THE SIZE, COST, ASSET ALLOCATION AND AUDIT ATTRIBUTES OF AUSTRALIAN SELF-MANAGED SUPERANNUATION FUNDS

Adrian Michael Raftery

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Accounting Discipline Group

University of Technology, Sydney

Supervised by:

Professor Andrew Ferguson

Professor Hazel Bateman [a]

Dr Anna Wright

[a] School of Risk and Actuarial Studies, University of NSW

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CERTIFICATE OF ORIGINAL AUTHORSHIP

I certify that the work in this thesis has not previously been submitted for a degree nor has it been submitted as part of requirements for a degree except as fully acknowledged within the text.

I also certify that the thesis has been written by me. Any help that I have received in my research work and the preparation of the thesis itself has been acknowledged. In addition, I certify that all information sources and literature used are indicated in the thesis.

Signature of Student:

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ABSTRACT

Using proprietary Australian Tax Office (ATO) data, this thesis documents the size, asset allocation and expenses incurred for a large sample of Australian self-managed superannuation funds (SMSFs) for the three fiscal years to June 2010. Further, it examines auditor industry specialisation, professional brand effects and auditor independence implications in the SMSF market. The analysis provides new insights into the fastest growing and largest segment of the Australian $1.8 trillion retirement savings industry by complementing and extending prior superannuation studies of both small and large APRA funds to SMSFs. Two recent Government reviews have highlighted a lack of basic descriptive knowledge of the costs associated with running an SMSF. As a result, I develop an SMSF Costs Matrix - across five different model portfolios - to assist gaining a greater understanding of the annual operating costs of an SMSF in accordance with its investment strategy. As expected, I observe that SMSFs enjoy economies of scale in relation to running costs, with the annual median cost being approximately half those of industry and retail funds. I estimate that the relatively low-cost structure of SMSFs may have a positive impact on the final retirement balance for a model portfolio when compared with the fees of two other types of superannuation funds.

In terms of economics of auditing implications, when I consider the impact of industry specialisation, after controlling for factors known to determine audit fees, I find evidence of fee discounting by the leading suppliers of SMSF audits. This finding is consistent with Simunic (1980)'s assertion of competition in the small audit client market. However, when the dependent variable is redefined to the total 'bundle' of services (including audit and non-audit fees), most industry leaders are shown to earn a fee premium. This finding suggests that industry specialists price strategically and use audits

as a conduit to supply higher margin non-audit services (NAS). In terms of auditor independence, the supply of NAS is shown to improve the auditors' ability to report breaches, suggesting no independence concerns arising from joint supply of audit and NAS. Last, I find evidence of audit fee premiums for auditors with higher quality professional affiliations who are required to comply with auditing and ethical standards.

GLOSSARY

Here is an explanation of the key terms and abbreviations used throughout the thesis:

ABS – Australian Bureau of Statistics.

ACR – auditor contravention report.

ACT – Australian Capital Territory, a territory of Australia. Its capital city is Canberra which is also the Australian capital city.

Accumulation phase – the period of time prior to the pension phase (where an individual reaches the preservation age and retires) where the member is amassing superannuation investments in the anticipation of funding retirement. The majority of superannuation funds are in this phase.

Approved auditor – auditor of self-managed superannuation funds. Currently the Auditor-General, registered company auditors and members or fellows from six professional bodies (ICAA, CPA, IPA, ATMA, NTAA and SPAA) can audit SMSFs. Since 31 January 2013, ASIC has the responsibility for the monitoring and registration of approved SMSF auditors.

AFSL – Australian Financial Services Licence – a licence provided by ASIC that authorises a person or organisation who carries on a financial services business to provide financial services.

APRA – Australian Prudential Regulation Authority – APRA is responsible for regulating large superannuation funds (corporate, industry, public sector and retail) as well as SAFs. www.apra.gov.au.

ASIC – Australian Securities and Investments Commission – the corporate, markets and financial services regulator in Australia. Since 31 January 2013, ASIC has the responsibility for the monitoring and registration of approved auditors. www.asic.gov.au.

