

Auditing and Assurance Guidance Statement

**AGS 1068**  
(October 2004)

# **Audit Requirements for Australian Financial Services Licensees under the Corporations Act 2001**

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



**Australian Government**

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**Auditing and Assurance Standards Board**

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**AUDITING AND ASSURANCE GUIDANCE**  
**STATEMENT**

**AGS 1068 “AUDIT REQUIREMENTS FOR AUSTRALIAN**  
**FINANCIAL SERVICES LICENSEES UNDER THE**  
**CORPORATIONS ACT 2001”**

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**Introduction**

- .01 This Auditing and Assurance Guidance Statement (AGS) has been prepared by the Auditing and Assurance Standards Board (AUASB) to provide general guidance to auditors on various matters relating to the audit requirements for Australian financial services (AFS) licensees in accordance with the requirements of the *Corporations Act 2001* (the Corporations Act).
- .02 The auditor of an AFS licensee considers the basic principles and essential procedures contained in Auditing and Assurance Standards (AUSs), including AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures”. The AUASB recognises that the audit of AFS licensees may give rise to a number of special audit considerations. Accordingly, this AGS has been developed to clarify 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.
- .03 It is important to note that this AGS does not impose any responsibilities on the auditor of an AFS licensee beyond those which are imposed by AUSs and the requirements of the Corporations Act. The provisions of the Corporations Act in this area are augmented by ASIC Policy Statement 166 *Licensing: Financial requirements*, and other regulatory pronouncements.

**Legislative Background**

- .04 The *Financial Services Reform Act 2001* (FSR Act) and the overall AFS licensing regulatory regime which is administered by the Australian Securities and Investments Commission (ASIC), formally commenced on 11 March 2002. The two year transition period ended on 10 March 2004 and the full provisions of the FSR Act are now operative for all AFS licensees under Chapter 7 of the Corporations Act.
- .05 The FSR Act amendments to the Corporations Act have introduced a single licensing regime for financial advice and dealings in relation to financial products. The Corporations Act now requires an entity that operates a financial services business to hold an AFS licence or be authorised by a licensee.

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**Regulatory Requirements for AFS Licensees**

*Forms FS70 and FS71*

- .06 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 2001* 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 (Statement of Financial Position) and notes to the Statement of Financial Performance and Statement of Financial Position (the “financial statements”) to accompany ASIC Forms FS70 “Profit and Loss Statement and Balance Sheet” (FS70) and FS71 “Audit Report” (FS71). FS70 and FS71 can be found on the ASIC website [www.asic.gov.au](http://www.asic.gov.au) under Company Forms.
- .07 Section 989D(1) of the Corporations Act states that AFS licensees that are not companies have up to 2 months after the end of the financial year to lodge FS70 and FS71 with ASIC and that AFS licensees that are companies have up to 3 months after the end of the financial year to lodge FS70 and FS71 with ASIC.
- .08 Many AFS licensees would already be required to lodge annual financial statements 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 applies to companies in general and is not affected by the FSR Act amendments. The FSR Act requires AFS licensees to lodge FS70 (which includes the annual financial statements) and FS71 (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 statements separately under both provisions. Only the financial statements lodged under Chapter 2M are on public record while FS70 and FS71 contain information that is not required under Chapter 2M. If an AFS licensee is not required to lodge annual financial statements under Chapter 2M, they are still required to lodge FS70 and FS71 with ASIC under Part 7.8 of the Corporations Act.

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- .09 It is expected that most AFS licensees that are companies will lodge FS70 and FS71 (under Part 7.8 of the Corporations Act) with ASIC within 3 months after the end of the financial year and then lodge their statutory financial statements (under Chapter 2M of the Corporations Act) with ASIC within 4 months after the end of the financial year (but within 3 months of the financial year for a disclosing entity or registered scheme). An AFS licensee can apply to ASIC for an extension of time to lodge FS70 and FS71 under Section 989D(3) of the Corporations Act, however, it is unlikely ASIC will grant an extension merely because the Chapter 2M lodgement dates are longer.
- .10 The FS71 audit report requires:
- (1) Positive assurance on the financial statements; and
  - (2) Negative assurance on certain statements made in FS70 relating to dealing with clients’ money and dealing with other property of clients; and
  - (3) Negative assurance about any matter referred to in subsection 990K(2) of the Corporations Act regarding the licensee’s ability to continue to meet its obligations; and
  - (4)
    - (i) Positive assurance if the licensee is a body regulated by the Australian Prudential Regulation Authority (APRA); and
    - (ii) Positive assurance if the licensee is a market participant or clearing participant; and
- If the licensee is not a body regulated by APRA or a market participant or clearing participant then ASIC requires the following:
- (iii) Positive assurance on all the financial requirements other than the cash needs requirement, except for paragraph (e) of the definition of Option 1 (see Appendix II for definition) if the licensee purports to comply with Option 1; and
  - (iv) Negative assurance for managing the risk of having insufficient financial resources to comply with the conditions of the licence;

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If the licensee is relying on satisfying the cash needs requirement by Option 1 or Option 2 then ASIC requires the following:

- (v) Positive 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
- (vi) Positive assurance that the licensee has correctly calculated the projections on the basis of the assumptions the licensee adopted for the projections described in subparagraph (4)(v) above.
- (vii) Negative 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.
- (viii) If the licensee relied on Option 1, negative assurance that the assumptions the licensee adopted for its projection were not unreasonable; and
- (ix) If the licensee relied on Option 2, negative assurance that the basis for the selection of assumptions to meet the requirements for the projection adopted was not unreasonable.

