



**Australian Government**

**Australian Taxation Office**

## SELF MANAGED SUPERANNUATION FUNDS

# Role and responsibilities of approved auditors

This guide:

- outlines the responsibilities of approved auditors of self managed superannuation funds under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS regulations), and
- explains what the Tax Office expects of auditors in conducting audits.



We recommended that auditors read this guide and make sure they are familiar with their obligations under the SIS Act and regulations, and the relevant compliance provisions for self managed superannuation funds.

## OUR COMMITMENT TO YOU

The information in this publication is current at June 2004 and we have made every effort to ensure it is accurate. However, if something in the publication is wrong or misleading and you make a mistake as a result, you will not be charged a penalty. You may have to pay interest, depending on the circumstances of your case.

If you feel this publication does not fully cover your circumstances, please seek help from the Tax Office or a professional adviser. Since we regularly revise our publications to take account of any changes to the law, you should make sure this edition is the latest. The easiest way to do this is by checking for a more recent version on our website at [www.ato.gov.au](http://www.ato.gov.au)

## YOUR RIGHTS

It's important that you're aware of your rights and obligations when dealing with the Tax Office. These are explained in the Taxpayers' Charter, along with the service and other standards you can expect from us.

When we make a decision about your tax affairs, we will tell you about your rights and obligations in relation to that decision. We'll also give you contact details in case you have any queries or need more information.

If you're still not satisfied, you have a right to complain. You can phone our complaints line on **13 28 70**.

## THE COMMONWEALTH OMBUDSMAN

If you are not satisfied with the Tax Office's decisions or actions, you can raise the matter with the Commonwealth Ombudsman's Special Tax Adviser. Before looking into a matter, the Special Tax Adviser may request that a complainant approach the Tax Office's complaints area. The Commonwealth Ombudsman's office can investigate most complaints relating to tax administration and may recommend that the Tax Office provides a solution or remedy to your problem. Investigations are independent, private, informal and free of charge.

Phone the Commonwealth Ombudsman's office on the National Complaints Line **1300 362 072** or visit your nearest Commonwealth Ombudsman's office. You can also visit the Commonwealth Ombudsman's website at [www.ombudsman.gov.au](http://www.ombudsman.gov.au) or write to:

**The Special Tax Adviser  
Commonwealth Ombudsman  
GPO Box 442  
Canberra ACT 2601**

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## FOREWORD

The purpose of this guide is to provide you, as the approved auditor of a self managed superannuation fund with an understanding of your responsibilities under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act), the *Superannuation Industry (Supervision) Regulations 1994* (the SIS regulations), and the Tax Office expectations in conducting self managed superannuation fund audits.

It is recommended that you read this guide and familiarise yourself with your obligations under the SIS Act and the SIS regulations, and the relevant self managed superannuation fund compliance provisions.



# CONTENTS

## FOREWORD

i

## 01

### **SELF MANAGED SUPERANNUATION FUNDS 3**

Introduction	4
What is a self managed superannuation fund	5
Annual audit requirement	6

## 02

### **ROLE AND RESPONSIBILITIES OF APPROVED AUDITORS 7**

Who can be an approved auditor	8
Role of the approved auditor	8
Provide an audit report in approved form	11
Comply with auditing standards	11
Do a financial and compliance audit	13

## 03

### **COMPLIANCE CHECKS DURING AN AUDIT 15**

What to check when doing a compliance audit	16
Structure of the fund	16
Sole purpose test	17
Investment strategy and investment restrictions	18
Contribution and benefit payment standards	23
Administrative obligations	26

## 04

### **HOW THE TAX OFFICE MANAGES COMPLIANCE 27**

Penalties	28
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## 05

### **CHECKLIST FOR AUDITORS 31**

### **MORE INFORMATION 39**



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SELF MANAGED  
SUPERANNUATION  
FUNDS

01

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## WHAT IS SUPERANNUATION?

Superannuation is part of the government's plan to ensure an adequate income for Australians when they retire by encouraging them to save for their retirement.

Superannuation is a long-term savings arrangement whereby employers, self-employed people, employees and family members on behalf of others (such as a spouse or children) contribute to a superannuation fund over a long period. The superannuation fund holds the contributions in trust for members and invests these contributions to increase the fund's assets. These assets are then used to provide benefits to members when they retire or suffer a serious disability, or to a member's beneficiaries if a member dies.

The government taxes superannuation savings and investment income at a lower rate than normal savings if the superannuation fund complies with certain conditions. This gives superannuation funds the opportunity to provide increased retirement benefits.

Australians can choose to contribute their personal superannuation contributions to an independently managed superannuation fund or to a self managed superannuation fund. The Tax Office regulates self managed funds. The Australian Prudential Regulation Authority regulates all other superannuation funds that do not meet the definition of a self managed superannuation fund.

For a self managed fund to be considered a complying superannuation fund for the purpose of the *Income Tax Assessment Act 1936* (ITAA 1936) and thereby receive tax concessions, it must first elect to be a regulated fund and governed by the rules of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act). A complying superannuation fund's income is taxed at a rate of 15%, while a non-complying fund's income is taxed at 47%.

As the regulator of self managed funds, the Tax Office monitors compliance under the SIS Act to ensure that the fund remains a complying superannuation fund and is therefore entitled to receive the tax concessions.

The SIS Act requires that the accounts and statements, and a self managed fund's compliance with the provisions of the Act, be audited each year by an approved auditor. Failure to perform the audits in accordance with the SIS Act may lead to significant penalties for the trustees and/or the auditor. The approved auditor therefore plays a crucial role in self managed fund compliance.

As part of our regulatory role, we carry out regular reviews of the work performed by approved auditors to:

- ensure there are no significant deficiencies in the audit processes
- improve the quality of audits and level of compliance of self managed funds by identifying areas where the auditor and trustees may need assistance and/or further education and development, and
- provide information about what we expect from an audit of a self managed fund.

# WHAT IS A SELF MANAGED SUPERANNUATION FUND?

Section 17A of the SIS Act sets out the definition of a self managed superannuation fund. Generally, with the exception of single member funds, a superannuation fund is a self managed superannuation fund if:

- it has a trust deed that meets the requirements of the SIS Act
- it has four or less members
- each member of the fund is a trustee
- no member of the fund is an employee of another member of the fund, unless they are related, and
- no trustee of the fund receives any remuneration for their services as a trustee.

A self managed superannuation fund can have a company as a trustee (known as a corporate trustee) if:

- the fund has four or less members
- each director of the company is a member of the fund
- each member of the fund is a director of the company
- no member is an employee of another member, unless they are related, and
- the corporate trustee does not receive any remuneration for their services as a trustee.

## SINGLE MEMBER FUNDS

It is possible to have a self managed superannuation fund with only one member. If the single member fund has a corporate trustee, the member must:

- be the sole director of the trustee company, or
- be related to the other director of the trustee company and there are only two directors of that company, or
- not be an **employee**<sup>1</sup> of the other director of the trustee company and there are only two directors of that company.

If the single member fund does not have a corporate trustee, the fund must have two individuals as trustees. The member must be one trustee and the other trustee must be:

- a person who is related to the member, or
- any other person, provided the member is not an employee of that person.

Special rules also apply where a member is an employee of an **employer-sponsor**<sup>2</sup> of the fund. These rules generally mean the employee of the employer-sponsor cannot be in a self managed fund with people associated with the employer-sponsor of the fund unless they are related. One exception is for directors of the same employer-sponsor company, where there is a specific exemption to the general rule that allows these individuals to be members of the same self managed fund, providing all the other rules are met.

## WHO CAN BE A TRUSTEE?

Essentially, anyone over the age of 18 can be a trustee of a superannuation fund unless they are a disqualified person. An individual is a disqualified person if they:

- have ever been convicted of an offence involving dishonesty
- have ever been subject to a civil penalty order under the SIS Act
- are an undischarged bankrupt, or
- have been disqualified by the regulator.

A company would not be permitted to act as trustee if:

- a responsible officer of that company is a disqualified person (a responsible person includes a director, secretary or executive officer)
- a receiver, official manager or provisional liquidator has been appointed to the company, or
- action has commenced to wind up the company.

Where a trustee becomes bankrupt, they are required to immediately notify the Tax Office in writing. The Tax Office will then work with the individual trustees or a corporate trustee.

## Legal personal representative

A legal personal representative can be a trustee (or director of a corporate trustee) for:

- a member who is under a legal disability
- a member for whom the representative holds an enduring power of attorney, or
- a deceased member, up until the time that death benefits are paid from the fund.

A disqualified person cannot have a legal personal representative acting as a trustee on their behalf.

Members under 18 years of age are considered to be under a legal disability and cannot be trustees of a superannuation fund. A parent or guardian can be a trustee for a member who is under 18 and does not have a legal personal representative.

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1 Under the SIS Act, an employee generally includes a person who is engaged to perform services for salary or wages, is working under a contract wholly or principally for their labour, or is a paid company director, and certain sportspeople, artists and performers.

2 An employer-sponsor is an employer who contributes to a superannuation fund for the benefit of:

- a member of the superannuation fund who is an employee of the employer, or an associate of the employer, or
- the dependants of such a member in the event of the member's death.

