



# INFORM

Accounting & Auditing Update, News, Information and Views Bulletin

## About Inform

INFORM serves as a communication tool between QAO, our staff and our clients. Any feedback on the publication is welcome and can be forwarded or e-mailed to us at the address on page 16. The publication provides information on emerging issues with an emphasis on those relevant to the public sector and QAO's perspectives on these issues. INFORM also provides information on new and revised accounting and audit pronouncements and changes to the Corporations Law.

## Checklist

QAO has developed a checklist of consider points to assist clients in the preparation of financial statements. This checklist is included as an insert to this publication.

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## QAO Update

### 1999 Contract Auditors' Conference

QAO hosted a conference for its contract auditors on 22 and 23 April 1999 to provide information in relation to public sector issues and outline QAO's audit expectations. The Conference also allowed contract auditors to discuss topical issues and areas of concern with QAO staff. Feedback from participants indicated that the conference topics were well received.

Individual papers presented by QAO staff at the conference addressed the topics listed below —

- ♦ **QAO Building Better Accountability – An overview of audit, public sector practices and process of reports to Government** – presented by Len Scanlan
- ♦ **What's New in Accounting and Auditing** – presented by Rod Taylor and Jo Hoffmann
- ♦ **Current Contract Arrangements and QAO Expectations of Contract Auditors** – presented by Glen Pettiford
- ♦ **Valuation of Local Government Infrastructure Assets** – presented by David Edgerton and Andrew Grima
- ♦ **Year 2000 Issues** – presented by John Adams
- ♦ **Corporate Governance in Local Government** – presented by Errol Mulvahl.

Please contact Ms Julie Dainty on 3405 1161 to obtain copies of the particular papers you require.



## Auditor-General's Reports to Parliament

**Audit Report No 4** was tabled in Parliament on 4 April 1999. This report includes the results of local government audits completed at 2 March 1999. It also includes comment on emerging issues relevant to local government.

**Audit Report No 5** was tabled in Parliament on 18 May 1999. This report includes the results of audits with a balance date between 30 June 1998 and 31 October 1998, and in particular those entities for which financial statement audits were not completed at 31 October 1998. The report supplements Reports No. 1 and 3 tabled in Parliament on 18 September and 14 December 1998 respectively. Comments on a performance management systems audit of the management of drugs at the Department of Health and commentary on current and emerging issues are also included in the Report. The Report also includes "Draft Guidelines for Queensland Government Publicity, Advertising and Communications". These Guidelines, which were recommended by the Parliamentary Committee for Electoral and Administrative Review Commission, have been reviewed and updated by QAO based on comments received from both internal and external parties.

**Audit Report No. 6** was tabled in Parliament on 27 May 1999. This report details the results of a sector wide performance management systems audit on the administration of grants and subsidies by government agencies. The report examines the co-ordination and observance by various

government agencies with best practice and the *Queensland Treasury Guidelines for Grant Administration*. The report also identifies a number of areas for improvement and provides recommendations to facilitate moves towards the better administration of grants and subsidies by government agencies.

**Audit Report No. 7** — Corporate Governance: *Beyond Compliance* was tabled in Parliament on 15 June 1999. This Report details the findings of a review of the corporate governance and risk management practices across a number of Queensland Government Departments. The underlying principles of Corporate Governance are referred to throughout the Report and the Report includes an overview of the responsibilities and common operational principles to be considered when implementing a Corporate Governance framework. The Report also identifies a number of areas for improvement in relation to the Corporate Governance of Government Departments.

**Audit Report No. 8** was tabled in Parliament on 29 June 1999. This Report contains the results of the audits of —

- ◆ fourteen Aboriginal Councils (and their nine controlled entities) and seventeen Island Councils (year ended 30 June 1998);
- ◆ seven Universities and their 26 controlled entities (year ended 31 December 1998); and
- ◆ eight Grammar Schools (year ended 31 December 1998).

### Further reading —

**Audit Reports No. 4, 5, 6, 7 and 8 1998-99, QAO. These reports are also available on our web site at [www.qao.qld.gov.au](http://www.qao.qld.gov.au)**

## ACAG Senior Executives Conference

The Australasian Council of Auditors-General (ACAG) is a network of Auditors-General from all Australian jurisdictions, New Zealand, Fiji and Papua New Guinea.

During May 1999, QAO hosted a three day conference for a group of senior officers from ACAG offices. The aim of the conference was to discuss topical and emerging issues impacting on the provision of public sector audit services and provide an opportunity for participants to share their approaches and experience.

Topics discussed included —

- ◆ Whole of Government Reporting
- ◆ Treasury Products
- ◆ Asset Valuations
- ◆ Corporate Governance
- ◆ Leadership
- ◆ Contracting Audit Services.

The conference not only provided an opportunity to discuss these topical issues in a formal setting, but also an opportunity to establish some inter-jurisdiction networks.

## Client Information Session — What's New for '99

QAO held two information sessions in Brisbane for clients on 2 and 16 June 1999. These sessions proved extremely popular with registration in excess of 200. The purpose of these sessions was to provide an update to clients covering accounting pronouncements and corporations law changes impacting upon 30 June financial reports, as well as provide an opportunity for clients to gather informally with QAO Senior Management. A number of topical issues were also discussed including —

- ◆ Assets with a written down value of nil
- ◆ Goods and Services tax
- ◆ Land Under Roads
- ◆ Provision for Maintenance — UIG Decision
- ◆ Year 2000 Reporting
- ◆ Condition Based Depreciation.

Issues or questions which have arisen from the seminars and that impact upon all public sector clients are outlined on page 16.

## Topical Issues

### Accounting Treatment of Computer Software

There is no specific accounting standard within Australia which deals with the accounting treatment of software purchased or developed for internal use. There is however some international accounting literature on this issue which can be referred to for guidance and best practice. This article endeavours to bring together the key issues on the accounting treatment for software and provides a number of considerations with respect to —

- ◆ The capitalise vs expense decision?
- ◆ If capitalised, what components of computer system development should be recognised?
- ◆ What term should these assets be depreciated over?