If the licensee is relying on satisfying the cash needs requirement with an eligible provider then ASIC requires:

- (x) Positive 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 (applying for at least the following 3 months) to pay an unlimited amount, or, up to the amount that the licensee may from time to time be liable taking into account all commercial contingencies that licensee should plan for, on demand to the licensee, the licensee’s creditors or a trustee for the licensee’s creditors; and
- (xi) Negative assurance that the basis for the selection of the assumptions adopted was not unreasonable.



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If the licensee is relying on satisfying the cash needs requirement by relying on licence condition 13(d)(iv) or 13(d)(v) as specified in ASIC *Proforma 209 Australian Financial Services Licence Conditions* reissued on 30 September 2004, then ASIC requires other audit requirements which will be discussed further in this guidance statement.

- (5) Positive assurance on the following matters as stated in Regulation 7.8.13(2) of the *Corporations Regulations 2001*:
  - (a) the effectiveness of internal controls used by an AFS licensee to comply with:
    - (i) Divisions 2, 3, 4, 5 and 6 of Part 7.8 of the Corporations Act; and
    - (ii) Division 7 of Part 7.8 of the Corporations Act other than section 991A;
  - (b) 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;
  - (c) whether all necessary records, information and explanations were received from the AFS licensee.
- .11 FS71 is a prescribed form, however, paragraph 4 of FS71 regarding the auditor's opinion of the AFS financial requirements has been left blank for the auditor to insert their opinions and/or statements required under the licensee's licence. Appendix I contains examples for paragraph 4 in different circumstances.
- .12 The AFS financial requirements are rather complex and ASIC has issued *Policy Statement 166 Licensing: Financial requirements* (PS166) on 20 December 2001 (updated on 8 November 2002) for guidance. This policy statement deals with the financial resource requirements for financial service providers. ASIC has also released a licensing guide *Meeting the financial requirements for your AFS licence – Compliance with Policy Statement 166* on 9 October 2003 (revised in December 2003 and January 2004).
- .13 In addition, ASIC *Pro Forma 209 Australian Financial Services Licence Conditions* (PF209), reissued on 30 September 2004, 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. However, it is very important that the individual AFS licence conditions are examined carefully so that the appropriate reporting and auditing obligations can be met.

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*Exemptions From Lodging Form FS71*

- .14 A foreign authorised deposit-taking institution (“ADI”) that has relief under Class Order 03/823 *Relief from licensing, accounting and audit requirements for foreign authorised deposit-taking institutions*, is not required to lodge FS71 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.
- .15 Where the foreign ADI is also regulated by APRA and the AFS licence contains condition 27 in PF209, 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 positive 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 FS71. To avoid any processing problems, ASIC requires the audit report to be lodged to be accompanied by a letter identifying the licensee, licence number and financial year, and clearly stating the reasons why FS71 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. ASIC are currently developing a covering form for lodgement of the annual documents for foreign ADI’s that have class order relief.

*Exemptions From Base Level Financial Requirements*

- .16 If the licensee is either:
- (a) a body regulated by APRA as defined in s.3(2) of the *Australian Prudential Regulation Authority Act 1998*; or
  - (b) a participant as defined in the operating rules of Australian Stock Exchange 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 that relate to financial requirements, taking into account any waiver by ASX; or a participant in the licensed market operated by Sydney Futures Exchange Corporation Limited (SFE) that restricts its financial services business to participating in the licensed market and incidental business

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supervised by SFE and complies with the SFE operating rules that relate to financial requirements, taking into account any waiver by SFE;

- (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 (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;

then the base level financial requirements do not apply but FS70 and FS71 are still required to be lodged with ASIC.

- .17 Where a licensee is a body regulated by APRA, ASIC requires the audit opinion in FS71 to state whether for the relevant period, on a positive 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 I shows an example FS71 paragraph 4 for a licensee regulated by APRA.
- .18 Where a licensee is a market participant or clearing participant, ASIC requires the audit opinion in FS71 to state whether, during any part of the period for which the licensee relied on being a market participant or clearing participant, on a positive assurance basis, the licensee was a participant in the market conducted by:
  - (a) the Australian Stock Exchange Limited (ASX); or
  - (b) Sydney Futures Exchange Corporation Limited (SFE), that restricted its financial services business to participating in the market and incidental business supervised by SFE.

Example 2 in Appendix I shows an example FS71 paragraph 4 for a market participant or clearing participant.

