QAO
QUEENSLAND
AUDIT OFFICE

INFORM

Accounting & Auditing Update, News, Information and Views Bulletin

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AUDIT OFFICE**

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WELCOME

Welcome to our first edition of "INFORM". This publication is prepared as an information bulletin for both QAO clients and QAO staff. It is intended to publish the newsletter as a minimum four times per year with additional publications as required. The objective of the newsletter is to provide information on new and revised accounting and audit pronouncements, changes to the Corporations Law, information on emerging issues with an emphasis on those relevant to the public sector and QAO perspectives on such issues. The information presented in this publication is a summary only and should be read in conjunction with any relevant pronouncements. Where applicable additional references to relevant readings or publications is provided.

QAO UPDATE

Auditor-General's Reports to Parliament

Audit Report No. 1 for 1998-99 was tabled in the Parliament on 18 September 1998. This report included the results of audits completed as at 9 September 1998, the results of a performance management system audit on the Competitive Procurement Practices within the State and commentary on various emerging issues.

Contents of the report included:

Status of Audits

- As at 9 September, 71 audit were completed

Audit findings

- The Lang Park Trust (year end 31/12/97) – Emphasis of matter note
- The Legal Practitioners' Fidelity Guarantee Fund (year end 31/3/98) – Emphasis of matter note
- Electricity Industry commentary

Special Audit Review

- Gold Coast City Council – Contract for provision of waste management services

Performance Management Systems Audits

- Competitive Procurement Practices within the State Budget Sector

Status of matters previously raised

- Basil Stafford Centre
- Members' and Ministers' entitlements
- Department of Main Roads / Department of Transport

Current Audit Issues

- Audit Arrangements for GOC's and controlled entities
- Implementation of New Generation of QGFMS (SAP R/3)
- Replacement of HR / Payroll Systems
- Year 2000
- Accrual Output Budgeting
- AAS 31 – Financial Reporting by Government.

Further reading: Audit Report No. 1, 98-99, QAO. A copy of the report is also available on www.qao.qld.gov.au

Performance Management System Audit

QAO recently completed an audit of the Competitive Procurement Practices within the State Budget Sector.

Findings included -

Local Policies and Procedures

The review identified the need for departments to ensure local purchasing instructions are maintained to a current status and in compliance with the principles of the State Purchasing Policy. The instructions need to be sufficiently detailed to provide guidance as to the procedures to be followed and the level of documentation and approval required, especially where the exemptions from competitive processes provided for in the State Purchasing Policy, such as sole or limited supply or genuine urgency, are invoked.

Compliance with Policy and Local Instructions

The level of compliance with the State Purchasing Policy and local instructions varied between departments and between locations within departments. The main areas requiring improvement related to:

- the level of documentation regarding quotes obtained
- the level of documentation supporting claims for exemption from open and effective competition such as sole supply or genuine urgency situations
- the level of documentation supporting variations to originally quoted prices.

Training in Purchasing Requirements

Audit identified a need for departments to provide those staff who are involved in the procurement process with adequate training in the requirements of the State Purchasing Policy.

Exemption from Competitive Quotes

The review indicated that there exists considerable uncertainty across departments as to the practical application of exceptions from the requirement to obtain competitive quotes, especially in regard to the level of quotes required from Government business units such as Go Print, which, while operating on a trust fund, is financed in the

main by clients funded through the Consolidated Fund.
Queensland Purchasing is currently reviewing this section of the State Purchasing Policy.

Managing Conflict of Interest

Given the current trend for increased staff mobility in the public sector, audit recommended that procedures be developed which allow for the timely identification of any potential conflict of interest situations including those arising from contracts which were awarded or recommended by former public officials.

As a result of this audit, QAO has developed a guide "Considerations for Better Management of General Procurement Practices". This guide will provide assistance to administrators in the general procurement of goods and services. This guide is included in the appendices to the Auditor-General's Audit Report No.1, 98-99.

Further reading: Audit Report No. 1, 98-99, QAO

WHOLE OF GOVERNMENT ISSUES

TRIDATA

Treasury is developing a whole of government financial information system (Tridata) to support the Accrual Output Budgeting initiative. The new system will combine the Central Finance System, the Budget Management System, and the Whole of Government reporting systems.

Tridata will be used to produce Queensland's first accrual budget (for 1999-2000), and is being designed to meet all of Treasury's financial management requirements, including the production of forward estimates, the preparation of Budget Papers, management of the budget process, and Whole-of-Government reporting. Tridata will replace the Central Finance System as the Government's central ledger.

Tridata will be a fully accrual system, which collects account level data and will be able to report using the standard suite of accrual financial statements, as well as reporting on a Government Finance Statistics (GFS) basis. GFS provides consistency of classification of financial information across all government jurisdictions.

Tridata will also collect non-financial information from departments, including output characteristics, performance targets and results and budget submissions (in summary form) etc.

A key feature of Tridata is that departments will have on-line access to the system, with the capacity to input and verify data, and to produce reports. There will be some cases where Tridata may be able to be used by departments as a substitute for developing their own systems or data repositories eg producing budgeted financial statements, or recording information on contingent liabilities.

Tridata will also record financial information provided by Statutory Bodies, to enable the production of a range of Whole-of-Government reports and facilitate data analysis at the Whole-of-Government level.