## ANNUAL AUDIT REQUIREMENT

### WHAT IF A FUND CEASES TO BE A SELF MANAGED FUND?

If a fund no longer meets the definition of a self managed superannuation fund, it will remain a self managed fund until the earlier of:

- the appointment of an approved trustee, or
- six months from the date it no longer met the definition of a self managed superannuation fund.

This six-month period allows trustees time to restructure the fund (for example, by transferring members out of the fund) if they want it to remain a self managed fund. However, this six-month period does not apply if the reason for ceasing to be a self managed fund is that one or more new members have been admitted.

You must notify the Tax Office within 21 days of your fund ceasing to be a self managed superannuation fund. You do this by lodging a *Superannuation entities - change of details* form.

➤ In a year where a fund switches regulators, a regulatory return must be lodged with both the Tax Office and APRA and a levy will be required to be paid to both. The trustee must also notify the Tax Office of the change in status

### CHANGING THE STRUCTURE OF A FUND

Trustees must be aware that any decision to change the structure of a fund may result in the fund no longer meeting the definition of a self managed superannuation fund. For example, if a new member is admitted (increasing membership of the fund to more than four) or a non-member is appointed as a trustee (apart from the exceptions already listed), the fund would no longer qualify as a self managed superannuation fund. Funds that are not self managed superannuation funds are subject to different regulatory requirements and trustees should contact APRA.

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ROLE AND  
RESPONSIBILITIES  
OF APPROVED  
AUDITORS


02

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## WHO CAN BE AN APPROVED AUDITOR?

Regulation 1.04(2) of the Superannuation Industry (Supervision) Regulations 1994 (the SIS regulations) defines an 'approved auditor' of a self managed fund as:

- a registered company auditor
- a member of the Australian Society of Certified Practising Accountants
- a member of The Institute of Chartered Accountants in Australia
- a member of the National Institute of Accountants
- a member or fellow of the Association of Taxation and Management Accountants
- a fellow of the National Tax and Accountants Association Ltd, or
- the Auditor-General of the Commonwealth, a state or a territory.

 The relevant professional bodies may impose additional rules governing their members undertaking audits of self managed funds.

## ROLE OF APPROVED AUDITOR

Your role as an approved auditor is to perform a financial and compliance audit of a self managed superannuation fund's operations for the year of income and give the trustees a report in the 'approved form' within the specified period after the end of the income year.

The responsibility for the audit of the fund lies with the trustees and you, as the approved auditor.

The trustees must appoint an approved auditor and provide all relevant documentation to enable the auditor to conduct and finalise the audit within the specified timeframe.

In accordance with best practice and as referenced within the Australian Auditing Standards issued by the Auditing and Assurance Standards Board, as an approved auditor you should, at a minimum:

- provide the trustees with a letter of engagement confirming acceptance of the appointment and establishing the scope of the audit
- maintain working papers – document all matters and include copies of relevant papers, statements and documents supporting your findings and opinion
- provide the trustees with a written report on any contravention of the SIS Act related to the provisions of the SIS Act and the SIS regulations that are required to be included as part of the audit compliance scope
- provide the Tax Office (the regulator) with a written report on any contravention of the SIS Act where you believe the contravention may affect the interests of members or beneficiaries of the fund
- provide the trustees with a management letter or audit finalisation report summarising the findings of the audit, any action taken or proposed by the trustees, and any potential weaknesses in administrative procedures or systems
- give the trustees a report in the approved form within the specified period after the end of the income year, including an opinion on whether:
  - the financial report represents fairly the financial position of the fund, its results of operations and its cash flows, and
  - the fund has complied with the relevant provisions of the SIS Act and SIS regulations during the income year.

You are mandated to audit a fund's compliance with the provisions of the SIS Act and SIS regulations. The Tax Office, as the regulator of self managed funds, publishes an approved form for the audit report titled *Self managed superannuation funds – Audit report* which prescribes those provisions of the SIS Act and SIS regulations that are required to be included as part of the audit compliance scope.

## WHAT TO DO IF THERE IS A CONTRAVENTION

Sections 129 and 130 of the SIS Act impose obligations on approved auditors who, in auditing a fund's accounts and financial statements, and compliance with the provisions of the SIS Act and SIS regulations, form an opinion that:

- a) the financial position of the entity may be, or may be about to become, unsatisfactory [section 130]
- b) it is likely that a contravention of the SIS Act or SIS regulations may have occurred, may be occurring, or may occur in relation to the self managed fund [section 129].

In such circumstances you are required to:

- notify the trustees in writing of all instances of non-compliance or contravention of the provisions of the SIS Act or SIS regulations [subsections 129(3) & 130(2)], and
- notify the Tax Office in writing of all instances of non-compliance that may affect the interests of members or beneficiaries of the self managed fund.

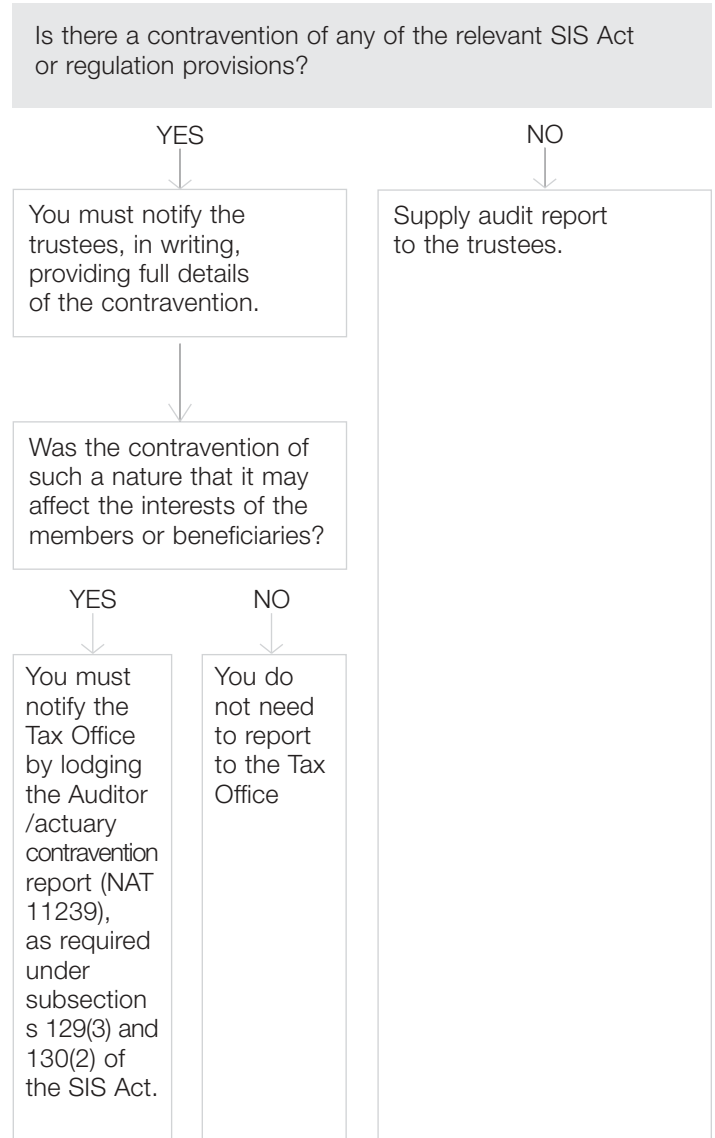
This is shown in the diagram on the following page.

**!** As a general rule, you should notify the trustees as soon as possible after you detect a contravention so that they can respond to the issue before you finalise the audit.

If you identify a weakness in administrative procedures or systems while doing an audit, even if this weakness has no impact on the financial report or does not give rise to a contravention under the SIS Act, you have a duty to report the weakness to the trustees and include the matter in your management or audit finalisation letter to them.

Furthermore, section 130A of the SIS Act requires you, as the approved auditor, to give the Tax Office any information you obtained in the course of audit or actuarial function that you believe may help us perform our regulatory function under the SIS Act, SIS regulations or the *Financial Sector (Collection of Data) Act 2001*.


## FLOWCHART: Requirements of approved auditors in addressing contraventions by self managed funds



## PROVIDE AN AUDIT REPORT IN APPROVED FORM

Subsection 113(1) of the SIS Act requires that each superannuation entity be subject to an annual audit and that the approved auditor provide a report in the 'approved form' to the trustees.

The Tax Office has developed an approved audit report form for self managed superannuation funds with a view to ensuring consistency with current auditing standards and formats. In preparing the form of the report, we consulted with the Australian Prudential Regulation Authority and representatives of the audit profession.

 As an auditor, you *must not* vary the wording of the report, except where explicitly allowed to do so.

The approved form for a report of an audit of a self managed fund as required under subsection 113(3) of the SIS Act is *Self managed superannuation funds – Audit report (NAT 7573)*.

Where a trustee is responsible for more than one fund, you are required to perform appropriate testing and provide a separate audit report for each superannuation entity. It is not acceptable to provide one audit report for multiple entities.

Both the financial and compliance sections of the audit report provide scope for you to insert additional material where you have been engaged by the trustee to express an opinion on additional aspects. Any such insertions *must not* limit or detract from the scope or opinion prescribed in the approved form. Any other variations to the content of the audit report would not be in the approved form.

