

Independence guide

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Accounting Professional & Ethical Standards Board Limited,
Chartered Accountants Australia and New Zealand,
CPA Australia & the Institute of Public Accountants

The Professional Accounting Bodies

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Accounting Professional & Ethical Standards Board (APESB) was formed in 2006 as an independent National Standards Setter with the primary objective of developing professional and ethical standards in the public interest for the members of the three Professional Accounting Bodies. The three Professional Accounting Bodies, namely Chartered Accountants Australia and New Zealand (formerly the Institute of Chartered Accountants Australia), CPA Australia and the Institute of Public Accountants (formerly the National Institute of Accountants) are the members of APESB.

APESB's standards development process is one of professional collaboration. APESB consults extensively with accountants in public practice and business, regulators, accounting firms and government agencies as part of its transparent standard setting process. APESB engages with stakeholders, both locally and internationally, as relevant to different issues.

At the domestic level, APESB has engaged with stakeholders through a variety of different media such as APESB taskforces, thought leadership events, roundtables, presentations at conferences, CPD events and other forums. At the international level, APESB represents Australia in the National Standard Setters Group of the International Ethics Standards Board for Accountants (IESBA), a standard setting board of the International Federation of Accountants (IFAC). APESB also actively participates in the global standard setting process by developing submissions in respect of international exposure drafts.

International professional and ethical standards issued by standard setting boards of IFAC are generally adopted by APESB. Where appropriate, APESB develops additional requirements or guidance to take into consideration the Australian environment. To date APESB has issued 2 pronouncements which use international standards as a base and in another instance, a pronouncement uses key elements of an international standard. In respect of APESB's other 18 pronouncements, these have been developed by APESB in Australia with the valuable assistance of APESB taskforces or by APESB technical staff.

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Foreword

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Chairman

Accounting Professional and Ethical Standards Board

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1. Purpose of the Independence Guide

This publication provides guidance on how to apply the conceptual framework to independence for audits, reviews and other assurance engagements as set out in Parts 4A and 4B of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code). It provides practical examples of independence issues encountered by accountants and auditors, including prohibited non-assurance services, interests, relationships and actions. The guide is designed for members in public practice addressing independence in the context of assurance engagements. It is not intended to amend or override the Code, the text of which alone is authoritative, nor is it intended to be a substitute for any other legal, regulatory or professional standards affecting independence. It is recommended that members become familiar with the Code and other applicable independence requirements prior to reviewing any arrangement to ensure independence is maintained.

The examples are illustrative in nature and not intended to, nor can they, include every circumstance that may be applicable when applying the conceptual framework and the independence standards. The examples are not a substitute for reading and applying the independence requirements to the particular circumstances faced by a member. Individual circumstances should be tested against Parts 4A and 4B of the Code as applicable, and professional or legal advice obtained if necessary.

1.1 Background

This guide was originally an initiative of CPA Australia and the Institute of Chartered Accountants in Australia (the Institute, which is now Chartered Accountants Australia & New Zealand (CA ANZ)). It was first published in October 2005 following significant consultations with the Commonwealth Treasury and the Australian Securities and Investments Commission (ASIC) and ongoing member input regarding the application of the professional independence standards. The National Institute of Accountants (now the Institute of Public Accountants (IPA)) cooperated with the Institute and CPA Australia to develop and publish an updated guide in June 2008. The 2008 update addressed practical application of the additional requirements in relation to independence arising from the Corporate Law Economic Reform Program Part 9 (CLERP 9).

The CLERP 9 approach recognised the responsibility of the auditor and the directors or audit committee of the entity, where applicable, to ensure that the auditor's independence is not impaired.

In the co-regulatory environment, post CLERP 9, the professional bodies established the Accounting Professional & Ethical Standards Board (APESB) to set the Code of Ethics and professional standards by which their members are required to conform, to ensure that standards continue to be robust and transparent and in the best interests of the public and the profession. APESB published *The Code of Ethics for Professional Accountants* in July 2006 as APES 110. This was based on the International Ethics Standards Board of Accountants (IESBA) *Code of Ethics for Professional Accountants*. APES 110 has continued to be revised and updated since then to align with revisions to the IESBA Code, legal and community expectations.

In November 2018, APESB issued the restructured APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)*, with an effective date of 1 January 2020. This is the most substantial revision of the Code in the last two decades with the auditor independence requirements being made stronger, clearer and more easily enforceable with significant input from global regulators.

The restructured Code is aligned with the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the IESBA with additional Australian specific paragraphs (prefixed with AUST). The restructured Code includes Independence Standards in Part 4A *Independence for Audit and Review Engagements* and Part 4B *Independence for Assurance Engagements other than Audit and Review Engagements*.

The Code has legal enforceability in respect of audits, reviews and other assurance engagements performed under the *Corporations Act 2001* due to Australian Auditing Standard ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements* and under the *Superannuation Industry (Supervision) Act 1993*.

A summary of current legal, regulatory and professional standards relating to auditor independence is set out in Appendix 1 to this guide.

Definition:

Independence requirements

In this guide 'independence requirements' refers to the Independence Standards in Parts 4A and 4B of the Code and all other applicable legal, regulatory and professional standards affecting independence.

1.2 Key changes

Major changes in this 2020 version of the Independence Guide include:

- Update all references to Parts, Sections and paragraphs of the restructured Code;
- Apply the enhanced conceptual framework in the Code to existing examples of independence issues;
- Inclusion of additional examples in Chapters 7 and 8 on the application of the enhanced conceptual framework to independence issues; and
- Additional amendments as required to reflect any changes to laws, regulations and professional standards.

1.3 Acronyms used throughout the guide

The Code and other Legislation

| | |
|------------------------|---|
| the Code | <i>APES 110 Code of Ethics for Professional Accountants (including Independence Standards)</i> |
| para | paragraph of the Code |
| Part 4A | Part 4A of the Code <i>Independence for Audit and Review Engagements</i> |
| Part 4B | Part 4B of the Code <i>Independence for Assurance Engagements Other than Audit and Review Engagements</i> |
| Section | Section of the Code |
| ACNC Act | <i>Australian Charities and Not-for-profits Commission Act 2012</i> |
| the Act | <i>Corporations Act 2001</i> |
| S | section of the Act |
| SIS Act | <i>Superannuation Industry (Supervision) Act 1993</i> |
| SIS Regulations | <i>Superannuation Industry (Supervision) Regulations 1994</i> |

Standards and Regulations

| | |
|-------------|--|
| ASA | <i>Australian Auditing Standard(s)</i> |
| ASRE | <i>Australian Standard(s) on Review Engagements</i> |
| ASAE | <i>Australian Standard(s) on Assurance Engagements</i> |
| ASRS | <i>Australian Standard(s) on Related Services</i> |
| APES | <i>Accounting Professional and Ethical Standard(s)</i> |

| | |
|-----------------|---|
| APES 320 | <i>Quality Control for Firms</i> |
| ASQC 1 | <i>Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements</i> |
| CPS 510 | APRA Prudential Standard CPS 510 <i>Governance</i> |
| SPS 510 | APRA Prudential Standard SPS 510 <i>Governance</i> |

Organisations

| | | |
|---------------|---|--|
| ACNC | Australian Charities & Not-for-profits Commission | acnc.gov.au |
| APESB | Accounting Professional & Ethical Standards Board | apesb.org.au |
| APRA | Australian Prudential Regulation Authority | apra.gov.au |
| ASIC | Australian Securities and Investments Commission | asic.gov.au |
| ATO | Australian Taxation Office | ato.gov.au |
| AUASB | Auditing and Assurance Standards Board | auasb.gov.au |
| CA ANZ | Chartered Accountants Australia and New Zealand | charteredaccountantsanz.com |
| CPAA | CPA Australia | cpaaustralia.com.au |
| IPA | Institute of Public Accountants | publicaccountants.org.au |

Other

| | |
|----------------|-------------------------------------|
| EQCR | Engagement Quality Control Review |
| PIE(s) | Public Interest Entity(ies) |
| SMSF(s) | Self-managed superannuation fund(s) |

1.4 Recent Global Developments

Given the focus on improving Audit Quality globally as well as here in Australia, there has been significant focus placed on reviewing the requirements for auditors in relation to independence. While this version of the guide focuses on the revised Code applicable from 1 January 2020, it would be remiss not to highlight to readers of this guide the changes made to the UK Code of Ethics known as Revised Ethical Standard 2019 and the proposed review by the SEC of the independence requirements in the US. IESBA have also made revisions to Part 4B of the International Code and propose changes in relation to non-assurance services and fees.

1.4.1 IESBA proposed changes to the Global Code

[To be completed]

2. Fundamental principles

Members of the Australian accounting professional bodies (CA ANZ, CPAA and IPA) have a responsibility to act in the public interest. In doing so, members shall observe and comply with the fundamental principles in Section 110 of the Code:

| Fundamental Principle (subsection) | Summary of fundamental principle |
|--|---|
| Integrity (111) | To be straightforward and honest in all professional and business relationships |
| Objectivity (112) | Not to compromise professional or business judgements because of bias, conflict of interest or undue influence of others |
| Professional competence and due care (113) | <ul style="list-style-type: none"> i. Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional activities, based on current technical and professional standards and relevant legislation; and ii. Act diligently and in accordance with applicable technical and professional standards. |
| Confidentiality (114) | To respect the confidentiality of information acquired as a result of professional and business relationships |
| Professional behaviour (115) | To comply with relevant laws and regulations and avoid any conduct that the member knows or should know might discredit the profession |

Members shall be guided not merely by the words but also by the spirit of the Code (para 1.7).

Independence is linked to the fundamental principles of objectivity and integrity. Members are obliged to be straightforward and honest in professional and business relationships and not to allow their judgement to be compromised by bias, conflict of interest or the undue influence of others. Independence comprises both (para 120.12 A1):

- Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism.
- Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's, or an audit or assurance team member's integrity, objectivity or professional scepticism has been compromised.

This means that members must not only act independently but they must also be perceived, by a reasonable and informed third party, to be independent. This is particularly relevant when providing assurance services.

3. Assurance engagements

3.1 Overview

The Code requires members to be independent of assurance clients.

An **assurance client** is defined as the responsible party that is the person (or persons) who:

- a) In a direct reporting engagement, is responsible for the subject matter; or
- b) In an assertion-based engagement, is responsible for the subject matter information and might be responsible for the subject matter.

An assurance client normally includes the contracted party and its related entities.

Related entity

The definition of a related entity in the Code can be a complex determination involving materiality and other factors. In relation to a company, its 'related entities' could include a holding company, an entity that has a significant influence in the company, its subsidiaries and associates, or any 'sister company' in a group.

The following independence requirements apply in the case of related entities (including paras R400.20, R600.10 and R900.17):

- For audit and review engagements of:
 - a listed entity, the independence requirements of Part 4A apply equally to the related entities of the listed audit client.
 - a non-listed entity, the independence requirements of Part 4A apply equally to the related entities over which the audit client has direct or indirect control.
 - all other related entities of a client, the related entities are included when applying the conceptual framework if there is reason to believe a situation involving the related entity is relevant.
- For assurance engagements other than audits and reviews where the requirements of Part 4B apply, the related entities are included when applying the conceptual framework if there is reason to believe a situation involving the related entity is relevant.

For corporate audit clients, there may be other similar terms in the Act that have their own meaning and implications (for example, a 'related body corporate').

In the context of 'assurance engagements', the Code has two Parts which set out the Independence Standards:

- **Part 4A:** *Independence for Audit and Review Engagements*
- **Part 4B:** *Independence for Assurance Engagements Other than Audit and Review Engagements*

It is therefore necessary to understand what an assurance engagement is and how to classify it.

3.2 Classification

An assurance engagement aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria). This could be an audit, a review engagement or other assurance engagement as defined by standards issued by the AUASB.

To obtain a full understanding of the objectives and elements of an assurance engagement, refer to the AUASB's *Framework for Assurance Engagements*. The framework is sector neutral and provides guidance on determining whether an engagement involves the provision of assurance.

Key factors of an assurance engagement:

- An outcome
- Criteria
- Subject matter
- User separate from responsible entity

For example, an opinion expressed by an auditor on a financial report ('outcome'), which resulted from applying IFRS ('criteria') to a company's financial position, performance and cash flows ('subject matter').

The intended user (such as a shareholder) is separate from the responsible party (the company's directors).

Assurance engagements are undertaken using the standards issued by the AUASB, and as required by governing legislation such as the *Corporations Act 2001* (the Act) or the *Superannuation Industry (Supervision) Act 1993* (SIS Act). The following table illustrates which Parts of the Code contain the Independence Standards that apply to different types of assurance engagements:

| | |
|--|--|
| <p><i>Audit and review engagements – Part 4A applies</i></p> | <p>All engagements using Australian auditing standards (ASAs), which includes auditing standards that are legally enforceable under the <i>Corporations Act 2001</i>, ASA 805 and ASA 810</p> <p>For example, audits of:</p> <ul style="list-style-type: none"> • Financial statements/reports • Single financial statements and specific elements, accounts or items of financial statements • Summary financial statements <p>All engagements using standards on review engagements (ASREs) 2400, 2405, 2410 and 2415</p> <p>For example, reviews of:</p> <ul style="list-style-type: none"> • Financial statements/reports (half-year or full year) • Condensed financial statements or internal management reports • Specific components, elements, accounts or items of a financial report • Historical financial information derived from financial records |
| <p><i>Other assurance engagements – Part 4B applies</i></p> | <p>All engagements using standards on assurance engagements (ASAEs) 3000 to 3500</p> <p>For example, a:</p> <ul style="list-style-type: none"> • Reasonable or limited assurance engagement to report on greenhouse gas emissions • Performance audit or review to assess the extent to which resources have been economically, effectively or efficiently managed • Service auditor's assurance engagement to report on the description and design of controls |

The crucial tests as to whether an engagement is an assurance engagement are the three-party relationship (assurance practitioner, responsible party and intended user), the subject matter, suitable evaluation criteria, an assurance report, and a process to gather evidence.

The following are not considered to be assurance engagements:

- Agreed-upon procedures engagements (refer ASRS 4400 *Agreed-Upon Procedures Engagements to Report Factual Findings*).
- Compilation engagements (refer APES 315 *Compilation of Financial Information*).
- Preparation of tax returns.
- Tax and management consulting work.
- Some types of legal and professional services (discussed in paragraph 14 of the *Framework for Assurance Engagements*).

For an understanding of the applicable independence requirements affecting different types of entities and assurance engagements, refer to Appendix 2. In this guide, 'independence requirements' means the Independence Standards in Parts 4A and 4B of the Code and all other applicable legal, regulatory and professional standards affecting independence.

4. Conceptual framework

4.1 Overview

It is not possible to list every circumstance that can threaten the fundamental principles of integrity and objectivity. Therefore, the Code contains a conceptual framework that specifies a systematic approach for a member to identify threats to compliance with the fundamental principles, evaluate the threats identified and address any threats by eliminating or reducing them to an acceptable level (para 120.2). If the service, relationship or interest creates a threat that cannot be eliminated and if safeguards are not available to reduce the threat to an acceptable level, the firm is required to decline or end the service or audit or assurance engagement.



When applying the conceptual framework, the member must (para R120.5):

- a) Exercise professional judgement;
- b) Remain alert for new information and to changes in facts and circumstances; and
- c) Use the reasonable and informed third party test (described in para 120.5 A4 and in section 4.3 below).

4.2 Step 1 – Identifying Threats

The first step of applying the conceptual framework is to identify facts and circumstances, including professional activities, interests and relationships that might compromise compliance with the fundamental principles (or threaten or appear to threaten a member’s independence). The Code contains examples of different circumstances and relationships that can cause threats, categorised as follows:

| Threat category | Brief description | Code para |
|-----------------------------|---|-------------|
| Self-interest threat | The threat that a financial or other interest will inappropriately influence a member’s judgement or behaviour | 120.6 A3(a) |
| Self-review threat | The threat that a member will not appropriately evaluate the results of a previous judgement made, or an activity performed by the member, or by another individual within the member’s firm or employing organisation, on which the member will rely when forming a judgement as part of performing a current activity | 120.6 A3(b) |
| Advocacy threat | The threat that a member will promote a client’s or employing organisation’s position to the point that the member’s objectivity is compromised | 120.6 A3(c) |

| Threat category | Brief description | Code para |
|----------------------------|--|-------------|
| Familiarity threat | The threat that due to a long or close relationship with a client, or employing organisation, a member will be too sympathetic to their interests or too accepting of their work | 120.6 A3(d) |
| Intimidation threat | The threat that a member will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the member | 120.6 A3(e) |

4.3 Step 2 – Evaluating Threats

The second step is to evaluate whether identified threats to compliance with the fundamental principles are at an acceptable level.

What is an acceptable level?

A level at which a member using the reasonable and informed third party test would likely conclude that the member complies with the fundamental principles (para 120.7 A1).

The Reasonable and Informed Third Party Test

This test is a consideration by the member about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the member knows, or could reasonably be expected to know, at the time the conclusions are made.

The reasonable and informed third party does not need to be a member, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the member's conclusions in an impartial manner (para 120.5 A4).

Examples of reasonable and informed third parties include, regulators, board members, senior members in business or public practice.

Factors Relevant in Evaluating Threats

The consideration of qualitative and quantitative factors is relevant to the member's evaluation of threats, as is the combined effect of multiple threats, if applicable (para 120.8 A1). If multiple threats are identified, they are evaluated in aggregate, even if the threats are individually insignificant.

Other examples of factors relevant to the client and its operating environment that may impact on the evaluation of the level of a threat can be found in the Code, including whether the client is (paras 300.7 A3 and 300.7 A4):

- An audit client (Part 4A applies and is discussed in Chapter 7);
- An audit client that is a Public Interest Entity (PIE) (Part 4A applies and refer to Chapter 5); or
- An assurance client that is not an audit client (Part 4B applies and is discussed in Chapter 7).

4.4 Step 3 – Addressing Threats

If threats are evaluated as not being at an acceptable level, the final step is to address the threats by eliminating or reducing them to an acceptable level by (para R120.10):

- Eliminating the circumstances, including interests or relationships, that are creating the threats;
- Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- Declining or ending the specific professional activity (engagement).

Depending on the facts and circumstances, a threat might be addressed by eliminating the circumstances creating the threat. However, in some situations declining or ending the engagement may be the only way to address the threat as the circumstances creating the threat cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level (para 120.10 A1).

The Code defines safeguards as actions, individually or in combination, that the member takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level (para 120.10 A2).

The member must conclude whether overall the actions they have taken eliminate or reduce the threats to an acceptable level, including reviewing significant judgements made or conclusions reached and using the reasonable and informed third party test (para R120.11).

4.5 Considerations for Audits, Reviews and Other Assurance Engagements

The Independence Standards in Part 4A and Part 4B set out requirements and application material on how to apply the conceptual framework to maintain independence when performing audits, reviews or other assurance engagements. The conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles applies in the same way to compliance with independence requirements.

Making an objective assessment

In applying the conceptual framework, members shall always consider what is in the public interest. Evaluating 'independence in appearance' can be particularly difficult.

When finalising a decision, it may be useful to ask these questions:

- Are we being honest and straightforward?
- Are we compromising our judgement?
- Would another member make the same decision?
- Would a reasonable and informed third party accept the decision we have made? Do I? Do my colleagues?
- Would we be comfortable discussing the issues with the client's audit committee, a regulator or a third party?

4.6 Responsibility

Firms must establish a system of quality control being, policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable others subject to independence requirements (including network firm personnel), maintain independence where required (paras 400.4 and 900.3, APES 320 and ASQC1). The policies and procedures and individual responsibilities are determined by the firm, depending on its size, operating structure and whether it is part of a network in order to comply with the requirements of the Code and quality control standards.

The auditing and assurance standards establish responsibilities in relation to independence requirements for engagement partners and engagement teams at the engagement level. Identifying, evaluating and addressing threats to independence needs to be undertaken for each assurance client and for each engagement period. Engagement teams are entitled to rely on a firm's system of quality control to assist them in managing independence requirements if those systems meet the requirements of the Code, APES 320 and ASQC1.

System of Quality Control

When establishing quality control systems, firms must be aware of the following:

- All partners and staff are required to have an understanding of the independence requirements.
- Firm-specific policies and procedures must be created to avoid inconsistent interpretations of the independence requirements within the firm, but also noting that the firm-specific policies and procedures should not be portrayed as a substitute for understanding the requirements of the Code.
- Policies and procedures must be created to deal with instances of non-compliance with the independence requirements, irrespective of whether or not a problem is expected to arise.
- The firm's policies must include specific requirements to enable compliance with the *Corporations Act 2001* (for example, auditor's independence declarations under S 307C and notifying ASIC of a contravention of S 311).
- The firm should devote sufficient ongoing resources to support its system of quality control (including, for example, regular training and communication on independence matters).
- The firm must plan and conduct regular testing of its system of quality control.

4.7 Documentation

It is crucial that the firm develops policies and procedures specifying the nature and extent of documentation for assurance engagements and for general use within the firm to provide evidence of the operation of each element of the system of quality control (APES 320 and ASQC1). These policies depend on a variety of factors, such as the complexity of the engagement and the firm's size, structure and assignment of responsibility. The relevant aspects of ethics and independence policies and procedures at the firm level, should be further detailed at the assurance division level. The policies are often supported by assurance engagement templates in the form of standard communications, questionnaires, checklists and memoranda. This practice tends to work well to ensure consistent application of the elements of the quality control system at the engagement level.

Under the Code (paras R400.60, 400.60 A1, R900.40 and 900.40 A1), members must document conclusions regarding compliance with the Independence Standards, including the substance of relevant discussions, in particular they must document:

- a) The nature of the threat and the rationale for the safeguards in place or applied when safeguards are applied to address a threat; and
- b) The nature of the threat and rationale for the conclusion when a threat required significant analysis and it was concluded it was at an acceptable level.

Documentation should also include written confirmation of compliance with policies and procedures on independence from all firm personnel that are required to be independent (refer to Chapter 9).

Overriding requirement for documentation

ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information* requires audit documentation in relation to the conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.

Documentation prepared should be understood by an experienced auditor, having no previous connection to the engagement. Without appropriate documentation, it may be difficult to prove to those charged with governance, regulators or other interested parties that independence requirements have been considered.

4.8 ‘Smaller firms’ and ‘smaller clients’

Some members of the accounting profession may consider certain types of clients, such as a self-managed superannuation fund (addressed in more detail in Chapter 8) or a small proprietary company, to be a ‘small client’ where the independence requirements do not necessarily apply, which is not the case.

The independence requirements apply equally to all assurance engagements, whether large or small.

The size of the client has a direct impact on the type and evaluation of identified threats. For example, close relationships with a client are often more prevalent between small clients and smaller accounting practices. This can make it harder to reduce the independence threats to an acceptable level.

In addition, smaller firms often find it difficult to apply some of the safeguards that would ordinarily be available to a larger firm. For example, it may not be possible for a smaller firm to segregate the teams that provide assurance and non-assurance services for a client.

Members in a practice, whether larger or smaller, must be vigilant in their approach to independence and apply the independence requirements with rigour to all assurance clients.