Source: Information provided by Qld Treasury Tridata implementation project team

Whole of Government Reporting

In order to prepare for the implementation of AAS 31 (operative 30 June 1999), Treasury is preparing a full set of audited consolidated financial statements for the State for 1997-98. The statements will consolidate more than 150 Queensland public sector entities but will not include the operations of universities or local governments.

Those entities that will be consolidated must complete a consolidation package as required by Treasury. These entities were required to confirm inter government balances and transactions by 15 August with a materiality threshold of $500,000 being applied for elimination purposes. The packages are to be returned to Treasury by 30 October 1998.

The auditee's and QAO will be certifying that the information contained in the package is in accordance with Treasury's instructions and is consistent with the audited financial information contained in the statements.

Further information: Whole of Government Unit - phn 3225 8127

TOPICAL ISSUES

Land under roads

As a result of concerns expressed by interested parties, the PSASB has established a working party to address the issue of the recognition and measurement of land under roads. The following questions are being addressed by the working party:

- Does a public sector entity control the land under roads? Under what circumstances would control exist?

⇒ A clear majority of the working party believe that if the entity controls the road, it also controls the land under these roads

⇒ Some members of the working party consider that the ability to sell or re-deploy the land under roads is necessary for control to exist

- Which measurement methodology(s) would best measure land under roads reliably?

⇒ A clear majority of the working party considered that the most appropriate approach is to value the land as "en globo" land

⇒ En globo land is undeveloped land with potential for sub-division, thus reflecting the undeveloped state of land under roads

⇒ A minority of the working party believed that the land under roads has no value as its value is transferred to adjoining properties or no identifiable value as there is a lack of transactions

- Can the value of land under roads be reliably measured and how?

⇒ A clear majority of the working party believed en globo values can be estimated reliably as the methodology uses available market evidence and uses accepted valuation methods

- Would the benefits of valuing and recognising land under roads exceed the costs?

⇒ Views were evenly divided on this question

⇒ Some argued that the information would have no bearing on asset management or the reported cost of services

⇒ Others argued that the information is integral to reporting the value of roads and to full accrual accounting

⇒ It was noted that a number of potential developments could significantly increase the benefits to users of recognising land under roads, namely;

➢ impact of agencies paying to the State a capital charge on net assets deployed

➢ likelihood that land tax will be imposed on local governments as a result of competitive neutrality reforms, which would require the cost of valuations to be borne in any event

➢ emerging trend toward user charging for road use

Currently, transitional provisions exist under AAS 27, 29 and 31, which allow entities to defer recognition until 1999 or 2000 to enable this debate to be resolved.

Strategic options are:

- Do not recognise land under roads
- Recognise only purchased land under roads (at cost)
- Recognise all land under roads (cost and/or current value).

In respect of this issue it has to be kept in mind that all States and Territories within Australia have their own peculiar circumstances, which inhibits consistent treatment of land under roads. For example the legislative requirement in Queensland is that ownership of land designated 'road reserve' vests in the Crown, which complicates the issue of control.

Source: The Standard: AARF and AASB, July 1998, pg 21 - 23

Tax deductibility of Year 2000 and software expenditure

Year 2000 Compliance Expenditure

Coinciding with the Federal Budget, the ATO released draft tax ruling TR 98/D5, which provided for an immediate deduction for Y2K related expenditure incurred on:

- Initial diagnosis work on software to determine the extent of Y2K compliance
- Modifying and subsequently testing software, to make it Y2K compliant (provided the work does not result in essence a complete replacement of the computer software). If this work also leads to substantial improvement not related to making the software Y2K compliant, the appropriate capital apportionment is required
- Modifying or completely replacing a computer chip or firmware to make the computer or equipment Y2K compliant (however, replacement of the whole, or substantially the whole, of a unit of **hardware or equipment** containing the Y2K compliant chip or firmware will be treated as capital expenditure).

In addition, the Federal Government has indicated that it will legislate to ensure the deductibility of expenditure incurred on acquisition of new software (including upgrades), and substantial rebuilding of current software, provided the expenditure is incurred prior to 31 December 1999 and has the predominant nature of ensuring Y2K compliance. This raises the issue of when expenditure is actually incurred and also what is predominant. For example if expenditure is 38% relating to Y2K and 35% and 27% relating to other aspects of business operations, can we infer that the Y2K is the predominant factor?

Software in General

Following the withdrawal on 11 May 1998 of tax ruling IT 26 (dealing with the tax treatment of software) the Federal Government has indicated that it will legislate to provide for systems and application software to be amortised at 40% pa straight line.

The 40% write-off will apply to contracts entered into, and commissioned / in-house developments commenced after the withdrawal of IT 26.

IT 26 will continue to apply until 30 June 1999 on expenditure incurred prior to 11 May 1998.

Faster write-offs apply to:

- non-renewable licences of less than 2.5 year duration (amortised over the lesser period)
- use of software ceasing within 2.5 years of acquisition (immediate deduction for unrecouped expenditure)
- items valued at less than $300 (deductible outright)
- commissioned or developed software will only be eligible for amortisation once the project is complete
- expenditure on enhancing or upgrading the functional capacity of software remains on capital account (amortised at 40%). Expenditure that does not enhance or upgrade functional capacity will be deductible.

