Bentleys
THINKING AHEAD

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Our Ref: SMSF Three-Yearly Audit Cycle

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Division Head
Retirement Income Policy Division
The Treasury
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Dear Sir/Madam

Bentleys Chartered Accountants welcomes the opportunity to provide a submission to the Retirement Income Policy Division, The Treasury, on the Discussion Paper "Three-yearly audit cycle for some Self-Managed Superannuation Funds".

Appendix A includes our responses to the discussion paper "consultation questions", supporting our preference for an annual audit of a SMSF.

Key Points Addressed in relation to the three-yearly audit cycle

1) Audit costs and fees are expected to remain the same or increase due to increased contraventions;
2) Alternative definition of "clear audit reports" to qualify for the three-yearly audit cycle;
3) Timely submission of a Self-Managed Superannuation Fund Annual Return (SAR) with the Australian Taxation Office (ATO) is lodging three years of SAR by the due date with no reported contraventions to the ATO;
4) Key events for a SMSF that would trigger the need for an audit;
5) A staggered audit cycle based on the month in which the SMSF was established;
6) Other issues considered in policy development; and
7) Conclusion

Yours faithfully
C/-Bentleys Chartered Accountants

David Francis
Chairman National Technical Audit Committee
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Appendix A

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

The Self-Managed Superannuation Fund (SMSF) audit is required prior to the lodgement of the SAR.

As such, many trustees of SMSFs rely on the services of an Accountant and Auditor to ensure the timely lodgement of the SAR with the ATO. The services of accountants and auditors alike have been developed over time and have laid the foundation of good record keeping and compliance in the SMSF Industry.

Introduction of a three-yearly audit cycle will create an environment where trustees may be tempted to abuse their rights under the SIS Legislation as they know the fund will not be audited annually.

Together with the Annual Audit Report issued by the Auditor, many Auditors issue a management letter to trustees of a SMSF communicating legislative requirements and ongoing guidance in relation to minor infractions of the law. Moving away from a yearly audit to a three-yearly audit will weaken the integrity of a well regulated industry as Auditors will not be able to intervene and advise SMSF trustees on an annual basis on the potential breaches of the law. The number of breaches being reported via the Auditor Contravention Reports (ACR) could increase due to changing to a three-yearly audit cycle.

The above circumstances would lead to increased audit costs and compliance costs would increase as the ATO would have to address and process more contraventions.

SMSF audit work is a specialised niche in the industry and accounting firms have trained specialist staff and dedicated registered SMSF audit partners to sign off SMSF audits. The full time occupation of such specialist teams is to audit SMSF's throughout the year. If a move to a three-yearly audit cycle is legislated, how practical is it going to be for the accounting industry to employ such specialist teams? It will not be reasonable to expect accounting firms to deploy such specialist teams in other areas of their practice for two years and reinstate them in year three (3) when the three-yearly cycle comes up. Such circumstances make the three-yearly audit proposal impractical and unworkable if the high standards of SIS Compliance and SMSF auditing are expected to be maintained. Under a three-yearly audit cycle some accounting firms may implement work arounds using non specialist staff leading to poorer quality audits and a higher compliance burden by the ATO and Australian Securities and Investment Commission (ASIC) in their regulation of a less skilled SMSF audit industry.

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It should also be noted that the cost of the SMSF audit will not effectively be reduced but deferred under the proposed new system. This is because the auditor will need to audit the three year period since the last audit was completed.

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

As per the discussion paper, only SMSFs with a history of three consecutive years of clear audit reports that have submitted their SARs in a timely manner will be eligible to move to a three-yearly audit cycle.

