31st August 2018

To whom it may concern,

RE: <u>UPDATED Submission to answer Treasury's consultation questions</u> in relation to the 2018 budget proposal regarding the SMSF audit cycle.

I wish to voice my concerns regarding the budget proposal to amend the annual audit for self managed superannuation funds from annually to a 3 yearly audit cycle (my understanding being that it is three years audits bundled into once every three years).

SMSFs control over 30% of the $2.3 trillion dollars in total super assets, so you would think this warrants maximum integrity and checking via the annual audit function. Jeremy Cooper in the Super System Review Final Report (chaired by Mr Jeremy Cooper) actually concluded, *"the Panel believes that the annual audit provides a high level of assurance to members, regulations, government and the community more generally* [and] *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"*

The average audit cost apparently only represents 0.05% of a SMSF's total assets, yet protects over 30% of the $2.3 trillion dollars in total super assets….. The ATO statistic of only 1.6% of SMSFs lodging ACRs is because audits are done on an annual basis. It is proof that the annual audit system works, and works very well, to maintain a high level of integrity in the industry.

Using the "only 1.6% of Funds lodge ACRs" is a very flawed figure to base this proposal on for a number of reasons;

(1) it doesn't include all the breaches that are detected but aren't reportable in the first year – we get many of these and it's the very fact that we do audit each year and detect and nip them in the bud straight away that they don't become big reportable problems. Under the new proposal given this wont happen, I foresee a huge jump in ACRs being lodged in these situations

(2) many breaches that auditors uncover are first year breaches that don't have to get reported, but need to be reported in the second year if they continue – given we will no longer be auditing that subsequent year we will not be able to check that the problem was fixed/stopped, so many breaches will go unreported that should be reported, and the ATO will be none the wiser at all, or at best 3 years later. For example, we regularly uncover breaches/errors of less than the $30,000 reporting threshold that we get the members to repay and correct straight away so that no reportable contravention is required. Having to pay your SMSF back up to $30k is unpleasant enough, but can you imagine when this is left for 3 years and that $30,000 problem that was easy to fix in year 1 is now a $90,000 repayment + compound interest over 3 years? Such things will have a detrimental effect on trustees, and the industry overall.

(3) the 2% figure is only addressing Part B breaches. We very regularly find issues with the financials/ breaches of Part A of the audit report which we help correct and bring to trustees attention. Without annual audits, these issues wont be detected and resolved and will accumulate, resulting in possibly very incorrect financials that trustees will then be relying on for planning their retirement/future

So in a nutshell, that 1.6% figure is a very poor statistic to use to assess the 'compliance health' of the industry.

In response to the questions raised by Treasury in their Request for Feedback to this proposal;

1. **How are audit costs and fees expected to change for SMSF trustees that move to a 3 yearly audit cycle?**

   I envisage the cost for the vast majority of SMSFs on a three year audit cycle to actually increase for the following reasons;

   - The proposal does not change the audit procedures that are required to be undertaken by the auditor, so the amount of work that is required by the auditor will be largely unaffected, however the efficiency and availability of information will be affected, which will no doubt lead to additional audit time and therefore audit fee increased
   - Audit will be less efficient where 3 years of information and queries thereon are required. Auditors, like accountants and lawyers, are effectively selling their time and therefore any decreases in efficiency that lead to an increase in time required by the auditor equates to an increase in audit fees. I am currently completing the audits for an accountant who is 3-4 years behind with all SMSF work due to personal circumstance/ tragedy. I am finding the audits to be very inefficient in terms of missing information given the lapse of time, difficulty finding missing information requested from trustee/accountant, and difficulty for trustees to recall details of events from several years ago when queried by myself as auditor
   - Auditors fees generally increase from year to year, at least by inflation. Therefore completing three years of audits in year three means all three audits are at year 4 prices, which will therefore cost trustees more than if they had done an annual audits and paid audit fees in those particular years.
   - Given errors will not be picked up by the auditor until year 4 when the 3 yearly audits are done, this will see a big increase in amended financials and tax returns being required, especially where errors are picked up in the earlier years which flow through to subsequent years and necessitate all years being amended. As the auditor will need to re-audit these amended financials, this will of course increase audit fees.
   - Compliance issues identified in years 1 or 2 that would have otherwise been nipped in the bud whilst small and immaterial via communications with the trustee in the auditors management letter will likely require reporting to the ATO given the (initially immaterial in size) compliance issue has been left to accumulate in size over 3-4 years until the 3 yearly audits are done, at which point the issue is now material and a Auditor Contravention Report (ACR) is required. This will naturally increase audit fees.
   - There is also much talk in the industry that given the increased risk of compliance issues occurring due to the lack of annual monitoring, and the likelihood that the magnitude/ monetary value of these issues being much larger given they have been left to accumulate over several years before the next 3 yearly audits are completed, that auditor insurance is tipped to increase dramatically. This increase in cost for auditors will naturally result in further pressure to increase audit fees
   - Workflow issues created by the 3 yearly audit cycle will also put upward pressure on audit costs given auditors are more likely to have staffing issues and be inclined to use more costly contractors rather than employees due to the very unpredictable and 'lumpy' workflow that this proposal will create, even if staggered, due to trigger events chopping and changing the audit cycle status.
   - I anticipate that accountant fees will also increase in addition to auditor fees. This is due to the increased time that will be required by accountants under the 3 year proposal to monitor which SMSF clients are on annual vs 3 yearly audit cycles, and to constantly monitor all SMSFs for trigger events that will change their audit cycle status. This increased time to administer this new proposal will be passed on to trustees in the form of higher fees. Accountants too may see an increase in their insurance for similar reasons noted above in regards to an anticipated increase