- .19 PS166.8 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. To apply for relief the licensee can apply with their licence application or request

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for a variation of licence for ASIC not to impose its standard licence conditions about financial requirements. ASIC requires the application to comply with ASIC *Policy Statement 51 Applications for relief* (PS 51) and contain all information relevant to the application including details as to the foreign regulatory arrangements.

*AFS Financial Requirements*

- .20 For all licensees that do not have an exemption, there are base level financial requirements to be complied with under the Corporations Act. The base level financial requirements are that the licensee:
- (a) be able to pay all its debts as and when they become due and payable; and
  - (b) have total assets that exceed total liabilities or adjusted assets (refer to definition in Appendix II) that exceed adjusted liabilities (refer to definition in Appendix II), as shown in the licensee’s most recent balance sheet lodged with ASIC; and
  - (c) have no reason to suspect that both the licensee’s total assets would not exceed its total liabilities and its adjusted assets would not exceed its adjusted liabilities on a current balance sheet; and
  - (d) meet the cash needs requirement by complying with either:
    - (i) the reasonable estimate projection plus cash contingency basis - Option 1 (refer to definition in Appendix II); or
    - (ii) the contingency based projection basis - Option 2 (refer to definition in Appendix II); or
    - (iii) a requirement that an eligible provider (refer to definition in Appendix II) being an APRA regulated entity or a prudentially regulated entity in accordance with the Basel Committee Guidelines, gives the licensee an enforceable and unqualified commitment to pay an unlimited amount on demand to the licensee, the licensee’s creditors or a trustee for the licensee’s creditors, that will apply for at least three months, taking into account all commercial contingencies the licensee should reasonably plan for.

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- (iv) a requirement that the licensee:
  - (A) is a subsidiary of an Australian ADI or a corporation approved in writing for the purpose of this condition;
  - (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 an 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
- (v) a requirement that the licensee ensure 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;
  - (B) 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”)
  - (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

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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;

- (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 requires 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) above, 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 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 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

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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) above 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.

.21 There are also additional financial requirements for:

- (a) managed investments and custody services (net tangible assets requirement) ;
- (b) foreign exchange dealers (tier one capital requirement);
- (c) holding client money or property (tiered surplus liquid funds requirement);
- (d) transacting with clients as principal (adjusted surplus liquid funds requirement); and
- (e) reporting triggers.

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 FS71 audit report requires positive assurance on those financial requirements.

.22 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 was amended on 1 June 2004, by Class Order 04/606 *Investor directed portfolio services - amendment* (CO 04/606) and

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on 28 June 2004 by CO 04/734 *Investor directed portfolio services - amendment* (CO 04/734). This class order provides an exemption from the 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. An AGS is currently being developed for *Investor Directed Portfolio Services and Investor Director Portfolio-Like Services: Special Considerations for the Auditor*.

- .23 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*.

**Considerations for the Auditor**

*Who May Audit the AFS Licensee?*

- .24 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 Audit Engagement*

- .25 The auditor and the AFS licensee are to agree on the terms of the AFS licensee audit engagement in writing. Such terms may be outlined in an audit engagement letter.<sup>1</sup> The auditor has regard to the requirements of AUS 204 “Terms of Audit Engagements” and considers applying the principles and essential procedures from that AUS when agreeing on the terms of an AFS licensee audit engagement.
- .26 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. The auditor obtains acknowledgment of this obligation from the directors of the AFS licensee when obtaining agreement on the terms of the AFS licence audit engagement.

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<sup>1</sup> Or other suitable form of audit contract.



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- .27 It is the responsibility of the AFS licensee to comply with all the conditions under its licence including all the financial requirements.

*First year and transitional requirements*

- .28 Under the Corporations Act, previously licensed entities providing financial services have been required to be relicensed, and many entities have been required to obtain a license for the first time due to the wider definition of “financial services” under the new regime.
- .29 For financial years up to and including 31 December 2004, not all licensees will have held their AFS licence for the entire financial year. The auditor considers whether FS71 only covers the period from the effective date of the AFS licence until the end of the financial year. However, since licences can be varied, the effective date stated may only be that for the current version of the AFS licence, and that previous AFS licences may have existed. The auditor considers enquiry of management and via the ASIC website register of licensees as to whether a licence has been varied during the year.
- .30 Entities who have transitioned from an old law Dealer’s Licence, Futures Brokers Licence or Insurance Brokers & Agents License during the financial year will no longer have any old law reporting requirements to fulfil.

*Planning*

- .31 In accordance with AUS 402 “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements”, the auditor obtains an understanding of the entity’ and its environment, including its internal control, sufficient to enable the identification and understanding of the events, transactions and practices that may have a significant effect on the financial information or on the FS71 audit report.
- .32 The auditor uses their understanding of the entity and its environment to:
- (a) assess risks and identify problems;
  - (b) plan the engagement; and
  - (c) perform efficient and effective procedures during the engagement.