## COMPLY WITH AUDITING STANDARDS

Any audits of self managed superannuation funds you undertake for the purposes of the SIS Act must be conducted in accordance with Australian Auditing Standards.

The Australian Auditing Standards are prepared and issued by the Auditing Standards Board of the Australian Accounting Research Foundation on behalf of CPA Australia and The Institute of Chartered Accountants in Australia. Members of these associations and members of other associations for approved auditors are required by their respective association rules to comply with Australian Auditing Standards when performing all audit services.

The Australian Auditing Standards state that an unqualified audit report should be issued only if you are satisfied that the financial report of the entity has been presented fairly in accordance with applicable accounting standards and relevant statutory requirements. The Australian Auditing Standards define materiality and offer guidance on auditing financial reports.

While the Tax Office does not necessarily monitor compliance with the Australian Auditing Standards or Australian Accounting Standards, after reviewing a self managed fund we may form the view that significant deficiencies are apparent in the work of an approved auditor. If we consider that such deficiencies bring into question that person's fitness, propriety and/or independence to be an approved auditor under sections 131 and 131A of the SIS Act, we may:

- consider disqualifying the person from being an approved auditor, or
- refer the matter to their professional association for possible disciplinary action.

## AUDITOR INDEPENDENCE

Auditing Standard AUS 202 *Objective and general principles governing an audit of a financial report* states that the auditor should comply with the ethical requirements of CPA Australia and The Institute of Chartered Accountants in Australia. The ethical principles governing your professional responsibilities as an auditor include independence, integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and technical standards.

While the SIS Act does not specifically comment on auditor independence, as an approved auditor of a self managed fund you should conduct your audit in accordance with Australian Auditing Standards and guidelines. You are responsible for determining your own independence and demonstrating that you meet the following prescribed standards set out by the professional bodies.

- Statement of Auditing Practice AUP 32 – *Audit independence* defines independence as a freedom from any interest incompatible with integrity and objectivity. As an auditor, you must not only be independent, but must also appear to be independent. Independence requires a freedom from bias, personal interest or association and susceptibility to undue influence or pressure.
- Code of Professional Conduct – *Professional Statement F.1 – Professional independence* states that professional independence is a concept fundamental to the accounting profession, requiring a member to approach their work with integrity and objectivity.
- Guidance Statement and Case Studies – *Application of Professional Statement F1 – Professional independence to assurance engagement*, jointly issued by the accounting bodies and the Auditing Assurance Standards Board, has added a level of clarity to the issue of determining audit independence.

As an approved auditor, you should maintain a high level of professional independence at all times. The lack of independence may be considered a contributing factor to unsatisfactory performance, especially where you are involved in the day-to-day management of a fund or are in a position to influence the fund's decision making processes.

If you were a member/trustee of a self managed superannuation fund or an accountant involved with the accounting/management functions of the fund, it would be difficult to argue that the question of auditor independence would not be compromised as a result of your other duties associated with that fund.

## AUDIT WORKING PAPERS

The Tax Office relies on the audit processes of approved auditors and their audit report to monitor the compliance of self managed funds with the relevant provisions of the SIS Act and the SIS regulations.

As part of our regulatory role, we review the work performed by approved auditors to ensure that there are no significant deficiencies in the audit processes. These reviews take the form of field or desk examinations of your files and working papers. If selected for review, you are required to make available your audit working papers and any other documentation deemed relevant to the fund's compliance with the SIS Act and the SIS regulations.

It is therefore essential that you maintain sufficient documentation to ensure we can be satisfied that you have conducted the audit in accordance with the legislative requirements and the Australian Auditing Standards. Your working papers should include copies of all relevant documents and papers, and provide sufficient evidence to support your findings and opinions about both the financial and compliance audit of the self managed fund.

As a minimum requirement, your audit papers should include the following:

- **letter of audit engagement**

Auditing Standard AUS 204 *Terms of audit engagement* states that it is in the best interests of both the trustees and the auditor for the auditor to send an 'engagement letter' to the trustees confirming the appointment and the scope of the audit to be conducted.

The letter of engagement avoids any misunderstanding about the nature and extent of the audit. It should confirm your acceptance of the appointment and clearly document the scope of the financial audit and compliance audit of the relevant provisions of the SIS Act and the SIS regulations, as set out in the Tax Office publication *Self managed superannuation funds – Audit report* (NAT 7573).

- **representation letter**

A statement by the trustees that, to the best of their knowledge, the fund complies with the requirements of the SIS Act specified in the letter of engagement.

## DO A FINANCIAL AND COMPLIANCE AUDIT

### ■ working papers

Auditing Standard AUS 208 *Documentation* states that: 'The auditor should prepare working papers that are sufficiently complete and detailed to provide an understanding of the audit. The auditor should prepare working papers that record the auditor's planning, the nature, timing and extent of the audit procedures performed, the results thereof and the conclusions drawn from the audit evidence obtained. Working papers would include the auditor's reasoning on all significant matters which require the exercise of judgement, together with the auditor's conclusion thereon.'

You should document all matters, and your working papers should include copies of all relevant papers, statements and documents that are important in providing evidence to support your findings and opinion.

Your audit working papers should include sufficient detail to provide the Tax Office with an understanding of the work performed and the basis for any decisions taken, and to substantiate that the audit was performed in accordance with Australian Auditing Standards.

### ■ management letter or audit finalisation report

Apart from providing the audit report in the approved form, you should provide the trustees with a management letter or audit finalisation report. This letter or report should summarise the findings of the audit, including details of all contraventions of the SIS Act and the SIS regulations, in accordance with sections 129 and 130 of the SIS Act, and any action taken or proposed by the trustees. It should also report on any potential weaknesses in administrative procedures or systems you detected during the audit.

### ■ a copy of the final, signed financial report of the self managed fund

Your working papers should contain a final, signed copy of the self managed fund's financial report and relevant accounting records supporting those statements for the income year under review.

### ■ a copy of the audit report in the approved form

As part of the audit papers, you should retain a copy of the audit report in the approved form, including your opinion and any qualifications.

### ■ a copy of written advice to the Tax Office (regulator)

You should retain a copy of any written advice provided to the Tax Office pursuant to subsections 129(3), 130(2) and/or 130A(1) of the SIS Act.

The SIS Act requires that a self managed superannuation fund's financial report, and compliance with the provisions of the SIS Act and the SIS regulations, be audited each year by an 'approved auditor'.

The *Self managed superannuation funds – Audit report* (NAT 7573) requires you, as the approved auditor, to examine and form an opinion on both the financial and compliance aspects of a self managed fund.

### FINANCIAL AUDIT

In undertaking a financial audit, you should comprehensively examine the accounts and the financial report of the self managed fund to enable you to form an opinion on whether the financial report presents fairly the financial position of the fund and its operations for the income year under review.

Self managed funds are required to comply with the financial statement formats specified in section 112 of the SIS Act and regulation 8.01 of the SIS regulations. Self managed funds are not 'reporting entities' and have special purpose financial statements, however, they should adopt in principle Accounting Standard AAS 25 *Financial reporting by superannuation plans* measurement principles and disclosures.

Section 112 of the SIS Act requires that the trustees of a self managed fund produce, as a minimum, a Statement of Financial Position and an Operating Statement.

Your financial audit should include (but not necessarily be limited to):

- **verification of the value of all investment and other assets of the fund** – you should obtain or sight such documents as valuation reports, share scrips or actuarial certificates, and
- **verification of ownership and separation of fund assets** – you should seek evidence of fund ownership of assets, such as property title deeds, share scrips and dividend receipts, to confirm that all assets are held in the name of the fund or in the name of the trustees on behalf of the fund (provided the trust deed allows for assets to be held in the name of the trustees on behalf of the fund).

## COMPLIANCE AUDIT

When auditing a self managed superannuation fund for compliance with the SIS Act and the SIS regulations, you must be satisfied that the fund has met the five main areas of compliance. You must ensure that:

1. the fund meets the definition of a self managed superannuation fund and has elected to be a regulated fund (sections 17A and 19 of the SIS Act)
2. the fund is maintained for the sole purpose of providing benefits to fund members upon their retirement, or to their dependants in the case of the member's death before retirement
3. the trustees have an investment strategy and comply with the investment restrictions
4. the trustees adhere to contribution and benefit payment standards, and
5. the trustees carry out their administrative obligations.

 See the next section for details of specific matters to check when doing a compliance audit.

You must report all instances of non-compliance to the trustees in writing, in accordance with section 129 of the SIS Act. In addition, where you are of the opinion that the contravention may affect the interests of the members or beneficiaries of the fund, you should report to the Tax Office by lodging the *Auditor/actuary contravention report* (NAT 11239).



