

6 September 2018

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

By email: [Superannuation@treasury.gov.au](mailto:Superannuation@treasury.gov.au)

Dear Sir/Madam,

**Re: Three-yearly audit cycle for some self-managed superannuation funds ('SMSFs')**

The National Tax and Accountants' Association Ltd ('NTAA') welcomes the opportunity to make a submission on the Government's 2018/19 Federal Budget announcement to change the annual audit requirement for some SMSFs, from 1 July 2019. The NTAA's submission also includes comments on the specific questions raised in a discussion paper ('the Discussion Paper') issued by Treasury in July 2018 on the proposed measure.

The NTAA is a national non-profit association, which currently represents the interests of approximately 10,000 member firms, including tax agent practices, taxation accountants and superannuation professionals, including SMSF auditors.

Specifically, the NTAA is dedicated to helping and providing support to these professionals by:

- providing a tax and superannuation consulting service through a national tax hotline;
- developing and running nationwide tax and superannuation seminars;
- participating in ATO tax forums and consultative groups; and
- liaising with Government on issues concerning the tax and superannuation profession.

**The role of an SMSF auditor – maintaining the integrity of the regulatory regime for SMSFs**

SMSFs are unique when compared to other superannuation funds in that they allow the members to have full control over the moneys in their fund in the course of saving for their retirement.

As a result, SMSFs are governed by a strict regulatory regime including, for example, the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation Industry (Supervision) Regulations 1994* ('the superannuation laws'), which imposes restrictions upon the trustees of an SMSF in relation to the operation of the fund.

As a safeguard, the superannuation laws also require a corresponding check on the way that SMSF trustees exercise their powers. This check is in the form of an annual audit of an SMSF by a qualified and independent auditor (i.e., an approved SMSF auditor).

In fact, approved SMSF auditors are the first line of defence in ensuring the integrity of the entire regulatory system for SMSFs, broadly as follows:

- SMSF auditors play an integral role in ensuring that SMSF trustees comply with all the regulatory rules associated with operating a fund.
- In most cases, the ATO would not be aware of contraventions of the superannuation law without regular reports from approved SMSF auditors.
- Regular contact with their auditor ensures that trustees of SMSFs are regularly reminded of their responsibilities.

### **NTAA concerns with the Government's proposed three-year audit cycle for some SMSFs**

Although the intent of the proposed three-year audit cycle for SMSFs (i.e., to reduce red tape and compliance costs) is laudable, overall, we have serious concerns that such a change will significantly compromise the integrity of the regulatory regime for SMSFs.

Specifically, the NTAA's concerns can be summarised as follows:

- (a) **Increase in (unchecked) breaches** – A lack of SMSF auditor presence in 'non-audit' years is likely to lead to an increase in unchecked breaches in the superannuation laws.

In particular, even 'good' trustees could be tempted to breach the law, particularly if they believe the breach would not be picked up for several years (i.e., until the fund is audited), or that it may go completely unchecked (especially if the breach is rectified in the meantime).

Examples of unchecked intentional breaches that could occur during periods that an SMSF is not being 'watched' by an auditor include the following:

- Making 'in-specie' contributions to an SMSF (i.e., by way of a permitted asset transfer) for less than market value, in order to avoid exceeding contribution caps.
- Treating an SMSF's bank account as a personal bank account, by accessing preserved superannuation entitlements before satisfying a 'condition of release' (e.g., 'retirement'), even where there is an intention to repay the fund within a relatively short period of time.
- Making loans to members of an SMSF and/or their relatives, even where such loans are intended to be repaid to the fund within a relatively short period of time.
- An SMSF paying pension benefits to a member that fall short of the total minimum pension amount for an income year.
- Under or overcharging a related party for use of an SMSF's business real property.

Even if an SMSF trustee unknowingly breaches a superannuation law, the first opportunity for rectification may not arise until it is identified during an audit of the fund, potentially some three years later. Unintentional breaches often arise due to a trustee's lack of knowledge or understanding of the superannuation laws.