Sources:

- **1998 Federal Budget Executive Brief, Price Waterhouse Coopers & Lybrand**
- **Australian CPA Journal, Aug 98, pg 30**
- **TR 98/D5, ATO**
- **IT26, ATO**
- **Taxation in Australia Vol 32, June 1998, pg 579**

Superannuation Industry – Year 2000 exposures

A Superannuation Fund could be adversely affected if any of the following fail to adequately address the Y2K situation:

- Issuers of securities in which fund assets are invested
- The fund's internal and external administrators
- Providers of hardware, software, firmware, etc (including sponsoring employers)
- The fund's investment managers and their delegates
- Custodians and sub-custodians holding fund assets
- Stock exchanges and clearing houses
- The fund's banks and other financial institutions with which assets are placed
- The fund's insurers.

From the point of view of trustees and trustee directors, there are two principal areas of risk. First, they could be liable for breach of trust or breach of the *Superannuation Industry (Supervision) Act 1993 and Regulations* (SIS) where a fund's investments are adversely affected. Second, they could also face liabilities under trust law or SIS if there are failures in administrative systems (incorrect benefits paid, benefit payments delayed, etc).

To fulfil its duties, the trustee's principal objective is to demonstrate that it has put in place appropriate systems to identify the risks faced by the fund, has exercised appropriate degrees of care, skill and diligence in seeking to manage the risk, and has not been negligent.

Auditing Guidance Statement AGS 1034 "Implications for Management and Auditors of the Year 2000 Systems Issue" provides clarification on this issue.

LOCAL GOVERNMENT ISSUES

National Competition Policy

The implementation of national competition reforms to some Councils' business activities has resulted in the establishment of commercial business operations within these Councils.

QAO was recently contacted by a Council for advice on the establishment of an appropriate capital structure for a business unit. The business unit had excess equity to debt and was seeking to increase the level of debt.

QAO's advice in this instance was that -

- The business unit is not a separate legal entity from the Council, therefore an arms length sale of the assets for a specified price is not possible

- The amount of Council debt initially transferred to the business unit must relate to the activities or assets of the particular business unit, i.e. the loans must have originally been used to acquire or construct the assets used by the business unit

- A change in debt to equity ratios could occur as a result of future funding decisions

- The transfer of assets and associated debt to the business unit, must be a decision made by a resolution of the Council and the details of this transfer, including applicable values, must be recorded in the minutes of the Council meeting.

Local Government Finance Standard

QAO has been advised that the following amendments will be made to the Local Government Finance Standard -

- ♦ Removal of the requirement to apply Statement of Accounting Practice 1 "Current Cost Accounting" in accounting for non-current assets

- Clarification of the definition of the current cost of a non-current asset

- Include the requirement to disclose the total revalued current cost **and** amount of accumulated depreciation for each class of non-current asset

- Removal of the requirement for financial statements to contain a note on the area of reserves and the length of roads controlled by the local government. This information is to be shown in the local government's annual report

- Removal of references to the Current Cost Reserve and inclusion of the Asset Revaluation Reserve, as a component of local government equity

- The proposed financial statements are to be presented to the local government (Council and Board) as soon as practicable after the statements are given to the Auditor-General (i.e. at the next meeting)

- The proposed and the final financial statements must both include a Management Certificate signed by the Mayor and the Chief Executive Officer

- The proposed financial statements given to the Auditor-General do not have to have the word "UNAUDITED" stamped on every page

- The date for an accounting manual to be in place is to be extended from 1 July 1997 to 1 July 1999

- Allow a local government to credit the capital account when initially recognising non-current assets acquired prior to 1 July 1994.

Probity Audits

A special audit review of a major tendering process has recently been completed for one local government in order to provide an independent report to the Council on the transparency of the process. QAO is available to perform these types of audits for local governments in certain circumstances.

Non-current Assets

Infrastructure assets acquired prior to 1 July 1994 must be recognised in the financial statements for 1998-99. Each local government must have a clear policy on the identification and valuation methodology for these assets. QAO **does not** have a requirement for external valuations. A valuation carried out using existing expertise within a local government is acceptable provided that there is clear documentation of assumptions made as well as documentation of the whole valuation process.

While there is no preferred method to be employed in carrying out these valuations, local governments should ensure that the method is appropriate for local conditions and results in values that comply with the requirements of the Local Government Finance Standard.

Use of the LGAQ net may provide input as to the methodologies being used by other local governments. Where there has been no recent construction work carried out, it may be possible to compare resulting valuations with those of surrounding local governments with similar terrain conditions.

Condition Based Depreciation

A number of local governments have proposed the use of condition based depreciation as they consider that current methods of calculating depreciation overstate this cost. However, this method of depreciation is not recognised under accounting standards or the Local Government legislation.

Although condition based depreciation cannot be used for financial statement purposes, including statements prepared by a commercialised unit, it may be used in determining prices for services.

CORPORATE NEWS

ASC Restructures

Commencing 1 July 1998 companies are now regulated by the Australian Securities and Investments Commission (ASIC). The ASIC takes over the functions of the Australian Securities Commission (ASC). Certain functions of the Insurance and Superannuation Commission (ISC) will now also be the responsibility of the ASIC. These include the regulation of a range of investment products, including superannuation, approved deposit accounts and retirement savings. Both the ASC and ISC will be abolished.

