

# **Senate Select Committee on Superannuation and Financial Services**

## **Main Inquiry Reference (a)**

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# **ROUNDTABLE ON STANDARDS OF AUDITING**

**Statement to the inquiry into Prudential Supervision,  
Consumer Protection for Superannuation, Banking  
and Financial Services**

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The Australian Taxation Office (ATO) welcomes the opportunity to contribute to the committee's inquiry into auditing in Australia.

As an organisation, we are very interested in hearing the communities views on the adequacy of Australian auditing and accounting standards and would be willing to assist the committee in any planned future activities addressing this area.

We are particularly interested in our role as the regulator of self managed superannuation funds (SMSF). Under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act), the trustees of every SMSF are subject to a mandatory annual audit by an approved auditor.

The Superannuation Business Line of the ATO is pleased with the strategies it has implemented since the transfer of regulatory responsibility for SMSFs occurred. We believe that our primary function is to promote the soundness of funds by requiring them to observe certain minimum standards and to assist those funds that have, in some form or another, found themselves in difficult circumstances. In this regard we see ourselves as being a facilitator rather than a revenue collector, with the aim of assisting fund members to reach their retirement goals.

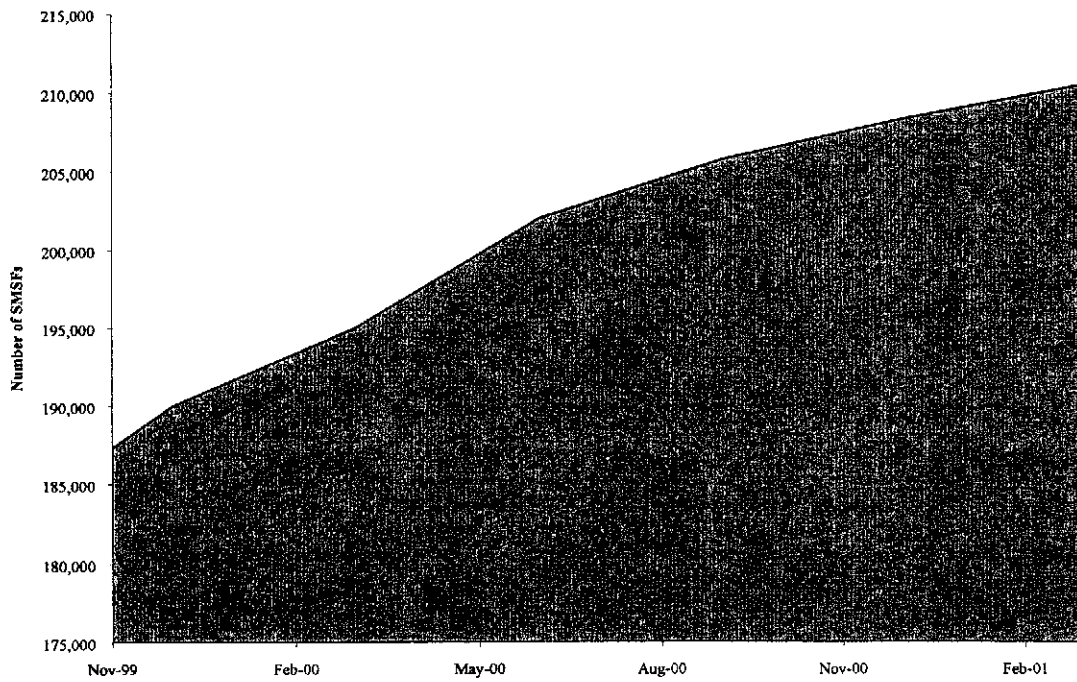
Our compliance improvement strategies clearly identify the role of the approved auditor as a crucial component. If carried out properly, the audit will identify contraventions of the SIS Act and will ensure that an appropriate plan for resolution is prepared and implemented by the trustees. Hence, in the first instance, the ATO relies heavily on the diligence of the approved auditor to identify and resolve contraventions of the SIS Act.

We have been actively participating in industry audit workshops and have a published circular detailing the ATO's requirements of approved auditors. However, it should be noted that we have only recently been presented with our first opportunity to collect and analyse regulatory data from SMSFs, via lodgement of the year 2000 income tax/regulatory return form. Our ability to discuss the issues raised by the committee will obviously be enhanced on the completion of this exercise.

