JCMB Consulting Pty Ltd

Principal (Kathryn) Michele Beattie

30 August, 2018

Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Sir/Madam

Submission to Treasury - Three-yearly audit cycle for Self-Managed Superannuation Funds

In the Consultation Paper it is stated that "allowing Self-Managed Superannuation Funds (SMSFs) with a history of good record keeping the choice to move to a three-yearly audit cycle will have benefits for SMSF trustees, including:

• a reduction in the compliance burden on SMSF trustees while maintaining appropriate visibility of errors in financial statements and regulatory breaches;

• a potential reduction in administrative costs and auditor fees for SMSF trustees due to less frequent audits, and

• an incentive for SMSF trustees to submit SARs in a timelier manner. "

Unfortunately, the Consultation Paper does not allow me to challenge these assertions; however, I will attempt to provide some feedback in answering the six Consultation questions that have been posed in the Consultation Paper - Please refer to the attached Appendix A.

My answers to the Consultation Questions do not only reflect my own views as a Chartered Accountant and approved SMSF auditor, but also the views of my network of Accountants, Auditors and Tax Agents who have provided me with their comments to include in this submission.

I would value your feedback or further enquiry on this submission.

Yours faithfully,

(KATHRYN) MICHELE BEATTIE
PRINCIPAL - JCMB CONSULTING PTY LTD

APPENDIX A
CONSULTATION QUESTIONS

1. How are audit costs and fees expected to change for SMSF trustees that move to three-yearly audit cycles?

There appears to be an assumption that an audit covering three years, performed on a three-yearly cycle, will in some way be less costly than three annual audits.

It is highly unlikely that there will be a cost saving in performing multiple years of audit, as each of those three years still requires a thorough audit to be completed, with the same need for documentation, work file preparation and collection of supporting documents.

The Financial Report and SMSF Annual Return (SAR) are still prepared on an annual basis; however, the supporting documents required by the accountant do not meet the needs of an auditor, in fact many accountants rely exclusively on transaction feeds, as is their right, without the need for supporting bank statements, dividend statements etc.

It is already a challenge to ensure that all the supporting documents are made available on a timely basis for an annual audit, and this will only be augmented by the need for the trustees to ensure that they collect and maintain all the necessary documentation over the three-year period.

It is this follow up of client documentation that often delays completion of the audit, which not only adds to the audit fees that are billed on a time spent basis but can also lead to delay in lodgment of SARs.

If it is a presupposition, as is written in the Consultation Paper, ***that there will be a reduction in the compliance burden on trustees while maintaining appropriate visibility of errors in financial statements and regulatory breaches***; then without an annual audit, the only way that this can be assured is if the Accountant takes on responsibility for ensuring that the Financial Report and SAR are free of errors/omissions and that there have been no compliance breaches.

In my consultation with my network of Accountants there is an overwhelming concern that trustees will rely on them to perform the work traditionally performed by the auditor to ensure that there are no errors/omissions or compliance breaches in the years where an annual audit is not conducted; however, they do not have the proper training and nor is it their role to perform this function.

Additionally, in the event that an error/omission or compliance breach occurs and is not detected and corrected early in the process, then the effects of these will be compounded over the three-year cycle, adding to the cost of the Financial Report and/or compliance audit as these are investigated, corrected and reported.

Without prompt recognition of errors/omissions or compliance breaches, trustees may well incur fines or tax penalties for failing to rectify matters in a timely manner.

For example, if a member fails to comply with a minimum pension requirement and this is not detected until two or three years down the track, they may well lose the Fund's Exempt Current Pension Income concession for multiple years, as they did not complete the necessary Pension Agreement to recommence the pension in the subsequent year.

The issues raised above demonstrate that not only is there potential for audit fees to increase, but accounting costs, trustee penalties and loss of tax concessions may greatly increase the cost and compliance burden on SMSF trustees.