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# COMPLIANCE CHECKS DURING AN AUDIT

# 03

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## WHAT TO CHECK WHEN DOING A COMPLIANCE AUDIT

When auditing a self managed superannuation fund for compliance with the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS regulations), you should check that:

1. the fund **meets the definition of a self managed superannuation fund as defined under section 17A of the SIS Act** and has made an **election to be a regulated fund** and governed by the rules of the SIS Act
2. the fund is maintained for the **sole purpose** of providing benefits to fund members upon their retirement, or to their dependants in the case of the member's death before retirement
3. The trustees **prepare and implement an investment strategy** and comply with the **investment restrictions** imposed by the SIS Act and the SIS regulations.  
These include:
  - in-house assets rules
  - restrictions on lending and providing financial assistance
  - prohibition on acquiring assets from related parties
  - restrictions on borrowings
  - the fund's investments be made and maintained on an arm's length basis, and
  - the trustees must not give a charge over, or in relation to, an asset of the fund.
4. the trustees adhere to **contribution and benefit payment standards**
5. the trustees carry out the **administrative obligations** imposed under the SIS Act and the SIS regulations.  
These include:
  - meeting record keeping requirements
  - appointing an approved auditor and making available all documents relevant to the audit of accounts and statements, and
  - reporting superannuation surcharge and reasonable benefit limits information to the Tax Office.

## STRUCTURE OF THE FUND

See section 1 of this guide for more information about the required structure of a self managed super fund and who can be a trustee.

The structure of a self managed superannuation fund is described in Section 17A of the SIS Act.

### AUDIT OF FUND STRUCTURE

You must be satisfied that the fund:

- meets the definition of a self managed superannuation fund under section 17A of the SIS Act
- has elected to become a regulated fund, and
- has trustees.

## SOLE PURPOSE TEST

The sole purpose test, according to section 62 of the SIS Act, requires that a regulated superannuation fund operates for the sole purpose of providing benefits for members on their retirement, or for a member's dependants in the case of a member's death before retirement.

The sole purpose test is divided into core and ancillary purposes. A regulated fund must be maintained for at least:

- one or more core purposes, or
- one or more core purposes and one or more ancillary purposes.

! It is unacceptable for a fund to be maintained for one or more ancillary purposes only.

### CORE PURPOSE

The core purpose provision is found in paragraph 62(1)(a) of the SIS Act. It covers providing benefits to a member when one or more of the following events occur:

- the member's retirement from gainful employment
- the member's attainment of a prescribed age
- the earlier of the member's retirement from gainful employment or attainment of a prescribed age
- the member's death, if the death occurred before they retired from gainful employment, where the benefits are provided to their dependants or legal representative, or
- the member's death, if the death occurred before they attained a prescribed age, where the benefits are provided to their dependants or legal representative.

### ANCILLARY PURPOSE

The ancillary purpose covers providing benefits for members in the following circumstances:

- termination of a member's employment with an employer who had made contributions to the fund for that member
- cessation of employment due to physical or mental ill-health
- death of a member after retirement where the benefits are paid to their dependants or legal representative
- death of a member after attaining a prescribed age where the benefits are paid to their dependants or legal representative
- other ancillary purposes approved in writing by the regulator. This purpose allows a fund to provide benefits in situations of financial hardship and/or on compassionate grounds, subject to the SIS Act, the governing rules of the fund and the approval of the Australian Prudential Regulation Authority (APRA).

### AUDIT OF THE SOLE PURPOSE TEST

You must be satisfied that the fund has not contravened the sole purpose test. You can determine whether a self managed fund has contravened the test by examining:

- the trust deed, to ensure that the fund has been established solely for providing benefits to fund members upon their retirement, or to their dependants in the case of a member's death before retirement, and
- the character and purpose of the fund's investments, to ensure that:
  - the investment arrangements do not indicate that the purpose of the fund is to provide financial assistance to another party who is not a fund member or beneficiary of the fund, unless allowed by the legislation
  - the fund is not running a business as part of its investment strategy – A superannuation fund has as its sole purpose the provision of benefits to members on retirement or attainment of a certain age, or to dependants on the death of a member. Therefore, superannuation funds are generally prohibited from carrying on an active business as there is an inherent risk in running a business that may jeopardise members' benefits. An indicator of a self managed fund operating a business would be the fund making payments or claiming a deduction for salary and wages or other business-related expenditure. Funds that operate a business may do so to exploit the tax concessions given to regulated superannuation funds, or
  - the trustees have not made the assets of the fund available for their own private use or that of their relatives
- there are no preserved benefits paid before a condition of release is met. [Regulation 6.01 and Schedule 1 – SIS regulations]

The Tax Office does not expect auditors to be too subjective in auditing compliance with section 62 of the SIS Act, but to report on sole purpose only where a reasonable person would objectively conclude that a contravention had occurred. On this basis, we have no objection to you adding the following paragraph (or something similar) to the scope of the audit report:

My procedures with respect to section 62 included testing that the fund trust deed establishes the fund solely for the provision of retirement benefits for fund members or their dependants in the case of the member's death before retirement; a review of investments to ensure the fund is not providing financial assistance to members, unless allowed under the legislation; and that no preserved benefits have been paid before a condition of release has been met.

# INVESTMENT STRATEGY AND INVESTMENT RESTRICTIONS

## INVESTMENT STRATEGY

The trustees of a self managed superannuation fund are solely responsible and directly accountable for the prudential management of members' benefits. It is their duty to make, implement and document decisions about the investment of fund assets and to carefully monitor the performance of those assets. The investment strategy, and the attendant decision making process, should be available in a written form so that both you and the regulator can determine whether the trustees have met the requirements of the legislation.


The trustees of a self managed fund are required to prepare and implement an investment strategy for the fund. The strategy must reflect the purpose and circumstances of the fund and have particular regard to the membership profile, benefit structure, tax position and liquidity requirements, including (but not limited to):

- a) the risk involved in making, holding and realising, and the likely return from, the entity's investments having regard to its objectives and its expected cash flow requirements
- b) the composition of the entity's investments as a whole, including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification
- c) the liquidity of the entity's investments, having regard to its expected cash flow requirements, and
- d) the ability of the entity to discharge its existing and prospective liabilities [paragraph 52(2)(f) – SIS Act].

An appropriate investment strategy should set out the investment objectives of the fund and detail the investment methods the trustees will adopt to achieve those objectives. The trustees must ensure that all investment decisions are made in accordance with the investment strategy. Breaches of this requirement may result in the trustees being fined or sued for loss or damages. In addition, the fund could lose its complying status.

## Audit of the investment strategy

You must be satisfied that the trustees have prepared an investment strategy for the fund in accordance with the provisions of the trust deed and that the actual investments are made in line with that investment strategy

 Decisions about the fund's investments are the sole responsibility of the trustees. It is not your role as auditor to provide investment advice.

## INVESTMENT RESTRICTIONS

The SIS Act restricts some investment practices of self managed funds. These restrictions aim to protect fund members from being overly exposed to undue risk and ensure that the trustees make investment decisions with the sole purpose of generating retirement benefits for members, rather than providing current day support. These restrictions include:

- in-house assets rules
- restrictions on lending and providing financial assistance
- prohibition on the acquisition of assets from related parties
- restrictions on borrowings
- the fund's investments are to be made and maintained on an arm's length basis
- the trustees must not give a charge over, or in relation to, an asset of the fund.

## In-house assets [Part 8 – SIS Act]

An in-house asset of a superannuation fund is defined under sub-section 71(1) of the SIS Act as:

an asset of the fund that is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between the trustee of the fund and a related party of the fund.

The trustees of a regulated superannuation fund:

- must limit total in-house assets to a maximum of 5% of the market value of the fund's total assets at year end, and
- are prohibited from making or acquiring an in-house asset that would cause total in-house assets to exceed the 5% in-house asset ratio limit.

The in-house asset rules are designed to ensure that the security of investments set aside to provide members' retirement benefits does not depend on the success of the business activities **of an employer or other related party**<sup>3</sup>.

<sup>3</sup> **Related party** – all members or trustees, standard employer-sponsors and all SuperannuationIS Act Part 8 associates of these (including, but not limited to, relatives, partners, companies where the members or their associates have a significant influence and majority voting interest, and related trusts).

In August 1999 the *Superannuation Legislation Amendment Act No. 4 1999* tightened the in-house asset rules to impose restrictions on loans to, investments in, and leases with related parties and related trusts of the fund. Before this Act was passed, in-house assets were simply investments in or loans to employer-sponsors and their associates.

Investments in place on or before 11 August 1999 that were not in-house assets under previous rules are exempt from the calculation of in-house assets under the post 11 August 1999 rules.

⚠ Trustees must not intentionally enter into or carry out a scheme that would have the effect of artificially reducing the market value ratio of a fund's in-house assets.

Under section 75 of the SIS Act, the following formula should be used to calculate the market value ratio of in-house assets:

$$\text{Market value ratio} = \frac{\text{Number of whole dollars in value of in-house assets of the fund}}{\text{Number of whole dollars in value of all assets of the fund}} \times 100$$

### Exemptions [subsection 71(1) – SIS Act]

Not all investments by funds in related parties, or arrangements with related parties, are classified as in-house assets. The exceptions to the general rule are:

- a **life policy** issued by a life insurance company
- a deposit with an **authorised deposit-taking institution** (for example, a bank or building society)
- an investment in a **pooled superannuation trust** made on an arm's length basis
- an asset of a **public sector fund**
- an asset which the regulator, by written notice or determination, determines is not an in-house asset
- **business real property** (defined in subsection 66(5) of the SIS Act) that is subject to a lease or lease arrangement between the trustee of a superannuation fund with no more than four members and a related party of that fund
- investment by a superannuation fund in a **widely held unit trust**
- property owned by a superannuation fund and a related party **as tenants in common** that is not property subject to a lease or lease arrangement between the trustee and a related party of the fund
- an asset included in a class of assets **specified in the regulations**.

