FINANCIAL PLANNING ASSOCIATION of AUSTRALIA

Division Head
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The Treasury
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Dear Sir / Madam

Re: Three year audit cycle for some self-managed superannuation funds.

The Financial Planning Association of Australia[1] (FPA) welcomes the opportunity to provide feedback in response to The Treasury's discussion paper: *Three year audit cycle for some self-managed superannuation funds*.

The FPA stands by the premise that SMSFs can be an appropriate option for many Australians, however they are not suitable for everyone. This point is reinforced by the risks and challenges associated with the proposed three year audit cycle.

We note that the proposed changes would be limited to those who have a proven track-record of good compliance. Further, that SMSFs that meet the criteria would still have the ability to assess the risks and potential benefits as they relate to their fund, and choose to move to a three year audit cycle or to remain with the annual audit requirement.

However an overwhelming majority of FPA members who have provided feedback on this proposal have raised significant and strong concerns about the proposed measure, including that it will:

- add to the complexity and obscurity of SMSF regulations
- increase the risk of non-compliance and undermine the integrity of the superannuation system
- remove a vital consumer protection mechanism and annual process that checks for all issues within the fund that affect the SMSF's performance, not just compliance with regulatory requirements, and
- increase (rather than decrease) the cost of regulatory compliance of SMSFs.

These concerns, as discussed below, highlight the need for clear information about the factors compliant SMSF trustees should consider when deciding whether to move to a three year audit cycle or to remain with the annual auditing process.

[1] The Financial Planning Association (FPA) has more than 14,000 members and affiliates of whom 11,000 are practicing financial planners and 5,720 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Graham McDonald, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 26-member countries and the more than 175,570 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 18 Australian Universities for degrees in financial planning. Since 1st July 2013 all new members of the FPA have been required to hold, or be working towards, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, e.g. CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

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However the overwhelming majority of FPA members who provided feedback were opposed to this measure stating that it is not in the best interest of fund members and could have a negative and material impact on those Australians whose retirement savings are invested in an SMSF.

Complexity

While SMSF trustees usually use professional service providers to assist with their compliance requirements, the ultimate responsibility for meeting their legal obligations under the SIS Act and SIS Regulations falls with them. The trustee is responsible for all the decisions about the operations of the fund, and often make decisions about the fund outside of the advice received from professionals and how it meets its legal obligations. However SMSF trustees are lay Australians who establish a SMSF in good faith in order to manage their superannuation to best meet their retirement needs. This means they must understand the complex legal environment and compliance requirements to operate a SMSF. This can be a steep learning curve for some and is one factor why a SMSF is not suitable for all Australians.

The annual audit process currently assists SMSF trustees to ensure they meet the rules applicable to the fund they operate. The proposal detailed in the discussion paper introduces a new set of compliance timeframes that can continually change and are inconsistent with other existing requirements, which will significantly increase the complexity of the SMSF regulations for trustees. The higher the complexity, the higher the likelihood of non-compliance.

For example, the discussion paper states:

> *"if a key event falls in a year when a SMSF is not otherwise required to be audited, the SMSF will be required to obtain an audit before submitting that year's SMSF Annual Report (SAR). An audit conducted due to a key event will be required to cover all financial years since the SMSF's last audit. After the occurrence of a key event, if the audit does not result in an ACR, the SMSF may continue to be eligible for a three-yearly audit cycle. This means that, as long as no other key events occur in the next three years and the SMSF continues to submit the annual SAR in a timely manner, the SMSF will next require an audit three years after the 'key event' audit."*

So a key event or an ACR triggers the need for an audit, and this audit must cover all financial years since the SMSF's last audit. If the key event occurred in year 3 of the proposed audit cycle, this would mean the auditor must complete an audit for multiple years which would take longer than the usual annual audit. Also, these audits must be obtained before submitting that year's SAR. This creates a risk that the multiple audits could delay the submitting of the SAR, putting the SMSF in breach of "*submitting the SAR in a timely manner*".

