Auditors found liable for failed investments

Introduction

It has been said that the Self-Managed Super Funds (**"SMSF**") sector is an important part of our superannuation system[1]. ASIC recently reviewed a number of files randomly based on Australian Taxation Office data and assessed compliance with the *"best interests"* duty and related obligations found in the *Corporations Act*. It found that in 91% of files reviewed, the advisor did not comply with the *"best interest"* duty and related obligations in the *Corporations Act*[2].

Auditors of SMSF's have also recently come under scrutiny in two recent decisions.

Recent Judgements

In *Cam & Bear Pty Ltd v McGoldrick* [2018] NSWCA 110, the NSW Court of Appeal found the SMSF Auditor negligent for failing to provide adequate warnings to the SMSF Trustee as to the recoverability of assets which were described as "cash". The Court considered that these assets were actually unsecured loans to a company related to the SMSF's investment advisor and that the auditor had an obligation to investigate the recoverability of the "cash". The auditor was also required to provide a qualified opinion given that he was a "very experienced accountant and auditor who was engaged for the purpose of protecting the Fund and its trustee against financial risks".

Similarly, in *Ryan Wealth Holdings Pty Ltd v Baumgartner* [2018] NSWSC 1502, the Court held that the SMSF auditor failed to detect and report to the Trustee irregularities which had existed over a number of years. The irregularities concerned a number of unsecured loans which were entered into by the plaintiff. It was alleged that the auditor knew, or ought to have known, that the investments were high risk and that pension from the SMSF was the beneficiaries sole source of income. The Court ordered damages payable to the plaintiff in the amount of $2.26 million which included a 10% apportionment to the plaintiff for contributory negligence.

ASIC guide for SMSF auditors

On 4 March 2019, ASIC issued *"RG 243 Registration of self-managed superannuation fund auditors"*, expressed to be a guide for those who wish to conduct audits of managed superannuation funds pursuant to the *"Superannuation Industry (Supervision) Act 1993*[3]*."* This guide deals with eligibility requirements for registration; lodging the application for registration; obligations on auditors after they registered and right to review. We will talk more about RG 243 in an upcoming newsletter/blog.

Conclusion

The judgements referred to above highlight the standard of care courts have applied where the trustee of the SMSF is relatively unsophisticated in financial affairs. For any advice or assistance in relation to these matters please do not hesitate to contact Shane.

1. ASIC press release "18-192MR SMSF advice needs significant improvement – 28 June 2018 (ASIC Deputy Chair Peter Kell)".
2. *Ibid* - ASIC press release – 28 June 2018.
3. ASIC Regulatory Guide 243 "Registration of self-managed superannuation fund auditors" – 4 March 2019

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Financial advisor held to be negligent

The recent judgement of Bankier v HAP2 Pty Ltd [2019] QSC 101 further clarifies the duty owed by a financial advisor and the level of warnings required to ensure that their client understands the full impact of a financial decisions to their personal circumstances and future goals/objectives. The plaintiff was injured in a car accident in 1997 and in or about 2002 was awarded approximately $2 million in damages for the injuries she suffered and for her future economic loss, medical expenses and other associated matters. Approximately $1.1 million of the award related to future medical and associated expenses. Mr Avery, a financial advisor, was engaged by the plaintiff in or about 2002. The total amount available for investment was $1,184,600.

The plaintiff alleged that Mr Avery should have provided the plaintiff with the following warnings about three matters considering that the award of damages was intended to provide for the plaintiff's future medical expenses and income requirements:

1. Spending money in excess of her estimated living expenses;
2. Borrowing money for investments; and
3. Starting a business in 2007.

The Court held that at paragraph 130 that the advisor's warnings about the plaintiff's spending (including the starting of the business) were *"low-key"* and that there *"had been no connection made between spending, the dissipation of her essential capital resource and the effect that would have on her future"*. His Honour held that had appropriate warnings been given by the advisor as to the plaintiff's spending habits, that she would have changed her way and reduced her spending accordingly.

With respect to the advice to borrow money to buy investments, the Court:

- accepted the opinion of the defendant's expert with respect to the purchase of agribusiness investments that *"whilst it was a marginal investment, it was not necessarily negligent to recommend it"* citing that the investment was only 8% of the plaintiff's overall portfolio; and

- accepted that the advisor recommended that the plaintiff finance an amount to acquire a property in Palm Beach (rather than purchasing outright) which caused the plaintiff to incur unnecessary interest expenses.

As for the advice provided by Mr Avery in 2007 when the plaintiff approached him about starting a business, the Court held that the advisor failed to provide a clear warning to the plaintiff as to the adverse effect on her capacity to afford the rental expenses in circumstances that annual rental costs increased from $27,000 to $60,000. The Court held that the advisor had breached his duties to the plaintiff with respect to the purchase of the Palm Beach property or the lease of the business premises[1]. The Court invited the parties to make submissions as to the loss suffered by the plaintiff.[2] For legal advice or assistance in relation to this issue, contact Callun using the contact details below.

1. The Court concluded that the agribusiness investments were not of significance given that they represented a small proportion of her assets.
2 His Honour understood that the calculation of loss based on the above findings was $637,508.

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