

INFORM

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Highlights

Welcome to edition 2 of INFORM for 2008. The focus of this edition is on:

- fraud prevention and detection
- public sector specific standards
- audit costs
- EQCR.

We hope these topics are of value to you.

Any feedback on this issue or suggestions for articles for the future would be appreciated. You can contact us via Inform@qao.qld.gov.au

PAC hearing

The role of the Public Accounts Committee (PAC) is to assess the integrity, economy, efficiency and effectiveness of Government financial management. Part of how it achieves this is by considering the reports of the Auditor-General and following up on matters raised in the reports to Parliament.

In February the committee held a public hearing on Report No. 4 for 2007 which was titled *Are departmental*

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PAC hearing (cont)

output performance measures relevant, appropriate and a fair representation of performance achievements?

Representatives from the Departments of Education, Training and the Arts, Tourism, Regional Development and Industry, Treasury, Queensland Police Service and the Environmental Protection Agency attended the hearing.

As well as following up on progress made by the agencies on the recommendations made in the report, the PAC were interested in discussing some specific

issues. These included the minimal alignment between the measures reported in the departments' strategic and operational plans, the MPS and the annual reports, and the development and implementation of suitable costing methods to identify the cost of products and services.

The findings of the PAC Hearing will be reported and tabled in the Parliament at the conclusion of the Committee's inquiries.

Withdrawal of standards

In July 2005 the Australian Accounting Standards Board (AASB) proposed the withdrawal of the following standards:

- AAS 27 *Financial Reporting by Local Governments*
- AAS 29 *Financial Reporting by Government Departments*
- AAS 31 *Financial Reporting by Governments.*

This proposal is based on significant developments in Australian financial reporting, including the introduction of Australian Equivalents to International Financial Reporting Standards (AEIFRS) which are based on principles of

“sector-neutrality”. As a result the AASB undertook a project for reviewing the requirements in AASs 27, 29 and 31 as part of a two-phased approach.

A short-term review of the requirements by the AASB focused on relocating

“The new and revised standards apply to financial reporting periods commencing on or after 1 July 2008.”

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requirements in AASs 27, 29 and 31 into either existing or new topic-based Standards. This was based on whether requirements were adequately provided for in the existing Standards. The longer-term review will focus on improving the relevant requirements, where necessary.

Because of the short-term review phase, the AASB at its December 2007 meeting announced that AASs 27, 29 and 31 would be withdrawn and the requirements reallocated in the following manner.

New standards

The following new topic-based Standards were introduced on the withdrawal of AASs 27, 29 and 31:

- AASB 1050 *Administered Items*
- AASB 1051 *Land Under Roads*
- AASB 1052 *Disaggregated Disclosures*.

Revised standards

As well as the new standards, AASB 2007-9 *Amendments to Australian Accounting Standards arising from the Review of AAS 27, AAS 29 and AAS 31* was released amending the following existing standards:

- AASB 3 *Business Combinations*
- AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*
- AASB 8 *Operating Segments*
- AASB 101 *Presentation of Financial Statements*

- AASB 114 *Segment Reporting*
- AASB 116 *Property, Plant and Equipment*
- AASB 127 *Consolidated and Separate Financial Statements*
- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

Accounting Standard AASB 1004 *Contributions* was also amended to accommodate accounting requirements for contributions previously found within AASs 27, 29 and 31.

The previously released AASB 1049 *Financial Reporting by General Government Sectors* was revised and re-released in October 2007 as AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. This change accommodated financial reporting requirements at the Whole of Government level previously contained within AAS 31.

These new and revised accounting standards do not contain any significant substantive changes to the existing accounting requirements for local governments, departments and Whole of Government. Though relevant agencies should familiarise themselves with the amendments to enable them to identify where relevant accounting requirements are located. The new and revised standards apply to financial reporting periods commencing on or after 1 July 2008.



Training & Industry

Fraud prevention and detection in government

With Shaun Mayfield, Audit Manager



Fraud is a major problem for all organisations and accounts for approximately thirty one per cent of all crime in Australia.¹

“The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and with management” as stated in ASA 240.²

Underestimating the size of this problem can have a significant impact on the Queensland public sector. According to the 2006 Association of Certified Fraud Examiner’s (ACFE) *Report to the Nation on Occupational Fraud & Abuse 2006*, the typical organisation loses approximately 5 per cent of its annual revenue to occupational fraud.³

According to the ACFE, fraud in the Government sector (11.5 per cent) was second only to the Banking and Financial Services sector (14.3 per cent), in reported cases of fraud.