### Australia

To qualify for recognition, the software must satisfy the following principles of SAC 4 —

- (a) it is probable that the future economic benefits embodied in the asset will eventuate; and
- (b) the asset possesses a cost or other value that can be measured reliably.<sup>1</sup>

Paragraph 11 and 12 of Queensland Treasury's Accounting Policy Guideline 11 requires the recognition criteria for assets in SAC 4 to be satisfied, otherwise the costs should be expensed - *"Costs should only be capitalised to the extent that future benefits are expected beyond reasonable doubt, to equal or exceed the costs, any previously deferred costs and any future costs necessary to give rise to the future benefits."*

If the software is of an operational nature eg. Windows 98, then it should be expensed as the future economic benefits are unlikely to be reliably measured. In addition there is a limited market for 2nd hand operational software.

If the software is part of a critical business system eg. SAP R/3, the existence of future economic benefits becomes a little more difficult to ascertain. There needs to be some evidence that future economic benefits will be generated from the asset. A possible source of this evidence, may be the business case developed to support the acquisition decision.

<sup>1</sup> Extracted from ASCPA Members' Handbook June 1999 issue, SAC4

SAC 4 has mandatory application for departments and statutory bodies.

### Other Accounting Pronouncements

The following table summarises the international and Queensland Treasury guidance on this issue —

	Expense	Capitalise
External Direct Costs incurred in developing or obtaining internal use computer software		◇, ❖, ▼
Payroll costs (salaries of programmers, systems analysts, project management and administrative personnel and associated employee benefits)		◇, ❖, ▼
Research and Development costs	◇	
Training and Maintenance fees	◇, ■, ❖	
Activities performed during the preliminary project stage of internally developed software	●	
Software development activities performed during the application development stage		●, ▼
Data conversion costs		■
Costs of developing, maintaining, or restoring intangible assets which are not specifically identifiable		■
Related Overhead Costs		❖, ▼
Subsequent costs	❖ unless – (a) It is probable that costs will result in future economic benefits exceeding the original assessed standard of performance; and (b) Reliable measurement & attribution of costs	
Materials, computer equipment		❖, ▼

#### Legend

◇ = Exposure draft “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use” - American Institute of Certified Public Accountants

● = Accounting Standards Executive Committee of the American Institute of Certified Public Accountants

■ = Accounting Policy Board Opinion 17 of the American Institute of Certified Public Accountants

❖ = International Accounting Standard 38 “Intangible Assets”. IAS 38 considers computer software, both developed internally & purchased externally, to be an intangible asset.

▼ = Queensland Treasury Accounting Policy Guideline (APG) 11.

### Queensland Public Sector

The former Department of Public Works and Housing on advice from an external accounting firm have developed guidelines on capitalisation of computer costs as follows.

In regards to developing internal systems, the general philosophy applied is that software research and development costs incurred prior to the assessment of the software’s technical feasibility should be recognised directly as an expense, as, prior to this stage, the future benefits are too uncertain to recognise (ie. carry forward) the costs as an asset.

Hardware and operating system software costs incurred directly in implementing major systems are accounted for separately from the associated application software (core application, configuration and programs and interfaces developed outside the core application) and other costs of implementation.

Include in Cost of Asset	Expense
<ul style="list-style-type: none"> <li>Acquisition cost of application software eg. initial licence fees</li> <li>Consultants</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing maintenance, systems support and ongoing application support charges in respect of application software and licences</li> </ul>
<ul style="list-style-type: none"> <li>Internal employee costs for those employees working on the project</li> </ul>	<ul style="list-style-type: none"> <li>Administrative costs and overheads eg. Management time and accommodation costs</li> <li>Ancillary application software eg. Word, Excel etc purchased externally, and expenditure on related user licences</li> </ul>

### Depreciation / Amortisation

There is little guidance within Australia or internationally as to the rate of amortisation specific to the development and purchase of computer software for internal use. For example, in Canada the costs of developing computer software should be capitalised where the future benefits are reasonably assured. Such costs should be amortised “in a rational systematic manner on the life of the asset”.

The depreciation method of assets generally is contained in AAS 4 / AASB 1021 “Depreciation”. It states that the depreciation method applied to an asset must reflect the pattern in which the asset’s future economic benefits are consumed or lost by the entity. In estimating the useful life, consideration must be given to expected wear and tear, obsolescence and legal or other limits on the use of the asset.

One agency within the public sector has capitalised all SAP R/3 associated costs with the exception of training costs provided to users. In this case, the useful life has been assessed at 10 years based upon the advances in technology and the whole of government commitment to implementation of SAP.

Some agencies have separately capitalised the SAP R/3 software licence over three years and other costs over five years such as project costs, training received costs, salaries and associated costs.

In relation to determining the useful life of intangible assets such as software, IAS 38 suggests the following considerations —

- ◆ Expected usage
- ◆ Technical, technological obsolescence
- ◆ Typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets and of similar usage
- ◆ Level of maintenance expenditure required to obtain expected future economic benefits from the asset
- ◆ Whether the useful life of the asset is dependent on the useful life of other assets.

IAS 38 states that the “nature of an intangible asset is such that estimates of its useful life become less reliable as the length of useful life increases.”

### Conclusion

Agencies should determine an asset policy outlining (amongst other matters) the recognition threshold and considerations for those components of computer systems which are capitalised vs expensed. Agencies need to re-assess annually the recoverable amount of the computer costs which have been capitalised. The rationale of the asset policy must be sound and the entity must consistently apply their asset policy.

## Revaluation and Depreciation of Assets

With the advent of accrual accounting and asset valuations, there is an increasing emphasis on the management of assets by agencies.

### Review of Useful Lives

One of the significant issues which arises is the requirement for agencies to annually review the remaining useful lives of their depreciable assets in accordance with paragraph 6.1 of AAS 4 “Depreciation”. In the event that an asset is nearing the end of its useful life but is still in use, it is much easier to account for the re-assessment of the useful life while the asset has some remaining written down value. This arises because paragraph 6.3 of AAS 4 prohibits any adjustment to past depreciation charges.

