30 August 2018

Mr. Robert Jeremenko
Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuation@treasury.gov.au

Dear Mr Jeremenko,

SMSF ASSOCIATION SUBMISSION ON THREE YEARLY AUDIT CYCLE FOR SOME SELF-MANAGED SUPERANNUATION FUNDS

The SMSF Association (SMSFA) welcomes the opportunity to make a submission on Treasury's discussion paper "Three-yearly audit cycle for some self-managed superannuation funds". We are pleased Treasury has undertaken an extensive consultation because the potential implications of the proposal are significant for the SMSF sector.

In simple terms, our submission assesses the benefits of the proposal against the likely costs and complexity involved, as well as risks to the integrity of the SMSF sector. An additional consideration is whether there will be a meaningful uptake of the proposed triennial audit by eligible funds and their advisers.

Our analysis leads us to believe that the costs and complexity of creating and implementing the proposed triennial audit proposal for eligible SMSFs, would outweigh the benefits provided to the SMSF sector and pose potential integrity risks. We believe cost reductions for SMSF trustees would not be substantial and would not justify the increased complexity and potential integrity risks for individual SMSFs as well as the broader sector.

We also believe that there may not be significant take-up of the proposed triennial audit by SMSF trustees as our research has shown that many SMSF advisers may recommend that their clients undertake annual audits to ensure that their fund is compliant.

There may be an audit proposal design that ultimately does allow appropriately eligible SMSFs to benefit from reduced audit requirements without significantly risking the integrity of the SMSF sector. However, the proposal will only be effective if eligible SMSFs decide to utilise the potential benefits.

In our analysis of the proposal below, we present results from a SMSF Association member survey, analyse policy and implementation issues with the proposal, and answer the discussion paper's consultation questions. The key points we make are:

- The proposal is unlikely to result in a significant cost reduction for eligible SMSFs.
- Take-up of the option to have a three-year audit may not be substantial and may not deliver benefits across the sector.
- The proposal may undermine the integrity of the SMSF sector and minor compliance breaches may become more difficult to rectify.
- The proposal will impact SMSF audit businesses and may reduce the quality of the SMSF audit workforce, affecting the quality of oversight of the SMSF sector.
- Current Australian Tax Office (ATO) statistics indicate that only 3% of SMSFs had a breach that was considered material in nature and reportable to the ATO. Unfortunately, due to the nature of compliance data, this is not a true indication of the role auditors play in resolving potential issues and maintaining the integrity in the SMSF sector.
- Eligibility criteria using "triggers" to require annual audits may make the current compliance system for SMSFs more complicated and outweigh any red-tape reduced by three-year audits.
- An appropriate transition to three-year audits is needed if the proposal is to be implemented.

SMSF Association membership view

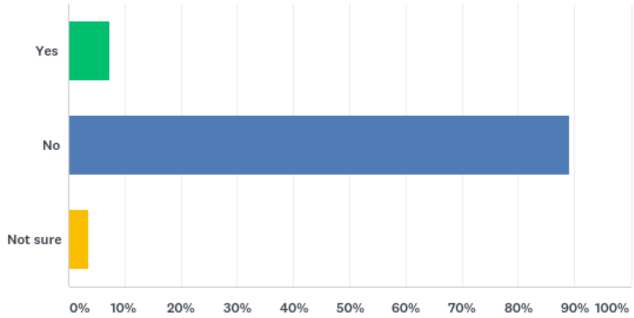
We have surveyed our professional members (249 responses) and they have indicated that they do not support the implementation of the three-year audit proposal. We believe that this is reflective of the broader sentiment across professionals working in the SMSF sector.

Key results from the survey indicated that:

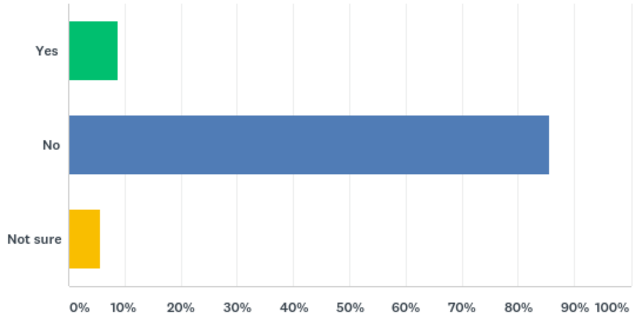
- 89% of our members do not support a three-year audit proposal.
- 86% believe that audit costs will not be reduced.