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- .33 The auditor plans the engagement in accordance with AUS 302 “Planning”. 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.
- .34 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.
- .35 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 and the detailed processes which it provides, together with a written description of the procedures and structures which the licensee has established to ensure compliance.
- .36 To further assist in the audit of the AFS licensee, the auditor considers various matters when planning the audit, including:
- (a) the licence conditions;
  - (b) 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;
  - (c) the nature and extent of any changes to the operation of the licensee itself;
  - (d) changes to the Corporations Act and related regulations;
  - (e) reports and other documents submitted to the board of the licensee regarding the operation of the licence and its compliance functions; and
  - (f) previous audit reports, including the audit report on financial reports for the licensee, and related management letters.

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*Materiality*

- .37 The auditor considers materiality when:
- (a) determining the nature, timing and extent of audit and review procedures.
  - (b) evaluating the effect of identified licence condition breaches or weaknesses.
- .38 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.
- .39 The guidance on the meaning and application of the concept of materiality contained in AUS 810 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.
- .40 As identified in AUS 810, when assessing materiality, the auditor considers qualitative factors as well as quantitative factors. The following are examples of qualitative factors that may be relevant:
- (a) the specific requirements of the terms of the engagement;
  - (b) the significance of identified weaknesses in compliance measures;
  - (c) the cost of alternative compliance measures relative to their likely benefit; and
  - (d) public perceptions and/or interest.

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*Quality Control*

- .41 The auditor needs to adopt quality control policies and procedures in accordance with AUS 206 “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*

- .42 AFS licensees are required to lodge annual financial statements attached to FS70 and FS71. Where licensees have not previously 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 the ASIC pursuant to the Corporations Act does not, of itself, deem that entity to be a reporting entity.
- .43 In July 2000, ASIC published Information Release 00/025 *Reporting requirement for non-reporting entities* (IR 00/025), which specifically outlines ASIC’s interpretation for licensed securities dealers, which states that “Licensed securities dealers and futures brokers would only be non-reporting entities in rare and exceptional circumstances (eg. where a securities dealer does not carry on any business and has no proper authority holders)”. ASIC requires the application of IR 00/025 to be applied to AFS licensee’s such that only in very rare circumstances will an AFS licensee be classified as a non-reporting entity.
- .44 Whilst the current legislation allows for a non-reporting entity to prepare “special purpose” financial statements, there is an expectation from ASIC for AFS licensee to be a reporting entity and hence lodge “general purpose” financial statements (ie. adopt all of the Australian Accounting Standards). FS71 requires a statement as to whether the licensee is a reporting entity or not.

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*Natural Persons*

- .45 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. This means that a natural person licensee could choose to exclude personal revenue and expenses and/or revenue and expenses that relate to any other business that they conduct.
- .46 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.

*International Financial Reporting Standards (“IFRS”)*

- .47 Licensees who are reporting entities are required by the Australian Accounting Standards Board (AASB), members of the Institute of Chartered Accountants in Australia and members of CPA Australia, to comply with all Australian Accounting Standards in preparation of their annual financial statements for lodgement with ASIC. As the IFRS have been adopted by the Australian Accounting Standards Board as Australian Accounting Standards, licensees will need to comply with the IFRS requirements for financial years commencing on or after 1 January 2005. IFRS also requires any comparative figures for the previous financial year to be restated in accordance with IFRS requirements.

**Reporting Requirements**

*Negative Assurance on Certain Statements made in FS70 relating to Dealing with Clients’ Money and Dealing with other Property of Clients*

- .48 The FS71 audit report requires negative assurance on certain statements at paragraphs 6 (has the licensee received client monies), 7 (has the licensee received client property) and 8 (has the licensee received a loan from a client) of FS70. The auditor considers the

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licensee’s statements on FS70 and through knowledge of the client and corroborative enquiry, concludes as to the reasonableness of the statements.

*Negative Assurance on Section 990K(2) Matters*

- .49 FS71 requires negative assurance about any matter referred to in subsection 990K(2) regarding the licensee’s ability to continue to meet its obligations. 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.
- .50 The auditor’s obligation is to report on the relevant matters if they have become aware of them during the course of the audit of the financial statements, performing work on FS71 or undertaking other audit work (eg. Managed investments compliance plan audits). However, if the auditor becomes aware of a 990K(2) matter that is outside the Corporations Act sections under audit, then the expectation is that the auditor would report on these section 990K(2) matters but has no obligation to go looking for matters outside the sections under audit.
- .51 To determine whether the licensee is meeting its obligations as a licensee, the auditor considers:
- Whether a compliance manual exists and whether it has been distributed?
  - Does the licensee monitor the conduct of its representatives?
  - Do procedures exist to ensure all staff are appropriately qualified and receive ongoing training?