in auditor insurance. Furthermore, the increased time in tracking down missing information and trying to ascertain details of events from several years ago with trustees will no doubt be much more time consuming under a 3 yearly audit cycle.

- The only cost saving I see is that of disbursements like title search fees whereby one title search can be done in year 4 that can be use for all three years audit reports, rather than paying for a title search fee each year. Having said that, title search fees can be as cheap as $7 and no more than $75, so the cost saving is very small, and is easily and significantly outweighed by the other predicted fee increases

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

- Clear audit reports should be based on both Part A and Part B considerations, not just Part B. Recent court cases regarding SMSF audits have shown that issues with Part A of the audit are just as important, if not more so, than part B issues given Part A issues are more likely to lead to litigation and losses suffered by SMSFs, and therefore the industry as a whole.
- Furthermore, an unqualified opinion of Part A and Part B of the audit does not mean there are no audit issues for the Fund – it just means that at the time of the audit the issues weren't material enough to warrant a qualified opinion. However if these issues are left unmonitored for 3 years, then these issues will likely snowball and become a large problem when the audits are done 3-4 years down the track. So consideration should also be given to audit issues that have been identified in the management letter, and not just the audit report.
- In regards to who reports whether a SMSF has a 'clear audit report', this should not be done by the accountant, tax agent or trustee, but from an independent party to ensure that this information is accurate and unbiased.

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

- An SMSF that has not lodged a late SAR in the most recent 3 years would be most appropriate ie if the proposal was to start 1 July 2019 then the SMSF would need to have lodged their 2019, 2018 and 2017 SARs on time.
- Having never lodged a late SAR is too strict, as there may have been reasons outside the SMSFs control as to why a particular year was lodged late (ie may have been the tax agent/accountant who was responsible for late lodgement due to staffing issues or some such thing that the SMSF shouldn't therefore be penalised for).
- Furthermore, simply requiring a SMSF to be up to date (by 1 July 2019 start date) with lodgements isnt appropriate as it ignores the SMSFs lodgement history by just looking at a point in time – this would therefore inappropriately allow SMSFs with poor lodgement history to move to three yearly audits just because they got all lodgements up to date just before the start of the proposal.
- *Using the SAR as a means of measuring eligibility is flawed in itself for a few reasons; (a) the auditor is not required to audit the SAR therefore the details therein may be inaccurate (b) arguably the SAR is not being prepared and provided by an independent party to the SMSF (ie the accountant/ tax agent) who arguably has a conflict of interest (c) it is not uncommon for accountants/tax agents to lodge the SAR before the audit is completed, especially when under deadline/ time pressures, which therefore skews the accuracy of the SAR lodgement as a means of assessing eligibility for the 3 year audit cycle*

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?**

From my experience, the following issues commonly create compliance issues or significant risk to the SMSF and therefore must be audited annually to minimise such;

- Limited recourse borrowing arrangements
- Properties with related party tenants/ leases
- Investments in related parties (ie related trusts or companies due to the strict compliance with reg 13.22 SIS Act that is required, loans with related parties)
- Collectible investments or personal use assets
- Commencing or commuting pensions
- Death of a member
- Exit/ rollout of a member or introduction/ roll in of a new member
- Acquisition of assets or selling of assets to related parties

5. **Should arrangements be put in place to manage transition to 3 yearly audits for some SMSFs? If so, what metric should be used to stagger the introduction of the measure?**

- The staggering of the introduction must be random so there is no room for manipulation
- Using the ABN or TFN (given some SMSFs don't have an ABN) could be used such that those SMSFs with no ABN or an ABN ending in 1-3 are audited in 2020 FY, then ABNs ending in 4-6 are audited in 2021 FY, then ABNs ending 7-0 are audited 2023

