

**CURRENT AUDIT CONSIDERATIONS**

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#NC2020

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**Belinda Aisbett**  
Director, Super Sphere Pty Ltd



Belinda is a director of Super Sphere Pty. Ltd., a specialist self managed superannuation company, where she is responsible for providing audit, consulting and training services in relation to self managed super funds.

Belinda established Super Sphere in 2003 to specialise in SMSF auditing and audit related services. This is in addition to providing an SMSF Audit Toolkit to other auditing professionals and undertaking numerous training engagements each year.

Belinda is a member of the CAANZ, and holds a Bachelor of Business (Accounting). Belinda is also a specialist member of the SMSF Association, co-chairperson of their audit discussion group, and a member of the SMSF Association education committee.

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**Current Audit Considerations**  
ATO & Auditor Risk Management

Investment Strategies  
SMSF Wind Up Considerations  
NALE

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## Current Audit Considerations

### Investment Strategies



The ATO letter, sent to 17,700 SMSF's, simply asked "Is your SMSF investment strategy meeting diversification requirements?"

The ATO letter went onto say their records indicated the SMSF may hold 90% or more of investments in one asset, or a single asset class.

The ATO letter then suggested this may mean the diversification requirement as outlined in reg 4.09 may not be met.

Penalties were mentioned, which resulted in borderline hysterics from some quarters!

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## Current Audit Considerations

### Investment Strategies



The ATO letter was sent to primarily support auditors in our role post the Ryan Wealth v. Baumgartner case

Auditors are required to sign off that the fund not only has a strategy that has regard to all that is required under SIS, but that the strategy has also been given effect to

The ATO did focus on SMSF's that were newly established, who had purchased a property via an LRBA

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## Current Audit Considerations

### Investment Strategies



In terms of diversification, SIS requires the following:

- The formulation of a strategy that has regard to the whole of the circumstances of the fund
- Including the composition of the investments (as a whole) including the extent to which the investments are diversified **OR** expose the fund to risks from a lack of diversification
- SMSF's **DO NOT** need to diversify

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## Current Audit Considerations

### Investment Strategies



What should the auditor be checking?

- Clearly the fund needs a strategy that covers the SIS requirements
- The auditor will need to establish a benchmark for what they consider a diversified fund, which is not as easy as it sounds
- Where a lack of diversification is identified the strategy should be reviewed to ascertain if the risks from a lack of diversification are documented, or that the strategy doesn't call for a diversified portfolio
- If the strategy has ranges, these should be checked at year end to ensure they are adhered to

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## Current Audit Considerations

### Investment Strategies



Where a fund has a single or dominant asset and the strategy says:

"the trustee will strive to achieve the maintenance of appropriate diversification across a broad range of assets"

There are two audit issues:

1. The trustee has not given effect to their strategy
2. The trustee has not documented the risks the fund is exposed to as a result of a lack of diversification

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## Current Audit Considerations

### Investment Strategies



Where a fund has a single or dominant asset and the strategy says:

"the fund will invest in a portfolio of assets"

There are again two audit issues:

1. The trustee has not given effect to their strategy
2. The trustee has not documented the risks the fund is exposed to as a result of a lack of diversification

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### Current Audit Considerations

#### Investment Strategies



Where a fund has a single or dominant asset and the strategy says:

“the trustee will consider investments as a whole, including the extent to which investments are diverse or involve exposure to risks from a lack of diversification” along with

“the trustee understands risks can be reduced through diversifying across a number of asset classes”

“notwithstanding the need for diversification, the trustee may take into account any non-super assets held by the members” and

0-100% noted for all asset classes

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### Current Audit Considerations

#### Investment Strategies



There are a number of audit considerations:

1. Auditors are unaware of the non-super assets to which the strategy refers (nor do we want to know)
2. SIS doesn't contemplate non-super assets when setting the requirements, and so non-super assets are not relevant to SIS compliance
3. Has the trustee given effect to their strategy given the lack of diversification?

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### Current Audit Considerations

#### Investment Strategies



Other issues:

- The trustee has not documented the risks the fund is exposed to as a result of a lack of diversification

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## Current Audit Considerations

### Investment Strategies



Where a fund has a single or dominant asset and the strategy says:

“the trustee will have proper regard to diversification” along with

“a single asset strategy may be adopted if the asset meets the investment criteria” noting “the trustee will endeavour to diversify at a later date as further contributions are made”

The audit issue:

1. The trustee has not documented the risks the fund is exposed to as a result of a lack of diversification

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## Current Audit Considerations

### Investment Strategies



The ATO have noted they believe the specific risks associated to the lack of diversification should be noted in the investment strategy.