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- Do recruitment procedures assess the competence of candidates?
  - Does the licensee have a documented complaints and dispute resolution policy?
  - Is the licensee a member of an approved dispute resolution scheme eg: Banking Ombudsman?
  - Does the licensee have written approval from ASIC of its compensation arrangements for retail clients?
  - Whether any non-compliance with ASIC directions or ASIC requests for information exists?
  - Has the licensee either become or ceased to be a participant in a licensed market or a licensed clearing settlement facility?
  - Whether any of the client documents specified by Corporations Regulation 7.6.01C (eg: Financial Services Guide, Product Disclosure Statement, Statement of Advice, application forms) do not have the client's licence number on it?
  - Whether copies of all correspondence with ASIC during the period have been received?
  - Whether the licensee's breach registers has been obtained to determine whether any breaches identified by the licensee are required to be reported in FS71?
- .52 The auditor considers whether any significant breaches have occurred. If so, were they reported by the licensee to ASIC within the timeframe? Guidance on significance include:
- number /frequency of similar breaches;
  - impact on ability to provide financial services;
  - extent to which breach indicates compliance arrangements are inadequate; and
  - actual /potential financial loss to clients.
- .53 Apart from the requirement to report section 990K(2) breaches in FS71, section 990K(1) requires auditors to report such breaches to ASIC (and any relevant market or clearing authority eg. 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. Ideally, 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. It is a matter of judgement for an auditor to determine how to

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resolve this conflict. The auditor considers *ASIC Practice Note 34, Auditors' obligations: reporting to ASIC* for further guidance.

*Negative Assurance on Risk Management Systems*

- .54 FS71 requires negative 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 expect 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.
- .55 The auditor considers enquiry of management as to the processes by which they manage these risks. The auditor considers whether a formal documented risk management system exist, 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.

*Positive Assurance on Certain Provisions in Part 7.8 of the Corporations Act*

- .56 The FS71 audit report requires positive 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 (ie: giving priority to client orders, transmission of instructions through licensed markets, maintaining records of instruction, dealing with non-licensees and employees).
- .57 Division 2 of Part 7.8 subdivision A and Corporations Regulations 7.8.01 – 7.8.05 relates to handling of client money including:



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- 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;
  - treatment of interest on client money.
- .58 The auditor considers firstly establishing whether the licensee holds client money. Then the auditor considers:
- 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; and
  - sample testing to establish whether withdrawals from the trust account are in accordance with Corps Reg 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.
- .59 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 projects);
  - 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 & 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 & conditions or subsequently agreed to in writing.
- .60 The auditor considers firstly establishing whether the licensee has received a loan from a client. Then the auditor considers:
- determining whether a trust account has been appropriately established for the financial period;
  - performing sample testing to establish whether money received has been appropriately paid into the trust account;
  - performing testing to establish whether clients have been given the appropriate statements;
  - performing sample testing to establish whether money lent has been used for an agreed purpose.

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- .61 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 deposit or register 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.
- .62 The auditor considers firstly establishing whether the licensee handles client property. Then the auditor considers:
- performing 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.
- .63 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 designing 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 The FS71 audit report requires positive assurance on the following base level financial requirements such that the licensee:
- (a) be able to pay all its debts as and when they become due and payable; and
  - (b) have total assets that exceed total liabilities or adjusted assets (refer to definition in Appendix II) that exceed adjusted liabilities (refer to definition in Appendix II), as shown in the licensee’s most recent balance sheet lodged with ASIC; and
  - (c) have no reason to suspect that both the licensee’s total assets would not exceed its total liabilities and its adjusted

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assets would not exceed its adjusted liabilities on a current balance sheet.

- .65 If any of the additional financial requirements are applicable to the licensee, then FS71 requires positive assurance on those financial requirements. The additional financial requirements are:
- (a) managed investments and custody services (net tangible assets requirement);
  - (b) foreign exchange dealers (tier one capital requirement);
  - (c) holding client money or property (tiered surplus liquid funds requirement);
  - (d) transacting with clients as principal (adjusted surplus liquid funds requirement); and
  - (e) reporting triggers.
- .66 When auditing compliance with a financial requirement throughout the period, it is important for the auditor to understand how the licensee derives their calculations, conclude as to whether this method is in accordance with the requirements, ascertain whether all the calculations prepared during the period demonstrate a compliant position, and finally sample test a number of calculations for accuracy based on underlying financial information.
- .67 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*

- .68 ASIC requires a licensee to meet the cash needs requirement by complying at all times with either:
- (a) the reasonable estimate projection plus cash contingency basis - Option 1 (refer to definition in Appendix II); or
  - (b) the contingency based projection basis - Option 2 (refer to definition in Appendix II); or
  - (c) a requirement that an eligible provider (refer to definition in Appendix II) being an APRA regulated entity or a

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prudentially regulated entity in accordance with the Basel Committee Guidelines, gives the licensee an enforceable and unqualified commitment to pay an unlimited amount on demand to the licensee, the licensee’s creditors or a trustee for the licensee’s creditors, that will apply for at least three months, taking into account all commercial contingencies the licensee should reasonably plan for; or

- (d) a requirement that the licensee:
  - (A) is a subsidiary of an Australian ADI or a corporation approved in writing for the purpose of this condition;
  - (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 an 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
- (e) a requirement that the licensee ensure 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;
  - (B) 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”)
  - (C) the parent entity complies with Option 1 or Option 2 as if it were the licensee, cash flows of any

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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;

- (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 requires 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) above, 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 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 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

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- (F) the licensee has no reason to believe that the parent entity has not complied with the requirement at subparagraph (C) above 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.

