Three-yearly audit cycle for SMSF Discussion Paper Response

Crowe Horwath audits approximately 9,000 self-managed superannuation funds nationally, with a significant presence within regional Australia. The following response is provided to the Three-yearly audit cycle for some self-managed superannuation funds discussion paper, issued July 2018. The response follows the consultation questions raised within this paper, and considers this in context of our clients and business.

We welcome the consultation process for this proposed change. We have reviewed the proposed change based on its ability to support a reduction in cost and complexity for our clients; and to reward appropriate trustee behaviour, whilst continuing to support the underlying integrity of the regulatory regime.

Our response concludes, that this proposed change, may nominally reduce audit costs for some of our clients, that administer their affairs within the compliance framework, supported by good record keeping. Currently, SMSF audit costs for these clients under the existing compliance arrangements, in our view, are not a significant cost to the fund. For those clients transitioning to automated platforms to maintain their records, there is currently a downwards market price movement in train already. The proposed three yearly audit cycle provides for a nominal cost reduction, whilst potentially significantly increases risks impacting on the integrity of the regulatory system, and potentially increases the cost burden on the regulator (ATO) to support the system integrity. On this basis, we do not support the proposed three-year audit cycle.

1. How are audit costs and fees expected to change for SMSFs that move to three-yearly audit cycle?

Approximately 90% of our SMSF audit clients have an appointed outsourced provider of superannuation administration services for their SMSF. This structure influences our response in respect of the audit fee ranges and associated costs of our SMSF audit clients.

The three year audit requirement is not clearly defined within the consultation paper. Our response assumes the movement to a three year audit cycle involves an opinion being issued in respect of each relevant year, following the third year in the cycle.

1.1 Factors that support a likely increase in audit fees and other associated costs.

1.1.1 The elapsed time period between year end and the conduct of the audit under the proposed three year audit cycle.

- Historical evidence indicates that the greater the length of time between the relevant year and the conduct of an audit, the greater the likelihood that the records presented for audit are initially incomplete, and the increased likelihood that the trustee, and /or outsourced provider of superannuation administration services, is unable to recall contextual information. This contextual information forms part of our audit evidence gathering process.

- Historical evidence indicates that suppliers of core information such as provision of bank statements, insurance policy statements, investors, etc can logistically struggle to provide information requested, if it is not provided timely. Automation and data feeds support information provision in a three year audit cycle. Sourcing of non-automated information can be problematic, if not provided within an annual timeframe.
- Where an outsourced provider of superannuation administration services is appointed, (as is the case for the majority of our clients), this provider, under the proposed three-yearly audit cycle, would continue to provide administration services annually to support the SMSF annual return. At a separate point in time (a number of years later), the provider would then provide services to support the conduct of the audit. This lag, duplicates handling of client affairs, and additionally may result in the clients affairs being handled by differing staff, and administrators than those, that completed the annual superannuation administration services historically.

- Superannuation administrators may need to extend the scope of administration services to support timely identification and reporting of compliance issues that were previously addressed in detail within the conduct of an audit. This may involve liaison with the auditor during the preparation of the SMSF annual return at a time that varies from the SMSF three year audit cycle.

- Compliance breaches not identified timely may not be identified within the SMSF annual return preparation process and may continue for an extended period. A minor breach if identified during the period, that would not be reportable by definition with an Auditors Contravention Report (ACR), may result in a material breach, based on reporting criteria of the Auditors Contravention Report within a three year audit cycle.

1.1.2 Business cycle variation

We anticipate our SMSF audit business will be more cyclical. This is based on 50% to 70% of our SMSF client base qualifying for the three year audit cycle as they would meet the proposed eligibility criteria. Even with a transition plan that supports some management of this variability in our business, we note the following factors are likely to increase the resourcing costs of our SMSF audit business:

- Currently, we have a two month low season in our SMSF audit business. This proposal is likely to add a variability in resource requirement for the remaining 10 months of each year within the three year audit cycle. We anticipate this will result in our SMSF audit work requirement in peak year/(s), within the three year audit cycle, exceeding the resource availability within our specialist SMSF audit team, and in non-peak year/(s) an under utilisation of our specialist SMSF audit team.

- It is unlikely that we will be able to resource the peak year/(s) from other business resources. This is, as the peak year/(s) months, where resources are required, will fall when other business resources are fully utilised.

