Busting the myths of SMSF accounting and auditing

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SMSF Asset classes – ongoing compliance and audit considerations

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When a Self-Managed Superannuation Fund (SMSF) considers acquiring an asset or making a new investment, there are several compliance rules and issues that need to be considered at the time of acquisition. For example:

- whether the asset can be acquired from a related party;
- does it fit within the fund's Investment Strategy;
- will the investment be regarded as an in-house asset; does the acquisition meet the sole purpose test; and
- is the acquisition or investment permitted under the Trust Deed.

In addition to these considerations at the time of acquisition, the on-going and potential future compliance and audit requirements should also be factored in when the trustees are weighing up whether a particular investment is one that the SMSF should be making. Assets acquired by an SMSF can have additional layers of compliance when compared to using other non-super structures to acquire and hold an asset. These on-going compliance requirements, potential costs and hurdles should be understood by SMSF trustees prior to acquisition.

Let's consider what these on-going compliance issues are for various types of commonly held SMSF assets.

Real Estate:

One of the most popular asset types held by an SMSF is real estate, which presents several on-going compliance issues for SMSF trustees to be aware of. A few of these are discussed below:

- **Year-end market value** - The market value of real estate held by an SMSF must be considered by the trustee(s) each and every 30 June. SMSF trustees need to be aware of the potential on-going costs associated with determining and substantiating market value for real estate. Potential costs include the expense of obtaining an independent valuation or other forms of market value evidence and additional administration and audit costs for an SMSF that owns real estate. The Australian Taxation Office (ATO) has recently released guidance on the evidence that SMSF trustees need to provide to their auditor to substantiate the market value used in the SMSF's financial statements (search QC 64053 on the ATO's website).
- **Leasing real estate to a related party** - Where the property is leased to a related party, trustees must ensure it continues to meet the definition of 'business real property' (BRP). There should be a review of the lease agreement to ensure

that the terms are being adhered to, including any review to market of rents and that it has not expired.

In addition to the initial costs to draft and execute a lease, there would be ongoing costs to extend, renew and vary the lease. This may include the cost of obtaining an independent assessment of market rental. Variation to a lease may also be caused by unexpected market conditions, for example the COVID-19 rent relief measures.

- **Residential property** - Where the property is residential, the SMSF auditor may require evidence that it has not been used by a fund member, relative or related party. This could be brought into question where the property is situated in a popular holiday destination and is leased out as holiday rental accommodation. An SMSF auditor may require the trustee(s) to provide evidence that the property has not been used by a related party and that this is provided at each annual audit.
- **Charges over the property** – The SMSF auditor may wish to conduct a search each audit year to ensure that the property has not been used to secure any borrowings, unless permitted. This may incur additional costs for the SMSF.
- **Investment Strategy** – It is not uncommon for an SMSF that owns real estate to have no other asset categories, apart from its bank account. The ATO and SMSF auditors have a focus on SMSFs with single asset investment strategies to ensure compliance with the requirements under SIS[1]. SMSF trustees need to be prepared to dedicate time to ensure that the investment strategy will stand up to audit scrutiny.
- **LRBAs** – Real estate held via a limited recourse borrowing arrangement (LRBA) is subject to certain SIS requirements. For example, the property cannot be developed. SMSF trustees need to be mindful of the limitations and restrictions of property held via a LRBA.

Units in a non-related unit trust:

A common scenario is where two or more unrelated SMSFs hold units in a unit trust and that unit trust acquires an asset, typically real estate. Each SMSF must not hold more than 50% of the issued units in the unit trust. This, together with other requirements, means that the SMSF's investment is not treated as an in-house asset.

- **Ongoing assessment of relationships –** In addition to an initial assessment to ensure that a unit trust is not a related trust of each of the SMSF unit holders, there will be a requirement for an on-going annual assessment to ensure that this remains the case. This would include assessing whether there has been any change in circumstances that make members from different SMSFs related parties. For example, a member from each fund jointly acquiring a rental property together or children of members from each SMSF getting married to

[1] Superannuation Industry (Supervision) Act 1993

each other may mean they become related parties. The SMSF trustee should not be surprised if their SMSF auditor reviews the structure each and every annual audit.

