements in a shorter time frame.
11. While 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 21.4 or 21.5 of Annexure 1, the audit report issued under Item 21.4 or 21.5 of Annexure 1, is undertaken as a separate engagement. It is acknowledged, however, that in situations where the audit reports are to be provided by the same auditor, much of the evidence to support the opinion under Item 21.4 and 21.5 of Annexure 1 will be derived from the financial report audit under the Act.
12. For engagements under Item 21.4 and 21.5 of Annexure 1, 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 21.4 and 21.5 of Annexure 1 opinion is a specific audit report on the directors' statement and stands in its own right.
13. 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 audit opinion under the Act, before being able to report under Item 21.4 or 21.5 of Annexure 1. 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 of the entity in order to assess the basis for the directors' statement.
14. The audit procedures performed to be able to report under Item 21.4 or 21.5 of Annexure 1, are likely to include an analysis and assessment of prospective information in relation to cash flows, revenue and payment streams and reflect 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. The auditor may refer to ASAE 3450 *Assurance Engagements involving Corporate Fundraisings and/or Prospective Financial Information* for further guidance on this area.

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<sup>3</sup> Refer to the definition of relevant period in ASA 570 paragraph Aus 13.2.

*Item 21.6 of Annexure 1*

15. In situations where the franchisor or the entity were insolvent in either or both of the last two completed financial years, and is required to report under Item 21.6 of Annexure 1, the auditor considers the guidance contained in paragraphs 10-14 of this guidance statement. The auditor considers the date on which the statutory declaration of the franchisor's solvency is provided and the date at which they sign the independent audit report in order to consider that any subsequent events under ASA 560 *Subsequent Events* have been treated appropriately by the franchisor.

*Other Considerations under the Franchising Code*

16. The franchisor is also required to disclose to the franchisee or prospective franchisee under section 17 of the Franchising Code any materially relevant facts that may affect a statement, declaration or a document referred to in Item 21 of Annexure 1, as soon as reasonably practicable prior to the parties entering into the franchise agreement.
17. In the circumstances where a materially relevant fact becomes known after the disclosure document is completed, the matter should be brought to the attention of the franchisee or prospective franchisee in writing within a reasonable time but not more than 14 days after the franchisor becomes aware of the matter.
18. The auditor needs to enquire of the franchisor as to whether there are any materially relevant facts that should be brought to their attention and applies their professional judgement to determine any impact on the engagement specific audit approach.
19. In the case where a materially relevant fact becomes known to the auditor after completion and distribution of the disclosure document (including the audit report) to the franchisee or prospective franchisee, that may have caused the auditor to amend the audit report the auditor must follow the requirements in ASA 560 to resolve the matter.

**Audit Approach**

20. The nature, timing and extent of the audit procedures appropriate to achieve reasonable assurance on the directors' statement under Item 21.4 or 21.5 of Annexure 1, 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
  - (d) the nature, timing and extent of the audit procedures conducted since the issue of the most recent audited financial report.

*Continuity in Auditor*

21. 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 21.1 of Annexure 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<sup>4</sup>. 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 21.1 of Annexure 1 statement, and for the auditor to report under Item 21.4 or 21.5 of Annexure 1, ASA 700 states that the auditor shall form an unmodified opinion.

22. 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 audit procedures. Some examples of audit procedures the auditor may consider are provided in paragraph 23(c) of this guidance statement.

*Initial Engagement – New Auditor*

23. For an auditor undertaking an initial audit engagement, and/or a situation where there has been a significant time lag since the issue of the latest audited financial report, and less extensive 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) consideration of procedures to obtain information for use in identifying the risks of material misstatement due to fraud under ASA 240 *The Auditor's Responsibilities Relating to Fraud in and Audit of a Financial Report- Appendix 2*.
  - (c) obtaining sufficient appropriate audit evidence under ASA 500 to support the directors' statement:
    - (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 e.g. collection of debtor days 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 directors' statement under ASA 570; and
    - (iv) obtaining written representations under ASA 580 *Written Representations* from management based on the assertions made throughout the engagement.
  - (d) consideration of subsequent events under ASA 560 that may have the potential to affect the directors' statement.

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<sup>4</sup> Refer to ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* for further guidance on areas the auditor needs to consider when undertaking the audit.

24. In any of the situations described above where the audit procedures create doubt 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**

25. The auditor is concerned with obtaining sufficient appropriate audit evidence that the position and declaration given in the directors' statement pursuant to Item 21.1 of Annexure 1 is fairly presented, based on the foreseeable commercial circumstances facing the entity and which the auditor can reasonably perceive to exist.
26. 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 representations made by the directors in their statement, the auditor issues an unmodified auditor's report under ASA 700. An example report is provided in Appendix 2 to this Guidance Statement<sup>5</sup>.
27. If the auditor is of the opinion that the audit evidence is inconsistent with the representation made by the directors, under ASA 570 the auditor needs to communicate with those charged with governance e.g. directors of the franchisor and/or audit committee, events or conditions arising from the audit that in the auditor's professional judgement may cast significant doubt on the entity's ability to continue as a going concern under ASA 570 and issues a modified report under ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*. In this scenario, the auditor may need to consider the basis for the modification and whether this may potentially result in a breach of the Franchising Code and may deem it appropriate to obtain legal advice to determine the appropriate course of action in the circumstances.
28. Under ASA 240, if the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity such as the regulator, in this case the Australian Competition and Consumer Commission.
29. 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.
30. Item 21.4(b) of Annexure 1, requires the copy of the independent audit [report] to be provided with the directors' statement before distribution of that report by the franchisor to any franchisee or prospective franchisee.

