

## **BY EMAIL**

[brad.tallents@supersystemreview.gov.au](mailto:brad.tallents@supersystemreview.gov.au)

[pedro.cafe@supersystemreview.gov.au](mailto:pedro.cafe@supersystemreview.gov.au)

4 June 2010

Dear Brad & Pedro

### **PRELIMINARY RECOMMENDATIONS - PHASE THREE - SMSFs**

SPAA wishes to raise the following concerns in relation to the preliminary recommendations on Phase Three made by the Review on 29 April 2010.

We generally agree with the Panel's view and support the majority of the preliminary recommendations, believing that these will assist the sector to be more secure and efficient.

The preliminary recommendations that SPAA does not support or seeks additional clarification on and the reasons for this follow.

#### **Recommendation 6.2.1 Superannuation Complaints Tribunal**

The Panel preliminary recommendation was that the jurisdiction of the SCT be extended to resolve death benefit disputes between an SMSF and a beneficiary who is not a member or a person in their capacity as the legal personal representative of a deceased member, and to resolve disputes involving external insurance. The Panel further recommends that the additional resourcing required for the SCT be addressed by way of the SMSF supervisory levy.

The recommended increase in the SMSF supervisory levy to fund resources so that the SCT can hear death benefit and insurance claim disputes for SMSF will increase costs across the sector for a resource that will only be used by some SMSFs.

SPAA is not opposed in principle to the concept of a Tribunal offering an alternative dispute resolution to the Court system.

However, without evidence to support the need for this alternate dispute resolution, SPAA questions the imposition of an additional charge for all SMSFs. SPAA is unsure of the number of instances that would require these specific arrangements to be considered independently of related inheritance matters in other courts, but would expect anecdotally that it would be minimal.

SPAA believes that the Panel should reconsider this preliminary recommendation to include additional research to be undertaken into the nature and extent of such claims and given the nature of SMSFs consider if the beneficiaries making the claims should fund the cost of the SCT hearing the matter.

### **Recommendation 7.2.1 SMSF Establishment gatekeeper mechanism**

The Panel outlines ideas considered and comments that the Panel has not yet reached a firm enough view on this issue to make any form of recommendation, but currently favours the online module option. This would require prospective SMSF members to complete an online module on a government website which would take them through their possible suitability to participate as a member and trustee of an SMSF.

SPAA appreciates that the Panel is yet to formulate a final position of this matter, but cautions the Panel on their favoured position to recommend that trustees complete an online module on a government website to determine their suitability to be a trustee. SPAA's primary concerns are:

- The Government's capacity and expertise to develop and deliver this type of online module;
- The cost of providing such facilities and who would fund these; and
- No similar precedent exists for establishing a company of other type of entity and the SMSF sector is heavily focused on the use of advisors to assist trustees to understand their roles and responsibly;
- SPAA does not favour any form of mandatory training as this imposes a prohibitive barrier to entry for this sector.
- SPAA does not agree that a 'suitability' online test should be developed by the regulator as it could be construed as 'advice'.

### **Recommendation 7.5.4 Independence of SMSF auditors**

The Panel recommends legislating full audit independence whereby an individual or firm providing any service in connection with an SMSF or its individual trustees or trustee directors in any capacity is to be expressly prohibited from auditing that SMSF.

SPAA believes legislating full audit independence to the extent suggested in the preliminary recommendation is excessive and unnecessary.

SPAA acknowledges that auditors play a fundamental and critical role in the regulation of self managed superannuation funds. However, the proposed independence requirements have the potential to make it commercially unviable to operate an accounting firm, where that firm also provided audit services to SMSFs.

There are currently a number of specialist SMSF audit practices in Australia, but these fall well short of the resources needed to audit some 420,000 SMSFs.

SPAA acknowledges that the Panel is reluctant to group SMSF and APRA regulated funds when considering reforms necessary for each sector. However, the recommendations in relation to independence impose a very serious restriction on the SMSF sector. The risks associated with SMSFs are in fact lower than those for APRA regulated funds where no such restrictions exist.

It is a well established fact that the risks associated with the audit of an APRA regulated funds are generally more significant than those of a SMSF. This is why every APRA regulated fund is required to be audited by a Registered Company Auditor. Independence requirements in relation to the audit of an APRA regulated fund are imposed on auditors via by the Australian Professional Ethical Standards Board (APESB).

It is also widely accepted practice that firms in which the auditor is a partner also provide tax, consulting and other services to APRA regulated funds provided they are satisfied that they meet the independence requirements prescribed by the APESB.

SPAA also believes that the ethical requirements imposed on auditors of ASX listed companies are less onerous than those being proposed by the Panel for auditors of SMSF. SPAA is unsure what the panel believes will be achieved by more stringent independence requirements. SPAA believes the majority of accountants and auditors are in fact complying with the ethical requirements imposed by APESB.

