NEWSLETTER

March 2020

Chartered Accountants
Level 5
75 – 85 Elizabeth Street
Sydney NSW 2000
Telephone +61 2 9232 1588
Facsimile +61 2 9235 1211
www.goodco.com.au
contact@goodco.com.au

NEWSLETTER

CONTENTS **Page**

This newsletter is written to assist in recognising issues and developing strategies so as to maximise profits and minimise and / or defer taxes payable in the current and future years. Estate planning must be an integral part of that strategy, so Wills should be reviewed concurrently as family dynamics change.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation and can be designed to provide substantial tax savings if correctly structured and managed.

If a strategy is to work, all the elements must be considered and kept in balance.

The strategy does not have to be in writing, but the elements should be clear and understood.

***You need to have wealth and tax strategy that deals with**:*

- ***freeing up cash to invest and by such means increasing your wealth;***
- ***increasing your return on investment;***
- ***paying off your home with pre-tax dollars; and***
- ***lowering tax rates across the family's income spectrum.***

The strategy should be understood by the owners, operators and their advisers.

For additional copies of this newsletter please refer to ***www.goodco.com.au***.

ARE COMPANIES OUT OF CONTROL?

As has been extensively reported in the press many companies, both large and small, have been underpaying their staff. It seems that CEOs want to place the blame anywhere other than on themselves or the Finance Director blaming complex awards.

- **What happened to the internal controls?**
- **Who was auditing them?**
- **How have so many breakdowns not been identified by the auditors in so many companies?**
- **Where were the audit committees in public companies while all this was happening?**

Directors are responsible to ensure that their Companies introduce and monitor and ensuring the internal controls are in place and that financial transactions are processed correctly and reflected in financial reports which are approved by them.

Amongst other things **CEOs and CFOs** are there to ensure the that all internal controls are implemented and monitor. It seems in many cases they have also **failed in their duties.**

Both Auditors and Directors form a view that financial reports are not materially incorrect, and it is quite apparent from the statements reported by the press that audited financial reports of prior periods of many corporations were materially incorrect.

More companies are going into administration or liquidation, particularly in the retail sector, and property developers are now starting to struggle with the sale of “Off Plan” apartments. Retail property companies are starting to see lower traffic flows, increased vacancies and pressure to reduce rents.

At the same time, there is a **Senate investigation into the role of Auditing Firms** and their practices of providing auditing services and non-audit work to the same client and whether, in so doing, are they being truly independent?

You may be surprised to know that just **leaving your affairs for a tax professional or accountant to handle does not guarantee that your affairs are being handled diligently or that you won’t be treated as having failed in performing and complying with your accounting or tax obligations**.

Too often we see accounting practices doing the minimum they think is required while the client is of the belief that they are obtaining quality professional advice. Many people think that paying for a service shifts the responsibility to the service provider. They are very wrong.

Are you guilty of blindly signing tax returns and financial reports trusting that your Accountant got it right? It is the duty of Directors to ask the right questions of management and their advisors rather than blindly trusting that those upon who they rely got it right.

Non-Auditor's responsibilities for the preparation of the Financial Report and Financial Statements

For non-audit clients ("Small Companies") accountants are obliged to attach a Compilation Report. The standard Compilation Report attached to Financial Statements includes the following statement / disclaimer;

> "*Since a compilation engagement is not an assurance engagement,* ***we are not required to verify the reliability, accuracy or completeness of the information provided to us*** *by management to compile these financial statements. Accordingly, we do not express an audit opinion or a review conclusion on these financial statements*."

In other words, **the accounting firm takes no responsibility for what is produced or the form it takes.**

This is a complete contradiction where many of the large **Accounting Firms "guarantee" their work** and then provide a disclaimer in their Compilation Report. An interesting legal question that we are sure will be tested in Court in the not too distant future

Many Small Companies have been induced by the offer of lower fees and "simplicity of process" to undertake BAS and or financial reporting based on cash movements only. Simplification has brought nothing but abuse, misstatement and more mismanagement.

It is very common to find that clients do not understand that what is described in the engagement letter as to the service being offered differs substantially from what they had in the past. Clients perceive that a reduction in cost comes from the work being done more efficiently, not from a reduction in the services provided, particularly when offered as a fixed fee.

Many clients are totally driven by price and not diligence. **It is not unreasonable for a client to expect that the professional engaged by them will perform some checks and balances** to ensure accuracy of information. They perceive these will be continuing to be forthcoming in what they have agreed to.

