



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 12. The publication provides information on emerging issues with particular emphasis on those relevant to the public sector. INFORM provides QAO with an opportunity to present its perspective on all of these issues. INFORM also provides information on new and revised accounting and audit pronouncements and changes to the Corporations Law.

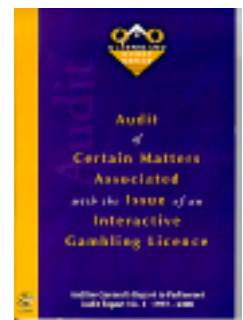
Newsflash!

Three new or revised accounting standards relating to the preparation of financial reports have recently been released. AAS 1 *Statement of Financial Performance*, AAS 36 *Statement of Financial Position* and AAS 37 *Financial Report Presentation and Disclosures* become operative for reporting periods beginning on or after 1 July 2000.

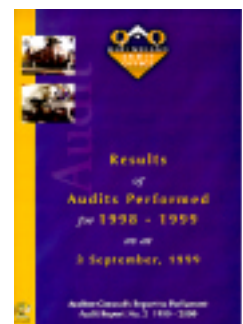
QAO Update

Auditor--General's Reports to Parliament for 1999-2000

Audit Report No 1 was tabled in Parliament on 30 September 1999. This report included the results of the audit of certain matters associated with the issue of an Interactive Gambling Licence.



Audit Report No 2 was tabled in Parliament on 4 October 1999 and included the results of audits completed at 3 September 1999. This report was the first general report on audits for the 1998-99 financial year and also contained comment on current and emerging issues such as Year 2000 and the Goods and Services Tax as it relates to the Queensland Public Sector.



The Queensland Audit Office 1999 Annual Report was tabled in the Parliament on 4 October 1999.



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Further reading —
Audit Reports No. 1 and 2 for 1999-2000 and the QAO Annual Report. These reports are also available on our web site -
www.qao.qld.gov.au

Topical Issues

Accounting for Asset Revaluations

There are two acceptable methods for calculating the revaluation of non-current assets under AAS10 -

- the gross method; and
- the net method.

The gross method is prescribed for government departments under the Treasurer's Minimum Reporting Requirements.

In the application of these two methods, audit has identified areas where computer systems may be calculating the depreciation of the revalued asset incorrectly. The following examples provide information as to how these errors could arise.

Gross Method

Example used:

1. **Estimated Useful Life = 5 years, ie 20% straight line depreciation.**
2. **Cost or Comprehensive Revaluation = \$100 as at 1/7/X1.**
3. **Revaluation indices = 10% each year as applied at 1/7/X 1 to X5**
4. **NOTE: The application of a revaluation index at 1 July each year could result in a materially different value from that certified as at June each year, which could result in a post-balance date event disclosure.**

Where the asset is revalued annually, the asset value will increase by 10% per annum (compounding). The depreciation rate of 20% per annum will be calculated on the annual revalued amount at 1 July, therefore, while the rate remains constant, the annual amount for depreciation will increase.

This method may be easier to program into the computer than the net method. Alternatively, the annual depreciation is calculated by dividing the adjusted book value by the remaining useful life.

Errors identified using this method

Some asset systems have not been adjusting the accumulated depreciation at the date of revaluation. As a result, the asset values have been overstated because of the understated accumulated depreciation figures. As a consequence of the above errors, the Asset Revaluation Reserve has also been overstated. As accumulated depreciation has been understated, the adjusted book value is higher than it should be when comparing it to the previous period's book value, resulting in a greater transfer to the Reserve.

As most software programs generally apply the depreciation rate against the adjusted cost figures, the correct depreciation expense has been charged to the Profit and Loss Account.

Adjustments required to correct the above error are:

Asset Revaluation Reserve	Dr
Accumulated Depreciation	Cr

Net Method

Under the net method of revaluation, the Accumulated Depreciation is written back against the asset prior to the revaluation being performed. The net figure is then revalued by the appropriate index.

Errors identified using this method

The difficulty arising from the use of this method is that the straight line depreciation rate may be incorrectly applied against the revalued figure at the date of revaluation.

If the computer system is not adjusted to calculate depreciation based on the revalued amount and the remaining useful life, and continues to depreciate on a straight line basis of 20% per annum, the asset will not be fully depreciated to its residual value at the end of five years.

The depreciation should be calculated by dividing the new asset valuation by the remaining useful life. The actual depreciation rate (as a percentage) will vary from year to year, based on the remaining useful life of the asset.

