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AUDITING THE SMSF AUDITOR

SERIES:
AUDITING THE
SMSF AUDITOR

PART 1:
Independence – The regulator’s view

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AGENDA

- AUDITOR INDEPENDENCE: WHAT IS IT?
- WHEN THINGS GO WRONG..
- THE LEGISLATION
- INDEPENDENCE SCENARIOS
- DOCUMENTING INDEPENDENCE
- CONCLUSIONS

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SERIES: AUDITING THE SMSF AUDITOR

INDEPENDENCE IS A REQUIREMENT

Every SMSF must be audited annually by an ASIC registered auditor.

In undertaking this task, all SMSF auditors must be independent.

This is a legislative requirement..

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INDEPENDENCE IS A REQUIREMENT

1. SISA s 128F:

Auditors must comply with the independence requirements produced by the Accounting Professional and Ethical Standards Board, as set out in the APES 110 Code of Ethics for Professional Accountants.

2. APES 110:

APES 110 requires that all that all SMSF auditors must:

- Identify any threats to their independence;
- Evaluate the significance of those threats;
- Apply safeguards as necessary to eliminate or reduce the threat to an acceptable level.

INDEPENDENCE – WHAT IS IT?

What is independence? There are 2 facets:

Independence of mind – ability to arrive at conclusions without outside influences compromising professional judgment.

Independence in appearance – the avoidance of facts and circumstances that would lead a reasonable and informed person to conclude that an auditor's integrity, objectivity and professional scepticism had been compromised.

INDEPENDENCE – WHAT IS IT?

Independence is not a judgment call.

It is an objective assessment, which applies without distinction all SMSF auditors – irrespective of fund size, complexity, or standard of audit work.

INDEPENDENCE – WHAT IS IT?

Defences that don't cut it:

It's a judgment call! After all, accountants & auditors are professionals – shouldn't they be able to assess their ability to remain independent?

It's a service benefit! If the accounts have been prepared by the firm, doesn't it make sense to conduct the audit internally as opposed to adding the fees and complications of an external service?

Our work is excellent… Independence is important, but it really applies to other people. The quality of my audit is excellent and thorough.

It's only a small fund… It couldn't possibly be worth involving an external party to conduct the audit.

It's my friend… My golfing buddy will not understand if I refuse to audit his fund.

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INDEPENDENCE – ACCOUNTABILITY

ATO – SMSF Regulator

The Australian Taxation Office (ATO) is the regulator for SMSFs.

The ATO is proactive in the matter of auditor independence. It's focus of review is to identify those auditors at high risk of not meeting their independence obligations.

The ATO will first generally approach an SMSF auditor with their concerns. If the issue is not addressed satisfactorily, the ATO will refer the case to ASIC, the regulator for SMSF auditors.

INDEPENDENCE – ACCOUNTABILITY

ASIC – Auditor Regulator

ASIC will then assess the situation and do the following:

- Impose conditions on the auditor's registration (ie education requirements); or
- Suspend or disqualify the auditor.

In the 2017 financial year, the ATO referred 12 auditors to ASIC on the basis of independence concerns.

Of these, ASIC disqualified several persons and imposed conditions on the registration of others.

Let's look at a few recent cases.

WHEN THINGS GO WRONG…

Case 1: Neil Wilson – disqualified

ASIC found that Mr Wilson had breached:

- Auditor **independence requirements** of APES 110 Code of Ethics for Professional Accountants, where he audited a fund of which he was a member.
- Audit **documentation requirements** of Australian auditing standards.

Case 2: Ross Russo – disqualified

ASIC found that Mr Russo had breached:

- auditor **independence requirements** of APES 110 Code of Ethics for Professional Accountants, where he audited the fund of a close family member;
- **audit evidence requirements** of Australian auditing standards.

WHEN THINGS GO WRONG...

