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Treasury Submission - three yearly audit cycle for SMSFs

Refer cover letter attached to this submission.

TREASURY SUBMISSION

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

We believe audit fees will not significantly decrease with a three-yearly audit cycle and will in fact increase.

The objective to reduce the audit fee for SMSFs' seems to contradict what happens in the real world. We searched our database and found that when we complete three years of audits at once the annual fee is 25%-30% higher.

Although efficiencies may be found in relation to an SMSFs permanent documentation (assuming there have been no changes in the funds structure), investments and transactions in each year will still need to be reviewed. Auditing requirements need to be met each financial year, even for the most basic fund.

A three-yearly audit cycle will likely lead to an increase in non-compliance and result in a spike of Auditors Contravention Reports (ACR) being lodged. Audited yearly, issues can be detected early and addressed within a reasonable time frame.

Historically, in our practice we have found multi-year audits cost more as mentioned above and thus this new cycle will defeat the purpose of reducing the audit fees for trustees and cutting red tape. Often documents are missing or have been misplaced, and generally the older the documents are, the harder they are for the trustee/accountant to locate. This all takes additional time, which generally equates to additional cost to the SMSF.

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

As per the discussion paper, 'clear audit reports' means no ACR was lodged in the previous three years. Although this definition is straightforward and already an existing part of the regulation, it does not cover all the likely events that could trigger further complicated compliance issues and therefore the definition should be broadened.

Although an SMSF's audit report may be qualified, only certain events (and depending on certain criteria) must be reported in ACR. It is therefore possible for Part B of the audit report to be qualified, but no ACR lodged. We believe, if a qualification has been reported in either Part A (financial) or Part B (compliance) in any of the previous 3 financial years, then the SMSF should not be entitled to a three-year audit cycle.

Currently a Part B qualification must be reported in the SMSF annual return (SAR). By changing this question to either a Part A or B qualification, the above definition of a 'clean audit report' can be easily identified.

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

The most appropriate definition would be a SMSF without any outstanding SAR and that has not submitted a late SAR in the last three years.

Outstanding or late lodgment could imply a poor management of record keeping and questionable behavior, however a SMSF should not be penalised for a previous bad lodgment history (ie beyond the previous three years).

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 following event should trigger the need for an annual audit and present significant compliance risks:
- Limited recourse borrowing arrangement (LRBA), both the commencement of and ongoing;
- Investments in collectables and personal use assets;
- Acquisition of a property;
- Any investments in or leasing of assets to related parties;
- Receipt of non-arm's length income (NALI);
- Change in trustee structure or circumstances (eg death of a member, change in residency status etc);
- Change in membership (new or exiting member) or circumstances (eg death);
- Commencement of an income stream.

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?

If a three-year audit cycle is introduced, it is extremely important this is done in a transitional manner, otherwise specialist SMSF audit firms will experience an enormous reduction in work for the first two years and then a major spike in the third year. In the meantime, SMSF specialists may be made redundant and either leave the audit industry or be forced to take up casual employment (eg a one in three-year contract).

Auditors will need to manage a fluctuating workflow. The swings in volume could possibly result in a need to outsource or subcontract the work or put current full-time employees onto casual employment. Some practices may even leave the industry. The SMSF sector could potentially loose its skills and jobs, if their use becomes intermittent.

A transitional approach would give the SMSF audit industry time to adjust, however we believe this would cause significant confusion as to which funds are eligible and when (especially if a trustee self-assessment method is adopted).

The three-yearly audit cycle may bring confusion as to whether an audit is due and when, depending on eligibility criteria, the good compliance of the trustees, and on key events.

The split on the SMSF sector into thirds could be a transitional arrangement although it appears difficult to administer (so no reduction in red tape). If late submission is already an issue for the ATO, complicating the audit cycle may not be the ideal solution.

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

The proposed three-yearly audit cycle appears in contradiction with the maintenance of the system oversight and integrity. Due to the volume of money invested in SMSF and the revenue collected by the ATO via taxes, one would assume that a constant and consistent yearly review is more appropriate to avoid or prevent breaches.

Furthermore, we should not forget trustees are using auditors as their sounding board. The relationship between trustees, accountants/advisors and the auditor is an important partnership that helps raise issues prior to the audit and these parties often work together towards implementing solutions before serious compliance matters arise. Given the complexity and the constant change in superannuation rules, a yearly audit of the trustees' investments provides much more visibility and integrity for SMSFs. Our clients value our role as a sounding board and this should not be under estimated.

One example of a better way to cut red tape and reduce costs to the SMSF sector would be for the ATO to review their current stance on actuarial certificates. From 1 July 2017 the ATO has gone against years of industry practice in relation to when an actuarial certificate is required, and how exempt current pension income (ECPI) is calculated. The practice of calculating ECPI has been made much more difficult with little change to the end result (ie the amount of tax free income a fund paying pensions is entitled to). An example of this is when a fund that is 100% pension is required to obtain an actuarial certificate when a fund member (because of their benefits in another, separate fund) has a total superannuation balance of over $1.6mill at 1 July 2017. The actuarial certificate will state an ECPI of 100%, which is already know, however the cost of the actuarial certificate is completely unnecessary.