

Auditor independence & the ATO's compliance approach

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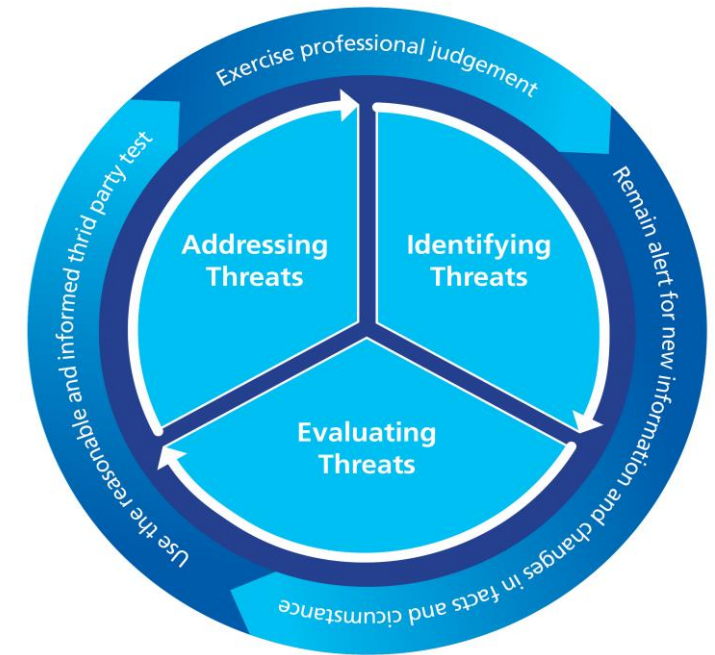
Code of Ethics for Professional Accountants

APES 110 Code of Ethics for Professional Accountants (including Independence Standards) issued November 2018 and effective 1 January 2020:

- Most significant restructure of the Code in two decades.
- New user guide, updated glossary and interactive PDF features.
- Requirements are **now separate** to guidance material – easier to implement and increases **enforceability**.
- Enhanced conceptual framework.
- Strengthened provisions on NAS, amended audit partner rotation provisions and NOCLAR.

The Code – Enhanced conceptual framework

- No longer threats & safeguards approach - **not all** threats can be addressed by safeguards.
- Identified threats that are **not** at an **Acceptable Level** must be addressed in one of three ways:
 - **Eliminate** circumstances creating the threats;
 - **Apply** safeguards; or
 - **Decline** or **end** the specific professional activity/service.
- **New requirements** – form an overall conclusion on effectiveness of actions and remain alert to new information or changes in circumstances.





Importance of Independent Audits for SMSFs

- Approved SMSF Auditors **must comply with the Independence Standards** in the Code as they are legally enforceable under SIS Act and SIS Regulations.
- Taking into consideration the knowledge, skills and expertise of Trustees, in **limited circumstances** auditors/firms **able to overcome prohibitions in the Code** where they are considering providing accounting and other services to SMSF audit clients.
- **Compliance audit report** that the **SMSF has complied with SIS legislation** and other compliance requirements creates **an additional independence threat**.
- **Public interest element** that these audits **are an independent check** on clients' **retirement savings**.

Auditor Independence Guide – Fifth Edition May 2020



Substantial rewrite incorporates changes to the restructured Code in collaboration between APESB, CA ANZ, CPA Australia and the IPA including:

- Application of the **enhanced conceptual framework** in the restructured Code (Chapters 4, 7 & 8).
- Examples of Public Interest Entities (PIEs) (Chapter 5).
- **Networks** and examples of network firms (Chapter 6):

Note: Firm includes a sole practitioner, partnership, corporation or other entity of professional accountants and an **entity that controls**, or is **controlled by**, such parties through ownership, management or other means.



Auditor Independence Guide – Fifth Edition May 2020



50 practical examples and scenarios to guide auditors in understanding independence obligations under the Code:

- Independence for audits and reviews covering fees, interests, relationships, actions and NAS (**Chapter 7**) many of which are also relevant to SMSF auditors.
- Examples for other assurance engagements under Part 4B of the Code (Section 7.19).
- SMSF specific scenarios (**Chapter 8**).



