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Attn: Division Head
Retirement Income Policy Division
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Attn: Division Head, Retirement Income Policy Division

Three yearly audit cycle

Please find attached for your consideration comments in response to the July 2018 Discussion Paper "Three Yearly audit cycle for some self-managed superannuation funds".

Executive Summary

As an SMSF Trustee the concept of a three yearly audit cycle is superficially attractive. However, as an SMSF auditor, I do not believe the proposal will result in a reduction in red tape or cost savings. Rather, based on my analysis and research, unintended consequences and practical implementation difficulties will result in the proposal ultimately driving increased audit costs, increased complexity, a significantly weaker regulatory environment and increased risk for Trustees.

In essence, the proposal does not change the nature or quantity of work the auditor will be required to undertake. Rather, it merely defers the work of the auditor for a number of years by which time the conduct of the audit will be more onerous, time consuming and expensive due to practical difficulties associated with obtaining and verifying supporting data from prior years.

I also note the cost saving objectives of this proposal are inconsistent with other legislative actions such as the ATO's review of low cost/low quality auditors and ASICs recent adoption of a fee-for-service model under which SMSF auditors will have to pay a one-off registration fee of $1,927, up from $107.

(https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/Speeches-and-presentations/SMSFs-and-the-ATO--key-issues-and-updates/?page=3#3_4_SMSF_auditor_quality_and_independence)

I do not believe there will be any substantive benefits arising from the three yearly audit cycle proposal. Further, I believe it may materially weaken what has been a successful regulatory regime to the detriment of both Trustees and Regulators.

Background
I am a Chartered Accountant who runs a practice which specialises in the audit of self managed superannuation funds. I currently employ two professional staff in the practice and would be classified as a mid-sized specialist SMSF audit firm. I provide no financial advice, tax advice or SMSF administration services.

I am also the Trustee and administrator of my own personal SMSF. Accordingly, I believe I am well placed to comment on the practicalities of implicating the three yearly audit cycle proposal.

Whilst I have a commercial interest in the outcome of this proposal, this submission is driven by my advocacy of SMSFs and my desire to ensure the SMSF sector continues to represent a competitive, well-regulated and attractive retirement savings vehicle for appropriately skilled and motivated Trustees. A competitive and well-regulated SMSF sector not only provides maximum choice for individuals, but also maximises competitive pressure on Industry and Retail funds ensuring better outcomes for their members.

The Proposal - Three-yearly audit cycle for some self-managed superannuation funds

The proposal as currently drafted identifies the following features and objectives:

- the Government is committed to reducing red tape and compliance burden for SMSF trustees where suitable
- Funds with good record-keeping and compliance history will have the choice to move to a three-yearly audit cycle
- The three-yearly audit cycle will cover all of the three preceding years, maintaining integrity within the SMSF sector. Funds will still be required to lodge an annual SMSF Annual Return ("SAR")

Current Process

As noted in the discussion paper, SMSFs are currently required to lodge an annual SAR following completion of an independent SMSF audit. The current system has the following important advantages compared to the proposed three yearly audit cycle:

- Annual returns, annual audits, annual contribution limits and annual pension minimums are easily understood by clients (and professionals). One of the unintended consequences of this proposal is that many Trustees may form the view that annual limits are no longer applicable or important. Some Trustees will (mistakenly) take the approach that annual caps can be averaged or spread over the three year period.
- Annual audits allow emerging problems to be quickly identified and rectified through proactive action initiated by auditors and other professionals engaged to assist Trustees with the operation of their funds. The ATO encourages auditors to issue a management letter at the completion of each audit, as a means of advising the Trustee of any matters noted during the course of the audit. In this regard, I note that whilst I issue Audit Contravention Reports ("ACR") for around 2.5% of the funds that I audit, I issue management letters

outlining minor corrective actions or technical compliance deficiencies to around 25% of the funds that I audit. This proactive corrective action significantly reduces the number of funds that ultimately have reportable contraventions

Concerns and issues

I set out below my concerns and issues with the proposal consistent with the Consultation questions presented in the Discussion Paper.

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

   Whilst Trustees may initially expect fees to be reduced as a result of moving to a three yearly audit cycle, the opposite outcome is likely for the following reasons:

   - The proposal will require the auditor to fully audit each of the three years in the period (i.e. it does not reduce the work to be undertaken, it merely defers the work). This will entail preparation of exactly the same work files and documentation as is currently prepared each year. My SMSF audit software provider has already confirmed that should the three yearly audit cycle proposal be implemented their licence fee charges will remain unchanged, that is, they will charge a fee for each yearly audit processed via the software regardless of whether this is done at the end of each financial year, or as three years at the end each three yearly period
   - Auditors are required by accounting and auditing standards to prepare audit files for each year (i.e. no documentation saving)
   - Auditors will need to put additional workflow processes in place to handle a request for three years audits as opposed to an annual audit request. The additional complexity and documentation will more than offset the minor savings associated with sending a single engagement letter covering all three years
   - SMSF Auditor workflow is likely to be become more “lumpy” even if some form of transitional arrangement is put in place. This will likely result in SMSF audit fee pricing premiums particularly around lodgement dates
   - SMSF audit fees are also likely to increase as a result of ASICs recent adoption of a fee-for-service model under which SMSF auditors will have to pay a one-off registration fee of $1,927, up from $107. This move appears to contradict the proposal’s stated intention of reducing SMSF audit costs to Trustees
   - Audit fees are a minor component of total fund operating costs. Despite the additional red tape associated with a number of recent legislative changes (e.g. transfer balance cap and changing contribution caps) audit fees have remained relatively stable reflecting economies of scale and increasing automation as specialist SMSF Audit firms become more common (Source : ATO)

SMSF auditor fees by year

SMSF auditor fees	2011	2012	2013	2014	2015
Average auditor fee	$596	$571	$737	$724	$754
Median auditor fee	$482	$462	$550	$550	$550

ATO data indicates the average SMSF fund held assets in 2015 of approximately $1.1m implying the average audit fee was 0.07% of fund assets. Any savings from this proposal, even if realised, are unlikely to be meaningful or material compared to fund assets and total fund operating costs.

