

# SPECIAL GAAP REPORT

## Accounting service banned (almost) when auditing SMSFs under revised ethics rules

Authored by Colin Parker and edited by Stephen Downes

### At a glance

APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* came into effect on 1 January. In May, the *Independence Guide* was issued by Accounting Professional & Ethical Standards Board Limited, Chartered Accountants Australia and New Zealand, CPA Australia, and the Institute of Public Accountants.

The guide has a specific chapter on self-managed superannuation funds and applies the principles in the code when accounting and bookkeeping services are provided to an audit client.

Revised ethical requirements for the provision of accounting and bookkeeping services that are not public-interest entities (PIES) in substance further restrict the provision of such services.

Previously, such services *were able to* be provided if they were routine or mechanical in nature and threats were reduced to an acceptable level.

Now such services *must not* be provided unless they are routine or of a mechanical nature. Also, any self-review threats – previously ‘any’ threat – must be reduced to an acceptable level.

The routine or mechanical nature consideration remains unchanged, but remember that accounting and bookkeeping services of these sorts require little or no professional judgement. In practice, judgement has often been inappropriately applied. It is difficult to sustain an argument that the preparation of financial statements (given their nature) is merely routine or mechanical.

Importantly, the revised requirement does not ban the provision of accounting and bookkeeping services for non-PIES. However, the revision *does* place a higher onus of proof on the auditor when providing them. It is vital that such assessments be documented.

A network firm has now been included within the requirements of this section.

There has been no change to examples of *routine or mechanical nature*. The examples of safeguards remain unchanged.

A reference has been included to the application of the conceptual framework to identify, evaluate and address threats to compliance with fundamental principles. Experience has shown that the framework has not been applied or has been poorly applied when accounting and bookkeeping services have been provided by an auditor’s firm.

The term *acceptable level* continues to be used but has been refined. It also includes a *reasonable and informed third party* and *reasonable and informed third-party test*.

The recently issued *Independence Guide* carries a certain authority as it was issued by Accounting Professional & Ethical Standards Board Limited, Chartered Accountants Australia and New Zealand, CPA Australia, and the Institute of Public Accountants. Importantly, the ATO has emphasised some key requirements.

The guide, inter alia, contains some strong statements for performing accounting and bookkeeping services of SMSFs when the firm is also the auditor of the funds.

Collectively, the *Code* and *Independence Guide* will require auditors where the firm provides accounting and bookkeeping services for non-PIES to re-evaluate whether it can provide them and undertake the audit of financial statements (general-purpose or special-purpose).

### This paper’s purpose

This paper aims to outline key themes and requirements of the code and other literature on accounting-and-bookkeeping-services requirements generally and specifically as applied to SMSFs.

It does not address the ethical requirements for PIES.

### Subsection 601 – accounting and bookkeeping services (operative from 1 January)

This subsection of the code has a new introduction that provides a description of applying the conceptual framework.

- ‘601.2 Providing accounting and bookkeeping services to an Audit Client might create a self-review threat.
- ‘601.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing an Audit Client with accounting and bookkeeping services. This subsection includes requirements that prohibit Firms and Network Firms from providing certain accounting and bookkeeping services to Audit Clients in some circumstances because the threats created cannot be addressed by applying safeguards.’

Requirements on the provision of accounting and bookkeeping services have been revised:

‘R601.5 A Firm or a Network Firm **shall not** provide to an Audit Client that is not a Public Interest Entity accounting and bookkeeping services including preparing Financial Statements on which the Firm will express an Opinion or financial information which forms the basis of such Financial Statements, **unless**:

- (a) The services are of a routine or mechanical nature; and
- (b) The Firm addresses any threats that are created by providing such services that are not at an Acceptable Level.’

Routine or mechanical nature are described as follows, and there is no change:

*'601.4 A1 Accounting and bookkeeping services that are routine or mechanical in nature require little or no professional judgement.'*

*'Some examples of these services are (abridged):'*

- *Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.*
- *Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.*
- *Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.*
- *Posting transactions coded by the client to the general ledger.*
- *Posting client-approved entries to the trial balance.*
- *Preparing Financial Statements based on information in the client-approved trial balance and preparing related notes based on client-approved records.'*

Examples are provided of safeguards. Again, there is no change:

*'Examples of actions that might be safeguards to address a self-review threat created when providing accounting and bookkeeping services of a routine and mechanical nature to an Audit Client include:*

- *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.'*

However, don't automatically default to either or both of these examples. These and other safeguards must be tailored to individual engagement circumstances and reduce self-review threat to an acceptable level.