The cheaper the price, the less (if any) advice and checking will be done by the Bookkeeper, BAS Agent or Accountant. Firms today are providing clients with fixed fees and guarantees. This is driven largely by automation. At the end of the day the accountant does very little work on the information you provide.

What clients aren't usually aware of is that the "guarantees" and "audit insurance" offered by accountants do not cover the underlying tax and / or GST and / or FBT payable arising from errors, disputes or incorrectly claimed amounts.

What the firms are guaranteeing is at the insurers' cost, to negotiate to minimise the fines and penalties for the client. **The tax and usually interest on unpaid tax is always payable by the taxpayer** and not the accountant or insurer. Many penalties can be imposed directly on the individual Directors under recent changes in legislation.

It is farcical that clients are sold products which only cover the cost that the accountant incurs in defending the mistakes that they hadn't picked up and / or the advice they hadn't given. These issues only become apparent when an audit is conducted by the Australian Taxation Office or someone similar, or the bad advice affects the business profitability or cash flow.

In many cases what is provided to the Bookkeeper, BAS Agent and / or accountant is processed by very junior employees in the business who have no tax, GST or FBT knowledge**.**

Data is then processed by staff in the Accounting Practice that equally have very basic or no tax, GST or FBT knowledge and in most cases is not reviewed or checked by any technically competent or knowledgeable staff.

When your in-house staff have no corporate and tax knowledge and your accountants and / or BAS agents perform minimal checks (if any) then the inevitable will happen. It is only a question of time.

When it all goes wrong the statement that "**I employed accountants to do this work and paid them a fee for service. Surely, they check for this sort of error or mistake**" is repeatedly said by officers, directors and taxpayers.

Most small businesses are given financial statements, with no explanation on what all the figures that they contain actually mean and what they demonstrate about the business. Is that not the primary role and purpose of the Accountant?

We accept that what you get is what you pay for, but the public expectation of what is a professional service, its cost, and the delivery of those services are a very long way apart and the care factor from the industry in general is very low.

Rarely do we see any correspondence from Accountants dealing with any management issues such as profitability, margins, levels of sales and bad debts (and collection issues generally), levels of stock and whether the stock holds the value attributed to it, levels of expenditure or recommendations as to sales versus cost analysis or margin movements in identification of under or over statement of taxable income or the real effect on ongoing profitability.

It is quite common when reviewing financial statements to see that margins have moved dramatically and yet this has not been pointed out to the client. There seems not to have been any effort to understand why the margins have moved. In many cases, clients / owners are not aware that it is or was an issue, and they do not understand how such issues can affect their business and profitability.

Clients are rarely provided with any recommendation to improve profitability or cash flow and are rarely coached by their accountants to understand the importance of break-even analysis or strategies to assist with cashflow management.

If the books are written up on a cash basis purely for the purpose of minimising fees, and not to be an informative management tool, then one surely has to ask, "how much due diligence was applied by the directors"? If and when the business falters or is examined by the Australian Taxation Office, then those officers will have responsibility for those actions (or inactions).

The current revelations of underpaid wage and unpaid compulsory superannuation and the lack of withholding and remitting PAYG, are by law the responsibility of the Directors.

The external BAS Agents and Accountants are not being held at least partially responsible for the unpaid wages, PAYG and compulsory super not paid by businesses and the failure to report such underpayments because they just do not check this as part of their "no responsibility" approach to the engagement.

Why is it not mandatory that external service providers such as BAS Agents and Accountants be required to review all fraud including deliberate under-payment of wages and **report these types of event to the Australian Taxation Office** unless the business on notification corrects the problem immediately?

Whether this kind of problem would still happen if the external BAS Agents and Accountants alerted owners to the problems is unclear, but the chances have to be reduced if that support was provided. **This is nothing less than social fraud.**

It never ceases to amaze the writers how often we are at a meeting where important accounting documents are placed in front of clients and they either seek no explanation of the documents, or express the view that "I am sure this is correct", and then blindly sign and certify these documents that they have not read or in many cases do not understand.

Many of these people are educated, intelligent senior executives, who have the responsibility of ensuring in their corporate role that the documents they certify (audited or otherwise) are not materially incorrect and that internal controls are in place and followed. However, it is often apparent that many directors of public companies do not understand their own personal affairs and the accounting and taxation documents relating to them. So, the question must be asked do they understand the financial reporting of the Corporations in which they are Directors?

