

INFORM

Accounting and auditing update, news, information and QAO views



INFORM is published to provide information to our clients and contractors about recent reports and activities of the Auditor-General; emerging issues relevant to Queensland public sector agencies; themes and lessons from our audits that have a broader application across the public sector; and current developments in accounting and auditing.

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A message from the Auditor-General

Welcome to this edition of INFORM.

QAO's vision is that we can positively contribute towards the achievement of "excellence in enhancing public sector accountability". I am passionate about the public sector and its importance in lifting the well being of the community. I believe that an efficient public service is a vital building block for the growth and development of any community.

The work that QAO undertakes is a critical part of the process of encouraging the public sector to operate as efficiently and effectively as possible. We can also take action to highlight areas for improvement in the delivery of services to Queenslanders. Where possible my recommendations in Reports to Parliament will clearly focus on improvement opportunities.

In the Government's Special Fiscal and Economic Statement of October 2005, the Honourable the Premier announced that as part of the Government's commitment to ensuring appropriate independent scrutiny of the performance of government agencies, the existing mandate of the Auditor-General for undertaking audits of performance management systems would be extended. In particular, The Special Fiscal and Economic Statement identified that the mandate would be extended to allow for performance management systems audits undertaken by QAO to include an assessment of the relevance of published measures used by agencies to assess their performance.

Since becoming Auditor-General I have tabled four reports on the results of financial and compliance audits. Reporting on diverse public sector entities in these Reports brought to the fore a number of common governance issues. Identifying these issues has confirmed my belief that a one size fits all governance regime across the public sector is not the solution. Information is included on page 5 on elements which should be considered when implementing good governance in the public sector regardless of the governance structure in place.

You may notice that the format and content of INFORM has changed. We have recognised that most of the users of INFORM are time poor so high level summaries of issues have been provided which include themes and lessons from our audits, examples of better practice and references to where further information can be obtained. We have focused on the important issues for public sector entities such as recent changes to legislation, guidelines and policies which have a financial impact and have included references to new guidance publications on topical issues. We also want to let you know a little about what is happening in QAO such as key staffing changes and emerging issues.

I am confident that you will find articles of interest to you in this issue of INFORM.

Glenn Poole
Auditor-General

Contemporary issues and better practice

Strategies for earlier financial statement preparation

While financial statements for departments, statutory bodies and government owned corporations have in the main been completed within legislative timeframes, there are always opportunities to improve the efficiency and effectiveness of the financial statements process to ensure timelier reporting for the Parliament and the community of Queensland.

Early planning is critical to the achievement of a more efficient and effective financial statement process. In Report No. 4 for 2005, we outlined strategies for earlier financial statement preparation, including planning the process, preparing financial statements and verifying financial statements. In 2005-06, QAO's auditors will consider the possible implementation of new strategies, including 'hard closes', when planning audits and in negotiating financial statement timetables with our clients.

A Better Practice Guide has now been developed to assist entities in earlier planning to achieve a more efficient and effective financial statement process. Key strategies are outlined below —

Planning the process

- Prompt financial statement production needs to be viewed as a critical business process.
- Developing and distributing a timetable ensures everyone knows what needs to be achieved.
- Ongoing monitoring ensures the process stays on track.
- An appropriate level and number of staff should be involved with the requisite skills and knowledge to deliver a quality outcome.

Preparing financial statements

- Faster finishing can be aided by early decisions on accounting policy changes.
- Hard closes and trial run financial statements may assist in faster statement finalisation.
- Ongoing monitoring ensures the process stays on track.

Verifying financial statements

- Well prepared financial statement working papers facilitate a more effective verification process.

- Quality control assists in identifying errors prior to certification of the financial statements.

The Better Practice Guide was launched at the QAO Client Information Session on 22 February 2006 and is available on our website www.qao.qld.gov.au.

Management of infrastructure assets by local governments

Information relating to unfunded depreciation by local governments has been reported in a number of Auditor-General's Reports to Parliament. However it is apparent that there is not a widespread and common understanding of what unfunded depreciation means or what the implications are for a council with unfunded depreciation.

While unfunded depreciation has been the primary focus for many in the local government sector, it is important to recognise that this is but one element of infrastructure asset management and needs to be addressed and managed in that context.

