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In recent years audit quality and the value of audit have been a focus of ongoing commentary in the public domain, and this has included public inquiries into a broad suite of issues, such as the basis and sufficiency of auditor independence, audit market competition, audit quality and the scope and purpose of the audit.

CPA Australia has long held the view that investors and other stakeholders need to better understand the existing reporting and auditing frameworks in order to appreciate the merits and impact of changes that may be proposed from time to time.

CPA Australia’s revised publication - *A guide to understanding auditing and assurance: Australian listed companies* explains in plain language the value and purpose of auditing and assurance. This will assist shareholders, investors and other readers of financial reports who are not experts in auditing and assurance to better understand the messages from the company’s auditor and make use of this information in their decision making.

Since its inception some years ago, the Guide has been widely recognised for its contribution to enhancing financial literacy across both Australian stakeholders and internationally. There have been some significant changes to the auditor’s report since the previous edition, including the introduction of “Key Audit Matters” to improve the information value of the auditor’s report to users. This Guide has been updated for all of the current requirements impacting the auditor’s report. In addition, it has been updated for changes to the auditor’s responsibilities when conducting an audit engagement, including how the auditor responds to suspected or identified non-compliance with laws and regulations, and highlights the directors’ role in supporting audit quality.

This updated Guide has been produced as part of CPA Australia’s ongoing commitment as a professional accountancy organisation to serve the public interest. It was first developed as an initiative of the External Reporting Centre of Excellence of CPA Australia.

Merran Kelsall FCPA
Deputy President
CPA Australia Ltd
WHY ARE AUDITS AND REVIEWS REQUIRED?

Shareholders of listed companies are usually quite separate from those managing and governing the companies they own. They need a reliable and independent source of financial information on which to assess the company, and the performance of management and those charged with governance. It is the same for other stakeholders of companies, such as creditors, lenders, employees, analysts, prospective shareholders, regulators, governments and communities. Audits and reviews enhance the credibility of the information contained within the financial report, comprising:

- the financial statements;
- notes to the financial statements; and
- the directors’ declaration about the financial statements and notes.

This information enables shareholders and other stakeholders to make assessments and decisions, such as investing, divesting, lending or contracting with the company, with confidence and on a consistent basis.

An audit of a listed company’s financial report is required annually, as well as a review of a listed company’s half year financial report in Australia.

WHAT DO USERS NEED TO UNDERSTAND ABOUT FINANCIAL REPORTS?

Auditors consider the information needs of users of financial reports when determining what is important (material) to those users, which drives what the auditor will focus on. It is reasonable for the auditor to assume that users of the financial report:

- have a reasonable knowledge of business, economic activities and accounting, as well as a willingness to study the information in the financial report with reasonable diligence;
- understand that the financial report is prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- make reasonable economic decisions on the basis of the information in the financial statements.

WHAT DOES ASSURANCE MEAN?

The term assurance refers to the expression of a conclusion by an assurance practitioner that is intended to increase the confidence that users can place in a given subject matter. An audit is a form of assurance engagement which provides an opinion giving reasonable assurance on a financial report. An auditor is an assurance practitioner who conducts an audit. Therefore, an auditor’s report provides a conclusion that increases the confidence that users can place in a company’s financial report. There are differing levels of assurance, which result in different types of conclusions, depending on the type of work that the assurance practitioner performs.

The following diagram illustrates different levels of assurance, in some of the different activities performed by accountants:
### WHAT IS THE IMPACT OF THE LEVEL OF ASSURANCE?

<table>
<thead>
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<th>Type of assurance</th>
<th>For example</th>
<th>Nature of key work performed</th>
<th>Example form of conclusion</th>
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<tr>
<td>Reasonable assurance</td>
<td>An audit of a financial report</td>
<td>Gathering of sufficient appropriate audit evidence based on an assessment of risk and materiality to support the auditor’s opinion.</td>
<td>In our opinion, the financial report is in accordance with the Corporations Act 2001, including giving a true and fair view of the company’s financial position at year end and of its financial performance for the year then ended and complying with the Australian Accounting Standards and the Corporations Regulations 2001. This is commonly referred to as positive assurance.</td>
</tr>
<tr>
<td>Limited assurance</td>
<td>A review of a half-year financial report</td>
<td>Primarily enquiries and analytical review, with less detailed procedures, based on an assessment of risk and materiality to support the auditor’s conclusion.</td>
<td>Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of the company is not in accordance with the Corporations Act 2001 including: giving a true and fair view of the company’s financial position as at 31 December 20XX and of its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 Interim Financial Reporting and Corporations Regulations 2001. This is commonly referred to as negative assurance</td>
</tr>
<tr>
<td>No assurance</td>
<td>• Preparing financial statements (compilation engagement); • Agreed-upon procedures</td>
<td>• Preparation of the financial statements • Performing an agreed set of procedures</td>
<td>• No conclusion provided • Factual findings from performing the procedures reported but no opinion (either positive or negative) is provided to the users on the work that has been undertaken.</td>
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WHAT IS AN AUDIT OF A FINANCIAL REPORT?

An audit of a listed company’s financial report is a reasonable assurance engagement where the auditor provides an opinion about whether the financial report is prepared in accordance with the Corporations Act 2001. This includes giving a true and fair view of the financial position of the company at year end, and of its financial performance for the period ended on that date, and complying with Australian Accounting Standards and Corporations Regulations 2001. Full-year financial reports of Australian listed companies are required by law to be audited. Many other types of entities are also required to have their financial report audited, including non-listed companies over a certain size threshold and large charities.

While the reasonable assurance obtained in an audit is a high level of assurance, it is not absolute assurance (that is, it is not a certification that the financial report is completely correct).