Examples of unintentional breaches that may occur include the following:

- Displaying artwork owned by an SMSF in the business premises of a fund member.
- Accepting contributions from a member aged 65 to 75 who has not met the 'work test'.
- A fund ceasing to be an SMSF (as defined in S.17A of the SIS Act) because not all directors of the corporate trustee are members of the fund.
- Failing to cash out a deceased member's benefits as soon as practicable after death, or paying the benefits to a non-dependant of the deceased member.

Several SMSF administrators have advised the NTAA that they would likely still require their SMSF clients to be audited annually, as this is considered to be a more prudent option. Many accountants have also commented that the annual audit is an effective review of their work before lodging an SMSF annual return (particularly as they are typically not SMSF specialists).

- (b) **Reduced contact with professional advisors** – Although trustees of SMSFs are ostensibly responsible for running their funds, they are still quite heavily reliant on their professional advisers, including their accountants, financial advisers, lawyers and, of course, auditors.

The NTAA believes that an SMSF auditor's role in this process is invaluable. In particular, an auditor may identify a minor or immaterial breach, or other systemic issue with an SMSF, and bring it to the attention of the fund's trustees (usually by way of a 'management letter'). Such breaches or other identified issues will not show up in the ATO's compliance statistics, as they are typically not required to be reported in an Auditor Contravention Report. This process ensures these matters are dealt with in a timely manner, and may avoid a minor breach becoming a major one. It also assists with the education of SMSF trustees.

Furthermore, in our experience, accountants preparing SMSF financial accounts and annual returns are usually not superannuation specialists. Therefore, they rely on a fund's auditor to assist with SIS compliance matters on an on-going basis, as they arise (particularly in light of recent superannuation reforms).

A concerning aspect of the proposed measure is that it will lead to reduced contact between SMSF trustees and auditors, as well as between auditors and accountants, over longer periods when the fund's activities are not being reviewed. This increases the potential for breaches to occur and, in turn, could severely mitigate the benefit of the professional relationship between an SMSF auditor, the trustees and accountant, as well as the benefit of on-going education for both trustees and accountants.

- (c) **Inability to maintain an adequate level of skilled SMSF auditors** – Depending on how many SMSFs are eligible for a three-yearly audit cycle (and the number of those that take up this option) and any transitional arrangements for staggering the proposed measure, the NTAA believes there may be an impact on the ability to maintain an adequate level of skilled SMSF auditors within the industry.

Ensuring qualified and independent individuals are available to audit SMSFs requires that they have a constant source of work to justify the time and cost of undertaking training and complying with the on-going professional development requirements. For example, under the current CPD requirements (in SIS Regulation 9A.04), an SMSF auditor must complete a minimum of 120 hours of CPD over each three-year period. The CPD must:

- include 30 hours of development about superannuation, at least eight hours of which is development about auditing SMSFs; and
- be such that it could reasonably be expected to enhance an SMSF auditor's technical skills or professional service delivery.

Introducing a three-yearly audit cycle will make it extremely difficult for SMSF auditors to justify the time and cost associated with achieving these minimum levels of CPD required to remain SMSF auditors (not to mention the additional cost of ASIC's registration fees for SMSF auditors, which was substantially increased from \$107 to \$1,927 from 1 July 2018).

If the proposed measure results in periods of reduced work for qualified auditors, some may leave the profession. This could lead to a skills shortage in the industry, which would further impact the integrity of the SMSF regulatory system. It would also be undesirable given the significant changes to the SMSF auditing profession in recent years (including compulsory registration with ASIC and the ongoing requirements to maintain registration).

Overall, this may result in an industry comprising part-time SMSF auditors, which is not ideal. Full-time, well-educated and independent auditors are crucial to the ongoing stability and integrity of the superannuation system.

