SMSF Auditors Association of Australia Ltd
ABN 70 627 274 248
Suite 304, 29 - 31 Solent Circuit
Baulkham Hills NSW 2153
www.smsfaaa.com.au *Email: admin@smsfaaa.com.au* *Ph: (02) 9684 4199*

28th August 2018

Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

RE: THREE-YEARLY AUDIT CYCLE FOR SOME SELF-MANAGED SUPERANNUATION FUNDS

SMSF Auditors Association of Australia Ltd is a newly founded body for SMSF audit professionals. We were founded in July 2018 and, at the time of writing, have 89 financial members. Our members are solely comprised of ASIC approved SMSF Auditors. It is our estimation that our members assist over 500 accounting practices and have audited over 10,000 Self-Managed Superannuation Funds in the last twelve months.

We welcome this opportunity to make a submission to Treasury regarding the July 2018 Discussion Paper released regarding changes to the annual audit requirement for some complying self-managed superannuation funds (SMSFs).

Our submission is in two parts:
Part A – current SMSF audit industry;
Part B – consultation questions from discussion paper.

This submission is made after consultation with and feedback from our members.

Yours faithfully,

KAREN STEWART
PRESIDENT
ASIC Approved SMSF Auditor
BBus(Acc) GradCertFinPlan CPA MAICD

TABLE OF CONTENTS

PART A: Current SMSF Audit Industry

Introduction

1) SMSF auditors are not lodging appropriate contraventions

2) Auditor independence and oversight may be compromised – Accounting Firms

3) Auditor independence may be compromised - SMSF Administration Firms

4) Lodgement of annual returns and audit integrity

PART B: Response to Consultation Questions

1. Cost of Audit

2. Clear audit reports

3. Timely submission of annual returns

4. Key events and compliance risk

5. Transitional arrangements

6. Other issues

Conclusion

PART A

Introduction

We aim to impress upon Treasury the practical realm of SMSF auditing where imparting this practical insight may provide Treasury with a realistic sector analysis upon which to make informed decisions.

The ATO estimates that reported contraventions are prepared for 1.6% of audited SMSFs. We suggest the percentage of audited funds requiring contraventions, however, may be somewhat higher than this. The following sections outline the factors we believe may be contributing to the potentially reduced number of lodged contravention reports.

1) SMSF auditors are not lodging appropriate contraventions

The transitional arrangements for existing 'approved auditors of SMSFs' as prescribed in *Regulatory Guide 243 Registration of self-managed superannuation fund auditors* specified an exemption of certain conditions of registration for twenty (20) or more SMSF audits in the twelve-month period preceding registration application. Auditing as few as twenty SMSFs does not allow broad exposure to a variety of investments that would facilitate sound knowledge of superannuation legislation. We contend this particular exemption may have given rise to a significant number of inexperienced SMSF auditors from the outset of ASIC approval, and not all of these low volume auditors have necessarily deregistered.

The superannuation sector is extremely complex and undergoes frequent changes. Experience in SMSF auditing is the most important aspect of recognising contraventions and knowing when they must be conveyed to the regulator via an ACR. Where SMSF auditors have not been exposed to unusual or unique investments there may be a considerable lack of knowledge due to their inexperience. It is difficult, therefore, to have confidence that an inexperienced SMSF auditor would be able to ascertain the reportable contraventions in a complex scenario within a self-managed superannuation fund.

The introduction of ASIC's ongoing mandatory education requirements has somewhat assisted in improving this deficiency of knowledge and this will be a continued area of improvement. It may be prudent for ASIC's annual declaration to request specific details of approved auditors' Continuing Professional Development thus ensuring adherence to ongoing competency standards. As a professional body specifically founded to support in the knowledge and education of ASIC approved SMSF auditors, we are well placed to rectify this recognised experience deficit. Our long-standing and experienced ASIC approved SMSF

auditors act as mentors in online discussions and debates to share their valuable experience and insights into the superannuation sector.

2) Auditor independence and oversight may be compromised

Member feedback and their employment experience have detailed practices within multi-partner accounting firms that give rise to auditor independence and audit review concerns. Practices which may jeopardise the perception of auditor independence or minimise audit oversight undermine the integrity of the SMSF audit sector.