Obtaining absolute assurance is not possible in financial report audits for a number of reasons, including:

- It would be impractical for the auditor to test and audit every transaction or balance.
- Preparation of the financial report involves judgements and estimates by management and may be contingent on future events, which means that valuation of assets or liabilities in the financial report often cannot be determined precisely.

WHAT IS A REVIEW OF A FINANCIAL REPORT?

A review of a half-year financial report, referred to as an interim financial report in the accounting standards, is a limited assurance engagement where the auditor provides a conclusion to the users of the financial report as to whether the auditor has become aware of any matter that makes them believe that the financial report is not in accordance with the Corporations Act 2001, including giving a true and fair view and complying with Accounting Standard AASB 134 Interim Financial Reporting and Corporations Regulations 2001.

Australian listed company half-year financial reports are required by law to be audited or reviewed by the same auditor that conducts the audit of the financial report at year end.

AASB 134 Interim Financial Reports.
RELATIONSHIPS IN FINANCIAL REPORTING

The following diagram illustrates the relationship between shareholders and other stakeholders, management, those charged with governance and the auditor. Those charged with governance are those responsible for overseeing the strategic direction and accountability obligations of the company, including the financial reporting process. In a listed company this includes the board of directors, which may include some executive members, and the audit committee.

In Australia, auditors attend a listed company’s Annual General Meeting (AGM) and are available to answer questions from interested parties that are entitled to participate in the meeting, such as shareholders. This is a useful opportunity for shareholders to clarify specific aspects of the audit.

WHAT IS THE ROLE OF THE AUDIT COMMITTEE?

The Australian Securities Exchange (ASX) requires listed companies included in the S&P All Ordinaries Index to have an audit committee and recommends all other listed entities have an audit committee, which is a sub-committee of the board of directors. The audit committee oversees the appointment or removal of the external auditor, the fees payable for both audit and non-audit work, rotation of the audit engagement partner, the scope and adequacy of the external audit, the independence and performance of the external auditor and the impact of any proposed non-audit services on the auditor’s independence.10

Consequently, the audit committee usually arranges the appointment of the auditor, which is then confirmed by the members at the AGM. The audit committee typically meets with the auditor during the year to discuss details such as scheduling, risks, financial reporting issues, the auditor’s findings, matters to be included as “Key Audit Matters” in the auditor’s report and other matters relevant to the audit of the financial report. At the end of the audit, the auditor often provides a more detailed, in-depth confidential report to the audit committee.

Audit committees also oversee the corporate reporting processes, internal control framework, the preparation of the financial report, including the appropriateness of the accounting judgements or choices exercised by management in preparing that financial report, and the internal audit function.

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1ASX listing rules. 2ASX Corporate Governance Council Corporate Governance Principles and Recommendations 4th Edition 2019, recommendation 4.1 3Corporations Act 2001 section 299A(1) requires a listed entity’s directors’ report to contain information that shareholders would reasonably require to make an informed assessment of the entity’s operations (section 299A(1)(a)), financial position (section 299A(1)(b)), and business strategies, and prospects for future financial years (section 299A(1)(c)) – the operating and financial review.
WHAT INFORMATION IS AUDITED?

Only certain sections of a company’s annual report are audited. The auditor’s report provides an opinion on the financial report, which comprises the financial statements, the notes to the financial statements and the directors’ declaration. The auditor’s report also provides an opinion on the remuneration report in the directors’ report but not on the Operating and Financial Review (OFR) or other information. This is important to remember as the directors provide their assessment of the company’s operations, financial position, and business strategies and prospects for future financial years in the OFR.

As the directors’ report is intended to complement and support the financial report, it may appear to be part of the audited financial information and may also include non-GAAP (Generally Accepted Accounting Principles) measures, which are financial information not prepared in accordance with the accounting standards.

Although the information provided in the directors’ report is not audited, with the exception of the remuneration report, the auditor still needs to consider and report on whether it contains material inconsistencies with the financial report, or knowledge gained through the audit, or appears to be materially misstated. This provides some comfort to shareholders. See section on “The Auditor’s Report - Other Information”.

The financial report may be published as part of an integrated report, which addresses how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term, by reporting on inputs, outputs and outcomes in relation to six capitals, of which financial capital is just one. The financial report may also be presented with other information in the annual report or with other reports which are prepared voluntarily by the company, such as a sustainability report.

WHAT INFORMATION IS REVIEWED?

An interim financial report for the half-year is required to be issued by listed companies and that interim financial report is required to be either audited or reviewed by the auditor of the company. The work conducted in a review is primarily comprised of making enquiries of persons responsible for financial and accounting matters and performing analytical procedures, and so the scope of a review is substantially less than the scope of an audit.

### Annual Report

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<td>Directors’ Declaration</td>
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| NOT Audited* | Operating & Financial Review | Other Information |

*Material inconsistencies with financial report and auditor’s understanding of the company identified only.

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Corporations Act 2001 section 299A(1) requires a listed entity’s directors’ report to contain information that shareholders would reasonably require to make an informed assessment of the entity’s operations (section 299A(1)(a)), financial position (section 299A(1)(b)), and business strategies, and prospects for future financial years (section 299A(1)(c) – the operating and financial review. 

ASA 720: The Auditor’s Responsibilities Relating to Other Information requires the auditor to obtain the final version of the annual report, if possible before signing their report, and consider if there is any material inconsistency with the financial report or the knowledge they obtained on the audit. 

Integrated reports are prepared using the International Integrated Reporting (IIR) Framework issued by the International Integrated Reporting Council (IIRC). 

Sustainability Reports may be prepared using, for example, the Global Reporting Initiative (GRI) framework. 

The half-year financial report is defined under section 303 of the Corporations Act 2001.
WHAT IS AUDITOR INDEPENDENCE?