- 84% will recommend that their clients continue annual audits and not make use of the proposal.

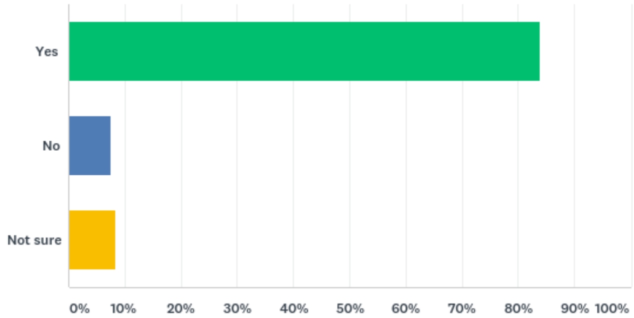
Q2 Do you support the change of the annual audit requirement to a three yearly cycle for eligible funds with a history of good record keeping and compliance?



Q3 Do you expect audit costs to be reduced for SMSF trustees that move to three year audits?



Q5 Will you recommend your clients continue annual audits? (Will you continue to opt-in for annual audits?)



Our members views on implementation and integrity issues are further reflected throughout this submission.

Exploration of benefits, costs, and risks to SMSF integrity

The proposal would have an indifferent impact as a cost reduction measure

We believe that the proposed policy would not achieve the policy rationale of reducing costs for SMSF trustees. As a triennial audit involves auditing three years at once, it is expected that this would push the existing annual costs into the final year of the three-year audit cycle, resulting in no or minimal savings for most SMSFs.

In the majority of cases, our members conveyed the notion that SMSF audit fees may in fact increase. Auditing three years' worth of information may not create the desired efficiency due to the fact that auditors and trustees will lose familiarity with the fund. This would result in further complexity in auditing transactions that have occurred up to 36 months prior.

Auditors would also need to spend more time confirming opening balances and validating transactions and assets to satisfactorily reach their audit opinion over this longer period. Consequently, we believe that this proposal may increase the time spent by auditors and trustees when conducting the audit, particularly when obtaining historical documentation and details for prior years.

It would also impact third parties, such as platform providers, who are accustomed to providing information about the financial year just passed. Under the proposed regime, they would also be asked to provide information about the preceding two financial years, but only in respect of those SMSFs that are having a three-year audit. This is envisaged to involve additional costs and delays.

Additionally, when issues do occur the potential for them to become major problems and the process of rectification may increase fees to the client. These issues are explored later in our submission.

However, there may be a subset of funds that can achieve small cost savings by moving to a three-year audit. This notion entirely depends on the simplicity of the SMSF and its quality of documentation. Typically, funds with 'vanilla' investments are the easiest to audit. Trustees may also appreciate not having to engage an auditor every financial year, giving them the ability to lodge SMSF Annual Return (SAR) earlier.

Based on anecdotal information provided by our members, an example of the 'best' outcome for an SMSF trustee utilising this proposal may involve a reduction of a $600 per annum audit fee to $1500 for three years. Ultimately, the savings are borne out of reducing work on multiple SIS compliance documentation, audit reports, the trust deed and the auditing of investments that are similar over three years.

The SMSFA has concerns that this benefit is quite minimal when compared to the risks of the increased costs to SMSFs and professionals who have to engage in a three yearly SMSF audit environment. This cost may be significant for those SMSFs which contain inadvertent errors and breaches, and, poor record keeping. It will also present a risk to the SMSF sector of a small percentage of SMSFs which intentionally do not comply with legislation not being subject to annual scrutiny by an independent auditor. Furthermore, a cost will arise for typical SMSFs which must navigate the three-year audit rules and seek advice on whether they are eligible for the proposal.