Reflecting back over the transitional period, I note with interest the concerns expressed by some commentators of a potential reduction in the attractiveness of small funds due to the ATO becoming a regulator.

Current ATO data indicates that these concerns were unwarranted. Since November 1999, when the ATO became the regulator of SMSFs, we have seen in excess of 29 000 new SMSFs establish. At the end of the June 2001 quarter there were approximately 214 000 SMSFs in total. In recent months we have seen accelerated growth rates in the number of SMSFs establishing, with approximately 1 900 newly established funds electing to be regulated by the ATO per month (see figure 1).

*Figure 1. Number of SMSFs.*



These figures reflect the growing importance of the SMSF market in the wider superannuation community. They demonstrate a clear need for appropriate systems to be in place to enable SMSF trustees to make informed and prudent decisions when managing the operations of their fund. They also reflect the valuable role the approved auditor can play in addressing compliance issues in a more timely manner.

## **Adequacy of auditing and accounting standards**

### Financial Statements

SMSFs are not considered to be reporting entities and are therefore not bound by AAS25 or any other Australian accounting standard when preparing financial information in respect of the fund. As a result, while trustees are still bound by the requirements of the SIS Act to prepare annual accounts and statements, they are free to present this information in the format and style that the trustee chooses. We accept that in the SMSF context this approach is valid.

In the course of our compliance work to date, the ATO has frequently asked to examine the financial information prepared by or for the trustees in respect of the fund. Overall the ATO has been satisfied with the standard of financial information presented and have found that in the majority of cases the trustees and accountant/auditor work together to ensure that appropriate financial information is prepared.

Of some concern to the ATO are instances where the trustee structure includes both passive and active trustees. Given the passive trustees reluctance to be fully involved in the decision making processes of the fund, it could be argued that the lack of standards governing the preparation of financial information places them at a disadvantage in assessing and interpreting the financial health of the fund. However, in addressing this concern the ATO's preference is to educate trustees on their role and responsibilities as a trustee of a superannuation fund.

### Annual Audit

As mentioned above, we have clearly identified the role of the approved auditor as a crucial component in our SMSF compliance improvement strategies.

The role of the approved auditor acts as a valuable leverage tool for the ATO in that:

- the audit report is prepared within nine months of the end of the year of income and may precede, by a significant time, any review action by the ATO. Prompt action by the trustees in response to the approved auditor's findings will prevent problems being exacerbated over time;
- there is an expectation held by trustees of all funds that their activities will be examined annually by an external auditor, encouraging compliance;
- approved auditors face the prospect of being reported to their professional body should the ATO decide that their performance is unsatisfactory; and
- in cases where the ATO considers that the auditor's deficiencies bring into question the person's fitness and propriety to be an approved auditor, it has the power under section 131 of the SIS Act to disqualify the person from being an approved auditor.

In effect, with the current process, a significant contribution to the overall compliance process is performed by the approved auditor. It is therefore in the best interests of

the ATO and the trustees that the approved auditor performs the external audit to a satisfactory level.

Failure to correctly carry out an approved audit may result in compliance issues going undetected and unrectified, leading to future complications and additional rectification expense when the issues are eventually detected. In addition, there is the increased risk to the members' benefits in the interim.

From our compliance activities to date, we have identified that the standards governing the functions of the approved auditor concentrate on the financial side of the audit. In the SMSF context it could be argued that the compliance audit is more important as it would be expected that SMSF trustees would manage their own money in a prudent manner.

Further, the standards appear to provide an adequate definition of materiality for auditors conducting a financial audit but do not include a definition for compliance materiality. This is something we often get asked to comment, that is, what is or isn't a material contravention when conducting a compliance audit for a SMSF.

Our intention has always been to seek a resolution to these issues in co-operation with the professional associations. One option might be to simply build on the ATO's approved auditor circular. Alternatively, the associations may view it as their responsibility to provide firmer standards or guidelines. Be it industry or ATO led, we are keen to see discussion on these issues commence.