## NTAA response to the Discussion Paper questions

Under the Government's proposal, SMSFs with a history of good record-keeping and compliance, can move to a three-yearly audit cycle. The concept of 'good record-keeping and compliance' is broadly defined as the 'timely submission' of SMSF annual returns and three consecutive years of 'clear audit reports'. However, an SMSF on a three-yearly audit cycle must be audited in any year that a 'key event' occurs, with such an audit covering all the years since the last audit.

The stated objective of the proposed measure is *"to incentivise good record-keeping and compliance by SMSFs whilst maintaining system oversight and integrity."*

In light of this, the following sets out the NTAA's comments in response to the specific questions raised in the Discussion Paper.

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

Two of the stated benefits for eligible SMSFs of moving to a three-yearly audit include:

- *"a reduction in the compliance burden on SMSF trustees while maintaining appropriate visibility of errors in financial statements and regulatory breaches;"* and
- *"a potential reduction in administrative costs and auditor fees for SMSF trustees due to less frequent audits".*

Whilst the NTAA is supportive of any measure that reduces the compliance burden and costs for SMSFs, we believe the proposed measure may instead **increase costs for SMSFs** and so will **not** achieve its stated objective.

Based on feedback from NTAA members involved in SMSF audits, the various costs for SMSFs that move to three-yearly audit cycles may increase for reasons including the following:

- Undertaking three financial year audits at the one time will achieve minimal economies of scale, mainly due to difficulties with revisiting transactions and work papers three years after the fact. Trustees may have difficulty recalling events from the past three years, there may be loss of documents, poor record-keeping, and difficulties obtaining documentation for prior year activities (e.g., where an SMSF changed accountants during the three-year audit period).
- Audit fees of themselves are not a major cost for most SMSFs. The Discussion Paper quotes the average auditor fee for 2016 was \$694. Even if savings could be achieved by auditing three-years of transactions in one year, those savings will not be significant.
- The costs associated with managing SMSF clients on different audit cycles, including monitoring whether a key audit event has occurred before the three-year period ends, may increase costs for all SMSF clients (i.e., even for those SMSFs with annual audit cycles).
- The costs and risks associated with contraventions (including inadvertent breaches) that remain unidentified for the period an SMSF is not 'watched' by an auditor (and which are not identified by ATO reviews of the SMSF annual return) will multiply for each year the fund is not audited. For example, a non-permitted asset acquired in Year 1 may stay in the system for two more years than it would under an annual audit regime.
- The costs associated with having to prepare and lodge an amended SMSF annual return where an auditor subsequently identifies a breach that arose in a prior year return.
- The escalating cost of any ATO penalties imposed on trustees for breaches (even where they are rectified), any tax-related liabilities of the SMSF (e.g., where a tax shortfall arises as a result of incorrectly applying the pension exemption) and associated interest charges.

**Question 2: Do you consider an alternative definition of ‘clear audit reports’ should be adopted? Why?**

We agree that a ‘clear audit report’ be defined as an SMSF with no financial or compliance contraventions reported in an Auditor Contravention Report (‘ACR’) in the previous three years.

The ACR is an existing part of SMSF regulation and its use ensures that a fund is not excluded from eligibility for a three-yearly audit cycle as a result of any non-reportable breaches, which are generally minor (compared to ACR-reportable breaches) and are often dealt with quickly under guidance from the SMSF auditor.

Whilst a ‘clear audit report’ could otherwise be defined, for example, as an ‘unqualified’ audit report, the use of the ACR enables the ATO to monitor an SMSF’s continued eligibility for a three-year audit cycle.

**Question 3: What is the most appropriate definition of ‘timely submission’ of a SAR? Why?**

Of the options provided in the Discussion Paper, the NTAA considers that the appropriate definition of ‘timely submission’ of an SMSF Annual Return (‘SAR’) is that an SMSF has not submitted a late SAR in the last three years. This option promotes ‘best practice’ and enables the ATO to monitor the risk of breaches.