### Investment by funds in related non-g geared entities

Regulations 13.22A to 13.22D of the SIS regulations commenced on 28 June 2000. They enable a fund with no more than four members to invest in a company or trust that owns real property used for business purposes and also allows business real property to be leased to members and employer-sponsors.

The main conditions that *must all be met* to qualify for exemption to the definition of an in-house asset under this exception are:

- the entity does not borrow
- there is no charge over an asset of the entity
- the entity does not invest in or lend money to individuals or other entities (normal deposits with authorised deposit taking institutions are permitted, but shares or units in other companies or trusts are not permitted)
- the entity has not acquired an asset from a related party of the fund after 11 August 1999, other than business real property
- the entity does not acquire an asset, other than business real property, that has been owned by a related party of the fund in the previous three years (not including any period of ownership before 11 August 1999)
- the entity does not directly or indirectly lease assets to related parties other than business real property
- the entity does not conduct a business, and
- the entity conducts all transactions on an arm's length basis.

### In-house asset investment made through a non-related party [subsection 71(2) – SIS Act]

Where, as the result of an agreement<sup>4</sup>, a self managed fund makes a loan to or investment in, or enters into a lease or lease arrangement with, an unrelated party, and

- that loan, investment, lease or lease arrangement was made as a result of entering into or carrying out an agreement, and
- any of the parties that entered into the agreement were aware that the result of carrying out the agreement would be that a loan would be made to, or an investment would be made in, or an asset would be subject to a lease or lease arrangement with, a related party of the fund, or an investment would be made in a related trust of the fund

the loan, investment, lease or lease arrangement is considered to be with the related party or related trust and therefore subject to the in-house asset rules.

### Audit of in-house assets

You should examine all loans, investments and leases to determine whether these were made to related parties. If made to related parties or related trusts of the fund, you must be satisfied that the total in-house asset ratio does not exceed the current limit of 5% of the total market value of the fund's assets at year end.

If the market value of in-house assets held by a fund at year end is more than 5% of total fund assets, section 82 of the SIS Act requires the trustees of the fund to prepare and carry out a plan before the end of the next income year to reduce the level of in-house assets maintained by the fund to 5% or less. The plan must set out the steps the trustees propose to take to ensure the fund's excess assets held at the end of the income year are disposed of during the next income year.

### LENDING AND PROVIDING FINANCIAL ASSISTANCE [section 65 – SIS Act]

The SIS Act includes two provisions that restrict when a self managed superannuation fund can provide loans to related parties of the fund:

1. the provision prohibiting the fund from providing loans or **financial assistance**<sup>5</sup> to a **member**<sup>6</sup> of the fund or a **relative of a member**, and
2. the in-house asset provisions in Part 8 of the SIS Act about providing loans to related parties and related trusts of the fund (see page 21 for a definition of related party).

Section 65 of the SIS Act requires that the trustees or an investment manager of a regulated superannuation fund *must not* lend money or give any other financial assistance to a member or a relative of a member.

The lending provisions of the SIS Act do not prevent a fund from providing a loan to an unrelated party, provided the transaction does not contravene any other investment provision in the Act and is consistent with the fund's investment strategy and investment objectives.

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4 An agreement includes any arrangement, understanding, promise or undertaking whether expressed or implied, and whether or not enforceable, or intended to be enforceable, by legal proceedings.

5 Financial assistance covers any assistance that improves the financial position of a person other than by a loan, such as entering into agreements to provide actual or potential financial assistance to a member using the resources of the fund. Examples are providing guarantees against fund assets for the private loans of members or charging fund assets for the benefit of members.

6 A relative of a member is defined in subsection 65(6) of the Superannuation SIS Act as 'a parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendent or adopted child of the member, or of the member's spouse; the spouse of the member (includes legal or de facto husband/wife, but not a divorced husband/wife), or the spouse of any of those relations.'

### **Audit of loans and provision of financial assistance**

You must be satisfied that the trustees have not lent money or provided any other financial assistance to a member or relative of a member at any time during the financial year under review.

### **Acquisition of assets from a related party**

#### **[section 66 – SIS Act]**

Section 66 of the SIS Act prohibits trustees or investment managers of a regulated superannuation fund from intentionally acquiring assets from related parties of the fund. Acquiring assets refers not only to purchasing assets, but is a broader reference to the fund trustees becoming the legal or equitable owner of an asset. Therefore, the intentional transfer of an asset from a related party of a fund to the trustees of the fund is also subject to the prohibition.

The rule prohibits such parties from selling assets to their fund or from contributing assets 'in specie' (subject to the exceptions listed below). The general prohibition does not prevent in specie contributions being made by a party other than a related party, provided the anti-avoidance provision or other investment provisions of the SIS Act are not contravened.

The purpose of this provision is to prevent the members of a fund transferring or selling an asset to the fund to obtain access to benefits before the members are entitled to receive those benefits.

### **Exceptions [subsection 66(2)]**

There are some exceptions to trustees of a self managed fund acquiring assets from a related party of the fund, as follows:

- trustees can acquire listed securities from related parties of a fund provided the listed securities are acquired at market value
- trustees can acquire business real property from related parties of a fund provided the property is acquired at market value
- assets can be acquired under a merger between regulated superannuation funds
- an asset of a kind that the regulator, by written notice/determination, determines may be acquired by the fund
- the trustees or investment manager can acquire certain in-house assets from a related party of a fund if the acquisition of the asset constitutes an investment that:
  - is an in-house asset of the fund within the meaning of subsection 71(1) of the SIS Act, or would be an in-house asset if not for the transitional arrangements set out in Subdivision D of Part 8, or is covered by any of the exceptions set out in paragraphs 71(1)(b) to (f) and (h) and (j); or is a life insurance policy issued by a life insurance company other than a policy acquired from a member of the fund or a relative of a member
  - is acquired at market value, and
  - does not result in the level of in-house assets exceeding the level permitted by Part 8 of the SIS Act (currently 5% of the market value of the fund's assets).

### **Audit of the acquisition of assets**

You must be satisfied that the trustees did not acquire any assets from any related party of a fund, apart from the exceptions allowed under section 66 of the SIS Act.

An examination of the title deeds, purchase contracts and/or transfer papers for the acquisition of the fund's assets, together with written confirmation from the trustees, should provide adequate documentation to satisfy you that no assets, other than those permitted under the exception provisions outlined above, were acquired from a related party of the fund.

### **Borrowing [section 67 – SIS Act]**

The trustees of a self managed superannuation fund must not borrow or maintain an existing borrowing of money, except in limited circumstances.

Borrowings usually involve receiving a payment from someone in the context of a lender/borrower relationship on the basis that it will be repaid, and include:

- a loan, whether secured or unsecured
- a bank overdraft, or
- a transaction where the borrower and lender are the same legal entity (for example, a common trustee of two superannuation entities borrows money held in one entity for the purposes of the other entity).

### **Exceptions**

The limited circumstances in which the trustees of a self managed fund may borrow are as a consequence of short-term liquidity requirements and include the following very temporary exceptions to the general rule:

- **to make a payment to a beneficiary** – limited to 10% of the value of the fund's assets and the period of the borrowing must not exceed 90 days. This should be required only in exceptional circumstances as the trustees should have prepared an investment strategy and cash flow budget that took into account the fund's liquidity requirements
- **to cover superannuation surcharge debts** – limited to 10% of the value of the fund's assets and the period of the borrowing must not exceed 90 days, and
- **to meet the settlement of security transactions** – limited to 10% of the value of the fund's assets and the period of the borrowing must not exceed seven days. The trustees cannot, as a matter of course, borrow to settle a security transaction unless, at the time they entered into the transaction, it was likely that the borrowings would not be needed. This means the trustees should not enter into any investment transaction with the intention of borrowing to cover the settlement.

### **Audit of borrowings**

You should examine the fund's creditors and accounting records to be satisfied that the trustees did not borrow any money at any time during the income year, except for the purposes and under the conditions outlined above.

### **Investments to be made and maintained on an arm's length basis [section 109 – SIS Act]**

Investments by a self managed superannuation fund *must* be made and maintained on a strict commercial basis, as follows:

- the purchase and sale price of the fund's assets should always reflect a true market value for the asset, and
- income from assets held by the fund should always reflect a true market rate of return.

### **Audit of arm's length requirement**

You must be satisfied that all of the fund's investment transactions have been made and maintained at arm's length. When assessing whether a transaction is on an arm's length basis, consider the following:

#### **Purchase or sale of assets**

- the purchase or selling price was at a fair market value (sight valuation reports where possible)
- money is actually paid – sight bank account statements

#### **Lease arrangements**

- written contract has been drawn up – sight contract
- the investment was entered into and maintained on commercial terms under the terms of the contract
- lease payments and residual value to be at market value – confirm commercial rates with local property market or industry
- lease payments are made – sight bank account statements

#### **Loans**

- written contract and repayment schedule exist – sight contract and schedule
- conditions of loan to be on commercial terms, including period of loan, repayments, security provided and interest rates – confirm by market rates
- repayments are made – sight bank account statements

#### **Investments in entities**

- realisation of investments, shares issued, units allocated at market value
- return on investments at commercial rates
- return on investments (such as trust distributions or dividends) paid – sight bank account statements.