Independence is the cornerstone of the auditing profession. An independent auditor is free from external influence or bias and is therefore able to maintain integrity, make objective judgements and exercise appropriate professional scepticism during the audit. Auditors must comply with the Code of Ethics for Professional Accountants (the Code of Ethics) or equivalent, including maintaining independence of mind and appearance, meaning that auditors must not only act independently, but also be seen to be independent. These requirements are more onerous for public interest entities, including listed companies.

Many of the laws, regulations and professional standards applicable to audits, such as those in the Corporations Act 2001, and the Code of Ethics set out independence requirements that auditors of relevant companies need to meet. For listed companies in Australia, there are additional requirements to other entities, including:

- rotation of lead and review auditors every five years, which can be extended up to seven years;\(^{15}\)
- three year cooling off period (where the auditor does not participate in the audit in any way or directly influence the outcome of the engagement) for lead and review auditors from 1 January 2019, increasing to five years cooling off period for lead auditors after 31 December 2023;
- restrictions on auditors holding board positions or employment at companies they have audited;
- prohibitions on contingent fees, financial interests in the client or related entity, loans to or from the client, deposits with the client, close business relationships and offering or accepting inducements, gifts or hospitality;
- prohibitions on the provision of certain services to listed company audit clients, such as:
  - assuming management responsibility;
  - serving as General Counsel;
  - accounting and bookkeeping services, including preparing accounting records and preparing financial statements;
  - promoting, dealing in, or underwriting client shares;
  - recruiting services for a director, officer or senior management who will have significant influence over accounting records;
  - if material to the financial statements, valuation services, preparing tax calculations, internal audit services and designing or implementing IT systems;
- limitation of fees from the company and related entities to no more than 15% of total fees received by the firm over two consecutive years.

The Corporations Act 2001 requires a declaration of independence to be provided by the auditor to the board of directors, which is published in the annual report.

\(^{15}\)See s324DAA of the Corporations Act 2001 which provides for directors to extend the audit partner time-on period for the audit of a listed entity.
UNDERSTANDING WHAT EXTERNAL AUDITORS CAN PROVIDE

DIFFERENCE BETWEEN INTERNAL AND EXTERNAL AUDIT

Internal audit is an appraisal activity which may be established within the company and functions usually under the oversight of the company’s audit committee. It is a management tool and forms part of the company’s internal control structure. In general, the focus of an internal audit is to evaluate the adequacy and effectiveness of the company’s internal control.

By contrast, under the Corporations Act 2001, an external audit is required to be undertaken by a registered company auditor, who is independent of the company, to express an opinion on the annual financial report and an opinion (audit) or conclusion (review) on the interim financial report. The Corporations Act 2001 requires the audit of listed companies’ annual financial reports in accordance with Australian Auditing Standards and sets the requirements for appointment, removal, registration, independence and rotation of the auditor and publication of annual transparency reports.

ASSURANCE ON NON-FINANCIAL INFORMATION

Audit is a form of assurance providing reasonable assurance on financial information. Assurance may provide either reasonable or limited assurance on a wide and expanding range of subject matters. Assurance reports can provide stakeholders with confidence in subject matters ranging from:

- compliance with legislation and regulations
- integrated reports under the <IR> Framework
- sustainability reports under the GRI Framework
- information reported under the National Greenhouse and Energy Reporting Scheme, Emission Reduction Fund or related schemes
- prospectuses
- design, implementation and operating effectiveness of controls.

WHAT IS AUDIT QUALITY?

Audit quality is challenging to define, measure and observe as most of the valuable work auditors do happens before a company’s financial report is released to the public (see also “What do auditors do?”). The International Auditing and Assurance Standards Board (IAASB) has issued a Framework for Audit Quality which says:

“Audit quality encompasses the key elements that create an environment which maximises the likelihood that quality audits are performed on a consistent basis.”
HOW CAN FINANCIAL REPORT USERS ASSESS AUDIT QUALITY?

As audit quality is difficult to measure and evaluate, shareholders and other stakeholders largely rely on the Board and audit committee to satisfy themselves that the auditor provides sufficient audit quality to give confidence in the auditor’s report. Sources of information which may be useful in assessing the audit include:

- Transparency reports, which cover information on the audit firm published on their website annually, including the audit firm’s:
  - internal quality control system and its effectiveness;
  - independence practices and internal independence reviews;
  - total revenue and revenue relating to audits;
  - legal and governance structures;
  - continuing professional development; and
  - voluntary reporting of actions to improve and maintain audit quality, audit quality indicators (such as: partner to staff ratio, staff turnover, technical resources support), internal review or external inspection findings and other relevant matters.

- ASIC Inspection findings, published annually including findings for each of the four largest audit firms from 2019, and audit firms’ own disclosures of findings.

- ASIC’s report on Audit quality measures, indicators and other information.

- Answers to questions at the AGM about:
  - reasoning for the key audit matters identified and outcomes of the procedures conducted;
  - whether the company’s audit was reviewed by ASIC in their audit inspections and, if so, what the outcomes were;
  - any modification to the auditor’s report; and
  - any Emphasis of Matter, Other Matter or Material Uncertainty relating to Going Concern paragraphs.

- Information included in the key audit matters, including whether they are relevant to the company rather than being boiler plate.

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16Transparency reports are required under section 322 of the Corporations Act 2001 for auditors of 10 or more listed companies and other specified entities. ASIC INFO 184 summarises the requirements for audit transparency reports. 17The Corporations Act 2001 section 250PA provides for written questions prior to the AGM and section 250T provides for questions at the AGM by members to the auditor on matters relevant to the conduct of the audit.
WHAT ROLE DO LISTED COMPANIES HAVE IN OBTAINING QUALITY AUDITS?

