

14 August 2018

Division Head  
Retirement Income Policy Division  
The Treasury  
PARKES ACT 2600

Dear Sir / Madam

**SUBMISSION RE: THREE-YEARLY AUDIT CYCLE FOR SOME SELF-MANAGED SUPERANNUATION FUNDS**

This submission is made by Marika Hollingsworth.

We welcome the opportunity to make this submission to Treasury regarding the discussion paper that has been released on the proposed three-yearly audit cycle for SMSFs.

As an accounting (and / or advisory) practice that deals extensively with Self-Managed Superannuation Funds (SMSFs), we are concerned that the proposed measures may have a profound impact upon for the service of this sector.

Our responses to the specific matters raised for comment in the discussion paper follow below.

Yours gratefully,



## **RESPONSE TO CONSULTATION QUESTIONS:**

### **Consultation questions**

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

**From our viewpoint as an accountant, we do not believe that a three-yearly audit cycle will result in fee reductions for SMSF trustees.**

There are several reasons for this view.

#### ***Feedback re the audit process –***

Firstly, the feedback we have received from SMSF auditors is that there is very little scope for economies of scale in a thoroughly conducted SMSF audit. Notwithstanding the efficiencies that may be gained by conducting the audit of three consecutive years at one point in time, the fact remains that three separate periods must be audited.

#### ***Our role as accountants / advisers –***

Our office currently liaises with a specialist SMSF auditor to resolve compliance matters. If the annual engagement should cease, this relationship will no longer be possible.

Accountants and advisors will be increasingly called upon to “wear the auditor’s hat” in dealing with SMSF compliance issues, communicating these matters to trustees, and providing remedial guidance as necessary. This can be time-consuming. It also frequently requires specialist skills sets, which our auditor currently supplies as part of the annual service. If our firm were to assume these duties, our fees would reflect this. We estimate that the increase in our annual fee would be significant.

If a triennial audit identifies an issue that requires retrospective amendment to SMSF financials, tax return or transfer balance account, this will add further time and cost.

#### ***Conclusion –***

The auditor / accountant relationship is robust and already cost-effective in our experience. The proposed change is unlikely to achieve cost savings for SMSF trustees. Indeed, administrative costs may increase.

### Consultation questions

2. Do you consider an alternative definition of 'clear audit reports' should be adopted? Why?
3. What is the most appropriate definition of timely submission of a SAR? Why?

### CONSULTATION Q 2: Definition of a Clear Audit Report

The discussion paper suggests that a 'clear audit report' be defined as the absence of financial or compliance contraventions in an ACR.

It appears that the Government therefore considers that all matters not reported in an ACR:

- Do not require annual review;  
OR
- If relevant for annual review, will be identified and dealt with as appropriate, notwithstanding the absence of an independent audit.

We have several objections to this assumption; these are detailed below.

### CONSULTATION Q 3: Definition of a Timely Submission of a SAR

First, we recommend that the timely submission of SARs should relate to the fund's lodgement history over the past three years. A three-year rolling history is consistent with other eligibility criteria and appears reasonable.

#### ***Objection 1: Financial contraventions do not appear in ACRs***

Apart from the recognition of fund investments at market value, material misstatements relating to the financial report do not require an ACR. An SMSF may:

- materially misstate taxable income, expenses or revenue
- cease to be a going concern
- receive a qualified, adverse or disclaimed opinion in the Part A Financial Statement audit

Without the issue being flagged in an ACR. Such funds obviously should not qualify for the three-yearly audit. We believe that material financial contraventions should be considered in defining what is meant by a 'clear audit report'.

#### ***Objection 2: Material compliance contraventions may not require an ACR***

Auditors are required to report a contravention only where:

1. A fund is less than 15 months old at 30 June and the contravention exceeds \$2,000;
2. A prior year contravention is repeated;
3. A prior year contravention is unrectified at the time of audit;
4. The contravention either exceeds \$30,000 or 5% of fund total assets.

This leaves vast scope for material contraventions that are not necessarily reported via an ACR. We believe that funds committing a material compliance breach should not be a candidate for the three-yearly audit. Material compliance contraventions should be considered in defining what is meant by a 'clear audit report'.

### ***Objection 3: Use the Management Letter***

The management letter is an important means of communicating non-material contraventions, preventative advice, and education instruction for fund trustees. In our view, the management letter is a critical part of compliance management. It is a key means of distinguishing between a 'clean' fund and a fund with serious (though perhaps not yet reportable) issues. We recommend that this document also be considered in assessing which funds are eligible for a three-yearly audit.

### ***Conclusions***

In conclusion, we recommend that a 'clear audit report' be defined as an audit report that is free from the following:

1. Issues reported via an ACR
2. Material financial contraventions – Part A audit
3. Material compliance contraventions - Part B audit

We also recommend that the management letter be utilised in assessing a fund's eligibility for the three-yearly audit.

#### Consultation questions

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?

Treasury's discussion paper recommends that, in addition to compliance with 'good record keeping and compliance' criteria, eligibility for a three-yearly audit cycle should only extend to those funds that do not have a 'key event'.

