

INFORM

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ABOUT INFORM

INFORM provides information on current and 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 Urgent Issues Group Abstracts and changes to the Corporations Law.

If you have a particular topic which you would like addressed in this publication, please contact the Audit Policy and Reporting Section of the Queensland Audit Office and we will attempt, wherever possible, to meet your request.

We may be contacted on our email address —

apr@qao.qld.gov.au

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QAO UPDATE

Auditor-General's Reports to Parliament

Audit Report No. 2 for 2000–01 was tabled in the Legislative Assembly on 17 May 2001. This Report contained the results of audits performed for 1999-2000 generally completed as at 28 February 2001.

Matters covered in this Report include —

- Consolidated Whole of Government Financial Statement.
- Results of Audits as at 28 February 2001 by Ministerial Portfolio.
- Audit of the Management of Official Travel and Hospitality – a performance management systems audit.
- Overview of Audits of Aboriginal and Island Councils and Associated Matters.
- Overview of Audits of Local Governments.
- Current and Emerging Issues including —
 - Commercial-in-Confidence Arrangements
 - Amendments to the Financial Administration and Audit Act 1977
 - Audit of the Goods and Services Tax
 - Guidelines for Accounting for Non-Current Assets



Audit Report No. 3 for 2000–01 was tabled in the Legislative Assembly on 29 June 2001. This Report contained the Results of Audits performed for 1999-2000 generally completed as at 31 May 2001.

Matters covered in this Report include —

- Status of Audits at 30 April 2000.
- Results of Audits of Aboriginal Councils and Island Councils for 1999-2000.
- Results of Audits of Grammar Schools for 2000.
- Results of Audits of Local Governments for 1999-2000.
- Results of Audits of Universities for 2000.
- Current and Emerging issues including —
 - Amendments to the Financial Administration and Audit Act
 - Accounting for Non-Current Assets



QAO Annual Report

QAO's Annual Report 2001 with the theme *In Focus: Foundations To The Future* was tabled in Parliament on 6 September 2001.

Copies of the above Reports may be obtained on the QAO website

qao.qld.gov.au

or from the QAO Service Centre by telephoning

3405 1100



New Appointments at QAO

Three Assistant Auditors-General have recently been appointed at QAO and a brief profile of each follows —

Mr John Harten

John has 32 years audit experience with QAO in performing and managing a wide range of audits including departments, statutory bodies, government owned corporations and companies.

He has Fellow status with CPA Australia, is a member of the Australian Institute of Management and completed a Graduate Certificate in Management during 2000.

John is the Chair of the Human Resource Strategy Committee, which is responsible for the annual preparation and implementation of QAO's Human Resources Strategy and Professional Development Plan.

Mr Brendan Worrall

Brendan joins QAO from Queensland Treasury. He has worked in a variety of organisations including Police and CSIRO in various financial management roles.

For most of the past three years, he has been the Chief Financial Officer/Director, Performance and Finance in the Queensland Treasury Department. In this role, he was responsible for the Department's financial and performance management (including procurement) as well as having a number of Whole-of-Government responsibilities.

Prior to joining the Queensland public sector, Brendan was an audit senior for three years with Pannell Kerr Forster in Brisbane. Before this, he worked for a Commonwealth statutory body (CSIRO) for a number of years, two as an internal auditor.

