

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a)

Submission No. 224

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29 June 2001

Senator John Watson
Chairman
Senate Select Committee on
Superannuation and Financial Services
The Senate,
Parliament House,
CANBERRA ACT 2600

Dear Senator

Re: Committee Hearings held 25 June 2001


The National Institute of Accountants (NIA), Australia's third largest professional accounting body with over 12,000 members, would appreciate the opportunity to make comments in relation to certain matters raised in the Committee hearings of 25 June 2001. These matters related to comments in relation to the audit of small superannuation funds.

The NIA is of the opinion that some of the comments made by representatives of APRA failed to provide a full representation of the facts and that some of the statements were of particular concern to the NIA and the reputation of its membership. The following submission will highlight these concerns. Also contained for your perusal is a brief statement on the membership requirements of the NIA, in an attempt to provide a fillip to some of the gaps in APRA's representations.

The NIA would like to take the opportunity to express its concern that representatives of APRA have made comments that were either false or did not contain the full facts and to which those representatives had no capacity or right to make. It is not the role of APRA to make policy on behalf of the government in relation to the standing of any professional accounting body.

If you would like to discuss any of the information provided above or have further questions please feel free to contact either Gavan Ord, Technical Policy Manager on (03) 8665 3114 or Reece Agland, General Counsel on (03) 8665 3115.

Yours sincerely



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RECEIVED TIME 29. JUN. 14:52

PRINT TIME 29. JUN. 14:58

Senate Select Committee on Superannuation and Financial Services

Auditors of Small Superannuation Funds

The National Institute of Accountants (NIA) has read with some much concern the comments raised in the Senate Select Committee on Superannuation and Financial Services in relation to the performance of auditors of small superannuation funds in the Committee hearings on Monday 25 June 2001. The NIA wishes to make comment on some of the issues raised and seeks an opportunity provide evidence to the Committee to clarify some of the issues raised, as they directly impact upon the professional standing of the some 12,000 NIA members.

Upon reading the comments contained, most notably those of Messrs Phelps and Stow, one would be excused for thinking that the majority, if not all, of the auditors of small superannuation funds where incompetent and possibly even fraudulent. The facts however do not reveal anything on the scale that the comments seem to infer.

Furthermore the inference from the comments suggests that the culprit for all these is the supposedly lax requirements in relation to who can become an "approved auditor". The comments suggest a misunderstanding by the regulators of the admission process of becoming a member of a professional accounting body and what membership of such a body entails. There is no evidence provided that suggest a credible link between process to be an approved auditor and the few examples of incompetence. More importantly there has been no proof provided that membership of one body or another is responsible for a disproportional number of the cases that have led to the disqualification.

A number of questions need to be looked at to gain a better understanding of the issues at hand. It is not good enough to say there is a problem without looking into what the problem is (and whether there is a problem) and what are the actual causes of that

problem and how can that be remedied? The NIA will attempt to provide a rational analysis of the suggested problem.

Question 1: Is there really a problem?

The Senators are right to say that any fraud or mismanagement of superannuation funds is not acceptable, we are after all talking about the retirement security of Australians. If a problem is identified there should be no knee jerk reactions that fail to understand the root cause of any problems that may exist. If a problem actually exists, it needs to be properly identified and the direct causes located not merely hinted at.

As noted in Hansard there are over 200,000 of these small superannuation funds, with thousands of auditors across the nation looking after them. In a five year period, therefore involving over a million audit reports, only 60 auditors in this category have been found by APRA to have acted in such a way as to deserve to be disqualified. The hard facts suggest therefore that the extent of any problem is minute. There is no evidence of systemic failure, of hundreds of superannuation funds being disadvantaged by their auditors, or of massive abuse of the system. Some individuals have failed in their duties, but the system itself is not failing.

The reality is that only a small percentage, far less than 1% of the over 200,000 funds, have experienced any serious problems as a result of the current auditor requirements. Yet APRA wants to paint a picture of an industry in crisis. There are several thousand accountants currently conducting these audits, the complaints in relation to them have generally been few. With over 200,000 audits annually by thousands of auditors it is fair to expect a number of errors, of individual failures and of the appointment of the odd inappropriate auditor.

