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Three-yearly audit cycle for some self-managed superannuation funds

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Consultation Process

Request for feedback and comments

Interested parties are invited to comment on this consultation paper. While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted. All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose. If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment.

Closing date for submissions: 31 August 2018

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Three-yearly audit cycle for some self-managed superannuation funds

The Government recognises that self-managed superannuation fund (SMSF) trustees appropriately face a number of regulatory requirements in administering their funds. However, the Government is committed to reducing red tape and compliance burden for SMSF trustees where suitable.

This paper is seeking feedback on a measure announced in the 2018-19 Budget to change the annual audit requirement to a three-yearly requirement from 1 July 2019 for SMSFs with a history of good record-keeping and compliance.

The objective of the measure is to incentivise good record-keeping and compliance by SMSFs whilst maintaining system oversight and integrity.

Under this measure, audits conducted for SMSFs on a three-yearly audit cycle will cover all of the three preceding years, maintaining integrity within the SMSF sector. SMSFs that do not meet the eligibility criteria will not be eligible for a three-yearly audit cycle and will continue to be annually audited.

Background

SMSF audits

As part of the regulatory requirements for the operation of a SMSF, the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) require that SMSFs be audited annually by an independent SMSF auditor that is registered with ASIC. Audits must be prepared prior to submission of a SMSF annual return (SAR).

In the course of audits, SMSF auditors are required to: form an opinion on the SMSF's financial position, form an opinion on whether the SMSF has contravened the SIS Act or SIS Regulations, and inform the SMSF trustee of their findings.

SMSF auditors are also required to report their findings to the ATO in an audit contravention report (ACR) if they form the opinion that the SMSF:

1. is at risk of no longer being a going concern (i.e. the fund is at risk of not remaining operational for the foreseeable future); and/or
2. has committed a reportable contravention, set out in the legislation. A number of factors determine whether a contravention is reportable, including whether the SMSF is a new fund, whether the contravention has previously been identified and the significance of the contravention. A list of the sections and regulations, which if breached are required to be reported, is at **Appendix A**.

The ATO estimates that in 2015-16, ACRs were prepared for approximately 1.6 per cent of audited SMSFs. Although not a legislative requirement, it is common practice for SMSF auditors to notify trustees if they send an ACR to the ATO in relation to the trustee's SMSF.

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

SMSF annual returns

SMSF trustees are required to annually submit financial information to the ATO once their SMSF audit is finalised. Trustees send this information to the ATO in SARs.

The ATO generally requires SARs to be submitted by May of the following financial year. SMSF trustees that submitted the SAR for the previous year late must submit their SAR by October of the following financial year. The ATO estimates that approximately 25 per cent of SARs received in 2015-16 were submitted late.

The ATO's role in regulating the SMSF industry is more difficult when SARs are submitted late or not submitted at all. As such, SMSF trustees that submit their SAR late may be subject to failure to lodge penalties and SMSF trustees that consistently submit late (or fail to submit at all) may be subject to stronger compliance action.

The three year audit measure will not affect the requirement for all SMSFs to submit SARs annually.

A three-yearly audit cycle

Allowing SMSFs with a history of good record keeping the choice to move to a three-yearly audit cycle will have benefits for SMSF trustees, including:

- a reduction in the compliance burden on SMSF trustees while maintaining appropriate visibility of errors in financial statements and regulatory breaches;
- a potential reduction in administrative costs and auditor fees for SMSF trustees due to less frequent audits. Annual fees for SMSF auditors range from less than \$500 to over \$2,000. For 2016, the average auditor fee was \$694 and the median was \$550; and
- an incentive for SMSF trustees to submit SARs in a timelier manner.

However, stakeholders have expressed concerns about SMSFs moving to a three-yearly audit cycle, including that:

- there could be increased non-compliance with tax and regulatory obligations; and
- a reduction in audit frequency could alter the workflow of the SMSF audit industry, reducing profitability. This could lead to a reduction in the number of businesses specialising in SMSF audits and lower quality audits.

These concerns will be mitigated by appropriate eligibility criteria and, if necessary, transitional arrangements. The ATO will continue managing the risk of tax and regulatory breaches by monitoring SARs, thus maintaining appropriate oversight of SMSFs on a three-yearly audit cycle. The ATO will continue to have the ability to audit particular SMSFs in response to identified concerns.