# CONTRIBUTION AND BENEFIT PAYMENT STANDARDS

## Trustees must not give a charge over, or in relation to, an asset of the fund [Regulations 13.11 and 13.14 – SIS regulations]

A charge is an arrangement where one party has a right to hold or use as security an asset of the party that has effective ownership of the asset until a debt is repaid. It includes a mortgage, lien or other encumbrance.

Regulation 13.14 of the SIS regulations prevents the trustees of a fund from using the assets of the fund or their future benefit as security for personal loans, mortgages or other types of encumbrance.

### Exception

The only exception to this general rule is that trustees are permitted to give a charge over an asset of the fund where it relates to an investment in a **derivative product**<sup>9</sup> [Regulation 13.15A].

A self managed fund that directly invests in derivative products through an Australian or international exchange that requires a charge be created over an asset of the fund *must* develop a **risk management statement** that outlines:

- the policies for the use of derivatives, including an analysis of the risks associated with the use of derivatives within the fund's investment strategy
- the restrictions and controls on the use of derivatives that take into consideration the expertise of the staff involved, and
- the compliance processes to ensure that the controls are effective.

The risk management statement should be subject to an annual sign-off by you as the auditor that:

- there was a risk management statement
- the procedures laid down in the statement were followed, and
- any changes to the statement were approved by the trustees.

A self managed fund should not use derivatives for speculation in situations where:

- the net exposure of the fund to an asset class is outside the limits set out in the fund's investment strategy, or
- the fund's total portfolio is geared up through derivatives to circumvent the borrowing limitations imposed by section 67 of the SIS Act.

## CONTRIBUTION STANDARDS [Part 7 – SIS regulations]

! The definition of 'contributions' excludes benefits that have been rolled over or transferred to a fund.

Trustees may accept contributions only in specified circumstances.

### Mandated employer contributions

The rules on acceptance of contributions depend on whether or not contributions are **mandated employer** contributions. These are superannuation guarantee contributions, superannuation guarantee charge and award-related contributions. The trustees of a regulated superannuation fund may accept mandated employer contributions for a person regardless of the age of the person or the number of hours they are working at that time.

The rules on acceptance of non-mandated employer contributions vary according to the person's employment status, age, health, and whether the contributions are eligible spouse contributions (see Regulation 7.04 of the SIS regulations for more detailed information).

### In-specie contributions

An **in-specie contribution** is where the fund obtains ownership of an asset in lieu of a cash contribution. Such contributions must be recorded at the current arm's length value of the asset.

! If a fund accepts an in-specie contribution from a related party, other than listed securities or business real property as allowed in subsections 66(2) and 66(2A) of the SIS Act, the fund will have contravened section 66 of the Act.

<sup>9</sup> A derivative investment product is an investment that is a financial contract, deriving its value from an underlying security, liability or index (for example, options, futures and warrants).

## Penalties for contravening the contribution standards

If a fund contravenes the contribution standards:

- it may be declared a non-complying fund for the relevant income years (that is, the fund loses its tax concessions), and/or
- the trustees may be prosecuted for contravening the contribution standards of subsection 34 of the SIS Act. The penalty for a trustee found guilty of intentionally or recklessly contravening the contribution standards is a fine of up to \$11,000.

## Audit of contribution standards

You must be satisfied that the trustees accept contributions into the fund only in accordance with the contribution standards in Part 7 of the SIS regulations.

## BENEFIT ACCRUAL AND PAYMENT STANDARDS [Part 6 – SIS regulations]

The payment standards within Regulation 6.17 of the SIS regulations prescribe the conditions that must be met before a benefit can be accessed. These are called **conditions of release** and set out the specific events that must have occurred before a benefit can be paid out to a member.

The payment standards work with the sole purpose test and the preservation rules to ensure that moneys in the fund are paid to members only in appropriate circumstances.

## Compulsory cashing of benefits [Regulation 6.21]

Benefits must be cashed immediately where:

- the member has reached age 65 but is less than age 75 and is no longer gainfully employed for at least 10 hours each week
- the member has reached age 75 and is no longer gainfully employed for at least 30 hours each week, or
- the member has died.

! Proposed changes to these provisions were announced by the Treasurer in February 2004. At the time the guide was published these changes had not yet become law.

## Voluntary cashing of benefits [Regulation 6.21 of the SIS regulations]

There are three factors involved with the voluntary cashing of benefits:

### 1. Type of benefits

- preserved benefits may generally be cashed only when a condition of release is satisfied
- restricted non-preserved benefits may be cashed on termination of employment with an employer who had contributed to the superannuation fund on behalf of the member, and
- unrestricted non-preserved benefits may be cashed at any time.

### 2. Conditions of release [Regulation 6.01]

Benefits may be released or paid out to members only for:

- retirement [subregulation 6.01(7), Schedule 1, Item 101]
- death [Regulation 6.21, Schedule 1, Item 102]
- permanent incapacity [Regulation 6.01, Schedule 1, Item 103]
- attaining age 65 or more [Regulation 6.21, Schedule 1, Item 106]
- termination of gainful employment with a standard employer-sponsor and the member's preserved benefits are less than \$200 [Schedule 1, Item 104]
- termination of gainful employment with an employer who had contributed to the fund in relation to the member (must be paid as a non-commutable income stream unless the benefit is classed as restricted non-preserved) [Schedule 1, Item 108]
- temporary incapacity (must be paid as a non-commutable income stream) [Regulation 6.01, Schedule 1, Item 109]
- severe financial hardship [subregulation 6.01(5), Schedule 1, Item 105]
- compassionate grounds [Regulation 6.19A, Schedule 1, Item 107].

### 3. Cashing restrictions

! The condition of release and cashing restrictions set out in Schedule 1 of the SIS regulations apply only to the voluntary cashing of preserved benefits and restricted non-preserved benefits. They do not apply to compulsory cashing of benefits.

### **Cashing benefits [Regulation 6.22A(2)]**

Where benefits are cashed following satisfaction of a condition of release, the trustee must cash the benefit in the following order:

- unrestricted non-preserved benefits, then
- restricted non-preserved benefits, then
- preserved benefits.

### **In-specie benefit payments**

Where permitted under the fund's governing rules, a lump sum payment may be in the form of an in-specie payment. An in-specie payment is made with fund assets (for example, shares in a publicly listed company) rather than money. When making an in-specie payment, trustees must be able to substantiate the value of the relevant assets for both SIS Act and tax purposes. Payments cannot be paid in-specie where they relate to a pension, severe financial hardship or compassionate grounds.

### **Minimum benefits standards [Regulation 5.08 of the SIS regulations]**

The trustees must ensure that a member's minimum benefits in the fund (as defined) are maintained in the fund until the benefits are:

- cashed as benefits of the member, other than for the purpose of the member's temporary incapacity, or
- rolled over or transferred as benefits of the member.

### **Payment of pensions**

Whether a self managed superannuation fund can pay a pension (including an allocated pension) depends on the governing rules of the fund's trust deed.

With the payment of a pension (including an allocated pension), the trustees of a self managed fund have several additional administrative obligations:

- obtain a tax file number from the payee
- register for pay as you go (PAYG) withholding and operate under the PAYG system
- withhold correct amounts of tax from pension payments and remit these to the Tax Office
- issue an end-of-year payment summary to the payee
- if the pension is commuted and taken in cash, issue an *Eligible termination payment (ETP) summary – superannuation payer* form, and
- report the commencement, commutation or direct rollover of pensions to the Tax Office for reasonable benefit limit purposes.

A complying superannuation fund is entitled to an exemption for so much of its income attributable to its liability to pay current pensions. Superannuation funds paying pensions, including allocated pensions, may require an actuarial certificate in order to claim the exemption on the income earned on the assets used to provide for current pension liabilities.

### **Audit of benefit accrual and payment standards**

You must be satisfied that:

- the trust deed permits the payment of pensions
- the trustee administrative obligations, as stated above, have been met, and
- the trustees have obtained an actuarial certificate, where one is required, in order to claim the exemption on the income earned on the assets used to provide for current pension liabilities.

# ADMINISTRATIVE OBLIGATIONS

There are a range of administrative obligations imposed on self managed superannuation funds under the SIS Act and SIS regulations. Trustees are responsible for ensuring that these obligations are met. Failure to do so may jeopardise a fund's eligibility to receive tax concessions.

## RECORD KEEPING REQUIREMENTS

Under the SIS Act, trustees of a self managed fund are required to:

- **keep accurate and accessible accounting records that explain the transactions and financial position of the fund and retain them for a minimum of five years [section 111]**

You must confirm that accounting records have been kept for a minimum of five years, or since the establishment of the fund if less than five years.

- **prepare an annual operating statement and an annual statement of the fund's financial position and keep these records for a minimum of five years [section 112]**

You must confirm that the accounts and statements have been maintained and prepared in accordance with accepted Australian accounting principles and practices.

- **prepare minutes of trustee meetings and retain them for a minimum of 10 years [section 103]**

You must confirm that the minutes of trustee meetings have been kept for a minimum of 10 years, or since the establishment of the fund if less than 10 years.