Payroll Tax

Employer superannuation contributions paid on or after 14 September 1999 in respect of services performed on or after 1 January 2000 will be included in the payroll tax base. Currently, payroll tax only applies to employer superannuation contributions made on behalf of an employee as part of salary-sacrifice arrangements.

Long Service Leave Scheme

The Long Service Leave Scheme (LSL) is a central actuarially assessed scheme to manage the long service leave liability of budget sector agencies. The Scheme covers all public servants and employees of Departments including employees in commercialised business units. The applicability to statutory authorities was decided on a case-by-case basis.

The Scheme came into effect on 1 July 1999. Departments/Agencies will remit a levy, currently 1.5% of gross salaries, to the Government Superannuation Office (GSO). Treasury will invest all levies to maintain the actuarial integrity of the scheme. In the 1999-2000 financial year, the levy will be paid quarterly (that is 30 September, 31 December, 31 March and 30 June). The timing of the levy payment will be reviewed for subsequent years. An interest assessment, similar to that applied to employer contributions, will apply to Departments/Agencies for late payment.

When employees take long service leave, the department or agency will pay the employee as the leave is taken and seek reimbursement from the scheme (ie GSO) at quarterly intervals.

The GSO is responsible for administering the LSL Scheme. All participating departments/agencies, 48 in total, have been contacted and provided with details of the administrative requirements and appropriate GSO Contact Officers for the Scheme.

As a result of this change, Queensland public sector entities participating in the scheme will no longer disclose a provision for long service leave in their financial statements.

Source: GSO Corporate Bulletin Board

Frequent Flyer Schemes

On 28 June 1999, the Office of the Public Service released *Guidelines for Frequent Flyer Schemes*. The major provisions of these guidelines are outlined below.

This Policy applies to all State public sector employees and all State public sector agencies.

Frequent flyer points generated as a result of government travel should only be redeemed for government travel purposes. Government officers who accrue frequent flyer points as a result of official travel are not to accept benefits from a frequent flyer scheme for personal or private use. Frequent flyer points accrued from government travel are not to be used to upgrade to a level of travel or accommodation to which an officer is not normally entitled.

Government agencies should implement suitable processes to manage the use of individual points to ensure that they are redeemed wherever practicable.

Government Owned Corporations should establish frequent flyer guidelines and procedures that take into account the expectations of public accountability set out in these Guidelines.

Accountable Officer responsibilities - Frequent Flyer Schemes

- **implementing internal control structures that ensure the effective, efficient and economical management of the agency's resources;**
- **developing and implementing a control environment that has a strong emphasis on accountability; and**
- **maintaining adequate audit trails.**

Source: *Guidelines for Frequent Flyer Schemes*, 28 June 1999

Recognition of Grants

The question has arisen as to whether, at reporting date, the outstanding balance of a grant should be recognised as unearned revenue (a liability). The following information is provided as guidance.

For government departments which are reporting under AAS29, paragraph 10.10 requires contributions other than contributions by owners to be recognised as revenues when the contributed assets qualify for recognition. For other entities, grant revenue should always be recognised at the time of receipt as per SAC 4 and AAS 15.

At reporting date, whether the unexpended balance is to be recognised as revenue or a liability will require an examination of the circumstances surrounding each grant and/or agreement in place at balance date.

Factors which will need to be examined include –

- the reciprocal nature of the grant - that is, where assets or services of equal value are exchanged between the grant provider and the recipient.
- whether any unspent grants meet the definition of liabilities in *SAC4*, and therefore need to be recognised as such in the financial statements.
- whether the grants are general or specific - for example, general operating grants versus specific purpose grants for capital purchases. General Grants are normally recorded as revenue in the year of receipt.
- whether contractual arrangements exist with third parties in relation to the specific purpose of the grant. The existence of an ongoing liability will be ascertained from the terms of agreements made by the reporting entity, including any financial penalties which would be incurred if the project did not progress.
- the level of note disclosure that would be appropriate, that is, where material balances are involved, comprehensive disclosure including details of grants received and amounts unexpended should be included in the financial statements.

Accounting for Leases

Novated Leases

A novated lease is a leasing arrangement where an employee and employer enter into a lease arrangement with a finance company. The employee effectively sub-leases for example, a vehicle, to the employer under this arrangement. This involves an employee leasing a car from a finance company but then passing on, or novating, the responsibility for lease payments and operating costs to the employer.