The Australian Auditing and Assurance Standards Board (AUASB) defines fraud as “an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of intentional misstatement are relevant to the auditor, that is, misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets...”

Fraud can be divided into three main categories, asset misappropriation, corruption, and fraudulent financial statements.

According to ACFE, asset misappropriation involves the theft or misuse of an organisation’s assets e.g. skimming revenues, stealing inventory or committing payroll fraud, and accounts for 91.5 per cent of all cases with a median loss of \$150,000 within government.

Corruption, where fraudsters wrongfully use their influence in a business transaction to procure some benefit for themselves or another person(s), e.g. by accepting kickbacks or engaging in conflicts of interest, accounts for 30.8 per cent of all cases with a median loss of \$538,000 within government.

Fraudulent financial statements, involving the falsification of an organisation’s financial statements e.g. include overstating assets and revenues, or understating liabilities or expenses for personal gain, were the least common with 10.6 per cent, but had the largest impact (Median loss - \$2,000,000) when they did occur.

The most common schemes occurring in government involved, billing schemes (procurement fraud) and non-cash theft each occurring in 21.8 per cent of all reported cases. Although payroll fraud followed a close third at 21.0 per cent, the incidence of this type of fraud was higher in government than any other industry surveyed, and has increased by three per cent over the last two years.⁴

Three elements are generally present when fraud exists. Incentive or pressure to commit fraud (e.g. unrealistic deadlines, greed, or lifestyle), perceived opportunity (generally due to a poor internal controls), and some form of rationalisation of the act (e.g. discontented or disgruntled employees). Although it is impossible to eliminate these elements from an agency, the implementation of simple strategies can help to reduce the incidence of fraud.



The provision of counselling services to employees can help resolve home and work related pressures before they become a problem. Active promotion of zero tolerance for fraud through fraud awareness training, and the implementation of continuous monitoring techniques to identify risk hot spots, can help to address the perceived opportunity for fraud.

Providing an anonymous mechanism (e.g. electronic suggestion box) where employees can air grievances, providing input for change in an organisations operations and providing a management response, can help to remove the perceived rationalisation for fraud.

Occupational fraud, in any industry is difficult to detect. According to ACFE, the most effective method of detecting fraud losses is through the use of anonymous fraud hotlines.

Organisations using hotlines had median losses of \$100,000 per scheme and were detected, on average within 15 months. Those without hotlines suffered twice the median loss (\$200,000), and took 24 months to detect their frauds.

Similar results regarding median losses and time periods were recorded where organisations conducted surprise audits, or anti-fraud training for their employees.

According to the ACFE fraud perpetrators have the following characteristics:

- The majority of occupational fraud cases are committed by managers (41.2 per cent), and employees (39.5 per cent).
- The higher the position in the organisation the greater the median loss (i.e. owners/executives - \$1,000,000, managers – \$218,000, employees – \$78,000).

- Most fraud perpetrators (87.9 per cent) have not previously been charged or convicted of a crime.
- Approximately 61 per cent of the fraud cases were committed by men. The median loss resulting from fraud by men was \$250,000 which is more than twice the median loss attributable to women.
- Nearly 40 per cent of all fraud cases are committed by two or more individuals. The median loss in these cases is \$485,000, almost five times greater than fraud cases involving one person.

QAO is currently conducting its own review over the status of Fraud Management Frameworks across a range of public sector agencies. The review will examine risk management policies and procedures adopted by public sector agencies for managing exposure to fraud.

The results of this review will be released in the Auditor-General's Report to Parliament No. 4 in June 2008.

- 1 Australian Institute of Criminology 2003.
- 2 Australian Auditing Standards.
- 3 Queensland Government - Consolidated Financial Statements 2006-07, Revenue from Continuing Operations, \$41.116 billion.
- 4 Association of Certified Fraud Examiner's (ACFE) Report to the Nation on Occupational Fraud & Abuse 2006.

“QAO is currently conducting its own review over the status of Fraud Management Frameworks across a range of public sector agencies...”



Source: Association of Certified Fraud Examiner's (ACFE) Report to the Nation on Occupational Fraud & Abuse 2006

Training & Industry



What is an EQCR?