4.9 Case study – Application of the conceptual framework

Scenario – An audit partner in a small regional centre trades with an audit client because there are no other suitable suppliers available. The terms are the same as are available to all other customers. The outstanding account balance fluctuates between \$5,000 and \$7,000.

| Identifying Threats | |
|--------------------------------|--|
| Self-interest | The audit partner may be reliant on the supplier, which could inappropriately influence the audit partner’s judgement or behaviour. |
| Familiarity | If the facts support it, the members of the audit team may have a long association with the supplier or officers and employees of the supplier and be too sympathetic to their interests. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. The level of the threats is increased by the fact that this is an audit engagement (Part 4A applies).</p> <p>Factors that could further increase the level of the threat:</p> <ul style="list-style-type: none"> • If the entity is a public interest entity (see Chapter 5). • There are no alternative suppliers available to the auditor (‘qualitative factor’). • Factors that may assist in reducing the threats to an acceptable level: • The balance does not appear to be substantial (‘quantitative factor’) • The terms are at arm’s length (‘qualitative factor’). |
| Addressing Threats | |
| Eliminate circumstances | As there are no other suitable suppliers available, and on the basis that trading with the supplier is essential, the audit partner may not be able to eliminate the circumstances. |
| Apply safeguards | The audit partner would then need to determine whether there are any safeguards available and capable of being applied to reduce the threats to an acceptable level. |

| | |
|---|---|
| | <p>The Act prohibits a firm from owing an amount to the client, unless the goods or services and the related debt arise on normal terms and conditions (S 324CF(1), 324CF(5) Item 1 and 324CH(1) item 15).</p> <p>The threats associated with these circumstances would generally not create a threat to independence if the transaction is in the normal course of business and at arm's length (para 520.6 A1). However, if the transactions were of a nature or magnitude that created a self-interest threat the auditor could eliminate or reduce the magnitude of the transaction (para 520.6 A2).</p> <p>If there are multiple threats or the client is a Public Interest Entity (PIE), the level of the threats would be higher and may require additional safeguards (individually or in combination). For example:</p> <ul style="list-style-type: none"> • A control that no member of the audit team is involved in ordering, taking delivery or paying for goods from the supplier; • Rotating senior members of the audit team to reduce the familiarity threat or appointing an engagement quality control reviewer; and/or • Setting a limit on the monthly purchases allowed from the supplier. |
| <p>Decline or end engagement</p> | <p>If the member cannot eliminate the circumstances creating the threats or there are no safeguards available or capable of being applied to reduce the threats to an acceptable level, the audit partner must decline or end the audit engagement.</p> |

5. Public Interest Entities

5.1 Overview

The independence requirements for Public Interest Entities (PIEs) are more extensive than for other audit and review clients, thereby recognising that the extent of public interest in an entity has a direct impact on how threats are identified, evaluated and addressed. Chapter 7 provides information about the differences in independence requirements for PIE and non-PIE audit clients and Appendix 2 sets out independence requirements by entity classification.

5.2 Effective date

The definition of a public interest entity was effective from 1 January 2013. The Part 4A provisions are applicable to all audit and review engagements for PIE's commencing on or after this date.

5.3 Definition

A PIE is defined in the Code as:

- a) A listed entity (includes a listed entity as defined in S 9 of the Act); or
- b) An entity:
 - i. Defined by regulation or legislation as a public interest entity; or
 - ii. For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation might be promulgated by any relevant regulator, including an audit regulator.

5.4 Responsibility

Firms must establish systems and procedures to determine whether any audit and review client, or categories of such clients, meet the definition of a PIE because they have a large number and wide range of stakeholders. This process will take into consideration the nature of the entity's business, its size and the number of employees.

The timing and individual responsibilities for classifying client as PIEs or otherwise is left to the firm to decide. A firm must regularly evaluate the decisions it has reached regarding its audit and review clients, taking into account any changing circumstances.

Large number and wide range of stakeholders

Firms need to determine whether other entities are to be treated as PIE's because they have a large number and wide range of stakeholders, taking into consideration (para AUST R400.8.1):

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples might include financial institutions, such as banks and insurance companies, and pension funds.
- Size.
- Number of employees.

The following entities in Australia will generally be public interest entities (para AUST 400.8.1 A1):

- Authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (NOHCs) regulated by the Australian Prudential Regulatory Authority (APRA) ¹ under the *Banking Act 1959*;

¹ Refer to the APRA *Prudential Standard CPS 510 Governance* for applicable regulatory requirements for APRA-regulated entities.

- Authorised insurers and authorised NOHCs regulated by APRA² under Section 122 of the *Insurance Act 1973*;
- Life insurance companies and registered NOHCs regulated by APRA³ under the *Life Insurance Act 1995*;
- Private health insurers regulated by APRA⁴ under the *Private Health Insurance (Prudential Supervision) Act 2015*;
- Disclosing entities as defined in Section 111AC of the *Corporations Act 2001*;
- Registrable superannuation entity (RSE) licensees, and RSEs under their trusteeship that have five or more members, regulated by APRA⁵ under the *Superannuation Industry (Supervision) Act 1993*; and
- Other issuers of debt and equity instruments to the public.

5.5 Examples of PIEs that are not listed or APRA regulated entities

The following are illustrative examples of entities that would likely be PIEs when applying the factors set out in the Code (para AUST R400.8.1). These are examples only and it is not intended to be a definitive list of what would constitute a PIE. It is also not intended to create 'thresholds' in relation to the size and number of employee factors as entities of smaller size and number of employees may be PIEs depending on individual facts and circumstances. The auditor should apply their professional judgement in all instances when determining whether an audit client is a PIE.

Public Utility Entity

- **Nature of Business:** Provides essential electricity services to over 1 million people.
- **Size:** Revenue of \$1 billion and \$5 billion in assets.
- **Number of Employees:** The business employs over 2,000 people.

Large Sporting Club

- **Nature of Business:** A large professional sporting club in a national competition.
- **Size:** Revenue of \$70 million per annum and \$40 million in assets. The club has in excess of 50,000 members.
- **Number of Employees:** The club employs in excess of 100 people.

Large Charity

- **Nature of Business:** Provides numerous programs to assist thousands of individuals including:
 - People at risk of homelessness or experiencing homelessness;
 - Migrants, refugees or asylum seekers;
 - People with disabilities;
 - Aboriginal and Torres Strait Islander people;
 - Overseas communities or charities; and
 - Victims of crime (including family violence).
- **Size:** Annual income of \$200 million and \$200 million in assets.
- **Number of Employees:** Over 1,000 full time equivalent employees and 5,000 volunteers.

² Refer to the *APRA Prudential Standard CPS 510 Governance* for applicable regulatory requirements for APRA-regulated entities.

³ Refer to the *APRA Prudential Standard CPS 510 Governance* for applicable regulatory requirements for APRA-regulated entities.

⁴ Refer to the *APRA Prudential Standard CPS 510 Governance* for applicable regulatory requirements for APRA-regulated entities.

⁵ Refer to the *APRA Prudential Standard CPS 510 Governance* for applicable regulatory requirements for APRA-regulated entities.

5.6 Changes in Entity Classification

Audit clients could change from being a non-PIE to a PIE (and vice versa) for various reasons, for example the client:

- Lists on the ASX;
- Becomes an APRA regulated entity; or
- Now meets certain criteria designated in the firm's systems and procedures about the types of entity's the firm would determine to be a PIE (under para AUST R400.8.1).

If a firm determines that an audit client temporarily does not meet the criteria of a PIE but it is anticipated that it will become a PIE again, it is prudent for the firm to continue to apply the PIE independence requirements to the audit client. Alternatively, if a firm determines that an audit client no longer meets the criteria of a PIE and it is extremely unlikely to become a PIE again (for example, the business is winding down) then the non-PIE independence requirements could be applied to the audit client.

6. Networks

6.1 Overview

For audit and review engagements, the independence requirements extend to network firms. In other words, firms that belong to a network are required to be independent of the audit and review clients of other firms in the network (para R400.51). The Code sets out explanations in relation to networks for audit and review engagements (paras 400.50 A1 to 400.54 A1).

For assurance engagements other than audits or reviews, when a firm has reason to believe that interests and relationships of a network firm create a threat to the firm's independence, the firm must evaluate and address any such threat (para R900.16).

6.2 Definitions

Whether an association of firms is a network requires professional judgement that takes into consideration all the specific facts and circumstances, and whether a reasonable and informed third party would likely conclude that a network exists.

Network firm means a firm or entity that belongs to a network.

Firm means:

- a) A sole practitioner, partnership, corporation or other entity of professional accountants;
- b) An entity that controls such parties, through ownership, management or other means;
- c) An entity controlled by such parties, through ownership, management or other means; or
- d) An Auditor-General's office or department

Paras 400.4 and 900.3 explain how the word 'firm' is used to address the responsibility of members and firms for compliance with Parts 4A and 4B, respectively.

Network means a larger structure:

- a) That is aimed at cooperation; and
- b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or significant part of professional resources.

6.3 Responsibility

Firms and audit and assurance teams must follow procedures to identify, evaluate and address threats to independence arising through network firms. Compliance with these requirements is dependent on whether the whole network coordinates the design, and consistently applies procedures to identify and manage threats to all the audit and review clients within the network.

Which individuals of a network firm must be independent?

- Any individual employed or engaged by a network firm who performs procedures on an assurance engagement, and
- For audit and review engagements, all those within a network firm who can directly influence the outcome of the engagement.

To assist in assessing independence in relation to network firms:

- Network-wide independence policies and procedures should be developed by following the same principles that are used to design a firm's system of quality control. These policies and procedures are then incorporated consistently into the quality control systems of each firm within the network. Regular communication between the firms within the network and ongoing testing of the system is paramount.
- Responsibility should be assigned for the maintenance of a database which lists all clients from whom independence is required, including relevant related entities (see Chapter 3). If used, the database should be easily accessible by all partners and staff within the firm or network and regularly updated.

6.4 Examples

The examples below explore several common scenarios and whether they may involve a network. It is assumed that there are no unmentioned facts which would be relevant.

| Facts | Analysis | Conclusion |
|--|--|---|
| <p>A is an association of firms formed to provide multiple services to clients. Each firm is a separate and distinct legal entity and each legal entity is financially independent. The firms within the association share common quality control policies and procedures. These policies and procedures were designed by A and have been implemented across the association and are monitored across the association. There is annual communication across the association of the scope, extent and results of the monitoring process. Under the association agreement, the monitoring of each firm is performed by a group of people from a central location. This group has the authority to make specific recommendations for action. The conditions of membership require firms to take the recommended action.</p> | <p>A is a larger structure aimed at cooperation. The larger structure shares common quality control policies and procedures.</p> <p>Refer paras R400.53(c) and 400.53 A4.</p> | <p>A is a network.</p> |
| <p>B is an association of firms, operating in 120 different countries, established to provide global services to clients. Each firm is a separate and distinct legal entity. All of the firms are listed in the global directory of B. When performing assurance engagements, all firms are required to use a common audit methodology which was developed by B globally. Each firm implements its own system of quality control policies and procedures and there is no shared monitoring of the assurance practices. All firms mention that they are a member of B association in marketing and promotional material. Eighty firms use the name when signing assurance reports. There are numerous common clients between these 80 firms. The 40 other firms use a local name. There are no common clients between these 40 firms and other firms in the association.</p> | <p>B is a larger structure which is aimed at cooperation. The 80 firms within the larger structure that use the name of B when signing assurance reports are a network. The other 40 firms, that use a local name when signing assurance reports, are not part of the network. These 40 firms should, however, carefully consider how their promotional material describes their membership in B to avoid the perception that they belong to a network.</p> <p>Refer paras R400.53(e), 400.53 A6 & 400.53 A7.</p> | <p>B is a network comprised of the 80 firms that use the B name in the signing of assurance reports. The other 40 firms are not part of the network.</p> |

| Facts | Analysis | Conclusion |
|--|---|-----------------------------------|
| <p>C is an international association of firms formed to provide global services to clients. Each firm is a separate and distinct legal entity. Under the profit sharing arrangement, 30 per cent of the profit of each firm is pooled and redistributed to individual firms based on a pre-defined formula.</p> | <p>C is a larger structure which is aimed at cooperation. The larger structure is clearly aimed at profit sharing.</p> <p>Refer para R400.53(a).</p> | <p>C is a network.</p> |
| <p>D is an association of firms in one country. Each firm is a separate and distinct legal entity. The firms use a common audit methodology and share a common technical department. Under the association agreement, all financial statements must be reviewed by the technical department before the audit report is issued. The advice from the technical department, either on review of the statements or through consultation during the audit, must be followed by the audit partner.</p> | <p>D is a larger structure aimed at cooperation. The use of a common audit methodology is not sufficient to conclude that the larger structure shares significant professional resources but there is also sharing of a technical department and the advice from this department is mandatory. This fact, coupled with the requirements for the technical department review of financial statements before release of the audit opinion, would indicate that the larger structure does share significant professional resources.</p> <p>Refer paras R400.53(f), 400.53 A8 & 400.53 A9.</p> | <p>D is a network.</p> |
| <p>E is an association of firms in one region. Each firm is a separate and distinct legal entity. A condition of membership of the association is that each firm will ensure its system of quality control for assurance and other related services engagements complies with APES 320 and ASQC 1.</p> | <p>E is a larger structure aimed at cooperation but does not share common quality control policies and procedures. The agreement to ensure firms' system of quality control complies with APES 320 and ASQC1 is not the same as sharing common quality control policies and procedures.</p> <p>Refer paras R400.53(c) & 400.53 A4.</p> | <p>E is not a network.</p> |
| <p>F is an association of firms in one country formed to exchange ideas, information and expertise with the goal of improving the quality and profitability of the firms within the association. Each firm is a separate and distinct legal entity. The association conducts a number of educational programs each year covering matters such as changes in accounting standards. The association also distributes a monthly newsletter on matters of interest. All firms within the association are listed in a members' directory. Member firms use the directory to locate other members for matters</p> | <p>F is a larger structure which is aimed at cooperation but it is clearly not aimed at profit or cost sharing and does not share common ownership, control or management, common quality control policies and procedures, a common business strategy, use of a common brand name or a significant part of professional resources. The reference by some firms to the membership of</p> | <p>F is not a network.</p> |

| Facts | Analysis | Conclusion |
|--|--|-----------------------------------|
| <p>such as referral of work or for identifying another firm with whom to partner for a specific piece of work. Many firms within the association indicate on their stationery and promotional materials that they are a member of F association. None of the firms use the F name in signing of assurance reports.</p> | <p>F association does not in itself create a network firm relationship. Such firms should, however, be careful how they describe the relationship to avoid the perception that the association is a network.</p> <p>Refer paras 400.50 A1R400.53, 400.53 A7 & 400.53 A9.</p> | |
| <p>G is an association of 10 firms in one country formed to share expertise to develop audit manuals to comply with new auditing standards. Each firm pays one-tenth of the cost of a small group of experts who are responsible for developing the audit manuals.</p> | <p>G is a larger structure which is aimed at cooperation but it is not clearly aimed at profit or cost sharing and does not share common ownership, control or management, common quality control policies and procedures, a common business strategy, use of a common brand name or a significant part of professional resources. The sharing of the costs associated with the development of the audit manuals does not in itself create a network relationship.</p> <p>Refer paras R400.53, 400.53 A2 & 400.53 A9.</p> | <p>G is not a network.</p> |

7. Examples of independence issues for Audit, Review and Assurance Engagements

7.1 Overview

The examples that follow are intended to provide guidance on common independence issues that arise in practice. The conceptual framework of the Code is applied to independence in Parts 4A and 4B. The scenarios that follow illustrate how Parts 4A and 4B are applied in dealing with each scenario. It is assumed that there are no other unmentioned facts that could be relevant. Examples of independence issues associated with the audit of SMSFs are covered in Chapter 8 of this Guide.

The Code sets out a conceptual framework for auditors to assess whether non-assurance services, interests or relationships create threats to the auditor's independence. The application of the conceptual framework involves a rigorous analysis of the service, interest or relationship to identify, evaluate and address threats to independence and involves a reasonable and informed third party test. If the service, interest, relationship or action creates a threat that cannot be eliminated, and if safeguards are not available to reduce the threat to an acceptable level, the firm is required to decline or end the service or audit/assurance engagement.

The Code and the prohibitions in Parts 4A and 4B have legal enforceability in respect of audits and reviews performed under the *Corporations Act 2001* due to Australian Auditing Standard ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*.

The factors that impact the significance of a threat and the safeguards proposed in the remainder of this chapter are only examples. Many other factors or actions could apply in any of the given situations.

In all situations, members must be mindful of their public interest obligations.

It is important to remember that there is an overarching prohibition in relation to all audit, review and assurance engagements for all client types of the auditor or audit firm not to assume a management responsibility (paras R600.7 and R950.6).

The table below sets out where relevant examples can be found for each Section of Part 4A (Examples 7.4.1 to 7.10.7). Consideration of assurance engagements that are not audits or reviews and are covered by Part 4B are included in section 7.11 of this Chapter.

| Description | Part 4A Section | Relevant examples |
|---|-----------------|-------------------|
| Applying the Conceptual Framework to Independence for Audit and Review Engagements | 400 | 7.1 and Chapter 4 |
| Fees | 410 | 7.4 |
| Compensation and Evaluation Policies | 411 | 7.5 |
| Gifts and Hospitality | 420 | 7.5 |
| Actual or Threatened Litigation | 430 | 7.6 |
| Financial Interests | 510 | 7.7 |
| Loans and Guarantees | 511 | 7.7 |
| Business Relationships | 520 | 7.8 |
| Family and Personal Relationships | 521 | 7.8 |
| Recent Service with an Audit Client | 522 | 7.8 |
| Serving as a Director or Officer of an Audit Client | 523 | 7.8 |
| Employment with an Audit Client | 524 | 7.8 |

| Description | Part 4A Section | Relevant examples |
|--|-----------------|-------------------|
| Temporary Personnel Assignments | 525 | 7.8 |
| Long Association of Personnel (Including Partner Rotation) with an Audit Client | 540 | 7.9 |
| Provision of Non-Assurance Services to an Audit Client | 600 | 7.10 |
| Reports on Special Purpose Financial Statements That Include a Restriction of Use and Distribution | 800 | - |

7.2 Prohibited Interests, Relationships and Actions

7.2.1 – Prohibitions in the Code

The Code recognises that there are some situations or circumstances that will always create threats to the fundamental principles that are not at an acceptable level and cannot be addressed with safeguards. These interests, relationships or actions are, therefore, specifically prohibited in Part 4A. These prohibitions are summarised in the following table:

| Prohibited Interests, Relationships and Actions (including materiality factors where noted) | |
|---|--|
| Acting where a conflict of interest compromises professional or business judgement (para R310.4) | Business relationships involving holding common interests in a closely held entity with a client if the business relationship is significant, any financial interest is material or the financial interest does not create control over the closely-held entity (para R520.5) |
| Contingent fees for an audit engagement or for a non-assurance service to the audit client where the fees are material to the firm (or network firm) or the outcome of the service is dependent on a judgement related to a material amount in the financial statements (paras R410.10 and R410.11) | Participating in an audit team if an immediate family member is, or was during the engagement period, a director or officer of the client or an employee able to exert significant influence over accounting records or financial statements of the client (para R521.5) |
| Commissions or similar benefits for assurance services (para R330.5.2) | Participating in an audit team if, during the period covered by the audit report, an individual served as a director or officer of the audit client or was an employee able to exert significant influence over the accounting records or financial statements (para R522.3) |
| Direct financial interest or material indirect financial interest in the client (para R510.4) | Partners or employees acting as a director or an officer of the client (para R523.3) A firm must refuse/withdraw from an audit if a partner or employee served as an officer or a director of the client or as an employee able to exert direct and significant influence over the subject matter of an audit (para AUST R523.3.1) |
| Direct financial interest or material indirect financial interest in the client's parent entity when the client is material to that entity (para R510.6) | Significant connections between a firm and a former partner or audit team member who is now employed by an audit client (para R524.4) |

| Prohibited Interests, Relationships and Actions (including materiality factors where noted) | |
|---|---|
| Common financial interests in an entity with a client where either of the financial interests is material and the client has significant influence over the entity (para R510.8). | For PIE audit clients only – Audit engagements for a client within defined periods where Key Audit Partners or senior or managing partners have joined the client as director, officer or an employee able to exert significant influence over accounting records or financial statements (paras R524.6 and R524.7) |
| Loans, or guarantees for a loan, to the client that are material (para R511.4) | Loan of personnel to the client unless specific requirements are met (para R525.4) |
| Loans, or guarantees for a loan, from a client that is a bank or similar institution that are not made under normal lending procedures, terms and conditions (para 511.5) | Long association with the client, including serving as an Engagement Partner, Engagement Quality Control Reviewer or other Key Audit Partner subject to specified cooling-off periods ⁶ (Section 540) |
| Deposits or brokerage accounts with a client that is a bank, broker or similar institution that are not under normal commercial terms (para 511.6) | Audit partners on a cooling-off period due to long association are prohibited from ⁶ (para R540.20): <ul style="list-style-type: none"> • Being on the audit engagement team; • Providing quality control; • Consulting with the client or engagement team on technical or industry-specific issues, transactions or events affecting the audit engagement; • Leading or coordinating the professional services provided to that client; • Overseeing the relationship with the client; or • Undertaking any other role or activity involving frequent interaction with senior management or those charged with governance of the client, or direct influence on the outcome of the audit engagement |
| Material loans, or guarantees for a loan, from a client that is not a bank or similar institution (para 511.7) | Gifts and hospitality from the client that are other than trivial and inconsequential (para R420.3) |
| Close business relationships with a client that are significant or involve a material financial interest (para 520.4) | Offering or encouraging others to offer inducements or accepting or encouraging others to accept inducements, that the auditor considers is made with the intent to improperly influence the behaviour of the recipient or another individual (paras R340.7 and R340.8) |

7.2.2 – Prohibitions in the Corporations Act 2001

Part 2M.4 Division 3 of the Act includes additional auditor independence requirements which auditors must be aware of. The independence requirements in the Act are aimed to prevent certain relationships or circumstances which create conflicts of interest and impair independence. Applying the independence provisions in the Act can be complex and it may be appropriate in certain situations for the audit firm and the former audit partner to seek professional or legal advice.

⁶ Refer to the APESB Technical Staff publication [Audit Partner rotation requirements in Australia Technical Staff Questions & Answers](#) for further details of these prohibitions.