- **Exit plan -** It is important that when this type of structure is entered into that the SMSF trustees are aware of the potential issues when one of the SMSF unit holders wants out, that is, to dispose of their units in the unit trust. The assessment of whether the investment is caught by the in-house asset rules is assessed from the perspective of each SMSF unit holder. A unit trust may be a related trust to one of the SMSF unit holders, but not another SMSF unit holder.

For example, a unit trust is set up with three unrelated SMSF unit holders (SMSF A; SMSF B and SMSF C), each holding one third of the issued units. SMSF C unit holder wants out and SMSF A offers to buy the units, at market value. From a practical perspective this achieves the desired outcome. However, there is now a significant compliance issue for SMSF A, as it now holds two thirds of the units in the unit trust. As SMSF A now holds more than 50% of the issued units, the unit trust is a related trust of SMSF A and caught by the in-house asset rules. From SMSF B's perspective, it still holds units that represent not more than 50% of the issued units and consequently the unit trust is not a related trust of SMSF B. Assuming SMSF A's unit holding value represents more than 5% of the total value of its assets, it will be required to dispose of the excess in-house asset amount by the following 30 June. This may cause issues, particularly where the asset held by the unit trust is the business premises of the business operated by members from one or more of the SMSFs.

SMSF trustees in this type of non-related unit trust structure need to have an exit plan prior to executing the acquisition to deal with unit holders wanting to dispose of their interest, either voluntarily or involuntarily, e.g. a member passes away.

- **Market value -** As with real estate, SMSF trustees that hold units in a unit trust, or any other unlisted entity, will be required to determine and substantiate the market value each and every 30 June.

Division 13.3A unit trusts:

Another common scenario is where an SMSF acquires an asset via an interposed unit trust that complies with SIS regulation 13.22C in Division 13.3A, commonly referred to as a "non-geared unit trust". This type of structure can be used where the SMSF is the sole unit holder or where the SMSF and a related party are the unit holders. Whilst the unit trust is prima facie a related trust of the SMSF, the SIS provisions exempt the units from being treated as an in-house asset, provided it complies with the requirements of SIS regulation 13.22C.

- **Checklist of prohibited events -** SMSF trustees need to be aware of the consequences where certain events occur after the structure has been established. These events are commonly referred to as 13.22D events and will cause the unit trust to be forever tainted as an in-house asset. A 13.22D event can occur simply by the SMSF buying listed shares with surplus cash. Rectification can be a challenge, as well as costly.

The SMSF auditor will need to assess, each annual audit, that there have been no 13.22D events.

Overseas assets:

Two issues that arise where SMSF acquire assets overseas, particularly direct assets like real estate, is ownership and market value. Often local laws prohibit the asset being held by the SMSF and an interposed entity is required to hold the asset as a custodian or nominee, resulting in additional costs. Without relevant documentation, substantiating asset ownership can be a challenge.

Market value is also a challenge and may require engaging a local valuer to provide a market value report. Again, this may be more expensive than arranging a valuation of a property situated in Australia.

- **Language used -** Where documents are in a non-English language, translation costs may be incurred so that the accountant and auditor can understand them.
- **Foreign currency translation -** Where a transaction in relation to the overseas asset is in a foreign currency, there may be additional accounting and compliance costs associated with translating the amounts into Australian dollars and dealing with the related income tax consequences. Further, the SMSF may have an obligation to lodge local foreign jurisdiction returns and pay taxes.

Generally, the administration and compliance costs associated with an SMSF owning an overseas asset, like real estate, will be higher than where the asset is situated in Australia.

Collectables & Personal Use Assets:

The rules for an SMSF owning these types of assets are very prescriptive and are generally seen as a back-door prohibition on SMSF's holding such assets. Commonly, when SMSF trustees are made aware of the ongoing compliance requirements of these types of assets, they decide to acquire the asset outside of their SMSF.

