Online SMSF Audit

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Re: Comment on Exposure Draft 03/21
Proposed Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

Introduction

I have been involved in SMSF Audit since 1990 a period of about 30 plus years. First as an employee of an auditor and then advisor / tax agent / Accountant of SMSF Trustees clients up to 2013 and thereafter as an ASIC Approved Auditor.

I started SMSF Auditors Association of Australia Ltd with other auditors, in my time of Directorship, our membership reached 700 ASIC Approved Auditors. In 2013, I also launched Australia's first online SMSF audit software which was used last year by over 900 SMSF Auditors to audit about 60,000 funds. Since 2006, I have provided face to face training in SMSF audit to over 1,000 ASIC Approved auditors all over Australia and continue to do so online.

It will be fair to say that I have in-depth knowledge about SMSF Audit and how the SMSF Audit Industry works. I was one of first to raise a flag to ATO, the only way to bring auditor independence was to amend the APES 110. I am glad that it is finally happening.

Below are my comments on the current state of play and suggestions on how referral sources and fee dependency issues are currently threatening auditor independency and a suggestions on how APES 110 can be amended to ensure auditor independence.

Note : Please note all my comments apply to only audit of SMSF's (non public interest entities) and specifically to changes in paragraph AUST R 410.14.1. My comments are assuming that audit firms adhere to the new guidance where the auditor or audit firm can only audit those fund where they were not involved in preparing financial statements of the fund.

Threats to independence when fees or referral source is an issue

In majority of cases in audit of an SMSF, it is the administrator who appoints the auditor rather than the trustee of the fund. The below analysis points out there three major size of administrators and my comment is based on the size of the administrator.

i. Where the administrator is medium to large - looking after 100 funds to 500 funds. Usually there is SMSF expertise in-house and the auditor is considered just a "tick off" process which must be followed. The audit fees to be paid to the auditor is generally decided by the administrator rather than the auditor. In other words, the administrator keeps looking for an auditor who will accept their offer. One fee is paid to the auditor irrespective to the complexity of the fund.

Result: These funds prior to 1st July 2021 were getting audited internally - by the audit partner, however due to the changes in code these firms need to use an external auditor for the first time. The auditor usually required by these firms is the one who will quickly issue the audit report and does not ask too many documents to slow down their process work. Auditor cannot be independent as usually only one auditor is appointed to conduct all the audits of the firm - there is intimidation threat and pressure to complete audit work quickly.

Solution: About 150,000 funds are expected in this group. If somehow these firms are forced to employ more than one auditor or say one auditor for each 50 funds, then it is possible that independence is achieved. The code emphasizes on 20% of the number of funds which it audits to come from one referral source and that is where I think is the problem lies.

If the conditions were changed that if legislation could be put in place to limit the number of funds an administrator can allocate to one particular audit firm or auditor, this matter can be resolved in a much un-disputed way rather than limiting the auditor which causes more confusion. This would mean that these firms would be forced to deal with multiple auditors as they will not be allowed to engage one auditor for more than 20% of their funds.

ii. **Where the administrator is very large** - looking after 500 funds or more funds. About 150,000 funds are being looked after by this group of about say 50 entities. The Trustees are charged a fee inclusive of audit. Usually the administrator will have three levels of administrative fee depending on their complexity of the fund. In some cases the work is outsourced to an overseas organization to provide accounting and audit services.

Result: The administrator either does the administration work in-house or conducts only supervisory work to an overseas accounting firm and lodges the income tax return of the fund. The auditor usually appointed is an audit firm which employs more than one SMSF Auditor. Some larger firms appoint more than one audit firms for quick turnaround time. Usually these firms give access to accounting systems to the auditor

Solution: If the administration work is done in-house in Australia, then the solution provided (i) will apply. However if the administration work is done by an overseas organization, they should not be also supplying audit services. Since there are 50 such entities, it is quite easy to manage them individually.

When the overseas entity offers accounting and audit work to the Australian administrator, the fee usually includes funds audit. These overseas firms then seek Australian auditors to tick off their work. A large number of funds are offered to be audited at a very low price and the auditor is expected to hand over their digital signature to be stamped on the audit report by the overseas entity. Usually no audit happens as there is a relationship between the overseas accounting firm and the Australian SMSF Auditor - at times the Australian auditor is a profit sharing partner of the Australian accounting firm.

For example, since my name suggests that I am of Indian and I get approached on linkedin, and offered $100 to $125 to sign off the work done in India by an Indian outsourcing company. auditors.

iii. **Where the administrator is in-charge of less than 100 funds**. This is where you will find a mixed bag of SMSF skills among the administrators and maximum risk lies. There are about half the funds or 300,000 are administered by this group.