We are concerned that such people have roles in the public arena where they are obliged to sign off that financial reports are not materially incorrect but do not understand in broad terms the accounting standards and principles under which they are prepared.

Maybe it is time that:

- **the report that the CEO and / or CFO make to the Board should:**
    - **be part of the published accounts**
    - **sign off on the adequacy of internal controls to detect and prevent fraud, ensure the proper payment of wages, compulsory superannuation and other taxes; and**
    - **state the materiality factor used in preparing the accounts (we discuss this further below)**
- **an accountant's engagement letter has to specify exactly what the Accountants are NOT GOING TO CHECK and that whenever they report that they will be taking no responsibility for any errors no matter how they were caused; and**
- **that where audits occur, the auditors should also state the quantum of the materiality amount they used to express their opinion.**

How owners, directors and officers do this is clearly a question of cost but surely if you want the protection of a corporation then the extra cost of doing so has to be weighed up against the benefits derived from lower ongoing business taxes and the protection of owners from personal liability.

Perhaps the Senate committee currently investigating the role of auditors in the market place should also look at whether directors and other officers of companies in both the private and public arena can and are capable of truly forming an opinion as to whether financial reporting is true and fair.

Audited enterprises

Audited companies are in the main "Large Companies" where:

1. Consolidated gross operating revenue for the Company is less than $25 million for the financial year;
2. The value of consolidated gross assets for the Company is less than $12.5 million; and
3. The Company has fewer than 50 full time employees at the end of the financial year

Their auditors are required under the Corporations Act to form an opinion like this:

Auditor's Responsibilities for the Audit of the Financial Report

> *"Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report."*

Audits are not only performed on large companies but small companies (where shareholders appoint auditors), charities and other institutions such as public unit trusts, clubs, societies that are governed by committees and overseen by The Australian Charities and Not-for-profits Commission and state and federal governments.

If you are a member of your local club and you attended an annual general meeting and the accounts were materially wrong what would you say is the amount that you say is materially wrong? Equally if you attend a BHP annual general meeting do you have any perception as to what is deemed to be material in those financial reports?

So how do so many companies underpay their staff? Why do the internal controls and external audits fail to detect the errors? Who is responsible for the error and the breakdown of the entity's internal controls?

The fact that these underpayments are not being detected shows that both directors and auditors do not currently have processes to ensure that the company has internal controls in place to detect material errors and fraud and is reflective of a critical flaw by both in forming opinions.

The words "not material" are liberally scattered through financial reports.

Rarely do either the **directors or auditors express** in dollar terms **what in their opinion is material,** so it is left to the reader to guess:

- Does the old rule of thumb apply?
- Is an item material if it has an effect equal to the lesser of 10% of the profit of the entity or 5% of its shareholder's funds?
- If so, is that a sensible rule to apply for all enterprises?
- What is the public perception of what is material?

The legal argument about how much and how materiality is measured is losing momentum as shareholders monitor more closely the actions and effectiveness of Directors.

The statement that "The issue at hand" (e.g. the understated wages and the fines being levied by ASIC) was not material in the view of the Directors and Auditors is becoming an unacceptable answer to shareholders? What is acceptable is interdependent of the enterprise size and profit and currently is very subjective.

CONTINUING PROFESSIONAL EDUCATION

The Federal Government, Australian Institute of Company Directors (AICD) and other appropriate bodies such as the accounting and secretarial bodies need to set and enforce higher standards. AICD and most regulating professional bodies now require that prior to being a member or continuing with their membership as directors, accountants, public practitioners and auditors they must demonstrate a professional standing plus continuing professional education. However, those bodies must also ensure that there is a real and open review of professional education components to ensure that appropriate and current education actually happened.

All bodies should insist that a full list of continuing education be submitted showing the who, where and when and that each submission should be reviewed by the professional body or cross correlated with that educational body.

It is not uncommon to find accountants who are:

- Fellows or Members of the Institute of Chartered Accountants; and / or
- Fellows or Members of the Certified Practicing Accountants; and / or
- Fellows or Members of the Tax Institute of Australia,

who have never been reviewed or audited by any of the professional bodies as to whether their required continuing professional education development ever occurred. **I am one of them with over 33 years professional practice.**

It is quite clear, using the accounting bodies as an example, that **the appetite for professional bodies to regulate the quality of their members is low**. Yet all the accounting, tax, legal and many other professional bodies hold themselves out to be diligent in their demands to stay up to date because they say they have standards that have to be met, yet they do not test to any extent whether their members actually do know what they are about or that they actually did what they certify they did. In many cases they did not do what was required yet certify that they did.