Where audit savings do occur, there is a risk that the proposal may merely push costs from the auditor to the SMSF adviser, administrator or accountant. It is highly likely that if an SMSF is moved to a three-year audit, an additional layer of checks and reviews will be undertaken by these parties as a 'best practice' process when an SMSF is unaudited in the financial year under review. We believe that SMSF advisers are already ensuring that their clients are creating accurate financial statements and have complied with the SIS legislation, but the SMSF annual audit is used as a 'back-up' to these processes. It has been expressed to us by members that a 'review' fee is likely under this proposal. Furthermore, our SMSF member survey found that 84% of respondents believe that a three-year audit cycle will increase the time spent on compliance by auditors, advisers, accountants, administrators, and trustees.

It is also important to note that audit fees are typically small compared to members' balances. A typical audit is estimated to cost between $500-$800. It is widely accepted that SMSF audits that are completed for fees much lower than this amount potentially lack rigour and compromise the quality of the audit. A three yearly audit may lower the costs for some SMSFs, however SMSF auditors are already experiencing pressure on fees through high levels of competitive pressure and technological advances.

We also believe that the majority of SMSF trustees aim to achieve their lodgement on time and keep good records. The incentives for trustees to do so include earlier taxation refunds, cheaper administration fees and less regulatory oversight and penalties. We do not imagine that a three-year audit will motivate a trustee any further than the current incentives that are on offer to them. This places further doubt over the policy rationale of the proposal.

Rectification and unwinding of breaches are difficult

Adding to the issue of cost-effectiveness and benefits accruing to the trustee, any error picked up in a triennial audit that must be rectified will result in more costs and burden to the trustee, auditor, and any accountant or adviser who provides services to the trustee.

Rectification of issues over a three-year period would involve the auditor sending compliance issues back to the trustee and accountant to correct. This process would be difficult and time consuming for advisers, administrators and accountants when multiple financial years are involved because a change in a particular issue in year one can result in a re-work of administration, accounts and amended tax returns for years two and three. A minor error that could typically be resolved simply through the annual audit process may become a material error in a later year, increasing costs to the auditor, trustee and accountant to unwind and rectify. For example, a common pension misstep is when an SMSF fails to pay the minimum pension by 30 June which would require multiple years of fund tax returns to be amended if it this is not picked up until year three.

In order to rectify an error, the auditor would have to notify the accountant to amend their financial statements and then re-audit the SMSF. This would result in an accountant re-opening financial years and amending transactions which can be a complex process. Opening up numerous financial years would complicate this process further by needing to ensure that market values and earning rates, closing balances and relevant compliance actions, which rely on these elements, have not changed. A triennial audit therefore has the risk of significantly increasing costs and time for accountants, washing out any savings SMSF trustees or industry may have garnered from moving to a three-year audit cycle. This also increases the work for the sector advising SMSF trustees with the likelihood that this cost will be passed on to the trustee.

Compliance breaches not being picked up

It has also been suggested that under a triennial audit, compliance breaches will not be picked up in a timely manner.

Annually, auditors detect issues such as member tax components errors, pension and contribution missteps, inappropriate related party transactions, and incorrect market values. Under a triennial audit, these issues will potentially go unresolved for up to three years. Noting that an estimated 20-30% of SMSFs have a compliance issue to some degree[1] (although most often not material and reportable to the ATO), these may be exacerbated over a three-year period, resulting in a compliance breach that otherwise might not have occurred. Therefore, the risk of inadvertent breaches not being identified and resolved annually significantly increases which could negatively impact the integrity and efficient functioning of the SMSF sector.

The proposal also increases the risk of trustee's inadvertently breaching certain SIS legislative provisions over multiple years which can result in increased costs, taxes and penalties for the fund. For example, if a market value of an asset was deemed incorrect by an auditor and the fund has utilised this asset to commence a pension under the $1.6 million transfer balance cap incorrectly, upon correction it may be that the trustee has in fact breached the $1.6 million transfer balance cap for a period of up to three years resulting in three years of adverse excess transfer balance tax outcomes.

However, we note that auditors only provide compliance checks after the fact and therefore cannot solely prevent all breaches in the first instance. Compliance with the required laws also rests with the SMSF trustee and advisers and the reduction of an annual audit may encourage advisers to be more thorough in ensuring that they are providing compliant advice. Ultimately, it is the increase in time between audits that increases the risk of non-compliance to the trustee.

Possible deterioration in SMSF standards and integrity

Without the compulsory annual audit, there is an argument that the overall compliance standards of SMSFs and the integrity of the SMSF sector may deteriorate. However, ultimately it is the trustees who are responsible for the compliance of their SMSF, not the independent auditor.