In order to determine whether a clear audit report or an unqualified audit report is the result of an audit, Auditors apply the Auditing Standards, for the Financial and Compliance audit. In performing the compliance audit, the Auditor considers factors noted below per Guidance Statement GS 009 Auditing Self-Managed Superannuation Funds, to determine whether a modification to an Auditors report is warranted and the result would therefore not be a "clear audit report":

a) The quantum of the breach;
b) The time taken to correct the breach;
c) Whether the auditor has previously reported a similar breach to the trustee;
d) The extent to which a limit has been exceeded or a statutory deadline missed;
e) Whether the breach was intentional; and
f) Actual or potential damage to members of a breach of the SISA and SISR occurring.

For an audit report to be regarded as clean or clear of issues, consideration of the above factors together with the suggestions below provide an alternative approach to issuing a clear audit report:

a) Removing the requirement to report a contravention if the contravention has been corrected prior to the end of the financial year; and
b) Removing the requirement of the auditor reviewing certain documents, for example, s103 being Minutes and records of the SMSF, allowing the Auditor to focus transactions that are contrary to the sole purpose of a SMSF.

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

As per the discussion paper, only SMSFs with a history of three consecutive years of clear audit reports that have submitted their SARs in a timely manner will be eligible to move to a three-yearly audit cycle.

The three options per the discussion paper are:

a) A SMSF that has never submitted a late SAR;
b) A SMSF that has not submitted a late SAR in the last three years; and
c) A SMSF without any outstanding SARs.

We consider timely lodgement of the SAR to be lodgement with the ATO before the due date in the last three years. SARs that have never been lodged or that do not have an outstanding SAR, do not qualify for the three-yearly audit cycle as they have not been assessed over the last 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.

A SMSF may be subject to an audit if the events per the discussion paper (included below) together with additional events listed below, being significant compliance risks, occur in the Fund during the year:

a) Death of a member;
b) Purchase or sale of an asset to a related party;
c) Establishment of a pension;
d) Large contributions made to a SMSF;
e) Rollout or addition of a member from and to a SMSF;
f) SMSF's entering into a Limited Recourse Borrowing Arrangement;
g) Investments, loans or leases with a related party;
h) SMSF 's with prior year breaches;
i) SMSF's paying a pension have an annual audit;
j) SMSF's with member balances greater than $1,600,000 should have an annual audit; and
k) SMSF's established in the current year should be required to have an annual audit for a period of three years to establish a good history of lodgement prior to being considered for the three-yearly audit cycle.

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?

Due to the significant impact of the three-yearly audit proposal, it would be prudent to manage the proposed transition from an annual to a three-yearly cycle to ensure clear understanding and direction in relation to a new system.

A reasonable appropriate measure to stagger the introduction of the proposed new system could be based around the month in which the Fund was established.

The example below deals with twelve SMSFs to stagger. We take funds established in the months January to April to be audited in 2020, and the funds established in the months May to August to be audited in 2021 and the funds established in September to December be audited in 2022. The cycle would start again in 2023 for the funds audited in 2020 and the funds established in later months would follow the same pattern:

	Month SMSF Established	Three-yearly Audit Due		Month SMSF Established	Three-yearly Audit Due
1	January	2020	7	July	2021
2	February	2020	8	August	2021
3	March	2020	9	September	2022
4	April	2020	10	October	2022
5	May	2021	11	November	2022
6	June	2021	12	December	2022

The year in which the proposed three-yearly audit is to take place could be recorded on eSat and the ATO Tax Agent Portal.

Further to the staggering above, if the prior year SAR notes the Fund has a LRBA and is in part pension and accumulation mode, the SMSF is not eligible to defer the audit to three years and is required to arrange an Annual Audit. If the SMSF was established in July and does not have any of the above events, it is due in 2021, per the above table.

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

Main Purpose
It is important to look at the SMSF Industry as a whole and to focus on the main purpose of the establishment of the SMSF industry i.e. to facilitate and encourage members of SMSF to provide for their own retirement and to reduce the reliance on the Australian Government's welfare system. The establishment of a system designed to further regulate the SMSF industry will result in the SMSFs absorbing the increased costs of regulation thus detracting from the core purpose of establishing a SMSF.

