



WHITE PAPER

Session 3: Super Audit Issues



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Audit Issues

In 2019, the most pressing concern for auditors of self-managed superannuation funds (SMSF), was the impact of two cases that went through the Courts. In both Ryan Wealth Holdings Pty Ltd v Baumgartner and Cam & Bear Pty Ltd v McGoldrick, auditors came in the firing line for the role they play in maintaining the integrity of the SMSF industry.

Whilst the takeaway lessons from these cases must never be forgotten and built into our audit processes, the most impactful change to SMSF auditors in 2020 will no doubt lie in the update of the Independence Guide, released in May 2020. For some, it will change the way they run their audit practice entirely.

Independence

Professional independence is a concept fundamental to the accounting profession, requiring a member to approach their professional work with integrity and objectivity.

In each professional assignment undertaken, a member in public practice must both be and be seen to be, free of any interest that may be in direct conflict with their objectivity. This is particularly relevant in the exercise of the audit function but also applies to all other professional work.

Some of the consequences that can occur if auditor independence is impaired include:

- The audit work completed may be of a poor standard;
- Compliance breaches which have occurred may be overlooked, therefore exposing the Trustees;
- Inappropriate conclusions drawn and therefore audit reports possibly incorrect;
- Trustees not receiving an audit conducted in accordance with industry best practices; and
- Damage to the audit firm's (and the industry as a whole) reputation.

In determining whether a member in public practice is or is not seen to be independent, the basic criterion is whether a reasonable person, having knowledge of the relevant facts and taking into account the conduct of the member and the member's behaviour under the circumstances, could

conclude that the member has placed himself / herself in a position where his or her objectivity would or could be impaired.

In May 2020, the Accounting Professional & Ethical Standards Board (APESB), in collaboration with Chartered Accountants Australia and New Zealand (CAANZ), CPA Australia and the Institute of Public Accountants (IPA), published the updated Independence Guide – Fifth Edition. The update Guide incorporates changes to the updated APES 110 Code of Ethics for Professional Accountants, which became effective on 1 January 2020, and are mandatory for all audits and reviews in Australia. Section 8 of the Guide specifically deals with the audit of self-managed superannuation funds (SMSF's).

In most instances, a SMSF is not going to be considered a Public Interest Entity (PIE), however, this does not mean that an SMSF auditor is not required to comply with APESB's auditor independence requirements. In fact, there is no difference in the application of the independence requirements whether you are auditing an SMSF or any other type of entity.

The Guide highlights that due to the generally "small" size of SMSF, they present their own unique independence threats. One such example given, is that close relationships between the client and the auditor are more prevalent for small clients. As such, this creates threats to independence and often makes it difficult to implement safeguards that will reduce these threats to an acceptable level. As a general rule of thumb, the Guide suggests that auditors should ask themselves if they would have any hesitation in qualifying an audit report of a SMSF client. If this answer to this is yes, then there is an indication that independence is impaired, and the auditor should decline the audit engagement.

The Guide provides the following scenarios involving SMSF's would always result in independence requirements being breached, and as a result, the auditor should decline the audit engagement:

- An auditor cannot audit their own or an immediate family member's SMSF;
- An auditor cannot audit the SMSF where a partner within their own firm is a member and/or trustee of that SMSF;
- An auditor cannot audit the SMSF where they have a business relationship with a member/trustee of the SMSF; and
- 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.

Can you Audit an SMSF if your Firm has Prepared the Financial Statements?

In the Fourth Edition of the Independence Guide, the Appendix provided that assistance with the compilation of financial statements and advice in relation to accounting treatments of transactions was allowed, but usually performed as an extension of the audit scope. It also provided that bookkeeping and payroll services could provide benefits to the company by using the auditor to provide these tasks. However, some of these services are restricted, and auditors should refer to **APES 110 – Code of Ethics for Professional Accountants**, as to whether or not it was appropriate they are undertaken.

The Fifth Edition provides that a firm must not provide to an audit client that is not a PIE *any* 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:

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

The definition of services that are of a routine or mechanical nature are those that require little or no professional judgement.

If there are threats to independence by providing services that are of a routine or mechanical nature, some examples of safeguards that might reduce the threat to an acceptable level include:

- Using professionals who are not audit team members (including the partner) to perform the service; or
- Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.