A lack of continual engagement with auditors may encourage a small minority of unscrupulous advisers and accountants to attempt to circumvent the SIS compliance rules due to the reduction in independent oversight. Adviser and accountant standards may also drop without the consistent expertise of an SMSF auditor and because for two out of each three years their work will not have independent oversight.

Conversely, the financial advice and accounting professions may further raise technical standards knowing that they have less of a safety net from the SMSF auditor. This is likely to occur through

[1] This estimate was provided by the majority of our SMSF professional members.

undertaking more thorough compliance assessments of their clients exercising greater diligence regarding compliance issues. To the extent that this proves to be the case, the extra input will come at a cost to the trustees.

We also note that engaged SMSF professionals may be able to more actively monitor compliance issues for their SMSF clients through the advent of real time data flows and event based reporting. These advances give a platform for inadvertent breaches to be picked up quicker throughout the year than in the past by highly engaged SMSF professionals.

Consideration must also be given to the risks involved with the provision of financial advice to SMSFs where the SMSF is unaudited in prior years. Currently, the annual audit cycle provides advisers with a certain degree of comfort that an SMSF has no outstanding or undetected compliance issues from prior years when providing advice. However, a three-year audit cycle may mean an adviser will need to make recommendations based on the assumption that the SMSFs circumstances are fully complying when this may not be the case.

In regards to the integrity issues highlighted in this section, there is a heightened risk for the subset of SMSF trustees who do not engage with an SMSF professional every year for accounting or administration services. For these trustees, their SMSF may be more prone to errors and non-compliance without a legislated annual audit.

The current annual audit process has delivered a high degree of compliance with the relevant taxation and superannuation laws in the SMSF sector. The independent audit and expertise of SMSF auditors has played an integral role in ensuring the integrity of the SMSF sector. This is especially important given the tax concessions afforded to superannuation funds as well as the significant sum of money held through SMSFs ($750 billion as of June 2018). This important role has been recognised previously as crucial to the success sf the SMSF sector by the Cooper Review and the ATO.

The Cooper Review noted that "[approved] auditors are the cornerstone of the existing regulatory framework and are heavily relied on by the ATO to manage SMSF compliance" and that "the annual audit provides a high level of assurance to members, regulators, government and the community more generally". From a regulatory perspective, we believe little has changed since the Cooper Review was published in 2010 to diminish the importance of the audit to the SMSF sector.

Where there are compliance issues, SMSF auditors play an integral role in assisting SMSF trustees and their advisers correct mistakes. This ensures the efficient management of the SMSF sector and SMSF auditors are an important backstop to ensure SMSF trustees are running their funds in accordance with the law.

While we strongly support striving for improved efficiencies in the sector, the SMSFA does not want to compromise the integrity of SMSFs. This is especially the case if the cost saving achieved by changing audit arrangements is minimal.

SMSFA Recommendation

The SMSFA believes policies to reduce costs and improve efficiency in the SMSF sector should always be considered. We believe there may be a subset of SMSFs that would benefit from small cost efficiencies achievable under a triennial audit regime.

However, the greatest concern for the SMSFA is that the proposal would not achieve a reduction in costs and efficiency or introduce sufficient incentives for the sector as a whole. Furthermore, the design and application to alter the current audit system to incorporate what is an eligible fund, trigger events for annual audits, monitoring and staggering of three-year audits, especially early on, may be so difficult that the costs and complexity outweighs the benefits. Integrity risks also need to be considered given the small cost saving likely to accrue from the proposal.

Noting these concerns and the fact that our members would continue to recommend that SMSF trustees opt-in to annual audits, we believe the Government should reconsider progressing the proposal. If the Government wishes to proceed, we have outlined further considerations and alternatives to the consultation questions below to ensure the proposal has the best possible chance of succeeding.

Consultation questions

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

For the reasons and issues highlighted above, we do not expect audit fees to significantly change for SMSF trustees that move to three-year audit cycles. Financial advice and accounting fees could increase if compliance burdens shift to those service providers and because extra advice is needed to comply with the new audit rules (particularly regarding SMSF trustees needing to assess if they have had a trigger event for an annual audit).