- .69 ASIC requires the positive assurance opinion on compliance with the financial requirements for the entire year, not just year end. Hence, audit procedures will need to include understanding the processes adopted by the licensee to ensure compliance through 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. AUS 804 “The Audit of Prospective Financial Information” provides guidance to auditors to report on prospective financial information prepared using best-estimate and/or hypothetical assumptions.
- .70 If the licensee has adopted Option 1 for the cash needs requirement then the auditor considers audit compliance throughout the period with the cash holding requirement in Part (e) of the Option 1 definition.
- .71 The auditor considers obtaining the cash flow projections throughout the relevant period and determining whether the cash flow projections were either:
- a projection of cash flows over at least the next 3 months based on the licensee’s reasonable estimate of what was likely to happen over this period (Option 1)
  - a projection of cash flows over at least the next 3 months based on the licensee’s reasonable estimate of what would happen if its ability to meet its liabilities was adversely affected by commercial contingencies that were sufficiently likely for a reasonable licensee to plan for (Option 2)
- The auditor considers establishing how often and when the cash flow projection was updated to ensure it continuously covered the following 3 months.
- .72 The auditor considers obtaining the licensee’s documented assumptions used to prepare the cash flow projections and checking

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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.

- .73 Based on the cash flow projections already obtained, consider whether there is evidence that the cash flow assumptions were not appropriately documented or that the projections did 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.
- .74 If the licensee relied on Option 1, then based on reviewing the assumptions in line with the auditor’s knowledge of the business and 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.
- .75 If the licensee relied 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 was unreasonable. For Option 2, there is no requirement to consider whether the assumptions themselves are reasonable, unlike for Option 1.
- .76 Where the licensee is using group cash flow projections to meet the cash needs requirement, on the basis of alternative A (under licence condition 13(d)(v)), the audit report will be required to include an audit opinion about 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 will be required to 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 period during which the commitment will apply was unreasonable.

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- .77 Where the licensee relies on alternative B (under licence condition 13(d)(v)), the audit report will be required contain a statement about whether the auditor has an 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 was unreasonable.
- .78 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(d)(iv)), the audit report will be 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 was unreasonable.

*Inherent Limitations*

- .79 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.
- .80 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 FS71 Audit Report**

- .81 Prior to issuing the FS71 audit report on the AFS licensee, 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 that the AFS licensee continues to meet the requirements of Part 7.8 of the Corporations Act.



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- .82 ASIC requires form FS71 to be lodged such that no modifications or deletions be made, unless consented to by ASIC.
- .83 The FS71 audit report includes the following:
- (a) the title;
  - (b) the AFS licensee details (name and licence number);
  - (c) the auditor’s details (name, firm, ABN etc)
  - (d) an identification of the purpose for which the auditor’s report has been prepared and of those entitled to rely on it, and a disclaimer of liability for its use for any other purpose or by any other person;
  - (e) a description of the scope of the audit, including:
    - (i) a statement that the auditor has conducted the engagement in order to meet the licensee’s obligation to lodge FS71 with ASIC in accordance with Section 989B(3) of the Corporations Act 2001; and
    - (ii) a statement that the licensee is responsible for establishing and maintaining effective internal controls in relation to compliance with the requirements of the Corporations Act 2001.
  - (f) a paragraph stating:
    - (i) because of the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. The overall internal control structure has not been audited and no opinion is expressed as to its effectiveness;
    - (ii) an audit is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed on the control procedures are on a sample basis;
    - (vi) any projection of the evaluation of internal control procedures to future periods is subject to

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the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate;

- (g) a statement that the audit has been conducted in accordance with Australian Auditing and Assurance Standards;
- (h) a statement in relation to projections such that:
  - (i) procedures have been restricted to an examination on a test basis throughout the relevant period to determine that the licensee had a projection in place, a review of projections identified on a test basis to ensure that they were materially in accordance with the requirements of paragraph (a) of the definition of Option 1 or paragraph (a) of Option 2 as applicable, and testing that projections identified on a test basis were mathematically accurate based on the underlying assumptions as documented by the licensee;
  - (ii) any statements made in paragraph 4 that are expressed as being on a review are based on a review rather than an audit. A review does not provide all the evidence that would be required in an audit and provides less assurance than an audit. We have not performed an audit and we do not express an audit opinion on the matters subject to a review;
  - (iii) the underlying assumptions for any projections are subject to significant uncertainties;
- (i) when the auditor’s opinion is qualified, paragraph 8 clearly describes all exceptions;
- (j) the auditor’s signature;
- (k) the date of the auditor’s report.

.84 It is also possible that ASIC may amend the forms without any announcement. Hence it is only by continually checking the ASIC forms website that changes can be identified.

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**Operative Date**

.85      This AGS is operative from date of issue.

**Compatibility with International Standards and Statements on Auditing**

.86      There is no corresponding International Standard or Statement on Auditing.