This is explained below —

Asset	Asset A	Asset B
Purchase date	1/7/X0	1/7/X0
Gross value	120	120
Useful Life	8 years	12 years
<b>As at 30 June X8 (ignoring requirement to revalue every 5 years.)</b>		
Accumulated Depreciation	120	80
Written Down Value	0	40
Reassessed Useful Life	10 years	13 years
Adjustment required	Requires full revaluation of the asset and the associated class of assets	Depreciation charge adjusted to \$8 p.a (WDV / no. of years remaining: \$40 / 5)

At 30 June 1998, Asset A has another two years of useful life. However because it has been written off (WDV =0), the asset must be re-lived i.e. revalued to ascertain a depreciable amount for the asset and depreciated over the remaining two years.

The revaluation of the asset will invoke paragraph 4.1 of AAS 10 “Accounting for Revaluation of Non-Current Assets” which requires the entire class of assets to be revalued.

At 30 June 1998, Asset B is assessed with an extra year of useful life. However as Asset B has not been written off, the depreciation charges can be adjusted to write off the remaining WDV over the reassessed useful life in accordance with paragraph 6.3 of AAS 4 without the need to revalue the asset or entire class of assets.

Paragraph 6.3 states -

6.3 “When depreciation rates or depreciation methods are changed, the change must be accounted for as a change in accounting estimate. The effect must be recognised in the reporting 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. Depreciation recognised in prior reporting periods must not be changed either by an adjustment via the profit and loss or other operating statement or via retained profits (surplus) or accumulated losses.”

The depreciation charges become \$8 p.a. (equal to the WDV / no. of years remaining).

Given the substantial values now applied to non-current assets across public sector entities, even small inaccuracies in the determination of remaining useful lives could result in a material misstatement of the written down value of assets and the associated depreciation expense.

### **Conflict of the Requirement of AAS 10 and s.45 of the Financial Management Standard 1997**

Two of the prescribed requirements in relation to the revaluation of assets include AAS 10 and s.45 of the Financial Management Standard (FMS). These requirements can operate concurrently despite an apparent inconsistency.

AAS 10 requires that when one asset in a class of assets is revalued, the entire class must be revalued (para 4.1).

However s.45(7) of the FMS states that in performing a revaluation of a class of assets, only those assets above the revaluation threshold need to be revalued. (A revaluation threshold is required by s. 45(7)(a) of the FMS.)

Both of these prescribed requirements can be satisfied if the agency’s revaluation threshold is set at an appropriate level i.e. if the revaluation threshold is set at a level that captures the material amount of the assets in the class. In this case, the material amount of the assets will be revalued as per the FMS and AAS 10 will be complied with to a material extent by revaluing the material amount of the assets in the class.

Setting the threshold at an appropriate level is also consistent with the intention of the FMS to provide useful and reliable information to the users of the financial statements.

**In order to properly manage assets and ensure accurate depreciation charges, agencies must have systematic and auditable processes in place to regularly review and reassess the useful lives of their assets. The routine application of standard rates of depreciation such as “taxation rates” is not acceptable. Agencies should pay particular regard to those assets nearing a WDV of zero to determine if any adjustments are required.**

### **Condition-Based Depreciation**

The Urgent Issues Group has included the issue of conditioned-based depreciation (CBD) in its work program.

The condition-based depreciation method involves the determination of depreciation charges through an assessment of the condition of the infrastructure asset, and determination as to the cost of restoring the asset to its required condition. The cost of the service potential consumed is expensed as depreciation. There is concern that some forms of CBD may not comply with the accounting standards and in particular AAS 4 and AASB 1021 “Depreciation”.

Arguments for and against condition-based depreciation include —

#### **Advocates**

- ◆ Acceptable method of depreciating complex infrastructure assets
- ◆ Practical method of ensuring that the financial statements correctly reflect the condition and service potential of assets and their use
- ◆ Linkage to information systems for asset management.

#### **Concerns**

- ◆ CBD may not be a reliable representation of the service potential consumed during the reporting period
- ◆ Some methods of CBD may not use historical cost (or amount substituted for historical cost) as the basis for determining depreciation expense as required by Accounting Standards

- ◆ CBD may include both the current cost of replacing service potential consumed during the current reporting period and a charge for the difference between the historic and current cost of replacing service potential consumed in prior periods.
- ◆ CBD does not account for legal and commercial obsolescence.

This issue is expected to be discussed at the 12 August meeting of UIG members.

### Year 2000 Information Disclosure Act 1999

The Commonwealth's Year 2000 *Information Disclosure Act 1999* became law on 26 February 1999. The Act is designed to encourage entities to fully disclose Y2K readiness without fear of potential legal liability.

The Queensland Government is also introducing similar legislation which is currently before Parliament. Should the Queensland bill become law it also will be effective from 27 February 1999.

To gain protection under the Act, section 8 requires that the Disclosure Statement must —

- ◆ Be in writing
- ◆ Relate solely to one or more of the Y2K issues listed in the Act (eg. detection, prevention and remedial action)
- ◆ Be made on or after 27 February 1999 and before 1 July 2001
- ◆ Include words to the effect —
 

*“This statement is a Year 2000 disclosure statement for the purposes of the Year 2000 Information Disclosure Act 1999. A person may be protected by that Act from liability for this statement in certain circumstances”*
- ◆ Identify the person or corporation who authorised the statement.

Protection will also be offered to republished statements whether in written or oral form (section 9).

Section 11 lists the exceptions to the protection provided by the Act.

Examples of these exceptions include instances where statements have been made —

- ◆ Recklessly in relation to whether the statement is false or misleading
- ◆ With the knowledge that they are false or misleading
- ◆ With the sole or dominant purpose of inducing a consumer to buy goods or services
- ◆ In connection with the formation of a contract
- ◆ In order to fulfil an obligation under a contract or imposed under a law
- ◆ Relating to civil actions concerning the infringement of intellectual property, copyright, a trade mark, design or patent
- ◆ Relating to restraining injunctions or applications for declaratory relief e.g. an action designed to stop the publication of defamatory statements
- ◆ Relating to civil actions undertaken by regulatory bodies such as the Australian Competition and Consumer Commission.

