

Technically Speaking: Valuations and the SMSF Audit

Written by Naomi Kewley SSA, SSAud, Managing Director, Peak Super Audits

Introduction

Property valuations are a subject of tension between auditors, administrators and the ATO.

SMSF auditors frequently land between a rock and a hard place on this issue: if the auditor accepts inadequate evidence, they open themselves to risk at the Regulator's hands and possible referral to ASIC. It is not an area for complacency. At the same time, it is unacceptable for auditors to 'err on the side of caution' by requesting evidence above and beyond that needed to support our audit opinion. Such a course of action may be 'safe' from an audit risk viewpoint, but those auditors are likely to find themselves without clients.

To prepare a robust file without alienating fund administrators, auditors must know where they stand in reference to:

- The legislation, on which we must report;
- The auditing standards, which dictate the requirements of our audit file;
- The Regulator's guidance (which should inform the actions of any sensible auditor).

Once the auditor understands their position on these authorities, they can more effectively communicate with administrators in obtaining sufficient appropriate audit evidence. The auditor will also be in a strong position to present and defend their audit file and report our findings correctly and clearly.

Why does the auditor report on valuations?

SMSF auditors must form an opinion as to the existence and value of fund assets. The auditor's assessment is a safeguard against the manipulation of SMSF investment values, motivation for which may include the following mischief:

- The 5% limit for in-house assets may be manipulated by suppressing the value of this investment or inflating the value of other fund assets;
- The annual minimum pension payment may be manipulated by understating asset values;
- A member's total superannuation balance may be artificially suppressed by undervaluing fund investments;
- Assets such as loans or investment in unlisted entities may be misstated to disguise fraud by asset managers;
- Capital gain or capital loss figures on the disposal of assets may be manipulated to impact the fund's tax position.



The auditor's obligation is of practical necessity. That being said, SMSF auditors need not concern themselves with the various motivations that may exist for manipulating property values within the SMSF. Our responsibility as auditors is to obtain sufficient appropriate evidence in support of our audit opinion (or report appropriately on any contravention should we be unable to confirm the fund's compliance). The auditor's opinion regarding the value of fund assets must be based on objective and supported data.

The three authorities

There are three authorities which inform the auditor's obligation to assess and report on the valuation of SMSF property investments:

- SIS Legislation and Regulations
- The Auditing Standards
- The ATO

Let's explore these authorities now.

Legislative & Regulatory requirements

A SMSF trustee must value all fund assets at market value when preparing the fund's annual accounts and statements. This requirement finds authority in SIS Act section 35B(1). The applicable regulation is 8.02B, which states:

For the year of income 2012-13 and any later year of income, when preparing accounts and statements required by subsection 35B(1) of the Act, an asset must be valued at its market value.¹

'Market value' is defined by SIS Act section 10(1). It is the amount a willing buyer of the asset could reasonably be expected to pay to acquire the asset from a willing seller, if the following assumptions were made:

- a) The parties dealt at arm's length;
- b) The asset was properly marketed prior to sale;
- c) Buyer and seller acted knowledgeably and prudently in relation to the sale.

There are several important things to note about SISR Reg 8.02B.

First, consider what the Regulation **does** say:

1. There is a requirement to mark asset values to market.
2. The requirement is an annual requirement. It must happen each year.

The requirements are unambiguous.

Also take a moment to consider certain things that the Regulation does **not** say.

¹ Bear in mind a market valuation may be required at other times in an SMSF. See, for example, SISR regulation 13.18AA and SISA section 66.



Reg 8.02B:

- Says nothing as to who is an appropriate valuer.
- Does not stipulate the form of evidence on which a valuation must be based.
- Does not distinguish the importance of valuing one asset over another. All fund assets must be carried at market value.
- Does not elevate the importance of a valuation in one year over another. It is not relevant whether the SMSF is in pension phase or accumulation. It is not relevant whether the members have any motivation to over or understate asset values. Valuations must occur annually.

While Reg 8.02B does not specify any detail regarding the annual market valuation, the auditor must satisfy themselves that assets are presented at materially correct values.

This requires the auditor to obtain sufficient and appropriate audit evidence to support their view.

For guidance and authority relating to the audit file, we turn to the Australian Auditing Standards.