Forewarned is forearmed

Advice at the time an SMSF acquires an asset or makes an investment to ensure that the superannuation rules are complied with is important, but such advice should not end there. Where SMSF trustees have the knowledge and understanding of the on-going compliance requirements for different types of asset classes, preparation of the annual financial statements and conduct of the annual independent audit can run a lot smoother. It also prompts forward planning to deal with potential future events. In fact, it may even lead to the SMSF trustees deciding not to acquire the asset or make the investment. Educating trustees on these and other asset type issues (not mentioned in this article) can reduce the risk of compliance issues or simply lessen the level of annual audit angst from trustees and their accountants (and even the auditor).

Why PS LA 2020/3 Covers All SIS Breaches

Author: Shelley Banton

Is there a glaring omission in the new **Practice Statement Law Administration 2020/3** (PSLA)?

It would appear at first glance that s166 SIS doesn't cover all the reportable breaches of SIS and applies to specific provisions only.

While this is technically true, it's a trick for young players because like everything to do with SMSFs, the devil is in the detail.

(Read our **previous article** for more information on the PSLA).

Reportable Breaches Covered by s166 SIS

Let's break it down.

There are twenty-nine (29) reportable breaches of SIS that SMSF auditors are obliged to review to ensure regulatory compliance for every fund.

The reality is that s166 SIS contains only eight (8) reportable breaches of SIS to which an administrative penalty will apply.

Does this mean that only 27% of all reportable breaches are covered?

How s166 SIS Works

The provisions of SIS listed in s166 SIS that SMSF auditors have to report mandatorily includes:

1. s35B – trustees must prepare, sign and retain accounts and statements
2. s65 – trustees must not loan monies or provide financial assistance to any member or relative at any time during the financial year
3. s67 – trustees must not borrow money
4. s84(1) – trustees must take all reasonable steps to ensure that the in-house asset rules are complied with
5. s103 – trustees must keep minutes of all meetings and retain the minutes for a minimum of 10 years
6. s104 – trustees must keep up to date records of all trustee or director of corporate trustee changes and trustee consents for a minimum of 10 years
7. s104A – trustees who became a trustee on or after 1 July 2007 must sign and retain a trustee declaration
8. s105 – trustees must ensure that copies of all member or beneficiary reports are kept for a minimum of 10 years

The list is heavily skewed towards breaches of minutes and records with only three (3) high-risk contraventions included: s65, s67 and s84.

While all three of these breaches will result in SMSF trustees personally incurring penalties worth a whopping sixty (60) penalty units each, or $13,320 per trustee, all the rest are worth ten (10) penalty units each or $2,200 (which is still nothing to sneeze at!).

But what about contraventions of separation of assets (r4.09A); illegal early access (r6.17); sole purpose test (s62); investments at arms-length (s109); investment strategy (r4.09) and market value (r8.02B)?

Has the Regulator finally given SMSF trustees a get-out-jail free card?

The s166 SIS Catch-22

Using the above approach is both limited and technically incorrect.

Section 31 SIS sets out the prescribed operating standards applicable to the operation of SMSFs and under which trustees must comply.

It contains standards that include, but are not limited to, the following matters:

1. trustee behaviour
2. number of trustees
3. contributions
4. preservation of benefits
5. retirement income streams
6. investment and management of assets
7. solvency
8. winding-up

Each of these operating standards broadly covers the missing twenty-one (21) reportable breaches in one way or another.

Section 34 SIS (listed in s166 SIS and worth twenty (20) penalty units) then says that the prescribed operating standards must be complied with at all times and s166 SISA imposes an administrative penalty for breaching those standards.

As a result, any reportable breach of SIS not explicitly covered in s166 SIS gets caught by the operating standards under s34 SIS at a $4,400 cost to each trustee.

ACR Reporting

Trying to circumvent the reporting of provisions of SIS listed in s166 is also fraught with disaster.

By way of example, problems can arise where a fund acquires an asset from a member for an amount greater than the asset's market value.

Under these circumstances, the trustees have contravened multiple provisions of SIS which include s65, s52, r4.09, s62 and s66. While s65 is the only breach listed in s166 SIS which gives rise to a penalty, the auditor may choose to report it as an s66 breach instead.

Regardless of how the breach gets reported, it will be the ATO's investigation into the activities of the fund and trustee behaviour that will decide the final application of penalties and whether they will be wholly, partially or not remitted.