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

- The integrity of the sector will be compromised for the many reasons and concerns that have been voiced by the professionals in the industry, both auditors and accountants.
- The proposal is likely to create more red tape through the complex administration of the proposal for both accountants, auditors and the ATO.
- The proposal will significantly increase the risk of fraud in the industry given the lack of annual monitoring via the annual audit – the idea of an annual audit in itself serves as a strong deterrent to fraud for all those involved, whether it be the trustees or their family, financial planner, custodian, accountant etc. Knowing the SMSF wont be reviewed for 3-4 years may act as a temptation to many to do the wrong thing, knowing the issue wont be detected for several years
- The proposal will encourage and facilitate aggressive tax planning/tax avoidance through the easier manipulation of contribution caps and pension balances (and the minimum and maximum pension payments thereon)
- The possible cost savings for what is anticipated to be only a small number of SMSFs will be outweighed by other costs such as amendments to trust deeds, higher accounting costs and possible ATO penalties for small, inadvertent mistakes that become reportable given they are left to accumulate and grow over a 3-4 year period.
- even if the proposal is staggered as suggested above, there will still be a detrimental impact to the workflow of auditors and accountants whereby trigger events will create unexpected lumpy workflow that auditors and accountants will struggle to manage, which could have unwanted flow on effects such as;
- decrease in auditor numbers which will put great pressure on thr industry given the introduction of ASIC auditor registration a few years ago already say auditor numbers nearly halve from over 11000 to approximately 6000
- increased use of contractors to manage lumpy workflow could see a decrease in audit quality

- increase in use of overseas outsourcing of audit work which could see decrease in audit quality and more importantly, increase in risk for the SMSF given the sensitive data being sent overseas for processing
- increase in 'in house auditing' as accountants may see it easier to manage the differing audit cycles/ and which SMSF clients are eligible if they are in control of the audit function and timing thereof – this will have a detrimental impact on the independence of the audit function. The Cooper Review some years ago actually recommended to stop in house auditing for independence reasons.

A recent survey was conducted by Saul SMSF – I strongly encourage Treasury to review the results of this survey for further insight into the issues and concerns raised by this proposal.

Below is a copy of my original submission to SMSF Association and CPA Australia which details my concerns regarding this proposal, and summarises how the disadvantages far outweigh the advantages for the key parties in the industry, not just auditors.

FOR THE AUDITOR

ADVANTAGES	DISADVANTAGES
Some economies of scale for a small number of Funds, however likely just in terms of disbursement costs which a very immaterial	More costly and complicated audits given there is 3 yrs worth of information to try and obtain from clients, and 3 yrs worth of queries and questions to resolve – especially where info/ documents are required from third parties
Possibly increased fees if less competition as many auditors go out of business given the detrimental impact on their workflow	Increased audit costs if there are issues existing for the 3 yr period that are much harder and more timely to fix
	Harder to fix audit issues if they have snowballed for 3 yrs
	More auditor contravention reports (ACR) required as 3 yrs worth of mistakes will more likely breach the auditor reporting thresholds and require ACRs to be lodged with the ATO
	Unpredicatable and 'lumpy' workflow even if the proposal is staggered in, given trigger events can happen at any time to change the timing of an SMSFs audit cycle, which makes workflow near impossible for auditors to manage from year to year
	Given the above lumpy workflow, the proposal will likely force auditors to use contractors over employees, which will further drive up audit costs
	Software issues – many audit software packages don't allow for numerous years audits to be conducted at once, and once an audit is done and the software is rolled forward to the next year it is very difficult to go back and amend things if need be. Therefore software packages will need to be developed and updated to allow for 3 yearly audits, and such expensive software developments costs will naturally need to be recovered by charging higher audit fees
	Given the workflow issues and staffing issues, many auditors will go out of business as they cannot survive such a business model. The number of auditors has already dropped from over 11,000 to approx. 6000 since the introduction of auditor registration with

	ASIC, so I don't think the industry could survive another drop in audit numbers – this may likely see a resurgence of in-house auditing, which the Cooper Review recommended should be banned, as it compromises the integrity of the system due to inherent independence issues

FOR THE ACCOUNTANT

Some possible economies of scale in a limited number of cases	Increased time (& therefore cost passed on to trustees) for monitoring which clients are on annual vs 3 yearly, and if on 3 yearly which staggered stream they fall in. Also need to constantly monitor SMSFs for trigger events that change their cycle from 3 yearly to annual
	Difficulty collecting 3 yrs of information from clients & having clients remember events from 3 yrs ago (more like 4 yrs ago by the time the audit comes to being done)
	Increased costs if errors are found in the 3 yrs being audited (especially if in the first year of the 3 yr period) as 3 yrs of amended financial reports and 3 yrs of amended tax returns are required
	Software issues as accounting softwares don't allow accountants to roll back prior accounting periods/ years to fix mistakes found by the auditor years later. Software development costs will naturally need to be recouped via higher fees to SMSFs