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*APPENDIX 1*

*EXAMPLE FS71 PARAGRAPH 4 INSERTIONS*

**Example 1: Paragraph 4 for a Licensee regulated by APRA**

*This suggested example paragraph 4 is to be included on ASIC’s Form FS71 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.*

4. Except as stated at paragraph 8, 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 4 for a Market Participant or Clearing Participant**

*This suggested example paragraph 4 is to be included on ASIC’s Form FS71 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.*

4. Except as stated at paragraph 8, 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 [the Australian Stock Exchange Limited (ASX)] or [Sydney Futures Exchange Corporation Limited (SFE) that restricted its financial services business to participating in the market and incidental business supervised by SFE] for the financial year.

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**Example 3: Paragraph 4 relying on Option 1 or Option 2**

*This suggested example paragraph 4 is to be included on ASIC’s Form FS71 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 (refer to definition in Appendix II). The licence conditions specified have been taken from PF 209 reissued on 30 September 2004, however the auditor should use the actual licence conditions of the licensee.*

4. Except as stated at paragraph 8,
- (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(d) of this licence, [except 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

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- (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 4 relying on licence condition 13(d)(iii)**

*This suggested example paragraph 4 is to be included on ASIC’s Form FS71 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 PF209 licence condition 13(d)(iii). The licence conditions specified have been taken from PF 209 reissued on 30 September 2004, however the auditor should use the actual licence conditions of the licensee.*

4. Except as stated at paragraph 8,
- (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(d) of this licence for the financial year; and
  - (ii) in my/our opinion, for the financial year when the licensee relied on subparagraph 13(d)(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 (applying for at least the following 3 months) to pay an unlimited amount, or, up to the amount that the licensee may from time to time be liable taking into account all commercial contingencies the licensee should plan for, on demand to the licensee, 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(d)(iii), we have no reason to believe that:

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- (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 4 relying on licence condition 13(d)(iv)**

*This suggested example paragraph 4 is to be included on ASIC’s Form FS71 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 PF209 licence condition 13(d)(iv). The licence conditions specified have been taken from PF 209 reissued on 30 September 2004, however the auditor should use the actual licence conditions of the licensee.*

4. Except as stated at paragraph 8:

- (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(d) of this licence for the financial year; and
- (ii) in my opinion, for the financial year when the licensee relied on subparagraph 13(d)(iv), following an examination of the documents prepared for subparagraphs 13(d)(iv)(C), the licensee complied with subparagraphs 13(d)(iv)(A) and subparagraph 13(d)(iv)(C) for documents prepared for the period to which the report relates; and
- (ii) based on my/our review, for the financial year when the licensee relied on subparagraph 13(d)(iv), following an examination of the documents prepared for subparagraph 13(d)(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.

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**Example 6: Paragraph 4 relying on licence condition 13(d)(v)**

*This suggested example paragraph 4 is to be included on ASIC’s Form FS71 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 PF209 licence condition 13(d)(v). The licence conditions specified have been taken from PF 209 reissued on 30 September 2004, however the auditor should use the actual licence conditions of the licensee.*

4. Except as stated at paragraph 8,:
- (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(d) of this licence for the financial year; and
  - (ii) in my opinion, for the financial year when the licensee relied on subparagraph 13(d)(v), the licensee complied with licence condition 13(d)(v)(A) and (B); and
  - (iii) in my opinion, when the licensee relied on Alternative A in subparagraph 13(d)(v)(E), the licensee has complied with Alternative A;
- or
- (iii) based on my/our review, for the financial year when the licensee relied on subparagraph 13(d)(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.



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*APPENDIX II*

*Definitions from ASIC Pro Forma 209*

*adjusted assets* means the value of total assets:

- (a) minus excluded assets (see definition below); and
- (b) minus any receivable of the licensee if the licensee has excluded a liability from adjusted liabilities on the basis that there is an enforceable right of set off with that receivable; and
- (c) minus the value of any assets that are encumbered as a security against liability to a person that provides a security bond to ASIC up to the amount of the bond; and
- (d) minus the value of any assets that may be required to be applied to satisfy a liability under a credit facility that is made without recourse to the licensee to the extent that the liability is excluded from adjusted liabilities; and
- (e) plus the value of any eligible undertaking (see definition below) that is not an asset; and
- (f) for calculating adjusted surplus liquid funds (ASLF), plus the value of any assets of any trust (other than a registered scheme) of which the licensee is trustee except to the extent the value exceeds the sum of:
  - (i) the liabilities of the trust; and
  - (ii) any increase in the amount of ASLF that is a result of assets, liabilities and contingent liabilities of the trust for accounting purposes being included in calculating ASLF.

*adjusted liabilities* means total liabilities:

- (a) minus any subordinated debt approved by ASIC; and
- (b) minus any liability that is the subject of an enforceable right of set off if the corresponding receivable is excluded from adjusted assets; and
- (c) minus any liability under a credit facility that is made without recourse to the licensee, to the extent that the assets to which recourse may be made under the credit facility are excluded from adjusted assets; and

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- (d) for calculating ASLF, plus liabilities of any trust (other than a registered scheme) of which the licensee is trustee.