Case 3: John Evennett – disqualified

ASIC found that Mr Evennett had breached:

- auditor **independence requirements** of APES 110 Code of Ethics for Professional Accountants, where he audited the fund of his immediate family member;
- **audit evidence requirements** of Australian auditing standards.

INDEPENDENCE - SCENARIOS

Where independence is an issue, other aspects of the audit file or function are often deficient.

The ATO is extending its focus from the audit of related SMSFs to less obvious misdemeanours:

> "Moving into 2017-18, we want to start examining some other structures and relationships that may also give rise to a compromise in an auditor's Independence."
>
> Kasey McFarlane, ATO Assistant Commissioner

What situations typically 'compromise' independence?

We will now unpack several scenarios highlighted in APES 110, together with industry guidance, such as GS009 and the Joint Accounting Bodies Independence Guide.

INDEPENDENCE – SCENARIOS
FUNDS OWNED BY AUDITOR / RELATIVES

The threat –

Auditing an SMSF of which the auditor or an immediate family member have an ownership interest, creates a SELF INTEREST threat that is so significant no safeguard can be implemented in this situation.

What can be done –

The auditor must decline or withdraw from the engagement to preserve their independence.

INDEPENDENCE – SCENARIOS
FUNDS OWNED BY AUDITOR / RELATIVES

Note:

APES 110 section 290.108 & 144 confirms that the same principle applies at the audit firm level:

No auditor within the firm is able to audit an SMSF owned by a partner in the audit firm or their family member. It is therefore impossible to 'swap' the audit of colleagues' funds among auditors in the same firm.

INDEPENDENCE – SCENARIOS
BUSINESS / PERSONAL RELATIONSHIPS WITH SMSF TRUSTEE

The threat –

Auditing an SMSF where the auditor shares a close personal OR a business relationship with the trustee creates:

- SELF INTEREST,
- FAMILIARITY
- and INTIMIDATION threats for that auditor's independence.

What can be done – Close personal relationships

- The audit firm must remove the interested party from the engagement team OR restructure their responsibilities to ensure they do not deal with the individual with whom they have a close relationship.

- If this cannot be done, the firm should decline the engagement.

What can be done –
Close business relationships

- Unless the business relationship is insignificant to both parties, there is no safeguard that will permit an auditor to perform assurance work for a business associate.
- The Joint Accounting Bodies also confirm this view:

> "An auditor cannot audit the SMSF where…the auditor has…a business relationship with the member/trustee of the SMSF."
>
> Independence Guide, section 9.4.

INDEPENDENCE – SCENARIOS
RELATIONSHIPS WITH A REFERRAL SOURCE

SMSF auditors often obtain their clients upon administrator referral. The auditor’s relationship with such firms and their personnel is therefore important with considering independence. If an auditor is constrained by administrator expectations, independence is compromised.

We now look at two situations of concern in referral source relationships. **The threats –**

1. If the **auditor has a close relationship** (business or personal) with a key employee of a referral source, FAMILIARITY and SELF-INTEREST threats may jeopardise independence.

2. If the **auditor is a consultant, former employee, or ex-partner** of a referral source, FAMILIARITY and SELF-REVIEW threats will arise – particularly if little time has passed since they left the firm.

What can be done – Close Relationships

If the persons in a close relationship significantly influences both preparation of accounts and audit conclusions, independence is jeopardised. (At very least, independence in appearance is compromised.)

The Joint Accounting Bodies Independence Guide provides the example of an auditor receiving referrals from an accounting firm in which the auditor's son is a principle.

The ATO's warns that these relationships will be targeted in 2017-18.

What can be done –
Consultant, former employee, or ex-partner

First year:

if an auditor or engagement team member has served as a director, officer, or employee with significant influence within the referral source firm ***during the audited year***, there is no effective safeguard available.

No recently employed individual should be involved in the audit of that client.