If unsure that the safeguards are appropriate and/or self-review has been reduced to an acceptable level firms may wish to seek independent confirmation.

### Preparing accounting records and financial statements – superseded requirements

For comparison, let's look at the superseded rules and guidance.

*'290.168 The Firm **may provide services** (my emphasis added) 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. Services that are routine or mechanical in nature require little to no professional judgement from the Member in Public Practice.'*

*'Some examples of such services are:*

- *Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.*
- *Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.*
- *Recording a transaction for which the client has already determined the amount to be recorded, even though the transaction involves a significant degree of subjectivity.*

- *Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.*
- *Posting client-approved entries to the trial balance.*
- *Preparing Financial Statements based on information in the client-approved trial balance and preparing the related notes on client-approved records.*

*'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.'*

### Acceptable level redefined in the revised code

Acceptable level has been redefined as:

*'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.'*

Reasonable and informed third party, and reasonable and informed third-party test support the revised definition.

*'The reasonable and informed third party 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 that 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. These terms are (sic again) described in paragraph 120.5 A4.'*

Previously, an acceptable level was defined as:

*'[A] level at which a reasonable and informed third party would be likely to conclude, weighing up all the specific facts and circumstances available to the member at the time, that compliance with the fundamental principles is not compromised.'*

### Revised independence guide

#### Intent

The *Independence Guide – Fifth Edition* (May 2020) was issued by Accounting Professional & Ethical Standards Board Limited, Chartered Accountants Australia and New Zealand, CPA Australia, and the Institute of Public Accountants,

Its stated purposes are:

*'Provides guidance on how to apply the conceptual framework in APES 110 Code of Ethics for Professional Accountants (including Independence Standards) to independence for audits, reviews and other assurance engagements as set out in Parts 4A and 4B of the Code.'*

*'Provides practical examples of independence issues encountered by accountants and auditors, including prohibited non-assurance services, interests, relationships and actions.'*

*'Designed for members in public practice addressing independence in the context of assurance engagements.'*

*'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.'*

## Self-managed superannuation funds

Chapter 8 addresses *Self-managed superannuation funds*. The following extracts are provided to assist with understanding requirements.

*'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.'*

*'SMSFs are extremely unlikely to be PIEs for the purposes of the independence requirements of the Code. However, firms must make that determination based on the specific facts and circumstances relevant to that fund.'*

*'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 a SMSF where the auditor, their staff or their firm has prepared the financial statements for the SMSF unless it is a routine or mechanical service (paras R600.7, 600.7 A1, 600.7 A3, R600.8, 601.4 A1, R601.5 and 601.5 A1).'*

*'Services that are "routine or 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". However, even if the service is routine or mechanical a reasonable and informed third party would likely conclude that threats to independence are not at an acceptable level and would need to be addressed.'*

*'In the context of the audit of SMSFs, it would always be necessary as a minimum to apply such safeguards. A sole practitioner cannot act as the auditor of a SMSF client where they have prepared the financial statements as no safeguards are available or capable of being applied to reduce the self-review threat to an acceptable level.'*

*'Where an accountant assumes management responsibility for the preparation of financial statements for a SMSF then the service would not be routine or mechanical and the self-review threat which arises, were that same firm to undertake an audit of those financial statements, would be so great that no safeguard could reduce the threat to an acceptable level.'*

*'Firms or network firms must not assume management responsibility for an audit client (para R600.7), which would include taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework (para 600.7 A3). To avoid assuming management responsibility, the firm must be satisfied the trustees make all judgements and decisions that are the proper responsibility of management (para R600.8). This would include ensuring the trustees have the suitable skill, knowledge and experience to remain responsible at all times for decisions and oversee the service and understand the objectives, nature and results of the services and the responsibilities of the trustees and the firm.'*

*'However, in a SMSF context it is likely to be challenging that 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. If the firm is unable to demonstrate the trustees' ability to take responsibility, the auditor, their staff or their firm would be unable to both prepare the financial statements and audit them.'*

## ATO and the Independence Guide

The ATO webpage *SMSF auditors: new Independence Guide and the Commissioner's focus for 2020–21* (24 June) states important contextual information for how the tax office sees the provision of bookkeeping and accounting services.