Further information on the changes is available on the ASIC web site at http://www.asic.gov.au.

ASIC targets annual financial statements

As part of its Financial Accounts Surveillance program, the ASIC has advised it will shortly be targeting selected companies with the aim of reviewing a group of discrete financial reporting issues. Areas to be reviewed are:

- Compliance with newly issued accounting standards and UIG pronouncements
- Treatment of Y2K disclosures
- Adjustments to retained earnings (under the guise of complying with harmonisation of accounting standards)
- Classification of financial instruments between debt or equity
- Asset write downs, especially in relation to assets based in Asia.

The targeted surveillance activities will draw on information available from:

- Accounting bodies in each State
- Other key organisations eg. The Group of 100, AASB, Institute of Company Directors and Chartered Secretaries
- Complaints and queries from the public
- AISC's own experience with companies, eg. companies with a history of poor financial reporting practices, those facing financial difficulties, those operating in industries that have unresolved accounting issues and those operating through novel structures.

Source: Chartac Accountancy News, Sept 1998, pg 1

Company Law Review Act

As part of the Corporate Law Economic Reform Program (CLERP), the Company Law Review Act was recently passed. The amendments to the Corporations Law resulting from the Review Act are operative from 1 July 1998; there are some exceptions with the main being in relation to the financial reports and audit provisions.

The key reforms within the Review Act affect the following provisions of the Corporations Law:

- Financial reports and audit
- The registration and basic features of a company
- Meetings and members' rights
- Share capital
- Annual returns
- Deregistration of defunct companies.

The new requirements are detailed in Chapter 2M of the Corporations Law and replaces Parts 3.6, 3.7, 4.4 and 4.5.

Some companies may need to amend their Articles of Association to take advantage of the procedural and administrative reforms contained in the Review Act. For example, a company's Articles may require the annual financial report to be signed by two directors under common seal. The Review Act removes both these requirements.

Only those public sector corporations subject to application of the Corporations Law will be effected by these changes.

A summary of the major reforms follows -

Financial Reports

The annual or half year financial report must consist of:

- Financial statements (profit and loss statement, balance sheet, statement of cash flows)
- Notes to the financial statements
- Directors' declaration (previously known as the directors' statement)
- Consolidated financial statements, if required by accounting standards.

All financial statements whether special purpose or general purpose must now include a statement of cash flow. It was common practice in the past for special purpose financial reports not to include a statement of cash flows.

Accounts of a Company

S294 has been repealed by the Act. This section previously required directors to take reasonable steps to ensure the provision of doubtful debts was adequate and to apply the recoverable amounts test to assets.

Financial Periods

The first financial year of a company, registered scheme or disclosing entity commences on the day the entity is registered or incorporated, the duration is 12 months, or such period determined by the directors however it cannot exceed 18 months. Subsequent financial years will commence from the end of the previous financial year and must be for a 12 month period. Directors do have discretion to extend or shorten the 12 month period up to a maximum of 7 days. If the directors wish to amend the period in excess of 7 days, permission from the ASIC must be obtained.

Equity Accounting

The Review Act has removed the legal impediment to the adoption of equity accounting by specifically permitting the application of equity accounting. The proposed revised AASB 1016 "Accounting for Investments in Associates" will become effective for financial years ending on or after 30 June 1999 and half-years ending on or after 31 December 1998. Until the revised standard becomes effective, companies will have the option to adopt the requirements of the revised standard (equity account for investments in associates) or continue to comply with the existing standard (disclosure only of equity accounted information in the notes). This choice is available through ASC Class Orders 97/798 and 97/799.

Directors' reports

Directors' reports for a financial **year** must now include the following additional matters:

- Review of operations
- Changes in state of affairs
- Subsequent events
- Future developments.

Where the operations of a company, disclosing entity or registered scheme are subject to any particular and significant environmental regulations under Commonwealth, State or Territory laws, the directors' report must disclose the entity's performance in regard to these environmental regulations.

The disclosure requirements in relation to the **half year** directors' report for a disclosing entity have been reduced and now only include:

- A review of the operations and the results of the operations for the half year
- Names of each person who was a director of the entity at any time during or since the end of the half year and the period for which they were a director.

There is an additional requirement in the directors' declaration (formerly the directors' statement) that directors declare that the financial statements comply with accounting standards.

The directors report and declaration (made out in accordance with a resolution of directors) are only required to be signed by one director.

Audit and Review Reports

Audit and review reports issued on financial reports for years or half years ending on or after 1 July 1998 must be prepared in accordance with the provisions of chapter 2M of the Corporations Law. The Auditing and Assurance Standards Board are revising the wording for audit and review reports to ensure compliance with chapter 2M.

Concise Financial Reports

The Review Act allows the option of sending concise financial reports to members in lieu of the full annual report. Members retain the right to request a full copy of the annual report. A concise financial report must consist of:

- A concise financial report prepared in accordance with the AASB accounting standard (currently an exposure draft)
- A directors' report
- A Statement by the auditor that the financial report has been audited and whether the concise financial report complies with the accounting standard applicable to concise financial reports
- A copy of any audit qualification or emphasis of matter which was included in the auditor's report on the financial report
- A statement that the report is a concise report and that a full annual report is available on request.