INDEPENDENCE – SCENARIOS
RELATIONSHIPS WITH A REFERRAL SOURCE

Subsequent years:

Threats to independence should be evaluated in the light of:

- The **position** the auditor previously held in the referral source – what influence did they hold over the entity or preparation of accounts?
- **Length of time** since that individual was employed;
- The **role** of that individual within the engagement team – can responsibilities be reassigned to establish independence?

It may be possible to acceptably reduce the threats by:

1. Conducting a review of the auditor's work
2. Restructuring responsibilities in audit firm

The threat –

If a significant percentage of an auditor's client base is obtained from a single referral source, SELF-INTEREST or INTIMIDATION threats are created.

The threat's significance depends upon the qualitative and quantitative nature of the referral source – how important is retention to the auditor?

What can be done –

The Joint Accounting Bodies suggest that if a single referral source would **double the auditor's fee base**, some (potentially all) of the audit work may need to be declined to reduce this threat to an acceptable level.

This is difficult for newly established firms. The following Safeguards may also be available to reduce fee dependency threats to an acceptable level:

- Engage an external professional (such as an unrelated approved SMSF auditor) to conduct regular quality reviews;
- Consult relevant third parties (such as the ATO or industry specialists) upon key judgments.

INDEPENDENCE – SCENARIOS
MANAGERIAL SERVICES / PREPARING FINANCIALS

The threat –

If an auditor or audit staff member assumes managerial responsibility in the preparation of SMSF accounts and financials,

SELF-INTEREST,

SELF-REVIEW,

and ADVOCACY threats arise.

What can be done –

These threats are so significant that no safeguard can reduce to an acceptable level. The auditor must decline the engagement.

When does an auditor assume 'managerial responsibility'?

INDEPENDENCE – SCENARIOS
MANAGERIAL SERVICES / PREPARING FINANCIALS

'**Managerial responsibilities**' include:

- Setting policies and strategic direction
- Directing employee actions
- Authorising transactions
- Choosing which recommendations to implement
- Responsibility for the preparations and fair presentation of SMSF financials in accordance with chosen framework
- Responsibility for designing, implementing and maintaining internal control.

Conclusion:

The Joint Professional Accounting Bodies confirm that independence is **impossible** where the same intelligent entity is responsible for both the preparation and audit of SMSF financials.

However, there are two important exceptions to this principle:

1. Auditor provides technical assistance during financials preparations
2. Effective segregation exists between audit and accounting functions.

Let’s now consider these exceptions.

1. PROVISION OF TECHNICAL ASSISTANCE

SMSF auditors are often called upon to provide technical assistance to trustees and administrators. These services may include:

- Guidance on the correct application of accounting or tax policy;
- Technical advice upon accounting matters on the correct application of accounting or tax policy;
- Proposing adjustments to be made via journal entry.

APES 110 section 290.166 confirms that these activities are part of the normal audit function and will not create a threat to independence.

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2. EFFECTIVE SEGREGATION

It is possible for the same firm to perform both the audit and accounting functions – but only if the two are fully independent:

- A firm has **separate business divisions** carrying out the different roles;
- **Reporting lines are distinct** to a partner with responsibilities that are mutually exclusive to that function;
- **Independence in appearance is also satisfied** – the firm's divisions and reporting lines must not only be separate, but also appear completely independent of one another.

Sole practitioner firms will find this impossible.

Small firms are likely to struggle.

If segregation is not possible, the industry-prescribed alternative is to outsource the audit function.

INDEPENDENCE – SCENARIOS
FINANCIAL ADVISORY SERVICES

The threat –

Auditors must assess a fund's compliance with superannuation law. If the same firm has offered the fund financial advice in a matter with compliance ramifications, the auditor may be reluctant to qualify their opinion in detriment to those recommendations.

What can be done –

APES 110 discusses a variety of non-assurance services that will threaten auditor independence.

The Joint Accounting Bodies also confirm that (irrespective of the quality of financial advice), the appearance of independence will be compromised. There is a strong consensus that such engagements should be declined.

INDEPENDENCE – SCENARIOS
RECIPROCAL AUDITS

The threat –

Outsourcing a firm's audit function does not necessarily guarantee independence.