A new guide, [Management of Infrastructure Assets by Local Governments](#), has been developed by QAO to provide mayors, councillors, chief executive officers and accountants of local governments with a clearer understanding of unfunded depreciation and its causes and implications, within the overall context of management of infrastructure assets. The guide, presented in a question and answer format, answers questions such as —

- Why do we need to manage our infrastructure assets?
- How do we make sure we charge the right amount of depreciation?
- What happens if we don't have a balanced operating budget?
- Do we have to fund depreciation on assets that will not be replaced?

The guide is available at www.qao.qld.gov.au.

Output performance measurement and reporting

In 2005, QAO conducted a series of performance management systems audits across Queensland public sector agencies to assess whether the systems and processes used by departmental agencies were robust enough to support reliable and timely reporting of output performance information to Parliament. The findings from these audits were published in the Auditor-General's Reports No. 3 and No. 5 for 2005.

Reporting on performance measures is not a precise science. We manage and operate in complex and interrelated systems, and performance measures are therefore only ever an approximation of real life outcomes. Performance measures are just one of the many tools we can use to help us better understand what we do.

Better Practice Output Performance Measurement and Reporting requires appropriate performance measures and —

(A) A robust output performance measurement framework —

- a formal organised structure for performance measurement and reporting;
- clearly defined roles, responsibilities and accountabilities for output performance measurement and reporting;
- well documented data quality standards and expectations for output performance information which are clearly communicated across the agency;
- monitoring and quality assurance procedures for performance information which enable assessment of the agency's service delivery; and
- integrating internal management reporting processes and accountabilities with reporting of output performance information.

(B) Effective systems for collecting, validating and using output performance information —

- data assurance arrangements for output performance information, including adequate documentation of data sources, collection methods, standards and procedures and clear management trails of data calculations;
- approved costing methodologies established and supported by appropriate assumptions and adequate documentation;
- controls established over data collection and processing to ensure the accuracy, completeness and reliability of performance information including input, validation and monitoring controls; and
- processes for the ongoing analysis and evaluation of output performance information and measures including variance analysis of results and progress to date against targets.

(C) Appropriate presentation and reporting of output performance information —

- an adequate management trail in place to support the external reporting of output performance information;
- fair presentation of output performance information in external reporting, including accompanying notes clearly explaining the context, variances and any limitations in the data reported; and
- adequate linkages and alignment of output performance information reported in the external accountability reporting documents with that included in an agency's Annual Report.

A performance measures or 'data' dictionary documents the attributes of a performance measure and helps us understand what performance measures mean, know what their limitations are, and assists us in identifying how they can be better used to achieve the positive outcomes we strive for.

A Better Practice Guide has been developed by QAO which includes the following guidance —

- a better practice checklist which brings together the minimum requirements for effective performance measurement and reporting;
- a checklist of items to consider when compiling a performance measures dictionary;
- a summary of our audit recommendations from Reports No. 3 and No. 5; and
- a list of the primary references used in this series of audits.

The Better Practice Guide is available at www.qao.qld.gov.au.

Governance in the public sector

There have been some major reviews of public sector governance performed in Australia in recent years, the most significant being the Review of the Corporate Governance of Statutory Authorities and Office Holders (the Uhrig Review) commissioned by the Prime Minister in November 2002 to identify reforms that might assist in improving the performance of those federal bodies, without compromising their statutory duties.

The Uhrig Review released in August 2004 identified a number of elements considered to be central to the governance of entities, irrespective of whether they operate in the public or private sector.

- **Understanding success** – meaning that those in control need to be clear about what the entity is to achieve and communicate that effectively to management.

- **Organising for success** – meaning that once an entity has developed an understanding of what it needs to achieve, it should be organised appropriately. This includes implementing the right organisational structures, clarifying roles and responsibilities and appropriately granting, delegating, limiting and exercising power.
- **Making sure success is achieved** – by ensuring individuals responsible for performance understand what outcomes they are required to achieve and are provided with the capacity to achieve them.