We believe that funds will the following investments or activity require the specialist skills of an SMSF auditor on an annual basis. These would therefore be considered as 'key events':

<b>Related party activity of any nature;</b>
<b>Joint ownership of an investment;</b>
<b>A limited recourse borrowing arrangement (any LRBA – but especially related party LRBAs);</b>
<b>Acquisition or continued investment in bitcoin;</b>
<b>Acquisition or continued investment in derivatives;</b>
<b>Acquisition or continued investment in collectible or personal use assets;</b>
<b>Commencement of a pension;</b>
<b>Death;</b>
<b>In specie contributions and in specie lump sum payments;</b>
<b>A corporate trustee that is also engaged in business activities or has previously been engaged in business activity;</b>
<b>A change of trustee in the current year;</b>
<b>Special circumstances in the composition of the fund's structure (such as appointment of an EPOA or trustees travelling overseas).</b>

### Consultation questions

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?

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

### CONSULTATION Q 5: Transition Arrangements

We believe that a transitional approach to introducing the three-yearly audit will be necessary in view of the major seasonal swings an unstaggered approach of this cycle could present.

We are uncertain as to the best means of achieving an effective transition, as it appears to us that any attempt to 'split' the SMSF sector is going to be difficult to administer and will add another layer of complexity. We suggest that the following would reward those trustees who are trying to do the right thing:

- **FIRST eligible:** Clean funds that have never had late lodgements or received an ACR;
- **SECOND eligible:** Funds with clean lodgement and compliance history for the last 5 years;
- **THIRD eligible:** Other eligible funds.

We are unsure if this would effectively stagger the sector. We do believe that this system will be challenging and costly to administer.

### CONSULTATION QUESTION 6: Other Issues

- **COSTS IN RELATION TO DEED UPGRADES**

We anticipate that a wide-scale upgrade of trust deeds will be required if the legislated annual audit changes to a three-yearly cycle. From our experience, arranging for trustees to update their trust deed is a challenging and costly to the fund. Many trustees do not understand the need to upgrade and resist our recommendations.

- **RISK OF POLICY FORCING EXIT OF SKILLS BASE FROM INDUSTRY & AUDIT MOVING OFFSHORE**

In order to manage extreme swings in the volume of audits from year to year, some audit firms with fewer staff may consider offshoring parts of the audit function to maintain efficient turnaround times (and avoidance of ATO late lodgement penalties). Exposing the security of Australian SMSF financial information to overseas audit providers is a risk that the pressures of industry should not bring to bear on SMSF trustees. The probable loss of industry skills and jobs overseas should also be a consideration of policy makers.

- **PRACTICAL DIFFICULTIES RE TRANSITION & TRACKING**

Policy developers need to consider how compliance status is to be tracked. Trustees will inevitably lose track of when their last audit took place and SMSFs could go years

overdue without scrutiny. Without a penalty regime in this regard, there will be no incentive for SMSF trustees to keep up to date with their three yearly audit cycle. There is a risk that there will be confusion as to when an audit was last conducted – particularly upon the change of accountants. Such confusion may ensue, even if a penalty regime is adopted and administered.

- **OTHER INDUSTRIES RELY ON THE SMSF AUDITORS ADVICE**

We note that other industries depend on the annual audit. We query what will happen if a fund requires financing from a bank and that institution requests the latest audited financial accounts. Such considerations may influence the financing decisions of trustees, with negative consequences.

- **FREE SMSF ADVICE WILL CEASE**

We foresee that the introduction of a three-yearly audit will reduce the auditor's provision of free advice to accountants, lawyers, financial planners etc. Loss of the accountant / trustee / auditor relationship is will be to the detriment of the Superannuation sector as a whole. As already discussed, if the accountant is obliged to assume the auditor's role of compliance referee, our fees will reflect this.

- **3 YEAR AUDIT CYCLE UNWANTED BY MAJORITY OF THE SMSF SECTOR**

It is our opinion that the proposal in its entirety is unduly complex, will not achieve looked-for cost reductions, and will cause significant disruption to the sector.

The overwhelming preference from industry participants of our acquaintance is that the measure be dropped. The annual audit was functioning well as an integrity measure before the 2018 budget. In the words of ATO Assistant Commissioner, Kasey McFarlane (our emphasis):

*“The role of SMSF auditors and the annual independent audit that every SMSF is required to undergo are **cornerstones** of good governance and regulatory compliance within the sector.*

*...Importantly, **it allows any irregularities to be identified at an early stage**, thus facilitating the timely resolution and rectification of the issues by trustees.”<sup>1</sup>*

A policy move to engender the goodwill of amendment-weary SMSFs trustees on the presumption that this “may” create cost savings and reduce red tape is not worth the integrity risk and disruption this will bring to the sector.

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<sup>1</sup> Kasey McFarlane, 'What the ATO Expects of SMSF Auditors' Sept 2016; accessed 15<sup>th</sup> July 2018 at <<https://www.smsfadvise.com/strategy/14736-what-the-ato-expects-of-smsf-auditors>>