The following table summarises the sections of the Act relevant to auditor independence. Some of these provisions are explored further in examples in this Chapter, however, auditors need to be cognisant of these provisions in full and how they might operate in practice.

| Act Section(s) | Description |
|------------------------|---|
| 324CA, 324CB and 324CC | General requirements to avoid conflict of interest situations – auditors, member of audit firm or audit company |
| 324CD | Conflict of interest situation |
| 324CE, 324CF and 324CG | Specific requirements to avoid specific relationships or activities – auditors, member of audit firm or audit company |
| 324CH | Relevant relationships for the purposes of S 324CE, 324CF and 324CG |
| 324CI | Special rule for retiring partners of audit firms and retiring directors of authorised audit companies |
| 324CJ | Special rule for retiring professional member of an audit company |
| 324CK | Multiple former audit firm partners or audit company directors |
| 324CL | People who are regarded as officers of a company for the purposes of the Act's independence requirements |

7.3 Prohibited Non-Assurance Services

Part 4A prohibits the provision of certain non-assurance services to audit clients due to the threats they create to the fundamental principles. These prohibitions become stricter and more extensive if the audit client is a Public Interest Entity (PIE), thereby recognising that the extent of public interest in an entity has a direct impact on how threats are identified, evaluated and addressed.

7.3.1 – Strictly Prohibited Non-Assurance Services

For PIE Audit Clients

The following non-assurance services are strictly prohibited from being provided to PIE audit clients:

| Strictly Prohibited Non-Assurance Services for PIEs |
|---|
| <ul style="list-style-type: none"> Assuming management responsibility for a client (para R600.7) |
| <ul style="list-style-type: none"> Accounting and bookkeeping services, including preparing accounting records or financial statements (para R601.6)⁷ |
| <ul style="list-style-type: none"> Serving as General Counsel (para R608.5) |
| <ul style="list-style-type: none"> Performing negotiations for a client as part of a recruiting service (para R609.6) |
| <ul style="list-style-type: none"> Recruiting services for a position at the client as director or officer, or for a senior management position that can exert significant influence over accounting records or the financial statements (para R609.7) |
| <ul style="list-style-type: none"> Promoting, dealing in or underwriting a client's shares (para R610.4) |
| <ul style="list-style-type: none"> Compensating or evaluating a key audit partner based on that partner's success in selling non-assurance services (para R411.4) |
| <ul style="list-style-type: none"> Serving as a Company Secretary (paras R523.4 & AUST R523.5) |
| <ul style="list-style-type: none"> Managing the administration of an insolvent client (para AUST 523.3.1) |

⁷ A Firm or Network Firm can provide routine or mechanical services in limited circumstances for divisions or related entities of the audit client if the personnel providing the service are not part of the audit team and the divisions or related entities are immaterial to the financial statements being audited, or the services relate to matters that are immaterial.

For Non-PIE Audit Clients

The prohibited non-assurance services listed in the table above for PIE audit clients are the same for non-PIE audit clients except for accounting and bookkeeping services which are permitted to be provided to non-PIE audit clients if (para R601.5):

- The services are of a routine and mechanical nature. Such services require little or no professional judgement (para 601.4 A1 includes examples of such services); and
- The firm addresses any threats that are created by providing such services that are not at an acceptable level.

7.3.2 – Prohibited Non-Assurance Services (based on materiality)

For PIE Audit Clients

The non-assurance services detailed in the table below are prohibited from being provided to PIE audit clients based on materiality.

The concept of materiality in relation to an audit is addressed in Auditing and Assurance Standard ASA 320 *Materiality in Planning and Performing an Audit* (Compiled) and in relation to a review in ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*. The determination of materiality involves the exercise of professional judgement and is impacted by both quantitative and qualitative factors. It is also affected by perceptions of the financial information needs of users (para 600.5 A3).

When assessing materiality, auditors must consider aspects of the matter under consideration which might have, or be seen to have, an adverse effect on the objectivity of the auditor (Introduction to Parts 4A and 4B).

| Prohibited Non-Assurance Services (Based on Materiality) |
|---|
| • Valuation services (para R603.5) |
| • Calculating current and deferred tax liabilities (or assets) (para R604.6) |
| • Tax planning or other tax advisory services where its effectiveness requires a particular accounting treatment or presentation in the financial statements, and there are reasonable doubts as to its appropriateness (para R604.8) |
| • Acting as an advocate for a client in the resolution of tax disputes before a public tribunal or court (para 604.11) |
| • Internal audit services, on a significant part of internal controls over financial reporting, financial accounting systems, or amounts/disclosures in the financial statements (para R605.5) |
| • Designing or implementing IT system services that are a significant part of internal controls over financial reporting or that generate information significant to accounting records or financial statements (para 606.5) |
| • Advocacy role in resolving a dispute or litigation (para 608.6) |
| • Litigation support services involving estimating damages or other amounts that affect the financial statements (paras 607.3 A4 and R603.5) |
| • Corporate finance services where its effectiveness requires a particular accounting treatment or presentation in the financial statements, and there are reasonable doubts as to its appropriateness (para R610.5) |

For Non-PIE Audit Clients

The prohibited non-assurance services for PIE audit clients listed in the table above are the same for non-PIE audit clients except for the following differences:

- The prohibitions on valuation services and litigation support services must also involve a significant degree of judgement for non-PIE audit clients (paras 607.3 A4 and R603.4).
- Providing the following services to non-PIE audit clients are not strictly prohibited, however, in deciding whether or not to provide these services, the auditor and audit firm need to apply the fundamental principles and the conceptual framework:
 - calculating current and deferred tax liabilities (or assets) (paras 604.5 A1 to A3);
 - internal audit services (paras 605.1 to 605.4 A5); or
 - IT systems (paras 606.1 to 606.4 A2).

7.4 Examples - Fees

7.4.1 – Where audit fee a large proportion of total fees of the firm

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| <p>Scenario – An audit firm performs the audit of a non-listed company and its subsidiary (that are not PIEs). The audit of the group contributes a large proportion of the total fees of the firm. For the 30 June 2020 audit, it is expected the fees will be 18 per cent of the total fees of the firm. In 2021, this is expected to be 19 per cent and the trend will likely continue in 2022.</p> | |
| Identifying Threats | |
| Self-interest | The audit partner may be unduly dependent on the fees and be pressured by the firm’s management to maintain or increase the fees with the client. There is a threat this financial interest will inappropriately influence the audit partner’s judgement or behaviour. |
| Intimidation | There is a threat that the audit partner will be deterred from acting objectively due to actual or perceived pressures not to lose the fees from the engagement. The audit partner may not exhibit professional scepticism in respect of audit matters in challenging management’s assertions. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Factors that are relevant in evaluating the level of such threats include (paras 410.3 A2 and 410.3 A5):</p> <ul style="list-style-type: none"> • The firm’s operating structure. • Whether the firm is well established or new. • The significance of the client qualitatively and/or quantitatively to the audit partner and/or the firm. • The extent to which the compensation of the audit partner is dependent upon the fees from this client. <p>The level of the threats may also be influenced by:</p> <ul style="list-style-type: none"> • Whether the increasing proportion of the fees from the group represent an increasing dependence on the client; • The extent to which the audit partners depend on keeping these engagements; and |

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| | <ul style="list-style-type: none"> The proportion of these fees to the partner's total firm budget. <p>In this situation, and in particular as the fee is increasing, a reasonable and informed third party would likely conclude that the threats are not at an acceptable level.</p> |
| Addressing Threats | |
| Eliminate Circumstances | Growth of the audit practice may, in the longer term, eliminate this threat as the percentage of the fees to the firm and the relevant audit partner decreases. |
| Apply Safeguards | <p>Examples of safeguards that might address the threats include:</p> <ul style="list-style-type: none"> Increasing the client base of the audit partner and/or the firm to reduce dependence on the audit client (paras 410.3 A3 and 410.3 A6). Having an appropriate reviewer who did not take part in the audit engagement review the work (para 410.3 A6). <p>Another potential safeguard would be to appoint an EQCR that is not based in the office of the audit engagement or is not tied to the financial performance of the firm or is completely independent from the firm. The EQCR should sign off on the sufficiency of audit evidence obtained and provide written acknowledgement to the audit partner prior to the financial statements being issued by the audit partner.</p> |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the audit partner and firm should resign from the audit engagement. |
| Change in Circumstances | <p>The client becomes listed in December 2020.</p> <p>As the client has now become a PIE, the Code includes additional requirements to those listed above. Where an audit client is a PIE and for two consecutive years the total fees from the audit client and its related entities represent more than 15% of the total fees received by the firm, the firm must (para R410.4):</p> <ul style="list-style-type: none"> Disclose to those charged with governance of the audit client that the fees represent more than 15% of the total fees received by the firm; and Discuss with the audit client whether an external pre-issuance or post-issuance review on the second year's audit is an appropriate safeguard to address threats and, if so, apply such a review. <p>The decision as to whether the review is a pre-issuance or post-issuance review is determined together with the client. The person who currently performs the quality control review could qualify to do the review if they are a member of the profession who is not a partner of the firm. As such, the EQCR suggested in the additional safeguard listed above could potentially undertake this review.</p> |

7.4.2 – Where audit fees have been outstanding for a period of time

Scenario – An audit firm performs the audit of a Listed Junior Explorer, who has made losses for the last three years as it is still in its exploratory stage of its life-cycle. The audit firm has two full years of audit fees and half year review fees outstanding as they head into the 30 June 2020 year end audit and the audit partner has been charged solely with the responsibility to recover the amounts outstanding. The company has successfully raised capital twice over the last two years.

| Identifying Threats | |
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| Self-interest | The audit partner may be unduly dependent on being paid the overdue fees. There is a threat that this financial interest will inappropriately influence the auditor partner's judgement or behaviour. |
| Intimidation | There is a threat that the audit partner will be deterred from acting objectively due to actual or perceived pressures to recover the outstanding fees. The audit partner may not exhibit professional scepticism in respect of audit matters in challenging management's assertions. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. The level of the threats may be influenced by:</p> <ul style="list-style-type: none"> • Whether the overdue fees might be equivalent to a loan to the client, in which case the requirements in Section 511 <i>Loans and Guarantees</i> may be applicable and the firm must determine whether it is appropriate for the firm to be re-appointed or continue the audit engagement (para R410.8); • The extent to which the auditor is receiving pressure internally for recovery of the debt. <p>In this situation a reasonable and informed third party would likely conclude that the threats to independence are not an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | The client makes full payment of the outstanding debt. |
| Apply Safeguards | <p>It is generally expected that the firm will require the payment of outstanding fees before an audit report is issued. However, examples of safeguards that might address the threats include (para 410.7 A2):</p> <ul style="list-style-type: none"> • Obtaining partial payment of the overdue fees. • Having an appropriate reviewer who did not take part in the audit engagement review the work performed. <p>Some other potential safeguards are:</p> <ul style="list-style-type: none"> • The audit partner should ensure that the appropriate EQCR is appointed as required by ASA 220. An appropriate additional safeguard might be that the EQCR is financially independent of the office (i.e. a partner from another office or a third-party consultant). • Require a payment plan with the client so that there is an agreed way forward for reducing the level of outstanding fees. • Seek prepayment into the firms' trust account of the whole of the June 2020 year end audit fees. |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the auditor and firm should resign from the audit engagement. |
| Change in Circumstances | The firm appoints an external debt recovery organisation. The firm accepts that the audit partner has done everything to recover the debt and has now taken the |

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| | <p>pressure off the individual audit partner to recover the debt, which may reduce the intimidation threat.</p> <p>The audit partner should document the change in circumstance and ensure that the EQCR role is effective as required by ASA 220.</p> |
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7.4.3 – Where the audit firm is looking to accept a contingent fee

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| Scenario – An audit firm plans to receive, in addition to the quoted audit fee, contingent fees for an audit of a group based on timely completion of the audit of each of the group entities. | |
| Identifying Threats | |
| Self-interest | The audit partner may be unduly dependent on being paid the whole audit fee (quoted fee plus contingent fee) which may inappropriately influence their judgement or behaviour. |
| Intimidation | The audit partner may not act objectively or exhibit professional scepticism in respect of audit matters in challenging management’s assertions to expediate finalisation of the audit in order to achieve the full fee. |
| Evaluating Threats | |
| Acceptable Level | The Code specifically prohibits the charging either directly or indirectly of a contingent fee for an audit engagement (para R410.10). |
| Addressing Threats | |
| Eliminate Circumstances | Decline any contingent fee arrangement. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | The audit partner must decline taking on this audit engagement based on receiving contingent fees for the timely completion of the engagement. The audit partner can perform the engagement for the quoted audit fee. |

7.5 Examples – Compensation and Gifts and Hospitality

7.5.1 – Firm evaluation and compensation system

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| Scenario – An accounting firm that provides audit services, business advisory services, corporate finance services and taxation services is considering establishing an evaluation and compensation framework for its partners, which includes several aspects. There would be a base salary element that is linked to performance against the firm’s underlying pillars. There would also be a profit-sharing element linked to the level of fees above budget that the partners achieve and the level of cross-selling to each partner’s existing clients of the other service lines. | |
| Identifying Threats | |
| Self-interest | If this profit-sharing mechanism is adopted, the audit partner is going to be more focused on identifying aspects of the audit client’s business that other service lines in the firm could service, which would result in a greater share of the profits of the firm and inappropriately influence the partner’s judgement or behaviour. |

| Evaluating Threats | |
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| Acceptable Level | The Code specifically prohibits a firm from evaluating or compensating audit partners based on that partner's success in selling non-assurance services to the audit partner's audit clients (para R411.4). |
| Addressing Threats | |
| Eliminate Circumstances | As the Code specifically prohibits this type of compensation, the firm cannot implement the proposed framework. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | Not applicable. |

7.5.2 – Audit partner providing hospitality

Scenario – An audit partner is holding an extravagant 50th birthday party involving overnight luxury accommodation and will cost well in excess of \$1,000 per guest. The guest list includes partners from the audit partner's firm and their spouses and the director of a number of the audit partner's listed audit clients and his spouse. This individual has referred a considerable number of new listed audit engagements to the firm and the audit partner. The audit partner is about to submit a tender for the audit of a large listed company of which this individual is a director.

| Identifying Threats | |
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| Self-interest | The audit partner may be perceived to have invited the individual to induce them to award the tender to the audit partner so as to build his client portfolio. This financial interest might inappropriately influence the audit partner's judgements or behaviours. |
| Familiarity | The considerable client base connected to the individual, together with the party invitation, creates a perception of the auditor being too familiar with and sympathetic to the director's interests, impairing professional scepticism and objectivity. |
| Evaluating Threats | |
| Acceptable Level | <p>This situation would need to be assessed against Section 340 <i>Inducements, Including Gifts and Hospitality</i>.</p> <p>The invitation would be deemed to be an entertainment or hospitality inducement (para 340.4 A1). To determine whether there is actual or perceived intent to improperly influence the director to accept the tender for the audit work requires the audit partner to exercise professional judgement and consider factors such as (para 340.9 A3):</p> <ul style="list-style-type: none"> • The extravagance of the event and value of the inducement. • The timing of the invitation which is just before the tender is due. • The invitation is limited to this particular individual and not a broader group. • The roles and positions of the audit partner and the director. |

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| | In this situation, a reasonable and informed third party would be likely to conclude that the intent was to improperly influence the behavior of the recipient which is prohibited by the Code (para R340.7). |
| Addressing Threats | |
| Eliminate Circumstances | Do not invite the director and his spouse to the party. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | If the audit partner invites the director to the party, he should not submit the tender for the audit engagement. The existing audit engagements should also be reviewed in respect of whether independence has been compromised. |

7.5.3 – Audit partner receiving hospitality

Scenario – An audit partner of a non-listed company has been invited to attend the Rugby Sevens in Hong Kong in 2020 by a director of the client. The director of the client knows how much the audit partner has always wanted to go as, they have often discussed it during their monthly lunch catch ups, which are always paid for by the director. The director has offered business class afares, hotel accommodation at the Shangri-La, tickets to the games and they will be travelling together.

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| Identifying Threats | |
| Self-interest | The audit partner’s judgement and behaviour may be inappropriately influenced by the director given the amount and frequency of hospitality. |
| Familiarity | The threat that the audit partner may be overly sympathetic to the client’s interests and not exhibit professional scepticism given the close relationship. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level.</p> <p>There are two aspects to this situation:</p> <ol style="list-style-type: none"> a) The trip to Hong Kong paid for by the director/audit client. The audit partner must not accept gifts and hospitality from an audit client, unless the value is trivial and inconsequential (para R420.3). A reasonable and informed third party would not consider business class flights and high-end accommodation as trivial and inconsequential, so this gift and hospitality must not be accepted by the audit partner; and b) The close relationship and monthly lunch catch ups paid for by the director. The level of threats may be influenced by: <ul style="list-style-type: none"> • The intent of the director and level of inducement (Section 340 <i>Inducements, including Gifts and Hospitality</i>). • The perceived close relationship between the director and the auditor. <p>Even if the value of the lunches is trivial and inconsequential, the audit partner must not accept these gifts and hospitality if the intent of the director in providing them is to improperly influence the audit partner (paras 420.3A1, 420.3 A2 and Section 340).</p> |

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| | Due to the nature of the relationship and the frequency of the lunches, coupled with the value of the Hong Kong trip offer, a reasonable and informed third party would likely conclude that the director is attempting to induce the audit partner with the intent to improperly influence their behaviour. Therefore, the gifts and hospitality must not be accepted (paras R340.8 and 340.9 A3). |
| Addressing Threats | |
| Eliminate Circumstances | Do not accept further hospitality from the director and turn down the invitation to Hong Kong. |
| Apply Safeguards | <p>Even if the circumstances above are eliminated, the threats to independence may still remain and some potential safeguards are (para 340.10 A2):</p> <ul style="list-style-type: none"> • Inform the firm's leadership or those charged with governance of the audit client that the director is trying to induce the auditor with offers of expensive hospitality. • Resign as the auditor if it is believed that the behaviour of the client's director will continue. <p>Other potential safeguards are:</p> <ul style="list-style-type: none"> • To change the audit partner on the engagement and advise the new partner of the past behaviour of the director. • The firm through the new partner needs to monitor the behaviour of the director. |
| Decline or End Engagement | If the audit partner does not address the threats as noted above, the firm must resign from the audit engagements. |

7.6 Examples – Actual or Threatened Litigation

7.6.1 – Threatened litigation over auditor's opinion

Scenario – An audit partner has been threatened with legal action from her listed client, claiming damages for issuing a disclaimer of opinion which resulted in a reduction in the company's share price and ,therefore, impacted the market capitalisation of the company.

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| Identifying Threats | |
| Self-interest | There is a threat that the potential adverse financial impacts of the threatened litigation will inappropriately influence the audit partner's judgement or behaviour. |
| Intimidation | The threat that the audit partner will be deterred from acting objectively because of the perceived pressure from the client. The client may be unwilling to make complete disclosures to the auditor. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner and the firm must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Factors that are relevant in evaluating the level of such threats include (para 430.3 A2)</p> <ul style="list-style-type: none"> • The materiality of the claim. • Whether the claim relates to a prior audit engagement. <p>The level of threat may also be influenced by:</p> |

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| | <ul style="list-style-type: none"> • The possibility of a timely resolution with a positive outcome to the auditor and audit firm. • The probability of the matter going to litigation. <p>A reasonable and informed third party would likely conclude that the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | These circumstances are difficult to eliminate, as once the threat has been created the effects are ongoing. In limited circumstances, depending on the nature and materiality of the threatened litigation, an action that might eliminate the threats could be to remove the audit partner from the engagement (para 430.3 A3). |
| Apply Safeguards | <p>Examples of safeguards that might address the threats are:</p> <ul style="list-style-type: none"> • Assign the audit engagement to another audit partner (para 430.3 A3 if the threat cannot be eliminated as above). • Have an appropriate reviewer review the work performed (para 430.3 A4). <p>Another potential safeguard is to ensure the firm leadership and potentially the firm's lawyers, and not the audit division, are dealing with the client in respect of the litigation.</p> <p>The audit partner needs to exercise professional judgement and the reasonable and informed third party test to determine whether any of these safeguards will reduce the threats to independence to an acceptable level.</p> |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the auditor and firm must resign from the audit engagement. This situation is particularly difficult and depending on the circumstances of the situation may lead directly from the identification of the threat to resigning as the auditor. |

7.7 Examples – Financial Interests and Loans and Guarantees

7.7.1 – Immediate family member owns shares in audit manager's audit client

Scenario – An audit manager has a listed client that has just taken over another listed company that was not a client of the audit manager's firm. The manager discovers that her husband has a substantial share-holding in the company that has been taken over, which he recently received as a result of an inheritance.