A Deed of Arrangement is entered into between the employee, employer and the financier. Under this arrangement, the employee's obligation to pay the lease rentals, the legal right to use the vehicle and other obligations under the lease are transferred to the employer for the term of the Deed of Novation. The amount of the lease payments will be deducted from the staff member's pre-tax salary as part of their remuneration package. This Deed of Novation is to comply with the guidelines in income tax ruling *IT 2509* and *Draft Determination TD98/D6*.

If an employee ceases employment for whatever reason, the Deed of Novation terminates immediately and the employer no longer has an obligation to pay lease rentals. The crucial point with novated leases is that the employee becomes responsible for the financial obligations to the finance company upon termination of employment.

Novated leases may be structured as operating or finance leases. Where the lease is structured as an operating lease, the risks and benefits remain with the financier, and the employee and employer do not have a legal right to acquire the vehicle at the termination of the lease. Alternatively, if the lease is written as a finance lease, the risks and benefits are borne by the employee who is responsible for any profit or loss on the vehicle. The employee has first option to purchase the vehicle at the end of the lease term.

Accounting Treatment - Finance Leases

Applying *AAS 17* paragraph 12.1, the lessor must recognise an asset (lease receivable) at the beginning of the lease term of an amount equal to the present value of the minimum lease payments. This amount equates to the fair value of the leased asset at the inception of the lease.

AAS17 paragraph 12.3 indicates that lease finance revenue is recognised progressively by the lessor over the lease term to achieve a constant periodic rate of return on the carrying amount of the lease receivable. The minimum lease payments are apportioned over the lease term between reduction in the lease receivable and lease finance revenue.

Where initial direct costs such as a one-off management fee or agency fees are charged at the inception of the lease and included in the interest rate in order to pass on the cost recovery to the client, these costs should be included as part of the lease receivable. AAS 17 paragraph 14.1 states that initial direct costs incurred by a lessor which relate to a direct financing lease must be included as part of the lease receivable. Future lease commitments should be disclosed in the notes to the financial report.

Accounting Treatment - Operating Leases

Where a lease is classified as an operating lease, in the books of the lessor the leased asset must be classified as a non-current asset and depreciated over its useful life to the lessor. Rental revenue must be recognised by the lessor in the operating statement by allocating minimum lease payments on a basis representative of the pattern of service rendered through the provision of the leased asset.

Initial direct costs incurred by a lessor which relate to an operating lease must be deferred by the lessor and amortised over the lease term in proportion to the rental revenue recognised in each reporting period.

Fringe Benefits Tax (FBT)

Queensland Treasury issues a newsletter on FBT titled FBTalk. This provides information on key items attracting FBT in the Public Sector, as well as updates on taxation reform, recent ATO determinations and a question and answer column. The contact person at Queensland Treasury is Mr Neil Donaldson.

Whole of Government Issues

Whole of Government Reporting - AAS31

Queensland Audit Office (QAO) will be certifying whether agency data in Tridata is correct for the purposes of preparing the Whole of Government consolidated financial statements. This certification is expected to be part of the audit process for the 1998-99 financial year.

A series of reports is being developed and tested by Treasury for audit purposes. These reports are the Tridata Whole of Government Reporting package (Tridata WOG Reports), which consists of –

- Operating Statement
- Statement of Financial Position
- Statement of Cash Flows
- Notes to the Accounts
- WOGFIR reconciliations
- Additional Information Schedules.

The additional schedules include an Elimination Details Report that lists all transactions and closing balances with other public sector agencies for amounts equal to or greater than \$1 million by Counter Party Identifier (CPID).

The auditor will verify that the Tridata WOG Reports reflect the same information as that contained in the audited financial statements and other records. The audit process will only be considered complete when QAO has certified both the Tridata Whole of Government Reporting Package and the Financial Statements.

Source: Treasury Financial Circular 99/3

Local Government Issues

Accounting Treatment by Local Governments of Contributions and Levies associated with the Installation of Electricity Infrastructure

This article discusses the correct accounting treatment of local government contributions towards the installation of electricity infrastructure.