Audit firms are ultimately responsible for performing quality audits, however the IAASB’s Framework for Audit Quality recognises the importance of the contribution and support of regulators, audited companies and other stakeholders in achieving quality audits that support reliable financial reports in the capital markets. The quality of financial reporting by the company can have a significant impact on the effectiveness of the audit. Directors and audit committees have an important role in ensuring the company provides a sound basis for a quality audit, including having appropriate governance arrangements, processes and controls, and providing sufficient challenge to management and the auditor. The directors are responsible for the financial report and need to be cognisant of their own responsibilities when assessing the information in the financial report so that they challenge the accounting treatments, seek explanations and professional advice appropriately, rather than relying on the external auditor.

The directors must take reasonable steps to comply with, or secure compliance with, the financial reporting and audit requirements of the Corporations Act 2001, including the requirement to keep proper books and records. This includes ensuring that the company’s records are complete and accurate by adopting appropriate accounting policies and designing and implementing appropriate controls and processes. The directors’ declaration for listed companies states whether:

- in the directors’ opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due;
- the financial statements and notes comply with accounting standards, and give a true and fair view of the financial position and performance of the company and any consolidated entity; and
- the directors have been given the declarations required by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO).

Directors need to read and understand the financial report, in order to ensure that the information it contains is consistent with the directors’ knowledge of the company’s financial position and affairs, and ensure that material matters known to the directors, or that should be known to them, are not omitted.

In relation to the audit, directors and audit committees need to:

- provide the auditor with all explanations and information that they require for the audit;
- bring to the auditor’s attention transactions, risks and difficult accounting judgements that may affect the financial report;
- ensure that the independence of the auditor is not compromised in fact or appearance, including a review by the audit committee of non-audit services and whether they affect auditor independence and inclusion of the auditor’s independence declaration in the directors’ report; and
- ensure that the audit fees are adequate to enable conduct of a quality audit.

ASIC provides guidance explaining the influence others have over audit quality:

- INFO 183 Directors and financial reporting.
- INFO 196 Audit quality: The role of directors and audit committees.
- INFO 223 Audit quality - The role of others.

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*Required for listed companies under the Corporations Act 2001.*
THE AUDITOR’S REPORT

UNMODIFIED AUDIT OPINIONS AND REVIEW CONCLUSIONS

The auditor’s report contains the auditor’s opinion on the financial report, in addition to a range of other information to explain the context in which that opinion has been reached. A review report contains the auditor’s conclusion on the interim financial report, which provides a lower level of assurance than an opinion, and also explains the context in which that conclusion was reached.

An unmodified auditor’s opinion for listed companies states that in the auditor’s opinion the financial report is in accordance with the Corporations Act 2001 including that it gives a “true and fair view” and complies with the Australian Accounting Standards and the Corporations Regulations 2001. This is often referred to as a “clean” audit opinion.

Likewise, an unmodified review conclusion for a listed company’s interim financial report effectively states that the auditor has not become aware of any matter that makes them believe that the half-year financial report does not give a “true and fair view” in accordance with the Corporations Act 2001, including Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001.

WHAT DOES A “TRUE AND FAIR VIEW” MEAN?

A financial report which gives a “true and fair view” is one which presents an accurate and unbiased picture of the company’s financial performance and position. This type of opinion is provided under a fair presentation framework, in which simply complying with the requirements of the financial reporting framework is not enough. A fair presentation framework also requires management to provide disclosures beyond those specifically required by the reporting framework, being the Australian Accounting Standards or, in rare circumstances, depart from a requirement of that framework.

BASIS FOR OPINION

The auditor’s report includes a basis for opinion paragraph, which provides important context about the auditor’s opinion that:

• states that the audit was conducted in accordance with Australian Auditing Standards;
• refers to the section of the auditor’s report that describes the auditor’s responsibilities under the Australian Auditing Standards;
• includes a statement that the auditor is independent of the company in accordance with the relevant ethical requirements and has fulfilled the auditor’s other ethical responsibilities;
• confirms the continued applicability of the independence declaration provided to the directors and included in the annual report; and
• states whether the auditor believes that the audit evidence they obtained is sufficient and appropriate to provide a basis for the auditor’s opinion.

When the auditor modifies the opinion on the financial report, the heading ‘Basis for Opinion’ is amended in accordance with the type of modified opinion (see Modified auditor’s opinions below) and within this section, the auditor includes a description of the matter giving rise to the modification.
KEY AUDIT MATTERS

Auditors of listed companies are required under the Australian Auditing Standards to report “key audit matters” (KAM). These are matters which are, in the auditor’s professional judgement, of most significance in the audit.

KAM are selected from matters communicated with the directors or audit committee that required significant auditor attention in performing the audit. KAM may include areas of higher assessed risk of material misstatement or significant risks and significant auditor judgements relating to areas of significant management judgement.

Matters Communicated with Those Charged with Governance
- Matters that required significant auditor attention
- Matters of most significance
- The KAM section includes, at a minimum:
  - why the matter was considered to be a KAM
  - reference to the related disclosure
  - how the matter was addressed in the audit.

Standardised wording, which is used in the rest of the auditor’s report, is not used in the KAM and the auditor needs to present the KAM in their own style and format.

Some auditors include additional information in their report, such as:
- the materiality benchmark, value or percentage applied
- the scope of the audit, which may include how materiality and KAMs influenced the scope
- the outcomes of the audit procedures in response to KAMs.

The provision of this additional information is voluntary in order to assist users in better understanding the auditor’s work. It may be provided because of their firm’s policy to ensure consistency in their auditor’s reports across jurisdictions.

EMPHASIS OF MATTER AND OTHER MATTER PARAGRAPHS

In some circumstances, the auditor will include additional wording in the auditor’s report directing users to information that is not included in KAM, but in their view is fundamental to understanding the financial report. This may be either:
- an “Emphasis of Matter” paragraph drawing the readers’ attention to matters included in the financial report, such as a note disclosure; or
- an “Other Matter paragraph” which draws the readers’ attention to matters that are not included in the financial report.