Requirements in the auditing standards

Of particular relevance to this discussion are the following standards:

- [ASA 500](#): Audit Evidence
- [ASA 540](#): Auditing Accounting Estimates, Including Fair Value Estimates
- [ASAE 3100](#): Compliance Engagements

Note, ASA 500 relates to the financial statements audit while ASAEs 3100 and 3000 are relevant to the compliance engagement. Both sets of standards require auditors to evaluate the work of trustee's expert before placing reliance upon such evidence. Our emphasis in this discussion will be on ASA 500, while bearing in mind that requirements for the compliance engagement are similar.

[ASA 500: Audit Evidence](#)

According to ASA 500 paragraph 8, if audit evidence has been prepared using the work of a trustee's expert (ie a real estate agent or professional valuer), the auditor shall:

(a) Evaluate the expert's competence, capabilities and objectivity of that expert

In formulating audit procedures relevant to this evaluation, the auditor needs to consider:

- If the expert is qualified and able to do the job;
- If there any conflict of interest.

An expert's qualifications and experience will attest to competence and ability. The auditor should check relevant documentation or a website to obtain this insight. The auditor may call the expert to discuss the valuation with them and assess their



independence and professionalism this way. Trustee representations may be obtained to confirm the expert is not related to the fund.

(b) Obtain an understanding of the expert's work

The auditor must consider the expert's field of expertise and whether this extends to the subject. A professional may excel in their field but be ill suited to form an opinion on other subject matter. An expert's suitability given their area of work is usually easy to establish.

(c) Evaluate the appropriateness of the expert's work as audit

Assuming the expert is competent, independent, and suited to the task, the auditor must then go on to evaluate their work as audit evidence.

According to ASA 500 paragraph A59, this involves considering:

- the relevance and reasonableness of expert findings
- the relevance and reasonableness of any significant assumptions
- the relevance, completeness and accuracy of any significant source data.

In our view, this does not mean it is impossible to place a high level of reliance upon an expert's opinion.

For example, when dealing with actuaries, most SMSF auditors perform minimal audit procedures in respect to evidence evaluation under ASA 500 paragraph 8. The actuary's calculations are not reperformed. Actuary assumptions are not extensively reviewed.

ASA 500 paragraph A47 supports this view by stating that the extent of audit procedures to evaluate the expert's work under paragraph 8 may be affected by several factors, including:

- Extent to which the expert may be influenced by the trustee
- Extent to which the expert is subject to performance standards / professional requirements
- The auditor's knowledge of the expert's field
- The auditor's prior experience with the expert's work

As with actuaries, a professional valuer engaged by the trustee will have their own duty of care to the client and must comply with their own professional standards in the service they provide. ASA 500 paragraph A47 indicates that our testing under paragraph may be reduced accordingly. While real estate agents are professionals, their conclusions regarding the SMSF will often be less reliable than a professional valuer's. Recall, the agent's opinion is frequently disclaimed. This does not eliminate the usefulness of an agent opinion as audit evidence, but it does mean that SMSF auditors must be prepared to undertake more extensive procedures to evaluate this evidence in compliance with ASA 500 paragraph 8.

If the agent refers to comparable sales in their assessment, the auditor should consider the relevance of such data to the assessment.



Likewise, if an expert's work refers to valuation methodology such as rent capitalisation or a price per square metre comparison, the auditor should ensure they understand the methodology and any calculations.

If rent yield is being used to support a valuation, the auditor should check that rent itself fairly reflects the marketplace. Auditors may not have a sufficient understanding of fair yield to make this judgement themselves. When presented with a valuation substantiated by a rental yield of 7%, the auditor may probably lack the knowledge to comprehend if this yield is good, bad or indifferent. We suggest the auditor ask for the agent for confirmation as to what is a reasonable yield as part of the valuation methodology.

If the tenant were a related party, the auditor should obtain a rental valuation to substantiate the yield prior to using this as a basis to extrapolate anything about the property's value.

Remember, auditors are not property specialists. The auditor is not expected to re-perform the valuation. Because our knowledge in the expert's subject area is limited, our ability to evaluate the agent's assumptions and data in performing their valuation is also going to be limited. However, we believe auditors should be confirming the existence and basic relevance of any dataset on which the agent's valuation assessment is based.