The normal process followed by Councils is as follows –

- The Council is required to make a contribution to Ergon/Energex of a specified amount over a number of years (eg. \$100,000 per year for 5 years = \$500,000)
- The Council then levies a special levy against affected landowners for a set number of years. (eg. \$3000 per year for 10 years. Assuming 20 properties = \$3000 * 10 * 20 = \$600,000)

It is contended that the correct accounting treatment for these transactions is as follows –

- A liability should be recognised for the total amount of the contributions once agreement is reached with the electricity authority. This is in accordance with the definition of a liability under SAC4.
- A corresponding intangible asset, representing the commitment by the relevant landowners to pay a “special levy” in future years should then be created. In terms of SAC4, the Council has acquired future economic benefits (special levies) resulting from the obligation of the landowners to pay for the infrastructure contributions made by the Council.
- The liability would be reduced upon payment of each annual instalment.
- The intangible asset should be amortised over the number of years during which the special levy is to be charged in accordance with the requirements of AAS4.
- As contributions are paid, the liability will decrease.

This treatment recognises the substance rather than the form of the transaction. The Council has entered into the transaction in order to improve the social well-being of the ratepayers through the provision of this infrastructure. An

important consideration in Council entering into the transaction is the monetary cost. The Council has determined that it is necessary for the intended benefactors (specific landowners) to provide the majority (if not all) of the finance by way of a special levy. Without this financing arrangement, the Council would not have paid for the infrastructure.

Goods and Services Tax – Auditing Services

Goods and Services Tax (GST) will be payable at the applicable rate for all auditing services performed by QAO staff and contract auditors on and from 1 July 2000. The estimated fee advised to clients for the audit of entities for the 1999-2000 financial year will include the advice that a 10% GST on all audit work performed on or after 1 July 2000 will be added.

These invoices will clearly indicate that GST is not applicable for any work performed prior to 1 July 2000. GST will only be applied to invoices for work performed after that date.

In accordance with the terms and conditions of the Contract for Audit Services, it is proposed that the contract will be varied to require contract auditors to provide a tax invoice for the supply of auditing services on or after 1 July 2000, in accordance with the requirements of the GST legislation. GST will then be payable to contract auditors for these services. Where practicable, an interim claim for auditing services performed prior to 1 July 2000 should be submitted to QAO by each contract auditor prior to 30 June 2000. Interim invoices will be issued to clients, where practicable, for work performed up to 30 June 2000.

Contracting Arrangements for Audit Services

Three quotes will be obtained, in future, for all new audit contracts where the estimated audit fee for a year is in excess of \$20,000. The auditors invited to supply quotes will be selected from the QAO Contract Auditor Database taking into account factors including –

- Capacity of the auditor and his or her firm to perform the audit.

- Past expertise in the particular type of audit.
- Location of the auditor and the client entity.
- Other audits currently performed by the auditor on behalf of QAO, having regard to an equitable spread of work among auditors on the QAO Contract Auditor Database.

The selected auditors will be provided with documentation relevant to the audit and audit process by QAO, such as previous audit plans and reports, and will also be invited to contact a nominated representative of the client entity for further information.

For further information in relation to contract auditing for QAO, contact Mr Glen Pettiford, Director of Audit, on (07)3405 1161.

National Competition Policy (NCP)

In 1998-99, local governments were required to report, for the first time, on their business activities in their financial statements. The requirements included disclosure of the nature of business activities undertaken and certain information on costs and income of specific activities. These financial statements are currently in the course of finalisation and audit. Common issues arising from these statements will be reported in a future edition of *Inform* and the relevant Audit Report to Parliament.

As part of the implementation of NCP reforms in the local government sector, the Local Government Association of Queensland held a series of Technical Issue Forums throughout Queensland during October. These forums were designed to -

- aid local governments implementing competitive neutrality reforms to identify particular issues of concern in relation to the implementation of these reforms;
- provide an up-to-date understanding of NCP and its impact on local governments;
- provide an opportunity to discuss technical issues in

regard to Full Cost Pricing; and

- to enable participation in the formulation of the most appropriate guidelines for local government in Queensland.

Further information can be obtained from Mr David Grugeon, Department of Communication and Information, Local Government and Planning.

Corporate News

Proposed Changes to Company Tax Rate

The Commonwealth Government has, in its response to the report of the Review of Business Taxation (the Ralph Report), proposed a comprehensive package of tax reforms including a staged reduction in the company tax rate from 36% to 34% for the year ended 30 June 2001 or substituted accounting period (SAP) and then to the targeted rate of 30% for the year ended 30 June 2002 or SAP and thereafter. The Urgent Issues Group (UIG) has issued a pronouncement that tax balances should not be restated in current year financial statements until the consequences of the announcement of the proposed tax reform package are further formalised by the Commonwealth Government.