Extracts are:

*'The Accounting Professional & Ethical Standards Board (APESB), in collaboration with the three Professional Accounting Bodies, Chartered Accountants Australia and New Zealand (CAANZ), CPA Australia and the Institute of Public Accountants (IPA), recently published a new and updated Independence Guide – Fifth Edition, May 2020 (the Guide).*

*'The Guide incorporates changes to the restructured APES 110 Code of Ethics for Professional Accountants (including Independence Standards) (the restructured Code), which became effective on 1 January 2020 and is mandatory for audits and reviews in Australia.*

*'There are changes to the Guide that **SMSF auditors must familiarise themselves with in Chapter 8** (emphasis added). In particular, as a result of the restructured Code, the Guide now makes it clear that an SMSF auditor cannot audit an SMSF where the auditor, their staff or their firm has prepared the financial statements for the SMSF unless it is a routine or mechanical service (paras R600.7, 600.7 A1, 600.7 A3, R600.8, 601.4 A1, R601.5 and 601.5 A1 of the restructured Code). The firm must also address any threats created by providing such services that are not at an acceptable level (R601.5(b)).*

*'Services that are "routine or mechanical in nature" require little or no professional judgement and examples are listed in para 601.4 A1 of the restructured Code. When monitoring whether the preparation of accounts by the auditor's firm is routine or mechanical under the new standard, **the Commissioner will expect to see appropriate evidence on the auditor's file that the SMSF trustees took responsibility for the financial statements and had sufficient knowledge, skills and experience to do so (R600.8)** (emphasis added). For example, this evidence could consist of trustee coded transactions and approved trustee entries in the trial balance that the auditor's firm then use to prepare pro-forma financial statements. Auditors shouldn't assume that copies of signed financial statements and trustee representation letters amount to audit evidence that meet this requirement.*

*'Even where the preparation of the financial statements is routine or mechanical, the Commissioner and the Australian Securities and Investment Commission (ASIC) as reasonably informed third parties require the auditor to use safeguards to reduce the self-review threat to an acceptable level (Section 4.3 and 8.4 of the Guide). These safeguards could consist of using professionals who are not audit team members to prepare the financial statements or having someone review the audit work who was not involved in preparing the financial statements (para 601.5 A1).*

*'The Guide also includes other practical examples relating to the following scenarios which auditors should look at to ensure they are not breaching the independence standards in the restructured Code:*

- *'the books' are prepared by the auditor*
- *the accounting firm acts as the registered tax agent and/or auditor*
- *auditors who audit an SMSF where the auditor was previously a consultant/partner or employee of the firm*
- *relationships between auditors and referral sources, including: auditing multiple SMSF clients of an administration firm, auditor doing SMSF audits for an accounting firm where the principal is related to the auditor, reciprocal auditing arrangements relating to auditors who audit each other's fund and auditors auditing each other's SMSF clients*

- concentration of referral sources in regional areas
- firms offering financial planning services
- auditors 'contracting out' accounting work for an SMSF client, and
- auditors who have a long association with SMSF clients.

'During the 2020–21 financial year, the Commissioner will write to auditing firms where ATO data indicates that the auditor could also be auditing financial statements prepared by the same firm to assist auditors comply with the requirements under the restructured Code.'

Remember what the ATO said late last year about its audits and reviews:

'We undertake audits and reviews of auditors where we have information indicating there are matters of concern, or where we want to provide assurance that an auditor is complying with their obligations.'

'Our audits and reviews will:

- Review your audit processes and performance to identify issues
- Ensure you are meeting the independence requirements of self-managed super fund (SMSF) auditors
- Test whether you are correctly applying the super laws
- Identify areas where you need support or education.'

## Reminders

To round out the conversation, here are a couple of important reminders.