Frequently the staff member who prepares the SMSF financial accounts may also prepare the audit working papers for the same SMSF. There is then a risk of the audit working papers receiving only a cursory review by the audit partner rather than a complete and satisfactory independent audit. There have been reports of audit partners returning the SMSF to the accounting staff, after commencement of the audit but prior to signing the audit report, to correct errors, misstatements, or possible reportable contraventions. This presents the threat of self-review and erodes the appearance of independence.

While ever an SMSF auditor is tasked with auditing the SMSFs within their own accounting firm, independence appears compromised. The segregation of duties within a small- to medium-sized accounting firm is seldom suffice to negate the conflict of interest situation to the extent necessary to achieve auditor independence.

The Accounting and Professional & Ethical Standards Board state that,

> *"Independence comprises:*
>
> *Independence of Mind*
>
> *The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism.*
>
> *Independence in Appearance*
>
> *The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a Firm's, or a member of the Audit Team's, integrity, objectivity or professional scepticism has been compromised."*[1]

[1] APES 110 Code of Ethics for Professional Accountants sec 290.6

A reasonable person would argue there is an appearance of diminished independence when the preparation of accounts and the audit of a SMSF are conducted within the same firm. The General Provisions of APES 110 state, *"Providing an Audit Client with accounting and bookkeeping services, such as preparing accounting records or Financial Statements, creates a self-review threat when the Firm subsequently audits the Financial Statements"*[2]. *Guidance Statement GS009 Auditing Self Managed Superannuation Funds* stipulates the services able to be provided by the accounting firm to their audit clients,

> *"If, however, the accounting services provided are of a routine or mechanical nature, such as posting transactions and entries approved by the SMSF or preparing the financial report based on a trial balance provided by the SMSF, the self-review threat may be reduced to an acceptably low level by applying safeguards, including:*
>
> - *Making arrangements so accounting services are not performed by a member of the audit team.*
> - *Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the SMSF.*
> - *Requiring the source data for the accounting entries to be originated by the SMSF.*
> - *Requiring the underlying assumptions to be originated and approved by the SMSF.*
> - *Obtaining the SMSF's approval for any proposed journal entries or other changes affecting the financial report.*
> - *Obtaining the SMSF's acknowledgement of their responsibility for the accounting work performed by the firm.*
> - *Disclosing to the trustees the firm's involvement in both engagements."*[3]

It would be challenging to impress upon an informed third party that the threats to self-review had been managed to an acceptable level. SMSFs frequently contain investments that are not entries of a "routine or mechanical nature" and the majority of SMSF trustees do not possess the necessary legislative knowledge to provide underlying assumptions nor the accounting knowledge to adequately approve proposed journal entries.

Where the accounting practice is also able to provide superannuation advice and had provided guidance to the SMSF trustees on pensions, taxation, contributions, investments, etc., the self-review threat is further difficult to manage down to an acceptable level that

[2] APES 110 Code of Ethics for Professional Accountants sec 290.168
[3] Guidance Statement GS009 Auditing Self Managed Superannuation Funds Para 39

would satisfy independent requirements. GS009 provides safeguards to manage this self-review threat,

> *"Provision of financial advice to a SMSF which is also an audit client may create advocacy and self-review threats. These threats may be reduced to an acceptably low level by safeguards such as:*
>
> - *Implementing policies and procedures to prohibit individuals providing advice from making managerial decisions on behalf of the SMSF.*
> - *Using staff and partners who are not members of the audit team to provide the financial advice.*
> - *Ensuring that the individual providing the advice does not commit the SMSF to the terms of any transaction or consummate a transaction on behalf of the SMSF."*[4]

We remain unconvinced these safeguards are being consistently implemented across accounting firms who provide several services to SMSFs.