- It is likely that we will need to contract resources from the market (locally or internationally) to manage the peak year/(s). This is not a counter cyclical timeframe internationally, is expensive for short term resources, and may impact on the quality of the SMSF audit product, as this is an Australian specific product and legislative framework. A more cost effective alternative is to consider an outsourced provider to manage peaks. These outsourced providers utilise overseas resources. We are reluctant to pursue this alternative, as we are embedded within the regional economies of Australia, and this does not support our core business focus around supporting local employment, whilst bringing expertise to these economies. We currently resource 100% of our SMSF audit's domestically.

- It is likely that we will need to adjust our specialist SMSF audit team core resource to reduce the core number, to provide for varying under utilisation, within non-peak year/(s). It is unlikely that the excess resource in these non-peak year/(s) will be fully able to be utilised by our other business service lines. This is contributed to by non-transferability of specialist skills and also reflects that these businesses are not counter cyclical within the proposed three year audit cycle.

1.2 Factors that support a likely decrease in audit fees and other associated costs

1.2.1 Complete records

The presentation of complete records where all information is accurately documented and /or recorded within a compliance framework, and no compliance matters occur (whether material or not material, or reportable or not reportable) is likely to decrease the time taken to complete an audit of a SMSF audit, whether or not it qualifies for the proposed three year audit cycle. This is currently taken into account in the establishment of our base fees for this product.

The business current base fee for the audit of a SMSF is on average, approximately $550 ex GST. The price point of this fee is set based on the market range for the provision of SMSF audit services. This fee is not a significant cost to the fund on an annual basis.

The fee does not substantially vary based on time involved during the conduct of the audit, where issues arise:

- Where incomplete records are provided for initial audit review, our fee does not vary, unless they are substantially incomplete.

- Where compliance matters are raised by management letter with the trustees, to support the reporting of non-compliance and other record keeping matters that are not otherwise reportable, and support the ongoing education of the trustees, this fee does not vary.

- Where compliance matters are reportable by an auditor contravention report, the fee charged does not directly relate to the time involved. This includes time liaising with financial advisers, administrators in addition to time spent in the education of trustees.

1.2.2 Business exits and consolidation of the sector

Based on this change, it is likely that there will be a new market base price for those SMSF funds qualifying for the three year audit cycle. This new market base price is likely to be significantly influenced by those operators within the market, that utilise lower cost base and outsourced overseas resourcing. Our business will complete a review based on the new market pricing ranges and consider on this basis whether we continue to offer SMSF audit services to qualifying clients, or we consider other alternatives such as an outsourced arrangement. As noted we are reluctant to pursue this alternative, as our business is embedded within the regional economies of Australia, and this choice does not support our core business focus around supporting local employment whilst bringing expertise to these economies, but we need to be realistic in balancing this with other stakeholder objectives.

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

The paper proposes that a clear audit report be defined as a SMSF without a financial or compliance contravention issued in an ACR in the previous three years.

A suggested alternative definition is as follows:

- Unqualified audit report [Part A (financial) and Part B (compliance)] , and
- No ACR, and
- No management letter matters.

In our view, this supports trustees qualifying for the 3year audit cycle based on an appropriate behaviour test.

A qualified audit report, [Part A and / or Part B], does not always coincide with an ACR lodgement. Where a qualification is issued for either of these parts it relates to appropriate record keeping and / or compliance. The notification to the trustee of a Part A or Part B qualification is made within the management letter. The following year audit considers the timely addressing of record keeping and compliance matters raised.

A number of compliance and/or good record keeping matters are also reported within the management letter. These are not material, and therefore do not result in a qualified audit report, or meet the requirements of reporting to the ATO, in an ACR. The management letter notifies the trustee of a compliance breach. The following year audit considers the timely rectification of this breach.

If the fund is eligible for the three year audit cycle based on the proposed definition, then the potential non-compliance based on the trustee behaviour test, will not be applied for a three year period. This delay in identifying reportable compliance matters, does not support the integrity of the reporting and monitoring system, or support the trustee in timely education in these and record keeping matters, and potentially, inadvertently, shifts to a greater focus on a penalties based enforcement system.

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

The paper suggests the following options that may be appropriate for defining timely submission of SARs.

a. A SMSF that has never submitted a late SAR;
b. A SMSF that has not submitted a late SAR in the last three years; or
c. A SMSF without any outstanding SARs

ATO data quoted in the paper indicates that 40% of SMSFs submitted a late SAR on at least one occasion in the three financial years from 2013-14 to 2015-16. This supports 60% of SMSFs meeting the requirement at b.