2. Do you consider an alternative definition of 'clear audit reports' should be adopted? Why?

The Consultation Paper states "It is proposed that a SMSF with a history of three consecutive years of 'clear audit reports' be defined as a SMSF without any financial or compliance contraventions issued in an ACR in the previous three years. While a 'clear audit report' could be defined differently, for example as an unqualified audit report, use of the ACR is straightforward and an existing part of SMSF regulation."

The concept of a "clear audit report" must firstly consider who has issued the audit report.

Both the ATO and ASIC continue to pursue and prosecute auditors who have issued "clear" audit reports, but there are in fact issues with auditor independence and other matters that affect the quality of the audit.

For example, the ATO has previously stated that it is targeting low cost audits, performed for a low set fee with a short turnaround.

As an auditor, I question how a $300 audit performed within 3-5 days adequately deals with the multitude of issues that need to be considered in a quality audit that is performed in accordance with SISA, Australian Auditing Standards and with the relevant professional and ethical standards issued by the Accounting Professional & Ethical Standards Board Limited, for all SMSFs, notwithstanding their member profile or investments.

This proposal provides further motivation for trustees to seek out these low quality, low cost auditors, as they value the concept of a clear audit report and less compliance costs over the protection of themselves and their fund assets.

There are also issues that are reported in Trustee Management Letters that do not require the completion of an ACR but should be followed up on a regular basis in order to prevent a compliance breach.

For example, members nearing retirement who are heavily invested in non-liquid investments need to consider the diversification of their investments in order to have sufficient liquidity to pay minimum pension payments.

In this case, the fund is not yet in an unsatisfactory financial position and no ACR is required; however, without early intervention the fund could be insolvent in two or three years if assets are not realised. My Management Letter would recommend that they seek financial advice as a priority to address this issue. Bearing in mind that the Accountant may not be able to advise on this matter, the trustees may not act on this recommendation, and by the time the three-year cycle arises again the fund is insolvent.

The issues raised above demonstrate that the integrity of the "clear audit report" is only as good as the integrity of the person who has issued it, and there is potential for matters that are not reported by way of ACR to still be of serious consequence to the trustees in subsequent years.

3. What is the most appropriate definition of timely submission of a SAR? Why?

The Consultation Paper states "There are a range of options for what constitutes timely submission of SARs. A SMSF that has submitted the fund's SAR in a timely manner could range from:

- A SMSF that has never submitted a late SAR; to
- A SMSF that has not submitted a late SAR in the last three years; to
- A SMSF without any outstanding SARs. "

The concept of a "timely submission of a SAR" must firstly consider the process involved in submitting the SAR.

There are a multitude of factors that may determine whether an SAR is submitted on a timely basis in any particular year.

The Accountant must first receive all the requisite information from the client in order to prepare the Financial Report and SAR. Life events such as death, incapacity, illness of the trustees can delay this process for months or even years. In these cases, the ability to choose a three-yearly audit cycle may well be the most beneficial option for the trustees to enable them to sort out their affairs without the threat of fines for late lodgment.

Currently, the auditor must receive all the requisite information required for the audit and then have the time to perform the audit. A thorough quality audit process may take a day to several months, depending upon the documentation provided, the issues raised and their resolution. The quality of the audit should not suffer because of an impending lodgment deadline.

The focus of timeliness of lodgment over the quality of the information provided in the SAR again provides further motivation for trustees to seek out quick turnaround times regardless of the quality of the supplier of the service.

4. What should be considered a key event for a SMSF that would trigger the need for an audit report in that year? Which events present the most significant compliance risks?

The Consultation Paper states that "It is proposed that eligibility for a three-yearly audit be based on self-assessment by SMSF trustees." And further, "If a key event falls in a year when a SMSF is not otherwise required to be audited, the SMSF will be required to obtain an audit before submitting that year's SAR. An audit conducted due to a key event will be required to cover all financial years since the SMSF's last audit.

Some examples of possible key events include:

• the commencement of a superannuation income stream by a member for the first time;

• the death of a member;

• the addition or removal of a member;

• receipt of non-arm's length income (NALI);

• commencement or maintenance of a limited recourse borrowing arrangement (LRBA);

• acquisition of an asset from a related party;

• investments, loans or leases with a related party; or

• in-species lump sum payments to a member. "

I agree that all of the above events are events that should trigger the need for an audit; however, I am concerned with the self-assessment aspect, particularly with respect to NALI and related parties.