Section 17 also provides that disclosure of Y2K information is to be exempt from section 45 of the *Trade Practices Act 1974*, which deals with anti-competitive conduct.

As a consequence of the Act, it is hoped that statements will flow more freely for the purpose of sharing and exchanging information about Year 2000 issues and problems.

Anyone potentially affected by Y2K Disclosure Statements should seek legal advice about their own particular circumstances.

*Source: Institute of Chartered Accountants, The Bulletin, May 1999*

#### Further reading —

More detailed information is available on the Australian Government web site

## UIG Abstract 26 — Accounting for Major Cyclical Maintenance

Abstract 26 “Accounting for Major Cyclical Maintenance” has been released by the Urgent Issues Group and applies to all reporting entities for reporting periods ending on or after 30 June 1999.

For the purposes of this Abstract, provisions for future maintenance are provisions for the anticipated future costs to be incurred under major cyclical maintenance programs.

The Abstract states that “Provisions for future maintenance must not be recognised as a liability, or as accumulated depreciation or as a reduction in the carrying amount of an asset”.

Upon adoption of the requirements of the Abstract, adjustments must be made against retained earnings at the beginning of the reporting period.

QAO has contacted Queensland Treasury to discuss their views on this issue in light of the following —

- ◆ Treasury’s Guidelines “Recording and Valuation of Non-Current Physical Assets” allows for a provision for maintenance to be created and shown as a deduction from the carrying amount of the asset
- ◆ Reference to deferred maintenance has been removed from the Treasury’s 1998/99 Minimum Reporting Requirements (MRRs)
- ◆ Consideration to include Abstract 26 as a prescribed requirement in the proposed amendments to the Financial Management Standard (FMS).

Treasury has advised that the removal of deferred maintenance from the MRRs is an indication of their view on this issue and UIG Abstract 26 will be incorporated in the list of prescribed accounting standards contained in Schedule 3 to the FMS.

As a result of the Abstract, the following action is required by agencies —

- ◆ Any provision for maintenance, whether disclosed as a liability or offset against the carrying value of the asset, must be written back through an adjustment to opening retained earnings or accumulated losses
- ◆ Future major cyclical maintenance will need to be expensed in the financial period it is incurred.

## Whole of Government Issues

### Minimum Reporting Requirements — Budget Sector Agencies

The 1998/99 Minimum Reporting Requirements (MRRs) have been issued by Treasury with only minor changes to the MRRs from the previous year. Changes include —

- ◆ aligning the MRRs to new and revised accounting standards
- ◆ improving the readability and the user friendliness of the document
- ◆ updating Year 2000 disclosures especially in regard to third party reliance
- ◆ statement of major activities is encouraged but not mandatory
- ◆ removal of references to deferred maintenance to align with UIG Abstract 26 on this topic
- ◆ change in terminology to align with AAS 29 “Financial Reporting by Government Departments”.

QAO considers that the statement of major activities should be prepared for 1998/99. Departments have been required to prepare this statement in previous years and should have sufficient systems and procedures in place to allow such statements to be prepared.

## Long Service Leave Liabilities — Budget Sector Agencies

Effective from 1 July 1999, long service liabilities will no longer be funded through individual budget sector agencies. Existing and on-going long service leave liabilities will be funded through Government with a central fund to be established to manage the liability. The fund will be actuarially assessed and will be administered by the Government Superannuation Office. Agencies will no longer record a liability for long service leave in their statement of financial position, as the liability will become a whole of government liability and will be reported as part of the government consolidated financial statements.

Each agency will be subject to an annual 1.5% levy of their gross salaries. This levy will be paid into the administered fund. When employees take long service leave (in-service or cash equivalent), the agency will pay the employee and seek reimbursement from the fund. The annual levy paid by agencies will represent the annual long service leave expense which will be recognised in the agency's operating statement. The levy will replace the shorthand method of calculating long service leave under AAS 30 "Accounting for Employee Entitlements".

The Sunshine Department Financial Statements for 1998-99 provide an example note disclosure (note 38 — Events Occurring After Balance Date) which will alert users to the changes in long service leave liabilities for 1999-00.

*Source: Queensland Treasury, Financial Management Circular, 99/1 & 99/3*

## Superannuation

### Annual Returns

It was reported in the last issue of INFORM that the Superannuation Industry Supervision Regulations have been amended in relation to lodging annual returns to the Australian Prudential Regulation Authority (APRA). The Government has recently issued a press release revising the dates that non-excluded non-public offer superannuation funds must lodge

their annual returns with APRA. For most non-excluded funds, this will be six months after the end of the year of income, that is, 31 December 1999.

The following APRA return deadlines apply —

Public Offer Funds	31 October 1999 (being four months after year-end)
All Other Funds	31 December 1999 (being six months after year-end)
Excluded Funds	31 March 2000 (being nine months after year-end).

In future years, annual returns for all non-excluded funds will be due four months after the end of a fund's year of income.

### The Superannuation Guarantee Arrangements

The Superannuation Guarantee Arrangements (SGA), introduced by the Commonwealth Government 1 July 1992, require employers to pay a minimum amount of superannuation support to their employees or pay a Superannuation Guarantee Charge.

A review of certain public sector agencies in 1997-98 identified some instances where entities were not fully complying with the requirements of the SGA legislation.

Public Sector entities should ensure that they are aware of their responsibilities in respect of SGA.

The key requirements of these arrangements are summarised below —

#### Payment Rate

- ◆ The superannuation guarantee payment rate effective for the period 1 July 1998 to 30 June 1999 is 7%.
- ◆ The payment rate is charged on an employee's earnings base, which is usually stated in an award or other agreement.

#### Salaries and Wages

- ◆ Salaries and wages include bonuses, commission, directors fees, meeting fees, casual loading and allowances other than a reimbursement of expenditure.
- ◆ The maximum salary for the purposes of the payment of the guarantee for the period 1 July 1998 to 30 June 1999 is \$24,480 per quarter (\$97,920 pa). If an employee earns over this amount, an employer's maximum contribution should be based on this maximum salary.