ASX – Australian Securities Exchange – the marketplace for trading shares, bonds and other securities in Australia. www.asx.com.au.

ATMA - Association of Taxation and Management Accountants www.atma.com.au.

ATO – Australian Taxation Office. The ATO's role is to manage and collect tax as well as act as regulator SMSFs in Australia. www.ato.gov.au.

Authorised representative – a person authorised to provide financial advice or a financial service on behalf of an AFSL holder.

CGT - Capital Gains Tax – the tax payable on the disposal of an investment asset that was acquired after 19 September 1985. It is not a separate tax, just part of your income tax. The most common way you make a capital gain (or capital loss) is by selling or disposing of assets such as real estate, shares or managed fund investments.

Complying Superannuation fund – a superannuation fund that is regulated by the ATO and has been issued with a notice of compliance. Complying funds that meet the *SIS Act 1993* standards qualify for a concessional tax rate of 15 percent.

Concessional contribution – a contribution made by an individual, an employer or another party into a superannuation fund that is taxable within the fund at the concessional tax rate. It is claimed as a tax deduction by the contributor. Contribution limit for each superannuation fund member is $25,000 per annum, increasing to $35,000 per annum for those aged 60 and over from 1 July 2013 (and for those aged 50 and over from 1 July 2014).

Concessional Tax Rate – superannuation funds which comply with the *SIS Act 1993* qualify for the concessional tax rate of 15 percent. Non-complying superannuation funds do not receive the concessional tax rate and are taxed at 45 percent. Contributions made by individuals earning more than $300,000 are taxed at 30 percent.

Condition of release – a condition, normally retirement, that must be satisfied before you can access your benefits in a superannuation fund.

Contribution – the money or asset directly contributed by an individual, an employer or another party into a superannuation fund.

CPA – Certified Practising Accountant – one of the three professionally recognised accounting bodies in Australia (along with ICAA and IPA) www.cpaaustralia.com.au

Defined benefits fund – a superannuation fund that pays a final superannuation benefit based on a formula that takes into account your final salary and the number of years that you work for your company or government department.

Defined contributions fund – a superannuation fund that is in accumulation phase.

Discounted capital gain – one-third reduction on the capital gain on disposal of CGT assets that were owned for at least 12 months in an SMSF (that is, a reduced concessional tax rate of 10 percent).

DIY Super - Do-It-Yourself superannuation, also known as an SMSF.

eSAT – electronic superannuation audit tool designed by the ATO to help approved auditors of self-managed superannuation funds undertake a fund's compliance audit.

Franked dividends – dividends paid by an Australian resident company from profits that have had Australian company tax paid on them.

Franking credits – the amount of tax paid previously by a company that are allocated to dividends paid to shareholders. The taxpayer receives the credit in their income tax assessment to avoid double taxation. Also known as imputation credits.

GDP – Gross Domestic Product.

GFC – Global Financial Crisis.

ICAA – Institute of Chartered Accountants in Australia – one of the three professionally recognised accounting bodies in Australia (along with CPA and IPA) www.charteredaccountants.com.au.

Imputation credit – see franking credit.

Investment strategy – a document setting out how you intend to invest your benefits in an SMSF. It must be in writing and must consider investment risks, the likely returns and whether you have sufficient cash on hand to discharge liabilities when they fall due.

IPA – Institute of Public Accountants – one of the three professionally recognised accounting bodies in Australia (along with ICAA and CPA) www.publicaccountants.org.au. Formerly called the NIA.

ITAA 1936 – *The Income Tax Assessment Act, 1936.*

ITAA 1997 – *The Income Tax Assessment Act, 1997.*

NAS – non-audit services provided by the approved auditor.

NIA – see IPA.

Non-Complying Superannuation fund – a superannuation fund that is not a resident of Australia or has been issued with a notice of non-compliance because it does not comply with the *SIS Act 1993*. Non-complying superannuation funds do not receive the concessional tax rate and are taxed at 45 percent.

Non-concessional contribution – a contribution made by an individual, an employer or another party into a superannuation fund that is not taxable within the fund nor claimed as a tax deduction by the contributor. Limit is six times the concessional contribution.

