DIY super – or DIY disaster?

THE number of self-managed superannuation funds (SMSFs) has dramatically risen over recent years. This growth in popularity, particularly among smaller family businesses, has been borne out of the perception that they are cheaper to run than other super funds, and give investors greater control and flexibility over where their funds are invested.

While this may be the case when the fund is large enough and investors have the necessary financial knowledge, there can be dire consequences for SMSF investors who are unaware of the pitfalls that await. These can include the loss of their hard-earned investment, an increased tax burden and severe penalties from the Australian Taxation Office (ATO), including large fines and even jail time in criminal cases. With the potential for a real financial disaster to occur, we examine why so many SMSFs fail to deliver the superannuation nirvana that smaller investors so desperately seek.

Non-compliance

The number-one reason many SMSFs are unsuccessful is due to non-compliance with government legislation. This is mainly brought about by a lack of understanding of Australia's complex and ever-evolving superannuation laws. And it seems to be a problem that won't go away. Recent data from the ATO shows that the number of SMSFs that were shut down for non-compliance breaches in 2009 was four times as many as 2008 and 20 times that of 2007.

Unfortunately for these investors, when a SMSF is deemed non-compliant and its notice of compliance is revoked, it loses its concessional tax status for not only the current year, but for all years in which the concessional tax treatment was applied. The tax rate applied to any affected investment earnings will jump from 15pc to 45pc, which can lead to a significant tax liability for the SMSF and a greatly reduced earning capacity for the retirement fund.

According to the same ATO data, the majority of non-compliant SMSFs in 2009 involved loans to members.

In most cases, the ATO found that many family-run businesses had borrowed funds from the SMSF to aid their business or prevent it from going into administration during the tougher economic conditions experienced recently. Many of these investors had simply failed to understand that according to superannuation law, the funds invested in the SMSF are not theirs to use or borrow until retirement, except in limited circumstances.

There is a very fine line between success and failure when it comes to any investment, let alone one so complex and regulated as superannuation. And the margin for error is getting smaller for SMSF investors, with the ATO recently announcing a major crackdown on tax agents acting on their behalf in 2010. A specially set up ATO audit squad will focus on income tax return issues, including assessing the accuracy and compliance of deduction claims and assessable income.

It's the first time that the ATO will officially put accountants and their SMSF clients under the microscope to check for under-reporting breaches and wrongly claimed deductions. So if you're thinking about starting an SMSF, be prepared for even greater ATO scrutiny.

Lack of expertise and knowledge

Another huge challenge facing SMSF investors is that not everyone has the significant amount of time, accounting expertise required or the inclination to properly manage every single aspect of administration, not to mention monitoring every intricate piece of super legislation. And, since there is no legal obligation for an SMSF investor to engage professional financial advice or accounting and administration services to maintain the fund, what was initially intended to offer an investor greater control may inevitably see their investment suffer.

In fact, a recent ATO survey of SMSF trustees found that an astounding 21pc of participating trustees had a low-to-medium or low knowledge of their obligations, while over 30pc of new trustees couldn't adequately explain the sole purpose test. However, what is more frightening is that over 15pc did not have an investment strategy[1].

As with your business, the buck stops with you when you run an SMSF. If your investment decisions lose money, there is no one else to blame. As a word of warning, anyone considering an SMSF should seriously evaluate their own capacity and knowledge to run a successful SMSF before proceeding.

Size of fund and ongoing costs

In the fast-growing SMSF environment, size really does matter, especially when it comes to the costs associated with maintaining your SMSF. The Australian Securities and Investments Commission (ASIC) recently recommended a minimum balance of $200,000 for an investor to establish an SMSF for it to be financially viable. SMSF investors with balances less than $200,000 risk losing funds because they have higher proportional costs than SMSFs with balances over $200,000.

Diversification of assets

Despite SMSF investors seeking flexibility, and the unlimited investment opportunities available, research indicates that one in five SMSFs have all of their investments in only one asset class[2]. Quite simply, many investors are faced with what looks like endless opportunities, but fail to take advantage of them.

Studies show that asset allocation is where the real super performance comes from, not market timing or stock picking. If a SMSF invests 100pc in one asset class, not only do they miss out on the investment opportunities offered by diversification, but they greatly increase their exposure to risk.

ATO data also suggests that many SMSFs tend to invest conservatively, with over 30pc of SMSF investments being invested in the form of cash or term deposits, while offshore investments remain consistently low[3].

The question has to be asked: Are SMSFs too conservative in their investment decisions because they lack the knowledge of all the available opportunities? Or are they sacrificing performance by choosing extremely low-risk/low-return investments?

At the end of the day, managing an SMSF can be very time consuming and challenging, not to mention risky. It can be virtually a full-time job just knowing all the relevant legislation and continually monitoring market performance.

A good thing to remember is that with an SMSF, you are literally playing with the money that needs to support you in retirement.

If you are 100pc sure in your ability to stay abreast of the legislation, administer the fund without any breaches and find high-performing investment choices, then SMSFs could be right for you.

Of course, you should also consider seeking professional advice.

So, what is the alternative for someone looking to save on costs, while still having greater control and flexibility?

As a business owner or self-employed worker, there are various industry super funds offering low-cost products that provide significant flexibility and allow you to determine your own asset allocation, giving you control over your super investment without having to worry about all the regulations.

AustSafe Super Personal is a simple alternative to a SMSF, where you can maintain control of your investment and access flexibility without the headache of having to do all the paperwork and manage the compliance yourself.

This product has been specifically designed for the business owner and offers the flexibility of nine investment options to invest across, not to mention access to financial advice to help you make the right investment choice.

What's more, you have the ability to change investment options each month giving you the control over how your super is invested.

The fees for AustSafe Super Personal are low[4] which means your investment won't suffer and the performance is strong[5].

As a member of AustSafe Super Personal you'll have access to a local Regional Manager, a range of educational facilities including contact with our Customer Service Centre, member seminars and a comprehensive website.

Most importantly, at AustSafe Super we have a team of experts and enlist the services of specialist firms to ensure all aspects of managing the Fund are done so to the highest standard, ensuring the best possible outcome. This means you retain control of your investment while we do the hard work.

So, what are you waiting for?

Give your regional manager a call today to find out how you can have greater control over your super investment.

- Simon Fielder, Northern Queensland: 0408 706 064.
- Stacey Watson, Central Queensland: 0437 490 445.
- Paul Meredith, Southern Queensland: 0419 601 908.
- Wayne Hulin, business development manager: 0407 749 470.

This article is general information only and does not take into consideration your personal financial situation.

1. Sherry, The Hon Nick, (2008). Trustee Duties and Education for the Self Managed Superannuation Member's Association Launch taken from: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2008/006.htm&pageID=005&min=njs&Year=&DocType=1; Retrieved 1 April 2010.

2. Cooper, J. (2010). A Conversation About SMSFs. Super System Review 2010, pp6.

3. Vivian, Raelene (2008). Pros and Cons of Self Managed Superannuation for National SPAA Conference taken from www.ato.gov.au/smsf/content.asp?doc=/content/70673.htm&pc=001/001/001/002/002&mnu=&mfp=&st=&cy=. Retrieved 1 April 2010.

4. Based on independent research by SuperRatings Pty Ltd. Fees may vary in the future.

5. Past performance is not an indication of future performance.

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