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**Explanatory Guide to
Auditing Standard
ASRE 2415 *Review of a
Financial Report - Company
Limited by Guarantee***

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



Australian Government

Auditing and Assurance Standards Board

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Explanatory Guide to Auditing Standard ASRE 2415

Review of a Financial Report - Company Limited by Guarantee

PURPOSE

1. The purpose of this explanatory guide is to provide information on the context within which the Auditing and Assurance Standards Board (AUASB) has issued Auditing Standard on Review Engagements ASRE 2415 *Review of a Financial Report - Company Limited by Guarantee*.

BACKGROUND ¹

2. Under the previous reporting framework, all companies limited by guarantee are required to prepare an audited financial report in accordance with the Australian accounting standards and a directors' report in accordance with the *Corporations Act 2001* (Corporations Act), regardless of their size.
3. The company limited by guarantee structure is used predominantly by not-for-profit entities to incorporate their operations.
4. The vast majority of companies limited by guarantee are relatively small. The small size of companies limited by guarantee means that they may not have the capacity to comply with extensive reporting requirements. However, it is recognised that reporting by companies limited by guarantee is an important governance and transparency mechanism given the public nature of these companies.
5. In June 2007, The Australian Treasury released a discussion paper on financial reporting by unlisted public companies. The paper sought comments on whether the existing reporting framework was appropriate for the 11,000 companies limited by guarantee and the 7,000 unlisted public companies limited by shares preparing financial reports under the Corporations Act. The majority of respondents to the discussion paper indicated that for reporting purposes, companies limited by guarantee could be differentiated on the basis of the size of their operating revenue. Tests based on assets or number of employees may not be accurate indicators of the 'size' of the company.

¹ See also Explanatory Memorandum, *Corporations Amendment (Corporate Reporting Reform) Bill 2010* — circulated by the authority of the Minister for Financial Services, Superannuation, Corporate Law and Human Services.

Summary of the new law - *Corporations Amendment (Corporate Reporting Reform) Act 2010*

6. Under the *Corporations Amendment (Corporate Reporting Reform) Act 2010*, a three tiered differential reporting framework has been introduced exempting “small companies limited by guarantee” from reporting and auditing requirements and providing other companies limited by guarantee with streamlined assurance requirements and simplified disclosures in the directors’ report. In addition, the process for companies to distribute the annual report to their members has been streamlined.
7. The new legislation is aimed at introducing a tailored financial reporting regime for companies limited by guarantee that will reduce the regulatory burden on these entities while ensuring that appropriate levels of financial transparency and governance are maintained.

Differential reporting framework

8. Under the new law, a three tiered differential reporting framework has been introduced for companies limited by guarantee.²
9. Under the first tier, companies are exempt from preparing the financial report and the directors’ report. As a result, companies in this tier are not required to have the annual report audited, or required to appoint an auditor. This tier comprises companies limited by guarantee with annual revenue less than \$250,000 and which do not have deductible gift recipient status.
10. Under the second tier, companies are:
 - required to prepare a financial report, which they could elect to have reviewed rather than audited;
 - required to prepare a streamlined directors’ report, rather than a full director’s report; and
 - subject to a streamlined process for distributing the annual report to members.

The second tier comprises the following companies limited by guarantee:

- companies with an annual revenue of less than \$250,000 that are a deductible gift recipient; and
 - companies with an annual revenue of \$250,000 or more but less than \$1 million, irrespective of whether the company is a deductible gift recipient.
11. Under the third tier, companies:
 - continue to prepare an audited financial report;
 - prepare a streamlined directors’ report, rather than a full director’s report; and
 - are subject to a streamlined process for distributing the annual report to members.

The third tier comprises companies limited by guarantee with an annual revenue of \$1 million or more, irrespective of whether the company is a deductible gift recipient.

² See Table 1 in the Appendix to this guide.

Constitutions

Companies electing to change from an audit to a review should closely examine their constitutional documents, or seek legal advice, to ensure proper due process is followed. For example, it may be necessary for the company to hold an extraordinary meeting to obtain member consent to the proposed change.

Audits and reviews

12. The previous framework requires companies limited by guarantee to have their financial reports audited by a registered company auditor in accordance with Australian Auditing Standards. Stakeholders have suggested that many small companies limited by guarantee are spending a disproportionate amount on audit fees. This reduces the resources that the company has available for member services.
13. Under the new law, companies falling within the second tier are given the option of having their annual financial report subject to a review, rather than an audit.

Terms of Engagement

Companies that have appointed auditors under the previous legislative regime should have engagement letters in place. When a company chooses a review instead of an audit, any previously-agreed terms of engagement will need to be re-negotiated and the engagement letter replaced or amended.

14. A review, in contrast to an audit, is not designed to obtain reasonable assurance that the financial information reported by the company is free from material misstatement. A review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review may bring significant matters affecting the financial information to the assurance practitioner's attention, but it does not provide all of the evidence that would be required in an audit.
15. This measure is intended to reduce the time and costs associated with having the financial statements audited, whilst ensuring that the financial information is still subject to an appropriate degree of assurance.
16. The review is to be conducted in accordance with a standard on review engagements issued by the Auditing and Assurance Standards Board (AUASB).
17. The review can be undertaken by:³
 - (a) a registered company auditor (an individual, a firm or a company); or
 - (b) an individual who is a member of a professional accounting body and who holds a prescribed practising certificate.
18. The associated regulations prescribe the following practising certificates:
 - the Certificate of Public Practice issued by the Institute of Chartered Accountants in Australia (ICAA);
 - the Public Practice Certificate issued by CPA Australia Ltd; or
 - the Public Practice Certificate issued by the National Institute of Accountants (NIA).

³ See Table 2 in the Appendix to this guide.