### Audit compliance with ethical requirements

ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements* includes a requirement for auditors, assurance practitioners, engagement quality-control reviewers, and firms to comply with relevant ethical requirements, including those pertaining to independence, relating to audits, reviews, and other assurance engagements.

Relevant ethical requirements means:

'[Ethical] requirements that apply to the auditor, assurance practitioner, engagement quality control reviewer and firm. In Australia, these include the applicable requirements of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)*, issued by the Accounting Professional & Ethical Standards Board Limited in November 2018, the applicable provisions of the *Corporations Act 2001* and other applicable law or regulation.'

### Independence assessment re provision of a non-assurance service

Before a firm or a network firm accepts an engagement to provide a non-assurance service to an audit client, the firm shall determine whether providing such a service might create a threat to independence (APES110.R660.4).

### Prohibition on assuming management responsibilities

A firm or a network firm shall not assume a management responsibility for an audit client. (APES110.R660.7).

Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgement. Examples of activities that would be considered a management responsibility include:

- Setting policies and strategic direction
- Authorising transactions
- Controlling or managing bank accounts or investments
- Deciding which recommendations of the firm or network firm or other third parties to implement
- Reporting to those charged with governance on behalf of management
- Taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial-reporting framework, and
- Designing, implementing, monitoring or maintaining internal control. (APES110.600.7A3)

To avoid assuming a management responsibility when providing a non-assurance service, a firm must be satisfied that a client's management makes all judgements and decisions that are their responsibility. (APES110.R600.8)

This includes ensuring that the client's management:

- Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the services. Such an individual, preferably within senior management, would understand: (i) the objectives, nature and results of the services, and (ii), the respective client and firm or network firm responsibilities. However, the individual is not required to possess the expertise to perform or re-perform the services
- Provides oversight of the services and evaluates the adequacy of the results of the service performed for the client's purpose, and
- Accepts responsibility for the actions, if any, to be taken arising from the results of the services (APES110.R600.8).

### Revised guidance on auditing SMSFs

In June, the AUASB issued revised guidance statement 009 *Auditing Self-Managed Superannuation Funds*. The update was carried out with the help of a working group comprising representatives from the ATO, accounting professional bodies, and the SMSF-auditing industry.

The revised 120-page guidance identifies, clarifies and summarises existing responsibilities of approved SMSF auditors and provides guidance on things to consider when planning, conducting and reporting on the financial and compliance engagement of an SMSF audit.

It helps auditors by clarifying their requirements under the *Superannuation Industry (Supervision) Act 1993* and *Superannuation Industry (Supervision) Regulations 1994*, and APES 110, as well as identifying applicable ASIC regulatory guides and class orders, ATO rulings, interpretative decisions, and guides.

The appendices include an example engagement and a representation letter, illustrative trust-deed checklists and financial audit procedures.

### ASIC moves against SMSF auditor misconduct

Recently, ASIC has moved to disqualify, or suspend and/or add conditions to the registration of, a number of auditors of SMSFs.

The actions followed the commission's concerns about failures to meet requirements, including independence standards and auditing standards, failing to comply with continuing-professional-development requirements and not being fit and proper persons.

Conditions imposed on auditors were:

- *Peer reviews* – having several audits reviewed by an independent SMSF auditor for compliance with auditing standards
- *Independence assessments* – performing and reporting on specific independence threat assessments for all clients
- *Restricted audits* – being restricted from conducting audits in independence-threat situations regardless of safeguards
- *Professional associations* – providing a copy of the conditions to their professional associations
- *Education* – completing specific courses of study, including in ethics and audit
- *Tools and templates* – reviewing tools and templates to ensure that they are up-to-date and complete
- *Exam* – sitting and passing the SMSF-auditor-competency exam, and
- *Proof of CPD* – Providing proof of compliance with CPD requirements annually for three years.

ASIC disqualified four SMSF auditors for significant audit-independence breaches.

