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

   Direct Costs

   Year End Asset Valuation Tests, Compliance checks, Member Balance, Transfer Balance Accounts, Total Superannuation Balance Accounts, Taxable/Tax Free components, preserved and non-preserved components, yearly earnings allocations and tax effect will have to be tested for each of the three years separately. Therefore direct costs would more than likely not change since the period of audit is not for one out of three years but for three years of audits done in one year.

   Requests, compilation and storage of audit support documents may become time consuming since these functions would be actioned for documents covering a triennial period of time which could result in an actual increase of direct costs.

   Trustees could possibly change advisors or auditors during the three-year cycle and audit document exchange for the three-year period between auditors and advisors could be on a one to many, many to one or many to many basis thereby increasing direct costs.

   Hidden & Indirect costs

   The eligibility criteria firstly states that eligibility for a three-yearly audit be based on Self-Assessment by SMSF Trustees. The superannuation sector has faced constant legislative changes with almost every political regime change in recent times, the most significant during the 2017 financial year. Policy implementation delays or complex calculations during such years of complex change could potentially delay the lodgement of a SAR in a timely manner which could impose a hidden cost to trustees if they fail to submit a SAR in a timely manner. This would also be the case in a year of trustee death or critical illness. The trustees may be asked by the ATO to have the fund audited for the respective breach year and/or impose further action. Accordingly, these contingent costs need to be considered.

   Errors detected by the auditor for the first year of the three-year audit period, which need rectifications could result in the trustees paying additional accounting fees to rectify such breaches. If there is an underpayment of income tax due to audit findings, GIC may apply from the time of lodgement of the 1st year return and the date of amendment which could be 3 years. This cost is completely minimised by annual audits. Depending on whether the error was caused by the trustee or advisor, the relevant party would incur the costs which is why prudent advisors would advise trustees to continue with annual audits.

   Advisor PI costs could be affected if claims are made by trustees for potential GIC and tax penalties arising from late amendments.

In the event that the trustees have changed advisor/accountant or auditor during the three year period and errors are detected, trustees could find it difficult to identify which advisor/accountant was responsible for the errors and may have to lodge a claim with both the advisors. Conversely, the PI risk for an advisor/accountant would be significantly higher if they accepted an appointment for an SMSF during an audit year where the previous two unaudited years SAR and Financial Statements were compiled by a different advisor with no assurance from an auditor that they have been correctly compiled and SARs lodged are true and correct.

2. **Do you consider an alternative definition of 'Clear Audit Reports' should be adopted? Why?**

Treasury has misunderstood the Audit Process where it defines "Unqualified Audit Reports" as "Clear Audit Reports" (CARs) and claims a low 1.6% of SMSFs were issued with Audit Contravention Reports.

It is common knowledge within the SMSF sector that a significant number of funds undergoing audits are either withheld for lack of documentation/ information and/or sent back for corrections. Our firm's census shows 30-35% of funds have to be rectified each year by the advisor/accountant and a staggering 40-45% of funds lack appropriate and valid documentation. Furthermore, in quite a few cases, the documentation is prepared or sourced after the audit enquiry. If the annual audit process was deferred to 3 yearly audits, the percentage of funds issued with ACRs in the third year would jump significantly. This would put an added compliance pressure on the ATO's already stretched resources.

CARs should therefore be redefined and distinguished from Unqualified Audit Reports. CARs should only be issued to Funds which have passed the following tests for the preceding three years:-

1. Unqualified Audit Reports issued for Financial Statements & Compliance; and
2. Proven recordkeeping signed off by the Auditor where they did not have to request for documentation; and
3. All documentation was already on file and not sourced or prepared after enquiry from the auditor; and
4. Auditor did not recommend changes to Financial Statements and SARs.

3. What is the most appropriate definition of Timely Submission of a SAR? Why

The most appropriate definition would be "an SMSF which has not submitted a late SAR in the last three years and has been issued with a CAR for the last three financial years.
The ATO's reaction times to ACRs is delayed by almost 18 months at times. The action taken by the ATO after issuance of an ACR is often a generic 1 page letter to the trustees asking them to rectify the breach or face Compliance Audits. Stringent testing therefore needs to be undertaken in the preceding three years and only funds with timely submitted SARs and having received a CAR from the auditor for each of the three years should be deemed to have submitted a true and timely SAR.