## Employees

- ◆ Employees include all workers employed on a full time, part time or casual basis and are not limited to PAYE employees.
- ◆ Employees include contractors, board members, local government councillors, members of parliament and guest speakers.

Exemptions include —

- √ Employees paid less than \$450 in a calendar month;
- √ Employees over the age of 70 (employees beyond age 65 must be working over 10 hours per week); and
- √ Employees under 18, working 30 hours or less per week.

## Contractors

- ◆ Contractors are considered employees if the value of the labour component of the contract is more than 50% of the value of the contract.
- ◆ The contract must be with the individual who will do the work (not with a company, partnership or other independent agency or a person who is free to hire other people to perform the work).
- ◆ Superannuation support is calculated on the labour value of the contract (can use a reasonable market value if not stated in the contract).

## Other

- ◆ The superannuation contributions must be paid into a complying superannuation fund (this should be confirmed with the fund's trustees).
- ◆ All superannuation contributions must be paid within 28 days of the end of the financial year.

The Australian Taxation Office (ATO) has been conducting a number of superannuation guarantee (SG) audits to ensure that employers are satisfying their obligations under the superannuation guarantee charge (SGC) legislation.

The ATO has found that most errors made by employers occur in the key areas of classification of workers and calculation of the guarantee amount as a result of using the wrong rate. The ATO has also identified that many contract and part-time workers, particularly females, are not receiving the required SG contributions. All employees earning more

than \$450 per month are entitled to receive the 7% SG contribution.

ATO audits will continue in 1999 to ensure that employees obtain their full SGC benefit. Employers should be reviewing their SGC systems to ensure that they are meeting their obligations in respect of all their SGC employees.

## Local Government

### Tropical Council Proforma Financial Statements

The Tropical Accounts have been updated in conjunction with the Department of Communication and Information, Local Government and Planning, to reflect changes in accounting pronouncements for 30 June 1999. The draft Accounts have been circulated to contract auditors and local governments for comment.



### Some Asset Valuation and Depreciation Issues

Queensland Public Sector agencies are required to value assets using the deprival valuation methodology. QAO has identified a number of common issues that have required extensive consultation between QAO, agencies, Queensland Treasury, contract auditors and industry bodies.

#### Value of Utility of Current Asset

Under the deprival valuation methodology, the agency must determine either the Market Value, Current Replacement Cost or Current Reproduction Cost of the utility of the existing asset. Current Replacement Cost is generally chosen when the existing asset would be replaced by something different in terms of size, capacity or technology.

When the “replacement” or “reference” asset is different from the existing asset, there will be a difference in the total utilities of both assets. Therefore, an adjustment must be made between the utility of the existing asset and that of the replacement asset. This concept is outlined in SAP1 “Current Cost Accounting” and demonstrated by way of an example.

The example adjusts the cost of the reference asset by factors determined by differences between the capacity and useful life of the existing and reference assets.

### Total Asset Life

Assets such as roads, water infrastructure and buildings are different from assets such as plant and equipment in that their lives can be extensively prolonged, some argue indefinitely, through a continuous maintenance program. This creates difficulty in trying to calculate the Written Down Value (WDV) and associated depreciation expense for these types of assets.

For example, assume the gross value of a replacement road is \$100 million and that the utility of the existing road is the same as the replacement road. If a road was originally constructed 100 years ago and its Remaining Useful Life (RUL) has been assessed as 20 years, does this mean that its WDV is —

$$\frac{20}{120} * \$100m = \$16.6m$$

The difficulty with this scenario is that the asset that exists today, is not the same asset that was constructed 100 years ago. Since then it has undergone significant maintenance and capital works including a number of reseals, sub-strata reconstruction and the use of technologically improved components.

For these types of assets, a “Nominal Life” must be determined. The Nominal Life should reflect an estimation of how long this asset would last, given its construction method, materials used, and projected usage, as if it were new. The nominal life is then used as the asset’s “total life” in calculating WDV and depreciation expense. In our example above, if 40 years is determined to be the Nominal Life, the WDV would be —

$$\frac{20}{40} * \$100m = \$50m$$

This reflects the true position in that 50% of the asset’s utility remains unused and therefore, by default, only 50% has been consumed.

### Method of Calculating Depreciation

AAS 4 “Depreciation” requires that depreciation rates be reassessed at least annually. This is normally done by the reassessment of RULs.

AAS 4 sets out a number of limitations on how changes to depreciation rates must be brought to account and provides an example that demonstrates a “complying” and “non-complying” method. In essence, the complying method requires the WDV to be divided by the RUL. The following example demonstrates the risk of material error by the adoption of a “non-complying” method.

Assume the information from the previous example. For 1998-99 the depreciation expense would be calculated as either —

#### Non Complying

Gross amount/Nominal Life : \$100m/40 yrs = \$2.5m  
WDV at 30 June 1999 will be \$47.5m: (\$100m - \$52.2m)

#### Complying

WDV amount/RUL: \$50m/20 yrs = \$2.5m  
WDV at 30 June 1999 will be \$47.5m: (\$50m - \$2.5m)

As a result of flooding and the inability to renew the roads because of budgetary constraints, in 1999-2000, the RUL is reassessed as 10 years. The difference in the two methods now produces considerable variances. Nominal Life has now been reassessed at 31 years (40 - 10 + 1 years).

#### Non Complying

Gross amount/Nominal Life: \$100m/31 yrs = \$3.22m  
WDV at 30 June 2000 will be \$44.28m: (\$100m - \$55.72m)

#### Complying

WDV amount/RUL: \$47.5m/10 yrs = \$4.75m  
WDV at 30 June 2000 will be \$42.75m: (\$47.5m - \$4.75m)

Therefore, under the Gross Method, depreciation is significantly understated and the WDV of the asset will not reduce to zero at the end of the RUL.

### Gross v Net Disclosure Method

Some jurisdictions allow disclosure of asset values using either the Gross Method or Net Method as outlined in AAS 10. In Queensland, the Minimum Reporting Requirements (MRRs) issued by Queensland Treasury require departments to apply the Gross Method. The Gross Method is also encouraged in relation to other entities and involves disclosing the Gross Value less Accumulated Depreciation to arrive at the WDV of the asset.