It is important to note that an Emphasis of Matter or Other Matter paragraph is not a modification to the auditor’s opinion (see Modified auditor’s opinions below).

GOING CONCERN

If a material uncertainty exists relating to events or conditions that may cast significant doubt on a company’s ability to continue as a going concern, either:
- the auditor’s report includes a section ‘Material Uncertainty Related to Going Concern’ if the uncertainty is adequately disclosed in the financial report; or
- the auditor issues a qualified or adverse opinion (see Modified auditors’ opinions below) if the financial report does not adequately disclose the matter.

The auditor is required to challenge the adequacy of disclosures for ‘close calls’ when an event or condition casts a significant doubt on the company’s ability to continue as a going concern, but due to mitigating circumstances the company concluded that no material uncertainty exists, so the financial report can be prepared on a going concern basis. The going concern basis is used when the company is expected to continue in business without the threat of liquidation for the foreseeable future, which management is required to assess for at least the next 12 months, after the end of the reporting period.20

OTHER INFORMATION

Although the auditor is not responsible for auditing other information in the annual report, which is not in the financial report, they are required to read the other information and consider whether there is a material inconsistency between that other information and either the financial report or the auditor’s knowledge obtained in the audit.\textsuperscript{21}

If the company refuses to correct a material inconsistency, the auditor describes the inconsistency in an ‘Other Information’ section of the auditor’s report. If the auditor’s report has already been issued, then the auditor must bring the inconsistency identified to the users’ attention by other means.

\textsuperscript{21}\textit{ASA 720 The Auditor’s Responsibilities Relating to Other Information}. 
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### CONTENTS OF PARAGRAPHS FOR SPECIFIC MATTERS IN THE AUDITOR’S REPORT

<table>
<thead>
<tr>
<th>Type of assurance</th>
<th>Matters included</th>
</tr>
</thead>
</table>
| **Key Audit Matters** | Matters which required significant auditor attention, selected from matters communicated with those charged with governance, which may include:  
- areas of higher assessed risk of material misstatement, or significant risks, such as areas of significant management judgement or significant unusual transactions  
- significant auditor judgements relating to areas in the financial report that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty and accounting policies inconsistent with the industry that have a significant effect on the financial report  
- the effect on the audit of significant events or transactions with related parties or that are outside the normal course of business for the company or that otherwise appear to be unusual, that may have required management to make difficult or complex judgements in relation to recognition, measurement, presentation or disclosure. |
| **Emphasis of Matter** | Matters which have been appropriately disclosed in the financial report and are not included in KAM, which represent:  
- an uncertainty relating to the future outcome of exceptional litigation or regulatory action  
- a significant subsequent event that occurs before the auditor’s report is signed  
- early application of a new accounting standard that has a material effect on the financial report  
- a major catastrophe that has had, or continues to have, a significant effect on the company’s financial position. |
| **Other Matter** | Matters which are not, and are not required to be, reported in the financial report and are not included in KAM, which law or regulation requires to be reported or the auditor considers it necessary to communicate, such as:  
- the planned scope of the audit  
- the application of materiality in the context of the audit  
- an explanation in the rare circumstances where it is not possible for the auditor to withdraw from the engagement despite a pervasive limitation of scope imposed by management  
- that another financial report has been prepared by the same company in accordance with another general purpose framework and that the auditor has issued a report on that financial report  
- that the auditor’s report is intended solely for the intended users, and should not be distributed to or used by other parties, if the auditor’s report is intended to meet the information needs of specific users  
- if management amends the financial report and a new auditor’s report is issued, reference to the note in the financial report that more extensively discusses the reason for the amendment of the previously issued financial report and to the earlier report provided by the auditor  
- if the financial report of the prior period was audited by a predecessor auditor, details of that auditor’s report, or if it was unaudited, the fact that the comparative figures are unaudited. |
| **Material Uncertainty relating to Going Concern** | A section in an auditor’s report, containing an unmodified opinion, about a material uncertainty relating to going concern which the company has adequately disclosed in the financial report. This section:  
- draws attention to the note in the financial report that discloses the relevant events or conditions that give rise to the uncertainty and management’s plans to deal with those events or conditions  
- states that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the company’s ability to continue as a going concern but that the auditor’s opinion is not modified. |
| **Other information** | A section which:  
- identifies other information contained in the annual report which is not audited, such as the directors’ report (except the remuneration report which is required by law to be audited), the corporate governance report and any voluntary reporting, such as an integrated report or sustainability report  
- identifies whether that other information was obtained prior to the date of the auditor’s report or is expected to be received afterwards  
- describes any uncorrected material misstatement in the other information if information included in an annual report is inconsistent with the audited financial report (for example, if the figures in the OFR\(^2\) within the directors’ report are inconsistent with those disclosed in the financial statements). |

\(^2\)For examples of key audit matters see IAASB website.  \(^2\)For listed entities, s299A(1) of the Corporations Act 2001 requires directors’ report to contain information that shareholders would reasonably require to make an informed assessment of the entity’s operations, financial position and business strategies and prospects for future financial years (the OFR).
HOW CAN YOU TELL IF THE AUDITOR’S REPORT IS CLEAN OR NOT?

To determine if an auditor’s report is “clean” or whether it has been modified, you need to look at the opinion section at the top of the auditor’s report. An unqualified or clean auditor’s report will state that in the auditor’s opinion the financial report is in accordance with the Corporations Act 2001, including giving a true and fair view, and complying with accounting standards and the Corporations Regulations 2001.

If the audit opinion is modified it can be either:

- Qualified opinion: a clean opinion is provided “except for” the matter identified.
- Disclaimer: the auditor cannot provide an opinion because the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for that opinion.
- Adverse opinion: because of the significance of the matter, the report is not in accordance with the Corporations Act 2001 in that either it does not present a true and fair view or does not comply with accounting standards and the Corporations Regulations 2001 (see also “Modified auditor’s opinions”).