What is to be done about it? Some vague notions of limiting the requirements on whom can conduct an audit. There is no analysis of why the current requirements are a cause of the failure, nor is there any real suggestion of how those requirements can be changed. In

reality the only non-discriminatory approach to further limit the scope of who may audit a small superannuation fund would be to limit it to Registered Company Auditors (RCA's). However as the Government well knows the current requirement to be an RCA are extremely restrictive, anti-competitive and all would agree can be inordinately expensive for small superannuation funds. There is currently a shortage of qualified RCAs and they are hardly going to be interested in wasting their valuable time to audit 200,000 small, generally family based super funds who do not have the capacity or the necessity to use them in the first place. It is a non-solution looking for a non-existent problem.

Question 2: Are the auditor requirements as they currently exist the cause of the perceived problems of small superannuation funds?

There has been no close analysis done to show that the cause of the few examples of where an Auditor has failed in their duty is due to the current definition of who may be an auditor. The analysis by APRA to the Senate Committee seems to be that there is a problem with 60 auditors, this is the definition of who may be an auditor, which must be the reason for the problem. Is this reasonable analysis of the problem? Should we not expect APRA to be able to present better arguments and provide more factual proof? Where is the link?

Looking at the scant evidence that was provided to the Committee, it is clear that a number of individuals did not meet their requirements and have been shown to commit errors. What are the reasons for that? Looking at the auditors involved they involve auditors who are members of all the recognised accounting bodies, no one accounting body in particular stands out as at fault. So membership of a particular body is clearly not a cause. The vast majority of members of all the accounting bodies have been shown to not be a problem. Furthermore the problems have involved auditors with wide ranging experience and training, from relative newcomers to auditors with many years experience, so there is nothing in that either that sticks out as a cause. What does stand out are examples of individuals who either did not fully appreciate the task they were undertaking or whom did not conduct their duties to the standards required of the profession, or who did not keep themselves abreast of the ever changing superannuation

environment. These are serious issues, but they are issues of individual negligence not of a systemic problem.

The major accounting bodies, including the NIA, undertake means to ensure that their members are up to the standards required by the profession. However they do not and cannot look over the shoulder of every member at every instance to ensure they are complying. Unlike the inference drawn in the Committee a person cannot merely walk up to one of the major accounting bodies, pay their fees and then receive carte blanche to do as they please. Such would be negligence on the part of the accounting body. The reality is that rules and requirements are put in place to limit membership to only those who meet certain educational and experience requirements. For those members who wish to undertake work in specialised fields such as public practice or auditing, further requirements are placed on them. Not only this but members of the NIA and the other major accounting bodies are required to undertake Continuous Professional Education (CPE) to keep their skills up to date and relevant. Furthermore each member is subject to ethical and professional standards of conduct and are subject to discipline and even removal for breaches of such. To infer that any person off the street may become a member and by inference become an auditor of a small fund is erroneous and potentially malicious. For further information on the professional requirements of the NIA and membership eligibility please refer to Attachment A.

Under the requirements of the NIA for a member to become an auditor of a superannuation fund the NIA requires members to have at least three years of work experience, be up to date with their CPE requirements and have the required training and competence to undertake an audit. We expect any member who undertakes audit of superannuation funds to keep themselves up to date on current developments and have the requisite knowledge of the appropriate accounting and auditing standards. If they were subsequently shown to be incapable of conducting such audits or are not applying the appropriate professional standard then action will be taken against them. Where a regulator or the Courts indicate to the NIA that a member has acted in an unprofessional or illegal way, immediate action is taken against such a member.

Therefore taking these facts and applying them to the definition of who may be an auditor for the purpose of small superannuation funds there can be no causal link to the problems that have occurred. Just as the law societies are not to blame for each individual error or fraud of a member, the accounting bodies cannot be blamed for the faults of 60 auditors out of tens of thousands. The definition as it currently stands is not a contributing factor to the small number of cases where problems have been shown to exist. In the vast majority of cases it is working and should stand as it currently exists.

Question 3: Why have accountants of approved bodies been allowed to undertake these audits?

What is the rationale of allowing accountants of approved professional bodies to undertake the audit of small superannuation funds in the first place? The reasons are many.