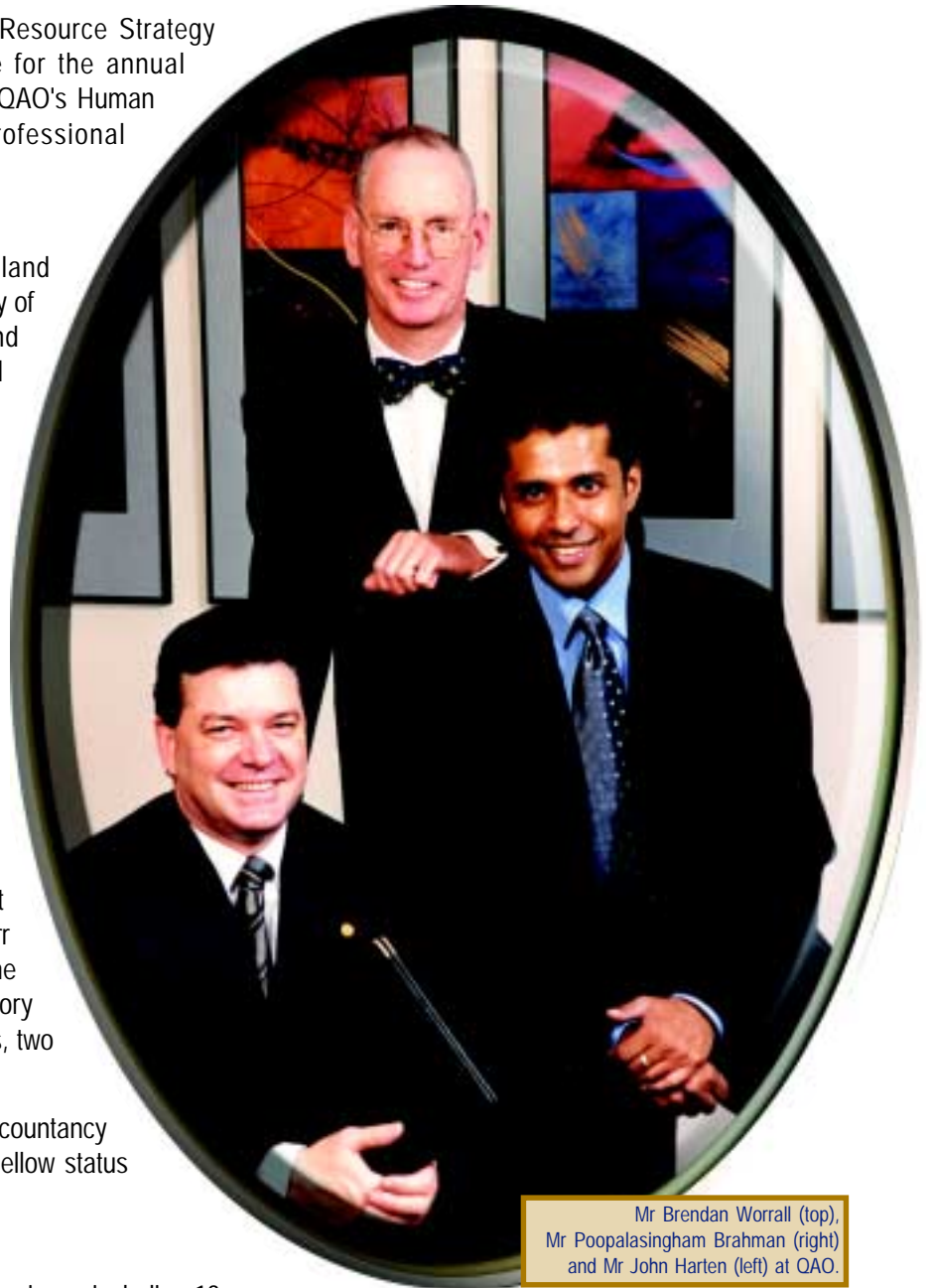
Brendan has qualifications in both accountancy and public administration and has Fellow status with CPA Australia.

Mr Poopalasingham Brahman

Brahman has sixteen years audit experience including 13 years conducting financial and compliance, information systems and performance management systems audits in the Queensland public sector.

In recent years, he has managed significant and complex performance management systems audits, including the Review of the Administration of Grants and Subsidies, Corporate Governance - Beyond Compliance and Review of the Sale of the State Gas Pipeline.

Brahman currently chairs the QAO Risk Management Committee and is the EMG sponsor of QAO's e-Business Focus Group.



Mr Brendan Worrall (top),
Mr Poopalasingham Brahman (right)
and Mr John Harten (left) at QAO.

TOPICAL ISSUES

Changes to the *Financial Administration and Audit Act 1977*

Since the last issue of *Inform*, the changes to the Financial Administration and Audit Act have been passed by Parliament, with an effective date of 7 June 2001. The most significant of the changes are discussed below.

Timeframe for Preparation of Financial Statements

The financial statements of departments and statutory bodies must be finalised within three months of the end of the financial year. The requirements for the preparation of the financial statements are contained in section 40AA and section 46FA of the Act. This is a reduction of one month from the previous requirement. There has been no change to the timeframes for the tabling of annual reports, with departments and statutory bodies required to table their annual reports within four months of the end of the financial year as per sections 39(1) and 46J(1) of the Financial Administration and Audit Act.

To finalise the financial statements within the three-month timeframe, the Act provides for a collaborative and consultative approach between agencies and the Auditor-General. In this regard, the Accountable Officer/Statutory Body is to agree on a date for the provision of the financial statements with the Auditor-General to allow the audit process to be completed within the three-month timeframe.

The revised amendments allow the three-month period to be extended only by the Treasurer in the event that a whole of government reason exists for an extension, for example a late budget, machinery of government changes, etc. There is no provision for extending beyond six months after the end of the financial year.

Action

A minimum of 10 working days should be allowed from the time the financial statements have been signed off by the Accountable Officer to allow audit to finalise its review of the final financial statements and to provide the appropriate independent audit opinion. This has been previously outlined in Reports to the Parliament.