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| Identifying Threats | |
| Self-interest | The threat that the manager's behaviour may be inappropriately influenced and not exercise professional scepticism in respect of audit matters to ensure the results of the group are maximised to maintain/improve the share price. |
| Intimidation | The threat that the manager will be deterred from acting objectively because her husband may be putting pressure on her to ensure the success of the group. |
| Evaluating Threats | |
| Acceptable Level | The Code specifically prohibits a direct financial interest in an audit client by an audit team member's immediate family (para R510.4(b)), which includes a spouse. |

| Addressing Threats | |
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| Eliminate Circumstances | The audit manager's husband sells down all of the shares immediately on becoming aware that owning the shares conflicts with the audit manager's role on the audit of the listed entity. |
| Apply Safeguards | If the husband does not dispose of the financial interest as soon as practicable then the audit manager should be replaced on the audit engagement. |
| Decline or End Engagement | If the husband does not sell the shares or the audit manager cannot be replaced, then the firm must resign from the audit engagement. |

7.7.2 – Power of attorney/executor of a close family member

Scenario – An audit manager has been asked to act as executor to his mother's will and she has given him full power of attorney. The manager and his immediate family are likely to inherit shares amongst other items from the estate. In the event of his mother's death, probate is expected to take six weeks to finalise. While the manager is not specifically aware of any shareholdings his mother may have, it is possible that her portfolio includes investments in some of the firm's audit clients.

| Identifying Threats | |
|--------------------------------|---|
| Self-interest | There is a threat that if the audit manager's mother holds any shares in the firm's audit clients it will inappropriately influence the audit manager's judgement and behaviour. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner and the audit manager must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level.</p> <p>The audit manager should obtain more specific information about his mother's shareholdings to determine whether there are any threats to independence that need to be addressed. If the audit manager becomes aware that his mother has shares (direct financial interest or a material indirect financial interest) in any of the firm's audit clients this creates a self-interest threat (para 510.10 A5), which would need to be addressed. If the mother does not have any shares in the firm's audit clients no threats are created.</p> |
| Addressing Threats | |
| Eliminate Circumstances | The mother disposes of any shares held in the firm's audit clients or the audit manager is removed from the audit teams of these clients (para 510.10 A7). |
| Apply Safeguards | <p>Assuming the mother holds shares in the firms' audit clients, the audit manager should immediately on becoming aware of the potential threat report the situation in accordance with the firm's quality control procedures, which as a minimum should ensure that the audit engagement partners are informed.</p> <p>A safeguard that might address the threat before the mother's death is to have an appropriate reviewer review the audit manager's work on any of the relevant audit clients (para 510.10 A8).</p> <p>Some other potential safeguards prior to the mother's death would be:</p> <ul style="list-style-type: none"> • Prevent the audit manager from having any influence on members of the relevant audit teams. |

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| | <ul style="list-style-type: none"> Require the audit manager to advise the firm when his mother's death occurs and when probate is obtained. <p>At the time of probate, the audit manager must dispose of the shares immediately. Where a direct financial interest or a material indirect financial interest in an audit client is received by way of an inheritance, gift, as a result of a merger or in similar circumstances and is not otherwise permitted (which it would not be under para R510.4(b)), any direct financial interest must be disposed of immediately or enough of the indirect financial interest is disposed so it no longer material (para R510.9).</p> |
| Decline or End Engagement | Not applicable. |

7.7.3 – Firm partner involved in loan application to a bank that is an audit client

Scenario – A partner at a firm has a substantial holding in a body corporate which is considering taking out a loan with a bank on more favourable terms and conditions than would normally be provided by the bank. The bank is an audit client of the firm. The partner has influence over the management of the body corporate and their decision to obtain a loan from the bank. The partner is not involved in the audit and does not provide any other professional services to the bank.

| Identifying Threats | |
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| Self-interest | The nature of the relationship between the partner and the audit team and the firm's operational structure could be factors in the assessment of whether the interest will inappropriately influence the audit partner's judgement or behaviour. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner of the bank must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threat is at an acceptable level. The bank is a PIE which impacts on the level of threats.</p> <p>The Act prohibits an entity which a member of the firm controls or a body corporate in which a member has a substantial holding from owing an amount to an audit client (S 324CF(1), 324CF(5) Item 10 and 324CH(1) Item 15). This prohibition can be disregarded under the '<i>Ordinary commercial loan exception</i>' if the loan is made in the ordinary course of business on normal terms and conditions (S 324CH(5B)). However, in this scenario, as the bank is offering the loan on terms and conditions that would not normally be offered this exemption is unavailable. If the body corporate takes the loan with the bank, the firm must discontinue the audit engagement.</p> |
| Addressing Threats | |
| Eliminate Circumstances | The body corporate does not take the loan out with the bank audit client or only takes the loan if it is on normal terms and conditions. |
| Apply Safeguards | If the body corporate takes the loan with the bank on favourable terms, there are no safeguards available or capable of being applied. |
| Decline or End Engagement | If the body corporate takes the loan with the bank on favourable terms, the firm must discontinue the audit engagement. |

7.7.4 – Audit senior with bank loan with an audit client and requires an additional loan

| Scenario – An audit senior on the audit of a bank has a mortgage with the bank and now wants to draw additional funds to purchase a bigger house. | |
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| Identifying Threats | |
| Self-interest | Having a loan may inappropriately influence the behaviour and judgement of the senior on the audit. |
| Evaluating Threats | |
| Acceptable Level | <p>The Code allows audit team members to have deposit accounts with bank audit clients provided they are under normal commercial terms (para R511.6) or loan accounts with bank audit clients under normal lending procedures, terms and conditions (para R511.5).</p> <p>The considerations would be similar to example 7.7.3 above. The Act would allow the original mortgage under the '<i>Housing loan exception</i>' (S 324CF(1), 324CF(5) Item (3), 324CH(1) Item 15 and 324CH(5)) and the drawing down under the '<i>Ordinary commercial exception</i>' (S 324CF(1), 324CF(1) Item 3, 324CH(1) Item 15 and 324CH(5B)).</p> <p>The auditor partner and the audit senior on the audit engagement team of the bank should still exercise professional judgement and apply the reasonable and informed third party test to determine whether the threat is at an acceptable level.</p> <p>The level of threat may be influenced by:</p> <ul style="list-style-type: none"> • The terms and conditions of the loan. • The materiality of the loan to the audit senior's financial affairs. |
| Addressing Threats | |
| Eliminate Circumstances | Not applicable. |
| Apply Safeguards | <p>A potential safeguard is at a minimum, the audit partner should be informed about the audit senior's loan with the bank audit client. The firm's quality control procedures may require the audit senior to also disclose the matter to the firm.</p> <p>The firm should also consider the independence requirements of the bank audit client which may require members of the audit team to not hold any of the bank's products, for example deposit accounts or loans.</p> |
| Decline or End Engagement | Not applicable. |

7.7.5 – Insurance claim against audit client

Scenario – The audit manager on the audit of an insurance company has a motor vehicle insurance policy with that audit client. He was involved in a traffic accident and has instituted an insurance claim with the insurance company and is waiting for the claim to be processed. The audit manager believes the insurance company is holding back on processing the claim unnecessarily.

| Identifying Threats | |
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| Self-interest | Having an outstanding claim, where the audit manager believes the insurance company may be taking a hard line, may inappropriately influence the audit manager's judgement and behaviour. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner together with the audit manager must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threat is at an acceptable level.</p> <p>The level of the threat may be influenced by:</p> <ul style="list-style-type: none"> • The size of the claim and how significant or material it is to the audit manager. • The reasons for the delay (both actual and perceived). <p>The significance of the threat could be increased by the fact that the insurance company is a PIE.</p> <p>A reasonable and informed third party would likely conclude that the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | The insurance company pays the full claim before the audit manager is involved in the next audit of the insurance company. |
| Apply Safeguards | <p>There is no specific requirement in the Act relating to insurance arrangements (S 324CE and S 324CH(1)). However, the audit partner is obliged to consider and avoid a conflict of interest situation whereby a member of the audit team is not capable of exercising objective and impartial judgement (S 324CA, 324CB and 324CC).</p> <p>Some potential safeguards are:</p> <ul style="list-style-type: none"> • The audit manager should be required to communicate the situation to the audit partner. • The audit manager may have to be removed from the audit engagement. |
| Decline or End Engagement | Not applicable. |

7.8 Examples – Relationships

7.8.1 – Sponsorship of an audit client

Scenario – A firm sponsors a sporting club client that competes in a national competition with revenue in excess of \$70 million, total assets of \$50 million and has over 80,000 members. The firm also conducts the audit of the sporting club. This sponsorship allows the firm signage at the ground, a link to the firm’s website from the club’s website and a number of hospitality benefits, including allowing the audit partner to present at one of the president’s luncheons annually.

| Identifying Threats | |
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| Self-interest | There is a threat that this business relationship may inappropriately influence the audit engagement team’s judgement and behaviour in order for the firm and for the individuals to maintain the benefits of the sponsorship. |
| Familiarity | There is a threat that the audit engagement team will be too sympathetic to the sporting club due to the close relationship. |
| Intimidation | There is threat that the audit engagement team will be deterred from acting objectively due to the actual or perceived threat of not wanting to lose a high-profile client. The audit partner may not act with an appropriate level of professional scepticism in respect of audit matters. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. This evaluation may be influenced by the fact that the sporting club may be deemed to be a PIE.</p> <p>A close business relationship arising from a commercial relationship includes where the client distributes or markets the firm or network firm’s products or services (para 520.3 A2), which can create threats to independence (para 520.2). A firm must not have a close business relationship with an audit client unless the business relationship is insignificant to the client and the firm (para R520.4).</p> <p>The significance of the business relationship may be influenced by the:</p> <ul style="list-style-type: none"> • Level of the sponsorship spend to the audit firm. • Marketing outcomes received as a result of the sponsorship. <p>Even if the business relationship was not considered to be significant, a reasonable and informed third party would likely conclude that the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | Relinquish the sponsorship. |
| Apply Safeguards | <p>There are no specific safeguards suggested by the Code for this scenario, however some potential safeguards are:</p> <ul style="list-style-type: none"> • Disengage signage and links to the audit firm’s branding. |

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| | <ul style="list-style-type: none"> • Appoint an EQCR, if not already deemed by the firm that the audit client is a PIE for the purposes of Part 4A. • Prohibit the audit engagement team members from benefiting from the hospitality aspects of the sponsorship. |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the audit partner and firm may need to resign from the audit engagement. |

7.8.2 - Close relationship with someone employed with an audit client

Scenario – An audit partner’s brother in-law has recently been appointed as the CEO of the audit partner’s Not-for-Profit client that is registered with the ACNC.

| Identifying Threats | |
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| Self Interest | There is a threat that the relationship with the CEO and family interests may inappropriately influence the judgement and behaviour of the audit partner. |
| Familiarity | There is a threat that the audit partner will be too sympathetic to the CEO’s interests or too accepting of his work due to their close relationship. The audit partner may not exercise professional scepticism in respect of audit matters and challenge assertions made by the CEO. |
| Intimidation | There is a threat that the audit partner will be deterred from acting objectively due to actual or perceived pressures from the CEO. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level.</p> <p>The audit partner must consult in accordance with the firm’s policies and procedures as in this instance there is a close relationship with an individual who is not an immediate or close family member (as defined in the Code) and the CEO is in a position to exert significant influence over the accounting records or financial statements to be audited (para 521.7). Factors that are relevant in evaluating the level of such threats include (para 521.7 A1):</p> <ul style="list-style-type: none"> • The nature of the relationship between the audit partner and the CEO (who is the audit partner’s brother-in-law). • The position held by the brother-in-law, which is the CEO. • The role of the audit team member, which in this case is the audit partner. <p>A reasonable and informed third party would likely conclude that the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | The CEO resigns or the audit partner is replaced with another partner of the firm to perform the audit engagement (para 521.7 A2). |
| Apply Safeguards | It would be difficult to apply a safeguard to reduce threats to an acceptable level. |

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| Decline or End Engagement | If the firm is unable to find another audit partner to perform the audit engagement, then firm must resign from the audit engagement. |
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7.8.3 - Audit firm brings in a director who has previously acted on ASX listed entities as a consultant to the firm

Scenario – A firm has laterally recruited an audit partner who was a high profile ASX Director who had previously held multiple directorships. His experience and contacts are expected to be very beneficial to the audit practice within the firm. In the last two years he has been a director on a number of the firm’s listed audit clients.

| Identifying Threats | |
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| Self-review | The new audit partner may review financial areas that he had previously been involved in directing and approving within the audit clients that he served as a director. This creates a threat that the new audit partner will not appropriately evaluate the results of previous judgements made, or activities performed, when forming judgements as part of the audit. |
| Familiarity | There is a threat that the new audit partner would be too sympathetic or accepting of the clients’ work due to his previous association with the clients. The partner may not exercise professional scepticism in respect of audit matters given his close knowledge of the audit clients. |
| Evaluating Threats | |
| Acceptable Level | <p>The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level.</p> <p>The new audit partner must not be on any audit engagement where the period covered by the audit reports includes where he served as a director of the audit clients (para R522.3).</p> <p>The Act precludes a previous director of an audit client from being a member of the audit team for effectively a two year period, as it includes the (S 324CF(1), 324CF(5) Item 4 and 324CH(1) Item 8):</p> <ul style="list-style-type: none"> • Period to which the audit relates; or • 12 months preceding the start of the audit period; or • Period when the audit is being conducted or the audit report is being prepared. |
| Addressing Threats | |
| Eliminate Circumstances | The circumstances cannot be eliminated in this situation. |
| Apply Safeguards | There are no safeguards available or capable of being applied to reduce the threats to an acceptable level. |
| Decline or End Engagement | The new audit partner must not be involved in any audit engagements where he was a director of the audit client in the preceding two years. |
| Change in Circumstances | <p>The new audit partner was a director of a number of the firm’s audit clients more than three years ago and has not held a director role since that time.</p> <p>The new audit partner would not be prohibited by the Code (para R522.3) or the Act from being on the audit team (S 324CF(1), 324CF(5) Items 3 & 4 and</p> |

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| | <p>324CH(1) Item 8) as the period that he was a director of the audits clients was more than three years ago.</p> <p>Threats might be created if, before the period covered by the audit reports, the new audit partner served as a director of the audit clients (para 522.4 A1).</p> <p>The factors that are relevant in evaluating the level of such threats include (para 522.4 A2):</p> <ul style="list-style-type: none"> • The position the new audit partner held with the client(s). • The length of time since the new audit partner left the client(s). • The role of the new audit partner. <p>A reasonable and informed third party would likely conclude that any threats would be at an acceptable level due to the length of time since the new audit partner was a director of the audit clients.</p> <p>If the threats were not at an acceptable level, a potential safeguard would be to have an appropriate reviewer review the audit work (para 522.4 A3).</p> |
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7.8.4 – Fellow partner a director/trustee of an audit client

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| Scenario – An audit partner is asked to audit a company or trust where a fellow partner is a director/trustee. | |
| Identifying Threats | |
| Self-interest | There is a threat that the fellow partner’s interest in the company or trust may inappropriately influence the judgement and behaviour of the audit partner. |
| Self-review | There is a threat the audit partner will not appropriately evaluate any judgements made by the fellow partner in relation to the company or trust when the audit partner is forming judgements as part of performing the audit. |
| Evaluating Threats | |
| Acceptable Level | The Code specifically prohibits a partner or employee of a firm or network firm serving as a director or officer of an audit client of the firm (para R523.3). |
| Addressing Threats | |
| Eliminate Circumstances | The circumstances creating the threats cannot be eliminated in this scenario. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | The audit partner must decline taking on this audit engagement. |

7.8.5 - Former partner joins audit client

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| Scenario – A former audit partner of a firm has joined her audit client as a director eleven months after the last financial year. She signed the auditor’s opinion for the previous financial year. | |
| Identifying Threats | |
| Familiarity | The threat is that the due to the long and close relationship with the former audit partner, the audit team may be too sympathetic to her interests or |

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| | accepting of her work. The former audit partner would be very familiar with the financial position of the company and the audit approach taken by the audit firm. |
| Intimidation | The threat is that the former partner inappropriately influences and deters the audit team from acting objectively due to actual or perceived pressures from the former audit partner based on the prior relationship with the audit firm. |
| Evaluating Threats | |
| Acceptable Level | <p>The Act requires a two-year 'cooling off' period for a former audit partner becoming an officer of a corporate audit client (S 324CI). As the former audit partner has joined the audit client in breach of this provision this situation must be addressed by the firm.</p> <p>The Code would also require the firm to ensure that no significant connection remains between the firm and the former audit partner (para R524.4).</p> |
| Addressing Threats | |
| Eliminate Circumstances | The former audit partner would need to resign as director of the audit client. |
| Apply Safeguards | There are no safeguards available or capable of being applied to reduce the threats to an acceptable level. |
| Decline or End Engagement | If the former audit partner does not resign as director of the audit client, the audit firm must resign from the audit engagement. |
| Change in Circumstances 1 | <p>The former partner joins the audit client as a director three years after last signing the financial statements of the company and does not have a significant connection with the audit firm either financially or through contacts (that is the requirements in para R524.4 have been met).</p> <p>Even if there is no significant connection between the former audit partner and the firm, familiarity and intimidation threats might still be created (para 524.4 A1). The firm must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. The factors that are relevant in evaluating the level of such threats include (para 524.4 A3):</p> <ul style="list-style-type: none"> • The position the individual has taken at the client. • Any involvement the individual will have with the audit team. • The length of time since the individual was an audit team member or partner of the firm or network firm. • The former position of the individual within the audit team, firm or network firm. An example is whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance. <p>The level of threats may also be influenced by:</p> <ul style="list-style-type: none"> • Whether the audit client is a PIE. • Whether connections remain between the firm and the former partner (that are not precluded by para R524.4). |

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| | <p>Examples of safeguards that might address the threats to independence are (para 524.4 A4):</p> <ul style="list-style-type: none"> • Modifying the audit plan. • Assigning to the audit team individuals who have sufficient experience relative to the individual who has joined the client. |
| Change in Circumstances 2 | <p>The former partner who has retired from the firm joins an audit client as a director. The former partner receives an annual variable pension that is linked to the ongoing financial performance of the firm. This amount would reasonably be expected to be in the vicinity of \$120,000 per annum.</p> <p>The Code specifically prohibits a significant remaining connection between the firm and a former partner when a former partner has joined the audit client as a director, and the benefits paid to the former partner are not made in accordance with a fixed pre-determined arrangement (para R524.4). As the payments in this scenario are not fixed and pre-determined, either the former partner would need to resign as director of the audit client or the firm would need to resign from the audit engagement.</p> |
| Change in Circumstances 3 | <p>The former partner is engaged as a consultant to the audit client on merger and acquisition projects for the audit client. The former partner does not receive any pension payments from the firm.</p> <p>There are no specific safeguards suggested by the Code for this scenario. However, a potential safeguard is the audit firm could ensure that the audit team does not have any direct contact with the former partner, to manage any perception of threats to independence. This should be documented on the audit file and in the minutes of the Board of the company on an annual basis.</p> |
| <p><i>NOTE: In all circumstances given the varying and complex requirements of the Act and the Code it may be prudent to seek professional or legal advice.</i></p> | |

7.8.6 – Corporate finance manager of a firm is temporarily loaned to an audit client to assist with financial modelling and forecasting

Scenario – An audit client, that is a company that is developing its business propositions and ongoing growth strategy, needs temporary assistance with development of financial modelling and forecasting, which is a service that the firm’s corporate finance division provides to clients. A manager in the corporate finance division is identified and is loaned to the audit client for a maximum period of six months. The firm’s manager has been tasked with taking full responsibility for the output of the assignment performed.

| Identifying Threats | |
|----------------------------|---|
| Self-review | There is a threat that the audit team will not appropriately evaluate the judgements or activities performed by the manager on loan to the client when forming judgements as part of the audit. |
| Advocacy | There is a threat that the loaned staff member would overly defend the position taken in the work conducted while being on loan to the audit client as they are taking responsibility for the output. |
| Familiarity | There is a potential threat that due to close relationships with the audit team and the manager on loan that the audit team will be too accepting of their work. |

| Evaluating Threats | |
|----------------------------------|---|
| Acceptable Level | The manager on loan to the client in this situation would likely be assuming management responsibility. The Code specifically prohibits a firm or network firm from assuming management responsibility for an audit client (para R600.7). |
| Addressing Threats | |
| Eliminate Circumstances | Do not loan the corporate finance manager to the audit client. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | Not applicable presuming the corporate finance manager is not loaned to the audit client. |
| Change in Circumstances | <p>The loaned staff is only a spare set of hands for a period of two weeks, does not assume any management responsibility and is under the direct authority of management.</p> <p>The Code specifically prohibits a firm or network firm from loaning personnel to an audit client unless (para R525.4):</p> <ul style="list-style-type: none"> • Such assistance is provided for a short time period; • The personnel are not involved in non-assurance services prohibited under Section 600; and • The personnel do not assume management responsibility for an audit client and the audit client is responsible for directing and supervising the activities of the personnel. <p>As the staff member is only loaned for two weeks, the service is not prohibited under Section 600 and no management responsibility has been assumed, it is unlikely to create any threats to independence.</p> |

7.8.7 – Audit client on a pro-bono basis

Scenario – A partner of a firm accepts a charity registered with the ACNC as an audit client on a pro-bono basis. She has a particular passion for the stated purpose of this charity and believes that offering the services of her firm will serve as a positive contribution.

| Identifying Threats | |
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| Self-interest | There is a threat that as the services are provided on a pro-bono basis that the audit partner will not undertake sufficient audit work which will inappropriately influence their judgement or behaviour. This could also impact on compliance with the fundamental principle of professional competence and due care. |
| Advocacy | There is a threat that the audit partner will promote the client's position to the point that her objectivity will be compromised given her stated support of this charity. |
| Evaluating Threats | |
| Acceptable Level | <p>The factors that may be relevant in evaluating the level of such threats include:</p> <ul style="list-style-type: none"> • The level of involvement the audit partner has had with the charity prior to accepting the audit on a pro-bono basis. • The amount of involvement of the audit partner during the audit process. |

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| | In this situation, a reasonable and informed third party might conclude that the threats to independence are not at an acceptable level and the threats would need to be addressed. |
| Addressing Threats | |
| Eliminate Circumstances | Do not accept the pro-bono audit engagement. |
| Apply Safeguards | Potential safeguards are: <ul style="list-style-type: none"> • Appointing an EQCR to independently review the audit conclusions. • Appoint a different audit partner that is not as attached to the purpose of the charity. |
| Decline or End Engagement | If the audit partner and the firm put the suggested safeguards in place, it is likely that a reasonable and informed third party would conclude that the threats were reduced to an acceptable level. |

7.9 Examples – Long association of personnel (including partner rotation) with an audit client

Using the same senior personnel on an assurance engagement over a long period of time may create familiarity and self-interest threats.

A familiarity threat might be created as a result of an individual's long association as an audit team member with (para 540.3 A1):

- a) The audit client and its operations;
- b) The audit client's senior management; or
- c) The financial statements to be audited or the financial information which forms the basis of the financial statements.

A self-interest threat might be created due to an individual's concern about losing a long standing client or an interest in maintaining a close personal relationship with senior management or those charged with governance. This could inappropriately influence the individual's judgement.

Audits and Assurance Engagements for Clients that are not Public Interest Entities (PIEs)

The Code sets out a principle-based approach for professional accountants to deal with threats created by long association with audit or assurance clients that are not PIEs. If the firm determines that the level of threats created by long association can only be addressed by rotating the individual off the engagement, the firm must determine an appropriate period for this rotation (not be a member of the engagement team, provide quality control for the engagement or exert direct influence on the outcome of the engagement) to allow the familiarity and self-interest threats to be addressed (paras R540.4 and R940.4).

Audits of PIEs

The Code sets out specific rules about when an engagement partner, engagement quality control reviewer or key audit partner must rotate or 'cool-off' from the audit of a PIE (Sections 540 and 940 of the Code). The 'cooling-off' period depends on whether the PIE is a listed or APRA regulated entity and whether it occurs during the transitional period between 1 January 2019 and 31 December 2023. Tables 1 and 2 summarise these requirements. Further detailed guidance and examples of how the long association rules apply in practice are available in the APESB publication *Audit Partner rotation requirements in Australia Technical Staff Questions & Answers*.

Table 1: Rotation requirements for Listed Entities and APRA regulated entities

| Role | Original Provisions (Pre 31 Dec 2018) | | Transition (1 Jan 2019 to pre 31 Dec 2023) | | Full Provisions (from 31 Dec 2023) | |
|--------------------------|--|-------------------------|---|-------------------------|---|-------------------------|
| | Time on (yrs) | Cooling off (yrs) | Time on (yrs) | Cooling off (yrs) | Time on (yrs) | Cooling off (yrs) |
| Engagement Partner | 5/7* | 2 | 5/7* | 3 | 5/7* | 5 |
| EQCR Partner | 5/7* | 2 | 5/7* | 3 | 5/7* | 3 |
| Other Key Audit Partners | 7 | 2 | 7 | 2 | 7 | 2 |

* In accordance with applicable laws and regulations, audit engagement and EQCR partners can serve in the same role for a maximum of five years⁸, but may be extended by the audit client or a regulator in accordance with applicable laws and regulations.⁹

Pursuant to para R540.9, firms may have the opportunity for relief from the partner rotation requirements in the Code based on an exemption provided by a relevant regulator, subject to conditions being imposed.¹⁰ Where such relief is available, the individual could remain as a key audit partner (for example, as the engagement partner) on the audit engagement in accordance with any conditions specified under such relief.