The main reason that such accountants were allowed to undertake these audits has to do with the nature of the superannuation funds in question. In large and even medium sized superannuation funds, auditors play a very special role in ensuring that members of that fund are given some protection, a guardian of sorts of their rights and interests, is there to ensure that the fund is complying with all the requirements and looking after the interests of the members. In a small superannuation fund that role is somewhat different. With small superannuation funds, those with fewer than five members and who are intimately related through family or business, it is generally appreciated that all the members of the fund are aware of the fund and how it is operating. It is more in common with a close company relationship or even small "mum and dad" stores. In most cases they are all members of the same family and have close personal connections and interests in common.

The whole purpose of superannuation is to improve the position of its members. This can be difficult for individual members to ascertain, in larger superannuation funds. In a small fund there is greater knowledge of the fund's operations and involvement in the

decision making process. It is perceived that potential harm is less in a small superannuation fund and therefore the audit requirements are significantly different from other funds (which is the reason why the Government transferred responsibility of such funds from APRA to the ATO).

There are also a number of other practical reasons. For one, in most instances the operation of a small superannuation fund is a relatively simple affair with only a few assets. The operations are not such that they would require an auditor with vast experience and an intricate knowledge of every aspect of superannuation law. Nor as noted above do most of these funds have vast amounts of money to employ an RCA to check on their simple funds. Money spent on such auditors (an RCA can run into the tens of thousands of dollars) is money that can not be invested in the superannuation fund or used in otherwise productive capacities. Furthermore as also noted above, the number of RCA's is limited, their skills and experience are required at the other end of the superannuation spectrum.

With over 200,000 such small funds in existence, where is the pool of experienced and trained auditors otherwise going to come from? The reality is the people most appropriate to do these audits are accountants who are subject to educational, experience and ethical requirements. The occasional bad apple can be dealt with under the current system, while the vast majority performs their duties admirably and with little fuss. The current system is the most workable and suitable and that is why it is in place.

Another reason for allowing accountants of the recognised bodies to do these audits that to be a member they are required by those bodies to have been educated in auditing. The minimal level of audit education and experience required by the bodies are sufficient to provide the knowledge required to undertake these types of audits. It was also recognised that the internal requirements in relation to ethics and code of conducts and the internal disciplinary procedures of those bodies would ensure that the majority of members would be able to conduct audits. It was not envisioned that there would be perfection in every case but that on a whole the most effective and efficient means to conduct audits of small

superannuation funds would be to allow accountants from the major accounting bodies to conduct them.

Conclusion

The comments made to the Senate Select Committee on 25 June 2001 did not reflect a true and accurate picture of the current arrangement in relation to the audit of small superannuation funds. It does indicate that there are the occasional examples of where an inappropriate auditor has been employed or the person employed did not meet the standard of the profession. However the facts on the ground do not indicate a system in chaos, of thousands of small superannuation funds having problems with their auditors or that the auditors are responsible for the financial position of small superannuation fund.

Some of the comments made appear to show a lack of understanding of the role and position of the accounting bodies. As indicated above the NIA cannot accept the inference that there is no system of checking the capacity and experience of people to become members. (particular reference is made to comments at SFS 1297 "CHAIR- But no experience? Mr Stow - No. Senator Allison - So they just have to be a member? They are not approved in any other sense, except virtue of their membership? Mr Stow - That is the case.") It is an affront to suggest anyone off the street may come in and become a member and start to do audits of small superannuation funds. This is clearly not the case. The accounting bodies set standards that have to be met for membership and make all endeavours to ensure members are up to date with their knowledge and are prepared to take action against members who fail to meet the high standards expected of the profession. The NIA has a rigorous and open standard to admitting members, it has experience and know how that is not available to either APRA or the ATO in these matters and has always shown a commitment to promoting a high standard for the accounting profession.

The NIA would therefore appreciate the opportunity to provide evidence to the Committee in order to clarify some of the issues coming out of the evidence given on 25 June 2001. It is important that a full understanding of the problem (if there is one at

all) is made and of any causes that may exist is clearly identified. Merely heaping further unnecessary restrictions on small superannuation funds will solve nothing and merely raise the ire of the hundreds of thousands of honest Australians who utilise small superannuation funds. The current arrangement, bar a few bad apples, is working and should not be unfairly tampered with.

If you have any queries in relation to the matters raised above or wish to discuss the matter further please contact Gavan Ord, Technical Policy Manager on (03) 8665 3114 or Reece Agland, General Counsel on (03) 8665 3115.