Other Amendments

- The clarification of the role of the Accountable Officer and Internal Audit (section 36);
- The granting of a power to the Treasurer to require agencies including Government Owned Corporations to provide information for budget monitoring or whole of government purposes for any period not limited to the financial year (section 38C);
- The addition of new provisions with respect to the electronic presentation of financial statements ie including a CD-ROM of the financial statements in the Annual Report (sections 39(7) and 46J(6));
- Clarifies that departments have the power to establish and form companies as controlled entities only with the Treasurer's approval (section 44);
- The time period for the transmittal of unclaimed moneys to the Treasurer's Unclaimed Moneys Fund has been extended to one year (section 46); and
- The definition of public sector entity has been extended to include "an entity that is controlled by one, or more than one, department, local government or statutory body or by a combination of departments, local governments and statutory bodies (Schedule 3).

Note

Section 75 of the Financial Administration and Audit Act provides for the appropriate Minister to give the Auditor-General information relating to public sector entities.

Specifically the Act requires the Minister for the public sector entity to give written notice to the Auditor-General about the establishment of the public sector entity or the fact that the entity has become a public sector entity.

Financial Management Standard

The Financial Management Standard is currently being reviewed. Advice to QAO is to the effect that it is expected that the final version will be available later in the year.

Abolition of Nonfeasance Immunity

Brodie v Singleton Shire Council; *Ghantous v Hawkesbury City Council* [2001] HCA 29 (31 May 2001)

On 31 May, by a 4-3 majority decision, the High Court of Australia abolished the historic common law principle by which Local Governments (and other statutory road authorities) were immune from legal liability for mere failure to repair a road – mere nonfeasance.

Under the nonfeasance principle, a person suffering damage or injury as a result of an accident caused by some defect in a road could not sue the Council as road authority for damages merely on the basis that the Council had failed to repair the road. If the defect, which caused the accident, arose through ordinary wear and tear, or through something done by a third party for which the Council was not responsible, the Council could not be made liable. This was true even if it had actual knowledge of the defect and/or even if the resources needed to repair the defect were readily available to the Council.

The nonfeasance rules have now been replaced by a general duty imposed on a Council to take reasonable steps by the exercise of its powers within a reasonable time to ensure that roads are adequately repaired and maintained. This is specifically stated to include a positive duty to undertake regular inspection programs to obtain actual knowledge about defects which may exist, including defects which may be "latent", that is, not immediately visible to road users or immediately visible by casual inspection.

(Source — Local Government Association of Queensland Advice)

Note

This decision could have ramifications for entities other than Local Government.

It was reported in Queensland Hansard of 20 June 2001 that the departments of the Ministers for Main Roads, Transport and Local Government and the Attorney General were examining these matters.

There is currently a Whole of Government Working Party investigating this matter.

Cost of Sales - To Disclose or Not?

AASB 1018/AAS 1 *Statement of Financial Performance* introduces the requirement to disclose "Cost of Sales". The revised standards are applicable to entities preparing financial reports with financial years ending on or after 30 June 2001. The Standard requires the disclosure of cost of sales relating to the revenue derived from the sale of goods. Where an entity is required to disclose revenue in accordance with AASB 1004/AAS 15 *Revenue*, they must also disclose the cost of sales relating to that revenue.

The Standard defines cost of sales to mean —

- (a) The carrying amount of inventories sold in the reporting period in which the related revenue is recognised; and
- (b) All unallocated production overheads relating to inventories sold in the reporting period.

This definition clarifies that an entity must have sold inventory during the period to disclose a cost of sales figure. An entity deriving revenue solely from the provision of services will therefore not be required to disclose a cost of sales component. An entity does not escape the disclosure of cost of sales merely because it carries no inventory at year-end or fails to recognise inventory during the year. Discussions between QAO and AASB staff have indicated that electricity generators and retailers, which do not carry inventories of electricity, nevertheless must disclose cost of sales.

The disclosure of cost of sales is required by AASB 1018, which applies to all entities preparing financial reports under the Corporations Act 2001, regardless of whether the entity is a reporting entity. Non-corporate entities preparing financial reports in accordance with AAS 1 *Statement of Financial Performance* need only disclose cost of sales if they are reporting entities, or the financial report is held out to be a general-purpose financial report. However, the disclosure of cost of sales is required only when the entity is also disclosing revenue from the sale of goods in accordance with AASB 1004/AAS 15 *Revenue*.

AASB 1019/AAS 3 *Inventories* explains which costs are to be included in the cost of sales. Production costs to be included in the cost of conversion are limited to costs that contribute to bringing inventories to their present location and condition, which includes the costs of distribution to the "point of sale", but does not include costs that relate to marketing, selling and subsequent distribution to the customer. Consequently, these costs should not be included in the calculation of cost of sales.