Accounting and Bookkeeping Services to SMSF Audit Clients

Section 8.4 and Scenarios 1 to 4 explore **prohibitions** on providing **accounting and bookkeeping services** to SMSF audit clients.

Three key considerations whether such services can be provided:

1. Does the accounting and bookkeeping service result in the firm (or network firm) **assuming management responsibility** (para R600.7)?
 - **YES** – service **prohibited**
 - **NO** – to avoid assuming management responsibility must be satisfied the client makes **all judgements** and **decisions** that are the proper responsibility of management including (para R600.8):
 - Individual with **suitable skill, knowledge and experience** responsible for client's decisions
 - Oversight of services and evaluates adequacy of results



Accounting and Bookkeeping Services to SMSF Audit Clients

2. Even if management responsibility not assumed - **accounting and bookkeeping prohibited** unless routine or mechanical services (paras R601.5(a) and 601.4 A1):
 - Little or **no professional** judgement.
 - Client involved in the process, for example, transactions coded by the client, client approved entries and trial balance.

3. Even if routine or mechanical **safeguards** must be put in place to reduce any threats that are not an acceptable level including (paras R601.5(b) and 601.5 A1):
 - Use professionals not on the audit team to provide the service.
 - Appropriate reviewer not involved in the service review audit work or service performed.



Other SMSF Auditor Independence Examples

Chapter 8 also provides guidance to SMSF auditors in relation to various circumstances that may create threats to independence including:

- Carrying out a SMSF audit where the auditor was previously a consultant, partner or employee of a firm (Scenario 5).
- Relationships between **auditors and referral sources**:
 - Fee dependence (Scenario 6).
 - Relatives (Scenario 7).
 - Regional areas (Scenario 10).
- **Reciprocal** auditing arrangements:
 - Two auditors that audit each other's SMSF (Scenario 8).
 - Two auditors that audit each other's SMSF audit clients (Scenario 9).
- **Financial planning** services to SMSF audit clients (Scenario 11).
- Auditors '**contracting out**' accounting work (Scenario 12).
- **Long Association** with SMSF audit clients (Scenario 13).



Fee Dependence

If total fees from multiple audit clients referred from one source is a large proportion of total Firm fees, the Firm must evaluate threats and apply safeguards when necessary to reduce threats to an acceptable level (paragraphs AUST R410.3.1 and AUST 410.3.1 A1):

- Included in the Code circa 2013 as it was considered a common risk in the SMSF sector.
- Factors relevant in evaluating threats include the Firm's operating structure, whether it is new or well established, and qualitative or quantitative significance (para 410.3 A2).
- Threats are also created when fees from audit clients represent a large proportion of revenue of a partner or office of a Firm (para 410.3 A4).
- Safeguards include increasing client base to reduce dependence (paras 410.3 A3 and 410.3 A6).
- Specific requirements and safeguards for Public Interest Entity (PIE) audit clients if fees exceed 15% of total firm fees.
- The IESBA has a current project on Fees related matters impacting or perceived to impact auditor independence including proposed requirements and safeguards for Non-PIE audit clients if fees exceed 30% of total firm fees.

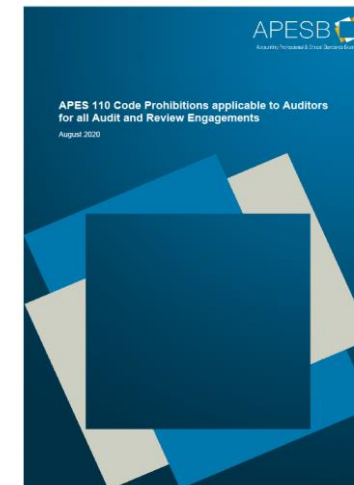
Other Relevant Matters

The current IESBA project on Non-Assurance Services (NAS) will strengthen existing prohibitions and the amendments aim to ensure provisions remain robust and high quality including:

- Prohibition on NAS to PIE audit clients **if a self-review threat**, tightening of **materiality** considerations including removal of qualifier for PIEs, and improve communication with TCWG about NAS.
- Amendments were considered at the **September 2020** IESBA BM and final standard was approved at the **December 2020** IESBA BM.
- Final International standard expected to be issued in March 2021 and **APESB** planning to issue an Australian **Exposure Draft in Q2 2021**.