Consultation questions

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

Eligibility criteria

The number of SMSFs eligible for the three yearly audit cycle will vary, depending on the design of eligibility criteria. Eligibility for the measure will be limited in two ways:

1. Good recording keeping and compliance: SMSFs will have to meet eligibility criteria of timely submission of SARs and three consecutive years of clear audit reports to move from an annual audit cycle to a three-yearly audit cycle; and
2. Key events: A SMSF on a three-yearly audit cycle will be audited in every year in which a key event occurs, with such audits covering all years since the previous audit.

SMSF trustees that are eligible for the three-yearly audit cycle can choose to continue annual audits. However, we expect many of those eligible will move to a three-yearly audit cycle.

It is proposed that eligibility for a three-yearly audit be based on self-assessment by SMSF trustees. However, if the ATO becomes aware that a SMSF trustee has incorrectly assessed their eligibility for a three-yearly audit cycle, has failed to submit a SAR in a timely manner or has failed to procure an audit in a year of a key event, the ATO will notify the trustee that an audit is required and consider further action if necessary.

Good record keeping and compliance

Only SMSFs with a history of three consecutive years of clear audit reports that have submitted the fund's SARs in a timely manner will be eligible to move to a three-yearly audit cycle.

It is proposed that a SMSF with a history of three consecutive years of 'clear audit reports' be defined as a SMSF without any financial or compliance contraventions issued in an ACR in the previous three years. While a 'clear audit report' could be defined differently, for example as an unqualified audit report, use of the ACR is straightforward and an existing part of SMSF regulation.

There are a range of options for what constitutes timely submission of SARs. A SMSF that has submitted the fund's SAR in a timely manner could range from:

- A SMSF that has never submitted a late SAR; to
- A SMSF that has not submitted a late SAR in the last three years; to
- A SMSF without any outstanding SARs.

ATO data indicates that the definition of a timely submission of a SAR could have a large impact on eligibility, with 40 per cent of SMSFs submitting a late SAR on at least one occasion in the three financial years from 2013-14 to 2015-16.

SMSFs that move to a three yearly audit cycle will be required to continue to submit the fund's SARs in a timely manner to remain on a three-yearly cycle.

Example 1: A SMSF moves to a three-yearly audit cycle

Mr and Mrs Anderson are a retired couple with simple superannuation affairs and are trustees of SMSF A – they have a moderate balance invested in Australian listed shares and cash. Mr and Mrs Anderson have a history of always submitting their SARs on time and SMSF A has not had an ACR issued for the last three years, making them eligible to move onto a three-yearly audit cycle from the 2019-20 financial year.

Mr and Mrs Anderson choose to do so and next have an audit undertaken prior to submitting their SAR for the 2021-22 financial year (they continue to submit their SARs on time and do not have a key event from 2019-20 to 2021-22). The audit covers the period from July 2019 to July 2022.

Example 2: A SMSF is ineligible for a three-yearly audit cycle

Mr and Mrs Baker are trustees of SMSF B. Mr and Mrs Baker have a history of always submitting their SARs on time. SMSF B had an ACR issued for the 2017-18 financial year but does not have an ACR issued for the 2018-19 financial year.

SMSF B will be ineligible for the three-yearly audit cycle on 1 July 2019 as it has had an ACR issued in the last three years. The earliest that SMSF B could be eligible to begin the three-yearly audit cycle is when submitting the SAR for the 2021-22 financial year (if Mr and Mrs Baker continue to submit their SARs on time and SMSF B does not have ACRs issued for the 2018-19, 2019-20 and 2020-21 financial years).

Should Mr and Mrs Baker choose to do so, they would next have an audit undertaken prior to submitting their SAR for the 2023-24 financial year (provided they continue to submit their SARs on time and do not have a key event in the 2021-22, 2022-23 and 2023-24 financial years). The audit covers the period from July 2021 to July 2024.

Consultation questions

2. Do you consider an alternative definition of 'clear audit reports' should be adopted? Why?
3. What is the most appropriate definition of timely submission of a SAR? Why?