I disagree this is required by reg 4.09, however...

Where you want to include comments regarding the specific risks applicable to the fund, care should be taken in providing the wording for the trustee, keeping in mind auditors are not licensed to provide any type of investment advice.

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## Current Audit Considerations

### Investment Strategies



Practical solutions for the auditor:

- Be proactive and contact funds that have a single or dominate asset strategy
- Suggest a new strategy should be drafted, having regard to **ALL** SIS requirements
- Don't accept back dated strategies that magically detail the exposure to risks from a lack of diversification – the ATO letter was September, 2019, so it is highly unlikely the fund has this documented as at 30 June, 2019
- Consider whether a minute is sufficient to avoid Part B qualifications and ATO reporting

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## Current Audit Considerations

### Investment Strategies



Minutes prepared for clients note:

- The current ATO focus on the requirement to consider diversification when setting the strategy, and in particular to document the risks associated with a lack of diversification
- The current strategy calls for diversification (or for it to be considered)
- The fund currently fails to achieve diversification given the single or dominate asset held
- Document the exposure to the risks of a lack of diversification
- Confirm – notwithstanding the apparent lack of diversification, that diversification was considered, and the risks from a lack of diversification were also considered

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## Current Audit Considerations

### Investment Strategies



Minutes prepared for clients note:

- For a client that held 100% of investments in cash – the minute noted “the trustee does not believe there is an associated risk from a lack of diversification given the low risk investment held by the fund”
- For a client that held 98% in unlisted unit trust – the minute noted “the trustee has considered diversification and has considered the risks associated with an exposure to a lack of diversification” and “that the trustee has given due regard to and accepts the risks associated, having regard to the fund objectives”

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## Current Audit Considerations

### Investment Strategies



What about 0 – 100% as the ranges for all asset classes?

ATO believe:

- “this is not acceptable”
- It is indicative the trustee considers the strategy a basic compliance exercise
- That the fund may as well not have a strategy!

The ATO are preparing guidance

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## Current Audit Considerations

### Investment Strategies



I believe:

- 0-100% (for one or all asset classes) is acceptable:
  - SIS doesn't require ranges to be documented
  - A strategy without ranges is acceptable
- Trustees do consider the strategy a basic compliance exercise, but this doesn't mean their investment considerations are blasé and uninformed
- The auditor can't force a client to document tighter ranges in their strategy or to list ranges in the first place

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## Current Audit Considerations

### SMSF Wind Up Considerations



ATO guidance for the trustee:

- Pay out or rollover all super (leave a sufficient amount in the fund bank account to pay final tax and expenses, if required)
- Arrange for the auditor to do the final audit
- Complete and lodge the tax return
- Pay any outstanding tax, and after all liabilities have been settled, close the fund bank account

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## Current Audit Considerations

### SMSF Wind Up Considerations



ATO guidance for auditors:

- Check the fund complies with the wind up requirements:
  - Requirements per the deed are met
  - All members agreed (in writing) to the wind up
  - The financial statements are correctly compiled
  - No accrued income or expenses are overdue at the wind up date (apart from tax accruals)
  - You have written representation from the trustee confirming any bank transactions occurring after the audit will comply with super laws

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## Current Audit Considerations

### SMSF Wind Up Considerations



ATO guidance for auditors:

- Auditors can add a qualification to the audit report where the fund has left the bank account open
  - The qualification should say the auditor is unable to verify the compliance of transactions occurring after the audit date because the account has remained open to receive the final tax refund, or pay the final tax liability
- Auditors might consider a management letter point to remind the trustee of their remaining obligations to formally wind up the fund

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## Current Audit Considerations

### SMSF Wind Up Considerations



In practice for my clients:

- We estimate the audit fees and send an invoice, allowing the client to pay in advance of finalising the fund and we request the accountant do the same
- Any rollover should be done factoring in all final costs, and should be done before the audit is completed
- Any amount needed to pay tax could be transferred to the accountant's trust account for payment when the tax return is finalised

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## Current Audit Considerations

### SMSF Wind Up Considerations



In practice for my clients:

- The bank account can then be closed, and statements to evidence this can be reviewed by the auditor
- If the bank account needs to remain open to receive a tax refund, the trustee needs to provide statements subsequent to year end evidencing the receipt of the refund, and to evidence the closure of the bank account

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – a summary

- How the NALI provisions operate where a trustee deals with another party and the expenditure is not arm's length
- Applies to 2019 financial year, regardless of whether the scheme was entered into before 1 July, 2018
- NALE is defined as a loss, outgoing or expenditure that is not at market value