Whilst it is permitted that an audit firm could provide services that are of a routine or mechanical nature, in reality, there is very few instances of where this would actually occur. For it to be allowable, the audit firm must not assume management responsibility for an audit client, which would include taking responsibility for the preparation and fair presentation of the financial statements. To be able to show that you have not taken management responsibility, you would need to provide that 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 responsibilities of the trustees.

Does a “Chinese Wall” give you Audit Independence?

One question often asked (particularly for medium to larger sized firms) is if there is a “Chinese Wall” between the division preparing the financial statements and the division undertaking the audit, will this be sufficient to overcome the independence issue.

The Guide provides an example where a partner in an accounting firm is responsible for the preparation of a SMSF’s financial statements, which are of a routine and mechanical nature. The trustees of the SMSF are financially literate and in a position to take responsibility for the preparation and fair presentation of the financial statements. Another partner within the same firm is assessing whether to accept the audit engagement. The SMSF’s investments consist of cash, blue chip shares and deposits.

Even in this scenario, the Guide states that there are threats to the auditor’s independence, due to being inappropriately influenced by the additional fees that would come from preparing the financial statements, and having their judgement impaired because of the relationship between the partners.

This highlights that there is going to be very limited circumstances where a firm could prepare the financial statements and undertake the audit, even if the preparation of the financial statements is of a routine or mechanical nature!

How do you Overcome the Potential Threats to your Independence?

One of the ways that has been previously suggested to overcome the threats to your independence, is for you to “swap” audits with another auditor. For example, if you audit 50 funds, and you know another auditor who audits 50 funds, then you swap the audits to create independence.

However, even this is said to create threats to your independence, as each auditor will be inappropriately influenced as they dependent on the audit fees. Furthermore, you may be independent, but have audited the funds for many years. According to the Guide, this could also cause threats to your independence, as you have come to depend on the fees.

So, what can be done? It seems like the only answer is to find an auditor who has had no involvement in the preparation of the financial statements, who is not reliant on the audit fees for their business survival and who you regularly rotate with other similar auditors!

GS009 – Auditing Self Managed Superannuation Funds

The Auditing and Assurance Standards Board (AUASB) has issued a number of Guidance Statements to assist auditors in fulfilling their objectives in an audit or assurance engagement. According to the AUASB website, the guidance statements include explanatory details and suggested procedures on specific matters for the purposes of understanding and complying with AUASB standards.

Paragraph 6 of GS009 Auditing Self-Managed Superannuation Funds provides that this guidance statement has been developed to identify, clarify and summarise the existing responsibilities which the auditor has with respect to conducting SMSF audits, and to provide guidance to the auditor on matters which the auditor considers when planning, conducting and reporting on the financial audit and compliance engagement of a SMSF.

An updated version of GS009 was released in June 2020. The purpose of revising GS009, was to undertake a review of the relevant sections of GS009 relating to the restructured APES 110, ethical requirements and auditor independence. This has been undertaken and GS009 now includes specific references to the APES 110 and cross references the Independence Guide.

As was previously the case, GS009 is an invaluable resource for auditors of SMSF's, as it provides specific examples of how to test the components of Part A and Part B of the auditor's opinion, as well as providing examples of planning, testing procedures and relevant documents to be prepared, such as engagement letters and representation letters.

SMSF Audit Issues Due to COVID-19

As a result of COVID-19, there have been several relief measures offered to trustees of SMSF's. The following outlines what the SMSF auditor needs to consider in undertaking the 2019/20 and 2020/21 audits of SMSF due to these measures:

LRBA Relief

Industry relief was offered to real estate investment loans of a 6-month deferral of principal repayments. Interest still accrued on these loans and must be paid back at a later point in time. As this is considered a commercial standard for these types of loans, the same relief could be offered for related party LRBA's without breaching the arm's length provisions and giving rise to NALI.

From an audit perspective, the auditor must form an opinion as to the commerciality of related party borrowing arrangements, and in doing so, will need appropriate audit evidence to support their opinion. This evidence should include:

- A minute or resolution to confirm the change in loan agreement terms. It should include the reason for the change in terms and refer to current banking practice in support of the relief measures. It should also outline the new timeframe for review of the measures (i.e. 6 months).
- Reference to the prevailing terms of the loan agreement permitting such changes should also be included, and the agreed changes should be signed by both the Fund and Lender.
- An updated loan repayment schedule, showing a temporary freeze on principal repayments and the accrual of loan interest over the deferral period should be provided. Commercial practice has shown that the deferred principal and interest payments should be caught up over the remaining term of the loan.