It would be misguided to believe that the ATO would be unable to identify the primary contraventions and impose the appropriate penalties.

Remember, too, that any ATO penalty remission decisions are looked at on a case-by-case basis for each trustee incurring a penalty.

Conclusion

The ATO has come full circle since the introduction of administrative penalties in 2014. The reason is that the educational approach they previously adopted did not make any in-roads into changing trustee behaviour.

The SMSF industry has been on notice for some time that the full impact of administrative penalties would hit poorly behaving trustees.

The result is that the recently released PSLA is an all-encompassing document that covers all reportable SIS breaches for administrative penalties. There is no get-out-of-jail-free card available regardless of whether s166 SIS lists a contravention or not.

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Clearing the Murky Waters of SMSF Auditor Independence

Author: Shelley Banton

The murky waters of SMSF auditor independence just got a whole lot clearer. The Accounting Professional & Ethical Standards Board (APESB) has released a new **Independence Guide** representing a significant change to the traditional model of in-house SMSF audits.

Many SMSF firms currently prepare the accounting work and undertake the audit function citing Chinese Walls, providing them with the 'ability' to separate the two services.

Not any longer.

The new guidelines dispel the myth that APES 110 Code of Ethics for Professional Accountants (including independence standards) does not apply to SMSF audit clients because they fall within the "small client" category. It is precisely this type of classification, according to the guidelines, that has a direct impact on the type and significance of independence threats.

What Compromises Independence?

Where an SMSF auditor has any doubt about their independence and is unable to eliminate the circumstances creating a threat to independence or fails to apply safeguards to reduce those threats to an acceptable level, they must decline the audit engagement.

SMSF auditors should be applying a litmus test by asking themselves whether they would have any hesitation in qualifying an audit report or writing up an adverse finding. By way of example, if an SMSF auditor identified a reportable compliance breach for a new client and dealt with it through a management letter, their independence is shot.

Can an SMSF Firm Still Audit In-House?

The guidelines explicitly state that an auditor cannot audit an SMSF where the auditor, their staff or their firm has prepared the financial statements unless it is a routine or mechanical service.

There can be no misunderstanding as to the nature of the guideline's intent about what constitutes a routine or mechanical service.

Services provided by the SMSF firm that is 'routine or mechanical' require little or no professional judgement, such as preparing the accounts from a trustee-approved trial balance.

The implication here, though, is that merely getting the trustee to approve and sign-off a trial balance prepared by the firm would not be considered routine or mechanical.

To this end, the firm must ensure the trustee has the suitable skills, knowledge and experience to remain responsible for their decisions. The trustee is also required to oversee the service and understand the objectives, nature, and results of the firm's services.

Where the firm is unable to demonstrate the trustee's ability to take responsibility, the auditor, their staff, or their firm would be unable to prepare the financial statements and audit them.

What About Reciprocal Arrangements?

An arrangement whereby two SMSF auditors audit each other's personal SMSF, or where two firms prepare the financials in-house and then enter into an agreement to audit each other's SMSF clients represents a reciprocal arrangement.

Both the ATO and ASIC have these arrangements on their radar as an area of concern.

There are no safeguards that can be put in place to eliminate the circumstances that create a self-interest, familiarity, or intimidation threat to independence where auditors have reciprocal arrangements for their personal funds. They must decline or end the arrangement.

One Referral Source Issue

Firms that have a large proportion of fees coming from one referral source, such as under a reciprocal arrangement or where an SMSF auditor predominantly has one large client, may not be able to eliminate an independence threat.

An appropriate safeguard would be to spread out the referral of clients to several different SMSF auditors, which would minimise the dependence on one source. Another might include engaging external quality control reviews or external consultation on critical audit judgements.

Yet another solution would be for the SMSF auditor to increase their client base, which is not the easiest thing to do in these fee-challenged times.

Are Long-Term Arrangements Affected?

Long-standing audit arrangements over ten (10) years can also provide the impetus for a self-interest or familiarity threat.

Under these circumstances, auditor rotation could eliminate independence threats but may be a challenge to implement in a small firm.