Defining ‘timely submission’ as meaning an SMSF has never submitted a late SAR is too harsh and could inappropriately exclude funds that have lodged late on just one occasion but otherwise have a history of good record keeping and compliance, from eligibility for three-yearly audits.

Whilst having no outstanding SARs would ensure that lodgments are up-to-date, requiring that there were no late lodgments in the last three years also encourages SMSF trustees to lodge SARs on time. This would greatly assist the ATO in monitoring the system and enable it to take appropriate action (where required) in a timely manner.

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

We believe events that present the most significant compliance risks and, therefore, should be considered a ‘key event’ for triggering an annual audit are those where SMSF assets (including money) are transferred out of the superannuation system, and those events involving related parties which are able to be manipulated.

Examples of possible key events would include the following:

- Investments, loans or leases with related parties (e.g., loans to members).
- Acquisitions of assets from related parties.
- Rollovers out of an SMSF.
- Payment of benefits to members (including in-specie payments).

We believe it is also appropriate for an audit to occur for an income year where certain other significant events occur, such as the following:

- The death or divorce (relationship breakdown) of an SMSF member.
- SMSF borrowings, including the commencement of a limited recourse borrowing arrangement.
- The year an SMSF is wound up.
- Where the status of the fund as an SMSF may be affected (e.g., where a person holding an enduring power of attorney for a member is appointed as trustee).

**Question 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 impact of the proposed measure on the SMSF audit industry ultimately depends on the number of SMSFs that would be eligible for a three-yearly audit cycle. The NTAA believes that a staggered introduction of the measure over a three-year period is appropriate. It would provide SMSF auditors with time to even-out their workflow, manage staff resourcing, training and expectations and deal with any potential loss of revenue.

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

Other issues to consider in the development of this policy include the following:

- If only a small number of SMSFs are likely to be eligible for the proposed measure, do the costs (in time and money) of administering the measure justify its implementation, or should other options be considered (refer below)?
- Whether the monitoring of SARs by the ATO is sufficient to achieve the stated objective of *"maintaining appropriate visibility of errors in financial statements and regulatory breaches"*? For example, an SMSF trustee's failure to make the minimum pension payment to a member for an income year is unlikely to be identified by the ATO monitoring the fund's SARs.
- The potential impact on the integrity of the super system. Intentional breaches may occur as some SMSF trustees take advantage of the longer period between audits when they believe 'no one is watching' or because they think there is time to rectify issues. Without the regular checks provided by annual audits, unintentional breaches are also likely to increase due to errors or lack of understanding by SMSF trustees. Left unsupervised for long periods, trustees may also be vulnerable to scams by scheme promoters. Furthermore, personal circumstances may make it difficult for SMSF trustees to resist, and may result in non-compliance (e.g., business issues, personal financial issues, etc.).

**Concluding remarks**

In summary, while the NTAA is supportive of measures that will reduce red tape for SMSFs, given the fundamental role that approved SMSF auditors play in the regulatory framework, we consider that the Government should **not** proceed with the proposal to introduce a three-yearly audit cycle for certain SMSFs, and that other options should be explored.

This is mainly due to concerns that the policy will not achieve its aim of reducing the compliance burden on SMSFs while still maintaining the integrity of the SMSF sector, and that the potential costs associated with the proposed measure is likely to outweigh any benefits achieved.

In light of the above, the NTAA recommends that other options for reducing compliance costs (including red tape) for SMSFs should still be explored. One such option could involve limiting the scope of annual SMSF audits so that the reviews are more targeted and strike a balance between being cost-effective and preserving the integrity of the audit function. An example of this may involve maintaining an annual SIS compliance audit, but with limited testing of the financial accounts.

If you have any questions regarding this submission, please feel free to contact Fatma Hashim on

Yours faithfully,



Geoff Boxer

Chief Executive Officer, NTAA