[ASA 540: Auditing Accounting Estimates](#)

SMSF auditors must consider the application of ASA 540 where their audit file contains estimates regarding the value of fund assets.

This ASA is relevant to all forms of accounting estimates, including those estimates made by a trustee's expert.

One noteworthy form of accounting estimate is seen where an SMSF trustee analyses the market themselves to provide a property valuation. The trustee's assessment is a valuation estimate. Let's examine the auditor obligations in respect to this kind of evidence.

ASA 540 paragraph 16 states that auditors must:

- Take into account the degree of 'estimation uncertainty';
- The degree to which the trustee's method, assumptions and data in making the estimate is affected by complexity, subjectivity or other risk;
- The degree to which any point estimate will be affected by complexity, subjectivity or other risk.

Estimation uncertainty and risk of error will obviously increase where availability of comparable data is limited or where skill or experience is required to make adjustments for varying features in a comparative data set. Trustees are usually not property valuation experts. All trustee valuation estimates are biased. The auditor must approach any trustee valuation estimate with professional scepticism.



We consider that trustee valuations are permissible evidence, but only where the estimate is objectively supported by relevant comparative sales or other data and the level of complexity involved in making the estimate is such that the risk of material misstatement will be considered low. The auditor may assess the degree of estimation uncertainty in a trustee's estimate and evaluate the risk of material error by:

- Understanding how the value estimate was made and evaluate the data on which it was based;
- Reviewing the trustee's evidence and methodology.

For example, the auditor should consider how many sale comparatives are identified, the extent to which they are comparable, how recent the evidence is, and whether the trustees have been able to differentiate for variables in their data set. If a professional valuation was obtained for the property in the previous year, the trustee may refer to this last valuation point as part of their current year analysis. The auditor should be looking to see that a sufficient pool of current supporting data is available and that the trustees have actively engaged with this data to provide a value estimate.

Finally, when dealing with trustee valuation estimates, the auditor needs to acquaint themselves with the market. Remember, a trustee's valuation estimate is inherently biased. The auditor cannot know if the trustee's dataset is representative unless they check the market themselves. The auditor may have access to subscription software that enables them to review relevant market activity. Alternatively, the auditor may use less precise tools such as Onthehouse.com.au or Realestate.com.au to scan the market.

Ultimately, while there is no requirement in either the regulation or the auditing standards to obtain a professional asset valuation, the complexity in valuing some properties will demand a professional assessment. There will be too much uncertainty associated with a trustee's valuation to accept this as audit evidence.

This completes our review of the auditor's obligations, both to report on a fund's compliance with SISR reg 8.02B and to prepare an audit file in compliance with ASA 500 and ASA 540. We now turn to consider how the ATO's guidance complements these obligations.

[ATO guidance in respect of property valuations](#)

[QC 26343](#) contains the ATO's views in respect to SMSF asset valuations and includes specific comments in regard to valuation of property.

This section of the paper examines five key guidance statements within QC 26343.

For the most part, the Regulator's guidance in QC 26343 confirms and clarifies a trustee's obligations under Reg 8.02B and the auditor's obligations in preparing an audit file in accordance with the relevant audit standards.

There are, however, some points of confusion.

It is important that SMSF auditors bear two things in mind when preparing their audit file:



1. Auditors are required to report on the fund's compliance with Reg 8.02B (that is: market valuation of all assets, each year);
2. Auditors are required to comply with the Australian Auditing Standards.

As Regulator, the ATO's guidance on property valuations is highly relevant to this discussion; but it is guidance only. It does not overrule the requirements of SISR reg 8.02B or the Auditing Standards. If the auditor should find themselves in a position that deviates from the ATO's guidance in compiling their audit file, it is critical that the auditor document their evaluation and conclusions regarding the evidence in a way that demonstrates compliance with the Auditing Standards.

Guidance Statement 1: Valuation by Qualified Independent Valuer Not Necessary

Consider the following extract from QC 26343 –

You are not required to obtain a valuation by a qualified independent valuer (external valuation) of the fund's assets for the purposes of preparing the fund's accounts and statements.

When valuing real property assets...the valuation may be undertaken by anyone as long as it is based on objective and supportable data.

