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Division Head
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The Treasury
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Dear Sir/Madam,

Our response to the Discussion Paper entitled **"Three-yearly audit cycle for some self-managed superannuation funds"** is detailed below. A summary of our responses are outlined as follows: '

- A three yearly audit cycle is unlikely to reduce the compliance burden on self-managed super fund (SMSF) trustees. In fact, the measure will likely increase the costs of administration and audit.
- Increases the risk that integrity of SMSF financials is impaired in that significant compliance issues may remain undetected, concealed and accumulate due to the longer intervals between audits of the self-managed superannuation funds financial statements.
- Other SMSF reporting obligations may be adversely affected due to potential misstatements remaining undetected due to the longer intervals between audits of the self-managed superannuation funds financial statements (i.e. Transfer Balance Account Report (TBAR)).
- While criteria such as "clear audit report" and "key events" may mitigate potential risks of non-compliance, it may result in a significant number of SMSFs (even good ones) to be ineligible for the three-yearly audit cycle resulting in a complex system
- The proposed three yearly audit cycle adds another layer of complexity for accountants, auditors, trustees and regulator alike instead of reducing them.

Our comments and responses are framed under the consultation questions contained in the Discussion Paper as follows:

A three-yearly audit cycle

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

Implementation of the three yearly audit cycle is unlikely to result in the reduction of fees because of the following:

- Auditors are required to perform the audit according to the requirements of the auditing standards. These requirements will not be reduced by auditing three years financial statements in one year.
- Auditors are required to obtain audit evidence to complete the audit. A triennial audit cycle will make it more difficult to obtain information and documents required to complete the audit because of the time lag. This will potentially increase both audit and administration costs.
- During the course of audit, if a material misstatement or error is detected in the financial statements in year one, it may require the amendment of the financial statements for all three years thereby likely increasing administration costs.
- Auditors will be required to manage their workflow around which funds are being audited or not and this will result in increased costs to the audit process.

Good record keeping and compliance

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

The current definition needs to amended to include all modified audit reports, irrespective of whether they are Part A or Part B modifications. Simply making reference to the Audit Contravention Report (ACR) is not sufficient as there are a significant number of audits with a Part A (financial statement) modification that do not result in an ACR. A financial statement modification usually results where insufficient audit evidence has been provided to support a significant balance or transaction, for example to support an investment valuation or loan recoverability.

If the definition of a clear audit report is based solely on what is indicated in the SMSF Annual Return (SAR), the implication is that only Part B modifications of the audit report will be considered. Two potential issues may arise:

- Some contraventions may not meet the threshold required to raise a Part B (compliance) modification of the audit report and/or are reportable under the ACR reporting guidelines. For self-managed superannuation deemed eligible for a triennial audit cycle, this increases the risk for these contraventions to graduate to being material breaches that are not detected and concealed until the next audit cycle.

- Effectively ignoring Part A modifications in the eligibility criteria increases the risk that the self-managed superannuation funds financial statements are materially misstated which will adversely impact the SMSF's other reporting obligations. If the SMSF's financial statements are materiality misstated, it would for example, potentially mean that the TBAR is misstated (for members with high balances) and misstated Centrelink reports (for members with low balances).

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

The submission recommends that the definition of timely submission is met where a self-managed superannuation fund has not submitted its SAR late over the last 10 years. We agree with this recommendation.

<u>Key events</u>

4. ***What should be considered a key event for a SMSF that would trigger the need for an audit report in that year?***

   All key events listed in the Discussion Paper are appropriate triggers for the need for an audit report in a particular year within the triennial period.

4a Which events present the most significant compliance risks?

The events that have presented risks in our past audits are:

- Related party transactions involving:
    - Lease arrangements over commercial property
    - Limited Recourse Borrowing Arrangements.
    - Acquisition of an asset
    - Investment in a related trust
- Benefit payments (pension commencement, lump sums and death benefits)
- Membership and Trusteeship in relation to:
    - Death or incapacity of member
    - Members living overseas

A key event not resulting in an ACR as a criteria to be eligible under the triennial audit cycle could be problematic as some contraventions may not initially meet the threshold required to raise a Part B modification of the audit report and/or are reportable under the ACR reporting guidelines.

Based on past experience, events that do not initially meet the Part B and ACR reporting guidelines in the first year of the cycle, may end up not being corrected by the trustees until they are raised as Part B and reported in an ACR based on trustee behaviour. If this happens, under the triennial audit cycle, such contraventions will become unreported and concealed until the third year of the cycle.

Transitional arrangements

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?***

All options appear to have its own challenges to administer. The three yearly audit cycle itself and the proposed transitional rules appear to add another layer of red tape.

However, should the measure be implemented then the best option would be to stagger the implementation or transition (i.e. splitting the eligible SMSFs into thirds) or simply on the basis of compliance and lodgement record for the past 10 years.

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

The stated intention of the triennial audit cycle is to reduce red tape or complexity in the administration and regulation of SMSFs thereby help reduce costs for SMSF trustees. However, nothing from this three yearly audit arrangement appears to accomplish the stated objectives.

Matters that need to be considered:

- Does the Australian Taxation Office (ATO) as regulator of the SMSFs have the capacity to undertake, administer and monitor this measure?

- If some professionals involved in the SMSF Industry already struggle with the core legislation, regulations and the attendant compliance issues, has Treasury considered the additional impact of the three yearly audit cycle on the trustees? Would self-assessment in relation to a SMSF's eligibility be appropriate in this case?

- Even with audits being required annually, some people in the industry (advisers and trustees alike) have already pushed against established boundaries. What would these risk takers do with a triennial audit cycle?

- How could this three yearly audit cycle be reconciled with the objective that only complying Funds are eligible for tax concessions?

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- The superannuation rules are already complex, what is the possibility that trustees are going to be able to keep abreast of the rules to ensure they do not breach their obligations. There is a risk that most trustees will not be able to assess themselves properly, which might result in non-compliance due to lack of awareness.

We thank you for the opportunity to express our views in relation to this matter.

Yours sincerely

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Partner

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