Rent Relief

Related party tenants are also able to participate in appropriate rental relief as a result of COVID-19. Again, given the broad nature and State Government advice around rent relief for tenants, this can be accepted as arm's length (where the tenant meets the criteria). Again, appropriate documentation is the key, and should outline:

- The extent of the relief;
- Appropriate terms of the Lease agreement allowing such relief;
- Signed by both the landlord and tenant.

Early Access to Superannuation Benefits

The ATO has confirmed that they will not require auditors to check whether members have met the eligibility criteria for compassionate early release of superannuation (such as being made redundant or having work hours significantly reduced). Rather, the ATO simply want auditors to confirm that members have not illegally accessed their superannuation benefits early, in accordance with regulation 6.17.

The ATO have confirmed that the auditor should check the following:

- Ensure the trust deed allows the release of benefits on compassionate grounds;
- Ensure the trustees received a copy of the release determination from the ATO confirming the member meets the grounds for early access to their superannuation;
- Ensure the payment was made after the date on the determination received from the ATO;
- Ensure the amount withdrawn agrees to the amount on the determination, by checking this to bank statements; and
- Ensure the benefit has been recorded against the relevant member's account.

Changes to the Audit Report

The Self-managed super fund independent auditor's report has not been updated for the year ended 30 June 2020. The most recent update was last year and was effective for reporting periods starting on or after 1 July 2019.

The changes to the audit report brought the report in line with the equivalent form prepared by auditors of APRA regulated funds, and included the following updates:

- Additional wording to provide clarification on how auditors can make a modification to the audit report where a qualified or adverse opinion is required;
- Moving the listed provisions (i.e. those sections of the Superannuation Industry (Supervision) Act 1993 (SISA) and Superannuation Industry (Supervision) Regulations 1994 (SISR) required to be tested as part of the audit process) to under the opinion clause;
- Improved clarification of the auditor's responsibilities so that they are more consistent with the auditing standards; and

- Including references to the updated version of APES 110 Code of Ethics for Professional Accountants, which includes the independence standards.

The ATO have provided guidance where you may identify contraventions of the Part B compliance sections due to COVID-19 relief specific to 2019-20 and 2020-21 financial years. This guidance is as follows:

Section or Regulation	Auditor Contravention Report not Necessary
Section 65	Where financial assistance comprising a rental waiver, reduction or deferral has been provided directly or indirectly to a related party tenant due to the impacts of COVID-19 on commercial terms.
Section 65	Where financial assistance comprising loan repayment relief is provided to a related party on commercial terms.
Section 84	Where an in-house asset contravention arises as a result of a rental deferral (constituting a loan) provided to a related party tenant on commercial terms.
Section 84	Where an in-house contravention arises as a result of a rental deferral (constituting a loan) provided by a Division 13.3A entity to a tenant on commercial terms, causing the fund's investment in the entity to cease being exempt from the in-house asset rules.
Section 84	Where the fund's assets exceed the 5% in-house asset threshold as at 30 June 2019 however a plan to dispose of the excess by 30 June 2020 is unable to be executed due to the impacts of COVID-19.

Section 84	Where the fund's assets exceed the 5% in-house asset threshold as at 30 June 2020 due to the impacts of COVID-19 however a plan to dispose of the excess by the end of 30 June 2021 is unable to be executed because the market has not recovered or it was unnecessary to execute the plan because the market has recovered.
Regulation 6.17	Where a SMSF member provides the trustee with a determination pursuant to regulation 6.19B, however payment of the benefits is not made, or a lesser sum than the amount stipulated in the determination is paid as a result of the member changing their mind.

Source: Australian Taxation Office

Even though you will not need to prepare an Auditor Contravention Report for the above contraventions, you will still be required to determine if you need to qualify the audit report. If using your professional judgement you deem that the contraventions are not material, and accordingly, you do not qualify the audit report, you must still notify the trustee of the contraventions. The most appropriate way to do this would be via a management letter to the trustee.

Tip

Remember – if preparing a management letter to the trustee, it is the auditor’s responsibility to ensure that the trustee receives the management letter.

In many instances, you will be auditing SMSF for another accountant. It is not sufficient to provide the management letter to the accountant.