I don't believe that all trustees have the knowledge to determine whether income should be treated as Nali and may not appreciate the scope of the definition of a related party, so in fact it will again fall to the Accountant to inform the trustees that they have met one of the criteria for an annual audit.

The Consultation Paper further states that if an "SMSF trustee has incorrectly assessed their eligibility for a three-yearly audit cycle, has failed to submit a SAR in a timely manner or has failed to procure an audit in a year of a key event, the ATO will notify the trustee that an audit is required and consider further action if necessary."

Given that it is not the Accountant's role to advise on these matters I am concerned that where a trustee is uninformed they will not be able to make the correct assessment and may suffer penalties if the ATO decided to take further action.

In addition to the above events, I believe that the following should be added as triggers for an annual audit, given the potential for an error or breach to occur and the need for timely documentation and in some cases, reporting to the ATO:

- Receipt of a contribution in-specie
- Implementation of a contribution and withdrawal strategy
- Implementation of a contribution reserving strategy

For clarification, I question what is intended by the maintenance of a LRBA. Does this mean that any fund with an LRBA in place will need to have an annual audit?

5. Should arrangements be put in place to manage transition to three-yearly audits for some SMSFs? If so, what metric should be used to stagger the introduction of the measure?

The Consultation Paper states "Depending on the eligibility criteria for the measure, transitional arrangements may assist the SMSF audit industry to adjust to changes to workflow associated with SMSFs transitioning to three-yearly audit cycles. There are different options for transitional arrangements.

For example, the SMSF sector could be split into thirds, with one third becoming eligible each year from 1 July 2019 to 1 July 2021.

Another option is to split the SMSF sector on the basis of good record keeping, with more timely and compliant SMSFs eligible on 1 July 2019, and less timely and compliant SMSFs becoming eligible at a later date/s."

I believe that it is essential that transitional provisions be put in place to stagger the introduction of the three-yearly audit cycle, as auditors will need to manage their work flows to accommodate their clients.

However, my concern is that a blanket measure such as splitting the sector into thirds or offering more compliant funds to go first will not necessarily be appropriate based upon the clientele of each audit firm.

It would be devastating to many audit firms from both a cash flow and workflow perspective if all clients were eligible for choice in the same year.

I believe that the only way that this can be dealt with is to allow the auditor to have input in to the timing of the audit of each of their funds that choose the three-yearly audit cycle; however, I am concerned as to how this will be administered. Will it then become the auditor's responsibility to inform each of their funds when they are required to be audited, or will this be administered by the ATO?

6. Are there any other issues that should be considered in policy development?

I have been in the superannuation industry for 25 years, the last 8 as an approved SMSF auditor. In all of my years participating in APRA, ASFA, CPA and ICA discussion groups, I have always been told that the ATO values the independent audit process as a way of regulating the SMSF sector without the need for further legislation.

Recent developments in the Financial Planning sector, Industry Funds, Banks and other providers of service have shown that there are serious compliance and ethical issues facing the superannuation sector as a whole.

The proposal to move to a three-yearly audit cycle for SMSFs, which are a viable alternative to the bank, retail and industry sectors, not only downgrades the perceived importance of the independent audit process, but enables and encourages providers of low cost, low quality superannuation audits to expend their services to SMSFs that were previously receiving quality audits.

The architecture of the Three Pillar Australian Retirement Saving System is based on the following:

- Age Pension
- Superannuation Guarantee
- Voluntary Saving for Retirement

Given the importance of voluntary saving to this Three Pillar system, any proposal to diminish the effectiveness of the independent audit system, and the subsequent potential for the loss or misuse of SMSF assets, appears to be at completely at odds with Government policy and the ATO's previously stated objectives in regulating the SMSF sector.

How then, can the implementation of the three-yearly audit cycle be reconciled with the need to ensure the security of member's savings for retirement?