Further, the proposed transition arrangements include:

- *the SMSF sector could be split into thirds, with one third becoming eligible each year from 1 July 2019 to 1 July 2021, or*
- *split the SMSF sector on the basis of good record keeping, with more timely and compliant SMSFs eligible on 1 July 2019, and less timely and compliant SMSFs becoming eligible at a later date/s.*

While noting these transition options have been developed in order to mitigate the impact of the changes on the auditing industry, they serve to add to the complexity of the measure.

The potential of auditing timeframes that may constantly change and be inconsistent with other obligations, creates confusion as to their application and will add to the complexity of the regulations, increasing the risk of non-compliance.

Compliance, system integrity and retirement savings

The annual audit is a vital independent assessment of the SMSF trustee's compliance with the rules and regulations required to be eligible for the tax concessions of the superannuation system. To remove this independent audit process for two out of three years will have a significant impact on the compliance rates of even the best trustees, and undermine the integrity of the system.

The discussion paper concludes that a fund with no ACR equates to good compliance. However there are many well intended trustees that still have compliance issues that are not key events and, if identified and addressed quickly, do not require an ACR to be filed with the ATO. Some issues require mandatory ATO reporting, but many do not. The annual audit helps to identify such compliance issues in a timely manner, educate trustees as to the rules applicable to their fund and the impact of the issue on the fund's performance, and rectify the matter before it has a material impact on the performance of the fund.

For example, a SMSF may have an issue in the fund in year 1 (but not a key event). If the fund has met the three year audit criteria, this issue will potentially continue throughout year 2 and year 3 and may not be identified until the audit is conducted at the end of year 3. An annual audit would have identified and corrected the issue in year 1. However due to the 3 year delay in correcting the issue, this would most likely cause the issue to escalate to an ACR being required for years 1, 2, and 3. ACR's are time consuming for an auditor to prepare, so where an issue in year 1 remains undetected and results in 3 ACRs, this will have a significant impact on the compliance costs for the SMSF. Leaving an issue unidentified for 3 years also significantly increases the impact it can have on fund performance.

Financial planners also have a concern about the numbers of SMSFs being established by people with too little money and inadequate financial capability to manage the trustee obligations. Allowing such funds to forego the annual audit for 3 years significantly increases the risk of unintentional and intentional non-compliance with the rules. The annual audit process is a key consumer protection mechanism that assists trustees to identify and rectify any compliance and other issues within the fund. This could be as simple as paying a bill from the wrong account, or as detrimental as rental income being deposited into the wrong account resulting in defaulting on loan repayments. These are issues that could result in the fund failing to achieve the goals of the trustees, significantly impacting on the retirement savings of fund members.

The independent oversight of an annual audit is extremely helpful in identifying such issues. The SAR does not identify such issues. Allowing funds to delay the annual audit process by three years puts both the trustee's retirement savings and the integrity of the system at risk.

As stated in the discussion paper:

> *"Information reported to the ATO in an ACR is one of the information sources the ATO takes into account in its monitoring and regulation of SMSF trustees. Possible compliance actions the ATO can take to ensure SMSFs comply with the law include issuing an education or rectification direction, applying an administrative penalty, removing a SMSF's complying status or disqualifying a SMSF."*

This demonstrates the high regulatory consequences for trustees of mistakenly or unknowingly breaching the SMSF rules.

This measure removes a vital compliance check from the system resulting in issues potentially being left undetected for a prolonged period, which will not be picked up through the SMSF annual reporting (SAR) requirements. It leaves SMSF trustees exposed to significant and material risk.

Cost and regulatory burden

Two of the government's anticipated benefits of this proposed measure for SMSF trustees are:

- *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.*

However this measure just delays the compliance burden, compounds the auditing requirements of three years when it is due, and risks considerably increasing the regulatory burden and costs as issues are left to escalate into significant material breaches.

Audit time will not decrease because three individual years' worth of audits will be required to be completed at one time. Each individual audit must be a standalone file in order to comply with auditing standards, meaning the same amount or even more auditing time is required.

Compliance with mandatory auditing standards imposed on all SMSF auditors require the auditor to form an opinion (for the financial statement audit) on the opening balances (and comparative figures reported in the financial report) of the year being audited. This essentially means the auditor would have to audit the year end balances in year two in order to form an opinion on the balances in year three; and repeat this process for each of the three years. This would, in part, defeat a two year audit free period, and ultimately negate the suggested cost reductions that these measures purport to produce.