Engagement Quality Control Review (EQCR) is defined in the Auditing Standard ASA 220 *Quality Control for Audits of Historical Financial Information* as, “A process designed to provide an objective evaluation, before the auditor’s report is issued, of the significant judgements the engagement team made and the conclusions they reached in formulating the auditor’s reports.”

For 2007-08, the Deputy Auditor-General, Mr Val Manera, is to undertake the role of EQCR for all of QAO’s significant audits. In general terms, significant audits are those with an audit fee greater than \$100,000.

Matters for consideration by EQCR are also set out in ASA 220 and include consideration of:

- the engagement team’s evaluation of QAO’s independence in relation to the specific audit engagement
- significant risks identified during the engagement and responses to those risks
- judgements made particularly with respect to materiality and significant risks
- whether appropriate consultation has taken place on matters involving

differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations

- the significance and disposition of corrected and uncorrected misstatements identified during the audit
- the matters to be communicated to management and those charged with governance and, where applicable, to other parties such as regulatory bodies
- whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached
- the appropriateness of the auditor’s report to be issued.

The review is to be conducted progressively at appropriate stages during the audit so that significant matters can be promptly resolved to the EQCR’s satisfaction before the audit report is issued.

Other considerations the Deputy Auditor-General as EQCR must take into account include:

- remaining independent from the engagement team
- not making decisions for the audit team
- being consulted on complex/ contentious issues
- not diminishing the Engagement Leader’s responsibility for the audit
- not replacing other internal quality review of audits.

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Audit fees revisited

A question we often are asked is why do we need to charge fees since we are auditing government entities.

The Auditor-General may, under the *Financial Administration and Audit Act 1977*, charge fees when he conducts an audit. While no-one likes to pay for a service they are obligated to receive, by providing an estimate of the fee at the beginning of the audit, there should be no nasty surprise at the end.

However this is only an estimate and although we do our best to make sure it is as accurate as possible, the final fee may be affected if there are factors that emerge during the audit we were not expecting.

The estimate is based on your accounting systems operating similarly to prior years and that draft financial statements, supporting schedules and working papers are provided when promised. If systems have changed, financial statements are not provided as agreed or unsatisfactory findings arise during the audit, this may increase the cost. Also if you ask us to do any extra work and we agree, this will be separately identified and charged.

We will advise you as soon as possible once we identify any issues which may cause the fee to vary from the original estimate.

Like a visit to the doctor is essential for maintaining your good health, an audit is good for an organisation's financial health. A public sector audit by QAO gives confidence to the people of Queensland that the State's finances are being well managed.

Annual reporting

Report to Parliament No. 1 for 2008, titled *Enhancing Accountability through Annual Reporting*, was tabled earlier this month. It looked at whether departmental annual reports complied with the prescribed requirements and assessed to what extent the performance information reported in annual reports aligns with better practice. The role of lead agencies and the guidance they provide to support continuous improvement with accountability requirements was also examined.

Overall, the audit found that:

- departmental annual reports do not fully comply with legislation and do not meet better practice standards for disclosure and transparency
- departments require further guidance to support accountability and promote a culture of performance management.

Further details are on our website at www.qao.qld.gov.au

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If there is anything you would like to see featured in INFORM or you have an interesting story idea or picture you'd like to contribute, please contact us at Inform@qao.qld.gov.au or on (07) 3405 5003.

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Contract auditors' workshop

Once again we are hosting a workshop for our contract auditors on Friday 2 May 2008. The theme of this workshop is Quality Partnerships. It is our aim to provide our contract auditors with information on our tendering of audits and management of these contracted audits. Other information they need to know about the audits in specific industries will also be provided.

Your feedback to us through our client feedback surveys has been considered and will be discussed with our contractors so we can continue to provide a value added service to you.



Audit and Risk Management Committee

At QAO we are committed to good governance and with this in mind we have two external members on our Audit and Risk Management Committee. This strengthens the independence of the committee which provides independent advice to the Auditor-General on the quality of internal operating controls as well as reviewing significant financial risk, internal and external audit reports and annual financial statements.



LtoR: Tom Tolhurst, Glenn Poole and Ken Moores AM.

Mr Tom Tolhurst and Professor Ken Moores AM, were previous members on the committee and I would like to thank them for their commitment and work performed over the last five years. With the end of their terms in December 2007, we approached Mr Colin Colquhoun and Dr Lyndal Drennan to fill the important external member roles on the committee. Both have agreed with Colin taking on the responsibility of Chair.