It must however be noted that the Gross disclosure method is only appropriate for assets valued at either Current Replacement Cost or Current Reproduction Cost.

In particular, paragraph 7.2 of AAS 10 "Accounting for the Re-valuation of Non-Current Assets" states —

*"Where an entity revalues depreciable assets by reference to current prices for assets newer than those being revalued, and adjusts those amounts to reflect the present condition of the assets, it may restate separately the gross amounts and related accumulated depreciation of the assets comprising the class of revalued assets."*

Therefore, if the valuation is based on market value the gross method is not applicable and only the market value can be disclosed. In subsequent years, the market value is to be depreciated and disclosed using the gross method of disclosure ie. Market Value less Accumulated Depreciation equals WDV. The Market Value approach is appropriate for assets such as rental housing where a strong retail market exists for these assets.

## Corporate Update

### ASIC Gets Tough

Issue 1 of INFORM (September 1998) outlined the scope of the Australian Securities and Investment Commission (ASIC) 1998 Financial Accounts Surveillance program review.

The review covering 180 financial reports has been completed. ASIC recently advised for 1999 that the following areas are to be reviewed —

- ◆ Financial instrument disclosures
- ◆ Acquisition accounting
- ◆ Subsequent events
- ◆ Abnormal items
- ◆ Amortisation of intangibles
- ◆ Emoluments of each director and each of the five highest remunerated officers of listed Companies.

For 1999, ASIC will expand its corporate targets to include not only listed companies but also unlisted companies, resource companies and companies with a history of non-compliance.

ASIC has also indicated that large proprietary companies in the public sector may be reviewed as part of its 1999 program.



ASIC is willing to litigate to enforce accounting standards where companies have adopted accounting policies which may mislead the market. This was evident in ASIC's recent federal court action against Media Entertainment Group (MEG)

Limited over its policy on revenue recognition. In this case the group recognised revenue as soon as contracts for services were signed. ASIC considered that revenue should not have been recorded as revenue until services had been provided. MEG's revenue accounting treatment resulted in sales of \$3.525m however if the revenue had been recorded in accordance with accounting standards, the amount would have been \$1.632m. ASIC believed that MEG's financial statements did not provide a true and fair view of the financial position and performance of the company.

This case indicates the necessity to not only comply with accounting standards but also ensure that accounting practices align with the accounting policy notes.

*Source: Accountant Pty Ltd, E-GAAP Update No. 1/99 and ASIC Media Release "ASIC Settles Accounting Action Against Media Entertainment Group Limited", 3 May 1999*

## What's New In Accounting?

### New and Revised Accounting Standards

Following is a brief description of recently revised accounting standards. To obtain a full appreciation of the effect of these changes, it is recommended that the relevant standard should be read in its entirety.

#### AAS 19/AASB1006 'Interest in Joint Ventures'

The principal change to these revised standards includes expanding the definition of a joint venture to include all forms of joint arrangements including incorporated entities and partnerships. The revised standards also prescribe the accounting treatment for interest in joint venture entities and joint venture operations.

*Operative on or after 31<sup>st</sup> December 1999.*

#### AASB 1039 'Concise Financial Reports'

This is a new standard which sets out the minimum content of a concise financial report.

*Operative date on or after 31<sup>st</sup> December 1998.*

#### Self-Generating and Regenerating Assets Standard has Been Deferred

The Australian Accounting Standards Board has announced that the introduction date for the AAS 35 / AASB 1037 'Self-Generating and Regenerating Assets' has been deferred for one year. The introduction date will now be 1 July 2000. The commencement date for compliance has been extended as a result of entities, especially primary producers having difficulty in developing recording and valuation methods to comply with the standard.

### Urgent Issue Group (UIG) Update

#### Abstract 25 'Redesignation of Hedges'

This consensus applies to foreign currency hedges of an anticipated purchase or sale of goods or services and to hedges of an anticipated sale of gold.

If a hedge is redesignated as a hedge of another exposure and the original anticipated transaction is still expected to occur, the gains and losses that arise on the hedge prior to its redesignation must be deferred and included in the measurement of the original anticipated purchase or sale when it takes place.

If a hedge is redesignated as a hedge of another exposure and the original anticipated transaction is no longer expected to occur, the gains and losses that arise on the hedge prior to its redesignation must be recognised in the profit and loss or other operating statement as at the date of the redesignation.

*Applies in respect of hedge redesignations that occur on or after 18 March 1999.*

#### Abstract 26 – 'Accounting for Major Cyclical Maintenance'

Refer to page 8 for a summary and discussion on this Abstract.

### Accounting Interpretations

The Australian Accounting Standards Board will be replacing its Accounting Guidance Releases (AAGs) with statements titled Accounting Interpretations (AIS).

The AAGs currently in place will continue to apply but will be considered in due course for reissue as Accounting Interpretations.

#### AI 1 'Amortisation of Identifiable Intangible Assets'

This statement addresses the applications of AAS 4 / AASB 1021 "Depreciation" to identifiable intangible assets. The statement states that identifiable intangible assets do fall within the scope of AAS 4 / AASB 1021 and in most cases these assets satisfy the definition of a "depreciable asset" and have "depreciable amounts" in terms of AAS 4 / AASB 1021.

*Issued June 1999.*

## AARF Publications

### Accounting Theory Monograph No 10 'Measurement in Financial Accounting'

This publication represents the first formal step in the development of a Statement of Accounting Concepts on the measurement of the elements of the financial statements.

Amongst other things, the monograph discusses —

- ◆ The attributes appropriate for measuring the elements of financial statements — historical, current, net selling or some other value
- ◆ The measurement unit which is appropriate — nominal or constant purchasing power dollars
- ◆ The capital maintenance concept which is appropriate – financial or physical capital.

**QAO will be reviewing the monograph for impact upon public sector entities**

## What's New In Auditing?

### New and Revised Auditing Standards

Following is a brief description of recently revised auditing standards. To obtain a full appreciation of the effect of these changes, it is recommended that the relevant standard should be read in its entirety.