Tax Depreciation of Plant and Equipment

Accelerated depreciation ceased on plant and equipment that commenced to be constructed or was acquired under contracts entered into after 11.45 am AEST on 21 September 1999, except for small business taxpayers. Depreciation is to be based on the effective life of the asset for plant and equipment acquired after this time.

The Commissioner of Taxation has published effective life schedules, or alternatively, taxpayers may self-assess useful lives of assets. Taxpayers will be able to reassess and adjust effective lives as assets are used to take into account the effects of technological and market developments.

Guidelines on GOC Executive Salaries

On 25 October 1999, State Cabinet approved new guidelines for the salary packages of senior executives employed by Queensland Government Owned Corporations (GOCs). All GOCs are now required to consult

Shareholding Ministers before any proposed change to the salary packages of senior executives and any changes to packages will need to be justified.

Salary packages must also be included in each GOC's Annual Report and Statement

of Corporate Intent, on a similar basis to that required of publicly listed companies by the Corporations Law.

GOC Boards will retain the right to appoint staff, including senior executives. Shareholding Ministers will be able to provide a direction to a GOC Board under Section 124 of the *Government Owned Corporations Act 1993* if they do not agree with a proposed salary package change.

**New
Guidelines
for GOC
executive
salaries**

ASIC Review of Company Financial Reports

In its surveillance of company financial reports during 1999-2000, ASIC has advised it will focus on –

- the amortisation of intangibles;
- environmental reporting requirements of the Law;
- provisions for future maintenance and other provisions for future costs which do not meet the definition of “liabilities” contained in accounting standards;
- asset valuations, in particular the disclosure of the current value of interests in land and buildings which will first apply for many entities for years ending 30 June 1999;
- revenue recognition;
- the disclosure of directors' and officers' emoluments; and
- the disclosure and nature of movements in share capital and reserves.

The review may also be extended to include unlisted companies.

What's New in Accounting?

Urgent Issues Group Update (UIG)

Abstract 27 'Designation as Hedges - Sold (Written) Options'

The UIG has issued a final Abstract in relation to the designation of sold options as hedges. A sold option by itself will not qualify for designation as a hedge.

An arrangement which involves a sold option will qualify for designation as a hedge when the arrangement involves a combination of sold and bought options with equivalent terms and conditions, including the same exercise prices, maturity dates and number of units of currency or commodity; or when certain other prescribed conditions are met.

This Consensus applies to all reporting entities for reporting periods ending on or after 31 December 1999.

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.

Deadline for Recognising Land Under Roads as an Asset Deferred Until 31 December 2002

The Public Sector Accounting Standards Board (PSASB) has decided to defer the deadline for local governments, government departments and governments to recognise land under roads as an asset until the end of the first reporting period ending on or after 31 December 2002. This decision will be implemented by amending the transitional provisions for the recognition of land under roads in the following

Australian Accounting Standards:

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

Currently, the transitional provisions for land under roads in AAS 27 apply until reporting periods ending on or after 30 June 2000, and the transitional provisions in both AAS 29 and AAS 31 apply until reporting periods beginning on or after 1 July 1999.

AAS 6/AASB 1001 'Accounting Policies'

These Standards have been revised to harmonise with International Accounting Standard IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*. The revised Standards outline when a change in an accounting policy is permitted, how it is to be accounted for and disclosed.

These Standards are operative for the financial years ending on or after 31 December 1999, but can be applied to earlier reporting periods.

International Exposure Drafts

Proposed International Accounting Standard - Exposure Draft E64 'Investment Property'

The Board of the IASC has issued this Exposure Draft for comment, proposing revised requirements for the recognition, measurement and disclosure of investment property.

The Exposure Draft proposes amending IAS 25 *Accounting for Investments* so that entities measure all investment property at fair value and recognise all changes in the fair value of the investment property in the income statement. The definition of investment property excludes owner-occupied property, a lessee's interest in a property held under an operating lease and property held for sale in the ordinary course of business.

Comments are sought on a number of questions, including the definition of investment property, measurement

subsequent to initial recognition, gains and losses on re-measurement to fair value and the disclosure requirements. If approved, the revised Standard would be applicable for financial years beginning on or after 1 January 2001.

The deadline for comments was 31 October 1999.