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 risk

Key events & events that present the most compliance risk and for which a fund should be subjected to Annual Audits are as follows: -

1. Change of Auditors or Advisors during a financial year. There is a very high compliance risk for a fund having changed Auditors or Advisors and not having an annual audit performed during the year of change,
2. Newly formed Funds,
3. Funds where a member has died during the year,
4. Funds that have introduced new members,
5. Funds that invest under Limited Recourse Borrowing Arrangements,
6. Funds having significant inward and/or outward rollovers of member benefits,
7. Funds commencing or terminating a pension,
8. Performing in-specie contributions/pensions,
9. Payments to/or performing related party transactions during a given year,
10. Funds carrying unlisted shares,
11. Funds carrying Collectibles and/or real property investments requiring independent valuations,
12. Funds affected during years in which comprehensive changes in Superannuation Legislation has occurred (as in 2017).
13. Funds wherein members have gone through a divorce/separation,
14. Funds with Pre-99 Trusts,
15. Div 13.22C Trusts,
16. Funds with Total Superannuation Balance > $1.6m and funds which have commenced pension accounts with maximum allowable TBCS,
17. Funds with segregated assets,
18. Funds with a TRIS account balance,
19. Funds in pension mode.

20. Funds with investments made in cryptocurrencies.
21. Personal injury (structured settlement) contributions.

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?**

Three years of CARs should be lodged for funds commencing between 2019 and 2021 financial years together with Timely submission of SARs for each of these years. The three year audit cycle should then commence from 2022 financial year and no earlier.

Policy makers should allow advisors to stagger 3 yearly audits of eligible funds by dividing the eligible funds on a 1/3rd basis and having a third audited for financial year ending 2022, a third during 2023 and the remaining in 2024. These three batches could then be audited every third year. Staggering it on this basis would ensure that the advisor and auditors do not have to cope with a significant amount of workflow .

Having all eligible funds audited in every third year would be similar to Treasury announcing and implementing budgets every third year and advising their staff to go on leave for the first two years and come back every third year.

6. **Are there any other issues that should be considered in Policy Development?**

1. **Commercial Viability & Survival of SMSF Audit Firms and Staffing Issues**

Treasury, while announcing the three year audit cycle utterly has disregarded the commercial realities of employment & staffing faced by SMSF Audit firms which are mostly small businesses typically run by a Licenced SMSF Auditor Principal and qualified staff.

The three year audit cycle policy if implemented will force these small businesses to terminate staff during years of non-audit and engage them again in the third year, a scenario so ridiculous that it is laughable. No thought has been given by the government on how these businesses are supposed to operate & maintain the continuous employment of qualified staff, survive during non-audit periods and then be expected to recommence work in the third year. Imagine, if treasury was told to shut down for two years and then draft and implement budget policies on a three-yearly basis in the third year.

The policy will provide no incentives for professionals to work in the SMSF Audit sector and accordingly make it extremely difficult for firms to source, train and retain professional staff.

This policy appears to be announced by a Government Sector, bereft of finance knowledge and not by the Treasury Department of a First World Country.

2. Australian Auditing Standards vs Trustee Self-Assessment

Australian Auditing Standards prescribe that Audits be generally conducted within a few months after the end of the **Annual Financial Reporting** period. This provides confidence to users of financial reports and regulators on various aspects of the entity's operations and its financial position. Treasury, by prescribing a three yearly audit cycle completely ignores these prescribed standards and is now prescribing its own Auditing Standards in the SMSF environment without consultation with Institutions like CAANZ and CPA Australia. The time delay in audits is fraught with dangers of non-compliance (in some cases irreversible) being detected very late. Furthermore, the burden of Self Assessment for the three yearly audit cycle is being shifted to the trustees rather than following Australian Auditing Standards which prescribe audits of continuous periods within a reasonable time after the end of the financial period.

CAANZ, CPA, IPA and other accounting bodies should accordingly prescribe that SMSFs continue with Annual Audits in line with Australian Auditing Standards and not in line with Treasury recommendation.

3. Professional Indemnity

As part of the Future of Financial Advice (FOFA) reforms, the 'accountants' exemption' was repealed on 1 July 2016. This reform required accountants providing strategic advice on SMSFs to either hold an AFS licence or to be a representative of an AFS licensee. An accountant that is licensed to provide SMSF advice is required to provide clients with a Statement of Advice (SOA) which defines the overall superannuation/SMSF strategy. The overarching intention of the legislation was to protect the trustees' interests through the process of articulating needs and formalising recommendations. A lesser known fact to treasury is that Advisors and Auditors communicate on a regular basis when providing client advice and also during the preparation/audit of financial statements. If issues are detected during the annual audit, rectifications are sought and SOAs are amended accordingly. However, if the 3-year audit cycle were to be implemented, and the auditor identifies an issue in the valuation of investments during the first year of the 3-year period, adjustments will be required to the total asset values & member account balances reported by the SMSF at the end of the first year. Effectively, member balances, pension payment advice, contribution advice, Transfer Balance Accounts, Total Superannuation Balances and various other items on Financial Statements and SOAs prepared by the accountant/advisor for the first year and the subsequent 2 years will be based on incorrect data and he/she may be liable to damages in case a professional indemnity claim is made by the trustees. Currently, the advisor or the accountant is not liable to opine on the accuracy of the information reported in the financial statements of the SMSF, since the SOAs are prepared after annual audits.