It also can be more difficult to locate the necessary historical documentation and information for an audit that is for previous years, other than the immediate year. This will add time to the audit process and result in an increase to the overall audit fees. To avoid this issue, SMSFs will still need to provide all the regular documentation to the auditor. Both of these issues negate the two intended benefits of this proposed measure of a reduction in the regulatory burden and compliance costs.

As indicated in the discussion paper, the audits must be completed before the SAR for that year can be filed with the ATO. The additional time required to complete three years' worth of audits at one time puts at risk compliance with the requirement to submit the SAR in a timely manner.

As previously stated, the discussion paper also indicates that any trustee with a key event they are unaware of that results in late audits and SARs that are not submitted in a timely manner, will face additional penalties. There is also the risk of additional compliances costs and burden of an issue occurring in year 1 being left undetected until the end of year 3, and resulting in 3 ACRs then being required prior to submitting the SAR. This would deliver a significantly increase compliance cost and burden for SMSF trustees.

It also begs the question - If an audit is not being done annually, who will be left to identify non-compliance? Accountants? Financial planners? Trustees themselves? Given the complexity of the regulatory environment, we suggest there would be few trustees appropriately equipped to identify all potential non-compliance with the rules for operating a SMSF. Therefore introducing a three year audit cycle would create a void in the compliance regime of the fund and transfer the risk of compliance gatekeeper to another professional services provider, who will charge a fee for their services, again negating the reduction in the compliance burden and costs the Government is anticipating from this measure.

Self-assessment

As detailed in the discussion paper, it is proposed that eligibility for the three-yearly audit would be based on self-assessment by SMSF trustees. This approach is problematic as it puts trustees at risk of innocently misidentifying a key event and misunderstanding that this puts them in breach of the 3 year audit criteria.

A three year audit cycle - Consultation questions

While the overwhelming majority of FPA members who provided feedback on this proposal do not support the introduction of the three-year audit cycle for some SMSF funds, we provide the following responses to the consultation questions.

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

As discussed above, we believe they will ultimately increase the overall compliance burden and cost for SMSF trustees for the following reasons:

- the longer the period of time between audits, the higher the risk is of missing information and documentation which will delay the audit process and increase the audit costs for each year
- while the requirement is to produce three years' worth of audit reports in a short time frame, the audits must be completed in order of consecutive years. Therefore a delay in completing the year 1 audit, delays years 2 and 3, and the production of the SAR, increasing the risk of non-compliance, which will impact on the audit and compliance costs and potential for infringement penalties.

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

The consultation paper states:

> *"It is proposed that a SMSF with a history of three consecutive years of 'clear audit reports' be defined as a SMSF without any financial or compliance contraventions issued in an ACR in*

the previous three years. While a 'clear audit report' could be defined differently, for example as an unqualified audit report, use of the ACR is straightforward and an existing part of SMSF regulation."

While the ACR presents a straightforward and existing part of SMSF regulation for measuring 'clear audit reports', as discussed above not all issues that have an impact on the performance of the fund are key events or trigger the need for an ACR. However creating new criteria for measuring and defining 'clear audit reports' will only serve to further complicate the SMSF regulatory system.

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

If the aim is to improve compliance and record keeping then eligibility must be based on a SAR never being submitted late.

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?

If a SMSF has one of the key events listed in the consultation paper, it should not be eligible for a three year audit cycle.

An addition key event - if a SMSF trustee breaches the pension standards, such as paying more than 10% of the account balance for a transition to retirement account-based pension or paying less than the minimum required amount for a retirement phase account-based pension.

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?

We understand that the proposed staggering of the transition arrangements aim to assist the auditing industry to adapt to these changes. However this will lead to an even more complex system with SMSFs needing to work out when and if the proposed policy applies to them.

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

The FPA is concerned that the proposed three-year audit for some SMSFs will create an overly complex system that will result in loopholes in the regulations and increase the risk of non-compliance, to the detriment of SMSF members' retirement savings.

We do not support a move away from the annual auditing system.

If you would like to discuss the matters raised in this submission in further detail, please contact FPA's Head of Policy, Ben Marshan [redacted] or myself [redacted] on [redacted].

Yours sincerely

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