A way to overcome this is to ensure that the trustee responds to your management letter. This way, you can have a level of comfort that the trustee has received your management letter.

Hint

If you are preparing a management to the trustee of a SMSF due to a contravention of sections as a result of the impact of COVID-19 (as per the above table), the ATO has recommended that you include in the management letter, that the Commissioner of Taxation will not be taking any compliance action against these contraventions for the 2019-20 and 2020-21 financial years.

Audit of the Auditor

With there being over 600,000 SMSF’s in Australia, holding over \$748 billion in assets, the audit function is a vital component to ensure the integrity of the superannuation industry. In order to meet these requirements, it is essential that auditors are aware of not only the audit process requirements as outlined in the audit standards, but are familiar with the various sections and regulations of the SISA and SISR that are required to be tested.

In the past, the ATO has raised concerns over the competency of SMSF auditors, on the basis that they may audit very few SMSF or they are not keeping up with their professional development.

Other common issues detected by the ATO include:

- Insufficient audit evidence to support the auditor’s opinion of:
 - Market valuation for unlisted assets;
 - LRBA documentation, particularly with regards to loan agreements and bare trusts; and
 - Market valuation and documentation for collectible assets.
- No signed trustee representation letters, engagement letters, management letters or financial statements included on the audit file.
- Not abiding by the SISA section 129 requirements to bring breaches to the trustee’s attention in a management letter.
- Failure to report contraventions to the ATO via the Auditor Contravention Report, particularly if the breach had been rectified during the year.

As a result of this, the ATO regularly undertake audits of the auditor, to ensure that auditors meet the competency standards required to be an SMSF auditor.

If you are selected by the ATO to be audited, the ATO will be auditing four areas:

- The SMSF auditor obligations;
- Your knowledge and application of the Australian Auditing Standards (ASA’s);
- Your audit process; and
- Your completion of the audit opinion and reporting to the ATO and/or trustees.

More specifically, the following will be considered under each of these broader categories:

SMSF Auditor Obligations

APES 110	Did the auditor audit their own or an immediate family member's fund (i.e. immediate family member means a spouse or a dependent)?
APES 110	Where the auditor is a sole practitioner, did the auditor prepare the fund's accounts or did their employee prepare the accounts?
APES 110	Where the auditor is a member of a firm, did the auditor, their staff, or the firm prepare the fund's accounts?
APES 110	Was the auditor involved in a reciprocal auditing arrangement (i.e. two auditors audit each other's SMSF, or two auditors audit each other's SMSF clients)?
APES 110	Is there any other independence issues (other than those considered above)?
Professional indemnity (PI) insurance	Does the auditor have a current, compliant PI Insurance policy in place?
Continuing Professional Development (CPD)	Has the auditor undertaken appropriate CPD, and is there evidence of this CPD being undertaken?
Fit and Proper	Is the auditor considered fit and proper to be an SMSF auditor?

Australian Auditing Standards

Audit Strategy and Audit Plan (ASA 300)	Is there evidence of an audit strategy and audit plan on file? Are the audit strategy and audit plan adequate? Is there a comprehensive audit checklist?
Engagement letter (ASA 210)	Is the signed engagement letter covering the year of audit on file?
Representation letter (ASA 580)	Is the signed representation letter covering all the provisions of the SISA and SISR relevant to the year of audit, on file?
SMSF IAR (Section 35C of the SISA)	Is the signed SMSF Independent Audit Report in the approved form, on file? Has Part A or Part B of the audit report been qualified?
Management letter (ASA 260 & section 129 of the SISA)	If required, is the signed management letter issues to the trustees on file?
Audit evidence (ASA 500)	Was sufficient and appropriate evidence obtained to support the auditor's opinion, including opening balances? Was the audit evidence adequately evaluated, including testing where data feeds or automation has been used?
Documenting the audit (ASA 230)	Has the audit been adequately documented to demonstrate relevant audit checks were undertaken and conclusions reached?
Auditor knowledge and understanding of risks (ASA 315)	Has the auditor demonstrated an appropriate level of knowledge and understanding to enable them to identify and assess risks during the audit of an SMSF?