NSW – New South Wales, a state of Australia. Its capital city is Sydney.

NT – Northern Territory, a territory of Australia. Its capital city is Darwin.

NTAA - National Taxation and Accountants' Association www.ntaa.com.au

Pension age – the age used to determine eligibility for certain government benefits, including the age pension. The pension age is currently 65 for men and 60 for women born before 1 July 1935, gradually rising to 65 for women born after 1 January 1949.

Pension fund – a fund set up to finance retirement. Benefits normally cannot be accessed until you reach your preservation age and you retire from the workforce. In Australia, the term for 'pension fund' is 'superannuation fund' and the two terms are interchanged throughout this thesis.

Pension phase – the period of time when an individual reaches the preservation age and retires and accesses its superannuation funds that were previously in the accumulation phase via an income stream to provide for retirement. The minority of superannuation funds are in this phase.

Preservation Age – the minimum age a member may be able access their preserved benefits. A benefit may be paid earlier if the member has met a condition of release. The preservation age varies depending on when the member was born.

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
After 1 July 1964	60

Preserved benefits – Superannuation fund benefits that you can access when you reach your preservation age and retire.

QLD – Queensland, a state of Australia. Its capital city is Brisbane.

Registered tax agent – A person who is authorised to give SMSFs advice in respect of managing their tax affairs and can lodge a tax return on their behalf. The fee they charge for their services is ordinarily a tax deductible expense.

SA – South Australia, a state of Australia. Its capital city is Adelaide.

SAF – small APRA fund – a small superannuation fund which has fewer than five members regulated by APRA. It must have an independent trustee.

Senior Australian – males aged over 65 and females aged over 64.5 (increasing to 65 in 2014).

SG – superannuation guarantee – compulsory super contributions paid every quarter by employers at a minimum of 9.25 percent of employees' ordinary time earnings. Gradually increasing to 12 percent by 2019–20.

SIS Act – *Superannuation Industry (Supervision) Act 1993*.

SMSF – Self Managed Superannuation Fund, also known as DIY Super – a pension fund with fewer than five members where: all members are trustees and there are no other trustees; no member of the fund is an employee of another member of the fund, unless the members concerned are relatives; no trustee or director of the corporate trustee receives any remuneration; and if the fund has a corporate trustee, all members are directors. It is a superannuation fund that you manage yourself and is regulated by the ATO.

SPAA - SMSF Professionals' Association of Australia www.spaa.asn.au.

Super co-contribution – if you make personal contributions to your super and are otherwise eligible, then the Federal Government will help boost your account with a super co-contribution of up to $500 per financial year. The amount of the co-contribution will depend on your total income level (you can earn up to $61,920 in the 2013/14 financial year) and the amount of personal contributions you make.

Superannuation fund – a fund set up to finance retirement. Benefits normally cannot be accessed until you reach your preservation age and you retire from the workforce. Around the world, the term for 'superannuation fund' is 'pension fund' and the two terms are interchanged throughout this thesis.

TAS – Tasmania, a state of Australia. Its capital city is Hobart.

TFN – tax file number – a unique number issued by the ATO to individuals and organisations to increase the efficiency in administering tax and other Commonwealth Government systems.

TFN withholding – tax withheld at the highest marginal rate (46.5 percent) on unfranked dividends and bank interest if you have not quoted your TFN. Taxpayers need to include the amounts withheld in their tax return in order to receive the credit in their assessment.

Trust – A legal obligation binding a person (the trustee) who has control over the investment assets (for instance, a share portfolio) for the benefit of beneficiaries.

Trustee – the individual or entity that has the responsibility of ensuring that the trust or superannuation fund is operated in accordance with its trust deed. Trustees must also comply with relevant legislation and regulations.

Unfranked dividends - dividends paid by an Australian resident company from profits that have not had Australian company tax paid on them.

VIC – Victoria, a state of Australia. Its capital city is Melbourne.

VIF – variance inflation factors.

WA – Western Australia, a state on the east coast of Australia. Its capital city is Perth.