Lodgement and Distribution of Annual Financial Reports

Entity	Lodgement with ASIC	Distribution to Members
Non listed disclosing entity	Within 3 months after year end	Earlier of 21 days before the AGM or 4 months after year end
Large proprietary company	Within 4 months after year end	Within 4 months after year end
Registered scheme	Within 3 months after year end	Within 3 months after year end

Company Seal

Use of a company seal is now optional.

Replaceable Rules (Memorandum and Articles of Association)

For all companies incorporated after 1 July 1998, the memorandum of association has been abolished and replaced by a constitution. Existing companies will continue to have their existing memorandum of association until they decide to repeal them. The basic rules for the internal management of companies (Table A and B) have been updated and are now located in the main body of the Corporations Law and are called "replaceable rules". These replaceable rules apply to all new companies unless displaced or modified by provisions in the company's constitution. That is, companies may adopt some, or all, of the replaceable rules or develop their own rules tailored to meet their specific needs.

Share Capital

Companies are now permitted to capitalise profits to share capital.

Status of Class Orders after the introduction of the Corporate Law Review Act

Some class orders have been revised or new ones issued to address implementation aspects introduced by the Act and to provide relief similar to that provided under the old law. The operative date for these new or revised class orders is 1 July 1998 for both half year and financial year accounts. The prior class orders will continue to apply to financial reporting obligations under the transitional arrangements unless they were revoked with immediate effect.

Those class orders that have not been revoked or replaced remain in effect.

Summaries of the Review Act are found in the following publications:

- **Accounting Alert, issue 11, Aug 98, Deloitte Touche Tohmatsu**
- **Reforming the Corporations Law, Ernst & Young**
- **Accounting and ASIC Compliance, Sep 98, Deloitte Touche Tohmatsu, Clayton Utz**

WHAT'S NEW IN ACCOUNTING?

New and Revised Accounting Standards

AAS 2 / AASB 1019 "Inventories"

The revised standards still require inventories to be measured at the lower of cost and net realisable value. Inventories must be assigned a cost using first-in-first-out or weighted average cost formula, except where inventories are not ordinarily interchangeable or are goods or services produced and segregated for specific projects, in which case the costs must be assigned by using the specific identification method. The standards detail the circumstances and manner in which write-downs to net realisable value are recognised.

The standards now apply to land development projects not covered in AAS 11 / AASB 1009 "Construction Contracts".
While the standards do not include cost of goods disclosures (harmonising with IAS 2), the AASB and PSASB are committed to requiring this disclosure in new and revised standards that aim to harmonise with IAS 1 "Presentation of Financial Statements" and IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies"

The standards also require more expansive disclosures.

Operative date is on or after 30 June 1999 but may be applied earlier

AAS 11 / AASB 1009 "Construction Contracts"

The main features of the revised standards is that the substance of a contract or a group of contracts is considered when determining the composition of a construction contract. Where the outcome of a construction contract cannot be reliably estimated the following is required:

- Any contract costs are recognised as an expense in the period in which they occur
- Where recoverability of costs is probable, revenue is recognised to the extent of costs incurred.

There are also additional disclosure requirements.

Operative on or after 31 December 1998

AAS 15 / AASB 1004 "Revenue"

The standards require:

- Revenue to be measured at the fair value of consideration or contributions received or receivable
- Revenue is recognised when it satisfies the recognition criteria in SAC 4
- Additional disclosures such as disclosing separately all revenues including revenue for sale of goods, revenue from services provided and interest revenue etc.

Operative on or after 31 December 1999

AAS 31 "Financial Reporting by Governments"

The principal changes are:

- Clarification of the accounting treatment of multi-year public policy agreements
- Allows pre-existing assets that are difficult to measure to be recognised at any time up to 1 July 1998, to be offset directly against accumulated surplus or deficiency
- Permits recognition or de-recognition of lands under roads up to 1 July 1999
- Exempts disaggregated disclosures from being reported as comparative information where there has been a significant change in the basis of determining this information
- Amends the time band disclosures for capital expenditure commitments to ensure consistency with other accounting standards.

Operative date is on or after 30 June 1999

AAS 35 / AASB 1037 "Self-Generating and Regenerating Assets"

The standard applies to all self-generating and regenerating assets (SGARAs) including consumable SGARAs with short term production cycles and bearer SGARAs with long term production cycles (such as orchards), other than those held for non commercial purposes.

The standards prescribe:

- Measurement of SGARAs at net market value
- Net market value increments or (decrements) to be recognised as revenues or (expenses) in the period in which the increment or (decrement) occurs
- The net market value of non-living produce extracted from SGARAs determined immediately after it becomes non-living to be recognised in the operating statement in the period in which the extraction occurs
- The cost of non-living produce of SGARAs is deemed to be the net market value of the produce immediately after it becomes non-living for the purpose of applying AAS 2 / AASB 1018 "Inventories"
- SGARAs to be presented separately in the balance sheet
- Specific SGARAs disclosures.