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

The SMSFA believes the definition of 'clear audit reports' as an audit without an Auditor Contravention Report (ACR) is too wide to be adopted for eligibility for the three-yearly audit unless stringent eligibility requirements are imposed (See question 4).

Current ATO statistics indicate that only 3% of SMSFs had a breach that was considered material in nature and reportable to the ATO. Unfortunately, due to the nature of compliance data, this is not a true indication of the behaviour and level of compliance in the SMSF sector because the vast majority of breaches are not material, the auditor may or may not qualify the audit for certain breaches if it does not meet the ACR reporting standards, or trustees are given the opportunity to rectify before lodgement of an ACR.

Research from Deloitte found that 28%, or around 1 in 4 audits, resulted in a finding that was reported to the trustee. This includes management letter points, and breaches which were not considered material and reportable to the ATO.

While most of these findings may not incur a significant risk to the integrity of the SMSF sector and trustees, some findings do present this risk.

For example, 43% of findings related to non-compliance with the investment strategy under Reg 4.09 which typically occurs when a member's investments fall out of the bands provided in the strategy due to market fluctuations or specific investments. This is generally a low risk finding that would not be sufficiently impacted whether under an annual or three-year audit cycle.

The same rationale may apply to the second largest finding of 18% regarding incorrect ownership of assets under Reg 4.09A, which typically relates to the incorrect naming of assets. This finding is also typically low risk, but in the event of a bankruptcy there is potential for the trustee to lose these assets because they are not clearly owned by the SMSF trustee.

However, 17% of findings related to the valuation of assets under Reg 8.02B. Under a three-year audit cycle, the risk to integrity of the sector, costs and compliance issues for this finding are quite substantial. For example, an incorrect valuation of an asset which is not identified early can involve material financial mistakes that need to be rectified and can also cause adverse tax results with the transfer balance cap, total superannuation balance and taxable income.

These findings are reportable ACR items, but typically due to the ATO reporting thresholds, materiality and propensity to be fixed they are not reported to the ATO. Auditors, SMSF professionals and the ATO actively encourage good compliance through these measures. Therefore, while most findings are able to be mitigated, the utilisation of a clear audit report via an ACR does not adequately recognise all the risks which can occur in an SMSF audit, especially over three years.

In determining eligibility, Treasury should also turn its mind to the Part A financial statement aspect of the SMSF audit. Material financial mistakes which affect taxable income, expenses and revenue, are not reportable contraventions and thus do not provide oversight to the ATO. Over three years, the potential for financial mistakes to occur increases, and for this to result in SIS breaches also increases. While financial misstatements are able to be rectified by the trustees, we recommend that the reporting system be amended under this proposal to ensure qualified audit reports under Part A are notified to the ATO via the SAR to ensure these funds do not fall under the definition of 'clear audit report'.

Conversely, if Treasury proposed that a clear audit report signifies no management letter points or non-material findings, while it provides a better indication of good compliance, the Government would have no formal oversight of this arrangement.

Unfortunately, there is no current clear best fit model available in the SMSF reporting regime which suits this proposal. While there may be merit in amending the reporting of audit requirements, materiality and standards to garner a more accurate indication of SMSF compliance, the costs and effort in doing so may be extensive and increase red-tape.

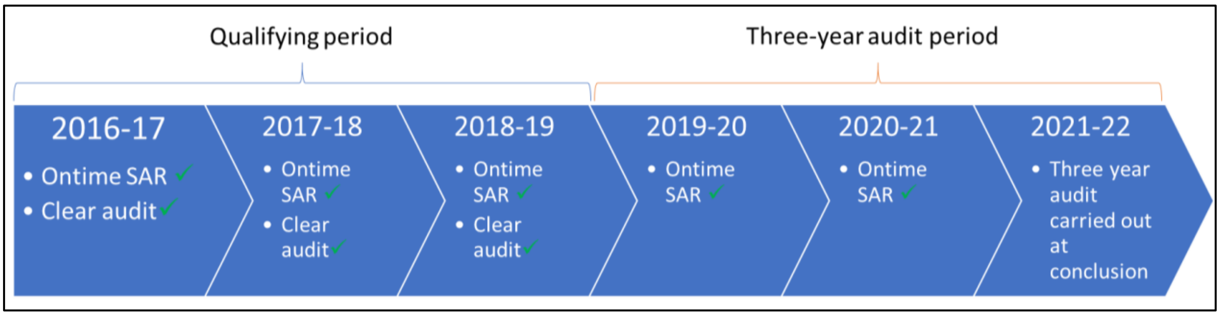
We believe the most appropriate definition of 'clear audit report' in this circumstance is an unqualified audit report for both Part A (financial audit) and Part B (SIS compliance audit) of the SMSF audit. Currently, the SAR only provides the ATO with oversight of Part B. The SAR should be amended to include Part A, even when an ACR is not lodged if this proposal is to proceed.