We find this view is consistent with both reg 8.02B and the auditing standards, which do not prohibit asset valuations either an expert such as a real estate agent or by the trustees themselves. It is confirming and reassuring for the ATO to recognise this, as the services of a qualified valuer are often costly and should not be insisted upon by the SMSF auditor unless required.

Guidance Statement 2: Qualified Independent Valuer is Recommended

The ATO do proceed to advise in QC 26343 –

You should consider using a qualified independent valuer if:

- ***the value of a fund asset represents a significant proportion of the fund's value***
- ***the nature of the asset indicates that the valuation is likely to be complex or difficult.***

The Regulator's second suggestion above is consistent with expectations raised in the auditing standards. Unique or complex property assessments are likely to be beyond the trustee's ability to perform (possibly also beyond abilities of the local agent) and should be passed onto experts equipped for the task.

If, as auditors, we hear the following objections to performing a valuation:

"It's a commercial property with unique characteristics."

"There really are no recent comparatives sales!"

"It's very hard to value."



There can be little doubt that the trustees should be engaging a professional valuer. This will come at a cost to the SMSF, but this cost must be taken into account as part of the SMSF's decision to invest in that asset. It is ultimately the trustee's responsibility to take required action to value the asset in compliance with Reg 8.02B (or accept the audit qualification.)

The Regulator's first suggestion above is curious. Though a property may form a major part of an SMSF's portfolio, this does not mean the investment is necessarily hard to value or that trustees or a local agent cannot provide an excellent supported valuation. We consider that it is prudent to take note of the ATO's guidance in this respect; but ultimately, as auditors, our lodestone in preparing the audit file is to obtain sufficient appropriate evidence. If our evidence is sub-par for any material asset, we need to improve our file. The amount of total fund resources invested in any given asset is not of primary relevance.

Guidance Statement 3: Prior Year Professional Valuations

We now come to a somewhat baffling recommendation in QC 26343 –

If you choose to obtain an external valuation for a fund asset, you do not need to have a valuation done each year. However, you must still consider whether the external valuation can be used to support your valuation of the asset each year.

For example, a real property asset may not need an annual valuation unless a significant event changes its value.

We find these statements perplexing. It is unclear to us how excusing an annual valuation on the grounds of a prior year professional assessment supports either:

1. the legislative requirement to annually revalue all SMSF assets to market value;
2. the auditor's obligations under ASA 500 to test any assumptions and evaluate any data set associated with expert's valuation.

Both the data set and assumptions used in a prior year professional valuation relate to the prior year. As auditors, we must consider the relevance of data and assumptions to the current year. We cannot assume prior year parameters continue to be relevant without receiving a current year assessment of the marketplace – that is, a current annual valuation.

We are assured by administrators quoting this section of the Regulator's guidance that the trustees are satisfied there has been no significant events or price movement and will provide a written statement confirming this belief. We explain in these situations that ASA 580 does not permit us to accept trustee representations on their own as sufficient appropriate evidence for any matter. Of course, we explain, the trustees are welcome to provide their own supported valuation assessment of the property – but as this involves time and effort, auditors are not popular for making this suggestion.

It is our experience that property values frequently undergo material change in the year following a professional valuation, despite no significant event being identified.

Ultimately, trustees have an obligation to annually reassess the market value of SMSF property assets. Auditors must obtain supported evidence for any valuation assessment as part of our audit file. These



obligations exist apart from the Regulator's guidance. It is regrettable that this part of QC 26343 persists in causing confusion among administrators.

Guidance Statement 4: Multiple Evidence Sources

A further extract from QC 26343 provides –

When valuing real property, relevant factors and considerations may include:

- ***the value of similar properties***
- ***recent purchase price in an arm's length market***
- ***whether the property has undergone improvements since last valued***
- ***independent agent appraisal (kerbside)***
- ***the rates notice (if consistent with other valuation evidence)***
- ***for commercial properties, net income yields (not sufficient evidence on their own and only appropriate where tenants are unrelated).***

Unless the property has been recently purchased by the fund, you should consider a variety of sources to substantiate the market value of real property. Generally, it is not sufficient for valuations to be based on only one item of evidence in the above list.

Note the QC's recommendation to obtain more than one item of evidence from this list.

While certain listed items will not provide sufficient appropriate evidence of themselves, the ATO's emphasis on multiple items across all listed forms of evidence is somewhat curious.