The Auditing and Assurance Standards Board provide legislative weight to the APES110 by expressing the importance of adhering to independence requirements, *"In the case of an audit engagement, it is in the public interest and required by APES 110, that the auditor be independent of the entity subject to the audit. APES 110 describes independence as comprising both independence of mind and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of professional scepticism."*[5]

The Australian Taxation Office addressed independence risk in their 2016 review of cases where SMSF auditors also acted as a tax agent to the SMSF. Of the auditor group contacted by the ATO for investigation, analysis suggested approximately 25% of these auditors required "*…further scrutiny as they appear to be at significant risk of being in breach of independence requirements."*[6]

---

[4] Guidance Statement GS009 Auditing Self Managed Superannuation Funds Para 41

[5] Auditing Standard ASA102 Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements Para A5

[6] National Superannuation Conference Session 5B, Kasey McFarlane, Assistant Commissioner ATO, Melbourne 25-26 August, 2016

It would appear there is a significant independence risk that is not consistently being managed to an acceptable level when accounting, audit, and financial services are provided to a SMSF within the same accounting firm. We believe this is a significant contributing factor for audit contravention reports not being lodged to the regulator, when they may otherwise be lodged by an independent third party SMSF auditor.

3) Auditor independence may be compromised - SMSF Administration Firms

SMSF administrators generally provide all the core services to SMSFs including establishment, end of year administration, compliance, investment, and audit services.

SMSF auditors are frequently employed by, contracted to, or referred work from a specific SMSF administration firm. This would seemingly constitute the SMSF auditor having one client upon whom they are heavily reliant for work and/or referrals. A SMSF auditor working for a SMSF administration firm may find their risk to independence of familiarity and intimidation to be such that is unable to be reduced to an acceptable level.

GS009 addresses the independence concerns when a firm conducts both management, accounting, and audit services for a SMSF, *"Assisting an audit client in the preparation of accounting records or financial reports may create a self-review threat when those records and reports are subsequently audited by the same firm. If the firm's staff also make management decisions for the SMSF, which may occur if the firm is providing administrative services to the SMSF, there are no safeguards available to reduce the self review threat to an acceptably low level, other than withdrawal from either the administration or the audit engagement."*[7]

4) Lodgement of annual returns and audit integrity

The list of ASIC approved SMSF auditors is a matter of public record.

Members have reported instances where they became aware of SMSF Annual Returns lodged to the ATO with their name as auditor, despite having not completed an audit for the SMSF. Members also reported having been dismissed by trustees upon communication of a reportable contravention to a SMSF.

As a matter of audit integrity, SMSF auditors would benefit from an annual SMSF lodgement listing or fund lodgement count to reconcile reported ATO lodgements to the auditor's own records.

[7] Guidance Statement GS009 Auditing Self Managed Superannuation Funds Para 38

This lodgement reconciliation would allow an auditor to alert the regulator to any funds lodged without updated SMSF auditor details and identify those funds lodged without an audit conducted at all.

PART B

Response to Consultation Questions on Discussion Paper

1) Cost of Audit

ASIC approved SMSF auditors are bound by the prescribed pronouncements by Accounting Professional & Ethical Standards Board, Auditing and Assurance Standards Board and their professional accounting body.

Opening balances for a financial statement are based upon the previous year's closing balances and incorporate the effects of accounting transactions and the application of accounting policies from prior periods.[8]

Guidance Statement GS009 Auditing Self Managed Superannuation Funds provides clear instruction on addressing Opening Balances from an audit perspective:

> *"Upon appointment to a new engagement, ASA 510 requires the auditor to obtain sufficient appropriate audit evidence that:*
>
> > *(a) the opening balances (account balances which exist at the beginning of the period) do not contain misstatements that materially affect the current period's financial report;*
> >
> > *(b) the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated; and*
> >
> > *(c) appropriate accounting policies are consistently applied or changes in accounting policies have been properly accounted for and adequately presented and disclosed."*[9]

Under a three-year audit cycle for some self-managed superannuation funds, opening balances for the current period would require verification in accordance with *Auditing*

[8] Auditing Standard ASA 510 Initial Audit Engagements-Opening Balances Para 4(b)
[9] Guidance Statement GS009 Auditing Self Managed Superannuation Funds Para 147

Standard ASA 510 Initial Audit Engagements-Opening Balances as the financial report for the prior two periods were not audited. GS009 states, *"If the prior period's financial report was not audited or when the auditor is not able to obtain sufficient appropriate audit evidence by examining the work of the previous auditor, the auditor undertakes further audit procedures to obtain sufficient appropriate audit evidence to ascertain whether the opening balances are stated fairly."*[10] A three-year audit cycle demands specific emphasis on the prior years as they have not been audited. A three-year audit cycle does not provide any practical audit efficiencies that would allow fees to decrease, in fact the result is opposite.