Other safeguards might include having a reviewer not involved in the audit to review the auditor's work or performing regular independent internal and external quality reviews of the engagement.

As a minimum, it is considered best practice to organise an internal or external independent review after auditing a fund for ten (10) years.

ATO Stance

The ATO continues to refer SMSF auditors to ASIC as a result of their focus on SMSF auditor independence.

In 2019, the ATO referred two (2) Top 100 SMSF auditors and twenty-nine (29) high-risk auditors to ASIC after a review that identified a failure to comply with auditor independence standards.

The ATO has always been concerned about the situation where the SMSF auditor is the registered tax agent is also involved in preparing accounts and statements for the SMSFs they audit.

Conclusion

The new guideline confirms that SMSF firms undertaking the audit and accounting function will no longer meet their obligations under professional standards and ethics.

SMSF firms who provide both services and have long held the belief that there is no need to give up the SMSF audit should think about revising their business model.

It will also be interesting to see how ATO responds to the new guidelines and how they expect SMSF auditors to comply with the standard. Still, it must be apparent to even the most steadfast SMSF firm undertaking audits in-house that the murky waters of SMSF auditor independence just cleared up.

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How a Routine or Mechanical Service Impacts Independence

Author: Shelley Banton

There has been much discussion surrounding the updated Independence Guide, published by the **APESB** and Professional Accounting Bodies, concerning how a routine or mechanical service impacts **SMSF auditor independence**.

Mirroring the recent changes made to the APES 110 Code of Ethics released by the APESB in January 2020, the guidelines specifically encompass a new direction for independence that challenges SMSF auditors in every way.

The guidelines state that an auditor cannot audit an SMSF where the auditor, their staff, or firm has prepared the financial statements unless it is a routine or mechanical service.

Within the SMSF industry, some believe that the concept of routine and mechanical is open to interpretation and that it throws up a new grey area for SMSF practitioners.

Nothing could be further from the truth.

The new guidelines align with APES 110 section 601.4 A1, which provides a thorough explanation about how the concept of 'routine or mechanical' works.

Services that Are Routine or Mechanical

Services provided by an SMSF firm that is 'routine or mechanical' require little or no professional judgement by the accounting firm. Under this context, the financials could mostly be prepared by administration staff as all instructions come solely from the trustee.

Examples cited in APES 110 include the accounting firm:

1. posting transactions coded by the trustee to the general ledger
2. posting trustee-approved entries to the trial balance
3. preparing financial statements based on information in the trustee-approved trial balance
4. preparing related notes based on trustee-approved records

It is evident from these examples that the trustee cannot simply "approve" everything after the fact, as they now squarely sit in the seat of decision-maker.

The New Era of Management Responsibility

Another pitfall faced by SMSF firms is that they must not assume management responsibility for an audit client. The guidelines show how the firm can avoid this issue – the firm must be satisfied the trustee makes all judgements and decisions that are the proper responsibility of management.

Most importantly, the firm must demonstrate and document that the trustee has the suitable skills, knowledge, and experience to remain responsible for their decisions. The trustee is also required to oversee the service and understand the objectives, nature, and results of the firm's services.

Practically, an accounting firm can no longer provide administrative or operational advice to trustees such as offering tax minimisation strategies; advising when to commence a pension and the required amount to meet the minimum or how much to contribute so as not to exceed the contributions caps.

Even the most steadfast SMSF firm must now concede that it is time to outsource the in-house SMSF audit.

What About Recurring Transactions

One may argue that a recurring transaction is routine or mechanical by nature, but let's remember that it is the trustee who must initially approve the appropriate account classification.

By way of example, SGC monies coming into a fund's bank account through SuperStream can be pre-approved and coded as a contribution by the SMSF trustee, but that represents only 12 transactions out of potentially hundreds throughout the year.

All other withdrawals and deposits have to be approved by the client, with the accounting firm keeping a record of the approval process for every single transaction.

What is Considered Routine or Mechanical

Those who consider 'easier' funds with an asset allocation of, say, listed shares and cash as routine or mechanical will also be disappointed.