Operative date is on or after 30 June 2000

Accounting Exposure Drafts

ED 91 "Financial Report Disclosures"

This exposure draft proposes a number of changes to AASB 1034 "Information to be Disclosed in Financial Reports" and proposes issuing an equivalent AAS to AASB 1034. Both standards will conform with IAS 1 "Presentation of Financial Statements", except that IAS 1 allows departures from accounting standards where compliance would not give a fair presentation. ED 91 does not propose harmony on this aspect as to do so would be contrary to the Corporations Law and professional requirements.

Other major proposed changes are:

- Assets and liabilities may be presented in order of liquidity in the balance sheet rather than the traditional current/non-current split
- The definition of current asset will be extended to include assets likely to be realised in, or held for sale or consumption in, the entity's normal operating cycle, even if that period exceeds 12 months
- Current liabilities will include liabilities arising in and expected to be settled in the normal operating cycle, again even if that period exceeds 12 months
- Certain expense items will require disclosure on the face of the operating statement as opposed to disclosure in the notes eg. borrowing costs and expenses from operating activities
- Disclosure of an analysis of expenses either on their nature or function, and where the functional basis is used, cost of sales is likely to require disclosure.

The most contentious proposed change in ED 91 is the new definition of 'current'. An operating cycle is defined as the average time between the acquisition of material entering a process and its realisation in cash or an instrument that is converted into cash. Under this definition, entities may have varying current periods therefore comparability between entities may be difficult.

ED 91 does not define particular classifications to be used in relation to classifying expenses by function or nature. This again would not facilitate comparability across entities nor improve current disclosure practices. Entities may also be concerned about disclosing cost of sales information to competitors.

Proposed application date is 31 December 1999

Comments closed 31 July 1998

ED 92 "Revaluation of Non-Current Assets"

This Exposure Draft proposes to harmonise AAS 10 / AASB 1010 "Accounting for the Revaluation of Non-Current Assets" with IAS 16 "Property, Plant and Equipment". The main proposals are:

- The recoverable amounts test will no longer be included in AAS 10 and AASB 1010
- A class of property, plant and equipment can be measured either at fair value or cost. Where the fair value basis is adopted, it must be kept up-to-date (regular revaluations) to ensure the carrying amount of revalued assets do not materially differ from their fair value at reporting date
- Revaluation decrements and increments are to be treated on an asset by asset basis, rather than on a class basis (**Public sector entities are exempt from this requirement**)
- Disclosure of cost base information where fair value is adopted (**Public sector entities are exempt from this requirement**).

In respect of public sector entities, transitional requirements are proposed in relation to regular revaluations to enable the continued use of progressive revaluations where prices are not fluctuating significantly and to allow public sector entities to maintain rolling revaluations over 5 years until 2004.

It should be noted that fair value measurement is compatible with the Deprival Value methodology.

If ED 92 is adopted in its current state, the AASB and AAS will differ in relation to the treatment of revaluation increments and decrements and the need to disclose cost base information.

Proposed application date is 31 December 1999

Comments closed 30 September 1998

ED 93 "Statement of Financial Performance and Ancillary Amendments"

This draft contains two sections. Section A proposes changes to AAS 1 "Profit and Loss or Other Operating Statements" and AASB 1018 "Profit and Loss Accounts" in order to harmonise with IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies". Main proposals in section A are:

- Adoption of the term "ordinary activities" in lieu of "ordinary operations" – the meaning will not change
- Adoption of the IAS 8 definition of extraordinary items to exclude discontinuing operation
- Separate disclosure of items of revenue and expense within the profit or loss or result from ordinary activities where their size, nature or incidence is relevant in explaining the performance of the entity
- Additional disclosures in relation to fundamental errors (prior period adjustments)
- Recognition of the effect of a change in accounting estimate in the period of the change if the change affects that period only, or in the period of the change and future periods if the change affects both. There is no such current requirement in AAS 1 or AASB 1018
- Disclosure of non-owner changes in equity as a separate component of the balance sheet along with disclosures of transactions with owners in their capacity as owners and transfers between reserves.

Section B of the draft proposes amendments to AAS 6 / AASB 1001 "Accounting Policies" in order to harmonise with IAS 8. The major proposals are:

- To specify that the accounting treatment of transitional provisions of a new accounting

- standard or UIG Consensus View should be dealt with in the new standard or UIG Consensus View
- Adoption of IAS 8 treatment for changes in accounting policies, other than changes arising from adopting new standards.

Comments are open until 31 October 1998

ED 94 "Concise Financial Reports"

This exposure draft prescribes the minimum content of a concise financial report as prepared by an entity in accordance with the requirements of Chapter 2M of the Corporations Law. As previously mentioned, Chapter 2M was introduced via the Company Law Review Act. ED 94 proposes that the concise financial report include:

- A profit and loss statement, a balance sheet and a statement of cash flows
- Discussion and analysis in relation to each financial statement
- Segment disclosure in accordance with AASB 1005 "Financial Reporting by Segments".

Operative date is on or after 31 December 1998 however can apply earlier as legislation was enacted on 1 July 1998

Comments closed 30 September 1998

Accounting Bulletins

AARF has commenced issuing Accounting Bulletins. These bulletins clarify the perfunctory questions arising in respect of the interpretation of standards. They will be issued on an as needs basis and are not official pronouncements of the AASB or PSASB, in this sense they are similar to media releases.