The ATO has recently highlighted the following outsourcing situations:

- Two SMSF auditors in separate firms agree to audit each other's' SMSF;
- Two firms, each with their own SMSF client base, agree to outsource their funds for audit to each other

Until recently these have been common arrangements. However, there are concerns that there is a lack of incentive to question the reciprocal auditor's work. This creates SELF-INTEREST, FAMILIARITY and INTIMIDATION threats, for which the ATO decline obvious safeguards.

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INDEPENDENCE – SCENARIOS
RECIPROCAL AUDITS

In the words of Kasey McFarlane:

"The auditing standards don't specifically address that issue but the ATO and ASIC's preliminary view is that there is a potential independence issue there…There are some potential issues around familiarity and potential threats that perhaps may not be able to be mitigated against. We are progressing some further work in this space."

Conclusion:

Care should be taken in reciprocal audit arrangements. To avoid the ATO spotlight, it may be time to consider alternative arrangements.

The threat –

Auditors must assess property valuations in the Part A Financial Statement audit and the Part B Compliance audit. Were an auditor to provide valuation services to its SMSF clients, a SELF-REVIEW threat arises.

What can be done –

- If the valuation has **material effect** on Financials on which Audit Firm expresses opinion

AND

- The valuation involves **fair amount of subjectivity**,

  APES 110 states that no safeguard will reduce the self-review threat to an acceptable level.

*A*n audit firm therefore must not provide a valuation for an audit client.

DOCUMENTING AUDITOR INDEPENDENCE

The most common deficiency relating to SMSF auditor independence is a failure to document:

1. Compliance with the requirements
2. Identified threats
3. Utilised safeguards

Even if an auditor **IS** independent, failure to document appropriately is viewed by the regulators as a failure to **BE** independent.

IF NOT DOCUMENTED, IT'S NOT DONE!

DOCUMENT, DOCUMENT, *DOCUMENT*

IT IS THE LAW..

SISA section 128F states that SMSF Auditors must comply with the relevant Australian Auditing Standards.

Both ASA 220 and ASAE 3100 require SMSF auditors to ***form a conclusion*** as to their independence for every engagement they undertake.

This conclusion must describe any threats identified and the details of any safeguards implemented to address those threats.

DOCUMENT, DOCUMENT, *DOCUMENT*

PROFESSIONAL BODIES MONITOR THIS..

The accounting bodies take the documentation of independence matters very seriously. Quality review assessors specifically look to see clear documentation in respect of each audit file re:

- Any **threats** to independence and evaluation of their significance;
- Any **safeguards** applied to address the threat
- A **conclusion** as to the auditor's independence

.

DOCUMENT, DOCUMENT, *DOCUMENT*

ATO FORMS ITS OWN CONCLUSIONS..

And if a professional body has approved a firm's independence documentation, do NOT become complacent.

The ATO will form their own conclusions on this matter should the audit be flagged for review.

As the regulator with the power to refer an auditor to ASIC, ATO's view on these issues is pre-eminent.

Be thorough and be consistent!

INDEPENDENCE CONCLUSIONS

- Auditor independence is the foremost topic in auditing the SMSF auditor. It is the bulwark on which this self-governed sector's integrity is founded.
- Independence is the regulator's canary in the coal mine – if independence is amiss, other aspects of the audit are immediately suspect & prone to inspection.
- Those who breach the independence guidelines do so at peril of their professional membership and ASIC registration. The ATO is increasingly proactive in this area.
- It is not enough to *be* independent. Auditors must document their independence considerations and conclusions for each engagement.

  If not documented, it is not done!

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ABOUT

About the SMSF Association

The SMSF Association is an independent organisation focussed on informing, educating, empowering and advocating for all Australians who self manage their superannuation.

We believe that every Australian has the right to control their own destiny, and to create a good quality of life in retirement.

Further to that, we believe better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.

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