Overall, the Uhrig review found there was a lack of effective governance for a number of the federal agencies reviewed. This was due to several factors, including unclear boundaries about what agencies had been delegated, a lack of clarity in the relationships with Ministers and portfolio departments, and a lack of accountability for the exercise of power.

Due to the diversity of operations in the Queensland public sector, different governance frameworks operate within the different types of public sector entities. Statutory bodies, government owned corporations and local governments more closely resemble the private sector in that they have management boards constituted under legislation, non-executive members on the board and usually a non-executive member as chairperson.

There is sometimes a perception that companies established or acquired by public sector entities are separated from the public sector and are not strictly public sector entities, but all public sector entities must be subject to the same high level of governance and accountability mechanisms, regardless of size or type.

When it comes to governance, it is clear there can not be one framework, one system, or one reporting method that fits all public sector entities. Governance should be designed to fit the specific organisation. It should be inclusive of a diversity of stakeholder views, and relevant to internal and external stakeholders.

The following elements must be considered to ensure good governance in public sector companies.

Appropriate organisational vehicles

The company structure is not always the appropriate structure to achieve the outcome that is actually required and should only be used once all other possibilities have been considered and determined to not be applicable.

Reporting structures

The creation and maintenance of a good governance regime is essential, particularly for companies which are effectively controlled by a number of public sector entities.

Directors' responsibilities

When several public sector entities are shareholders in a company there can be a blurring of the accepted roles of directors and shareholders. Directors are often employees of the shareholding departments. Directors may be expected to undertake management responsibilities within the company and also be responsible for the oversight of the investment in the company on behalf of the individual shareholders. This may conflict with the responsibility that directors have to act in the best interests of the company.

Quality public sector Reporting

Good quality information and reporting is not just important for board and shareholders of public sector companies but for all users of public sector information. Good reporting on both financial and operational performance aspects is central to public sector governance and accountability.

Relationship between QAO and audit committees

Audit committees are a crucial component of the governance framework and should act as a liaison between external audit - QAO - and the accountable officer. For this reason, it is essential that a co-operative relationship is maintained between audit committees and QAO. Public sector audit committees can assist QAO and ensure independence by considering the following —

Committee independence

- ☒ The role of an audit committee is one of corporate governance - it is not a management committee.
- ☒ The committee must provide assurance over the independence of committee members from matters discussed at committee meetings.

Access to members

- ☒ QAO should have the opportunity to speak from time to time directly with the audit committee in the absence of management and Internal Audit.

Relationship between QAO, internal audit and the audit committee

- Appropriate channels of communication and protocols should be established to ensure an open relationship between QAO, internal audit and audit committees.
- The Committee should assist in co-ordinating the assurance activities between internal audit and QAO.
- Protocols should be established to enable the Chief Executive Officers and the audit committee to determine the scope of the work program to be undertaken by internal audit. As QAO endeavours to rely on the work of internal audit to the greatest extent possible, any changes to the agreed program for internal audit should be discussed with QAO as soon as possible to minimise any subsequent impacts on the external audit work plan.

Attendance at meetings

QAO should have a standing invitation to attend all aspects of audit committee meetings and should —

- be provided with copies of the agenda and papers prior to the meeting;
- be provided with the opportunity to include matters on the meeting agenda or raise additional matters at the meeting, where it is considered necessary; and
- have access to minutes of completed meetings.

Agencies should also refer to the Guidelines on Audit Committees issued by Treasury Department as well as other better practice guides, including the Australian National Audit Office's recently updated Better Practice Guide on Audit Committees available at www.anao.gov.au.

Accounting and auditing update

Progress in the adoption of Australian equivalents to International Financial Reporting Standards (AeIFRS)

For reporting periods commencing on or after 1 January 2005, Australian entities are required to adopt the requirements of the Australian equivalents to International Financial Reporting Standards (AeIFRS) in preparing financial statements. For entities with a reporting date of 30 June, the time for preparing the first published financial report prepared in accordance with AeIFRS is fast approaching.

To ensure this financial report can be produced in a timely manner and in compliance with AeIFRS requirements the reporting entities should already have completed the following steps —

- Finalisation and approval of all significant accounting policies to be adopted under AeIFRS;
- Preparation of an opening AeIFRS balance sheet and review of the opening balance sheet to ensure it accurately reflects any subsequent changes to approved accounting policies; and
- Recasting of balances reported for the previous financial year to ensure compliance with approved accounting policies adopted under AeIFRS.