- **keep and retain for at least 10 years, records of changes of trustees, changes of directors of any corporate trustee and all written consents to be appointed trustee [section 104]**

You must confirm that records of changes of trustees, changes of directors of any corporate trustee and all written consents to be appointed trustee have been maintained and kept for a minimum of 10 years, or since the establishment of the fund if less than 10 years.

- **keep copies of all annual returns lodged and copies of all reports given to members for a minimum of 10 years [section 105]**

You must confirm with trustees that these returns and reports are being kept for a minimum of 10 years, or since the establishment of the fund if less than 10 years.

- **where a superannuation entity changes its status to become or cease to be a self managed fund, give written notice to the Tax Office [section 106A]**

You must confirm that the trustees have given written notice to the Tax Office where the fund has changed its status to become or cease to be a self managed fund.

## APPOINTMENT OF AN APPROVED AUDITOR

### [section 113 – SIS Act]

The trustees must appoint an approved auditor and make available all documents relevant to the audit of accounts and statements.

You must be satisfied that the trustees have made all arrangements and provided the necessary support to enable you to conduct the audit in a professional and timely manner.

You must ensure that the audit is completed within the specified period.

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# HOW THE TAX OFFICE MANAGES COMPLIANCE

# 04

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A range of penalties apply to a self managed superannuation fund or a trustee of a fund depending on which obligation has been contravened. This section provides a summary of the main sanctions used when breaches occur.

# PENALTIES

## REGULATORY PENALTIES

To protect members' retirement incomes, the Tax Office regulates self managed funds to ensure they comply with both the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS regulations). Failure to comply is known as a 'contravention' of the Act and/or regulations and may result in the Tax Office taking enforcement action.

- Section 133 of the SIS Act allows the Tax Office to suspend or remove a trustee or all the trustees of a self managed fund. If the Tax Office suspends a trustee, section 134 of the SIS Act requires the Tax Office to appoint a constitutional corporation or an individual to act as the trustee during the period of suspension. The appointee is called the acting trustee. The Tax Office then has the power under section 141 of the SIS Act to direct the acting trustee to do or not to do one or more specified acts or things in relation to the fund, which may include winding up the fund or disqualifying the trustees.
- Section 120A of the SIS Act allows the Tax Office to disqualify a trustee as not being a fit and proper person.
- Under section 264 of the SIS Act, the Tax Office may, by written notice given to the trustee or investment manager, direct them not to dispose of or otherwise deal in a particular way, any of the assets of the fund until the notice is revoked.
- A complying fund that has been made non-complying can suffer serious tax consequences. The fund's total assets (less any member contributions for which no tax deduction has been claimed) are subject to tax at the highest marginal rate. In addition, any income in a year in which a fund is non-complying is taxed at the highest marginal rate.
- Setting up or using a self managed fund to gain improper early access to superannuation is illegal. Trustees who knowingly allow improper access to benefits may suffer severe penalties, including heavy fines and imprisonment. This action may also result in the fund being declared non-complying and the fund's assets being taxed at the top marginal tax rate.
- If a trustee is prosecuted and is found guilty of either a civil and/or criminal offence under a civil penalty provision, the maximum penalties that may apply under Part 21 of the SIS Act are \$220,000 (civil proceedings) and/or five years imprisonment (criminal proceedings).

 Using a self managed fund to gain early access to superannuation benefits is a breach of the law. A range of penalties apply. Members of self managed funds who access any benefits will lose their tax concessions and are likely to face higher taxes and additional penalties.

## CONTRIBUTION SURCHARGE PENALTIES

If trustees do not meet their surcharge obligations (under section 13, 14, 15B or 35 of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*), the Commissioner can issue a contravention notice.

The prescribed penalty is five penalty units for each week or part of a week during which the contravention continues. A penalty unit is \$110 for individuals or \$550 for a corporation. This means the penalty is \$550 for individuals and \$2,750 for corporations for each week or part of a week in which the contravention continues.

## INCOME TAX PENALTIES

An **administrative penalty** may be applied where a trustee makes a statement (or fails to make a statement) that results in an underpayment of tax.

A penalty may apply if a superannuation fund does not lodge an income tax and regulatory return and/or fails to make a statement.

As a trustee, you are liable for an administrative penalty if you make a statement to the Commissioner that results in a 'shortfall amount' and:

- the statement is false and misleading
- you take a position that is not reasonably arguable
- you fail to make a statement when required, or
- you do not follow a private ruling.

Depending on your conduct with respect to the shortfall, the base penalty ranges from 25% to 75% of the shortfall amount or tax-related liability for failing to make a statement. This penalty range is affected by circumstances such as the trustee:

- voluntarily disclosing information
- hindering the Commissioner's enquiries, and/or
- repeating the error.

A **general interest charge** is a single rate of interest for all tax where a payment is not received by the due date. The charge applies to (but is not limited to):

- an amount of tax that remains unpaid after the due date
- an underestimate or underpayment of an instalment of tax
- late lodgment of income tax returns for certain years
- an underpayment of tax following amendment of an assessment
- an underpayment of tax following a revision of an activity statement, and
- failure to lodge penalties that remain unpaid after the due date.

The general interest charge rate for a day is worked out by adding seven percentage points to the 90 day bond accepted bill rate for that day, and dividing that total by the number of days in the calendar year.





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# CHECKLIST FOR TRUSTEES

# 05

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The checklist in this section is designed to provide details that you, as an approved auditor of a self managed superannuation fund, may wish to bring to the attention of the fund's trustees. It does not cover every detail of managing a self managed fund. The fund's compliance is a matter that can be determined only at a given point in time and considering all the facts at that time.

## HOW TO USE THE CHECKLIST

The checklist highlights some of the more important rules under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS regulations) that trustees must comply with. We recommend that you consult the checklist regularly to ensure you are complying with all requirements in running your self managed fund. If we identify that you have contravened your legislative requirements, you may be penalised and lose your tax concessions. For more information see the section on 'Penalties' in the previous section.

### If, when using this checklist, you identify a possible problem with your fund or need more information:

- seek advice from your tax agent, accountant, financial planner or adviser
- phone **13 10 20**
- phone **13 28 60** to obtain a fax, or
- visit our website at [www.ato.gov.au/super](http://www.ato.gov.au/super)

## CHECKLIST

### Trust deed

#### My fund's trust deed:

- is properly executed
- states the name of the fund
- includes a statement that the fund must appoint a corporate trustee

#### OR

- that the sole or primary purpose of the fund is to provide old age pensions.

#### It also sets out:


- who the trustees are
- how trustees are appointed and how they can be removed from the fund
- the powers of the trustees

#### Deeds may also cover:

- that the members agree to act as trustees
- confirmation that the trustees are not 'disqualified persons'
- that trustees cannot accept payment for services as trustees
- paying benefits to members
- what contributions the fund can accept
- who can be members
- winding up the fund.

#### Overall:

- I have read and understand my trust deed
- I know the deed sets out the rules that all the trustees of the fund must comply with.

 Trustees are bound by their deed and responsible for any contravention of the rules set out in the deed.

## Trustees and members

**My fund is a self managed superannuation fund because:**

- there are fewer than five members in the fund
- all members of the fund are trustees of the fund (or directors of the trustee company)
- each individual trustee of the fund, or director of the trustee company, is a member of the fund
- no member of the fund is an employee of another member of the fund, unless those members are related
- no trustee of the fund receives any remuneration for their services as a trustee.

**OR, for single member funds:**

- no trustee of the fund receives any remuneration for their services as a trustee
- the member is the sole director of the trustee company
- the member is related to the other director of the trustee company (and there are only two directors of that company)
- the member is not an employee of the other director of the trustee company (and there are only two directors of that company)
- the member is one of only two trustees, of whom one is the member and the other is a relative of the member, or
- the member is one of only two trustees and the member is not an employee of the other trustee, and
- no trustee of the fund receives any remuneration for their services as a trustee.

There are some exceptions to these general rules, for example, where a member is under a legal disability.

## Electing to be regulated

- An election that the SIS Act is to apply to the fund was lodged with the Tax Office within 60 days of establishing the fund.

A fund must elect to be a regulated superannuation fund and comply with the requirements of the SIS Act to ensure it is a complying superannuation fund. If it does not, the fund may not receive concessional tax treatment and/or other sanctions may be imposed on the trustees of the fund for contravening the SIS Act where the fund is a regulated superannuation fund.

## Tax file number

- The fund has its own tax file number.

## Australian business number

- The fund has its own Australian business number (ABN).

Although it is not compulsory that your fund has its own ABN, it may be beneficial to the fund to obtain an ABN.

## Separate bank account

- A separate bank account has been opened so that money belonging to the fund can be kept separate from accounts of the members, the trustees and related employers (employer-sponsors).

This is very important to prevent the fund contravening the SIS Act rules and also assists trustees in preserving and protecting their retirement income.

## Accepting contributions

- The trustees are aware of the SIS regulations rules that relate to gainful employment, and age restrictions for accepting contributions.
- The trustees are aware that funds can accept contributions only in accordance with their fund's deed. The deed can also impose restrictions on the fund's ability to accept contributions so trustees need to decide what contributions they wish to accept and to ensure the fund's deed allows those contributions to be accepted.
- The trustees are also aware they cannot accept contributions from related parties in the form of assets other than money (known as 'in specie' contributions), except assets that are expressly allowed to be acquired from related parties under the SIS Act.