Only Government has the power to step up to the plate and enforce the professions to examine themselves.

How about the Government require ALL professional bodies to report as to?

How many members they have registered?

- how many of those are in public practice; and
- how many other members are registered with the profession?

How many members have been audited?

- as to their continuing professional development; and
- quality of work papers for BOTH audit and non-audit clients.

How about giving the Tax Agents Board the authority to direct the Professional Bodies to carry out **independent** Agent Audits on both audited and non-audited taxpayers?

How about **we make agents partially responsible to take reasonable care** rather than disclaiming total responsibility and make them state that they have done just that? Processing rubbish for a fee knowing that it is wrong is a fraud both against the client and the professional body who registered them to carry out such work.

Let the subsequent audit then show if care was taken and was it reasonable and if not then refer the agent to the Tax Practitioners Board or the Professional Body for appropriate action.

RECORD RETENTION AS IT APPLIES TO DUE DILIGENCE

In this cyber cloud environment in which we live are you aware that your business records and documents need to be kept for:

Income Tax - **5 years from the date of assessment** *of that year's income*.

These include all records covering:

- all transactions;
- all work expenses;
- car expenses;
- business travel expenses including diaries and itineraries;
- capital gains records for the date of purchase;
- fringe benefit records including calculations and declarations; and
- GST records and declarations

Corporations Law covering Companies, Trusts etc. – **7 years**

These include all records covering all of the above required for taxation and also:

- All financial records including:
    - cash books;
    - bank statements;
    - journals;
    - all ledgers including:
        - debtor;
        - creditor;
        - wages;
        - all other subsidiary ledgers such as stock, job costing etc; and
        - general ledgers.
- All financial reports and statements;
- Income tax returns and supporting work papers; and
- Company registers, minute books and other secretarial records.

As a public officer or director of a business can you, as part of your due diligence, certify to anyone inquiring that the entity for which you are responsible holds all those records for the time required by Law and if not are you prepared to be held personally responsible?

Maybe it is time you checked because the environment in which you are currently operating is changing. The statement that it is not your responsibility as it falls to other officers, human resources, the CFO or external accountants will not be an acceptable excuse.

It is becoming more prevalent that officers are increasingly being held financially responsible for the failure to fulfil their legal responsibilities which include the retention of documentation required under the respective Acts.

EXPATS AND DOMESTIC RESIDENCE EXEMPTIONS

Changes to legislation originally introduced in Australia may result in expats disposing of their main residences or returning to Australia to resume residency for tax purposes.

Legislation assented to on 12 December 2019 has amended the availability of the main residence exemption on capital gains tax to foreign residents for tax purposes. If you are an Australian Expat this will affect you.

Under the previous legislation, expats who sold their Australian main residence whilst living overseas were generally still entitled to the main residence exemption.

Partial exemptions were also available to expats who used their main residence to produce assessable income for part of their ownership period and / or who were temporarily absent from their main residence for a maximum of 6 years.

Under the new legislation, this exemption will now only be available to:

- Owners who are tax residents of Australia on the date of the capital gains tax ('CGT") event (e.g. date of contract for sale and not settlement); and

- Owners who have been expats for 6 years or less and have sold the domestic residence due to a life event (e.g. the owner, their spouse or child had a terminal illness, the owner's spouse or child passed away or the owner and their spouse went through a relationship breakdown).

Expats who acquired their main residence before 9 May 2017 have been given a transitional period to 30 June 2020 to dispose of their main residence and apply the full main residence exemption on any capital gain made. Expats who miss this window and do not satisfy the new criteria for an exemption, will be liable for the full amount of CGT.

Expats who acquired their main residence after 9 May 2017 and do not meet the new criteria for an exemption, will also be liable for the full amount of CGT. Expats will no longer be entitled to any concession on CGT based on days in the residence during the ownership period. *The "6 year temporarily absent" exemption is also no longer available.*

This approach is a severe departure from the application of other CGT exemptions and concessions based on days in residence and days in non-residence.

This will no doubt result in some expats disposing of their main residences before they had previously anticipated or returning to Australia to resume residency (for tax purposes) and sell their main residences while they are here.