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Sent: Friday, 24 August 2012 1:54 PM
To: Taskforce
Cc: Observers
Subject: SMSF Auditor Independence

Dear All

As discussed at the last taskforce meeting please forward to Liz your comments on the SMSF chapter of the JAB Independence guide.

Thereafter Liz will provide us with a revised SMSF chapter for the taskforce's consideration.

Project pathways

To summarise, the potential approaches to move the project forward are:

1. Development of a standard;
2. Development of a guidance note;
3. Development of SMSF specific paragraphs for the Code; or
4. If the JAB Independence guide addresses the issues raised in the SMSF context then the potential to use that as guidance.

As discussed at the taskforce meeting option 1 and 2 are probably not appropriate in this instance as it has the potential to undermine the existing APES 110. If taskforce members have further queries in this regard please contact me directly and I am happy to explain further. This then leaves us with Option 3, 4 or a combination.

We will probably be in a better position to develop the recommendations to the Board once Liz circulates the next draft of the JAB Independence Guide.

Option 3 can be considered if the specific SMSF issue is not covered by the existing Code.

At the meeting in this context a brief discussion was held on the issues of accounting vs. auditing and referral sources.

I have outlined below the key topics discussed and pointed out where there is existing requirements and guidance in APES 110.

Key topics

The key topics discussed at the taskforce meeting were:

- Audit firm providing accounting or bookkeeping services;
- Audit firm providing other services such as investment advice or tax advice;
- Referral fees;

Accounting or bookkeeping services

As per paragraph 290.167 of the Code, management (in this case the SMSF Trustee) is responsible for the preparation of the accounts. Paragraph 290.168 then states that where a firm provides accounting or bookkeeping services to an audit client it creates a self review threat when the firm has to subsequently audit it. Then the key paragraph to consider is paragraph 290.171 which is attached for your information (Underlining has been added).

This paragraph is in the context that assistance provided by the audit firm is routine and mechanical. All that has occurred is that the Client (SMSF Trustee) has made all the decisions and the audit firm has just lent a “pair of hands” to complete the work. So if the facts of the circumstance indicate that the firm is to only undertake routine and mechanical tasks then the next step is to see whether there are appropriate safeguards that can be implemented.

In this context (where the audit firm is also involved in accounts preparation) the level of involvement of the Client (i.e. SMSF Trustee) in the accounting process is important. If you consider a continuum of different levels of Client involvement, where there is significant involvement and decision making by the Client (i.e. SMSF Trustee) in the accounts preparation then you are more likely to satisfy 290.171 vs. where there is minimal to no involvement or decision making by the Client (SMSF Trustee) in the accounts preparation.

Provision of other Services such as investment advice or tax advice

Paragraph 290.156 of the Code identifies that provision of Non-assurance services (e.g. tax and investment advice) by an audit firm creates threats to the Firm’s independence. The threats most often created are **self-review, self-interest and advocacy threats**. Paragraph 290.158 states that before an audit firm accept an engagement to provide a non-assurance service, a determination must be made whether providing such a service creates threats to a firm’s independence. Where the threat cannot be addressed adequately then the firm must not provide the service.

At the taskforce meeting in this context the general prohibition on performing Valuation Services by the audit firm in respect of material balances on the financial statements was discussed.

Whilst investment advice is not specifically addressed in the Code it will be captured by the general provisions relating to non-assurance services in paragraphs 290.156 – 290.159.

Taxation advice is specifically addressed in the Code in paragraphs 290.181 to 290.194. Paragraph 290.182 recognises that performing certain tax services creates self review and advocacy threats and notes that the significance of the threats will depend on certain factors. In respect of tax return preparation services paragraph 290.183 recognises that providing tax return preparation services does not generally create a threat to independence if management (i.e. SMSF Trustee) takes responsibility for the returns including any significant judgements made.

Paragraphs 290.187 and 188 discuss providing tax planning and other advisory services. In certain instances it recognises that a self-review threat may be created where the tax advice affect matters to be reflected in the financial statements.

Referral fees

The Code addresses refer referral fees in Section 240.5 – 240.7 of the Code. However, in the SMSF context it is not that a referral fee is paid for each audit that is referred. It is whether the auditor’s independence is impacted as the auditor may get a significant number of audits from one source (who may also be preparing the SMSF accounts of the clients referred which is subject to audit).

Paragraphs 290.220-221 discuss circumstances where the audit fee from an audit client represents a large proportion of the total fees of the firm expressing the audit opinion. These paragraphs are probably more suited to address the SMSF situation.

In the SMSF context it is actually a collection of clients who comes from one source. In respect of this issue Robert in his email recommended the development of a provision based on paragraph 290.222 in the existing Code (which is applicable to Public Interest Entities). This provision introduces additional safeguards of pre-issuance or post issuance reviews where an auditor earns 15% of the

auditor's fees from one audit client. If the referral sources issue is prevalent then this issue should be considered further.

A link to the existing Code for you to review the sections noted above is provided here

<http://www.apesb.org.au/attachments/1-APES%20110%20Code%20of%20Ethics%20for%20Professional%20Accountants%20December%202010%20-%20Final.pdf>

Way forward

Taskforce members to provide review comments to Liz on the JAB Independence guide (next week) and also perform an assessment of whether you believe that the Code adequately addresses the key issues discussed at the taskforce meeting.

If based on your review you believe that there are additional provisions or areas to be addressed in the Code then please make a note and inform Rob or myself by 5th September 2012.

We will then include the matters you have identified as an agenda item for the next taskforce meeting.

Subsequent to Liz sending out the next draft we will schedule the next taskforce meeting to review the JAB Independence guide and to discuss any issues you have identified.

Thank you for your valuable contribution to this taskforce.

Have a great weekend.

Kind regards

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Attachment: 290.171 of APES 110.doc

290.171 The Firm may provide services related to the preparation of accounting records and Financial Statements to an Audit Client that is not a Public Interest Entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an Acceptable Level. Examples of such services include:

- *Providing payroll services based on client-originated data;*
- *Recording transactions for which the client has determined or approved the appropriate account classification;*
- *Posting transactions coded by the client to the general ledger;*
- *Posting client-approved entries to the trial balance; and*
- *Preparing Financial Statements based on information in the trial balance.*

In all cases, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an Acceptable Level.

Examples of such safeguards include:

- *Arranging for such services to be performed by an individual who is not a member of the Audit Team; or*
- *If such services are performed by a member of the Audit Team, using a partner or senior staff member with appropriate expertise who is not a member of the Audit Team to review the work performed.*