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Our understanding is that a SMSF SAR is not late if it is lodged by the due date with approved ATO extensions. Our view is that a history of timely lodgement is required to support appropriate trustee behaviour. Three years is considered an appropriate history.

The following risks and considerations are noted in terms of the employment of this measurement as a mechanism for eligibility for the three year audit cycle:

- Within the current SAR structure, timely lodgement may not necessarily correlate with timely issue of an audit report. Although the audit report issue date is required to be noted on the SAR, this may not necessarily reflect the date issued. The auditor currently has no oversight of this process.
- Timely lodgement may be impacted by circumstances outside the control of the trustees. For instance the timeliness may be due to the performance of the outsourced administrator.
- Trustees potentially may compromise quality in year one and year two of SAR, to assist in meeting lodgement timeframes. Where this occurs time pressure may be brought to bear on the SMSF auditor to complete the audit for the fund to continue to qualify for the three yearly audit cycle. The management of the quality of the audit product in this changed regulatory environment needs to consider and mitigate this risk.

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 risk?

In our view, introducing numerous exceptions to the proposed three year audit cycle, based on the increased compliance risk associated with these transactions, or events, increases the complexity of a process, that is already complex for SMSF trustees.

Key events or transactions that trigger an increased compliance risks from our experience are noted as follows:

- Investments in unlisted entities that are not required to provide an audited GPFR including a market price per share, or where this is not available at the SMSF 30 June balance date, and the security has no ready market;
- Property investment, and in particular; investment in commercial property and residential property in regional economies, and investment in international property;
- Investments, loans or leases with a related party;
- Investments in portable assets such as bullion that are not stored by an independent party;
- Commencement of a limited recourse borrowing arrangement (LRBA) non-related and for related LRBA's commencement and maintenance of the arrangement;
- Changes in trustee/s;
- Addition or removal of a member;
- Death of a member;

- In-specie contributions by a member and in-specie benefit payments to a member;
- Rollover of a benefit
- Family law split of superannuation benefits
- Commencement of a superannuation income stream at any time;
- Commutation of a pension
- Wind up of a super fund

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?

Our view is that the management of the transition is significant to supporting the ability of existing providers of SMSF audit services to manage the impact on their business workflow, and continue in their role of supporting the integrity of the SMSF regulatory system. A phase in approach, together with a randomised metric applied to eligible funds, may support a fairness in transition, together with providing businesses time to consider, and adjust.

6. Any other issues that should be considered in policy development

The proposed change may negatively impact on the integrity of the system of reporting and monitoring of SMSFs. We note the following matters that are of concern in this regard;

- The proposed self-assessment process based on the exclusion of certain events and transactions with increased risk is complex, and may not support the integrity of a self-assessment process.

- The proposed three year audit cycle does not support the auditor playing a role in the ongoing education of trustees in compliance and record keeping requirements. This educative role, also extend to regular liaison with financial advisors and business advisors, associated with the trustee. In our view this change will result in an increase in material compliance issues arising, increased regulatory costs for the ATO, and increased penalties for trustees.

- The proposed structure needs to provide for certainty of business, and sufficient profitability, for registered SMSF auditors to continue to supply this product within the Australian market. The proposed policy provides increased uncertainty of business, and profitability, and risks an exit of a significant number of providers, a reduced number of registered SMSF auditor entrants and reduced sector employment within Australia, as the industry is increasingly outsourced overseas to support a lower market price.

- Sufficient safeguards are not considered as part of the consultation paper and have not been communicated as part of the proposed three year audit cycle in respect of the process of appointment and removal of SMSF auditors to support the integrity of the system, mitigating such matters as the risk of “opinion shopping”.

- Businesses supplying this product, such as ours, will need to review and implement sufficient safeguards to support the independence of the SMSF registered auditor, and their ability to gather sufficient evidence to form an opinion, without being unduly affected by the risks attached to the proposed regulatory regime in particular the following:

  - The risk attached to the inclusion of a three year clean audit report as a qualifier for a three year audit. This is expected to increase pressure on an individual SMSF auditor to issue a "clear audit report" as defined. It is noted that there is already significant pressure, within the industry, to not lodge an ACR when a compliance issue is identified.

  - The risk attached to the timely lodgement of SAR requirement as a qualifier for the three year audit cycle. This risk is likely to increase timeframe pressures that may compromise audit quality.

  - The management of peak workflow based on a three year cycle that may compromise audit quality.