Therefore, the most appropriate test for eligibility may require two legs. First, the fund must have three years of 'clear audit reports'. Second, it must not have any investment or "trigger events" that require annual audits or pass a more principles-based eligibility test (discussed further below). We believe this would provide an appropriate balance between allowing some funds to be eligible for three-year audits and maintaining the integrity of the SMSF sector.

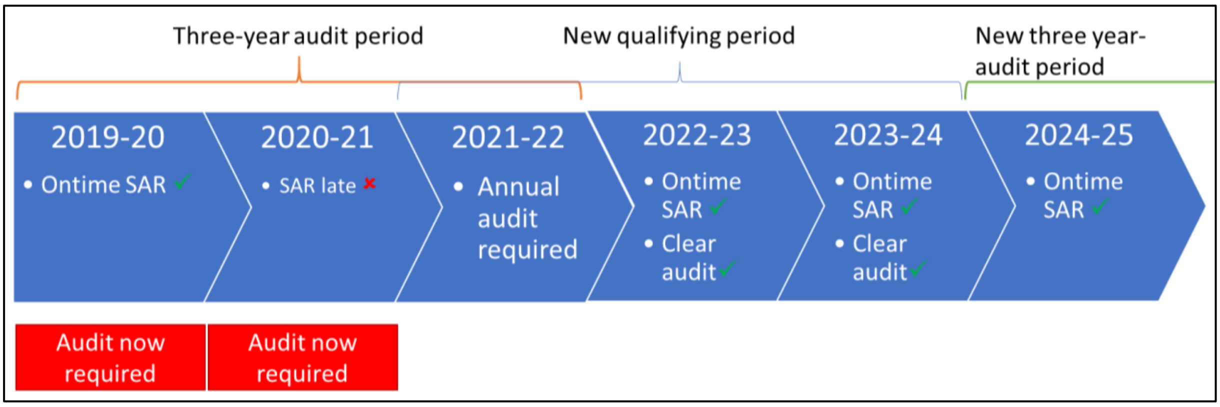
3. What is the most appropriate definition of timely submission of a SAR? Why?

The SMSFA believes that there needs to be two different eligibility tests for SMSFs wishing to access the three-year audit rules – one for new entrants and one for ongoing users of the three-year audit proposal.

For new entrants the most appropriate definition of timely submission of a SAR should look at the three prior years before entering a three-year audit cycle. During this period the SMSF should have lodged on time and have a clear audit of their SMSF for each year. This would look like:



For funds that are already using the three year-cycle, they must also be required to lodge their SAR on time to continue utilising the three-year audit proposal. This would mean that if a fund fails to lodge on time during a three-year audit cycle period they will lose the right to the three-year audit and be required to have annual audits for the recent years. They will then need to have three years of on time lodgement and clear audit reports be eligible again.



Late lodgement has a significant penalty on the SMSF of having to requalify for eligibility for the three-year audit. This should reinforce the incentive to lodge the SAR on time.

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?*

Key events or further triggers are essential to ensure that those SMSFs that present a higher risk of non-compliance should submit to an annual audit, especially if complex SMSFs can access the three-year audit proposal through good lodgement and clear audit reports. However, we believe this system will be overly complex and increase compliance costs for SMSFs.

The SMSFA broadly agrees with the key events listed in the Treasury proposal paper as being relevant and appropriate.

We deem the following events as essential key events:

- All related party transactions.
    - We believe annual audit requirements should apply to SMSF with an investment with a related party. Related party transactions are susceptible to causing SIS breaches due to their complexity and potential to be used to create inappropriate tax planning arrangements.
- Any commencement of income streams due to valuation issues.
    - Any time a pension is commenced we believe documentation and valuation of assets should be audited in a timely manner.
- Death/Removal of a member.