### **Conformity with International Pronouncements**

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

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<sup>5</sup> This example independent audit report on a Directors' Solvency Statement can be adapted accordingly for similar audit engagements across different subject matter e.g. *Competition and Consumer (Industry Codes – Oil code) Regulation 2006*.

## Appendix 1

(Ref: Para. 3)

### Excerpt from Franchising Code of Conduct

#### 21 Financial details

- 21.1 A statement of the franchisor's solvency that:
- (a) reflects the franchisor's position:
    - (i) at the end of the last financial year; or
    - (ii) if the franchisor did not exist at the end of the last financial year—at the date of the statement; and
  - (b) is signed by at least one director of the franchisor; and
  - (c) gives the directors' opinion as to whether there are reasonable grounds to believe that the franchisor will be able to pay its debts as and when they fall due.

- 21.2 Financial reports for each of the last 2 completed financial years in accordance with sections 295 to 297 of the *Corporations Act 2001*, or a foreign equivalent of that Act applicable to the franchisor, prepared by the franchisor.

Note: See also items 21.4 to 21.6.

- 21.3 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.

Note: See also items 21.4 to 21.6.

- 21.4 Items 21.2 and 21.3 do not apply if:
- (a) the statement under item 21.1 is supported by an independent audit provided by:
    - (i) a registered company auditor; or
    - (ii) if the franchisor is a foreign franchisor—a foreign equivalent for that franchisor;within 4 months after the end of the financial year to which the statement relates; and
  - (b) a copy of the independent audit is provided with the statement under item 21.1.
- 21.5 If the franchisor or consolidated entity (the *entity*) has not existed for two or more financial years, then instead of providing the financial reports mentioned in item 21.2 or 21.3, the following:
- (a) a statutory declaration of the entity's solvency;

- (b) an independent audit report on the entity's solvency as at the date of the entity's declaration.
- 21.6 If the franchisor or consolidated entity (the *entity*) was insolvent in either or both of the last two completed financial years, the following:
- (a) a statement of the period during which the entity was insolvent;
  - (b) a statutory declaration of the entity's solvency;
  - (c) an independent audit report on the entity's solvency as at the date of the entity's declaration.

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## Appendix 2

(Ref: Para. 27)

### Example of An Unmodified Auditor's Report

#### INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

##### Opinion

We have audited the statement by directors (“the statement”) of [name of franchisor] dated [insert date] [which comprises [name of franchisor] position at [date] and the directors declaration of the entity's solvency] made for the purposes of fulfilling the requirements of Item 21 of Annexure 1 to the *Franchising Code of Conduct*.

In our opinion, the statement dated [insert date], presents fairly, in all material respects, the directors' opinion pursuant to Item 21 of Annexure 1 to the *Franchising Code of Conduct*, that there are reasonable grounds to believe that [name of franchisor] will be able to pay its debts as and when they fall due.

##### Basis of Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Statement* section of our report. We are independent of the franchisor in accordance with the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the statement in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

##### Basis of Preparation and Distribution

The statement has been prepared pursuant to Item 21 of Annexure 1 to the Franchising Code of Conduct for distribution to the franchisees and prospective franchisees of [name of franchisor]. 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.

##### Directors' Responsibility for the Statement

The [name of franchisor] directors are responsible for the preparation and fair presentation of the statement as at [date of financial year end] to reflect the position of the franchisor at that date, and the ability of [name of franchisor] to meet their debts as and when they fall due over the 12 month period from that date. This responsibility includes such controls as the directors' determine is necessary to enable the preparation of a statement that is free from material misstatement, whether due to fraud or error.

In preparing the statement, directors' are responsible for assessing the franchisor's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors' either intend to liquidate the franchisor or to cease operations, or has no realistic alternative but to do so.

The directors' are responsible for overseeing the franchisor's financial reporting process.

##### Auditor's Responsibilities for the Audit of the Statement

Our objectives are to obtain reasonable assurance about whether the statement as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material

if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the statement.

**The following information may be provided in an Appendix to the Auditor's Report**

*As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:*

- *Identify and assess the risks of material misstatement in the statement, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.*
- *Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the franchisor's internal control.*
- *Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors'.*
- *Conclude on the appropriateness of the director's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the franchisor's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to this matter or, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the franchisor to cease to continue as a going concern.*

*We communicate with the directors' regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.*

*We also provide the directors' with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.*

**Inherent Limitation**

Because of the subjective nature of prospective information required to fulfil the requirements of Item 21 of Annexure 1 to the Franchising Code, the persuasiveness of the evidence available is limited. Prospective information is information about events and/or actions that have not yet occurred and may not occur. It reflects assumptions about future events and is subject to future changes in the business and 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 audit 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.

[Auditor's signature]

[Auditor's address]

[Date of the auditor's report]