The concept of routine or mechanical has nothing to do with the type of assets in a fund. It has everything to do with the trustee being responsible for coding all transactions so that the service provided by the firm becomes routine or mechanical.

In real terms, it appears that meeting the criteria of a routine or mechanical service involves the trustee providing an excel spreadsheet containing a trial balance to the SMSF firm, who uploads it into their SMSF administration software for processing.

The difficulty will be finding an SMSF accounting firm willing to work in this manner.

SMSF Auditor Sets Up Own Firm

What about the situation where the SMSF auditor sets up their firm to accept audits from the firm where they were previously a consultant, partner or employee of that firm?

Not only do self-review and familiarity threats arise, but there is also the threat of fees coming from one-referral source posing an additional intimidation threat.

Paragraph 8.5.3 of the new guidelines outline this very situation and concludes that the only safeguard available is to have an appropriate reviewer who is not involved in the audit, or who is not from the firm who prepares the financials, to review the work. Otherwise, they must decline the engagement.

While this defeats the very purpose of setting up a separate entity, it also demonstrates that looking for alternative solutions will only create new independence issues.

The outcome for SMSF Industry

There is no doubt that the new guidelines present a disruption to the entire SMSF industry. With the number of SMSF auditors standing at 5,294 (source: ATO SMSF statistical overview 2017-18), it would be folly to think that outsourcing the entire book of SMSFs currently audited in-house will be without incident.

While anecdotal evidence suggests that there are around 30% to 40% funds of these funds, the business models of SMSF firms flagged with independence issues now require careful consideration.

Capacity, workflow, staffing issues, technology, and lodgement deadlines, to name but a few business concerns, means any transitional period will require high-level planning to ensure the continued integrity of the superannuation system.

ATO Position

The ATO has said that they will not be taking compliance action against SMSF auditors who breach the new independence guidelines during the 2020-21 financial year. Instead, they will be writing to auditing firms where their data indicates that the auditor could also be auditing financial statements prepared by the same firm.

While this measured approach from the ATO provides SMSF auditors with the confirmation that they have time to comply with the requirements under the restructured code, the necessary steps will have to be put in place sooner rather than later.

Conclusion

While the process of outsourcing SMSF audits as a result of the new independence guidelines may appear daunting, SMSF firms are well-advised to start thinking about how they can transition across to this new business model.

Identifying a checklist of requirements for any new SMSF auditor is essential. But it is critical to ensure that both firms can work collaboratively together through a set of common goals and values, transparent communication, trust, mutual respect and problem resolution. It is this approach that provides the blueprint for success.

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The Limitations of Routine or Mechanical Accountants

Author: Shelley Banton

The new rules for SMSF auditor independence are clear about the choice facing SMSF firms undertaking both the audit and accounting functions in-house: they can either continue doing the audit or the accounting work, but not both.

Choosing the audit work means SMSF firms enter a new paradigm that creates limitations for routine or mechanical accountants.

What is a Routine or Mechanical Service?

The restructured **APES 110 Code of Ethics** makes it clear that an SMSF auditor cannot audit an SMSF where the auditor, their staff or firm has prepared the financial statements unless it is a routine or mechanical service. Safeguards must also be put in place to address threats (APES 110, paragraph 601.5).

While a routine or mechanical service requires little or no professional judgement (paragraph 601.4 of the restructured code), the concept continues to be a very grey area in the SMSF industry.

Some believe that where client assets are on data feeds through SMSF-specific software may constitute a routine and mechanical service under the new independence requirements.

But we need to be clear on one fact: the only criteria for a routine and mechanical service is having the client responsible for making decisions in the preparation of accounting records and financial statements.

Data feeds, technology, asset allocation or specific SMSF software has nothing to do with an accounting service being routine and mechanical.

Where the data feed is in place for the full year, the software will still require intervention to match transactions, establish the processing rules and make behind the scenes adjustments.

Even the simplest of funds will need the involvement of an accountant because asset allocation has no impact on whether the preparation of accounts can be routine or mechanical. After all, it is client-specific.

Choosing Audit over Accounting

An SMSF firm may decide to choose the audit and offer a routine or mechanical accounting service. If we use the example of a newly established fund with some rollovers and in-specie contributions of shares, all is not as simple as it seems.