We have interpreted that the recommendation would capture a number of situations, including the following:

- If a partner in a firm provides audit services to a SMSF, that firm would be prohibited from providing technical compliance advice in relation to an investment transaction proposed by that fund as this would not constitute audit services.
- If a partner in a firm provides audit services to a SMSF, that firm would be prohibited from providing taxation compliance services such as preparing a tax return for a trustee and/or member of the fund, irrespective of those services being provided by another partner who has no connection with the audit of the SMSF.
- Similarly, the firm could not facilitate lodgement of the annual return, this would prohibit the firm from conducting the audit.
- The auditor would be precluded from providing compliance advice in relation to a transaction proposed by the trustees who were seeking to determine if it was permissible, as this would not be part of the annual audit.

All of the above situations would be permitted if a Registered Company Auditor was undertaking an audit of Australia's largest corporations, but not if the auditor is auditing a SMSF.

In addition, the concept of independence is subjective and will depend on circumstances which will vary significantly from auditor to auditor and firm to firm. In SPAA's view it would be difficult and undesirable to legislate for full audit independence given the subjective nature of what constitutes independence.

In conjunction with the recommendation for registration of SMSF auditors, SPAA favours further industry consultation on the issue of auditor independence rather than legislating for full audit independence. SPAA encourages the Panel and industry to consider the auditor independence standards which underpin SPAA's Specialist SMSF auditor designation. These standards acknowledge the subjective nature of the term "independence" and provide appropriate independence standards to adhere to in different circumstances. The SPAA standards also incorporate a required level competency to be achieved, similar to the current standards required of Registered Company Auditors.

#### **Recommendation 8.2.1 5% in-house asset limit (IHA)**

Subject to transitional provisions that apply until 30 June 2020, the Panel recommends that the 5% IHA investment limit be removed so that no IHA investments would be allowed.

Given the legislative conditions which must be satisfied before a fund is permitted to invest in an in house asset, including the investment strategy, covenants and arm's length requirements it is difficult to argue that an investment in a related company or trust which cannot exceed 5% of the fund value is an inappropriate investment for a SMSF.

In SPAA's view, these investments which represent less than 5% of SMSF value undermine confidence in the sector.

In light of the legislative constraints, the related party nature of these transactions should not be an overriding consideration or concern. SPAA argues that the requirement for these investments to be on commercial arm's length terms already imposes adequate restrictions on SMSF's investing.

To remove the 5% limit would serve little purpose and would unfairly penalise those SMSFs who legitimately hold IHAs for the investment potential and diversification benefits they provide.

As outlined in the Panel's preliminary recommendation, this proposal would require the introduction of further transitional provisions around the in house asset rules and this, in SPAA's view, will create further complexity and should be avoided unless tangible benefits can be clearly demonstrated.

### **Recommendation 8.3 Collectables and personal use assets**

Subject to transitional provisions that apply until 30 June 2020, the Panel recommends that SMSFs be prohibited from acquiring and owning personal use assets and collectables.

The sole purpose test exists to ensure funds do not purchase assets which would otherwise be inappropriate for a superannuation fund. Rather than singling out and prohibiting certain types of investments, the sole purpose test is designed to be an objective measure of the character and purpose of a fund's investments. In addition, other investment standards such as the fund's investment strategy, the in-house asset rules and the requirement for fund investments to be made on an arm's length basis assist to ensure fund investments are diversified.

To apply a different assessment measure to some fund assets is, in SPAA's view, inappropriate and raises questions about the objective and adequacy of the sole purpose and the other investment standards. SPAA believes if the Panel has concerns about the adequacy of personal use assets and collectables in the SMSF sector, then the Panel should consider reviewing the sole purpose test and other investment standards rather than introducing measures which potentially undermine it.

SPAA believes there is room for improvement in the guidelines issued by the regulator in regard to the purchase and storage of physical assets. In SPAA's view, it is the inappropriate use and storage of physical assets held by a SMSF which is of primary concern to the regulator and the sector. This can be addressed, in conjunction with industry consultation, by the regulator issuing further guidelines on how these assets must be maintained and stored. This will ensure that the trustees comply with a process to ensure the fund's assets are properly protected and the integrity of the sector is upheld.

The investment diversification benefits of these investments should not be underestimated nor should the task of defining what a "collectable" or "personal use asset" actually is.

As outlined in the Panel's preliminary recommendation, this proposal would require the introduction of further transitional provisions which in SPAA's view, will create further complexity and increased costs in the operation of the fund.

In SPAA's experience the majority of trustees who hold "collectables" in their fund have expertise in relation to that asset class. Therefore, it is entirely appropriate to expect that most trustees have undertaken the necessary due diligence and that the investment characteristics are well understood.

Thank you for your consideration and please do not hesitate to contact me if you would like to discuss any aspect of this letter further.

Yours sincerely,



**Andrea Slattery**

Chief Executive Officer, SPAA

T: (08) 8212 5999 | E: [ceo@spaa.asn.au](mailto:ceo@spaa.asn.au)