Table 2: Rotation requirements for all PIEs other than Listed Entities and APRA regulated entities

| Role | Original Provisions (Pre 31 Dec 2018) | | Full provisions (from 1 Jan 2019) | |
|--------------------------|--|-------------------------|--------------------------------------|-------------------------|
| | Time on (yrs) | Cooling off (yrs) | Time on (yrs) | Cooling off (yrs) |
| Engagement Partner | 7 | 2 | 7 | 5 |
| EQCR Partner | 7 | 2 | 7 | 3 |
| Other Key Audit Partners | 7 | 2 | 7 | 2 |

Restrictions on Activities During the Cooling-off Period

Audit partners on a cooling-off period due to long association are prohibited from (para R540.20):

- Being on the audit engagement team;
- Providing quality control;
- Consulting with the client or engagement team on technical or industry-specific issues, transactions or events affecting the audit engagement;

⁸ Refer to s324DA of the *Corporations Act 2001* for Audit Partner rotation requirements for Listed Entities. APRA *Prudential Standards CPS 510 Governance* (July 2019) and *SPS 510 Governance* (July 2017) provides partner rotation requirements for APRA regulated entities.

⁹ Refer also to s324DAA of the *Corporations Act 2001* in respect of extension of Audit Partner time-on periods for Audit Engagements of Listed Entities.

¹⁰ Refer to s342A of the *Corporations Act 2001* which specifies that the Australian Securities and Investment Commission (ASIC) may grant extensions. APRA has the authority to grant extensions for Audit Partners of APRA regulated entities.

- Leading or coordinating the professional services provided to that client;
- Overseeing the relationship with the client; or
- Undertaking any other role or activity involving frequent interaction with senior management or those charged with governance of the client, or direct influence on the outcome of the audit engagement.

7.10 Examples – Provision of non-assurance services to audit clients

The overarching prohibition when assessing any non-assurance services over and above those set out in Sections 7.2 and 7.3 above is that a firm or network firm shall not assume a management responsibility for an audit client (para R600.7).

7.10.1 – APRA prudential reporting to an audit client’s Board

Scenario – A Risk Management partner has been asked to conduct an independent review of a bank’s risk management framework under APRA’s Prudential Standard CPS 220 *Risk Management* and report the findings to the bank’s Board, under the direction from the bank’s Chief Risk Officer. The bank is an audit client of the firm. The subject matter for the review does not utilise historical financial statements, nor is it included in the annual report and the firm has not provided any other services related to the risk management framework of the bank. The engagement team does not include members from the audit team.

Identifying Threats

Self-review

There is a threat that aspects of the risk management system may overlap with the control environment and that controls subject to the financial statement audit may not be appropriately evaluated when forming judgements as part of the audit given the findings of the firm in the CPS 220 report.

The service could create a self-review threat if the firm assumes a management responsibility when performing the service, such as designing the required improvements to the risk management framework.

Evaluating Threats

Acceptable Level

Before a firm accepts an engagement to provide a non-assurance service to an audit client (such as the CPS 220 engagement) the firm must determine whether providing such a service might create a threat to independence (R600.4).

The audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level.

If there is an assumption of management responsibility in the delivery of the service, it would be prohibited by the Code (para R600.7). However, in this scenario the service does not assume management responsibility as it is for a prudential review with findings reported to the Board. Additionally, the bank’s Chief Risk Officer has the necessary skill, knowledge and experience to be responsible for the bank’s decisions and to oversee the service.

Other factors that are relevant in evaluating the level of threats in this scenario (para 600.5 A1) include:

- The nature, scope and purpose of the service – the report is on the review of bank’s risk management framework, which considers future circumstances and events and does not impact the historical financial statements.
- The degree of reliance on the outcome of the service – the report in this instance will not be relied upon during the external audit process.

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| | <ul style="list-style-type: none"> • Whether the outcome of the service will affect matters reflected in the financial statements to be audited – the basis for the review is not on historical financial statements and the results of the review would not affect the current financial statements or be subject to audit procedures. • Whether the client is a PIE – the audit client is a bank and therefore a PIE which might be perceived to result in a higher level of a threat. <p>The use of a separate engagement team to perform the risk management review also reduces the level of threats.</p> <p>Based on the above evaluation, a reasonable and informed third party would likely conclude that the threats to independence are at an acceptable level.</p> <p>The firm would also need to consider and comply with any applicable APRA independence requirements in respect of the CPS 220 engagement.</p> |
| Addressing Threats | |
| Eliminate Circumstances | Not applicable. |
| Apply Safeguards | Although no specific safeguards are required to reduce threats to an acceptable level, a potential safeguard to temper any potential perception of a threat to independence is to have a team separate to the audit team to undertake the CPS 220 engagement as is the case in this scenario. |
| Decline or End Engagement | Not applicable. |

7.10.2 – Accounting and Bookkeeping Services

7.10.2.1 – Providing payroll services to an audit client who is not a PIE

Scenario – A firm has a very successful payroll services division. and also has audit, taxation and corporate finance divisions. An audit partner has just been advised that the firm’s payroll services division has been providing full scope payroll services to his audit client that is not a PIE.

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| Identifying Threats | |
| Self-interest | There is a threat the audit partner’s interest in the fees earned from the payroll services will inappropriately influence their judgement or behaviour. |
| Self-review | There is a threat that the payroll aspects of the audit would not be appropriately evaluated when forming judgements for the audit engagement as a result of the firm performing payroll services. |
| Evaluating Threats | |
| Acceptable Level | <p>The Code specifically prohibits a firm or network firm from assuming management responsibility for an audit client (para R600.7). Providing full scope payroll services would be deemed by a reasonable and informed third party to be assuming management responsibility.</p> <p>These services would not be considered to be routine and mechanical due to the level of professional judgement required (paras R601.5 and 601.5 A1).</p> |

| Addressing Threats | |
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| Eliminate Circumstances | The Code specifically prohibits a firm or network firm from assuming management responsibility for an audit client (para R600.7). |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | As the payroll services have already been provided, the audit partner and the firm must resign from the audit engagement. |
| Change in Circumstances | <p>The scope of the payroll services now only include preparing payroll calculations and summary reports based on client-originated data. Payroll calculations are authorised and payments made by the client.</p> <p>For entities that are not PIEs, the auditor may only provide accounting and bookkeeping services if the services are of a routine or mechanical nature and the auditor addresses any threats to independence that are not an acceptable level (para R601.5).</p> <p>The services are now routine or mechanical as the payroll services are limited to preparing payroll calculations or reports based on client-originated data for approval and payment by the client (para 601.4 A1). However, a reasonable and informed third party might still conclude that threats are not at an acceptable level.</p> <p>If so, examples of safeguards that might address the threats to independence are (para 601.5 A1):</p> <ul style="list-style-type: none"> • Using professionals who are not audit team members to perform the service. • Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed. <p>If the above safeguards are available and capable of being applied, it will generally reduce any threats to an acceptable level and the audit firm would not be required to end the audit engagement.</p> |

7.10.2.2 – Preparing the financial statements of an audit client

Scenario – An audit firm has been requested by an audit client that is not a PIE to provide assistance with preparing their financial statements for the year ended 30 June 2020. The financial statements will be prepared based on a complete trial balance approved by management and books and records approved by management for the notes to the financial statements.

| Identifying Threats | |
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| Self-review | There is a threat that the financial statements and notes will not be appropriately evaluated when forming judgements as part of the audit given that they were prepared by the firm. |
| Evaluating Threats | |
| Acceptable Level | <p>The firm must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level.</p> <p>For entities that are not PIEs, the auditor may only provide accounting and bookkeeping services including preparing the financial statements and notes that the firm will be auditing or financial information which forms the basis of such</p> |

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| | <p>financial statements, if the services are of a routine or mechanical nature and the auditor addresses any threats to independence that are not an acceptable level (para R601.5).</p> <p>Accounting and bookkeeping services that are routine or mechanical in nature require little or no professional judgement and an example of such a service is “<i>preparing financial statements based on information in the client-approved trial balance and preparing related notes based on client-approved records</i>” (para 601.4 A1).</p> <p>The level of the threats may also be influenced by the extent to which the financial information provided and approved by management is complete.</p> <p>Although the services in this scenario are routine and mechanical, a reasonable and informed third party might conclude that the services create threats that are not at an acceptable level which would need to be addressed (para R601.5).</p> |
| Addressing Threats | |
| Eliminate Circumstances | Do not prepare the audit client’s financial statements and notes. |
| Apply Safeguards | <p>Examples of safeguards that might address the threats to independence are (para 601.5 A1):</p> <ul style="list-style-type: none"> • Using professionals who are not audit team members to perform the service. • Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed. |
| Decline or End Engagement | If the above safeguards are available and capable of being applied, it will generally reduce any threats to an acceptable level and the audit firm would not be required to end the audit engagement. |
| Change in Circumstances 1 | <p>The audit partner discovers that the audit client has been unable to fulfil their obligations in relation to the completeness of the trial balance or a number of books and records needed to prepare the financial statements and notes. The threat has now significantly increased due to the fact that the firm will likely be recording transactions, determining account classifications and originating journal entries.</p> <p>The first consideration is whether undertaking the services results in the firm assuming management responsibility for the audit client, which is strictly prohibited by the Code (para R600.7). If so, the services must not be performed or the firm would need to resign from the audit engagement.</p> <p>If the firm is NOT assuming management responsibility for the audit client, an assessment would still need to be made as to whether the services were routine and mechanical. If the services were not routine and mechanical, the services must not be performed or the firm would need to resign from the audit engagement.</p> <p>If the services were deemed to be routine and mechanical, some potential safeguards may be available to reduce the threats to an acceptable level (depending on significance) for example:</p> <ul style="list-style-type: none"> • Having the client evaluate the account classifications and proposed adjustments and accept responsibility for them (paras R600.8, 601.3 A3 & R601.5). |

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| | <ul style="list-style-type: none"> Having a qualified person, who is not a member of the audit team, take responsibility for performing the non-audit services and obtaining the client's acknowledgement of responsibility for the financial statements. <p>If safeguards are not available or capable of being applied to reduce the threats to an acceptable level, the services must not be performed or the firm would need to resign from the audit engagement.</p> <p>If the auditor is a sole practitioner, it will be impossible to reduce the significance of the threats to an acceptable level because there is no opportunity within the practice to segregate ultimate responsibility for the audit engagement from the non-assurance services (even if a qualified senior manager who is not on the audit performs the non-assurance services). The services could not be performed or the firm would need to resign from the audit engagement.</p> |
| Change in Circumstances 2 | <p>The audit client listed on the ASX in December 2020.</p> <p>The Code strictly prohibits the preparation of financial statements for audit clients that are PIEs, which includes a listed company (para R601.6).</p> |

7.10.2.3 – Providing accounting advice to an audit client

Scenario – An ACNC registered charity has requested that its auditor assist with the implementation requirements of a significant new accounting standard. It is generally held that the implementation aspects will be complex for all entities that are required to adopt the standard and retrospective adjustments are likely to opening retained earnings. The scope of the engagement encompasses:

- Determine the likely scope for the charity and what system changes might be required;
- Develop the accounting policies that would demonstrate compliance with the requirements of the standard; and
- Apply the requirements of the accounting standard to determine the accounting entries that will be required to be made retrospectively and in the current accounting period.

Identifying Threats

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| Self-review | There is a threat that the auditor will not appropriately evaluate the area of the financial statements impacted by the implementation of the new accounting standard when forming judgements as part of the audit as they received fees for that advice. |
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Evaluating Threats

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| Acceptable Level | The Code specifically prohibits a firm or network firm from assuming management responsibility for an audit client (para R600.7). |
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Addressing Threats

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| Eliminate Circumstances | As the Code specifically prohibits undertaking management responsibility, the auditor should not undertake the service. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | If the auditor does not decline the service, they must resign from the audit engagement. |
| Change in Circumstances | The client's management now simply asks the auditor prior to the commencement of the audit process whether their proposed approach to ensure |

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| | <p>compliance with the new accounting standard is in line with the auditor's expectations.</p> <p>The Code would not usually prohibit this service (para 601.3 A3):</p> <ul style="list-style-type: none"> • As the audit process necessitates dialogue between the audit team and the audit client in applying accounting standards. • As these activities are considered to be a normal part of the audit process and do not usually create threats. • The audit partner should ensure that management at all times accepts responsibility for making decisions in the preparation of accounting records. <p><i>Please note that the decision points as raised above would not vary if the audit client was a PIE.</i></p> |
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7.10.3 – Valuation Services

7.10.3.1 – Valuation of assets in a group audit of an ASX listed client

Scenario – A corporate finance division of an accounting firm in an overseas country (which is not a network firm) has completed valuation services of the significant mining tenements of a material subsidiary of an ASX listed junior explorer. The accounting firm in the overseas country that completed the valuation is also appointed as the component auditor for group reporting purposes.

| Identifying Threats | |
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| Self-review | There is a threat that the auditor will not appropriately evaluate the area that the component auditors firm conducted the valuation of when forming judgements as part the audit. |
| Evaluating Threats | |
| Acceptable Level | The Code specifically prohibits the provision of valuation services to an audit client that is a PIE if the valuation service would have a material effect on the financial statements being audited (para R603.5). |
| Addressing Threats | |
| Eliminate Circumstances | The accounting firm that provided the valuation services must not accept the engagement to be a component auditor. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | If the firm that provided the valuation services accepts the engagement as component auditor, the Australian firm must resign from the audit engagement. |
| Change in Circumstances | <p>The group is private and the Australian parent is not listed. The valuation service involves a significant degree of subjectivity and would have a material effect on the financial statements being audited.</p> <p>The Code specifically prohibits the provision of valuation services to an audit client that is not a PIE if the valuation service involves a significant degree of subjectivity and would have a material effect on the financial statements being audited (para R603.4).</p> |

7.10.4 – Tax Services

7.10.4.1 – Tax return preparation

| Scenario – An accounting firm does the audit of a company’s financial statements and their taxation services division prepares the income tax return. | |
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| Identifying Threats | |
| Providing tax return preparation services does not usually create a threat to the auditor’s independence (para 604.4 A1). | |
| Evaluating Threats | |
| Acceptable Level | <p>Tax return preparation services are usually based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice (para 604.4 A3). Further, the tax returns are subject to management review and management will take responsibility for the financial information contained in the tax return.</p> <p>Generally, a different individual from the firm prepares the tax return that is not on the audit team, as is the case in this scenario.</p> <p>As such, a reasonable and informed third party would conclude that the preparation of the tax return generally does not create threats that are not at an acceptable.</p> <p>If the preparation of the tax return includes complexities including the provisions of tax advice, refer to example 7.10.4.3 below.</p> |
| Addressing Threats | |
| Eliminate Circumstances | Not applicable. |
| Apply Safeguards | Although no specific safeguards are required to reduce threats to an acceptable level, a potential safeguard to temper any potential perception of a threat to independence is to have a team separate to the audit team to prepare the income tax return, as is the case in this scenario. |
| Decline or End Engagement | Not applicable. |

7.10.4.2 – Preparation of tax effect accounting calculations by a firm’s tax division for the purpose of preparing the relevant accounting entries for financial statements

| Scenario – An audit client that is not a PIE does not have appropriately skilled staff to prepare tax entries for the purpose of the preparation of the financial statements. The CEO has asked that the tax services division of the firm prepare the calculations for which the CEO will take full responsibility. The resulting calculations are unlikely to have a material effect on the financial statements. | |
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| Identifying Threats | |
| Self-review | There is a threat that the audit team will not appropriately evaluate the tax balances that were prepared by the firm’s tax division when forming judgements as part the audit. |

| Evaluating Threats | |
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| Acceptable Level | <p>The firm must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Factors that are relevant in evaluating the level of the threats include:</p> <ul style="list-style-type: none"> • Whether the calculation might have a material effect on the financial statements on which the firm will express an opinion (para 604.5 A2), which is not the case in this scenario. • The level of tax expertise of the client's employees (para 604.3 A2 which includes other factors to consider, which might be relevant to the evaluation of other circumstances). In this scenario, the audit client's staff do not have the requisite skills to prepare the tax entries. <p>The level of the threat may also be influenced by the extent to which management take responsibility for the calculations, which in this scenario the CEO will take full responsibility for the work.</p> <p>A reasonable and informed third party might conclude that the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | Do not conduct the tax calculation engagement. |
| Apply Safeguards | <p>Example safeguards that might address the threats include (para 604.5 A3):</p> <ul style="list-style-type: none"> • Using professionals who are not audit team members to perform the service, which in this situation is already in place as the tax division is undertaking this work. • Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed. |
| Decline or End Engagement | If the above safeguards are available and capable of being applied, it will generally reduce any threats to an acceptable level and the audit firm would not be required to end the audit engagement. |
| Change in Circumstances 1 | <p>The CEO now believes that they do not have the skills to take responsibility for the tax calculations and will be completely reliant on the tax services division members to take full responsibility for the calculations.</p> <p>The Code specifically prohibits a firm from assuming a management responsibility for an audit client (para R600.7). The tax calculation services must not be performed or the firm would need to resign from the audit engagement.</p> |
| Change in Circumstances 2 | <p>It is anticipated that the tax balances will now be material to the financial statements and that a Board member can take responsibility for the calculations as he is a Fellow of a professional accounting body.</p> <p>Apply the same safeguards as under "Apply Safeguards" above noting the materiality may impact their ability to reduce the threats to an acceptable level (para 604.5 A2).</p> |
| Change in Circumstances 3 | <p>In 2021 the audit client lists on the ASX and the calculations, if undertaken, would be material to the financial statements.</p> <p>The Code specifically prohibits the preparation of tax calculations of deferred tax liabilities (or assets) for a PIE audit client for the purpose of preparing accounting</p> |

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| | entries that are material to the financial statements being audited (para R604.6). The tax calculation services must not be performed or the firm would need to resign from the audit engagement. |
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7.10.4.3 – Tax advice in relation to an audit client’s Research and Development (“R&D”) claims

Scenario – An audit partner has received a request from his non-PIE audit client to gain access to one of the firm’s tax partners to discuss the scope of an R&D engagement. The scope is likely to be as follows:

- Determination of what is required to make an R&D claim, which is unlikely to be subjective, however it is likely to be material to the financial statements.
- Determine the systems and supporting records that are required to support an R&D claim.
- Preparation of the actual claim on an annual basis.
- Lead discussions with the ATO when required.
- The CEO and the board will take control of this project.

Identifying Threats

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| Self-review | There is a threat that the audit team will not appropriately evaluate the R&D claims when forming judgements as part the audit and objectively assess their recoverability as they were prepared by the firm’s tax division. |
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Evaluating Threats

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| Acceptable Level | <p>The first consideration must be whether the firm was assuming management responsibility for an audit client when undertaking the services, which is specifically prohibited by the Code (para R600.7). Therefore, if the services assumed management responsibility, the services could not be performed or the auditor would need to resign.</p> <p>Assuming in this scenario that the firm is NOT assuming management responsibility for an audit client, the factors that are relevant in evaluating the level of such threats include (para 604.7 A3 and para 604.3 A2, which has additional factors which may be relevant in other circumstances):</p> <ul style="list-style-type: none"> • The degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements. In this scenario, the tax advice is straightforward and unlikely to be subjective. • Whether the tax treatment is supported by a private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements. • The extent to which the outcome of the tax advice will have a material effect on the financial statements. Given the results of the tax advice will have a material impact on the financial statements that the same firm will audit, this will increase the level of the threats. <p>A reasonable and informed third party would likely conclude even though not a complex calculation, it is material and therefore the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
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Addressing Threats

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| Eliminate Circumstances | The tax services division do not conduct the non-assurance service. |
| Apply Safeguards | Examples of safeguards that might address the threat include (para 604.7 A4) |

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| | <ul style="list-style-type: none"> • Using professionals who are not audit team members to perform the service. • Having an appropriate reviewer, who was not involved in providing the service review the audit work or service performed. • Obtaining pre-clearance from the tax authorities. |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level the auditor and firm must resign from the audit engagement. |

7.10.4.4 – Representing an audit client in a tax dispute

Scenario – A tax partner has been requested to represent an audit client in a dispute with the Australian Taxation Office (ATO).

| Identifying Threats | |
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| Self-review | There is a threat that the audit partner will not appropriately evaluate the results of the work of the tax partner conducted on the tax dispute when forming judgements as part of the audit engagement. |
| Advocacy | There is a threat that the audit partner will be deterred from acting objectively to promote the work carried out by the tax partner. |
| Evaluating Threats | |
| Acceptable Level | <p>If the service involves acting as an advocate for the audit client before a public tribunal or court and the amounts involved are material to the financial statements being audited, then such services are prohibited by the Code (para R604.11).</p> <p>This does not preclude the firm from having a continuing advisory role in relation to the matter before a public tribunal or court, for example (para 604.11 A1):</p> <ul style="list-style-type: none"> • Responding to specific requests for information. • Providing factual accounts or testimony about the work performed. • Assisting the client in analysing the tax issues. <p>If the service does not include an advocacy role, the audit partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Factors that are relevant in evaluating the level of such threats include (paras 604.3 A2 and 604.10 A3 include the following and some additional factors, which may also be relevant in other circumstances):</p> <ul style="list-style-type: none"> • The particular characteristics of the engagement. • The level of tax expertise of the client's employees. • The role management plays in the resolution of the dispute. • The extent to which the outcome of the dispute will have a material effect on the financial statements to be audited. • Whether the advice provided by the firm is the subject of the tax dispute. <p>In this situation, particularly as the extent of the representation is unknown, a reasonable and informed third party might conclude that the threats are not at an acceptable level.</p> |

| Addressing Threats | |
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| Eliminate Circumstances | The firm could decline to represent the audit client in the tax dispute with the ATO. |
| Apply Safeguards | <p>If the service does not include an advocacy role (prohibited by para R604.11) the firm could consider applying the following safeguards (para 604.10 A4):</p> <ul style="list-style-type: none"> • Using professionals who are not audit team members to perform the service. • Having an appropriate reviewer who was not involved in providing the service review the audit work or the service performed. |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the audit partner and firm should resign from the audit engagement. |

7.10.4.5 – Ten hour “maximum hours test”

Scenario – A partner in the tax division of a firm has been asked to assist an audit client with a complex tax issue. The engagement is expected to require more than 10 hours. The partner’s wife works for the audit client and receives share options as part of her salary bonus scheme. She is not an officer of the company nor in an ‘audit critical’ role. The share options have a vesting period attached to them. The tax partner and his wife normally sell down the shares once the share options have vested.

| Identifying Threats | |
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| Self-interest | There is a threat that the financial interest of the tax partner may influence the judgement and behaviour of the tax partner. |
| Advocacy | There is a threat that the tax partner will be deterred from acting objectively due to the financial interest in the client. |
| Evaluating Threats | |
| Acceptable Level | The Act specifically prohibits the tax partner from becoming a ‘non-audit service provider’ to the audit client (S 324CF(1), 324CF(5) Item 7, 324CH(6) and 324CH(1) Item 10). This prohibition is based on the existence of the bonus scheme and unvested options. The prohibition arises when a tax partner provides more than 10 hours of non-audit service (the ‘maximum hours test’) and an immediate family member (tax partner’s wife) has an investment in the audit client. |
| Addressing Threats | |
| Eliminate Circumstances | The tax partner declines to provide the tax services to the audit client. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | If the tax partner does not decline to provide the tax services, the audit partner must resign from this audit engagement. |
| Change in Circumstances | The tax service is not as complex as first thought and will take less than 10 hours. |