Even where there is a clean opinion, it is important to look for and pay attention to the Key Audit Matters raised and any Emphasis of Matter, Other Matter or Material Uncertainty relating to Going Concern paragraphs, which can each highlight matters of significance contained in the financial report.

DOES A CLEAN AUDITOR’S REPORT MEAN A CLEAN BILL OF HEALTH FOR THE COMPANY?

Auditor’s reports are intended to increase the degree of confidence users have in the information in the financial report. It is not about the soundness of the business strategies, its future viability or whether it is a safe investment.

An unmodified auditor’s opinion means investors or other stakeholders can assess the company based on its financial report, with more confidence that the information is materially correct and unbiased, than if the report was modified or if there were no auditor’s report.

The directors are required to include a formal statement on the solvency of the company in the financial report upon which the auditor’s opinion is expressed. Auditors assess the appropriateness of the going concern assumption underpinning this solvency statement and the preparation of the financial report, but this cannot be taken as a conclusion on the future prospects of the company nor does it reflect the business risks which could impact the company’s financial performance and outcomes (see “What do auditors do in regard to going concern?”).

The directors’ report addresses these matters in the OFR, which is required to contain information that shareholders would reasonably require to make an informed assessment of the company’s:

(a) operations
(b) financial position
(c) business strategies, and prospects for future financial years.

However, the OFR, which is required for listed companies, is not required to be audited. See ASIC Regulatory Guide RG 247 Effective disclosure in an operating and financial review.

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MODIFIED AUDITOR’S OPINIONS

Modified auditor’s opinions are issued when the auditor believes the financial report contains a material misstatement, or when the auditor is unable to obtain enough evidence to form an opinion. Such an opinion should be a red flag for readers, as it indicates that part or all of the financial report cannot be relied upon. The following table sets out the different types of modified auditor’s opinions that may be issued in these situations.

<table>
<thead>
<tr>
<th>Type of modified audit opinion</th>
<th>Description for FMC Reporting Entity entities</th>
<th>Situations where this type of report may be issued</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified or “except for” opinion</td>
<td>The opinion states the financial report is in accordance with the Corporations Act 2001, in that it gives a true and fair view and complies with the Australian Accounting Standards and the Corporations Regulations 2001, except for the effect of a specific matter or matters.</td>
<td>A qualified opinion is issued when a specific part of the financial report contains a material misstatement or adequate evidence cannot be obtained in a specific, material area, but the rest of the financial report is found to give a true and fair view.</td>
<td>The auditor has a different view on the valuation of a material asset than that applied by management in the financial report, but the rest of the financial report was found to be free of material misstatements.</td>
</tr>
<tr>
<td>Disclaimer of opinion</td>
<td>The auditor does not express an opinion on the financial statements because of the significance of the matters described. They are unable to obtain sufficient appropriate audit evidence to provide a basis for an opinion.</td>
<td>A disclaimer of opinion is very rarely issued as it indicates that either: • the auditor cannot obtain sufficient appropriate evidence on which to base an opinion on the financial report overall and the possible effects on the financial report could be both material and pervasive; or • the auditor cannot form an opinion due to the cumulative effect on the financial report of potential interaction of multiple uncertainties.</td>
<td>The company’s financial reporting information system was corrupted and key data was lost, so that sufficient appropriate evidence is not available to support all of material disclosures in the financial report.</td>
</tr>
<tr>
<td>Adverse opinion</td>
<td>The opinion states that the auditor believes the financial report is not in accordance with the Corporations Act 2001, including giving a true and fair view and complying with the Australian Accounting Standards or the Corporations Regulations 2001.</td>
<td>An adverse opinion is issued when the auditor identifies misstatements which are both material and pervasive to the financial report.</td>
<td>The auditor believes that due to a significant economic downturn, a credit provider’s management has inadequately provided for impairment of the company’s loan portfolio which represents a very significant proportion of their assets. The auditor believes that the financial assets are overstated, so the financial report is materially misstated.</td>
</tr>
</tbody>
</table>

BASIS FOR MODIFIED OPINION

The basis for modified opinion section provides greater clarification to the reader of the auditor’s report about why the auditor expressed a modified opinion. The basis for a qualified opinion due to a misstatement or an adverse opinion describes the misstatement by either quantifying the financial effects of the misstatement, explaining how qualitative disclosures are misstated or by describing the nature of any omitted information and including the omitted disclosures. The basis for a qualified opinion due to insufficient evidence, or a disclaimer provides the reasons for the auditor’s inability to obtain sufficient appropriate audit evidence.
THE AUDIT AND REVIEW PROCESS

**WHAT DO AUDITORS AND REVIEWERS DO?**

The audit or review of a full or half-year financial report, respectively, is a systematic process designed to identify instances of **material misstatement** in that report. The Corporations Act 2001\(^{26}\) requires audits and reviews to be conducted in accordance with the auditing standards, which are issued by the Australian Auditing and Assurance Standards Board (AUASB) and comprise a suite of standards for audits of financial reports and a single standard for reviews of half-year financial reports. These standards closely follow the international auditing standards so that what auditors are required to do is consistent across jurisdictions.