#### AUS 702 'The Audit Report on a General Purpose Financial Report'

The above Auditing Standard has been reissued with certain changes to its Appendices. These appendices will now provide guidance to auditors in respect of audit reports on concise corporate reports prepared in accordance with AASB 1039 "Concise Financial Reports". In particular —

- ◆ Appendix 3 'Summary of the Auditing Reporting Requirements of the Corporations Law' has been expanded to include guidance to auditors on the audit reporting requirements relating to concise financial reports

- ◆ Appendix 5 'Example of Audit Reports on Concise Corporate Financial Reports' has been added to provide an illustration of various forms of audit reports on concise financial reports.

*Operative from February 1999.*

### Auditing Exposure Drafts

#### ED 71 'External Confirmations' (Revision of AUS 504)

Currently, AUS 504 deals only with the confirmation of accounts receivables, and there are many other financial report items where confirmations may provide audit evidence. ED 71 is less prescriptive than the existing AUS and requires auditors to consider whether the use of external confirmations is an effective way of obtaining sufficient and appropriate audit evidence to support assertions in the financial report.

**QAO is in general agreement with the proposed changes in ED 71**

### Auditing Guidance Statements

#### Addendum 2 to AGS 1034 'The Year 2000 Issue – Risk Assessments and Internal Controls, Impact on the Going Concern Basis and Disclosures Concerning the Year 2000 Issue'

This addendum has been prepared to provide guidance to auditors in relation to —

- ◆ Understanding the effect of the Year 2000 issue on internal control, risk assessments and audit strategies
- ◆ How the Year 2000 issue may effect the entity's ability to continue as a going concern, and the potential effect on the audit procedures and reporting relating to an entity's ability to continue as a going concern
- ◆ The auditor's responsibilities in relation to disclosures concerning Year 2000.

*Operative from February 1999.*

### **AGS 1038 'Access to Audit Working Papers'**

This new Statement provides guidance for auditors when establishing and agreeing to conditions under which third parties are granted access to audit working papers and related documentation. This Statement will not apply to QAO as s.92 of the *Financial Administration and Audit Act 1977* prohibits disclosure of confidential information to third parties.

*Operative from February 1999.*

### **Auditing Omnibus Statement**

AUS/AGS Omnibus 2 'Miscellaneous Amendments to AUSs and AGS' was issued in February 1999.

This statement outlines amendments (mostly minor word changes) to a wide range of existing AUSs and AGSs.

These amendments have resulted from changes —

- ◆ in the Corporations Law as a result of the *Company Law Review Act 1998*; and
- ◆ to AUS 806 'Performance Auditing' clarifying the application of certain aspects of the guidance that have been raised by auditors applying AUS 806 in the public sector.

*Operative from February 1999.*

## **International Developments**

### **Discussions with Audit Committees**

Maintaining an independent relationship between external audit and the client is paramount. The Independence Standards Board (ISB) of the United States (US) is on a mission to improve the US standards in developing a framework for auditor independence. The ISB has issued a standard regarding independence discussions with audit committees, the principles of which are just as relevant to public sector auditors.

The standard states that the auditor of a public company must at least annually —

- ◆ Disclose to the audit committee of the company (or the board of directors if there is no audit committee), in writing, all relationships between the auditor and its related entities and the company and its related entities which in the auditor's professional judgement may reasonably be thought to bear on independence
- ◆ Confirm in the letter that, in its professional judgement, audit is independent of the company within the meaning of the relevant corporations legislation
- ◆ Discuss audit's independence with the audit committee.

*Source: American Institute of Certified Public Accountants, Journal of Accountancy, April 99*

## **Miscellaneous Publications**

### **Operations and Financial Condition – Publication by Group of 100**

The Group of 100 is an association of senior accounting and finance executives representing the major companies and government owned enterprises in Australia. The Working Party of the Group of 100 has prepared the publication "Guide to Review of Operations and Financial Condition".

This Guide makes an important contribution to best practice considerations in corporate governance as well as providing a basis for companies to improve communication with shareholders and other users of financial reports. Detailed guidance is provided in respect of matters concerning the review of operations, review of financial condition, risk management, corporate governance and statement of compliance.

The Guide is based on the Operating and Financial Review Statement issued by the United Kingdom Accounting Standards Board.

Copies of the Guide may be purchased by forwarding an email request to [g100@group100.com.au](mailto:g100@group100.com.au).

## Questions and Answers

### Year 2000 Disclosures



Have the details of the Year 2000 Information Disclosure Bill (currently before Parliament) been included in Queensland Treasury's Minimum Reporting Requirements (MRRs) for 1998/99?

The MRRs suggest that Departments should have regard to the *Commonwealth Information Disclosure Act 1999*. Section 7 of the Queensland Year 2000 Bill outlines areas that should be covered in a Year 2000 disclosure statement. These areas include —

- ◆ Year 2000 processing including detection and prevention of problems
- ◆ The consequences or implications for the supply of goods or services, of problems relating to Year 2000 processing
- ◆ Contingency planning, risk management, remediation efforts or other arrangements for dealing with the aforementioned consequences or implications.

Agencies should refer to the Bill to identify those specific details to be included in the disclosure statement. Refer to page 7 of this edition of INFORM for a summary of the Bill.