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| | Although no longer prohibited under the provisions of the Act listed above, depending on the nature of the tax services the matters detailed in examples 7.10.4.1 to 7.10.4.4 above needs to be considered. |
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7.10.5 – Information Technology Services – IT Software implementation

7.10.5.1 – Implementation of entire software suite

Scenario – A audit client that is not a PIE has discussed with the audit partner the fact that they are looking to upgrade their entire software suite. The current software suite used for sales and purchases does not automatically integrate with the general ledger. The audit partner suggests that the client speaks with the firm’s IT services team, to suggest appropriate systems and to assist with implementation.

| Identifying Threats | |
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| Self-review | There is a threat that the audit engagement team will not appropriately evaluate the outputs of the system when forming judgements as part of the audit if the firm’s IT team conduct implementation services on a new IT system that directly impacts the financial reporting systems. This may impact on the audit team’s exercise of professional scepticism or objectivity. |
| Evaluating Threats | |
| Acceptable Level | <p>When providing IT systems services to an audit client, the firm or network firm must be satisfied that (para R606.4):</p> <ol style="list-style-type: none"> a) The client acknowledges its responsibility for establishing and monitoring a system of internal controls; b) The client assigns the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system to a competent employee, preferably within senior management; c) The client makes all management decisions with respect to the design and implementation process; d) The client evaluates the adequacy and results of the design and implementation of the system; and e) The client is responsible for operating the system (hardware or software) and for the data it uses or generates. <p>The level of threat may be influenced by (para 606.4 A1):</p> <ul style="list-style-type: none"> • The nature of the service, which in this scenario is in respect of the entire software suite. • The nature of IT systems and the extent to which they impact or interact with the client’s accounting records or financial statements, which in this scenario the proposed system will integrate with the general ledger. • The degree of reliance that will be placed on the particular IT systems as part of the audit. <p>A reasonable and informed third party would likely conclude, based on the nature of the service and integration with the general ledger, that the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |

| Addressing Threats | |
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| Eliminate Circumstances | Do not provide IT implementation services. |
| Apply Safeguards | An example of a safeguard that might address the threat would be using professionals who are not audit team members to perform the service (para 606.4 A2). This assumes that management takes full responsibility for the implementation process and the firm is satisfied that all the requirements in para R606.4 have been met. |
| Decline or End Engagement | If the audit partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the auditor and firm must resign from the audit engagement. |
| Change in Circumstances | The client becomes a PIE prior to the non-assurance service being performed. The Code specifically prohibits the provision of IT systems services to audit clients that are PIEs if the services involve designing and implementing IT systems that form a significant part of the internal control over financial reporting or generate information that is significant to the client's accounting records or financial statements (para R606.5). |

7.10.5.2 – Implementation of software developed by audit firm for AASB 16 Leases

Scenario – The IT Services division of a firm develops a software program designed to assist clients with the implementation of and ongoing compliance with the new accounting standard AASB 16 Leases. The firm makes this software program available to its clients.

| Identifying Threats | |
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| Self-review | There is a threat that the audit teams will not appropriately evaluate the outputs generated by the AASB 16 software developed by the firm, which directly impacts the accounting records and financial statements of the audit clients, when forming judgements as part of the audits. |
| Evaluating Threats | |
| Acceptable Level | <p><u>PIE Audit Clients</u></p> <p>Designing or implementing IT system services that are a significant part of internal controls over financial reporting or that generate information significant to accounting records or financial statements or prohibited for PIE audit clients (para 606.5). As the AASB 16 software generates information that is significant to the accounting records or financial statements, the firm must not provide or sell this software to its PIE audit clients.</p> <p><u>Non-PIE Audit Clients</u></p> <p>As detailed in Example 7.10.5.1 above, when providing IT systems services to an audit client, the firm or network firm must be satisfied on specific requirements as set out in the Code (para R606.4). Even if the firm is satisfied that all of these requirements are met the firm would still need to assess whether a self-review threat remains. Factors that are relevant in evaluating the level of any threats include (para 606.4 A1):</p> <ul style="list-style-type: none"> • The nature of the service. • The nature of IT systems and the extent to which they impact or interact with the client's accounting records or financial statements. |

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| | <ul style="list-style-type: none"> The degree of reliance that will be placed on the particular IT systems as part of the audit. <p>As the AASB 16 software generates information that is significant to the accounting records or financial statements, a reasonable and informed third party would likely conclude the threats to independence are not at an acceptable level and the threats would need to be addressed.</p> |
| Addressing Threats | |
| Eliminate Circumstances | Do not provide or sell the AASB 16 software to audit clients. |
| Apply Safeguards | <p>An example of a safeguard that might address the threat would be using professionals who are not audit team members to perform the service (para 606.4 A2) as is the case in this situation. This assumes that management takes full responsibility for the implementation process and the firm is satisfied that all the requirements in para R606.4 have been met.</p> <p>However, this safeguard does not change the fact that the AASB 16 software generates information that is significant to the accounting records or financial statements. As such, it is unlikely that the firm would be able to apply safeguards to reduce the threats to an acceptable level and, therefore, should not provide or sell the AASB 16 software to its non-PIE audit clients.</p> |
| Decline or End Engagement | Decline to provide or sell the AASB 16 software to audit clients. |

7.10.6 – Recruiting Services – CEO and CFO

Scenario – An audit client in the not-for-profit sector has approached the audit partner to assist in the recruitment of a CEO and a CFO, given the knowledge and contacts the audit partner has in the sector. The client has asked that the audit partner takes the lead role in the recruiting process.

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| Identifying Threats | |
| Familiarity | There is a threat that the officers of the company would be known to the audit partner, which may mean that the audit partner is overly sympathetic and does not apply the appropriate professional judgement or behaviour. |
| Intimidation | There is a threat that the audit partner may be deterred from acting objectively due to the perceived pressure to be sympathetic to an officer of the company that the audit partner was involved in recruiting to the company. |
| Evaluating Threats | |
| Acceptable Level | The Code specifically prohibits the provision of recruiting services when the firm acts as a negotiator (para R609.6). Further, the Code specifically prohibits the searching for or seeking out of candidates for a director or officer position or a senior management position that could exert significant influence over the preparation of the financial statements (para R609.7). |
| Addressing Threats | |
| Eliminate Circumstances | The audit partner must not assist with the recruitment of the CEO and CFO. |

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| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | The audit partner must not assist with the recruitment of the CEO and CFO. |

7.10.7 – Corporate Finance – Debt structuring through convertible notes

Scenario – The corporate finance division of a firm is considering assisting one of the firm’s audit clients with seed capital debt structuring advice where convertible notes will be issued during the current financial period. This advice would include assistance with the discount rate, the interest rate, written options and the vesting periods. The effectiveness of the corporate finance advice is dependent on the client’s accounting treatment, which is subjective and based on the structure of the capital raising. The corporate finance division will not be providing advice about the client’s accounting treatment. The outcome of the advice is material to the financial statements.

Identifying Threats

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| Self-review | There is a threat that the audit engagement team may not appropriately evaluate the convertible notes when forming judgements as part of the audit as the firm provided the capital raising advice. This may impact on the audit team’s exercise of professional scepticism over audit matters related to debt structuring. |
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Evaluating Threats

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| Acceptable Level | <p>The Code specifically prohibits a firm from providing corporate finance advice where the effectiveness of such advice depends on a particular accounting treatment or presentation in the financial statements and (para R610.5):</p> <ol style="list-style-type: none"> The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation; and The outcome or consequences of the corporate finance advice will have a material effect on the financial statements, which is the case in this scenario. <p>Given the effectiveness of the corporate finance advice depends on the appropriateness of the accounting treatment which involves a level of subjectivity, the audit team may have a reasonable doubt about the appropriateness of the accounting treatments. If so, all three aspects of the prohibition have been triggered and the corporate finance advice must not be provided.</p> |
|-------------------------|---|

Addressing Threats

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| Eliminate Circumstances | The corporate finance division should not provide the debt structuring advice. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | If the corporate finance division decides to provide the debt structuring advice then the firm must resign from the audit engagement. |
| Change in Circumstances | All the factors above remain the same except the outcome is not material to the financial statements. |

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| | <p>As the above prohibition requires <u>all</u> three aspects to be present, when the outcome is not material it is not prohibited despite meeting some of the factors (para R610.5).</p> <p>Some examples of safeguards that might address the threat are (para 610.3 A3):</p> <ul style="list-style-type: none"> • Using professionals who are not audit team members to perform the service, as is the case in this scenario. • Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed <p>Another potential safeguard might be to have a technical expert, either from within the firm or external to the firm, review the appropriateness of the accounting treatment.</p> <p>If no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the corporate finance division should not provide the debt structuring advice.</p> |
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7.11 Examples – Proposed Provision of Non-Assurance Services (NAS) to an Assurance Client

Assurance engagements that are not audits or reviews have similar independence considerations to those that relate audits and reviews. The table below notes the relevant examples auditors could review when considering specific Sections in Part 4B. There are also additional examples (7.11.1 and 7.11.2) that relate to other assurance engagements.

| Description | Part 4B Section | Relevant examples |
|--|-----------------|-------------------|
| Applying the Conceptual Framework to Independence for Assurance Engagements Other than Audit and Review Engagements | 900 | 7.1 and Chapter 4 |
| Fees | 905 | 7.4 |
| Gifts and Hospitality | 906 | 7.5 |
| Actual or Threatened Litigation | 907 | 7.6 |
| Financial Interests | 910 | 7.7 |
| Loans and Guarantees | 911 | 7.7 |
| Business Relationships | 920 | 7.8 |
| Family and Personal Relationships | 921 | 7.8 |
| Recent Service with an Assurance Client | 922 | 7.8 |
| Serving as a Director or Officer of an Assurance Client | 923 | 7.8 |
| Employment with an Assurance Client | 924 | 7.8 |
| Long Association of Personnel with an Assurance Client | 940 | 7.9 |
| Provision of Non-Assurance Services to Assurance Clients Other than Audit and Review Engagement Clients | 950 | 7.10 |
| Reports That Include a Restriction of Use and Distribution | 990 | - |

7.11.1 – Assurance over a trade certificate

| Scenario – An audit firm has been asked to conduct a direct reporting assurance engagement to certify a trade certificate for a company. A partner of the firm is a director of the company. | |
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| Identifying Threats | |
| Advocacy | There is a threat that the objectivity of the assurance partner will be compromised as a result of a fellow partner being a director of the company. |
| Evaluating Threats | |
| Acceptable Level | The Code prohibits a partner of a firm from serving as a director of an assurance client (para R923.3). |
| Addressing Threats | |
| Eliminate Circumstances | The partner of the firm could resign from being a director of the company. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | The assurance partner must decline taking on this engagement. |

7.11.2 – Assurance Engagement under ASAE 3100

| Scenario – An assurance practitioner has been asked by a franchisee, who is part of a globally exclusive brand, to undertake an assurance engagement for him. The assurance practitioner has known the franchisee a long time. The assurance practitioner and the franchisee have several joint ventures together which are very profitable. Annually the franchisee has to report to head office compliance with the brand's compliance manual, which covers brand elements and not financial elements. The assurance practitioner has determined that ASAE – 3100 <i>Compliance Engagements</i> will be the appropriate standard. | |
|---|--|
| Identifying Threats | |
| Self-interest | There is a threat that the assurance practitioner's interests in the joint ventures may inappropriately influence the professional judgement and behaviour of the assurance practitioner. |
| Familiarity | There is a threat that as the assurance practitioner has known the franchisee for a long time and is involved in several joint ventures, may mean that the assurance practitioner is overly sympathetic to the assurance client's interests. |
| Evaluating Threats | |
| Acceptable Level | <p>The Code specifically prohibits a firm or an assurance team member from having a close business relationship with an assurance client unless any financial interest is immaterial and the business relationship is insignificant to the client or its management and the firm or an assurance team member (para 920.4).</p> <p>A reasonable and informed third party would conclude that the assurance practitioner's financial interest is material and/or the business relationship (other joint ventures) is significant. As such, assurance practitioner must not accept this engagement.</p> |

| Addressing Threats | |
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| Eliminate Circumstances | The assurance practitioner does not conduct the ASAE 3100 engagement. |
| Apply Safeguards | No safeguards are available or capable of being applied to reduce threats to an acceptable level. |
| Decline or End Engagement | The assurance practitioner must decline taking on this engagement. |

DRAFT

8. Special consideration: Self-managed superannuation funds

8.1 Overview

For self-managed superannuation fund (SMSF) audits, there is **no difference** in the application of the independence requirements and the conceptual framework of the Code from other types of audit engagements. Approved SMSF auditors must comply with auditor independence requirements produced by the APESB and set out in the Code (as per section 128F(d) of the SIS Act and regulation 9A.06 of the SIS Regulations). The following guidance provides direction in applying the independence requirements and framework from an SMSF perspective. However, this chapter should not be read in isolation from other chapters in this guide.

8.2 Superannuation funds as public interest entities

As detailed in Chapter 7, there are additional independence requirements for audit and review clients that are public interest entities (PIEs). Auditors of superannuation funds will be required to comply with the requirements of Part 4A related to public interest entities if the fund meets the relevant definition. Chapter 5 demonstrates the application of the definition of public interest entities.

SMSFs are generally not considered to be public interest entities for the purposes of the independence requirements of the Code. However, firms must make that determination based on the specific facts and circumstances.

8.3 Self-managed superannuation funds (SMSFs)

There is a strong misconception that the auditor independence requirements of the Code do not need to be applied to SMSF audit clients, largely because of their relative size. SMSFs generally fall within the 'small client' category as discussed in Chapter 4. This classification has a direct impact on the type and significance of independence threats. As an example, close relationships with a client are often more prevalent between small clients, such as SMSFs and their auditor. This can make it challenging to eliminate the circumstances creating threats to independence or apply safeguards to reduce those threats to an acceptable level, but it does not diminish the need for the application of the independence requirements of the Code.

A legal requirement exists under the SIS Act for SMSF trustees to have their fund audited annually. As a professional accountant and SMSF auditor, you are obliged to carry out such an audit in accordance with auditing standards and in compliance with the independence requirements of the Code. This applies regardless of the size or simplicity (or level of complexity) of the SMSF or any perception that the fund is otherwise complying with other legal requirements. Furthermore, independence requirements of the Code apply regardless of how proficiently or thoroughly an auditor may believe they can or are able to carry out an audit.

This chapter includes discussion of instances where independence may need to be considered as a consequence of relationships with the client away from the audit client themselves; for example, the source of the referral of audit work may lead to auditor independence concerns. This may include the relationship with the referral source or the volume of work being received from one referral source.

If an SMSF auditor has any doubt about their independence in carrying out an audit and they are unable to eliminate the circumstances creating threats to independence or apply safeguards to reduce those threats to an acceptable level they must decline the audit engagement (para R120.10). As part of the process in assessing independence, auditors may consider as a 'litmus' test, asking themselves if they would have any hesitation in writing up an adverse finding or in qualifying an audit report. If there is any hesitation, it may be an indication that independence is impaired and consideration should be given to declining the audit engagement.

8.4 Scenarios where independence is always compromised

The examples that follow are intended to deal with common independence issues that arise in practice in relation to SMSFs. The factors that impact the evaluation of a threat to independence, potential ways to eliminate the circumstances creating the threats and the safeguards proposed are only examples. In

all situations, members must be mindful of their professional obligations to act in the public interest and, in particular, whether a situation could pass the 'independence in appearance' test. Auditors should seek advice from their professional accounting body where necessary.

The following scenarios involving SMSFs would always result in independence requirements being breached. In each of these cases, it would be expected that an auditor would decline the audit engagement:

- 1) An auditor cannot audit an SMSF where the individual auditor has significantly prepared the financial statements for the SMSF (paras 601.4 A1, R601.5 and 601.5 A1);
- 2) An auditor cannot audit an SMSF where staff reporting directly to them have significantly prepared the financial statements for the SMSF (paras R600.7, 600.7 A1, 600.7 A3, 601.4 A1, R601.5 and 601.5 A1);
- 3) An auditor cannot audit their own SMSF (Paras 510.3 A3, R510.4 and R523.3);
- 4) An auditor cannot audit the SMSF where a partner within their own firm is a member/trustee of that SMSF (paras 520.3 A1 to 520.4 A1 and R523.3); and
- 5) An auditor cannot audit the SMSF where a relative or a related party of the auditor is a member/trustee of that SMSF or where the auditor has a close personal relationship (paras 521.3 A1 to 521.3 A2) or business relationship with a member/trustee of the SMSF (para 520.3 A1 to 520.4 A1).¹¹

An auditor cannot audit an SMSF where they or their staff have significantly prepared the financial statements

A firm (or network firm) must not provide to an audit client that is not a public interest entity accounting and bookkeeping services including preparing the financial statements that the firm will be auditing or financial information which forms the basis of such financial statements, unless (para R601.5):

- a) the services are of a routine or mechanical nature; and
- b) the firm addresses any threats created by providing such services that are not an acceptable level.

Services that are '*routine and mechanical in nature*' require little or no professional judgement and examples are listed in para 601.4 A1, which includes "*preparing financial statements based on information in the client-approved trial balance*".

Examples of safeguards that might address threats created when providing accounting and bookkeeping services of a routine and mechanical nature to an audit client include (para 601.5 A1):

- using professionals who are not audit team members to perform the service; or
- having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.

In the context of the audit of SMSFs, it would always be necessary as a minimum to apply such safeguards.

However, the scenario contemplated by para R601.5 does not permit an individual auditor to take full professional responsibility for the preparation of an SMSF's financial statements, and then to provide an audit report on those financial statements. The paragraph contemplates a minimal or restricted set of services ('of a routine or mechanical nature') requiring little or no professional judgement. Where an accountant takes full professional responsibility for the preparation of financial statements for an SMSF, in a manner which legally binds the accountant to the statements produced, and where the accountant would be responsible at law for rectifying any defects, then the self-review threat which arises, were that same accountant to undertake an audit of those financial statements, would be so great that no safeguard could reduce the threat to an acceptable level.

On this basis, a sole practitioner or their staff would be unable to both prepare the financial statements and audit them, as they would of necessity be taking full professional responsibility for both services. In

¹¹ Reference to SIS Act definitions for relatives and related party should be considered.

this situation, the auditor may be assuming management responsibility in breach of para R600.7 as they take responsibility for the preparation and fair presentation of the audit client’s financial statements (para 600.7 A3).

An auditor cannot audit their own SMSF

A partner or employee of the firm or a network firm must not serve as a director or officer of an audit client of the firm (para R523.3). Therefore, where a person is a member and trustee of an SMSF, that person would be unable to conduct the audit of that SMSF. The Code defines ‘director or officer’ to mean “those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title” and therefore covers the individual trustees of an SMSF, or the directors of a trustee company.

An auditor cannot audit the SMSF where a partner within their firm is a member/trustee of that SMSF

Also, by application of para R523.3, no audit can be undertaken of an SMSF in which a partner (or employee) of the firm or network firm is a member and trustee of the SMSF. Note that ‘partner’ should not be read in the narrow sense of a partnership at law. Although ‘partner’ is not a defined term in the Code, it is used extensively in the professional standards issued by the APESB, and is defined in APES 320 as “any individual with authority to bind the firm with respect to the performance of a professional services engagement”. It should be read similarly in the context of para R523.3 and would apply to directors of a corporate entity and trustees of a trust, in addition to partners of a partnership.

8.5 Examples

Not all scenarios are clear cut when determining whether appropriate safeguards are in place to meet professional obligations around independence. The following seeks to provide guidance on some common scenarios.

8.5.1 ‘The books’ are prepared by the auditor

The approach to this question is the same as in the scenarios in Chapter 7. However, in each case, the evaluation of the identified threats and the safeguards that are applied will be influenced by factors such as:

- The required specialised knowledge or competency that may be necessary to undertake the engagement;
- Skills, knowledge and experience of the trustee who prepared the accounts; and
- The existence of relationships between the auditors and the members and trustees of the fund.