Overall I think it's important to restate our position that the role and functions performed by the approved auditor are crucial in our on-going regulation of SMSFs. For these reasons the ATO would be reluctant to support any proposed action that would lead to the current standards, governing the audit process and responsibilities of the approved auditor, being diminished.

### **Independence and accountability of auditors**

The greatest perceived risk we have identified to date is an inadequate audit due to the failure of the auditor to maintain true independence. The SIS Act does not prescribe any standards in relation to independence, however, members of the approved professional associations must conform to the Statement of Auditing Standards and Codes of Professional and Ethical Conduct. Among other things, this states that an auditor must be and must be seen to be free of any interest which is incompatible with objectivity.

In order to better understand the industry situation with regard to independence, we have commenced analysing the break up of SMSFs among auditors. This preliminary analysis is based on information supplied to the ATO via the 2000 year income tax/regulatory return form.

We have identified that there are approximately 16 500 auditors with SMSF clients. Of these, 13 337 auditors have between 1-10 clients; 2 915 auditors have between 11-50 clients and 493 auditors have over 50 SMSF clients. Our initial analysis indicates that there are potentially 2 997 instances where the tax agent and auditor are the same

people who have lodged more than 5 returns, totalling potentially 87 432 funds or in excess of 43% of total lodgements<sup>1</sup>. While these figures require further refinement and validation, we believe that they are indicative of the current levels of true independence that exist.

The role of the approved auditor has been raised as an issue in a number of forums with industry bodies. Independence and the presence of cursory audit reports were identified as of significant concern. Views range from the belief that the audit report is 'not worth the paper it is written on', through to anecdotal evidence that when done properly the report is a powerful compliance tool.

In addition, during independent market research interviews, some intermediaries expressed a desire for the relaxation of auditing requirements. This may imply that some intermediaries find the current auditing requirements onerous and possibly time consuming.

In sum, qualitative and quantitative research together with anecdotal evidence suggests that a lack of independence and cursory audits on the part of the auditor are significant risk factors. Lack of technical expertise is a lesser issue.

In view of this, the ATO would be supportive of any potential industry review on the issue of auditor independence.

### **Role of professional bodies in ensuring adherence by their members to ethical standards**

Our activities to date have centred on providing assistance to the professional associations in the education of their members by actively participating in industry audit workshops and in openly discussing the ATO's expectations of the approved auditor. From this process we have been able to develop strong relationships with auditors and auditor groups and have detected a genuine desire from the industry to work in unison with us to improve the overall standards and knowledge of members.

Under the SIS Act, we have the ability to refer individual auditors to their association for action if we encounter an unsatisfactory audit or are unsatisfied with the processes adopted by the auditor. At this stage of our regulation of SMSFs, it has not been necessary for us to pursue this course of action in respect of an individual auditor.

This could conceivably change with the recent lodgement of the year 2000 income tax/regulatory return form.

We intend to examine the working papers of auditors who are in our 'at risk' category. This applies particularly to those auditors where we have identified contraventions that should have been identified in the course of the audit. Naturally, we will be having discussions with the relevant professional associations about our methodology so as to ensure minimal impact. However, in cases where the ATO considers that the auditor's deficiencies bring into question the person's fitness and

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<sup>1</sup> The figures are based on 78% of total SMSF lodgements for the 2000 year and reflect instances where the agent and auditor have indicated the same contact details (and the agent has lodged >5 returns).

propriety to be an approved auditor, we will have no hesitation in referring them to their relevant association for action.

From the relationships that we have developed since the regulatory transfer occurred, we would expect to receive a co-operative approach from the associations in addressing our concerns when raised.

### **Qualifications and experience required for auditors**

SMSF auditors are required to hold appropriate qualifications and membership status to qualify as approved auditors under the SIS Act.

It has been suggested to us that not all SMSF auditors would have had the opportunity to be adequately across the recent superannuation changes given the impacts of tax reform. Of particular concern seems to be the smaller firms who by necessity have to cover a wide range of taxation and superannuation issues with relatively small staff numbers. Given the importance the ATO is placing on the role of the approved auditor, comments of this nature are of concern.

Auditors without the resources to be confidently across all areas may need to consider their priorities, and perhaps consider outsourcing the SIS Act components of their work.