Recent Superannuation changes for SMSFs

The SIS Regulations have been amended by the Superannuation Industry (Supervision) Amendment Regulation 2012 (No 2), registered on 6 August 2012, to require trustees of self-managed superannuation funds (SMSFs) to:

- value the assets of the fund at "market value" for reporting purposes;
- consider whether to hold a contract of insurance for one or more of their members;
- "review regularly" the investment strategy; and
- keep money or other assets of an SMSF separate from money and assets held by a trustee personally or by a standard employer-sponsor (or an associate).

Market values to be used for investments

New reg 8.0B of the SIS Regs requires trustees of SMSFs to value their assets at "market value" when preparing accounts and statements from the 2012-13 year of income, as required by s 35B of the SIS Act. That is, SMSFs must begin to value their assets at market value when preparing a statement of financial position and an operating statement for the 2012-13 year of income and later years of income.

The regulations adopt the meaning of "market value" in s 10(1) of the SIS Act. That is, the amount that a willing buyer of an asset could reasonably be expected to pay to acquire the asset from a willing seller if the following assumptions were made:

- that the buyer and seller dealt with each other at arm' s length in relation to the sale;
- that the sale occurred after proper marketing of the asset;
- that the buyer and seller acted knowledgeably and prudentially in relation to the sale.

As a result, SMSFs will no longer be able to use historical value for asset valuations for reporting purposes. Note that a person commits an offence if the person contravenes s 35B (penalty $11,000). This is also an offence of strict liability (penalty $5,500).

Previously, SMSFs were generally able to choose either historical cost or market valuation accounting method to value their assets when preparing a statement of financial position and an operating statement, as required by s 35B. SMSFs in pension phase (and in-house assets) are already required to value assets at "market value" each year.

The Cooper Review found that the differing valuation methods used by SMSFs had a significant impact on a member' s ability to ascertain current superannuation benefits, affected the reliability and usefulness of superannuation data and compounded the difficulty in comparisons with large APRA-regulated funds

Keeping SMSF assets separate from your own assets

A new operating standard will require a trustee to keep money and other assets of an SMSF separate from any money or assets held by a trustee personally or by a standard employer-sponsor (or an associate): SIS Regs 4.09A.

This requirement is currently established by way of a covenant under s 52(2(b) of the SIS Act which is deemed to be incorporated into the governing rules of the fund. However, the Tax Office was previously unable to enforce compliance with covenants and relied on voluntary compliance by trustees. By making this requirement an operating standard, the Tax Office will have a direct power to enforce compliance. A person who intentionally or recklessly contravenes reg 4.09A is guilty of an offence punishable on conviction by a fine up to $11,000.

The Cooper Review noted that breaches of the existing covenant occurred with some frequency, such as where an SMSF is operated using a member' s bank account rather than having a separate account established for the SMSF, or where assets are recorded in one or more member' s name personally, rather than in their capacity as trustee of the SMSF.

There is now a stronger argument than ever that a fund should not operate with individual trustees as there is difficulty in ensuring the separation of assets occurs.

Investment Strategy Requirements have changed

Under the *Superannuation Industry (Supervision) Regulations 1994* (regulation 4.09), all SMSFs, are required to prepare and implement an investment strategy for the fund. The strategy must reflect the purpose and circumstances of the superannuation fund and have particular regard to the duties laid out in section 52(2)(f) of the *Superannuation Industry (Supervision) Act 1993*. These include:

- investing to maximise member returns, taking into account the risk associated in holding the investment;
- appropriate diversification and the benefits of investing across a number of asset classes (for example, shares, property, fixed deposit) in a long-term investment strategy; and
- the ability of the superannuation fund to pay benefits as well as other costs of the superannuation fund as they become due and payable.

From 7 August 2012, self managed superannuation fund (SMSF) trustees are also required to consider whether to hold a contract of insurance that provides insurance cover for one or more of their members when they formulate, regularly review and give effect to the fund' s investment strategy pursuant to regulation 4.09. This requirement does not mean that an SMSF must have insurance cover for each member. Rather, an SMSF trustee just needs to document as part of the investment strategy that the issue of insurance for members has been considered appropriately. Trustees can substantiate compliance with these new requirements by documenting decisions in the minutes of trustee meetings. In meeting this requirement, trustees should have regard to the personal circumstances of their members and other legislative requirements such as the sole purpose test. Trustees of SMSFs are expected to be self-reliant in determining the type and level of insurance cover members might require whether within or outside their SMSF. As the investment strategy requirement is a prescribed operating standard, a person who intentionally or recklessly contravenes this standard is guilty of an offence punishable on conviction by a fine up to $11,000.

The investment strategy ensures that the investment objectives of the fund are met.

If an investment the trustee desires to make falls outside the scope of the strategy, the strategy must be altered and the reason for the alteration documented.

An appropriate investment strategy sets out the investment objectives of the superannuation fund and details the investment methods the superannuation fund will adopt to achieve these objectives. Trustees must ensure that all investment decisions are made in accordance with the investment strategy and should seek investment advice or appoint an investment manager if in any doubt.

Investment objectives and strategies for the fund must be set and documented.

The main purpose in setting an investment strategy is to determine the fund's asset mix. This involves deciding on an appropriate asset mix and strategic range of assets. The strategy limits the discretion of the investment manager to predetermined limits on asset selection. For example, the trustees may decide that the optimum level of Australian equities is 40% and the acceptable range for equities is 20% to 50% at the discretion of the manager.

Strategic decisions may be based on current economic and political outlooks. For example, the trustees may decide that the outlook for property is poor in the short- to medium-term and reduce the fund's exposure to property. These decisions may be delegated to the investment manager, but ultimately, the investment decision is the responsibility of the trustees.

In developing the investment strategy, the following aspects must be considered:

- risk;
- diversity;
- liquidity;
- ability to discharge the fund's existing and prospective liabilities; and
- whether the trustees should hold insurance for the members.

This does not mean that an investment cannot have elements of risk or that a fund must invest in only one asset or one type of asset.

In determining the investment strategy, the fund in its entirety should be assessed, and for small funds, the individual members' own wealth and investments should be considered as a part of this process.

Such matters as the member's age, financial position, the types of investments the member currently holds, the financial experiences and current employment of the individual and the form in which the member would like to take their benefit, should also be considered.

The investment strategy operating standard has also been revised to require the trustee of the entity to formulate, "review regularly" and give effect to an investment strategy that has regard to the whole of the circumstances of the fund including, but not limited to, the circumstances specified in subregs 4.09(2)(a) – (e). Trustees can substantiate compliance with this requirement to "review regularly" by documenting decisions in the minutes of trustee meetings.