Scenario 8.5.1 – The auditor of an SMSF is asked to prepare the accounting records and/or the financial statements of the fund. This may include the auditor:

- a) recording the transactions when the fund has very few transactions, preparing the general ledger and trial balance and proposing and posting journal entries. No advice is given in relation to the financial statements; or
- b) in addition to a) the auditor undertakes tax calculations and provides advice to the trustees on how to prepare the financial statements.

| Identifying Threats | |
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| Self-review | As the member prepared the financial statements and is also undertaking an audit of those financial statements there is a threat that they will not evaluate the results of their judgements in preparing the financial statements when undertaking the audit. |

| Evaluating Threats | |
|----------------------------------|---|
| Acceptable Level | <p>For entities that are not PIEs such as SMSFs, the auditor may only provide accounting and bookkeeping services including preparing the financial statements that the firm will be auditing or financial information which forms the basis of such financial statements, if the services are of a routine or mechanical nature and the auditor addresses any threats to independence that are not an acceptable level (paras 601.4 A1 and R601.5).</p> <p>The auditor must determine how the extent of their involvement in the preparation of financial statements and the level of professional judgement required will impact their independence in carrying out an audit, for example:</p> <ul style="list-style-type: none"> • If the SMSF trustees prepared the accounts and the auditor filled in pro-forma financial statements based on the trustees' work, this is more likely to be routine and mechanical (paras 601.4 A1 and R601.5(a)). However, a reasonable and informed third party would likely conclude that the threats to independence are at not an acceptable level so the auditor would need to address those threats (para R601.5(b)). • If the auditor undertakes tax calculations and/or provides advice to the trustee on how to prepare the financial statements, the service would not be routine or mechanical and independence requirements cannot be met (paras 601.4 A1 and R601.5). Consideration would also need to be taken as to whether the auditor has assumed management responsibility which is a breach of the Code (paras R600.7 and 600.7 A3). |
| Addressing Threats | |
| Eliminate circumstances | The auditor may not be able to eliminate the circumstances creating the threat to independence. |
| Apply safeguards | <p>In situation a) if the preparation of the financial statements is determined to be routine and mechanical (para R601.5(a) and 601.4 A1), the member is required to address any threat that is not an acceptable level (para R601.5(b)), for example by applying safeguards if they are available and capable of being applied to reduce the threats to an acceptable level, such as (para 601.5 A1):</p> <ul style="list-style-type: none"> • using professionals not on the audit team to prepare the financial statements; or • having an appropriate reviewer who was not involved in preparing the financial statements review the audit work or service performed. |
| Decline or end engagement | <p>In situation a) if the auditor cannot apply safeguards to reduce the self-review threat to an acceptable level, they must decline the engagement to prepare the financial statements (para R601.5).</p> <p>In situation b) as the preparation of the financial statements of the fund is not routine and mechanical the auditor must decline the engagement (paras R601.5(a) and 601.4 A1).</p> |

8.5.2 Carrying out the accounting and/or tax role and audit function in the same firm

Scenario 8.5.2(a) – A partner within an accounting firm is responsible for the preparation of an SMSF's financial statements and tax returns. Another partner within the same firm is assessing whether to accept the audit engagement for the SMSF for the year ended 30 June 2020. The SMSF's investments consist of blue-chip shares, deposits and bank accounts.

| Identifying Threats | |
|--------------------------------|---|
| Self-review | As the auditor is required to audit financial statements prepared by another partner in the same firm, there is a threat that the auditor will not evaluate the results of judgements made by the other partner in preparing the financial statements when forming judgements as part of the audit. |
| Intimidation | Depending on the facts and the nature of the relationship between the partners of the firm there is potential that the auditor will be deterred from acting objectively because of actual or perceived pressures from the other partner of the firm. |
| Evaluating Threats | |
| Acceptable Level | <p>The auditor must exercise their professional judgement and use the reasonable and informed third party test in determining whether the identified threats are at an acceptable level. The auditor should consider qualitative and quantitative factors, such as:</p> <ul style="list-style-type: none"> • The size of the firm and number of partners. Generally, the larger the firm is will increase the ability to segregate the duties for the preparation of the financial statements and tax returns from the audit which may reduce the self-review threat; and • The level of professional judgement involved in the preparation of the financial statements. As the SMSF's investments are relatively straight forward, the level of professional judgement is reduced in the preparation of financial statements meaning it is more likely to be routine and mechanical (paras 601.4 A1 and R601.5). <p>A reasonable and informed third party would likely conclude that the self-review threat (and potentially the intimidation threat) are not at an acceptable level so the auditor must address these threats. This evaluation of the combined effect of multiple threats is also applicable (para 120.7 A1).</p> |
| Addressing Threats | |
| Eliminate circumstances | The auditor may not be able to eliminate the circumstances creating the threats to independence. |
| Apply safeguards | <p>Larger firms may find it easier to apply appropriate safeguards to reduce threats to an acceptable level in carrying out an SMSF audit in addition to the preparation of the financial statements and tax returns.</p> <p>Often referred to as 'Chinese walls', it is possible for a larger firm to carry out both the accounting, tax and audit work for an SMSF client. Where appropriate segregation of the actual roles and responsibility for the preparation of the financial statements and tax returns and the audit exists, auditor independence may not be impaired. However, it is often what constitutes segregation of duties that causes much uncertainty and where SMSF auditors may struggle to ensure they meet their professional obligations.</p> <p>Where a firm has separate business divisions carrying out the different roles with distinctly different reporting lines to partners within those divisions, it could be possible for this arrangement to establish an appropriate safeguard to reduce threats to an acceptable level. Typically, this would involve a business services division (or SMSF administration services division) and a separate audit division. Staff within each division would carry out the work reporting to the partner of each of those divisions. A factor that may be relevant and could potentially increase the level of segregation is if the different divisions are in separate offices and/or different cities.</p> |

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| | <p>Smaller firms with two or three partners would find it difficult to put appropriate safeguards in place as there may not be distinct business divisions and sufficient segregation of duties.</p> <p>An alternative safeguard would involve the SMSF client taking explicit responsibility for the financial statements and any adjustments that the firm makes. However, in an SMSF context it is unlikely this could be applied in practice, unless the firm can demonstrate their assessment that the SMSF trustees had sufficient knowledge of the financial statements and any changes, to truly be in a position to take responsibility for them; and that in fact the trustees did take responsibility for them.</p> |
| Decline or end engagement | <p>This scenario is common for professional accountants in public practice and for many firms where safeguards cannot be put in place to reduce threats to independence to an acceptable level and, therefore, the only feasible decision is to decline the audit engagement and outsource the audit function. In particular, smaller firms with two or three partners would in most situations be unable to apply appropriate safeguards and would have to decline the audit engagement.</p> <p>As detailed above, a sole practitioner cannot act as the auditor of an SMSF client where they have taken responsibility for the preparation of the financial statements as no safeguards are available or capable of being applied to reduce the self-review threat to an acceptable level.</p> |
| Change in circumstances | <p>During the 2021 financial year, the SMSF divests a large proportion of its blue-chip shares and term deposits and invests the money in a racehorse, some artwork and an investment property partly financed by a limited recourse borrowing arrangement.</p> <p>As the investment mix in the fund has changed dramatically and become far more complex, the level of professional judgement required to prepare the financial statements and tax returns has increased significantly. As such, these services are no longer likely to be routine and mechanical and if so, the auditor must decline the engagement (paras 601.4 A1 and R601.5(a)). This is the case irrespective of whether the audit function could be appropriately segregated from the preparation of the financial statements and tax returns as the service does not satisfy the first limb of para R601.5.</p> |

Scenario 8.5.2(b) – A staff member within a sole practitioner accounting firm prepares the financial statements and tax returns for a simple SMSF and the service is determined to be routine and mechanical in nature. The sole practitioner principal of the firm is assessing whether to accept the audit engagement for the SMSF.

| Identifying Threats | |
|----------------------------|--|
| Self-review | As the auditor is required to audit the financial statements prepared by one of their staff members there is a threat the auditor will not evaluate the results of judgements made by that staff member in preparing the financial statements when forming judgements as part of the audit. |
| Evaluating Threats | |
| Acceptable Level | A reasonable and informed third party would conclude that the auditor would not comply with the fundamental principle of objectivity and the self-review threat is not at an acceptable level. Even though the service provided by the staff member to prepare the financial statements is determined to be routine and mechanical any |

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| | threats to independence that are not at an acceptable level must be addressed (para R601.5). |
| Addressing Threats | |
| Eliminate circumstances | The auditor cannot eliminate the circumstances creating the threat to independence. |
| Apply safeguards | Sole practitioners would not be able to put appropriate safeguards in place to reduce the threat to an acceptable level, as all of their staff are essentially reporting to them and there is no opportunity within the practice to segregate ultimate responsibility for the audit engagement from the non-assurance services. It is not relevant that different staff are carrying out each separate function or that a staff member prepares the financial statements that are then audited by the partner. It does not matter if the partner had no role in the preparation of the financial statements. The issue is that the reporting mechanisms within the firm are such that all staff ultimately report to the sole practitioner (auditor). Similarly, it would not suffice for the sole practitioner to prepare the financial statements which were then audited by a staff member. |
| Decline or end engagement | As the auditor cannot eliminate the circumstances creating the threat and no safeguards are available or capable of being applied to reduce the threat to an acceptable level the auditor must decline the audits and outsource the audit function for their SMSF clients. |

Scenario 8.5.2(c) – An accounting firm acts as tax agent for an SMSF. They assist the SMSF client in preparing the SMSF annual return (tax return) and tax calculations for which the client takes responsibility. The auditor (another partner in the firm) is assessing whether to accept the audit engagement for the SMSF.

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| Identifying Threats | |
| Self-review | Preparation of the SMSF annual return where the client takes responsibility will not generally create a self-review threat. However, other tax services including tax calculations could create a self-review threat that the auditor will not evaluate the results of judgements made by the other partner undertaking tax services which impacts the financial statements when forming judgements as part of the audit. |
| Evaluating Threats | |
| Acceptable Level | <p>Paras 604.4 A1 to 604.4 A3 addresses the issues of tax return preparation. Where the client takes responsibility for the SMSF annual return (tax return), including any significant judgements made, it is generally not considered to create a threat to independence (para 604.4 A1).</p> <p>Auditors need to be careful, however, when other tax services including tax calculations are provided to the client as they may pose a threat to auditor independence (paras 604.3 A1 to 604.3 A2). Factors that are relevant in evaluating whether the threats created by providing any tax service to an audit client are at an acceptable level include (para 604.3 A2):</p> <ul style="list-style-type: none"> • The particular characteristics of the engagement. • The level of tax expertise of the SMSF trustees. • The role of the ATO and the firm. |

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| | <ul style="list-style-type: none"> The complexity of the tax regime and degree of judgement in applying it. <p>Preparing tax calculations of current and deferred tax liabilities (or assets) for the audit client for the purpose of preparing accounting entries which will be subsequently audited creates a self-review threat (para 604.5 A1).</p> |
| Addressing Threats | |
| Eliminate circumstances | The auditor may not be able to eliminate the circumstances creating the threats to independence. |
| Apply safeguards | <p>Auditors will need to consider a range of factors in determining whether appropriate safeguards can be put in place to reduce threats to independence to an acceptable level, including the complexity of any tax advice given and the level of tax expertise of the client's employees who are receiving the advice. Examples of safeguards to address a self-review threat might include (para 604.5 A3):</p> <ul style="list-style-type: none"> Using a professional not on the audit team to perform the tax service. Having an appropriate reviewer not involved in the tax service review the audit or tax work. |
| Decline or end engagement | If the auditor cannot eliminate the circumstances creating the threats and safeguards are not available or capable of being applied to reduce the threat to an acceptable level, they must decline the engagement. |

8.5.3 Carrying out an SMSF audit where the auditor was previously a consultant, partner or employee of a firm

Scenario 8.5.3 – An auditor has been approached to conduct the 2020 audits for clients of a firm providing accounting and tax services to SMSF clients. The auditor was previously a consultant, partner or employee of that firm and finished working for the firm 12 months ago.

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| Identifying Threats | |
| Self-review | Threats may exist that the auditor may not appropriately evaluate the results of their previous judgements made by, or advice provided to, clients of the firm that they provided when they were a consultant, partner or employee of the firm. |
| Familiarity | Due to the previous relationship, there is a threat that the auditor may be too accepting of the work of the firm they previously worked at, particularly where minimal time has passed since the auditor worked for the firm. |
| Evaluating Threats | |
| Acceptable Level | <p>After a staff member leaves a firm or a partner retires, they are sometimes asked to undertake the audit role for that firm's SMSF clients. Some firms may regard this as outsourcing the audit work for their SMSF clients to a third party and therefore relieving themselves of any threats to independence for those clients.</p> <p>However, prior to accepting the audit engagement, the auditor who was previously a consultant, partner or employee of the firm will still need to assess their independence in relation to the SMSF clients and the firm, even though they are not associated with the firm as a consultant, partner or employee at the time they undertake the audit.</p> <p>It is important to understand that outsourcing SMSF audit activity does not guarantee independence. An auditor must assess their independence on each and every audit engagement, giving consideration to a range of factors aside from the client relationships at the time the audit is being undertaken.</p> |

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| | Where minimal time has passed since the auditor was at the firm, a reasonable and informed third party would likely assess that threats to independence would not be at an acceptable level. As such, the auditor must address those threats. |
| Addressing Threats | |
| Eliminate circumstances | If the auditor now works at another firm where there are other partners who can undertake SMSF audits, threats could be eliminated if one of those other partners undertook the audits. |
| Apply safeguards | If available and capable of being applied, an example of an appropriate safeguard might be to have an appropriate reviewer (not from the firm who provides the accounting and tax services to the SMSF clients) who was not involved in the audit to review the audit work. |
| Decline or end engagement | If the auditor cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the auditor must decline the audit engagements. |
| Change in circumstances | <p>The auditor declined to undertake the 2020 audits, however, they are approached the following year to conduct the 2021 audits for clients of the same firm that the auditor was previously a consultant, partner or employee. It is now over 2 years since the auditor worked for that firm.</p> <p>If the time period from when an auditor was a consultant, partner or employee of a firm exceeds 2 years, it will generally not be considered to create threats to independence. However, this is dependent on the particular facts and circumstances of the situation and the auditor must exercise professional judgement and apply the reasonable and informed third party test to determine if any threats to independence exist.</p> |

8.5.4 Relationships between auditors and referral sources

Referrals of SMSF audit clients will often come from accountants rather than appointments arising from individual trustees. These types of referral arrangements must be considered in light of independence requirements. This is despite the fact that the subsequent appointment or engagement is with the SMSF trustee.

Scenario 8.5.4(a) – An auditor is asked by an administration firm to accept the audit work of multiple SMSF clients. The fees generated from this work would effectively double the fee base of the auditor.

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| Identifying Threats | |
| Self-interest | There is a threat that the auditor's financial interest in doubling their fee base from this referral source will inappropriately influence their judgement or behaviour. For example, the auditor may be reluctant to issue an adverse finding for fear of losing this referral source. |
| Intimidation | There is a threat that the auditor will be deterred from acting objectively because of actual or perceived pressures from the referral source. For example, the administration firm may exercise undue influence on the auditor not to issue an adverse finding. |
| Evaluating Threats | |
| Acceptable Level | Where a large proportion of an SMSF auditor's fees comes from one referral source, the auditor must evaluate the significance of that and apply safeguards to eliminate |

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| | <p>the threat or reduce it to an acceptable level (para AUST R410.3.1). There is potential dependence on that referral source and concerns related to retaining the audit clients.</p> <p>Although the audit engagement is an arrangement between the auditor and the SMSF trustees, the reality is that a number of clients have been referred from one source. Consequently, the auditor will need to consider the possible impact of reliance on one referral source on auditor independence. Remember, an auditor must be independent in both fact and appearance and dependence on a referral source can create a perception of impaired auditor independence.</p> <p>Factors that are relevant in evaluating the level of threats to independence include (paras 410.3 A2 and AUST 410.3.1 A1):</p> <ul style="list-style-type: none"> • The operating structure of the firm • Whether the firm is well established or new • The significance of the referral source qualitatively and/or quantitatively to the auditor. <p>In this example, this referral arrangement will double the fee base of the auditor (quantitative factor). A reasonable and informed third party would likely conclude that the auditor is dependent on this referral source and that threats to independence are not at an acceptable level.</p> <p>In other circumstances, the referral source could be significant to the auditor for qualitative reasons and create threats to independence even if that referral source only represents a small percentage of their fee base. For example, the auditor may have just commenced a new practice and obtains audit work for some SMSF clients of a prestigious accounting firm which may assist the auditor in obtaining additional referral sources.</p> |
| Addressing Threats | |
| Eliminate circumstances | The auditor may not be able to eliminate the circumstances creating the threats to independence. |
| Apply safeguards | <p>Paras 410.3 A1 to AUST 410.3.1 A1 specifically address fees and appropriate safeguards that could be put in place where a large proportion of fees comes from one referral source include (para 410.3 A6 and AUST 410.3.1 A1):</p> <ul style="list-style-type: none"> • Increase the auditor’s client base to reduce dependence on the referral source. • Having an appropriate reviewer who did not take part in the audits to review the audits. <p>Other appropriate safeguards might include external quality control reviews or external consultation on key audit judgements.</p> |
| Decline or end engagement | If the auditor cannot eliminate the circumstances creating the threats and there are no safeguards available or capable of being applied to reduce the threats to an acceptable level, the auditor must decline the audit engagements. |
| Change in circumstances | <p>Threats to independence may be further exacerbated if the:</p> <ul style="list-style-type: none"> • Referral source is a former employer of the auditor (refer example 8.5.3) which could create a self-review threat in auditing an SMSF to which they may have provided services at a previous employer or a familiarity threat due to this prior relationship. • Auditor also receives referrals for non-audit work from the same source such as compilation or tax engagements which may impact dependence. |

Scenario 8.5.4(b) – An auditor is asked by an accounting firm to accept the audit work of their SMSF clients. The principal in the accounting firm is the auditor’s son.

| Identifying Threats | |
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| Self-interest | If the auditor is dependent on the fees from this referral source (refer example 8.5.4(a)), there may be a threat it will inappropriately influence their judgement or behaviour |
| Familiarity | Due to the close family relationship there is a threat that the auditor will too sympathetic to their son’s interests or too accepting of their work. |
| Intimidation | Due to the close family relationship, there is a threat that the auditor will be deterred from acting objectively due to actual or perceived pressures. For example, the son may exercise undue influence on the auditor not to issue an adverse finding. |
| Evaluating Threats | |
| Acceptable Level | <p>Although each audit engagement is with an individual SMSF audit client there is likely to be a perception that the auditor is not independent in carrying out the audits. Similar factors as in example 8.5.4(a) need to be considered by the auditor in respect of any dependence on the referral source from the son’s accounting firm.</p> <p>In addition, although the auditor’s son (defined as a close family member in the Code) is not strictly the ‘client’ they may be in a position to exert significant influence over the SMSF clients’ financial statements that are being audited which can create self-interest, familiarity or intimidation threats (para 521.6 A1). Factors that are relevant in evaluating the level of such threats include (para 521.6 A2):</p> <ul style="list-style-type: none"> • the nature of the relationship between the auditor and his son. • the position held by the son, who in this example is the principal of the accounting firm. • the role of the auditor, such as whether they are a sole practitioner or in a firm with other SMSF auditors. <p>Consider, for example, where the auditor is contemplating an adverse finding on a SMSF client that ultimately will reflect badly on the auditor’s son. Where it was a blatant breach by the client the auditor may not be reluctant to qualify an audit report. However, if the breach occurred due to an error on the part of the auditor’s son, some reluctance may exist. As such, the perception of independence would be questioned.</p> |
| Addressing Threats | |
| Eliminate circumstances | <p>If the auditor is a sole practitioner they cannot eliminate the circumstances creating the threats to independence.</p> <p>If the auditor works in a firm where there are other partners who can undertake SMSF audits, threats could be eliminated if one of those other partners undertook the audits and the father is not a part of the audit team (para 521.6 A3). However, this situation would still be subject to consideration about whether any threats existed due to dependence on the referral source (refer example 8.5.4(a)).</p> |
| Apply safeguards | An appropriate safeguard might be to have an appropriate reviewer who was not involved in the audits to review the audit work. |

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| | In this example, it is unlikely that the example safeguard in para 521.6 A4 could be applied as the auditor's son is the principal of the accounting firm. |
| Decline or end engagement | If the auditor cannot eliminate the circumstances creating the threats and there are no safeguards available or capable of being applied to reduce threats to an acceptable level, the auditor must decline the audit engagements. |
| Change in circumstances | <p>The auditor is a sole practitioner and should decline to accept the audit work of their son's SMSF clients as they could not eliminate the circumstances creating the threats and no safeguards were available to reduce the threats to an acceptable level.</p> <p>Subsequently, the auditor's nephew who operates another accounting firm asks the auditor to accept the audit work of his firm's SMSF clients.</p> <p>This situation will also likely create self-interest, familiarity and intimidation threats and the same factors as above are relevant in evaluating the level of such threats. Whilst the auditor's firm's policies and procedures may be relevant (para R521.7), depending on the nature of the relationship between the auditor and their nephew, the auditor may not be able to eliminate the threats (para 521.7 A2) and safeguards may not be available or capable of being applied to reduce threats to independence to an acceptable level (para 521.7 A3), so the auditor may need to decline the engagements.</p> |

Reciprocal Auditing Arrangements

Reciprocal auditing arrangements can occur where two SMSF auditors audit each other's personal SMSF or where two professional accountants that are also SMSF auditors each have SMSF clients and prepare the financial statements for their respective clients then enter into an arrangement to audit each other's SMSF clients' financial statements.

Scenario 8.5.4(c) – Members A and B each have their own personal SMSF. Member B agrees to audit Member A's SMSF and Member A agrees to audit Member B's SMSF.

| Identifying Threats | |
|--------------------------------|---|
| Self-interest | There is a threat that each auditor's interest in their own SMSF will inappropriately influence their judgement or behaviour. For example, Member A may be less likely to issue adverse findings about Member B's SMSF in fear that Member B may subsequently issue adverse findings on A's SMSF. |
| Familiarity | Due to the close relationship between the auditors there is a threat that each auditor will be sympathetic to the other's interests or too accepting of each other's work. |
| Intimidation | There is a threat that the auditors will be deterred from acting objectively due to actual or perceived pressures. For example, one auditor may exercise undue influence on the other auditor not to issue an adverse finding. |
| Evaluating Threats | |
| Acceptable Level | A reasonable and informed third party would consider the threats to independence in this situation would not be at an acceptable level and would need to be addressed by the auditors. |
| Addressing Threats | |
| Eliminate circumstances | In this situation, the auditors cannot eliminate the circumstances creating the threats to independence. |

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| Apply safeguards | There are no safeguards available or capable of being applied to reduce the threats to independence to an acceptable level. |
| Decline or end engagement | As the circumstances creating the threats cannot be eliminated and no safeguards are available to reduce threats to an acceptable level, each auditor must decline the respective engagements. |

Scenario 8.5.4(d) – Auditor A has 50 SMSF clients and Auditor B has 60 SMSF clients. Auditor A and B enter into a reciprocal arrangement where Auditor A audits Auditor B’s SMSF clients and Auditor B audits Auditor A’s SMSF clients.

| Identifying Threats | |
|--------------------------------|---|
| Self-interest | There is a threat that this referral arrangement will inappropriately influence the auditors’ judgement or behaviour if they are dependent on the fees. For example, it may lead to the auditors being reluctant to issue adverse findings due to the risk of losing all these clients. This could also create a threat as the members may not want to risk losing the auditor of all their SMSF clients. |
| Familiarity | Due to the close relationship between the auditors there is a threat that each auditor will be sympathetic to the other’s interests or too accepting of each other’s work. |
| Intimidation | There is a threat that the auditors will be deterred from acting objectively due to actual or perceived pressures. For example, one auditor may exercise undue influence on the other auditor not to issue adverse findings. |
| Evaluating Threats | |
| Acceptable Level | The same considerations in example 8.5.4(a) above are relevant in evaluating the threats resulting from fee dependency (paras 410.3 A1 to AUST 410.3.1 A1). As each auditor is auditing all of the SMSF clients of the other auditor, this creates a significant reliance from both a qualitative (administrative ease and familiarity) and quantitative perspective (level of and dependency on fees). As such, a reasonable and informed third party would consider the threats to independence in this situation would not be at an acceptable level and would need to be addressed by the auditors. |
| Addressing Threats | |
| Eliminate circumstances | In this situation, the auditors cannot eliminate the circumstances creating the threats to independence. |
| Apply safeguards | Paras 410.3 A1 to AUST 410.3.1 A1 specifically address fees and appropriate safeguards that could be put in place where a large proportion of fees comes from one referral source. An appropriate safeguard would be to spread out the referral of clients to a number of different SMSF auditors which would minimise the dependence on one source and to reduce threats to an acceptable level. Another appropriate safeguard could be to have an appropriate reviewer who did not take part in the audits to review the audit work (para 410.3 A6). Other appropriate safeguards might include external quality control reviews or external consultation on key audit judgements. |

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| Decline or end engagement | If the circumstances creating the threats cannot be eliminated, and if appropriate safeguards are not available or capable of being applied, each auditor must decline the engagements and end the reciprocal arrangement. |
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Referral Sources in Regional Areas

Scenario 8.5.4(e) – An SMSF auditor in a country town in Victoria receives referrals from two local professional accountants who believe it is too hard to access other auditors. The accountants and their SMSF clients also prefer to use auditors they know.

| Identifying Threats | |
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| Self-interest | There is a threat that these referral arrangements will inappropriately influence the auditor's judgement or behaviour if they become dependent on the fees from these sources. For example, the auditors may be reluctant to issue adverse findings in audits due to the risk of losing all the SMSF clients from a particular source. |
| Familiarity | Due to the close relationship between the auditor and the accountants and the auditor and the SMSF clients there is a threat the auditor will be sympathetic to the accountants' and the SMSF clients' interests or too accepting of the accountants' work. |
| Intimidation | There is a threat that the auditors will be deterred from acting independently due to actual or perceived pressures. For example, one of the accountants may exercise undue influence on the auditor not to issue adverse findings in relation to their client(s). |
| Evaluating Threats | |
| Acceptable Level | The same considerations in example 8.5.4(a) above are relevant in evaluating the threats resulting from fee dependency (paras 410.3 A1 to AUST 410.3.1 A1). As the auditor is receiving referrals of SMSF clients from two local accountants, either or both of these referral arrangements may represent a large proportion of the auditor's total fees and create a dependency from both a qualitative (administrative ease and familiarity) and quantitative perspective (level of and dependency on fees). As such, a reasonable and informed third party may consider the threats to independence are not at an acceptable level and need to be addressed by the auditor. |
| Addressing Threats | |
| Eliminate circumstances | The auditor may not be able to eliminate the circumstances creating the threats to independence. |
| Apply safeguards | Paras 410.3 A1 to AUST 410.3.1 A1 specifically address fees and appropriate safeguards that could be put in place where a large proportion of fees comes from one referral source. An appropriate safeguard would be for the auditor to increase their client base and referral sources to reduce dependence on the two local accountants and their SMSF clients (paras AUST 410.3.1 A1 and 410.3 A6). The auditor could broaden their referral base from other surrounding country towns or even further afield. This could be coupled with reducing the referral of clients from the two local accountants and rotating the SMSF clients that they audit from these sources periodically. These safeguards would minimise the reliance on these referral sources and may reduce threats to an acceptable level. |

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| | <p>Living in a close community may actually increase threats to independence due to close relationships and familiarity highlighting the importance for auditors in such situations to adhere to independence requirements.</p> <p>Another possible safeguard could be to have an appropriate reviewer who did not take part in the audits to review the audit work (para 410.3 A6).</p> |
| Decline or end engagement | If the auditor cannot eliminate circumstances creating the threats and safeguards are not available or capable of being applied to reduce the threats to an acceptable level, the auditor must decline the engagements from the two accountants. |

8.5.5 Firms offering financial planning services

Scenario 8.5.5 – A partner within a firm that offers financial planning services is assessing whether to accept the audit engagement for an SMSF to whom financial planning services are supplied by another partner in that firm.