QAO is in general agreement with the comments in the Exposure Draft, however, is of the opinion that where a property is held for rental or capital appreciation, but fails to meet the definition of an investment property because of concerns about the ability to measure its fair value reliably on a continuing basis, specific disclosure should be required. The disclosure should outline why such a property fails to meet the definition and the value of these assets in the financial statements.

Proposed International Accounting Standard - Exposure Draft E65 'Agriculture'

The Board of the IASC has recently issued this Exposure Draft on accounting for agricultural activity, a matter not covered in any prior International Accounting Standard. Agricultural activity is the management of the transformation of living animals and plants into agricultural produce awaiting further processing, sale, or consumption or into additional biological assets. The Exposure Draft requires that all biological assets be measured at each balance sheet date at their fair value and that the change in fair value of biological assets be reported in net profit or loss.

Requests for comments are raised in regard to a number of matters including the requirement to measure at fair value, the reliability of fair value measurement, components of biological assets and the proposed disclosures. If approved, this Standard would be applicable for financial years beginning on or after 1 January 2001.

The deadline for comments is 31 January 2000.

Condition Based Depreciation

The Urgent Issues Group (UIG) considered a Discussion Paper concerning condition-based depreciation (CBD) methods. CBD methods are usually applied to long-lived infrastructure assets and require a detailed assessment of the condition of the assets, often annually. Some members noted that condition assessments could provide reliable measures of the consumption of service potential during a reporting period but expressed concern that some CBD methods may not comply with the requirements of Accounting Standards. Members agreed that a draft Abstract dealing with the depreciation of infrastructure assets should be prepared and should clarify that depreciation methods would not comply with Accounting Standards where they did not, for example, differentiate between maintenance and capital enhancement expenditure (where such distinctions were possible), or determine the depreciation charge by reference to the carrying amount of the service potential consumed, or recognise that depreciation charge as an expense.

The UIG observed that while this issue was initially sourced from the public sector, it clearly has ramifications for all entities with long-lived assets. This issue is really about whether information about the consumption of these assets and their forecasted maintenance needs, which management uses for pricing and budgeting purposes, is appropriate for inclusion in general purpose financial reports. In resolving this issue, the UIG is to consider whether such information complies with the Accounting Standards on depreciation.

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 be read in its entirety.

AUS 520 'Management Representations'

This Auditing Standard has been reissued as part of the Auditing and Assurance Standards Board's (AuASB) ongoing program of reviewing existing Auditing Standards, taking into account recent changes in Standards in other countries. The AuASB formed the view that the basic principles and essential procedures and supporting guidance in AUS 520 remain appropriate. The only change is the addition of an Appendix containing an example representation letter. It is noted, however that the contents of a management representation letter will vary depending on engagement circumstances and the availability of sufficient appropriate audit evidence.

The deadline for receipt of comments was 31 October 1999

Exposure Draft ED 73 'Related Parties (Revision of AUS 518)'

As part of its ongoing program of reviewing existing Australian Auditing Standards, the AuASB has reviewed AUS 518 'Related Parties' taking into account recent international changes. The Exposure Draft proposes the guidance be revised to reflect a more detailed and explicit implementation of the 'audit-risk' approach to related parties.

The Exposure Draft provides that the auditor should assess the risk that related parties and related party transactions will not be identified, or that related party transactions will not be disclosed or measured in accordance with the relevant financial reporting framework. This involves a discussion of inherent risk and control risk including a review of a number of factors in relation to related parties. For example, the level of inherent risk is influenced by the complexity of the organisation, the number of related parties and the volume of related party transactions.

Comments are invited as to the acceptability or otherwise of the proposals.

The deadline for receipt of comments was 31 October 1999.

Exposure Draft ED 74 'Terms of Audit Engagements (Revision of AUS 204)'

Auditing Standard AUS 204 *Terms of Audit Engagements* has been reviewed as part of the AuASB's program of

evaluating the adequacy of existing Auditing Standards. The Exposure Draft proposes that auditors be required to record, in writing, the terms of audit engagements that are agreed to with their clients. The Board is seeking specific comment as to the acceptability or otherwise of this new requirement.

The documentation of the agreed terms of the audit engagement should assist auditors in minimising any potential risk exposure which might arise as a result of any misunderstandings as to the auditor's responsibilities in the absence of an engagement letter or other form of audit contract. In the past, there has been a tendency for disputes to arise between auditors and their clients in situations where the terms of the audit engagement have not been appropriately documented.