- I have frequently been asked to audit multiple years for a single fund. Based on my experience, I do not believe there are any meaningful savings compared to auditing the same fund on an annual basis. In particular, the following practical difficulties often result in higher costs compared to auditing the same fund on an annual basis:
  - difficulties obtaining data in relation to transactions which took place several years earlier (documents have been lost or destroyed, companies holding the data on behalf of the fund have closed, professional relationships with accountants or financial advisors who prepared the accounts in prior years have broken down)
  - Where an audit issue is identified it often compounds over time. This becomes problematic when auditing multiple years as a minor issue typically becomes progressively more difficult and time consuming to rectify
  - Trustees tend to adopt a less rigorous approach to compliance if they believe an audit will not be undertaken for several years, rather than at the end of the current financial year

Should the three yearly audit cycle proposal be implemented, I plan to structure my fees for auditing an SMSF for a three year period to be <u>at least</u> three times the fee I would charge for auditing the SMSF for a single year. I will also add a fee premium to cover the practical difficulties noted above and also to cover the additional “lumpiness” in workflow this proposal will generate (particularly around key SMSF lodgement dates).

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

The discussion paper proposes to allow funds to move to a three yearly audit cycle provided the fund has three consecutive years of 'clear audit reports', defined as a SMSF without any financial or compliance contraventions issued in an ACR in the previous three years.

In the absence of any other measure, I would agree this is an appropriate indication of a good compliance history. I would caution however:

- Only a minority of funds are ever issued an ACR. In my practice for every ACR issued there are approximately 10 funds where minor technical contraventions are addressed via a management letter or a qualified audit report is issued but the event is less than ACR reporting thresholds
- In a three year audit cycle, many of these minor events will become reportable contraventions in the second or third year of the audit as the impact compounds. I therefore expect a significant increase in reportable contraventions should the three yearly audit cycle be legislated. This is contrary to the stated intention of reducing costs and red tape applicable to SMSFs

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

I note the discussion paper canvasses a variety of alternatives in relation to what might be deemed timely submission of a SAR including:

- 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.

As a practitioner, it is my experience that most Trustees are not familiar with the SAR lodgement due date. This is not surprising given the lodgement date varies dependent on:

- Is this a new fund?
- Has the fund lodged on time in prior years? (lodgement date is brought forward for prior year late lodgement)
- Is the SAR lodged by the Trustees or by a registered tax agent?

If this proposal is implemented it will be necessary for the ATO to have a mechanism to clearly communicate the SAR due date to Trustees. Failure to have such a system in place will lead many Trustees (and their advisors) to assume the fund has lodged SARs on time and therefore be eligible to participate in the three yearly audit cycle.

Furthermore, I assume the ATO will be provided with additional powers to penalise Trustees who do not provide an audit report when required. This appears to be contrary to the stated objective of reducing red tape. It will also result in additional ATO costs and staffing which is inconsistent with recent moves to "user pays" pricing for regulatory services.

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 discussion paper envisages a system whereby an audit will be required in any year when a key event occurs. I understand Trustees will "self assess" whether a key event has occurred. Some of the key events listed are:

- commencement of a superannuation income stream by a member for the first time;
- death of a member;
- 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-specie lump sum payments to a member.

The majority of Trustees will not be aware of these key events (they will hear "an audit is only required every third year"). Even those Trustees who are aware of the existence of "key events" will require professional advice as to whether their fund's transactions are deemed "key events". For example, if a pension is rebooted, does this constitute "commencement of a superannuation income stream"? Whilst technically this satisfies the definition (triggering the need for an audit), most Trustees will not recognise this as creating a new income stream.

The technical nature of this decision implies additional work for SMSF advisors (increasing cost and red tape). Furthermore it is unclear what incentive will exist to encourage/force Trustees to arrange an audit when a "key event" occurs. Additional ATO powers and penalties will need to be legislated covering circumstances where a key event occurs and Trustees fail to correctly self assess that an audit is required. This monitoring and reporting will need to be undertaken by the ATO implying additional cost and red tape.

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?

I consider it vital that some form of transitional arrangement be put in place if this proposal is implemented. Failure to put such arrangements in place will result in a dramatic fall in SMSF audit activity for the two years following implementation, with many professionals leaving the industry. In the third year there will be insufficient professional resources to manage the workload with a resultant dramatic increase in fee levels and/or lowering of work standards.

I expect the ATO will need to implement some form of transition and monitoring program for funds specifying when a fund is eligible to participate in the three yearly audit cycle taking into account the fund's risk profile, timely lodgement record and compliance history.

Such a program should also be structured to ensure a balanced spread of funds required to undertake audits in each year of the three yearly cycle. The requirement to have a fund audited will then need to be communicated to the fund Trustees, in much the same way a car which requires inspection as part of registration is communicated to the owner.

Whilst this proposal states one of the objectives is a reduction in red tape, SMSF audit scheduling will become an additional ATO function with resultant additional reporting, systems and staffing. As noted above, this is contrary to the stated objectives of a reduction in red tape, particularly when the cost saving objectives are questionable and/or miniscule.

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

I have no other issues to raise in relation to the proposal

I trust this submission adequately outlines my concerns. Should you wish to discuss any aspect of this response please do not hesitate to contact me on [redacted]. I would be happy to participate in face to face discussions or presentations if you believe this would be useful.

Yours faithfully,

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