Identifying Threats

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| Self-interest | There is a threat that as the firm's fees may be directly linked to the financial planning advice provided it will inappropriately influence the auditor's judgement or behaviour. |
| Self-review | There is a threat that the auditor will not appropriately evaluate the results of the judgements or activities, such as financial planning advice provided, by the other partner when the auditor is forming judgements in the audit. |

Evaluating Threats

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| Acceptable Level | <p>Financial planning services can offer a particular independence challenge for firms where they wish to offer SMSF audit services to the same client.</p> <p>The auditor must exercise their professional judgement and use the reasonable and informed third party test in determining whether the identified threats are at an acceptable level. The auditor should consider qualitative and quantitative factors, which include (para 600.5 A1):</p> <ul style="list-style-type: none"> • the nature, scope and purpose of the service; and • whether the service will affect matters reflected in the financial statements. <p>The remuneration structure the firm uses for the financial planning advice may increase the self-interest threat and place an auditor at particular risk of a breach in independence principles, however, it is not the only factor that needs to be considered.</p> <p>Depending on the nature of the financial planning services provided, there is likely to be a significant amount of professional judgement in the provision of those services. As the level of professional judgement increases, so does the self-review threat.</p> <p>If an auditor is assessing the compliance or validity of a particular financial product or investment arrangement that has been recommended or implemented by the firm, it may be perceived that the auditor would not be independent in undertaking their role. For example, if a limited recourse borrowing arrangement has been recommended and set up for an SMSF client by the firm, the auditor may not be independent in making an assessment of whether the arrangement is compliant or has been correctly set up. Despite the fact that they may be extremely knowledgeable about such arrangements, a reasonable and informed third party may not perceive them as being independent in making that assessment.</p> |
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| Addressing Threats | |
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| Eliminate circumstances | The auditor may not be able to eliminate the circumstances creating the threats to independence. |
| Apply safeguards | <p>There is no exhaustive list of the types of scenarios in which financial planning services pose a particular problem for an auditor in applying appropriate safeguards.</p> <p>Where a firm is receiving remuneration as commissions or asset-based remuneration, appropriate safeguards are unlikely to be available or capable of being applied to reduce threats to independence to an acceptable level. This is largely because the firm's income is directly linked to the financial planning advice given.</p> <p>A genuine fee for service model may reduce the level of threats to independence. However, an auditor would still need to approach independence in a similar manner as when the firm offers tax or accounting services (discussed above) and similar assessments will still need to be made. Particular attention needs to be paid to the types of financial planning services provided, including the level of professional judgement required and where product recommendations are made.</p> <p>In most cases it will be very difficult for an auditor to put appropriate safeguards in place and in those cases the firm would need to outsource the audit function. Even if the firm ceases to offer financial planning services, an auditor would still be facing the same risks, as effectively they would still be auditing the firm's work in subsequent years while product recommendations and investment decisions remain in place.</p> <p>It is the absence of independence (or perception of independence) that would require the auditor to decline the audit engagement in this circumstance.</p> |
| Decline or end engagement | In most cases, the circumstances creating the threats cannot be eliminated and appropriate safeguards are not available or capable of being applied to reduce threats to an acceptable level so the auditor must decline the engagement. |

8.5.6 Auditors 'contracting out' accounting work

Scenario 8.5.6(a) – The auditor uses a contractor that is a professional accountant and tax agent to prepare the SMSF clients' financial statements and tax returns then they audit these funds.

| Identifying Threats | |
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| Self-review | The auditor is required to audit financial statements based on the financial statements and tax return prepared by a contractor. Depending on the nature of the relationship, there may be a threat that the auditor will not evaluate the results of judgements made by the contractor when forming judgements in the audit. |
| Familiarity | Where there is a close relationship between the auditor and the contractor, there is a threat the auditor will be sympathetic to the contractor's interests or too accepting of their work. |
| Evaluating Threats | |
| Acceptable Level | Although the auditor may consider the contractor to be a third party which would not create threats to independence, depending on the nature of the relationship such threats may exist. For example, if the contractor reports directly to the auditor, the |

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| | <p>relationship is akin to that of employer and employee and a reasonable and informed third party would not consider the threats to independence to be at an acceptable level.</p> <p>In addition, if this one contractor prepares the financial statements and tax returns for all the SMSF clients that the auditor undertakes the audit for, then the matters discussed in 8.5.4(a) are relevant and may result in threats to independence not being at an acceptable level.</p> |
| Addressing Threats | |
| Eliminate circumstances | If the contractor reports directly to the auditor, the auditor cannot eliminate the circumstances creating the threats to independence. |
| Apply safeguards | <p>If the substance of the relationship is that of employer/employee there are no safeguards available or capable of being applied to reduce the threats to independence to an acceptable level. The factors and assessment in example 8.5.2(b) above are relevant to this situation.</p> <p>Even if the third-party arrangement creates a bona fide separation of duties there may still be a dependency on the fees creating threats to independence that are not at an acceptable level. The auditor would need to assess whether any safeguards could be applied as per example 8.5.4(a) above, such as, to have an appropriate reviewer who did not take part in the audits to review the audit work (para 410.3 A6).</p> |
| Decline or end engagement | If the auditor cannot eliminate the circumstances creating the threats and safeguards are not available or capable of being applied to reduce threats to an acceptable level, the auditor must decline the engagements. |
| Change in circumstances | <p>Instead of using an external contractor, an employee of the auditor sets up a separate company of which they are the sole director and they prepare the financial statements and tax returns for the SMSF clients and engage the auditor to undertake the audits.</p> <p>Although the parties involved have tried to alter the form of the engagement to eliminate threats to independence, the substance of the relationship remains as employer/employee. No safeguards are available or capable of being applied to reduce the threats to independence to an acceptable level and the auditor must not enter into this arrangement.</p> |

8.5.7 Long Association with SMSF clients

Scenario 8.5.7 – The auditor has a small client base in regional NSW and has been auditing XYZ SMSF for in excess of 10 years and no internal or external independence review has been undertaken.

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| Identifying Threats | |
| Self-interest | A threat may be created where the auditor is concerned about losing XYZ SMSF as a client or a relationship with the trustees which might inappropriately influence the auditor's judgement (para 540.3 A2). |
| Familiarity | Due to the long relationship with XYZ SMSF, its trustees and the financial statements that are being audited, there is a threat that the auditor will be too sympathetic to their interests (para 540.3 A1). |

| Evaluating Threats | |
|----------------------------------|---|
| Acceptable Level | <p>Factors that are relevant in evaluating the level of threats to independence include the (para 540.3 A3):</p> <ul style="list-style-type: none"> • Length of the relationship. • Auditor's ability to influence the audit. • Closeness of the relationship between the auditor and the trustees. • Nature and complexity of XYZ SMSF's accounting and financial reporting issues and whether they have changed. <p>As the auditor has been auditing XYZ SMSF's financial statements for in excess of 10 years, a reasonable and informed third party would likely consider threats to independence are not at an acceptable level and would need to be addressed by the auditor.</p> |
| Addressing Threats | |
| Eliminate circumstances | <p>An example of an action that might eliminate the self-interest and familiarity threats would be to rotate the auditor off the engagement (para 540.3 A5), however, this would depend on the size of the firm and if other SMSF auditors were available to undertake the engagement.</p> <p>If a firm decides that threats can only be addressed by rotating the individual off the audit team, the firm shall determine an appropriate period during which the individual must not be a member of the engagement team, provide quality control for the audit or exert direct influence over the outcome of the audit (para R540.4).</p> |
| Apply safeguards | <p>Appropriate safeguards to address self-interest and familiarity threats include (para 540.3 A6):</p> <ul style="list-style-type: none"> • having an appropriate reviewer not involved in the audit to review the auditor's work. • performing regular independent internal and external quality reviews of the engagement. <p>As a minimum, it is considered to be best practice after auditing a fund for 10 years that an internal or external independent review of the audit be undertaken.</p> |
| Decline or end engagement | <p>If the auditor cannot eliminate the circumstances creating the threats and appropriate safeguards are not available or capable of being applied to reduce the threats to an acceptable level, the auditor must end the audit engagement with XYZ SMSF.</p> |

9. Independence communications

9.1 Overview

The Code and the Act contain specific requirements for auditors to communicate regarding independence, both within the firm and with those charged with governance at clients or prospective clients. As has been illustrated in Chapter 7 circumstances often change so it is important when applying the conceptual framework for the auditor and those charged with governance to be agile to changing circumstances. Even when it is not required, regular two-way communication on independence matters between the auditor and those charged with governance of an audit client is encouraged and would represent best practice.

Please note that none of the guidance or templates below have taken into consideration the requirements of other jurisdictions, for example the USA.

9.2 Auditor's independence declarations

9.2.1 – Auditor independence declarations – Entities audited in accordance with the Act

In the case of entities audited in accordance with the Act, the auditor shall communicate with those charged with governance through a statement that the engagement team and others in the firm as appropriate, the firm and when applicable network firms, have complied with the independence requirements of S 307C of the Act.

ASA 260 *Communication with Those Charged with Governance (compiled)* further mandates the specific requirement for the auditor of listed entities to communicate:

- A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence. This should cover all relationships and other matters between the firm, network firms and the entity that, in the auditor's professional judgement, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial report for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor.
- The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

The entities for which an independence declaration under S 307C is required for an audited or reviewed financial reports are shown in the table below:

| Type of entity | Independence declaration (S 307C) |
|---|-----------------------------------|
| Disclosing entity where the financial report is required under Chapter 2M | Yes |
| Public company where the financial report is required under Chapter 2M | Yes |
| Registered scheme where the financial report is required under Chapter 2M | Yes |
| Large proprietary company where the financial report is required under Chapter 2M | Yes |
| Small proprietary company where the financial report is required under Chapter 2M pursuant to a direction by shareholders or from ASIC | Yes |

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| Small proprietary company under foreign company control that prepares a financial report under s. 292(2)(b) | Yes |
| Financial services licensee where the financial report is required under Chapter 7 | No, unless the financial report is also required under Chapter 2M |

Template 1 below could be used or amended to demonstrate compliance with these requirements.

Template 1 – Auditor’s independence declaration (S.307 of the Act)

AUDITOR’S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001 TO THE DIRECTORS (OR THOSE CHARGED WITH GOVERNANCE) OF [name of client]

As lead engagement [partner/auditor], I declare that, to the best of my knowledge and belief, during the year ended [Day/Month/Year] there have been:

- no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the [audit/review]; and
- no contraventions of any applicable code of professional conduct in relation to the [audit/review].

OR where necessary

As lead [engagement partner/auditor] for the [audit/review] engagement, I declare that, to the best of my knowledge and belief, the only contraventions of the independence requirements of the *Corporations Act 2001* in relation to the [audit/review], and any applicable code of professional conduct in relation to the [audit/review], are set out below:

[provide details of contraventions]

[Name of Firm]

[Name of Auditor]

[Auditors designation (Partner etc.)]

Location:

Date: [.../.../...]

9.2.2 – Auditor independence declarations – Entities audited under the ACNC Act 2012

In the case where entities are audited under the ACNC Act 2012, section 60.40 requires an Auditor's or Reviewer's independence declaration. The ACNC Act 2012 makes specific reference to applicable codes of professional conduct of which the Code is considered to be the main reference point.

Template 2 could be used or amended to demonstrate compliance with these requirements.

Template 2 – Auditor's independence declaration – ACNC Act 2012

AUDITOR'S INDEPENDENCE DECLARATION TO THE DIRECTORS (OR THOSE CHARGED WITH GOVERNANCE) OF (COMPANY NAME)

I declare that, to the best of my knowledge and belief, during the year ended [.../.../...] there have been:

- (i) No contraventions of the auditor independence requirements as set out in the *Australian Charities and Not-for-profits Commission Act 2012*, in relation to the audit, and
- (ii) No contraventions of any applicable code of professional conduct in relation to the audit.

[Name of Firm]

[Name of Auditor]

[Auditors designation (Partner etc.)]

Location, :

Date: [.../.../...]

9.2.3 - Auditor independence statements – SMSFs

As noted in Chapter 8.1, the SIS Act and SIS Regulations require that an auditor be independent in line with the requirements of the Code. Neither the SIS Act or SIS Regulations require the auditor to make a specific declaration but require independence in line with the Code. The ATO issued an approved form *Self-managed superannuation fund independent auditor's report* effective for reporting periods starting on or after 1 July 2016 setting out their requirements for a self-managed superannuation fund independent auditor's report. This form is available on the ATO's website: www.ato.gov.au

In summary, the auditor is required in their opinion to state that they have complied with the independence requirements of the Code as follows:

- (i) In the Basis for Opinion (Financial Report); and
- (ii) Under the Independence and quality control section (Compliance Report).

9.3 Independence confirmations

9.3.1 - Whole of firm level

Both ASQC1 (paragraph AUS 24.1) and APES 320 (paragraph 29), require a firm to obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel that are required to be independent by relevant ethical requirements, and applicable legal and regulatory requirements, at least annually. The firm should also at the induction stage for personnel also seek such a confirmation, that would then be updated on the firm's annual confirmation cycle.

Template 3 – Sample annual/induction whole of firm independence confirmation

[.../.../...]

[Addressed to the firm]

Dear []

Annual/Induction written confirmation

I have read and understood APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* and the firm's policies and procedures relating to ethical requirements. To the best of my knowledge and belief, I confirm that I am compliant with the requirements of the most recent version of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)*, and the firm's policies and procedures relating to ethical requirements, including the independence requirements for audit and assurance clients.

I am aware of my responsibility to promptly (at a maximum 7 days from when I first became aware of an ethical issue) inform the firm of any threat, or suspected threat, that may indicate the requirements of most recent version of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* and the firm's policies and procedures relating to ethical requirements are not being complied with.

I, my immediate or close family members do not have a direct or material indirect financial interest in any of the entities listed on the firm's Restricted Entities Listing.

I confirm that I have consulted with appropriate firm personnel where necessary to support my confirmation

[Name and signature]

9.3.2 – Audit/Assurance engagement level

ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information* paragraph 11 requires that:

Independence

The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

- (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- (b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- (c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is possible under applicable law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

In order for an engagement partner to demonstrate adherence with this requirement, it is best practice for firms to embed a process at the audit engagement level for all members of the audit engagement team. Please note the Code's definition of an audit team includes those who provide consultations regarding technical, transactions or events for the audit engagement, so this could include people in Tax, Corporate Finance the firm's internal technical experts and external technical experts.

It is worth noting that audit software providers (for example CaseWare) have engagement level independence confirmations within their standard templates. For those firms who don't use such software the following template may be of assistance.

Likewise, inter-firm declarations can be used where other firms perform the audit of subsidiaries that will form part of the audit of a group. Auditing Standard ASA 600 *Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)* provides further guidance.

Template 4 – Sample audit engagement level confirmation

[.../.../...]

[Addressed to the firm]

Dear []

Independence confirmation: [Audit/Review/Assurance as appropriate] Engagement of [Name of client] and its [controlled/related entities] for the period ended [insert period end date]

I acknowledge that I will be part of the [audit/review/assurance as appropriate] team for the above-mentioned engagement.

I am familiar with the requirements of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* and the firm's policies and procedures relating to independence for [audit/review/assurance] clients. To the best of my knowledge and belief, I confirm that I am not aware of any circumstance or relationship that could impair or be seen to impair my independence with regard to this engagement.

In particular:

- Neither I, nor any of my immediate or close family members, owe any amount to the client other than amounts that arose in the ordinary course of business and in accordance with normal terms and conditions;
- Neither I, nor any of my immediate or close family members, have any direct or material indirect financial interests or relationships with the client;
- [add other as required]

I will promptly inform the engagement partner if there is any change to any of the assertions that I have duly made above.

[Name and signature]

9.4 Conflict checking

A firm's system of quality control shall set out how the firm requires its audit engagement teams to establish whether there is a conflict of interest when accepting or re-accepting an audit engagement. To this end, most firms have what is commonly referred to as a conflict checking process and maintain a Restricted Entities Listing (a listing of all the firm's clients that personnel of the firm cannot have a direct financial interest in or a material indirect financial interest) that is accessible to all firm personnel.

Conflict checking in larger firms is usually done through the firm's own proprietary IT systems. For smaller firms an email is usually sent by partners when being asked to tender for a client.

Template 5 – Conflict of Interest email

Subject: Conflict and relationship check [*Insert entity name*]

[*Firm Name insert firm details*] are proposing to provide [*define services*] services to [*Insert entity name*].

[*Insert 1 sentence describing what the entity does*]

Directors of [*Insert entity name*]

- [*insert names*]

Please respond to [*insert Firm's partners name*] by [*insert date you want responses by*] only if:

1. You or your spouse, equivalent or dependents have a financial interest in the entity;
2. Your spouse, equivalent, dependents or close family have an employment relationship with this entity; and/or
3. You provide any professional services to the entity or directors.

Nil response is taken as no conflict has been identified.

Regards

[*Insert Firms partners email signature*]

10. Appendices

Appendix 1 – Applicable independence requirements

| Standard / Legislation / Regulation | Operative date | Issued by | Website |
|---|----------------|-------------------------|--|
| APES 110 <i>Code of Ethics for Professional Accountants (including Independence Standards)</i> – the Code is mandatory for members of the professional bodies, registered company auditors and SMSF auditors | In effect | APESB | www.apesb.org.au |
| APES 320 <i>Quality Control for Firms</i> – requires firms to establish a system of quality control (including relevant ethical requirements) | In effect | APESB | www.apesb.org.au |
| ASCQ 1 <i>Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements (Compiled)</i> – requires firms to establish a system of quality control (including relevant ethical requirements) | In effect | AUASB | www.auasb.gov.au |
| ASA 102 <i>Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements</i> – establishes requirements for compliance with relevant ethical requirements | In effect | AUASB | www.auasb.gov.au |
| ASA 220 <i>Quality Control for an Audit of a Financial Report and Other Historical Financial Information</i> – includes specific responsibilities for ethical requirements and related documentation | In effect | AUASB | www.auasb.gov.au |
| ASA 260 <i>Communication with Those Charged with Governance (Compiled)</i> – includes requirements for communicating on matters of independence | In effect | AUASB | www.auasb.gov.au |
| <i>Framework for Assurance Engagements</i> – describes the elements and objectives of an assurance engagement and identifies engagements to which the AUASB standards apply | In effect | AUASB | www.auasb.gov.au |
| <i>Corporations Act 2001</i> – includes sections relevant to auditor independence for the audit and review of full-year and half-year financial reports The provisions are contained mainly in s. 307C and Divisions 3, 4 and 5 of Part 2M.4. Division 5 contains the requirements for auditor rotation for listed companies | In effect | Commonwealth Government | www.legislation.gov.au |
| Regulatory Guide 187 <i>Auditor Rotation</i> – includes the interpretation of the legislation relating to auditor rotation for listed entities and specifies how ASIC will regulate it | In effect | ASIC | www.asic.gov.au |

| Standard / Legislation / Regulation | Operative date | Issued by | Website |
|---|----------------|-----------|--|
| <p>Prudential Regulatory Standards – these prudential regulatory standards include certain provisions dealing with the independence requirements for auditors which are consistent with the <i>Corporations Act 2001</i>:</p> <ul style="list-style-type: none"> • CPS 510 <i>Governance</i> – applicable to deposit taking, general insurance, life insurance and private health insurance industries, and a Head of a group • SPS 510 <i>Governance</i> – applicable to Registrable Superannuation Entity (RSE) licensees | In effect | APRA | www.apra.gov.au |
| <p><i>Australian Charities and Not-for-profits Commission Act 2012</i> – specific requirements relating to an independence declaration in Section 60-40</p> | In effect | ACNC | www.acnc.gov.au |

Appendix 2 – Applicable independence requirements (by entity classification and type of engagement)

| Applicable independence requirements | | | | |
|--|--|------------------|---|---|
| Type of engagement | Outcome | Part of the Code | Corporations Act 2001 Reference | Other applicable regulations for PIEs |
| Audit engagements of historical financial statements | Financial statements | Part 4A | Divisions 3,4 and 5 of Part 2M.4 and S 307C | <i>ASIC Regulatory Guide 187 Auditor Rotation</i> (for listed entities) CPS 510 or SPS 510 <i>Governance</i> (for APRA regulated entities) |
| | Single financial statements and specific elements, accounts or items of financial statements Summary financial statements | Part 4A | | |
| Review engagements of historical financial information | Financial statements (half-year or full year) | Part 4A | Divisions 3,4 and 5 of Part 2M.4 and S 307C | <i>ASIC Regulatory Guide 187 Auditor Rotation</i> (for listed entities) CPS 510 or SPS 510 <i>Governance</i> (for APRA regulated entities) |
| | Condensed financial statements or internal management reports Specific components, elements, accounts or items of a financial report Historical information derived from financial records | Part 4A | | |
| Other assurance engagements | Reasonable or limited assurance engagement to report on greenhouse gas emissions Performance audit or review to assess the extent to which resources have been economically, effectively or efficiently managed Service auditor's assurance engagement to report on the description and design of controls | Part 4B | | |

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DRAFT