It will also be important for reporting entities to ensure appropriate involvement of QAO auditors in the auditing of key deliverables in the lead up to the preparation of the first AeIFRS compliant financial report. This will ensure the timely identification and resolution of matters likely to impact on the financial statements.

Some public sector entities with an earlier financial reporting date than 30 June, have already completed their first AeIFRS compliant financial statements. These statements have been audited by QAO and no significant issues relating to the adoption of AeIFRS were identified during these audits.

Harmonisation of GFS with GAAP

One of the biggest emerging challenges facing accountants in the public sector will be the harmonisation of government finance standards (GFS) with the generally accepted accounting principles (GAAP).

The aim in converging these two frameworks is to achieve an Australian accounting standard for a single set of government financial reports that are auditable, comparable between jurisdictions and in which the outcome statements are directly comparable with the relevant budget statements. In progressing this project the Australian Accounting Standards Board (AASB) released for comment Exposure Draft ED 142 Financial Reporting of General Government Sectors by Governments in July 2005. ED 142 proposed that each General Government Sector (GGS) prepare a General Purpose Financial Report adopting a partial-consolidation basis and disclosing convergence differences between GFS and GAAP.

After considering submissions received on ED 142, the AASB decided to continue developing a standard for the GGS based on the proposals contained in ED 142 amended, where appropriate, to account for comments received from respondents to ED 142. The AASB also decided that rather than the application date of 1 July 2006 included in ED 142, the mandatory application date of the standard would be determined at a future meeting. In due course the AASB also intends to develop an issues paper considering the extent to which the Board's decisions for reporting by GGSs should be applied to other public sector entities.

In accordance with these decisions the AASB prepared Draft Accounting Standard Financial Reporting of General Government Sectors by Governments for consideration at their meeting of 7-8 June 2006.

For more information, visit the AASB website www.aasb.com.au.

“Force of law” auditing standards

On 1 May 2006 the Auditing and Assurance Standards Board (AUASB) issued their set of revised auditing standards which will be legally enforceable for audits conducted under the Corporations Act 2001. The standards also apply to audits of financial reports for other purposes and as such will be applied by QAO in conducting audits of public sector entities. The application of these reissued auditing standards to audits conducted by QAO will also be reinforced through the QAO Auditing Standards issued pursuant to section 97(1) of the *Financial Administration and Audit Act 1977*.

In drafting the reissued standards the AUASB have attempted to clarify —

- The mandatory requirements of the standards, while providing guidance on how these requirements can be implemented; and
- The level of documentation required to support the exercising of professional judgment by auditors in applying the standards.

The AUASB has also aimed to enhance public confidence in the work of auditors, through the inclusion of ethical requirements in the auditing standards.

The new standards, renamed as “ASAs”, will apply to audits of financial reports that are conducted for reporting periods commencing on or after 1 July 2006. The existing standards continue to apply to audits conducted during the current financial year.

At present QAO consider that there will be no impact on costs for the 2005-06 audits undertaken by QAO and its contract auditors. Any areas identified that impact on QAO audit processes and audit costs for the 2006-07 financial year are expected to be minimal and, where identified, will be discussed with management when delivering QAO Client Audit Strategies for the 2006-07 financial year. Contract auditors will also need to discuss with QAO any specific areas identified as likely to result in a change in audit requirements leading to an increase in the proposed audit fee for 2006-07 prior to the proposed fee being approved and advised to management of the entity being audited.

For more information, including copies of the standards, visit the AUASB website at www.aasb.gov.au.

Sector-neutral accounting standards

With the adoption of Australian equivalents to International Financial Reporting Standards (AeIFRS) the AASB is adopting a strategy of incorporating financial reporting requirements into topic-based standards rather than industry-based standards. This has included the Board proposing the withdrawal of standards specifically applicable to the public sector, namely, AAS 27 Financial Reporting by Local Governments, AAS 29 Financial Reporting by Government Departments and AAS 31 Financial Reporting by Governments. In support of this strategy the AASB released a revised strategy paper as at 28 February 2006 on Australian Accounting Standards and Public Sector Entities.