AB 1 "Application of AASB 1033 and AAS 33 to Compound Financial Instruments Issued on or after 1 January 1998"

The issue considered in this bulletin is whether an entity that has issued a compound financial instrument on or after 1 January 1998 is required to classify the instrument into liability and equity components in the period ending 30 June 1998.

The response is no. For periods ending on or after 1 January 1998 but before 31 December 1998, an entity need not classify into component parts compound financial instruments it issues, even if they are issued on or after 1 January 1998.

When preparing 30 June 1999 financial statements, entities will need to make retrospective adjustments to reclassify into component parts all compound financial instruments issued between 1 January 1998 and 30 June 1998 inclusive.

To avoid this retrospective adjustment, entities can elect to classify compound financial instruments issued between 1 January 1998 and 30 June 1998 into liability and equity components for the period ending 30 June 1998.

AB 2 "Optional Recognition of Land Under Roads"

This Bulletin was issued in response to the uncertainty of whether an entity should recognise land under roads as an asset while a working party of the PSASB is considering the issue.

The bulletin states that entities wishing to recognise land under roads should not be discouraged from doing so while this issue is being reviewed.

Refer to our previous comments in relation to Land Under Roads.

AB 3 "Accounting for Convertible Debt"

This bulletin clarifies the requirements of AAS 33 / AASB 1033 "Presentation and Disclosure of Financial Instruments" in relation to disclosing convertible debt as financial instruments and apportioning those financial instruments to their respective equity and liability components.

The bulletin considers an example of where an entity issues convertible debt and assigns the carrying amount to the liability component and then further provides practical responses to the subsequent accounting treatment for the following:

- The payment of the contractual obligations to the holder of the instrument
- The liability and equity elements appearing in the balance sheet
- The settlement of the instrument by payment or by issuing of shares.

Urgent Issues Group Update

UIG Abstract 19 "The Superannuation Contributions Surcharge"

The UIG agreed that the obligation to pay the superannuation contributions surcharge gives rise to a liability and expense of a superannuation plan. The liability is recognised only if it satisfies the probability and reliable measurement criteria in SAC 4 "Definition and Recognition of the Elements in Financial Statements".

Disclosure of the following specific information is required:

- The accounting policy adopted for the recognition of the surcharge
- The amount of the liability and expense recognised in the reporting period
- Whether there is any unrecognised liability for the surcharge at reporting date and the reasons for non-recognition.

The consensus view is applicable on or after 30 June 1998, however the Abstract explains that for most superannuation plans, particularly in the early years of operation of the surcharge legislation, a reliable measure of the liability may be difficult until such time as a surcharge assessment is actually received by the plan.

Accounting for Major Periodic Maintenance

The UIG has included this topic in its active work program. This issue relates to whether the practice of establishing a provision (liability) for future maintenance expenditure is consistent with current guidance in SAC 4 and the requirements of AAS 4 / AASB 1021 "Depreciation".

WHAT'S NEW IN AUDITING?

Auditing and Assurance Standards Board

The Auditing Standards Board is now known as the Auditing and Assurance Standards Board (AuASB). The new name reflects the changing environment of the auditing profession. Auditors' roles are now expanding beyond traditional financial reporting functions to a broader range of 'assurance' services that enhance information credibility on a wide range of subject matters.

The relevance of this change for QAO is highlighted in the increasing audit service areas being provided by QAO, in particular performance management systems appraisal audits and more recently probity audits.

New and Revised Auditing Standards

AUS 514 "Audit Sampling and Other Selective Testing Procedures"

The revised standard has extended its scope to encompass other selective testing procedures. Guidance is provided on the selection of specific items for testing to cover selection of high value or key items, items that provide information on a client's business, nature of the transactions or accounting and internal control systems, and items to test that a particular internal control procedure is being performed.
The remainder of the standard is substantially unchanged.

Operative from 1 July 1998

Auditing Exposure Drafts

ED 69 "Special Considerations in the Audit of Small Entities"

ED 69 is based on an international exposure draft of a proposed International Auditing Practice Statement of the same name. ED 69 has been modified to reflect Australian requirements. The exposure draft reinforces the principle that AUS's are applicable to the audit of small entities. Content include:

- A discussion on the features of small entities
- Guidance on the application of AUS's to the audit of small entities
- Guidance on the implications of the auditor's work where that auditor is also providing accounting services to the small entity, as permissible under the Code of Professional Conduct jointly issued by the ASCPA and ICAA.

ED 70 "Communication with Management on Matters arising from an Audit (AUS 710)"

ED 70 proposes amendments to AUS 710 of the same name. The amendments include:

- A requirement for audit to communicate on corporate governance issues
- Provision of written management communication at or near completion of the audit in order to meet management expectations, including a 'no matters to report' communication.

Auditing Guidance Statements

AGS 1014 "Privity Letter Requests"

The AGS has been updated following the judgement of the High Court in 1997 in *Esanda Finance Corporation Limited v Peat Marwick Hungerford.*

This guidance statement relates to circumstances where third parties such as investors, lenders or providers of goods or services seek reliance on a general purpose financial report.

The guidance statement alerts auditors to the risks associated with a privity letter request. It provides guidance as to how to reduce the risk of undue reliance on the auditor's report in specific circumstances.

The AGS includes a number of sample letters to cover the following situations:

- Auditor declines responsibility
- Auditor acknowledges responsibility to a third party seeking general reliance on an audited general purpose financial report and the auditor's report thereon.