Key events

Subject to good record keeping and compliance (eligibility criteria) and any transitional arrangements (covered in a later section), SMSFs will be eligible for a three-yearly audit cycle from 1 July 2019. However, a number of events can represent a material change to the situation of the fund and may increase the risk of a breach under the SIS Act, SIS Regulations and financial reporting requirements. In these cases, an audit in that year can help mitigate these risks and ensure ongoing compliance.

If a key event falls in a year when a SMSF is not otherwise required to be audited, the SMSF will be required to obtain an audit before submitting that year's SAR. An audit conducted due to a key event will be required to cover all financial years since the SMSF's last audit.

Some examples of possible key events include:

- the commencement of a superannuation income stream by a member for the first time;
- the death of a member;
- the addition or removal of a member;
- receipt of non-arm's length income (NALI);
- commencement or maintenance of a limited recourse borrowing arrangement (LRBA);
- acquisition of an asset from a related party;
- investments, loans or leases with a related party; or
- in-species lump sum payments to a member.

After the occurrence of a key event, if the audit does not result in an ACR, the SMSF may continue to be eligible for a three-yearly audit cycle. This means that, as long as no other key events occur in the next three years and the SMSF continues to meet good record keeping criteria, the SMSF will next require an audit three years after the 'key event' audit.

Example 3: A SMSF on three-yearly audit cycle has a key event

Ms Collins is the trustee of SMSF C. Ms Collins has always submitted her SARs on time and SMSF C has not had an ACR issued for the last three years, making Ms Collins eligible to move onto a three-yearly audit cycle from the 2019-20 financial year.

Ms Collins chooses to do so and is not required to have an audit undertaken for the 2019-20 and 2020-21 financial years. Ms Collins submits her SAR for the 2019-20 financial year in a timely manner.

In the 2020-21 financial year, Ms Collins retires and commences an income stream for the first time. As a key event has occurred, an audit covering 2019-20 and 2020-21 financial years is required before the submission of the SAR for the 2020-21 financial year. The audit does not result in an ACR. Ms Collins is next required to have an audit undertaken before the submission of the SAR for the 2023-24 financial year – provided she continues to submit her SARs on time and no key event occurs in the 2021-22, 2022-23 and 2023-24 financial years.

Consultation questions

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?

Transitional arrangements

Depending on the eligibility criteria for the measure, transitional arrangements may assist the SMSF audit industry to adjust to changes to workflow associated with SMSFs transitioning to three-yearly audit cycles. There are different options for transitional arrangements.

For example, the SMSF sector could be split into thirds, with one third becoming eligible each year from 1 July 2019 to 1 July 2021.

Another option is to split the SMSF sector on the basis of good record keeping, with more timely and compliant SMSFs eligible on 1 July 2019, and less timely and compliant SMSFs becoming eligible at a later date/s. This would reward timeliness and compliance, but may be harder to administer.

Consultation questions

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?

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

Consultation questions

1. How are audit costs and fees expected to change for SMSFs that move to three-yearly audit cycles?
2. Do you consider an alternative definition of 'clear audit reports' should be adopted? Why?
3. What is the most appropriate definition of timely submission of a SAR? Why?
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?
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?
6. Are there any other issues that should be considered in policy development?

Appendix A: List of reportable sections and regulations¹

Section or regulation	Section or regulation title
S17A	SMSF definition
S35C(2)	Trustee to provide documents to the auditor
S52(2)(d) or R4.09A (commenced 07/08/2012)	Separation of assets
S62	Sole purpose test
S65	Lending or providing financial assistance to members or their relatives
S66	Acquisition of assets from related parties
S67	Borrowing by the fund
S82	In-house assets – exceeding in-house assets ratio
S83	In-house assets – prohibition on further acquisition
S84	In-house asset rules must be complied with
S85	In-house assets – prohibition of avoidance schemes
S103	Minutes and records
S104A	Trustee declaration
S109	Investments to be maintained on an arm's length basis
S126K	Disqualified persons not to be trustees
R4.09	Investment strategy
R5.08	Minimum benefits
R6.17	Restriction on payment of benefits
R7.04	Acceptance of contributions
R8.02B	Valuation of assets
R13.14	Charges over assets of the fund
R13.18AA	Investment in collectables and personal use assets

¹ Source: ATO website, reporting criteria, Table 1, <https://www.ato.gov.au/Forms/Auditor-actuary-contravention-report-instructions/?page=3>