[APES 110 Code Prohibitions Summary](#)

- Issued August 2020
- High-level summary of prohibited interests, relationships, actions or non-assurance services
- Expands list to **all audit clients** not just PIEs



Further Information

- For more information:
 - www.apesb.org.au
- For timely updates, follow the APESB page:
 - [LinkedIn](#)
- To download APESB's mobile app:



Where auditor is prohibited from auditing the SMSF

An auditor cannot audit the fund under the following circumstances:

- where the auditor is a trustee or director of a corporate trustee, and/or member of the fund
- where an immediate family member (spouse or equivalent, or dependant) of the auditor is a trustee or director of a corporate trustee, and/or member of the fund
- where the auditor's firm (or network firm) has assumed a management responsibility for the fund
- where the auditor, their staff, or their firm (or network firm) has prepared the financial statements for the SMSF, unless it is a routine or mechanical service and appropriate safeguards are applied
- where a partner of the auditor's firm (or network firm) is a trustee or director of a corporate trustee, and/or member of the fund
- where the auditor has a close business relationship with a trustee or director of a corporate trustee, and/or member of the fund, unless any financial interest is immaterial, and the business relationship is insignificant, and
- where the auditor is involved in a reciprocal auditing arrangement in which two auditors agree to audit each other's SMSF



Where auditor must evaluate independence threats

Independence threats arise in situations where an auditor:

- has a close family member (parent, child or sibling who is not an immediate family member) who is a trustee or director of a corporate trustee, and/or member of the fund
- where the auditor has a close personal relationship with a trustee or director of a corporate trustee, and/or member of the fund
- is reliant on one or two referral sources for all or a large proportion of their SMSF audits and fees
- provides advice (such as financial or investment advice, or taxation advice that goes beyond just preparation of the fund's tax return) to the trustee(s) of the fund being audited
- audits an SMSF client in circumstances where either they, their staff or their firm (including network firm) provide other non-assurance services to the fund, and
- enters into a reciprocal auditing arrangement whereby two auditors (who are also accountants) prepare the financial statements for a number of SMSFs and agree to audit each other's clients



The auditor will need to evaluate whether any threats are at an acceptable level and address those threats by taking appropriate action

Providing non-assurance services

The **independence rules** apply to **all approved SMSF auditors**, including **auditing firms** and **network firms** who provide non-assurance services to SMSF audit clients

Before a firm accepts an engagement to provide a non-assurance service to an audit client the firm or network firm **must** determine whether providing the service might create a threat to independence



Non-assurance services include:

- accounting and bookkeeping services
- administrative services
- valuation services
- tax and financial planning services
- internal audit services, information technology systems services
- litigation support services/ legal services
- recruiting services, and
- corporate finance services

Providing tax services

- Firms are prohibited from providing the following tax services in certain situations:
 - tax planning & other tax advisory services (para R604.8)
 - tax services that involve assisting in the resolution of tax disputes (para R604.11)

- Preparing current and deferred tax calculations for an SMSF audit client may create a self review threat at an unacceptable level if the calculation has a material effect on the financial statements

- If an auditor only prepares the SMSF annual return for an audit client this will not generally give rise to an independence threat (604.4 A1)



In-house audits – 3 important requirements

First Requirement

A firm or network firm **shall not** assume a management responsibility for an audit client (para R600.7)

Management responsibilities:

- involve controlling, leading and directing an entity (para 600.7A1)
- depends on the circumstances and requires exercise of professional judgment

Examples include (para 600.7 A3):

- setting policies and strategic direction
- authorising transactions
- controlling or managing bank accounts or investments
- deciding which recommendations of the firm or network firm to implement
- taking responsibility for the preparation and fair presentation of the financial statements



Management responsibilities in SMSFs

Other examples of management responsibilities in the SMSF context include:

- **setting up the fund** (for example, decisions around structuring the fund, preparing and organising execution of the fund's trust deed, and developing and maintaining the fund's investment strategy)
- **making and managing fund investments** (for example, decisions around structuring investments to comply with the investment restrictions, sole purpose test and non-arm's length income rules)
- **preparing the fund's accounts and financial statements** (for example, decisions made when setting up and maintaining data feeds to capture income from investments), and
- **accepting contributions and paying benefits** (for example, decisions around maximising the contributions caps, when to commence a pension, and how best to structure the payment of benefits)



Many SMSF trustees rely on tax professionals to assist them manage their fund. If firm engages in these activities they **cannot** provide audit services to the fund.