The proposed withdrawal of AAS 27, 29 and 31 represents a potential risk to financial reporting requirements of public sector entities where AeIFRS requirements do not adequately address issues specific to public sector entities.

To minimise these risks the AASB has undertaken a paragraph-by-paragraph review of AAS 27, AAS 29 and AAS 31 to identify those requirements that are adequately addressed through the AeIFRS requirements and those that are not presently addressed and are required to be incorporated into these standards. The AASB intend to issue an Exposure Draft proposing that AAS 27, AAS 29 and AAS 31 be withdrawn for reporting periods ending on or after 30 June 2007, with earlier adoption allowed.

Even if the AASB are able to ensure all financial reporting requirements presently contained in these standards are adequately addressed through the AelFRS, they will also need to ensure that an appropriate focus on public sector issues and public sector reporting is maintained in the future development of topic based Standards.

For more information, visit the AASB website www.aasb.com.au.

In November 2005 the Financial Reporting Council (FRC) engaged a consultant to undertake research into how adequately a “sector neutral” approach to the development of accounting standards can meet the information needs of users of financial statements and the public interest more generally. In response to this review CPA Australia have prepared a submission to the consultant summarising the views of CPA Australia’s public sector members obtained through a series of Think Tanks and an online survey. This included input from the Auditor-General of Queensland at the Brisbane Think Tank on 23 January 2006.

For more information, visit CPA website www.cpaaustralia.com.au.

Valuation of assets damaged by Cyclone Larry

A number of queries were recently received as to how damage caused by Cyclone Larry should be taken into account in valuing assets in the 2005-06 financial statements. Entities are reminded that where items of Property, Plant and Equipment are recorded at fair value under AASB 116 Property, Plant and Equipment, the value of the asset at reporting date should be reflective of the present condition of the asset. This would mean that, unless the asset has been repaired prior to the reporting date, items of property, plant and equipment would need to be valued based on their damaged condition.

The damaged condition of items of property, plant and equipment would also need to be considered as a factor indicating impairment when undertaking tests for impairment under AASB 136 Impairment of Assets.

Electronic presentation of audited information

INFORM 16 identified that QAO had revised its policy relating to the inclusion of signatures on independent audit reports for financial statements published on websites and other electronic media. While under the revised policy it is permissible to include the signatures, entities were requested to include an appropriately worded disclaimer.

This disclaimer was required regardless of whether the signatures were or were not included in the electronic version of the financial statements. In reviewing a sample of financial statements of public sector entities for 2004-05 published on websites, QAO identified a large number of entities which did not include the required disclaimer.

To clarify the position with regard to the use of disclaimers, there are two disclaimers required in relation to the presentation of financial statements on websites. The first is a general disclaimer required by the agency to be placed on its website which is as follows —

Disclaimer

The materials presented on this site are provided by the Queensland Government for information purposes only. Users should note that the electronic versions of the financial statements on this site are not recognised as the official authorised version. The electronic versions are provided solely on the basis that users will take responsibility for verifying their accuracy, completeness and currency. Although considerable resources are used to prepare and maintain the electronic versions, the Queensland Government accepts no liability for any loss or damage that may be incurred by any person acting in reliance on the electronic versions.

The second disclaimer is required to be included within the independent audit report for the electronic version of the financial statements —

Matters Relating to the Electronic Presentation of the Audited Financial Report

The audit report relates to the financial report of [name of entity] for the financial year ended 30 June {insert year} included on [name of entity’s] web site. The Accountable Officer [or equivalent] is responsible for the integrity of the [name of entity’s] web site. We have not been engaged to report on the integrity of the [name of entity’s] web site. The audit report refers only to the statements named below. It does not provide an opinion on any other information which may have been hyperlinked to/from these statements. If users of the financial report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial report, available from [name of entity], to confirm the information included in the audited financial report presented on this web site.

This paragraph must be included between the Addressee (i.e. to the Accountable Officer [or equivalent]) and the Scope section of the Independent Audit Report. This paragraph also relates to the presentation of the audited financial report in other electronic media including CD Rom.