Current practice suggests that the terms of the audit engagement are best documented either through an engagement letter or some other form of audit contract. Consequently, the AuASB is of the view that from a risk management perspective, AUS 204 should be amended to adequately reflect current practice.

The deadline for receipt of comments is 30 November 1999.

Audit and Assurance Alert

Audit and Assurance Alert 5 - 'Electronic Reporting and Continuous Assurance Engagements'

This Alert describes audit/assurance issues and opportunities that are likely to evolve as technology is further developed and utilised by entities. Rapid advances in information technology (IT) are making vast amounts of information available to an ever increasing number of users on a more timely basis. If decision-makers need continuous information on which to base their decisions, it is likely that they will also need independent assurance on the reliability of that information.

The AuASB will continue to monitor progress in this area and develop guidance as issues are identified and resolved.

Interim Guidance to Auditors Regarding Audit Reports for Audits of Compliance Plans of Managed Investment

Schemes Pursuant to Section 601HG of the Corporations Law

This interim guidance has been issued by the AuASB to provide an example audit report which may be used when reporting on audits of compliance plans of managed investment schemes pursuant to section 601HG of the Corporations Law.

In order to register a managed investment scheme, section 601EA(4) of the Corporations Law provides that, among other things, a copy of the scheme's constitution and the scheme's compliance plan must be lodged with the Australian Securities and Investments Commission (ASIC). The directors of a responsible entity are responsible for the development of a compliance plan, together with those compliance measures in the plan, that are necessary to monitor and control compliance risks.

The role of the compliance plan auditor under section 601HG(3) of the Corporations Law is to examine the scheme's compliance plan and carry out an audit of the responsible entity's compliance with that plan for the financial year. However due to the limited nature of audit testing and other inherent limitations of an audit, the audit opinion is expressed in terms of reasonable assurance and does not constitute a guarantee that the compliance plan is completely free from any deficiency or that all compliance breaches have been detected.

The AuASB is currently liaising further with ASIC on various issues related to the audit of such compliance plans and is developing an Auditing Guidance Statement. As an interim measure, auditors of compliance plans are encouraged to use the example audit report that is attached to the Interim Guidance.

Who is responsible for detecting fraud?

An international survey has found that 75% of the general public, including a majority of people knowledgeable in financial matters, expect an audit to detect all kinds of frauds. The survey also found that 61 per cent of the general public believe that auditors routinely search for fraud.

These findings have raised concern that an expectation gap exists, as fraud detection is not the auditor's prime

responsibility when auditing the financial report. In response to these concerns, the accounting profession is planning increased education of the general public. Another way of dealing with this expectation gap is to clarify the audit scope section in audit reports.

Australian Auditing Standards clearly explain that the auditor's role is not to prevent fraud, but to plan and conduct an audit engagement in such a way that there is a reasonable expectation of detecting material errors which may arise from fraud or other irregularities. There are, however, limitations as to whether a diligent auditor can detect even a material fraud, as this act often involves concealment, collusion, deception, forgery, failure to record transactions and material misrepresentations.

A majority of entities in the private and public sectors is concerned about fraud. An increasing number of entities are producing and communicating to their staff, codes of ethics or codes of conduct. It is essential that Directors and management ensure that an effective fraud control strategy is developed, implemented and maintained in their organisation.

The audit committee should ensure that appropriate systems are in place to minimise the risk of fraud. The Auditing Standards Board, the Australian Institute of Company Directors and the Institute of Internal Auditors issued the publication *Audit Committees - Best Practice Guide* in 1997. The terms of reference for audit committees include the prevention and detection of fraud as best practice.

Audit committees should seek assurance from management that the entity has sufficiently strong internal control systems, particularly key controls in areas such as segregation of duties and authorisation. Management should consider those areas where the risk of fraud is highest, ensuring they consult with both internal and external audit.

Audit committees should clarify the scope and coverage of internal and external audit work. If the committee concludes that the level of comfort from proposed procedures is inadequate, they should increase the coverage by either internal audit or a separate engagement by the external auditor.

Source: Audit Committee Matters, PriceWaterhouseCoopers

QAO Best Practice Guidelines and Other Publications

Recent publications —

- **INFORM Issue 3 (June 99)**
- **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 /AASB1036: Borrowing Costs (Dec 98)**
- **INFORM Issue 1 (Sept 98)**

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

We are on the web
www.qao.qld.gov.au

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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.

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