Reece Agland
General Counsel
National Institute of Accountants

Attachment A

Requirements to be a Member of the NIA

MEMBERSHIP

- The minimum academic requirement for "Associate" status of the NIA is the successful completion of an Advanced Diploma in Business (Accounting) from a College of TAFE. The Advanced Diploma is a two (2) year full time course (or the part time equivalent) which covers the full range of accounting requirements including auditing. However this is only the minimum requirement at the entry level. Significant numbers of NIA members hold tertiary degree level qualifications or higher. NIA rules prevent "Associate" members from becoming an auditor of a small superannuation fund.
- To qualify for full "Member" status a person must have either completed the Graduate Certificate in Professional Accounting from the University of Southern Queensland or an approved accounting degree plus a course in Business Ethics. Furthermore they must also have a minimum of three (3) years work experience in an accounting or related field. Only members who have reached the "Member" or above status may be eligible for a Public Practice Certificate (PPC). Both the Graduate Certificate and other Tertiary accounting degrees have minimal requirements in relation to audit. They provide the foundations for the knowledge to undertake the audit of small superannuation funds.
- **New PNA Level:** In recognition of the increasing number of degree qualified or above members, the NIA has created an additional designation of Professional National Accountant (PNA). For Admission to this new level, an applicant must have an approved degree in accounting, plus have undertaken a course in Business Ethics and have the requisite three (3) years relevant experience. PNA members will be able to take out a PPC if they are officially at "Member" level. These members will be able to undertake audits of small superannuation funds.
- **Members in Public Practice:** A sizeable proportion of the NIA's membership are public practitioners. The members in public practice are subject to greater scrutiny and higher levels of professional conduct. All members applying for a PPC must undertake the Public Practice Orientation Program, which introduces them to some of the rigours of public practice and the greater responsibility and requirements on members in public practice. The PPC is renewed annually and may be cancelled by the NIA. Public practice members must not only adhere to the Code of Ethics that applies to all members but also to the guidelines of the "Conduct of Members in Public Practice". All public practitioners must have a minimum level of public liability insurance, for the forthcoming year this has been increased to a minimum of \$500, 000 cover.

SUPERVISION/CONTINUED EDUCATION

The NIA requires the following arrangements for members in relation to supervision and continued educational requirements;

- All members must undertake Continuing Professional Education on an ongoing basis. For "Fellows" and "Members" in Public Practice this is now 80 hours CPE per biennium, for those not in public practice the requirement is 60 hours per biennium. From audits of members CPE activities it has been shown that many members exceed the minimum. The NIA runs seminars on a number of issues that are important to members professional development including on audit and of superannuation funds.
- All members must conduct their professional endeavours in a ethical manner, which is supported by an identifiable and enforceable Code of Ethics which is based on well established ethical standards. The Code of Ethics is based on the concept that members will act legally at all times and imposes moral and ethical standards to follow. As noted above members in public practice are also subject to the "Conduct of members in Public Practice".
- NIA Public Practitioners must adhere to the *Public Practitioners Manual* which includes a section on quality assurance (QA). Members are expected to implement the QA processes as appropriate to the size of their particular practice. The NIA is implementing a program of quality assurance reviews of its members in public practice.
- NIA members are required to abide by the Accounting and Auditing standards as set in Australia. These standards are recognised as amongst the most stringent in the world.
- Members who hold money "in trust" for clients are subject to requirements to have trust accounts which are audited annually.

DISCIPLINE

- The Code of Ethics is supported by processes in relation to the investigation of alleged breaches of the Code or of the law or other ethical breaches. These are investigated by an independent "Investigator". Where warranted matters then proceed to a Disciplinary Committee. Members found to be in breach may be fined, admonished, suspended or may even be removed from membership of the NIA. The NIA is also implementing a process for external mediation of disputes between members and the public.
- If APRA were to inform the NIA that one of our members had been disqualified to be an auditor and provided the NIA with the reasons for this, the NIA would take appropriate disciplinary action, with the likely outcome of the member either

being removed from the NIA or have their PPC revoked. The NIA takes seriously any complaints against our members. We believe that a complaint against one member can be seen as a complaint against all, if a member has lowered the standard of the profession and the name of the NIA then they do not deserve to retain membership of the NIA.