Operative from February 1998

Addendum to AGS 1034 "Implications for Management and Auditors of the Year 2000 Systems Issue"

The addendum reinforces the auditor's need to consider the impact of the Year 2000 issue when auditing or reviewing half-yearly financial reports.

The addendum also provides guidance on appropriate wording for letters of engagement and management representation letters in relation to this issue.

Operative from July 1998

INTERNATIONAL DEVELOPMENTS

The International Accounting Standards Committee (ISASC) has approved the following two International Accounting Standards and one Exposure Draft:

IAS 35 "Discontinuing Operations"

This is a presentation and disclosure standard. It focuses on how and what information is to be presented in a discontinuing operation's financial statements.

Operative date is 1 January 1999

IAS 36 "Impairment of Assets"

This standard specifies the methods to use to ensure the carrying value of an asset is not impaired. That is, to ensure the carrying value does not exceed its recoverable amount through use or sale of the asset. The standard prescribes the accounting treatment for impairment loss and the disclosures required.

Operative date is on or after 1 July 1999

E 62 "Financial Instruments: Recognition and Measurement"

E 62 proposes recognition of all financial assets and financial liabilities on balance sheet, including derivatives. They would initially be measured at cost (ie. fair value of the price paid or received to acquire the financial asset or liability).

Subsequent to initial recognition, all financial assets would be re-measured to fair value, except the following, which are carried at amortised cost:

- Fixed maturity investments such as debt, loans, receivables and mandatory redeemable preference shares, that an entity intends and is able to hold to maturity
- Financial assets whose fair value cannot be reliably measured.

In contrast, most financial liabilities after acquisition will be measured at original recorded amount less principal repayments and amortisation. Only derivatives and trading liabilities are remeasured to fair value.

FOR YOUR INFORMATION

Guide for Members of Government Boards, Committees and Statutory Authorities

The Department of the Premier and Cabinet has prepared the above guide. The guide examines the roles of government boards and committees, the role of key players, selection, nomination and recruitment, remuneration, induction, duties and responsibilities of board members, liability and indemnity and evaluation of board performance.

A copy of this guide is available from QAO's Technical Services Unit or Department of Premier and Cabinet.

Better Practice Guide on Corporate Governance

The Audit Office of New South Wales has issued the above guide. The guide is designed to assist governing boards and advisory boards/committees to review their present governance practices and to develop strategies to align them with better practice. It addresses key factors that impinge on board effectiveness and efficiency.

A copy of the guide can be obtained from the Performance Audit Branch of the Audit Office of NSW on (02) 9285 0058 or fax (02) 9285 0060

Income Taxes – publication by ASCPA

To bring members up-to-date with the new methodology proposed in Exposure Draft 87 "Income Taxes", the ASCPA's External Reporting Centre of Excellence has released a publication "Towards a New Income Tax Accounting Standard".

What's new on Treasury's web site?

The following new documents, publications and financial management policies are new on Treasury's web site.

1998-99 Budget Papers

Budget Speech, Overview of the Budget, Capital Outlays, Budget in Brief

QGFMS Lead Agency Strategic Plan 1998 - 2003

Contents include:

- Lead agency mission and values
- QGFMS: Concept, roles of key stakeholders and agencies
- The strategic framework and critical success factors
- Key outcomes

- Performance Criteria
- Strategies

Leasing in the Queensland Public Sector – Policy Guidelines

The guidelines address the following issues in relation to asset leasing:

- The responsibilities of public sector entities to ensure prudent financial management with regard to the lease vs buy decision
- The distinction between an operating lease and a financial lease and the methodologies which should be used to classify a lease
- The transfer of risk in the residual value of an asset associated with the use of operating leases
- The powers of public sector entities to enter into lease arrangements
- Lease documentation and other associated issues
- Bundling of services in lease transactions.

Physical Asset Strategic Planning Guidelines

This document describes physical asset strategic planning, the process involved, what should be included in a physical asset strategic plan and provides an example of a plan.

Source: Reproduced with the permission of Qld Treasury. Further information may be obtained from Treasury's website at www.treasury.qld.gov.au

COPIES OF REPORTS AND PUBLICATIONS

QAO's other publications (eg. Best Practice Guidelines, Auditor-General's Reports to Parliament) are available free of charge and may be obtained by ringing QAO on (07) 3405 1100. These publications are also available on our web site.

Copies of Australian Exposure Drafts, Standards, Australian Accounting Standards Board and Australian Accounting Research Foundation (AARF) publications can be obtained by contacting the Customer Service Officer, AARF, 211 Hawthorn Road, Caulfield, Victoria 3162 (tel 03 9524 3637 or fax 03 9523 5499 or email standard@aarf.asn.au).

Copies of International Accounting Standards, Exposure Drafts and International Accounting Standards Committee (IASC) publications may be obtained direct from the IASC, 166 Fleet Street, London EC4A 2DY, United Kingdom (tel +44 (171) 353 0565 or fax +44 (171) 353 0562 or email iasc@iasc.org.uk or Internet **http://www.iasc.org.uk**).

QAO in-charge auditors are usually first point of contact for technical matters. QAO Technical Services unit provides technical and policy advice to QAO in-charge auditors and staff.