Audit Process

Assets exist	Is there evidence that the assets reported in the financial statements exist?
Ownership	Is there evidence that the fund trustees own the assets reported in the financial statements and any income and expenses relate to the fund?
Completeness	Is there evidence that fund transactions are complete and recorded in the correct period?
Classification	Is there evidence that transactions and events have been recorded in the correct accounts?
Valuation	Is there evidence that assets, liabilities and member entitlements are reported at the correct valuation?
Definition (s17A of the SISA)	Is there evidence that the fund meets the definition of an SMSF?
Fund accounts and statements (s35B of the SISA)	Is there evidence that the trustees have signed the fund's accounts and financial statements?
Sole purpose (s62 of the SISA)	Is there evidence that the fund meets the sole purpose test? Is there evidence that there are no arrangements or investments that have been entered into with the intent of providing a present-day benefit to members?
Loans or financial assistance to members or relatives (s65 of the SISA)	Is there evidence that no loans or financial assistance have been provided to members or relatives of fund members?
Acquisitions (s66 of the SISA)	Is there evidence that assets acquired were permitted to be acquired by an SMSF?

Borrowings (s67, s67A and s67B of the SISA)	Is there evidence that no borrowings have been made by the fund unless they meet the borrowing exemptions?
In-house assets (ss82-85 of the SISA)	Is there evidence that the fund has no in-house assets (loan to, leases with or investments in related parties)? Is there evidence that if the fund does have an in-house asset, that it represents less than 5% of total fund assets?
Trustee records (ss103-105 of the SISA)	Is there evidence that trustees have kept and retained minutes of meetings, records of changes in trustees and beneficiary reports (for new trustees and/or directors after 30 June 2007)?
Arm's length (s109 of the SISA)	Is there evidence that SMSF investments have been made and maintained on an arm's length basis?
Unlisted investments (potential in-house asset, sole purpose and arm's length issues)	Has the auditor identified any unlisted trusts or unlisted companies, and undertaken the appropriate audit evidence on these to ensure they do not breach the provisions of the SISA?
Other assets	Is there evidence that confirms the assets are held by the fund, including purchase and sale documents, market value information, investment returns and ownership?
Investment strategy (r4.09 of the SISR)	Is there evidence to show that the trustee has prepared an investment strategy, that considers the whole of the circumstances of the fund including risk, return, liquidity, diversity of investments and any insurance needs for the members? Is there evidence to show that the trustee has regularly reviewed the investment strategy

Separation of assets (r4.09A of the SISR)	Is there evidence to show that the fund's money and assets are kept separate from those held personally by the trustee?
Market value (r8.02B of the SISR)	Is there evidence to show that the trustees have valued assets at market value in the financial statements?
Collectable and personal use assets (r13.18AA of the SISR)	Is there evidence to show that collectable and personal use assets owned by the fund comply with the SISR, including that they have been insured within 7 days of acquisition in the fund's name, not used by, leased to, or stored in the premises of a related party, and only sold to a related party at market price as determined by a qualified independent valuer?
Contributions	Is there evidence to show that contributions met contribution acceptance standards, including member's age, employment status, in accordance with the trust deed, and that the member's TFN has been quoted?
Benefit payments	Is there evidence to show that benefit payment met the payment standards, including eligibility of members and minimum benefit payment standards?
Exempt Current Pension Income (ECPI)	Is there evidence to show that any ECPI claimed has been claimed in the appropriate circumstances, including the members and the benefit payment they received met eligibility requirements, annual minimum pension payment requirements were met, actuarial certificates were provided if required and ECPI calculations are correct?
Tax calculation	Is there evidence to show that there has been a review of the tax calculation to ensure the correct amount of exempt income has been identified and that the income has been correctly treated for tax purposes?

Deductions claimed	Is there evidence to show the expenses incurred by the fund and payment has been made?
Income	Is there evidence to show that all income has been recorded properly and non-arm's length income has been identified?

Completion of the Audit Opinion and Reporting to the ATO and/or Trustees

Financial position and fund compliance reporting in SMSF Independent Audit Report (s35C of the SISA, ASA 700 and Compliance Engagements ASAE 3100 and ASAE 3000)	Is the auditor's opinion expressed in Part A and Part B of the Independent Auditor's Report, appropriate in the circumstances, based on the auditing and assurance standards and the requirement under the SISA and SISR?
Contravention reporting (s129 of the SISA)	Has the auditor / actuary contravention report been lodged? Have the trustees been notified in writing (i.e. via a management letter)?