19. This measure will expand the category of individuals that are permitted to undertake a review, which will provide greater flexibility and reduce unnecessary burden on companies limited by guarantee and their auditors, particularly during peak periods.

RELEVANT PRONOUNCEMENTS

AUASB

20. Under the existing *Framework for Assurance Engagements* (April 2010), reviews are recognised as providing limited assurance. This is contrasted to audits that provide reasonable assurance. The Australian framework is consistent with the equivalent framework issued by the International Auditing and Assurance Standards Board (IAASB).
21. At the date of this explanatory guide, the following relevant standards issued by the AUASB, are operative:
- *ASRE 2400 Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*
 - *ASRE 2410 Review of Interim and Other Financial Reports Performed by the Independent Auditor of the Entity* (Compiled, 08/08)
 - *ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity* (10/09)

AUASB DECISIONS AND APPROACH

AUASB Decisions

22. The AUASB has decided that in order to provide a suitable standard for auditors conducting a review of a company limited by guarantee, the appropriate course of action is to issue a “transitional standard” that directs the auditor to pre-existing review standards.
23. The AUASB does not consider the changes in legislation to be sufficiently significant to warrant the development of an entirely new review standard that differs substantively in terms of procedures, reporting and the level of assurance provided, from existing review standards.
24. In due course, the AUASB will consider the revised international standard, ISRE 2400, when issued, to determine the appropriate action regarding Australian standards. Accordingly, ASRE 2415 is referred to as a “transitional” standard.

AUASB Approach

25. The AUASB has developed a concise standard that directs the practitioner to the appropriate (pre-existing) review standard—ASRE 2400 or ASRE 2410. The decision as to which standard is to be used is driven by whether or not the practitioner has conducted an audit of the company’s previous financial report. The title of the standard is:

ASRE 2415 Review of a Financial Report – Company Limited by Guarantee

26. When an audit of the previous financial report has been conducted, the auditor has gained an understanding of the entity and its environment through compliance with the Auditing Standards. Accordingly, ASRE 2410 is appropriate to conduct a review under the new legislation.

27. Where companies limited by guarantee have been in existence for some time and opt for a review of their financial report, it is reasonable to conclude that their auditors, appointed under the existing legislative regime, will generally be asked to perform the review.

28. On the other hand, when an auditor has *not* conducted an audit of the entity’s (previous) financial report, as in the case of:

- a newly incorporated company limited by guarantee; or
- a newly appointed auditor with no previous experience of the company,

the auditor will not have obtained an understanding of the company in accordance with Auditing Standards. Accordingly, ASRE 2400 is the appropriate standard to use.

TABLES

Differential Reporting Framework (Ref: Para. 8)

Table 1 on the following page, is a simplified representation of the revised reporting framework applicable to certain companies limited by guarantee. It is included as helpful guidance and is *not* to be considered a substitute for reading the relevant sections of legislation. The authoritative revisions to the reporting framework applicable to certain companies limited by guarantee are contained in the *Corporations Act 2001*, as amended.

Note: Under new section 294A, members with at least 5% of the votes in a “small company limited by guarantee” may give the company a direction to prepare a financial report and directors’ report, and have the financial report audited or reviewed. Similarly, under section 294B, ASIC may give the company a direction.

Auditors (Ref: Para. 17)

Table 2 on the following page, is included to highlight that reviews of financial reports of certain companies limited by guarantee can be undertaken by:

- (a). registered company auditors; or
- (b). practitioners (individuals) who are members of a professional accounting body (PAB) and who hold a practising certificate issued by the relevant PAB.

Practitioners falling under (b) above, are exempt from registering under the Act as registered company auditors. However, under section 324BE of the Act, such practitioners are “taken to be registered company auditors for the purposes of a review of a financial report of a company limited by guarantee”. Effectively, such reviewers are deemed to be registered company auditors and therefore are required to comply with all the requirements of the Act that a registered company auditor would have to comply with.

Accordingly, only the term “auditor” has been used in ASRE 2415 so as to avoid unnecessary descriptive narrative and the potential for confusion.

COMPANIES LIMITED BY GUARANTEE

Table 1: Differential Reporting Framework

| <i>Tier</i> | <i>Annual Revenue (A\$)\$^A</i> | <i>Excluded Entities</i> | <i>Audit</i> | <i>Review</i> |
|----------------|--|--|--------------------------------|----------------------------|
| 1 ^B | < \$250,000 | <ul style="list-style-type: none"> ▪ Deductible Gift Recipient (DGR) ▪ Commonwealth entities^C ▪ Certain bodies corporate^D | No requirement | No requirement |
| 2 | < \$250,000 (DGR) ≥ \$250,000 and < \$1,000,000 | <ul style="list-style-type: none"> ▪ Commonwealth entities | Can elect to have an audit; or | Can elect to have a review |
| 3 | ≥ \$1,000,000 | | √ | N/A |

Table 2: Auditors

| | <i>Registration Requirements under the Act</i> | <i>Audit</i> | <i>Review</i> |
|----------------------------------|--|--------------|---------------|
| Registered Company Auditor (RCA) | Section 324BA (individuals); section 324BB (firm); and section 324BC (company). | √ | √ |
| Practitioner | Exception from registration under section 324BE if the <i>individual</i> is a member of a professional accounting body and holds a practising certificate. | N/A | √ |

^A Or annual consolidated revenue, if part of a consolidated entity.

^B Small companies limited by guarantee are defined in section 45B of the Act.

^C A Commonwealth company, a subsidiary of a Commonwealth company, or a subsidiary of a Commonwealth authority.

^D A transferring financial institution of a State or Territory; or a 'building society', 'credit society' or 'credit union' (under sec. 66 of the *Banking Act 1959*).