Event Based Reporting
The changing face of the SMSF brings with it Event Based Reporting for SMSF. As referred to previously, trustees rely on accountants to comply with their reporting obligations which in-turn increases the compliance/operating costs of a SMSF. Taking the cost of Event Based Reporting into account on its own, could potentially surpass the average cost of $694 noted below for an annual audit, eroding retirement savings.

SMSF auditor fees, by year

SMSF auditor fees	2012	2013	2014	2015	2016
Average auditor fee	$ 571	$ 737	$ 725	$ 759	$ 694
Median auditor fee	$ 462	$ 550	$ 550	$ 550	$ 550

The data for this table excludes those SMSFs that did not report an audit fee greater than $0 in their SMSF annual return.

Source ATO - https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2015-2016/?anchor=t25#t25

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An alternative to separate independent Event Based Reporting, would be to integrate additional fields with current annual or quarterly reporting requirements to capture information required in the Event Based Reporting. The result would be the ATO capturing the information required. Consequently, the SMSF would bear the same cost associated with the current annual or quarterly reporting requirements incurring a small increase in fees to capture additional data.

Increased reliance on the Accountant

The proposed three-year audit measure will not affect the requirement for all SMSF to lodge an annual SAR. However, if there is no annual audit, there will be an increased reliance placed on Accountants to ensure that SMSF's comply with the Superannuation Industry (Supervision) Act and its Regulations. As has been seen for the Audit of SMSF, many SMSF trustees have taken out audit insurance to mitigate the risk of a deficient audit. In the same light, trustees may replicate the same for the preparation of Accounts.

Cooper Review

It is important to look back to the Super System Review (Cooper Review), being the root of the idea "Timing of Audits". The Cooper Review highlighted the following:

"7.5.1 Timing of audits
The Panel believes that the annual audit provides a high level of assurance to members, regulators, government and the community more generally. Without this assurance, it would be unlikely the current 'control' features enjoyed by trustees could be retained.

Some SMSF trustee submissions recommended the removal of the audit requirement or for its frequency to be reduced. These submissions often cited cost and the belief that the audit was unnecessary. The Panel strongly rejects these views, noting that the extent of tax concessions for SMSFs justifies the public interest in independent assurance about the existence and value of fund assets, and funds' compliance with legislated requirements.

On the other hand, other submissions indicated that having less frequent audits would result in increased compliance costs and potentially a greater number of contraventions throughout the sector. The Panel agrees with these views and it also believes the annual audit acts to engage trustees with their superannuation.

Given the growing size of the SMSF sector and the importance of the audit role, the Panel believes that the current frequency of annual audits is appropriate and should not be reduced."

Given the Cooper Review has assessed and recommended that the timing of the audits should not be reduced, generous consideration should be given to the above detail and the merits of retaining an annual year audit for SMSFs.

SMSF Changing Landscape

The ever changing SMSF landscape makes it hard for stakeholders to keep up with changes and comply with requirements and welcomes the opportunity for unidentified breaches. As highlighted in the Cooper Review, the annual audit acts to engage trustees with their superannuation achieving the overall objective of providing for their own retirement and reducing reliance on the Australian Government's welfare system.

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7/ Conclusion

The Government's proposed three-yearly audit cycle is designed to reduce red tape and compliance burden for SMSF trustees, whilst maintaining system oversight and integrity. However, as discussed above oversight every three years will not overcome contraventions of the law or mitigate breaches and educate trustees in the law.

The three-yearly audit cycle will not reduce the red tape or cost as the three years of audit work will have to be completed in the third year. In the event of there being a breach the trustees compliance responsibility is increased as noted above.

The small benefit achieved by deferring the audit to a three-yearly audit cycle may lead to the breakdown of the history of good record keeping and compliance of the SMSF Industry reversing the hard work laid down and established over time by Auditors, Accountants and the ATO.