Trustees exercising Management responsibilities

Second Requirement

To avoid assuming a management responsibility **the firm must** be satisfied that the SMSF trustee(s) make all judgements and decisions that are the proper responsibility of management.

This includes ensuring that the trustee's management (para R600.8):

- a) possess suitable skill, knowledge and experience to be responsible at all times for the trustee's decisions and to oversee the services. Such an individual would understand:
 - (i) the objectives, nature and results of the services, and
 - (ii) the respective trustee and Firm or Network Firm responsibilities
- b) provides oversight of the services and evaluate the adequacy of the results of the service performed for the trustee's purpose
- c) accepts responsibility for the action, if any, to be taken arising from the results of those services



Routine or mechanical rule for preparing financials

Third Requirement

A Firm or network firm **shall not** provide to an audit client that is not a Public Interest Entity accounting and bookkeeping services including preparing Financial Statements on which the firm will express an opinion, unless:

- the services are of a *routine or mechanical nature*, and
- the firm addresses any threats that are not at an acceptable level (para R601.5)

Routine or mechanical services require little or no professional judgment

Examples include (para 601.4 A1):

- posting transactions coded by the client (trustee) to the general ledger
- posting client (trustee) approved entries to the trial balance
- preparing financial statements based on information in the client (trustee) approved trial balance and preparing related notes based on client approved records



This test only becomes relevant where the firm has not assumed management responsibility for the SMSF and the trustee takes full responsibility for the financial statements

Routine or mechanical rule and safeguards

Even where the preparation of the financial statements is routine or mechanical, the Commissioner and ASIC require the auditor to use safeguards to reduce the threats to an acceptable level

Examples include:

- using professionals who are not audit team members to perform the accounting service
- using an appropriate reviewer not involved in preparing the accounts review the audit or the accounting service



Evidence required on the auditor's file – in-house audit

We expect to see the following on the auditor's file:

- evidence that the auditor was satisfied the firm did not assume any management responsibilities for the SMSF
- evidence that the trustee had the relevant skills, experience and knowledge to take responsibility for the preparation of the financial statements such as:
 - copies of trustee coded transactions which the firm used to post to the general ledger, and/or
 - client approved entries to the trial balance
- ATO may independently verify the evidence with the firm and/or trustee(s)
- signed financial statements and trustee representation letters are insufficient evidence



Tips for restructuring

- Best practice is to use a panel of auditors to avoid self-review threats
- Avoid reciprocal auditing arrangements which can create fee dependency issues where the **total fees referred from one source represents a large proportion of the total fees of the firm** (AUST R410.3.1)
- Audit pooling arrangements can have risks such as:
 - fee dependency issues if reciprocal auditing involved
 - potential for networks to be formed amongst participating firms



Be aware of outsourcing the auditing services to a previous partner, employee or consultant of the firm who provided accounting and/or tax advice to the same SMSF clients (“2 year rule”)

ATO's compliance focus for 2020-2021

We are taking a transitional approach to compliance with the standards that impact in-house audits:

- During the 2020-21 income year we will be taking an educative approach to compliance and supporting auditors to help them meet their obligations. Auditors can also use their professional associations for further guidance and support in relation to compliance with the Code.
- For any audits completed **on or after 1 July 2021** (regardless of the income year to which they relate), we will enforce compliance with the new requirements
- We will take compliance action if we find auditors are not complying with the new rules and may refer auditors to ASIC for further action



Firms should contact us prior to 1 July 2021 if events beyond their control will prevent them from restructuring by this date

Further information



- We plan to issue further guidance on our website by March 2021
- This web content will provide SMSF auditing firms and tax professionals with guidance on:
 - the independence standards under the Code, and
 - our position on key issues of concern to industry, including in relation to in-house audits

Refer to:

[ATO guidance on independence standards – update for SMSF auditors | Australian Taxation Office](#)

Thank you



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