Not all advisers are experts at valuations and compliance issues and not all accountants prepare true and correct unaudited financial statements. Even with the level of automation, honest mistakes are often made and incorrect advice is drafted which is easily corrected during the annual audit checks. An annual independent audit report provides significant comfort not only to an SMSF trustee but also to the advisor/accountant - should anything go wrong, or should any advice they provide be incorrect or even illegal, checks and balances within the audit system will allow amendments to be made in a timely manner. This in turn provides protection for advisors against Professional Liability claims as well as liability protection for Trustees against compliance breaches at no additional cost. Some of the issues arising may not even be correctable (e.g. an overvaluation of assets in year 1 could potentially have a TRIS member drawing more than the maximum 10% in subsequent years. Conversely an undervaluation of assets could result in a retirement phase pension member drawing less than the minimum required).

If the 3-year audit cycle is enacted, there will be a steady rise in professional indemnity claims and trustee breaches which will in turn increase fund administration costs for the industry in general, let alone, the time value of money in defending potential liabilities for advisors and trustees. We are looking up to the American governing system, where there will be less regulation but excessive legal claims, if these measures are implemented.

4. Resource issues

The Australian Taxation Office is ill-equipped with resources to follow up on audit contraventions. Matters are often followed up 12 months after the audit has been completed, which in most cases is 18 months to two years after the actual breach. A 3-year audit cycle reporting contraventions in the fourth year may potentially be picked up by the ATO in the fifth year after the issue is reported in the fourth year. There could be time bar issues for the trustees and advisors who could potentially face penalties for time barred breaches that cannot be reversed.

5. Administration software

The normal process for Advisors is to prepare draft financial statements and SARs and have them audited before performing a year end close. The ATO specifically asks for date of audit completion on a SAR each year.

SMSF accounting and administration work is performed on a variety of software platforms, many of which, from a compliance and data capture point of view, are not sophisticated. Year end closures conducted on such unsophisticated systems make it very difficult to reopen a closed financial year and amend errors or mistakes. This is easily achievable if errors are detected during the audit process before year end closures. These systems are not automated to capture market valuations of assets, calculations of earning rates, allocations of earnings to member accounts, tax effect and deferred tax accounting entries, maintenance of Total Superannuation Balances, Transfer Balance accounts and other calculations which accountants have to perform and manually input into these systems. A 3-year audit cycle detecting errors in the 1st year would make it extremely difficult for the accountant to recalculate accounts and balances in these systems. Accountants with a relatively small SMSF client base find it uneconomical to invest in sophisticated systems and therefore an annual audit would be the preferred choice for these Accountants to ensure all checks have been done before performing year end closures and thereby safeguarding themselves and the Trustees.

Conversely, sophisticated accounting systems perform automatic calculations for valuations of listed assets, earning rate calculations, member earnings allocations and tax effect entries. They also maintain Member Registers, Total Superannuation Balances and Transfer Balance account registers which are updated regularly. However, these systems still require earnings, buy-sell and valuation reviews from the end user for unlisted, property and other asset classes and for calculations of exempt pension income. These systems automatically calculate and allocate earnings on a daily basis and issue year end close warnings that closed years should not be re-opened unless the user wishes to perform a re-entry of fund data. This makes it even harder to reopen two preceding years and adjust major errors. Any changes to previous year balances will result in incorrect earning allocations for following years depending on the frequency and volume of pensions, contributions and earnings. In most cases, reopening two previous years would require a re-entry of earnings, contributions and pension data to ensure correct allocations and calculations are made by the system. Accountants administering a large SMSF client base using these systems could potentially face an equally large volume of unnecessary amendments on these systems and face huge time costs. They too would opt for an Annual Audit to ensure that correct year end closure is performed after an annual audit.

Treasury has not researched the process of SMSF Financials/SARs preparation and the audit process before announcing the budget measures.

Given the Other Issues surrounding a three yearly audit cycle, the policy should not be implemented. Guidance should be sought from CAANZ, CPA Australia, IPA and auditors and accountants to further provide assurance to Treasury that the policy is unworkable.