- Death and removal of members incur specific legal and compliance obligations which should require an annual audit.
- Election of segregated assets
  - Without oversight over a three year period the fund may have incorrectly claimed exempt current pension income
- Investments that do not have a widely available independent market value.
  - Assets which do not have an independent easily sourced market value are more susceptible to compliance breaches and compromising SMSF integrity.
- Where an SMSF trustee does not engage with an SMSF 'professional' financial adviser, accountant or administrator who is licensed to provide SMSF advice.
  - These SMSFs will have no external oversight or compliance assistance for three years.

We believe that SMSFs that do not engage with a 'professional' such as an accountant, financial adviser or administrator each year would be more susceptible to risks under a three-year audit. In this scenario, there is no external oversight over the trustee's actions and running of their fund until the lodgement of the SAR. Therefore, the risks regarding the trustee's potential to beach the SIS rules is exacerbated.

SMSFs that invest in assets which are not transparent and independently valued (e.g. such as on a public exchange) also increase the potential for three-year audits to create an integrity risk the for the SMSF sector. For example, unlisted trusts, property investments and investments that do not have an easily accessible independent market value can be valued incorrectly each financial year without oversight from the auditor. This can cause adverse tax and SIS compliance results as highlighted above.

These issues and assets highlight the potential for trustees to have compliance problems including breaching contribution caps, not complying with the transfer balance cap and minimum pensions not being withdrawn as well as the rectification those goes with these compliance issues.

We believe that, once an SMSF has completed a three-year audit after a key event, each key event that occurs afterwards should again trigger an annual audit.

A less complex approach

It is clear that there are many events that can increase the risk of SMSF audit difficulty and risk to the sector that need to be considered. We believe that a black-letter law approach of listing "trigger" events or investments that would require an SMSF to have an annual audit will increase complexity of the law and create another compliance point for SMSF trustees, entailing additional costs. This would result in SMSF trustees and their advisers needing to evaluate whether they have "triggered" the need for an annual audit every year. To avoid this complex approach, we believe a more principles-based approach to determining which funds are eligible should be considered, rather than excluding SMSFs from eligibility through a black-letter law approach.

We propose that SMSFs that undertake the services of an SMSF 'professional' and only invest in assets that have an independent market value should be eligible for the three-year audit. We believe this would encompass the following assets based on the SAR:

- Cash and term deposits
- Debt securities
- Listed shares
- Listed trusts
- Insurance policies
- Other managed Investments (*This should include managed funds and like products that produce a unit price or net asset value)*

If an SMSF lodges an SAR with inclusion of another SMSF asset then the trustee would not be able to lodge the return until an annual audit is conducted.

This provides a limited and simple eligibility requirement that only seeks to ensure funds that are deemed to be less complex, are able to audited simply and have less susceptibility to breaches are able to opt-in for a three-year audit and benefit from reduced oversight. In conjunction with the definition of a 'clear audit report' for the past three years, this should ensure that SMSF integrity is not risked and the type of funds which are able to benefit from reduced audit requirements will be able to access these benefits.

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?

Depending on the amount of SMSFs that will first be able to, and then elect to be audited triennially, the proposal may cause major seasonal swings in audit workflow. Significant seasonal swings in audit businesses has the potential to cause staffing and resource issues. We anticipate 10-20% of the SMSF population will be eligible and may opt in for SMSF three-year audits.

However, we note that 80% of respondents to our member survey have expressed they will not recommend for their clients to choose the option for a three-year audit. Additionally, throughout consultation on this proposal, audit firms also said that they provide a substantial amount of technical advice to their professional clients such as accountants. We do not anticipate this service to cease, but will be a motivation for the profession to continue to seek annual audits.

Without adequate staffing and resources, this may force smaller audit firms to exit the industry and reduce competition. This is pertinent when the majority of SMSF auditors audit less than 250 SMSFs annually. Specific concerns for an audit firm would occur where there is a lack of work for staff in years one and two of the proposal and an overload of work after year three. In addition, the proposal will also affect the cash flows of audit firms depending on their business model.