### Action items

The following action items need to be considered:

1. Appoint a responsible person to champion overseeing the changes and continued compliance
2. Engage with other stakeholders within the firm regarding the changes, the risks faced, and identify the changes that will be necessary to systems, processes, templates, and client engagements
3. Document existing SMSF relationships (such as those with administrators, other accounting/auditing firms, and non-standard SMSF audits) and procedures for compliance with revised requirements
4. Reconsider the appropriateness of existing processes, and tailor safeguards to the firm's overall approach to accounting/bookkeeping and audit services to SMSFs, also tailoring them for specific clients' circumstances (where appropriate)
5. Update engagement letters for providing accounting/bookkeeping and audit services to reflect revised requirements
6. Organise training for SMSF audit teams, and
7. Consider independent quality assurance of revised policies, procedures, and templates.

### Conclusion

The provision of accounting and bookkeeping services is prohibited unless they are routine or mechanical nature and the self-review threat is reduced to an acceptable level. Don't make these assessments lightly.

Independence is the cornerstone of an audit. Don't put your audits at risk by failing to understand and inappropriately applying the ethical rules.

### How we can help

We have four GAAPinar recordings (1.5 hours each) from our 2019 series on the revised code:

- *#7 Understanding the revised ethics code for accountants and auditors (Part 1)* – Colin Parker
- *#8 Understanding the revised ethics code for members in public practice (Part 2)* – Sonya Sinclair
- *#9 Understanding the revised ethics code relevant to independence for audit and review engagements (Part 3)* – Sonya Sinclair and Colin Parker, and
- *#10 Understanding the revised ethics code for independence assurance engagements other than audit and review engagements (Part 4)* – Sonya Sinclair.

These can be obtained by contacting [andrew 0421-088-611andrew@gaaptraining.com.au](mailto:andrew@gaaptraining.com.au) or from [www.gaaptraining.com.au](http://www.gaaptraining.com.au).

As well as our advisory services on the interpretation of accounting, auditing, and ethics standards, *GAAP Consulting* can help you with:

- **Risk management** – quality-assurance reviews of audit files and risk-management systems (under auditing and ethical standards rules) and help with enquiries from regulators and accounting bodies, and managing litigation risks. Assistance with the transition to the revised SMSF requirements as described above
- **Training** – face-to-face (and Zoom video communications) and web-based (*GAAPinars*) training on standards, legislative developments, and business risks as well as client briefings on contemporary issues for boards, accountants and auditors. There is also an extensive library of *GAAPinars* ([www.gaaptraining.com.au](http://www.gaaptraining.com.au)). Ninety hours of CPD are just a mouse-click or two away ([www.gaaptraining.com.au](http://www.gaaptraining.com.au)). Yes, we can meet your SMSF audit training needs through personalised training or through our forthcoming dedicated SMFS *GAAPinars*
- **Improving communication skills** – we can help you to communicate better, editing and rewriting professionally your tenders, client communications, and internal manuals. They'll be clearer, simpler, more powerful and easier to read and to understand. We can also help you to prepare formal and informal talks, speeches and seminars
- **Financial reporting** – implementation of new accounting standards such as AASB 16 *Leases*, and, for NFPs, AASB 15 *Revenue from contracts with customers*, AASB 1058 *Income of Not-for-profit Entities* and pre-issuance reviews of financial statements
- **Information services** – use of proprietary technical content from *GAAP Alert*, *Special GAAP Reports*, and *NFP Risks and Compliance* newsletters to enhance your brand awareness and expertise to existing and potential clients, and
- **Whistleblowing service** – *ReportFraud* is a cutting-edge fraud protection tool you need to have. It's designed to safeguard your organisation from fraud, bribery, and corruption 24 hours a day, seven days a week. It allows whistleblowers to report unethical activity safely and – most importantly – anonymously ([www.reportfraud.org.au](http://www.reportfraud.org.au)).



Technical Content

**Colin Parker**

Principal, *GAAP Consulting*  
Head of the GAAP Consulting Network  
Email [colin@gaap.com.au](mailto:colin@gaap.com.au)  
Mobile 0421 088 611  
Website [www.gaap.com.au](http://www.gaap.com.au)



Client Services

**Andrew Parker**

Director – Marketing and Event  
Management  
Email [andrew@gaaptraining.com.au](mailto:andrew@gaaptraining.com.au)  
Mobile 0401 858 889  
Website [www.gaaptraining.com.au](http://www.gaaptraining.com.au)

 GAAP Consulting  GAAP Consulting  Colin Parker

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