We are on the web  
[www.qao.qld.gov.au](http://www.qao.qld.gov.au)



**This newsletter is of a general nature only and is not intended to be a substitute for or relied upon for specific professional advice. No responsibility for loss occasioned to any person acting on or refraining from action as a result of any material in the publication can be accepted.**

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

### QAO Best Practice Guidelines & Other Publications

#### Recent publications —

- INFORM Issue 2 (Feb 99)
- Consideration for Better Management of General Procurement Practices (Jan 99)
- Best Practice Guidelines for the Sale of Material Public Sector Assets (Jan 99)
- QAO's Strategic Plan (Dec 98)
- Guidelines – AAS 34 / 1036: Borrowing Costs (Dec 98)
- INFORM Issue 1 (Sept 98)

#### Existing Publications —

- Guidelines – AAS33 / AASB 1033: Presentation and Disclosure of Financial Instruments (Jul 98)
- Guidelines for the Implementation of New Generation QGFMS (SAP R/3) (Jun 98)
- Our Audit Process (Jan 98)
- Best Practice Guidelines – Information Systems (Revised) (Oct 97)
- Guidelines for Dealing with Reportable Gifts – Including Hospitality and Entertainment (Oct 97)
- Guidelines for Year 2000 Compliance (Sep 97)
- Guidelines on AAS29 – Financial Reporting by Government Departments (Nov 96)
- QAO Auditing Standards (Jul 96)
- Guidelines for the Conduct of Audits of Performance Management Systems (Mar 95)

**These publications are available free of charge and may be obtained by ringing QAO on (07) 3405 1100. The publications are also on our web site.**

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# Checklist

## for Preparation of Financial Statements

<b>Timetable</b>	<b>Yes</b>	<b>No</b>	<b>N/A</b>
<p>Have you prepared a financial statement preparation timetable which includes crucial dates such as —</p> <ul style="list-style-type: none"> <li>◆ Date Financial Statements to be provided to CEO</li> <li>◆ Date Financial Statements to be provided to Audit Committee</li> <li>◆ Date auditable Financial Statements and work papers to be provided to audit</li> <li>◆ Key dates for preparation of certain disclosures and determination of key account balances</li> <li>◆ Key dates for providing financial information to Treasury for Budget papers</li> <li>◆ Key dates for preparation of Whole of Government Consolidation Packs</li> </ul> <p>When preparing the timetable, have you considered your printer's deadlines for publication of the annual report?</p>			
<p>Have you identified critical activities in the timetable?</p>			
<p>Has the audit committee approved the timetable?</p>			
<p>Have you assigned responsibility to specific officers for the completion of respective activities in the timetable?</p> <p>Are these officers adequately trained in what is required (eg. advising expectations at workshops, use of intranet, use of pro-formas for consistency of data especially when the same data is being collected from a number of branches)?</p>			
<p>Have you included the collection and collation of information from branches and regions in the timetable (where applicable)?</p>			
<p>Have you allowed sufficient time for contingencies?</p>			
<p>Have you obtained written agreement between the officer responsible for financial administration and the Auditor-General in relation to the timetable and any amendments to the timetable?</p>			
<p>Have you allowed sufficient time in the timetable for review and certification by management and audit (minimum of 2 weeks)?</p>			
<p>Have you allowed sufficient time for the Audit Committee to be informed of all major audit issues and an opportunity for the committee to consider the financial statements?</p>			

	Yes	No	N/A
<p><b>Timetable continued</b></p> <p>Are senior management and the audit committee being kept informed regarding the financial statement preparation process and progress with the timetable?</p>			
<p>Have you advised audit promptly of any delays or inability to meet agreed timeframes?</p>			
<p>Have you considered dividing the financial statements into “parts”, so that when completed they can be progressively provided to audit for review?</p>			
<p>Have you identified at an early stage, if any extension will be required, especially in relation to 31 August and 31 October statutory timeframes (eg. 31 August – accounts to audit; 31 October – provision of annual report to the Minister. Refer <i>Financial Administration and Audit Act 1977</i>)</p>			
<p><b>Quality Control</b></p> <p>Has someone quality controlled all documentation relating to financial statement preparation and work papers, eg sign off by a reviewing officer?</p>			
<p>Is the reviewing officer at an appropriate senior level?</p>			
<p>Has the Audit Committee reviewed and recommended the certification of the financial statements?</p>			
<p>Has Internal Audit been involved in the financial statement preparation process and if so, to what extent?</p>			

	Yes	No	N/A
<p><b>Work Papers</b></p> <p>Have you prepared a schedule for each significant balance (including the notes to the accounts) to identify the individual accounts/balances which make up the total account balance?</p>			
<p>Have the work papers been cross-referenced and supporting documentation attached?</p>			
<p>If supporting documentation is not attached to the work papers have you cross-referenced your work papers to the original source documents?</p>			
<p>For material items within each significant account balance, have you included the original documents/supporting documents for these items in the work papers?</p>			
<p>Are your Financial Statements and work papers filed logically and referenced back to the account balance schedule?</p> <p>For significant balances, supporting general ledger account balances should be included in the work papers.</p>			
<p>Has the officer responsible for the preparation of the financial statements signed and dated the account balance schedules?</p>			
<p>Do your work papers identify and explain significant variances between 1997-98 and 1998-99 major financial statement balances?</p>			
<p>Do the work papers include —</p> <ul style="list-style-type: none"> <li>◆ certified results of stocktakes, including explanations for major variances and authorities to write on/off adjustments;</li> <li>◆ evidence of the annual verification of non-current assets and portable and attractive items ;</li> <li>◆ third party confirmations of assets and liabilities in your work papers (eg. bank confirmations, investment confirmations, loan confirmations, imprest account confirmations);</li> <li>◆ details of the methodology used to calculate employee entitlements?</li> </ul>			
<p>Are all adjustments to your financial statement balances fully documented and supported?</p>			
<p>Have you advised audit of any changes you have made to your work papers?</p>			

	Yes	No	N/A
<p><b>Financial Statements</b></p> <p>Have you considered materiality when preparing the financial statements?</p> <p>If decisions to include or not include items are being made on materiality levels, have you notified and discussed these matters with audit?</p>			
<p>Are you controlling the number of financial statement drafts in use?</p> <p>(Once the completed financial statements are given to audit, no changes should be made without advising audit.)</p>			
<p>Have you agreed on a cut-off point after which no changes (other than those which are material) are to be made?</p>			
<p>Have you kept audit informed of significant developments?</p>			
<p>Have you confirmed inter-agency transactions and balances (current threshold is \$5 million)?</p>			
<p>Have you identified and advised audit of any post balance date events or going concern issues?</p>			
<p>Have you ensured inter-agency transactions and balances which are to be eliminated in the whole of government consolidation (ie. &gt;\$1m) have been identified and recorded? (Refer to Queensland Treasury Budget Circular 99/5).</p>			