Result: This group of administrators usually employ known people. These known people could be old friends, relatives or ex-employees etc. Here the issue is not more about fees, rather than how quickly the auditor can complete their audit work and issue an audit report without any fuss. In my opinion, it is virtually impossible to find an auditor who is truly "independent" in this group. Many auditors visit the accountants office or get documents sent to them. Usually all the funds of a firm are audited by one single auditor. Fee dependency issue is a major concern in this group.

Solution: By amending the APES 110 by limiting an auditor engagement by not more than 20% of audits from one referral source, the code is encouraging auditors to work in semi-reciprocal arrangements. Where Administrator of "group A" gives audit work to "B group of Auditors" who are also administrators who will then give audit work to "C group of Auditors" who will engage "group A" and so on.

By limiting the number of audits from one referral source - say to 20%, APES 110 merely aims that the auditor is engaged by 5 or more administrators who will not give more than 20% of their work to them. This can diversify the auditors work coming from multiple sources, but in pursuit of independence, the code is ignoring the main cause of poor quality audits.

In my opinion auditor independence can only be introduced by auditor rotation, where the auditor cannot sign off the 4th years audit or one auditor cannot be appointed for not more than 3 years for the same fund. If we increase this to 5 years, errors will remain un-reported for many years.

Quality of audits

After 15 years of experience in providing training to a large number of SMSF auditors of various ages, I am of the opinion that that about half the ASIC Approved auditors should not be auditing funds due to their lack knowledge of SIS legislation and superannuation basic compliance issues and no understanding of Australian Auditing Standards.

For many years APES 110 has allowed SMSF to go without an audit - some may call them in-house audits, but I call them "no audit" at all and there are lots skeletons which are yet to come of the closet.

Having worked for almost 20 years in four different places, the reality of the situation is that one person in the office prepares the accounts of the fund and maintains two files, one for Tax and one for Audit. The audit partner in most cases does not even look at the audit checklist or "conducts an audit" and relies on the staff member to brief him if there are any issues.

Imagine letting loose these auditors to audit other firms funds. There will be a huge misinterpretation of law as now they will be checking / auditing other administrators work. Quality will be compromised.

How long does it take to audit a fund and what should be the Auditors fee

The board must understand that fees should never be a yardstick to judge independence in turn competency of the auditor - or threat to the auditor. There are a very large number of retired or semi-retired auditors who are doing a fantastic job. They are wealthy and are not conducting SMSF audits to earn an income. In fact many do not want to earn and income above the tax free threshold. Their fee is usually low and they want to audit about 120 funds a year as it takes them about half a day to do one fund for 240 working days.

The board should look at what the ATO auditors discovered when auditing the top 100 auditors. Almost half did not pass their test. They will find similar results in each band of auditors, especially those who audit less than 50 funds per year. The board should find a way to weed them out.

This weeding can only happen with an annual exam. I found the ASIC exam quite a joke when i took it some years back, anyone can pass it. But I doubt half the auditors will be able to pass an exam which I set for them. For starters the exam had no questions on Australian Auditing standards. I am told that about 75% of current SMSF auditors have done a course in Australian Auditing Standards over 10 years back and about 30% have never done this course as they are overseas accountants!

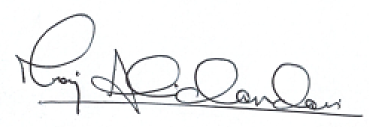
Many auditors applied for ASIC registration in 2013, based on prior knowledge of auditing 20 funds in prior to 2013 financial year when ASIC registration become compulsory. At that time there were over 12,000 SMSF auditor and now we have half or approx 6,000 and if half are removed, then we will have about 3,000 auditors for 600,000 funds or 200 funds if they are spread evenly.

Also measuring CPD is not a solution as many SMSF Auditors can sleep during a face to face presentation or simply tune off in an online presentation and yet have the required number of CPD hours. In my opinion the only solution is an annual exam and this exam should not to be set by ASIC. ASIC may run the exam for adherence purposes, but for setting these exams - you will need to employ a group of industry experts - say 10 individuals who are not affiliated to any one particular association and change 5 of these 10 individuals, every year, so that fresh exams are set each year.

Let's admit to it that the system is not working and independence is an offshoot of lack of knowledge and lack of CPD, that is why in 2021, ATO provides details of the sections number of SIS Act and Regulation at the back of their audit report ! - Guess why? - because about half of the SMSF Auditors do not know what they have to audit. That is a fact.

I strongly feel, the above recommendations should be considered if you want SMSF's Audits to be independent and Auditors to follow a robust conceptual framework.

Kind Regards



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