Given these risks, there is also a potential for the audit profession as a whole to suffer through a loss of knowledge and skill. This is further exacerbated by the fact that the ability to attract new staff to the profession and retain existing skilled staff will be diminished.

Therefore, the SMSFA believes that a transitional arrangement is essential for the audit profession and maintaining the quality service it provides. We believe a staggered introduction of the proposal where SMSF eligibility for the three-year audit is split into thirds would be appropriate. We believe this should occur randomly through fund name or Australian Business Number, rather than by allowing funds with less compliance difficulty or simpler arrangements to access triennial audits first. This mitigates any risk of adverse effects to the audit profession caused by seasonal swings that may occur and will ensure that 'more complex' funds are not left to one specific year that increases audit workload.

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

The SMSFA understands the intention of Government to reduce fees and incentivise good compliance behaviour for SMSF trustees. The SMSFA supports these goals, but believes the three-year audit proposal is unlikely to achieve these goals.

The following issues while not forming substantive reasoning in our submission may need to be considered in policy development:

- There may be a conflict of duty and interest for SMSF auditors who could be motivated to lodge ACRs or deem contraventions as material in order to ensure SMSFs continue to have an annual audit.
- The increased role that trustees and their advisers are taking on in unaudited years.
- Increased compliance costs to the ATO when there is less annual oversight of the sector.
- SMSF trustees that are led astray by poor advice may be potentially worse off when compliance breaches and issues are not identified.
- Eligibility requirements that incentivise "vanilla" investment strategies and a lack of diversification may not be in the best interests of members.
- Trust deeds may need to be amended to allow for an SMSF's financial statements to have the option of a three-year audit.

Given, the analysis in the submission we believe this proposal will not create significant benefit for SMSFs. Judging that annual audits should remain in place, we think annual audits can be streamlined or made more efficient by the following suggestions.

We believe that an appropriate way to reduce SMSF regulatory burden is to ensure that audit standards and tasks are amended to be made more appropriate for SMSF audits. Currently, SMSF auditors must review certain documentation and specific aspects of the law that are time consuming and do not materially add value to the SMSF audit.

For example, the SMSF trust deed must be reviewed annually when typically, there is no change in circumstances that will affect the audit. We are happy to expand and consult further with SMSF audit standard setters and relevant stakeholders in light of the above recommendation.

However, if the Government chooses to proceed with a three-year audit cycle for eligible SMSFs we believe that these SMSFs should have a lighter, high level audit in years one and two to preserve the integrity of the SMSF sector.

This potential solution would require SMSFs that are eligible to have an audit once every three years to have a lighter 'audit' or review in years where the SMSF is not being audited. In these intervening years, an SMSF auditor may only be compelled to issue a notice on key SIS compliance risk areas. This would ensure that SMSFs are being reviewed on risk areas (for example, valuation and ownership of assets), allow auditors to remain familiar with the fund and provide guidance and education, maintain SMSF integrity, reward good behaviour and record keeping and lower fees in non-audit years.

Particularly when upwards of 50% of SMSFs do not have any issues in their annual audits, a light 'audit' may be appropriate, would benefit more of the sector as a whole and would not require high levels of stringent and complex eligibility requirements.

In essence, this proposal aims to amend and streamline the audit standards, in the intervening unaudited years for low risk and eligible funds. We would be happy to explore this idea further if the Government believes this is an appropriate way forward.

Conclusion

On balance, the SMSFA does not believe that the Government's proposal to allow some SMSFs to have a three-year audit cycle will reduce costs for SMSFs. Reducing costs and making the sector more efficient are laudable goals, however, we do not believe this proposal will achieve these policy outcomes.

There are also legitimate concerns that reducing independent oversight will potentially damage the integrity of the SMSF sector. We do not believe reduced integrity is an appropriate trade-off for lower costs.

We recommend that the Government consider amending existing SMSF audit requirements to streamline the SMSF audit process which would assist in reducing audit costs for SMSF trustees as an alternative to this proposal.

If the Government does choose to proceed with the proposal then we strongly suggest that it considers a simplified, principles-based eligibility test and requiring SMSFs that are using a three-year audit cycle to have a light touch compliance check style audit in the non-audit years.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

John L Maroney

John Maroney
CEO
SMSF Association