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – a summary

- Where a fund has NALE specific to a revenue stream, the revenue stream (less relevant expenses) will be treated as NALI
- Where a fund has NALE and there is a sufficient a nexus between the whole of the income of the fund and the expense, the total income of the fund will be treated as NALI
- To be a sufficient nexus the expense must have been incurred in gaining or producing the relevant income
- The expense does not have to be deductible to have a NALI consequence

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – a summary

- NALE can be revenue or capital account
- NALE incurred (or not incurred, as the case might be) in acquiring an asset will have a sufficient nexus to all the income attributed to that asset, and all income from that asset (including any capital gain) will be NALI

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – example

- A member holds a commercial property worth \$800k
- During the 2020 financial year the property is sold to the member's SMSF for \$200k
- The acquisition results in all rent (less property expenses) being treated as NALI. When sold the capital gain would also be treated as NALI
- Of course, the acquisition also fails s.66, and would need to be disposed of
- If the acquisition is then accounted for as \$200k purchase, and \$600k contribution, the rent on the property is still considered to be NALI (refer par 24)

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – example

- If the contract is documented as being part cash and part in-specie there would be no NALE, and therefore no NALI on the property (refer par 35)
- What if the contract required no deposit to be paid on the acquisition of the property?

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – example

- A related party holds listed shares worth \$900k
- During the 2019 financial year the shares are sold to the member's SMSF for \$500k
- The acquisition results in all dividends being treated as NALI. When sold the capital gain would also be treated as NALI
- Of course, the acquisition also fails s.66, and would need to be disposed of
- Refer par 52 for market value substitution rules (they do not affect the application of the NALE provisions)

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – example

- In the 2021 financial year a member engages her accounting firm to provide accounting services to her SMSF
- The firm does not charge the fund for those services
- The ATO believe there is a sufficient nexus between the NALE and all of the ordinary income of the fund, and therefore all income would be NALI for the 2021 year

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### Current Audit Considerations

#### NALE



LCR 2019/D3 – example

- In the 2019 year the fund entered into a non-commercial LRBA for a property worth \$2m
- The fund borrowed 100% of the purchase price, and interest was set at 1.5%, and the loan agreement required only annual repayments
- The debt terms are not considered to be arm's length
- All rent (less property expenses) would be treated as NALI. When sold the capital gain would also be treated as NALI

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### Current Audit Considerations

#### NALE



LCR 2019/D3

- NALE provisions are not intended to capture services provided by a trustee in their capacity as trustee
- NALE provisions are invoked if services are provided by a trustee in their individual capacity

The auditor now needs to consider whether services are provided in a trustee capacity or an individual capacity

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### Current Audit Considerations

NALE



LCR 2019/D3

Capacity considerations

- Factors that indicate an individual capacity
  - Individual charges the fund for performing the services (although no charge is not necessarily indicative of a trustee capacity)
  - Individual uses the equipment and other assets of their business, profession or employment
  - Individual performs the activities pursuant to a licence or qualification relating to their business, profession or employment
  - The activity is covered by an insurance policy relating to their business, profession or employment

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### Current Audit Considerations

NALE



LCR 2019/D3 - examples

- Trustee is a CA and RTA who is employed in an accounting firm
- In the capacity as trustee the financials and tax return are prepared, without using the equipment or assets of her employer, nor does the tax return get lodged using the trustee's tax agent registration
- No fee is charged
- NALE does not apply as the duties were performed in the capacity as trustee of the fund

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### Current Audit Considerations

NALE



LCR 2019/D3 - examples

- Trustee is a licensed real estate agent and runs a real estate business (inc. property management)
- The trustee provides property management services to their SMSF and utilises equipment and assets of the business to provide the services
- 50% of the regular fee is charged
- NALE does apply as the duties were performed in an individual capacity
- The rent on the property (less expenses incurred) becomes NALI for each year this continues

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## Current Audit Considerations

### NALE



LCR 2019/D3 – transitional relief

- The ATO will not allocate compliance resources to determine if the NALI provisions apply for the 2019 and 2020 financial years where the fund has incurred NALE of a general nature
- The ATO expect trustees that have incurred NALE of a general nature that has a sufficient nexus to all ordinary income to alter these arrangements in order to ensure the NALI provisions don't apply
- There is no transitional relief if the expense is not of a general nature

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## Current Audit Considerations

### NALE



Recommended audit approach:

- Where a fund has property but no, or low management fees, the auditor needs to ascertain if a related party or related party employer provides the management services, and if so, how the services are provided
- Where a fund has no or low accounting fees, the auditor needs to ascertain if a related party or related party employer provides the accounting services, and if so, how the services are provided
- Consider a management letter point advising that market value fees need to be paid by the fund for services provided on an individual capacity

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## Disclaimer



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