The following diagram illustrates at a very high level what is involved in financial report audits and reviews, and the order in which activities usually take place during the year:

<table>
<thead>
<tr>
<th>Primarily performed prior to period end</th>
<th>Primarily performed after period end</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial assessment and agreement on terms of the engagement</td>
<td>Finalisation and auditor’s report signed (Australian listed companies: within 3 months of period end date)</td>
</tr>
<tr>
<td>Understanding the entity, including internal control relevant to the audit, and assessing risks of material misstatement in the financial report</td>
<td>For more on auditor’s reporting, see the example independent auditor’s report in appendix 2.</td>
</tr>
<tr>
<td>Performing interim procedures to test the operating effectiveness of controls on which the auditor plans to rely and substantive procedures on transactions and balances</td>
<td>In order to obtain sufficient appropriate audit evidence and meet the reporting deadlines, the auditor conducts procedures during the period which is supplemented after year end to support the opinion or conclusion.</td>
</tr>
<tr>
<td>Performing procedures to address the risk of material misstatement in the financial report</td>
<td>The types of procedures applied involve judgement and will vary significantly depending on the risks of material misstatement, nature of the entity and whether the engagement is an audit or review.</td>
</tr>
</tbody>
</table>

\(^{26}\)Corporations Act 2001, section 307A Audit to be conducted in accordance with auditing standards.
WHAT IS A MATERIAL MISSTATEMENT?
Auditors’ work is concerned with identifying material misstatements, rather than any misstatement in the financial report. Material misstatements are those that are significant enough to affect the decisions made by the users of the financial report. This can be in terms of the quantitative or qualitative significance of misstatements.

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantitative</td>
<td>The quantities or dollar amounts in the financial report. For example, quantitatively material misstatements could include:</td>
</tr>
<tr>
<td></td>
<td>• Impairment of assets</td>
</tr>
<tr>
<td></td>
<td>• Overstating revenue</td>
</tr>
<tr>
<td></td>
<td>• Missing/not recorded liabilities</td>
</tr>
<tr>
<td></td>
<td>• Understating expenses</td>
</tr>
<tr>
<td>Qualitative</td>
<td>The nature of items in the financial report. For example, qualitatively</td>
</tr>
<tr>
<td></td>
<td>material misstatements could include:</td>
</tr>
<tr>
<td></td>
<td>• Not disclosing certain related party transactions</td>
</tr>
<tr>
<td></td>
<td>• Not disclosing management’s remuneration</td>
</tr>
</tbody>
</table>

These disclosures are important in evaluating how the company has been managed, although they may be small quantitatively in comparison to the scale of the company’s overall operations.

WHAT DO AUDITORS DO IF THEY FIND NON-COMPLIANCE WITH LAWS AND REGULATIONS?
If an auditor suspects or discovers non-compliance with laws or regulations, other than those which are inconsequential, they must take action and cannot turn a blind eye. Whether the non-compliance is by company staff, management or external parties, auditors must respond in a timely way so that the adverse consequences to stakeholders and the general public are rectified, remediated or mitigated.

The auditor needs to be satisfied that the company has taken appropriate and timely action to address the consequences and deter further non-compliance, or the company has disclosed the matter to an appropriate authority where required by law or regulation or where necessary in the public interest. If not, auditors are required to follow an escalation process, initially through an appropriate level of management.

If the company’s response is inadequate, management is involved or there will be actual or potential substantial harm to stakeholders or the general public, the auditor must take further action. This may warrant disclosing the matter to an appropriate authority, even if not required by law, and/or withdrawing from the engagement, in which case they must apply to ASIC for consent to resign. The auditor continues to hold office until consent has been granted and, if consent is given, informs any incoming auditor of the circumstances of their resignation. Disclosure to an appropriate authority is not considered a breach of the duty of confidentiality if the auditor is acting in good faith.

WHAT DO AUDITORS DO WITH RESPECT TO FRAUD?
Auditors consider the possibility that fraudulent activities can result in material misstatement in the financial report and take this into account in planning and performing their work.

Fraud as defined in the auditing and assurance standards is an intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain unjust or illegal advantage.

An audit is not an investigation intended to uncover all instances of fraud. However, an auditor is required to treat fraud risks as significant risks and must obtain an understanding of the company’s related controls. Therefore, an audit is only likely to detect instances of fraud that result in material misstatement, although there is no guarantee that an audit will detect any material frauds perpetrated against the company due to the nature of fraud.

As fraud is usually coupled with some form of concealment or deception, the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. Fraudsters may employ forgery, deliberately fail to record transactions, or make misrepresentations to the auditor, which may be even more difficult to detect when accompanied by collusion. The auditor’s ability to detect a fraud depends on factors such as the skill of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated and the seniority of those individuals involved. In addition, frauds which are not material to the financial audit are unlikely to be detected by the external auditor.
WHAT DO AUDITORS DO IN REGARD TO THE GOING CONCERN ASSUMPTION?

The going concern assumption is that a company will continue in business for the foreseeable future. The going concern assumption has a significant impact on how a company’s financial report is presented (see “If going concern doesn’t apply”).

In preparing the financial report, management assesses whether the company will be able to continue in business for the foreseeable future, which is at least twelve months from the end of the reporting period. The directors’ declaration in the financial report includes the directors’ opinion about whether there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

The auditor performs work to evaluate the appropriateness of management’s use of the going concern basis of accounting as part of the audit. The auditor considers a period of approximately twelve months from the date of the auditor’s current report to the expected date of the next auditor’s report on the corresponding half-year or annual financial report. As the directors’ declaration is only required to cover twelve months from the end of the reporting period, the auditor must request management to extend its assessment period to correspond to the relevant period used by the auditor. 27

The auditor:
- evaluates management’s assessment of the company’s ability to continue as a going concern, including whether it reflects all relevant information of which the auditor is aware as a result of the audit;
- concludes on the appropriateness of management’s use of the going concern basis of accounting;
- concludes on whether a material uncertainty exists, related to events or conditions that may cast significant doubt on the company’s ability to continue as a going concern; and
- determines whether the financial report adequately discloses any material uncertainty.

The going concern assumption involves judgements about events taking place in the future, which are inherently uncertain. Where there is significant uncertainty in the company’s ability to continue as a going concern and this has been disclosed by management in the notes to the financial statements, the auditor includes wording in the auditor’s report to direct users to the applicable note disclosure, in a “material uncertainty related to going concern” paragraph.