As auditors, our emphasis must be on obtaining 'sufficient appropriate' evidence for our audit file. The concept of 'sufficient appropriate' is based on both the quantity and quality of evidence, where 'sufficiency' is the measure of evidence quantity, while 'appropriateness' is a measure of how relevant and reliable the evidence is – ie its quality. ASA 500 paragraph A8 explains that the necessary quantity of evidence may reduce in response to the quality of evidence obtained. Auditors are warned that quantity of evidence will not necessarily compensate for quality.

It is therefore possible that a single piece of high-quality evidence may be both sufficient and appropriate. This will involve a judgement call for each auditor in any given situation. While prudent to consider the ATO's recommendation for multiple sources, auditors must remember that their first obligation is to the auditing standards. If the auditor does place reliance upon a single piece of evidence, care must be taken to ensure the audit file demonstrate compliance with ASA 500.

Guidance Statement 5: Requirement for Supporting Data

Our final extract from QC 26343 refers to the need for supporting data –

A valuation undertaken by a property valuation service provider, including online services or real estate agent, would be acceptable.



However, the valuation must stipulate the supportable data.

For example, in the case of a real estate agent appraisal or online report, the valuation should list the comparable sales it relied on.

This guidance is in basic agreement with the paragraphs we have explored from ASA 500 and ASA 540. The Auditor needs to consider the expert in term of competence and objectivity. Though it may be possible to reduce our testing of assumptions and data under ASA 500 paragraph 8 depending on the expert's own professional standards, we are always required to evaluate the expert's conclusions as audit evidence. It is a reasonable expectation under the standard that a real estate agent would explain the basis for their conclusions and provide information to enable an SMSF auditor to review the agent's assumptions and supporting data set.

Rent valuations – NALI and compliance considerations

Relevant to any discussion on the valuation of property within an SMSF is the valuation of rent.

An SMSF is required to deal with its tenant on an arm's length basis. Where an SMSF has a related commercial tenancy, the question of arm's length rent immediately becomes contested. The onus of proof lies with the trustee: unless the trustees can demonstrate their related party dealings ARE arm's length, the ATO may assume they are not. To confirm the trustee has dealt at arm's length, the auditor must obtain evidence to establish an arm's length standard of dealing.

In practical terms, this means:

- Existence of a current enforceable lease agreement
- That stipulates the payment of arm's length rent on arm's length terms,
- That is complied with by both parties.

To evidence the arm's length payment of rent, auditors must receive a rental valuation. This valuation should current and supported, either by reference to comparative rentals or through some other demonstrated methodology, such as a competitive rental yield.

Depending on the lease, a rent valuation is not necessarily required each year. Many third party leases mark rent to market periodically. Rent should be linked to an appropriate index and adjusted accordingly each year. Rent MUST be supported by a valuation on commencement of a new lease or on exercise of an option.

We qualify the above with a comment regarding long term leases. It is not appropriate for trustees to mark rent to market once every 15 years and potter along in the meantime with periodic CPI increases. Any lease that permits such delay in revaluing rent is itself not arm's length. Dealings in compliance with such a lease would not be arm's length either. The SMSF needs to start with a compliant lease and then implement it.

Where an SMSF fails to deal at arm's length in a related party tenancy arrangement, we believe the auditor is presented with two problems.



The NALI problem

If an SMSF fails to deal at arm's length with a related tenant, the fund may have non-arm's length income for tax purposes. Any non-arm's length income (NALI) is taxed at the highest marginal rate. Income is considered NALI where, as the result of a scheme in which the parties were not dealing with each other at arm's length, ordinary or statutory income is one or more of the following (see ITAA97 section 295-550):

- more than the SMSF might have been expected to derive if the parties had been dealing with each other at arm's length;
- gained or produced at a loss, outgoing or expenditure that is less than the loss, outgoing or expenditure that the entity might have been expected to incur if the parties had been dealing with each other at arm's length;
- gained or produced in the absence of loss, outgoing or expenditure that the entity might have been expected to incur if the parties had been dealing with each other at arm's length.

This means the SMSF will have a NALI problem where expenses associated with the property are being *underpaid* to advantage the SMSF or where rent is being *overpaid* to benefit the fund.