Overwhelmingly our members saw no significant change in the audit fees applied to SMSFs, although acknowledged the potential for a fee increase. The additional investigation required in verifying the opening balances is going to considerably increase the audit fee charged in the year the audit is undertaken. The effect of the three-year audit cycle is to transfer the payment of annual audit fees to being that of a larger amount in the third year of audit. This may have consequences for the cash flow of the SMSF and the liquidity of investments.

The deductibility of the audit fee, depending on the phase of the members, is an additional consideration to trustees. The deductibility of an expense may be forgone as a result of a three-year audit cycle. An audit fee may have been deductible to the SMSF had it been expensed annually while in accumulation phase, although that member now withdrawing a pension is not able to claim the deduction against exempt current pension income. The accrual of accounting fees during the preceding years of accumulation is unlikely to be reliably measured or consistent with the application of accounting policies for similar transactions within the SMSF.[11]

2) Clear audit reports

Audit reports provide important information to the trustees about the compliance, or otherwise, of their SMSF. SMSF Auditors are encouraged by the ATO to issue management letters at the completion of each audit as a means of advising the trustee of any matters noted during the course of the audit. These annual management letters are instrumental in highlighting to trustees where potential breaches of legislation or financial reporting

[10] Guidance Statement GS009 Auditing Self Managed Superannuation Funds Para 150
[11] AASB 108 Accounting Policies, Changes in Accounting Estimates and Error

requirements may arise. Trustees benefit from the foresight of SMSF Auditors in addressing pertinent audit matters and the removal of this annual reporting mechanism may cause a future contravention and penalties.

The concept of ‘clear audit reports’ may be too limited in the information provided. The eligibility criteria may need to be expanded to include a broader range of available reports, such as an unqualified audit report and an annual management report free from audit warnings.

3) Timely submission of annual returns

Timely submission of annual returns would be constituted by a SMSF that, on the majority of occasions, submits lodgements on time per the ATO lodgement schedule. This would most likely be indicated by the last three years (being the proposed three-year audit cycle) plus the two years prior to that being lodged on time; being five years in total. This would exhibit a pattern of lodgements corresponding to two complete audit cycles when including the current financial year being prepared.

4) Key events and compliance risk

Key events should be those events that materially affect the fund, have a higher expectation of error or increased contravention risk. The discussion paper provides examples of possible key events that would trigger an audit for a SMSF. The key events being recognised are based upon the trustees’ understanding of the definitions of terms within superannuation legislation; many of which are complex in nature.

SMSF trustees have not typically undergone the level of education that provides adequate cognisance and confidence of superannuation legislation to recognise when an event has occurred. The recognition of a transaction being non-arm’s length income may present a difficulty for a trustee. The definition of a related party is particularly convoluted incorporating further complicating definitions such as Part 8 Associates and employer-sponsors. This lack of comprehensive knowledge may increase the risk of an unreported breach under the SIS Act, SIS Regulations and financial reporting requirements.

SMSF trustees who engage an accountant or tax agent to prepare their financial reports and annual return may receive additional support or assistance in recognising possible key events. Whilst an accountant may be in a position to recognise possible key events, it may

be considered outside the scope of the accounts preparation of a SMSF. Further, an accountant engaged to prepare SMSF accounts does not necessarily possess the in-depth audit expertise to recognise complex SMSF transactions that may constitute a reportable contravention. The terms of the accounting engagement letter must stipulate which party has the responsibility to recognise the key events and refer the fund for audit.