If the auditor ultimately does not agree with management’s assumptions regarding going concern, the result would be a modified opinion (see “The auditor’s report”).

If the going concern basis doesn’t apply

Companies that are not a going concern, when management intends to liquidate the company or to cease trading, or has no realistic alternative but to do so, need to report on a different basis from companies that are a going concern – for example, assets and liabilities would be recognised at their immediate sale value/liquidation value rather their value in future use.

27ASA 570 Going Concern, paragraph Aus 13.1 requires the auditor to request management to extend its assessment period to correspond to the relevant period used by the auditor, being twelve months from the date of the auditor’s report, if management’s assessment covers a shorter period.
Accounting standards: Mandatory standards applied in preparing financial statements. In Australia, these standards are issued by the Australian Accounting Standards Board and are formally referred to as “Australian Accounting Standards”. Internationally accounting standards are issued by the International Accounting Standards Board.

Assurance: The expression of a conclusion that is intended to increase the confidence of users in subject matter against criteria (see also “What does assurance mean?”).

Assurance practitioner: A professional assurance services provider.

Auditor’s report: The final report that sets out the auditor’s opinion (see also “The auditor’s report”, and an example of an auditor’s report in Appendix 2).

Auditing and assurance standards: Mandatory standards applied by assurance practitioners in audits, reviews and other assurance engagements. In Australia these standards are issued by the Australian Auditing and Assurance Standards Board, and internationally by the International Auditing and Assurance Standards Board.

Fair presentation framework: Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Australian Accounting Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

Financial statements: Four primary financial statements for the current and comparative financial period (statement of profit and loss and other comprehensive income, statement of financial position, statement of changes in equity, and cash flow statement), plus the notes to the financial statements. See also, “A guide to understanding annual reports: Listed companies” available on CPA Australia’s website.

Going concern: An entity that is expected to continue in operation for the foreseeable future, taken to be a 12-month period from the date of the auditor’s report for the purpose of auditor going concern assessments. (see also “What do auditors do in regard to going concern?”).

Limited assurance: A level of assurance that is meaningful, but lower than reasonable assurance (see also “What does assurance mean?”).

Material misstatement: An inaccuracy or omission in the financial report that is significant enough to affect the decisions made by users.

Reasonable assurance: A high but not absolute level of assurance (see also “What does assurance mean?”).

Review report: The final report that sets out the review conclusion (see also “The auditor’s report”).

Those charged with governance: the person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. In a listed company this includes the board of directors, which may include some executive members, and the audit committee.

True and fair view: Presenting an accurate and unbiased picture of a company’s financial performance and position in the financial report.
APPENDIX 2 – EXAMPLE INDEPENDENT AUDITOR’S REPORT

INDEPENDENT AUDITOR’S REPORT

Who is the report for?

The report is addressed to the members or shareholders of the company

To the Members of ABC Company Ltd.

What does the report cover?

This section sets out the basic details of the engagement – the applicable reporting period, name of the company, and what was audited

In our opinion:

(a) the accompanying financial report of ABC Company Ltd. is in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the company’s financial position as at 30 June 20XX and of its performance for the year then ended; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

What was the audit outcome?

The auditor sets out their overall finding in the opinion. This is an example of an unmodified or ‘clean’ audit opinion.

We have audited the accompanying financial report of ABC Company Ltd., which comprises the statement of financial position as at 30 June 20XX the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and the directors’ declaration.

How did the auditor form their opinion?

The auditor provides important context about the auditor’s opinion.

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Report section of our report. We are independent of the Company in accordance with the auditor independence requirements of the Corporations Act 2001 and the ethical requirements of the Accounting Professional and Ethical Standards Board’s, APER 110 Code of Ethics for Professional Accountants (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

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

Which matters were significant in the audit?

The auditor outlines the matters most significant in the audit of the financial report of the current period.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report of the current period. These matters were addressed in the contexts of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter. Example:

Valuation of Financial Instruments

The Company’s investments in structured financial instruments represent [x%] of the total amount of its financial instruments. Due to their unique structure and terms, the valuation of these instruments is based on entity-developed internal models and not on quoted prices in active markets. Therefore, there is significant measurement uncertainty involved in this valuation. As a result, the valuation of these instruments was significant to our audit.]
What is done on sections of the annual report which are not audited?

The auditor explains the procedures they have conducted with respect to the other information in the annual report.

Other Information
The directors are responsible for the other information. The other information comprises the information included in the Company’s annual report for the year ended 30 June 20XX, but does not include the financial report and our auditor’s report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

What is the Directors’ role?

This describes the Directors’ responsibilities for the preparation of the financial report, the internal controls in the company and assessing the company’s ability to continue as going concern.

Responsibilities of the Directors for the Financial Report
The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

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

What is the Auditor’s role?

The auditor sets out their responsibility for auditing the financial report and provides a brief description of what this means (see also “What do auditors and reviews do?”)

Auditor’s Responsibilities for the Audit of the Financial Report
Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/ Home.aspx. This description forms part of our auditor’s report.

What is the remuneration report audit outcome?

This section is to report on other reporting responsibilities addressed by the auditor.

Report on Remuneration Report
Opinion on the Remuneration Report
We have audited the Remuneration Report included in [page x to y] of the directors’ report for the year ended 30 June 20XX.

In our opinion, the Remuneration Report of ABC Company Ltd, for the year [period] ended 30 June 20XX, complies with section 300A of the Corporations Act 2001.

Responsibilities
The directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the Corporations Act 2001. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Who is the Auditor?

The auditor provides their name and firm.

[Auditor’s name and signature]
[Name of Firm]
[Date of the auditor’s report]
[Auditor’s address]