### According to my trust deed, the fund:

- can accept contributions from a member's employer
- can accept contributions from members
- can accept rollover payments
- can accept contributions in respect of a member's non-working spouse
- can accept contributions in respect of minors.

## Investment strategy

### My fund has a medium to long term investment strategy that considers:

- a wide range of investment possibilities, including such things as:
  - cash-based, low-risk investments
  - growth investments, for example, shares
  - combinations of investment types
- the return on investments compared with risks involved
- the ease of converting assets to cash in order to meet payments due by the fund
- members' ages and individual retirement benefit needs
- overall, the aim of my fund's strategy is to increase members' benefits over time.

Contravention of the requirement to have an acceptable investment strategy can result in the trustees being fined or sued for loss or damages. The fund can lose its compliance status and, as a result, its concessional rate of tax.

## Investing

The assets of the fund are kept separate at all times from those of:

- the members
- the trustees
- related employers.

- Each member has a separate account in the fund.
- The fund's accounting and banking records are kept entirely separate from those of members/trustees/employers.
- All transactions by the fund are conducted on a strict commercial basis.
- The fund can demonstrate that market value has been paid and received on all transactions.


These requirements are very important to prevent the fund:

- contravening the sole purpose test, and
- exposing the members' retirement benefits to unnecessary risk.

## Investment restrictions

### The trustees can demonstrate that they have not:

- lent money to or provided financial assistance using the resources of the fund to a member or member's relative
- borrowed money
- acquired assets from 'related parties' of the fund. Related parties include all members of the fund and their associates and all employer-sponsors of the fund and their associates
- leased, loaned or invested more than 5% of the fund's total assets in related parties of the fund. These assets are known as 'in house assets'.

 There are limited exceptions to the above restrictions, refer to *Self managed superannuation funds – investment strategy and investment restrictions* (NAT 2063) for a more detailed explanation.

## Record keeping

Wherever possible, responsible accounting practices will be adopted by the trustees, such as:

- joint signatories to signing cheques
- separating of accounting functions, for example, receipts and payments
- segregation of duties

Trustees must keep the following records for at least five years:

- accurate and accessible accounting records that explain the transactions and financial position of the fund.
- an annual operating statement and an annual statement of the funds financial position
- copies of annual returns lodged

Trustees must keep the following records for at least 10 years:

- minutes of all meetings
- records of changes of trustees
- records of changes of directors, if corporate trustees
- written consents by members to be appointed as trustees

Penalties apply if trustees fail to keep the records listed above for the required period.

## Paying a benefit

The trustees:

- will pay benefits only in accordance with the SIS Act, SIS regulations and the trust deed of the fund
- are aware that the SIS Act sets payment standards based on events such as reaching a certain age and termination of employment, and can place restrictions on how a benefit can be paid.

All paperwork in relation to the following will be completed:

- eligible termination payments (ETPs)
- withholding tax from ETPs and superannuation pensions and annuities and remitting the tax to the Tax Office
- reasonable benefit limits.

Benefits should be checked for accuracy before payment. The payment standards of the SIS Act work with the sole purpose test and the preservation rules to ensure monies are paid to members only in appropriate circumstances.

## Annual requirements

The trustees will:

- appoint an approved auditor to examine the records at the end of the financial year
- lodge the combined income tax and regulatory return (Form F) with the Tax Office by the due date
- pay the supervisory levy and the fund's tax liability when due
- comply with surcharge requirements.

There are penalties for failing to meet the annual requirements listed above.

## Tax matters

The trustees will keep records of:

- deductions claimed for administrative and operating expenses of the fund
- sales/purchases of assets for capital gains tax purposes
- tax file numbers of members
- deductions claimed for the provision of death and disability benefits for members.

## ADDITIONAL REFERENCES

### Self managed superannuation funds (SMSF) – Information products

Product ID	Product name	Description
NAT 2057	<i>Introduction to superannuation – for self managed superannuation funds</i>	Describes how superannuation is a long term savings arrangement that operates primarily to provide income for retirement.
NAT 2058	<i>What is a self managed superannuation fund?</i>	Defines what a self managed superannuation fund is
NAT 2059	<i>Setting up a self managed superannuation fund</i>	Provides a guide to the steps involved in setting up a fund. Topics covered include: <ul style="list-style-type: none"> <li>&gt; Obtaining a trust deed</li> <li>&gt; Corporations basis or pensions basis</li> <li>&gt; Appointing trustees</li> <li>&gt; Electing to become a regulated fund, and</li> <li>&gt; Obtaining a tax file number (TFN) and Australian business number (ABN)</li> </ul>
NAT 2060	<i>Duties of trustees</i>	Trustees of self managed superannuation funds are the ones who are ultimately responsible for the running of their fund. It is imperative that each trustee understands the duties, responsibilities and obligations of being a trustee.
NAT 2061	<i>Sole purpose test</i>	Explains the object of the sole purpose test is to ensure that self managed superannuation funds are maintained for the purpose of providing benefits to members upon their retirement.
NAT 2062	<i>Acceptance of contributions</i>	Explains to trustees of self managed superannuation funds the minimum standards relating to the acceptance of contributions prescribed under the <i>Superannuation Industry (Supervision) Act 1993</i> . Current as at November 2002.
NAT 2063	<i>Investment strategy and investment restrictions</i>	A key area of responsibility for trustees of self managed superannuation funds is investment management
NAT 2064	<i>Administrative obligations</i>	There is a range of administrative obligations imposed on self managed superannuation funds under the law.
NAT 2065	<i>Our compliance approach</i>	Self managed superannuation funds with fewer than 5 members must comply with the rules and are encouraged to self regulate.
NAT 2067	<i>Election and return lodgment – APRA or the Tax Office</i>	Explains the process for election and annual return lodgments and who regulates and manages the process – Tax Office or APRA.
NAT 2069	<i>Checklist for self managed superannuation funds (long version)</i>	The checklist highlights some of the more important rules under the <i>Superannuation Industry (Supervision) Act 1993</i> that a trustee must comply with
NAT 2070	<i>Preservation rules</i>	Trustees of self managed superannuation funds are required to comply with the preservation rules set out under the <i>Superannuation Industry (Supervision) Act 1993</i> .
NAT 2071	Payment of benefits	Trustees of self managed superannuation funds need to know the requirements of the <i>Superannuation Industry (Supervision) Act 1993</i> when paying benefits from their fund.

Product ID	Product name	Description
NAT 4591	<i>Actuarial certificates</i>	Outlines the two distinct purposes for which a self managed superannuation fund may need to obtain an actuarial certificate in relation to pensions.
NAT 6854	<i>Checklist for self managed superannuation funds (short version)</i>	This short form checklist is designed to draw attention to details that a trustee of a self managed superannuation fund must be aware of in the operation of a fund.
NAT 6733	<i>Allocated pension payments</i>	<i>The Superannuation Industry (Supervision) Regulations 1994</i> requires a pension payment at least annually. This information sheet explains allocated pension payments for self managed superannuation funds.
NAT 6732	<i>Allocated pension deductions and rebates</i>	Explains if a recipient receives a deductible amount and a tax offset (rebate) on an allocated pension/annuity
NAT 6730	<i>Tax implications for allocated pensions</i>	If your fund pays a pension it can avail itself of one of two methods under the <i>Income Tax Assessment Act 1936</i> , to exempt from tax, that 'proportion' of the fund's income earned in respect of its current pension liabilities.
NAT 6731	<i>Payment for allocated pensions</i>	Provided that the trust deed allows for the payment of benefits as an income stream, the self managed superannuation fund can pay for the allocated pension.
NAT 6734	What is an allocated pension?	An allocated product can be treated as a pension by meeting specific conditions under <i>Superannuation Industry (Supervision) Regulations 1994</i> . An allocated pension can be set up within a superannuation fund to pay a benefit as income.
NAT 7236	<i>Penalties</i>	Discusses penalties that may apply to self managed superannuation funds who contravene the <i>Superannuation Industry (Supervision) Act 1993</i> .
NAT 10417	<i>Illegal arrangements to withdraw your superannuation</i>	Explains the Tax Office's concerns that schemes involving self managed superannuation funds are being used to gain improper early access to preserved superannuation and the consequences of being involved.

### Self managed superannuation funds (SMSFs)— Circulars

Product ID	Product name	Description
NAT 8311	Australian Taxation Office Superannuation Circular 2003/1—valuation of assets	The Tax Office intends that self managed superannuation funds should use market values for all valuation purposes. This includes valuations for determining the purchase price of a pension and the use of market value accounting for all financial statements. The purpose of this Circular is to provide the basis for conducting these valuations.



## MORE INFORMATION

If you need more information about the responsibilities of auditors of self managed superannuation funds, you can:

- visit our website at [www.ato.gov.au/super](http://www.ato.gov.au/super)
- phone **13 10 20**
- obtain a fax by phoning **13 28 60**, or
- write to  
Superannuation Business Line  
Australian Taxation Office  
PO Box 277  
WTC VIC 8005

If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**.

If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