Ordinary or statutory income derived in the above circumstances will be classified as non-arm's length income (NALI). This will impact the SMSF's tax provision. If the risk of NALI exists and the SMSF's income tax provision does not reflect this increased liability, it will be necessary to qualify the Part A audit opinion in any year the misstatement could be material.

This is the auditor's NALI problem.

The auditor may also have a compliance problem.

The compliance problem – SISA section 109(1A)

There is a widely recognised rule expressed in SISA section 109(1) that prohibits dealings of a nature that are not arm's length and to the SMSF's detriment.

Section 109(1)(a) states:

A trustee...must not invest...unless the trustee...and the other party to the relevant transaction are dealing with each other at arm's length in respect of the transaction.

Section 109(1)(b) goes on to confirm:

A trustee...must not invest...unless both:

- The trustee...and the other party...are not dealing with each other at arm's length in respect of the transaction;*
AND
- The terms and conditions of the transaction are no more favourable to the other party than those which it is reasonable to expect would apply if the trustee...were dealing with the other party at arm's length in the same circumstances.*



It is important to note, however, that section 109(1)(a) & (b) deals only with the acquisition of assets.

Once the SMSF has acquired asset and goes on to maintain the investment (ie through a lease arrangement), the relevant provision becomes section 109(1A). This provides:

If a trustee...during the term of the investment...is required to deal...with another party that is not at arm's length...the trustee...must deal...as if the other party were at arm's length with the trustee.

There is no mention in section 109(1A) as to the acceptability of non-arm's length dealing to benefit the SMSF. This would appear to indicate that:

- When *making* an investment transaction, the SMSF trustee must either act on an arm's length basis or on terms favourable to the SMSF.
- When *dealing* with an existing investment, the trustee is restricted to arm's length terms only. The trustee has no liberty to act in a non-arm's length manner to benefit the fund.

We suggest that if an SMSF is required to deal with a related party under the contractual obligations of a lease or loan agreement, the fund should be dealing at arm's length: no better, no worse. If the SMSF fails to deal with at arm's length with a related tenant, either in regard to the underpayment or overpayment of rent, we believe the fund has both a NALI issue and a compliance issue.

Section 109(1A) is a reporting provision. As SMSF auditors, we are required to report on the whole of section 109. It appears in the current SMSF independent auditors report. The ATO's explanation of the section is seen below in **Figure 1**:

| | |
|------|--|
| S109 | All investment transactions must be made and maintained at arms-length – that is, purchase, sale price and income from an asset reflects a true market value and or rate of return |
|------|--|

Figure 1

Auditors should carefully consider their reporting obligations in respect of section 109 in all its respective parts.

Presenting the audit file – ensure the evidence ‘speaks’

As auditors, our audit file must be capable of understanding by any other experienced auditor not previously acquainted with the audit. In other words, the evidence should be clearly set out in relation to each relevant assertion. Any cross referencing should be clear. The file must be complete and coherent. It should not require a map, compass and notes to follow.

Beyond this, however, it is critical to ensure the evidence in our file ‘speaks’.

As we have discussed, ASA 500 & 540 require SMSF auditors to evaluate the evidence we receive. All auditors do this. We have obtained our market valuation. We have checked the date, the comparatives, made sure the expert is a professional who is not the trustee's grandpa.



But to what extent do we demonstrate this analysis as part of our audit file?

If we don't include our reasoning, we are assuming that another person reviewing the file will see exactly what we see, follow our reasoning, and accept our conclusions without explanation or argument. Sometimes the evidence is such that they will. Sometimes it is not.

As auditors, we should not underestimate the clarity and force of including comments in our audit file. Our comments need not be lengthy or profound, but the file should set out why we consider the evidence to be sufficient and appropriate.

When dealing with expert property valuations, remember the evidence requirements in ASA 500 paragraph 8, A59 & A47. Does our file show that we have:

- Established the expert's competence and objectivity?
 - Evaluated the extent to which the expert is bound by their own professional standards of conduct and has a duty of care to the client – and on this basis to what extent is it appropriate to place reliance on their opinion?
- Where appropriate, increased our scrutiny under ASA 500.8 to:
 - Confirm reasonableness of assumptions and methodology;
 - Evaluate and accept as relevant any supporting data set.