5) Transitional arrangements

It is imperative transitional arrangements are implemented to afford the industry smooth consistency during a considerable change to workflow. Without transitional arrangements, the challenges to auditors would be significant enough to hinder the management and administration of staff and workflow. An industry workflow bottleneck is likely to result in late lodgements and auditors failing to conduct the audit within the prescribed 28 days from receiving the documentation from trustees.[12] Avoiding seasonal audit swings, therefore, is essential to minimising operational and financial risks to practitioners and auditors.

A random split of the SMSF sector into thirds would be appropriate as part of transitional arrangements to a three-year audit cycle. A random division of the SMSFs should arrange the complexity of the funds in a relatively well distributed manner across the three-year period.

6) Other issues

a) Utilising a three-year audit cycle for some self-managed superannuation funds places a lengthy administrative burden upon trustees to ensure all their records are adequate and well maintained for audit purposes. This administrative burden may be exacerbated in situations where a trustee has not engaged an accountant or tax agent and amateurly prepared financial accounts require further audit substantiation. The death of a trustee may present significant difficulties for executors or beneficiaries to locate adequate audit documentation. Where substantiation from a prior year is not available to the extent it impacts the verification of opening balances, ASA510 expressly states, *"If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the*

[12] Superannuation Industry (Supervision) Regulations 1994 Reg 8.03

auditor shall express a qualified opinion or disclaim an opinion on the financial report, as appropriate, in accordance with ASA 705."[13]

b) Investment and administrative knowledge may vary greatly between trustees in a SMSF. Accountant and auditor feedback indicate SMSFs frequently have a trustee that is more active and possesses considerably more financial knowledge than another trustee. An annual audit provides some certainty that the investments are compliant where a passive trustee takes little action to safeguard their superannuation assets.

c) Administration costs may actually increase for a SMSF in the absence of an annual audit. There may be an increased reliance upon tax advisors and financial planners due to the lack of an annual audit management letter. SMSF trust deeds may not facilitate an audit being conducted other than annually which would require a deed update.

d) Currently *Superannuation Industry (Supervision) Regulations 1994* stipulates that the audit report must be provided within 28 days of the trustee providing all necessary and relevant documentation.[14] This legislation relates to an annual audit comprising only one period. Where the transactions contributing to the opening balances of unaudited financial statements could extend to two financial years, this 28-day turnaround may no longer be appropriate.

e) A three-year audit cycle for some superannuation funds may allow SMSF trustees to operate contrary to legislation for up to three years with minimal oversight. A history of compliance does not necessarily determine that a trustee maintains a future of compliance; changing personal circumstances may compromise an otherwise compliant trustee. There may be matters that are continually difficult to monitor throughout an audit cycle, such as appropriate purchase of an actuary certificate and monitoring residency status of the fund. Compliance issues may only be realised by auditors and the regulator years after an error or contravention occurred.

[13] Auditing Standard ASA 510 Initial Audit Engagements-Opening Balances Para 10
[14] Superannuation Industry (Supervision) Regulations 1994 Reg 8.03

Conclusion

We remain unconvinced the introduction of a three-year audit cycle for some self-managed superannuation funds is likely to facilitate the desired outcomes as expressed in Treasury's Discussion Paper. There is also no significant indication to imply there would be a reduction of compliance costs through the implementation of a three-year audit cycle.

The removal of oversight could diminish industry integrity as increased errors, contraventions, and reporting failures will have a negative impact on the SMSF sector overall. The long-term consequences of less scrutiny may be significant if it involves decreased tax collection and the loss of member superannuation balances. These unwanted outcomes may subject the Australian taxpayer to fund these failures in other ways via increased taxes elsewhere or funding the aged pension to those no longer able to support their retirement through superannuation.

The administrative requirements of running a self-managed superannuation fund are not particularly onerous and the continued establishment of funds in the SMSF sector would support this assertion. Further, we do not consider that adherence to legislation, rules, and regulations constitutes such a compliance burden to trustees so as to command minimisation of its oversight.

The self-managed superannuation fund industry succeeds due to the trustees' direct participation and management of their investment decisions.

The integrity of the self-managed superannuation fund succeeds due to the specific oversights that ensure SMSF trustees' direct participation further supports domestic markets by providing valuable and stable capital.