FOR THE ATO

	Increase in ACRs being lodged given small errors (if audited and uncovered annually) will compound over three years and become reportable via ACRs – the ATO apparently do not have the resources to deal with the ACRs that are currently lodged under the annual audit system, so not sure how the ACR will manage a much larger number of ACRs being lodged
	Increase number of amended tax returns being lodged if errors are discovered in audit that require amendments to be made to tax returns
	Increased time (and therefore costs) to manage and monitor which clients are annual vs 3 yearly, and movement between those lists. Where the 3 yr audit is staggered to smooth workflow, this creates added complexity of having three different streams of 3yearly audits to try and monitor and manage
	Increased difficulty identifying which Funds are due/overdue to have audits done given complexity in managing/monitoring who is required to have audits done in which year and who may or may not have had a trigger event requiring them to have annual audits
	Increase in ATO penalties needing to be issued where contraventions occur that have strict liability provisions – causing likely public backlash against ATO

FOR TRUSTEES

ADVANTAGES	DISADVANTAGES
Can take advantage of a delayed audit review and may attempt to circumvent SIS compliance	Inadvertent errors which would be small if picked up annually will snowball into larger reportable errors that will increase accounting and audit costs for trustees, and possible ATO penalties
Some very small cost savings on small disbursements like title search fees that don't have to be done every year	Difficulty in retaining/ finding records, and remembering transactions and circumstances from 3-4 years ago
	Increased accounting fees and audit fees given more messy and time consuming accounting and audits
	Lack of annual communication and advice with/ education from auditor will result in more errors and issues
	Risk of assets not being safeguarded if auditors are not regularly/ annually checking on this
	Increased risk of fraud from third parties, knowing that audits only occur every 3 yrs , and if fraud does occur and given there is a significant (3-4 yr) delay in detecting this fraud the damage will likely be worse/compounded
	Increased costs with updating trust deed to allow for three yearly audits, as the vast majority of SMSF deeds require annual audits
	Increased risk of trustee penalties if errors are found that have been left to compound for 3 years into reportable (ACR) problems
	Increased risk of elder abuse is amplified where the audit is delayed

Given the above, I do not think changing the annual audit cycle to 3 years bundled together will reduce red tape and costs. Not only will it almost certainly have the exact opposite effect, but it will also damage the integrity of the sector. *I am currently completing the SMSF audits for an accountant who is 3-4 years behind with all his audits, and we are finding these audits to be much more messy and time consuming to complete. We are very rarely realising any economies of scale, and overall our audit fee is actually higher than normal for these audits given the inefficiencies created when such a passage of time has passed between audits.*

If you are looking to reduce red tape / audit costs, this can be much better achieved in other ways such as keeping annual audits but removing;

- some of the trivial requirements from the annual audit, such as checking and reporting if bank accounts go into overdraft by small amounts
- some of the administrative requirements like checking the retention of records and preparation of minutes by trustees
- not requiring auditors to re-report ongoing contraventions to the ATO given all details have already been provided and re-reporting adds no value or new information
- reviewing the Australian Auditing Standards in light of their application to SMSFs – possibly designing more relevant and efficient auditing standard specifically for SMSFs given the current auditing standards can be quite irrelevant as they encompass the audits of other entities such as companies, which are vastly different to SMSFs.

- Further to the above, amending the auditing standards to allow SMSF auditors to allow on work from other professionals such that auditors aren't required to re-audit work of others at the cost of the SMSF
- Removing the requirement for SMSFs that are 100% pension mode to get an actuary certificate – this was never required in the past however given the recent budget changes, this is now required and it adds unnecessary red tape and cost to the audit for little/ no value (as the actuary percentage will confirm 100% exempt anyway)

The above suggestions would benefit all SMSFs across the board, rather than this 3 year audit cycle which will only benefit a select few whilst arguably being to the detriment of other SMSFs, and the industry overall.

I believe it is much better to do a quicker, cheaper annual audit (based on the suggestions above) that focuses on the important things, rather than do a 3 yearly, more expensive audit that includes more trivial things.

My biggest concern is that this proposal will create animosity between accountants and auditors and trustees given the added costs, complexities and disadvantages (which appear to greatly outweigh the advantages) this proposal will create - it is already a delicate relationship but I think this proposal will see a breakdown in collaboration between the parties within the sector.

If you would like to discuss my submission further, please do not hesitate to contact me on [redacted] or at [redacted]

Kind regards,

Cherie Archibald
Registered SMSF Auditor, SMSF Specialist Auditor, CPA, NTAAF