When dealing with accounting estimates (especially in the highly biased area of trustee valuations), does our file show that we have:

- Evaluated 'estimation uncertainty';
- Gained an understanding of how the estimate was made;
- Assessed relevance and completeness of the trustee's data set.

An example of possible evaluation and conclusion regarding audit evidence is seen in **Figure 2** below:

Comment Summary

 PROPERTY - 151 Curlew Drive Lanitza

TITLE:

See search at F5-3 (May 2023).

SMSF has individual trustee structure;

Ownership is confirmed per ackn of trust; see P5; OK

VALUATION:

See 30-6-22 property valuation by trustees (F5-1-1);

The valuation collates available market evidence to support minimal price movement in rural property within this geographical area over FY2021-22. The trustees refer to the prior year professional valuation (dated May 2022) in support of their assessment (F5-2).

I have considered the trustee's reasoning & data and accept this valuation as materially accurate.

Figure 2



Note, no amount of comment or explanation will improve deficient evidence; but the auditor's presentation of the file should make it difficult to misunderstand evidence that does satisfy our obligations under the auditing standards.

Reporting obligations

If the auditor concludes that an SMSF property investment is materially misstated in the financials (or – as more frequently the case – the we have insufficient evidence to confirm an asset value is materially correct), the auditor must consider their reporting obligations.

SISA section 129 requires auditors to report as appropriate regarding contraventions that may HAVE occurred, may BE occurring, or may YET occur. Section 129 also informs the auditor of our reporting obligations to both the trustee and the ATO. Remember, any contravention must be communicated to the trustees in our management letter.

In respect to our audit report to the trustees:

PART A – Financial statements opinion

When considering our Part A Financial Statement opinion, auditors must consider the asset's materiality and the possibility of material misstatement. Unless the auditor is dealing with a very large fund, a property investment will usually be material. If the auditor has received reliable valuation evidence not adopted by the trustees, it may be possible to identify the exact valuation misstatement. More frequently, the exact misstatement will be unknown, and the auditor is left with the possibility that the financials are materially misstated.

In this situation, the auditor is required to qualify the Part A Audit Opinion.

PART B – Compliance opinion

If the SMSF's financial statements may be materially misstated through a failure to value fund assets, the SMSF will also have a material compliance breach. We cannot conceive a situation where an auditor would be required to qualify their Part A opinion in respect to market valuations and not also be required to qualify their Part B opinion. If the asset or misstatement is material for the financials, there will be material non-compliance with Reg. 8.02B.

Where this is so, auditor will need to qualify their Part B Audit Opinion.

ATO reporting criteria

The auditor must also consider whether it is necessary to lodge an Auditor Contravention Report (ACR) with the Regulator in respect of a reg 8.02B compliance breach.

The ATO's reporting criteria present a different form of materiality. According to the ATO's financial threshold reporting criteria at Test 6 and 7, where the value of all possible contraventions represents either 5% of fund assets or \$30,000 as a total amount, the auditor will need to lodge an ACR. In this sense, it may be necessary to lodge an ACR and qualify the Part B Compliance Opinion where the valuation misstatement is immaterial to the Financial Statements audit. In such a situation, the auditor would qualify their Part B opinion but issue an unmodified Part A opinion.



The ATO suggest that in situations where the auditor has insufficient evidence to quantify a compliance breach, it is acceptable to report the asset value as the maximum possible contravention. While this figure is not necessarily correct, this approach is usually preferable to guessing at a contravention's value. Where the auditor has adopted this approach, this should be communicated to the Regulator in our ACR.

Conclusion

The valuation of property investments within an SMSF is a high stakes area for auditors.

The ramifications of either accepting inadequate evidence or persisting in requesting beyond what is required for our audit file can be costly.

Auditors must equip themselves for tough conversations by understanding their obligations in regard to legislation and the auditing standards. The ATO's guidance does much to support SMSF auditors in this, but it is important to recognise that this guidance is not a substitute for understanding our obligations. Auditors must know where we stand on all three sources of authority, both to explain our requests for evidence and to demonstrate that the evidence in our file is sufficient and appropriate to support our conclusions. Having formed their opinion, auditor must ensure they report according to the requirements of SISA section 129 and the Regulator's reporting criteria.

CPD quiz

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