Will the trustee provide instructions to process the rollover and allocate it correctly to ensure it's not double counted as a contribution?

How will the in-specie contributions be classified? What happens when the SMSF trustee incorrectly fills out the off-market share transfer form?

The routine or mechanical accountant cannot provide advice or assistance in these and any other situations. Additionally, they won't be able to set the fund up in the software without instructions from the trustee.

What will happen when the trustee submits a ledger with errors? The accountant can't make corrections to it because that breaches the routine and mechanical service ethic.

Limitations of Routine or Mechanical Accountants

The routine or mechanical accountant is limited because they never help their SMSF clients regardless of whether members divorce; die; start a pension; are below their contribution limits or need help with estate or succession planning.

The question is, why would a client stay with an accounting firm offering a routine or mechanical service when their accountant cannot resolve their SMSF issues?

The in-house auditor won't be able to help either because then they will be auditing their own work and create an independence threat.

Interestingly, making this decision goes against the grain of the very reason why most accountants are in practice: because they love helping their clients.

Firms need to choose which service is most important to them and realise that they are putting their business and clients at risk where they continue to provide both services.

Management Responsibility

Another interesting point to note under the updated guidelines: a firm (or network firm) must not assume the management responsibility for an audit client. The firm must be satisfied that the trustee is making all judgements and decisions themselves. (para 600.7)

Regardless of whether the preparation of the financial statements is routine or mechanical, if the firm is making decisions on behalf of the fund, they can not accept the audit.

To avoid assuming a management responsibility, the trustee will need to demonstrate that they make all decisions concerning the fund that are the proper responsibility of management (para 600.8)

The ATO will expect to see evidence on the auditor's file that the SMSF trustees took responsibility for the financial statements and had sufficient knowledge, skills and experience to do so.

Signed copies of financial statements and trustee rep letters and won't meet this requirement. Nor would passing an online SMSF trustee course, as both are considered insufficient audit evidence to demonstrate that the trustees understand the operations of the firm and how the SMSF software works.

The ATO has also said it will contact trustees directly in some cases to test their knowledge on the preparation of the financial statements.

Where the firm is unable to demonstrate the trustee's ability to take responsibility, the SMSF audit would not be able to be done in-house where preparation of the financial statements also took place.

Financial Literacy

To use the argument that SMSF trustees must be financially literate and have responsibility for the financial statements because that's the role of a trustee doesn't take into account case law.

By way of example, the trustees in the Cam & Bear vs McGoldrick case were not financially sophisticated. They further acknowledged they would have continued to invest monies in high-risk assets administered by their financial adviser/accountant irrespective of a modified audit report.

Here's a clear example of an SMSF trustee putting their hand up and saying they weren't financially literate. Still, they were not required to take any ownership of the losses incurred by the fund as a result of their own investment decisions.

Embedded in case law, this should ring alarm bells for SMSF firms in the light of the new independence guidelines.

SMSF Administration Firms

Remember, too, that independence is compromised where an SMSF administration firm prepares the financial statements and performs the audit but "white labels" the financial statements, so they are lodged under a different firm's tax agent number.

While there are SMSF administration firms who are genuinely independent, 'routine and mechanical' does not refer to who lodges the SMSF annual return; it relates to who does the work.

In this context, where SMSF administration firms perform both functions, regardless of who lodges the tax return, independence has been compromised.

The ATO has previously said this practice is not acceptable, and more information will be forthcoming from them in the future.

Conclusion

Integrity, innovation and independence are of the utmost importance when we consider the superannuation industry.

These discussions must take place because a balanced conversation is the best way forward and provides the optimum outcome for all participants.

SMSF firms have a difficult decision to make but need to start thinking about how they will transition across to a new business model.

One thing is certain: there are limitations involved in choosing to be a routine or mechanical accountant.

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Also part of the workshop handout, please refer the Technically Speaking article by Shelley Banton dated 9 November 2020 titled: Technically Speaking: The Perfect SMSF Storm: Options & Crypto

Click here to read the Technically Speaking article.