*eligible provider* means:

- (a) an Australian ADI; or
- (b) an entity (other than a registered scheme of which the licensee or the licensee’s associate is the responsible entity):
  - (i) whose ordinary shares are listed on a licensed market or an ASIC-approved foreign exchange under ASIC Policy Statement 72 *Foreign securities prospectus relief* as at the date of this licence that has net assets (excluding intangible assets) of:
    - (A) more than \$50 million; or
    - (B) at least 4 times the amount of the commitment;whichever is the greater, as shown in the most recent audited financial statements of the provider lodged with ASIC; and
  - (ii) that the licensee has no reason to believe no longer has net assets of at least that amount; or
- (c) an Australian government (ie the Commonwealth or a State or Territory government) or a foreign government of an OECD country; or
- (d) a foreign deposit-taking institution approved in writing by ASIC for this purpose; or
- (e) a CS facility licensee; or
- (f) an entity approved by ASIC in writing for this purpose.

*eligible undertaking* means the amount of a financial commitment (disregarding any part previously paid), provided by an eligible provider in the form of an undertaking to pay the amount of the financial commitment to the licensee, that

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- (a) is an enforceable and unqualified obligation to pay on written demand by the licensee; and
- (b) remains operative (even if, for example, the licensee ceases to hold an AFS license) until ASIC consents in writing to the cancellation of the undertaking.

*excluded assets* means:

- (a) intangible assets (ie: a non-monetary asset without physical substance); and
- (b) except when allowed under paragraphs (f) or (g) of this definition, receivables from or assets owing from (“receivables”), or invested in, any person who:
  - (i) is an associate of the licensee; or
  - (ii) was an associate of the licensee at the time the liability was incurred or the investment was made; or
  - (iii) became liable to the licensee because of, or in connection with, the acquisition of interests in a managed investment scheme the licensee operates; and
- (c) except when allowed under paragraph (h) of this definition, any:
  - (i) beneficial interest; or
  - (ii) interest in a managed investment scheme; or
  - (iii) superannuation product;in respect of which the licensee or its associates may exercise any form of power or control; and
- (d) except when allowed under paragraphs (f) or (g) of this definition or required to be included by paragraph (f) of the definition of adjusted assets in this licence, a receivable from the trustee of any trust in respect of which the licensee or its associate may exercise any form of power or control; and
- (e) assets that secure any current or future liability of another person to the extent of that liability; and
- (f) despite paragraphs (b) and (d) of this definition, a receivable is not excluded to the extent that:
  - (i) it is adequately secured; or
  - (ii) the following apply:

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- (A) it is receivable as a result of a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arms length basis; and
  - (B) no part of the consideration in relation to the transaction is, in substance, directly or indirectly invested in the licensee; and
  - (C) the total value of such assets (before any discount is applied) is not more than 20% of the assets less liabilities of the licensee; and
  - (D) for the purposes of calculating ASLF, the amount is further discounted by 10% of the value after any adjustment required by paragraph (a) or (b) of the definition “adjusted surplus liquid funds” of the licence; or
- (iii) the following apply:
  - (A) it is receivable from an insurance company that is a body regulated by APRA and results from a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms application to persons that are not associated with the licensee on an arm’s length basis, and
  - (B) there is no reason to believe that any amount invested in the licensee would not have been invested if the transactions that caused the receivable had not taken place or were not at the time of the investment expected to take place; and
  - (C) there is no reason to believe that the recoverability of the receivable will materially depend on the value of an investment by any person in the licensee; and
  - (D) disregarding this subparagraph (f)(iii), the total value of the receivables under this subparagraph (f)(iii) before any discount is applied is not more than 60% of the adjusted liabilities of the licensee; or
- (iv) ASIC consents in writing to the licensee treating the amount owing as not being an excluded asset; and
- (g) despite paragraphs (b) and (d) of this definition, the licensee can include a receivable amount to the extent that it is owing by way of fees from, or under rights of reimbursement for expenditure by the

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licensee out of property of, a superannuation scheme, an IDPS or a registered scheme (“Scheme”) to the extent that the receivable:

- (i) exceed amounts invested by the Scheme in or lent (other than by way of a deposit with an Australian ADI in the ordinary course of its banking business) directly or indirectly by the Scheme to the licensee, a body corporate the licensee controls, a body corporate that controls the licensee or a body corporate that the licensee’s controller controls;
  - (ii) if the receivable for fees, represents no more fees that are owing for the last 3 months; and
  - (iii) if the receivable is under rights of reimbursement for expenditure by the licensee, has not been receivable for more than 3 months; and
- (h) despite paragraph (c) of this definition, the licensee does not have to exclude a managed investment product unless any part of the amount invested is, in substance, directly or indirectly, invested in the licensee.

*Option 1* means the reasonable estimate projection plus cash contingency 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 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

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- (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, 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 (ie: Statement of Financial Performance), adjusted to produce a 3-month average.

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.

*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 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 calculation 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 flow when those cash flows cease to cover the next 3 months or if the licensee has reason to suspect that an updated projections would show that the licensee was not meeting paragraph (d) of this definition; and

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- (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 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.