The determination as to whether an entity has sold a good or provided a service must be decided, based on the individual facts and circumstances. Where an entity discloses inventories on the face of the Statement of Financial Position, the general rule is that cost of sales should be disclosed. This rule does not apply in all circumstances. For example, as stated above, in the electricity industry, retail electricity sellers buy electricity from the market and are at the same time supplied by the distributors without recording the electricity as inventory. However there is a cost of sales to be disclosed by the retailer, which will include the energy purchases and the distribution and transmission charges incurred.

Information Standard 26

Information Standard 26 has now been approved and promotes the use of the Internet by agencies as a way to provide accessible delivery of information and services to the Queensland public.

The framework of Information Standard 26 consists of 9 Mandatory Principles relating to agency websites and is accompanied by a Best Practice Supplement.

Overview

Principle 1 – Website Provision

Requires that agencies have a website within the qld.gov.au domain and ensure the site provides agency specific content to the public. A link to the Queensland Government Internet Gateway must also be included.

Principle 2 – Website Compatibility

Requires that websites meet the Corporate Style guidelines as outlined by the Department of Premier and Cabinet.

Principle 3 – Website Accessibility

Requires that agency websites be designed for maximum accessibility and comply with W3C Web Content Accessibility Guidelines for people with disabilities.

Principle 4 – Quality of Information

Requires agencies to implement procedures to ensure the quality, accuracy, and currency of information on their websites, including a process for authorising publication of all material on the website.

Principle 5 – Privacy and Security of Information

Requires the website to include a Privacy statement as outlined in IS 42 and ensure it is linked throughout the site.

Principle 6 – Non-Queensland Government Links

Links to non-Queensland government information must be labelled and a copyright and disclaimer notice must also be accessible from all pages.

Principle 7 – Electronic Mail

Agencies must implement email systems.

Principle 8 – Directory Use

Agencies must use hierarchical directory structures for consistency across government.

Principle 9 – Planning and Feedback

Agencies must include customer feedback mechanisms to gather comment on website content or information. A process must also be in place to utilise this feedback when planning further Internet initiatives.

Implementation Timetable

Full implementation, including the W3C Guidelines for Accessibility by July 2002.

The Department of Innovation and Information Economy website includes a list of all standards currently under review and under development.

Information Standard 42 – Information Privacy

On 10 September 2001, Queensland Cabinet approved two new information standards that together establish a framework for the responsible collection and management of personal information in the Queensland public sector. Queensland Information Standard 42 aims to establish a framework for the responsible collection and handling of personal information in the Queensland public sector.

Information Standard 42A is designed specifically for the health sector and will be implemented by Queensland Health. IS 42A is written in accordance with the private sector regime, not the public sector.

The framework of Information Standard 42 consists of 11 Information Privacy Principles (IPPs) which have been adapted from Commonwealth privacy legislation.

Overview

IPPs 1–3 Collection of Personal Information

An agency can only collect personal information (defined as any information which can identify someone) directly related to its activities and only by fair means. The collection of this information should not unreasonably intrude upon the privacy of the person concerned.

IPPs 4–5 Storage and Security

Agencies in possession of personal information are to ensure there are reasonable safeguards to prevent unauthorised access, use or disclosure of the information.

IPPs 6–7 Access and Alteration

Individuals are entitled to access records containing personal information and to alter those records if they are inaccurate, subject to Queensland laws. The rights of access under IPPs 6 and 7 are the same the rights to access and amend under the Freedom of Information Act 1992 (Qld).

IPP 8 Accuracy

Reasonable steps are to be taken by agencies to ensure that any personal information proposed to be used is accurate, up-to-date and complete.

IPPs 9–11 Use and Disclosure

In general, an agency must use personal information only for the purpose for which it was collected and disclose personal information only if the individual concerned is aware of, or has consented to that disclosure. (Exceptions apply if authorised by law and for certain types of law enforcement.)

Implementation Timetable

The implementation schedule for the Standard requires that within one month of the Standard being endorsed by Cabinet, an agency should —

- nominate an agency contact officer; and
- inform all staff of Information Privacy Principles (IPPs) and requirements of the Standard.

Within six months, an agency should —

- undertake a personal information audit to identify where personal information may be held within agency datasets (eg personnel files, working papers, whistleblower information);
- identify and note any statutory requirements that supersede the IPPs scope;
- review entity contracts, licence agreements etc for compliance with IPPs;
- review all entity documents and forms to ensure they comply with the IPPs;
- identify which entity policies and procedures may need to be developed or changed to comply with the Standard;
- complete a Privacy Plan with an implementation schedule;
- publish the Privacy Plan on the agency's website.

Further Details

Copies of the Privacy Standards and Best Practice Guides are available online from the Department of Innovation and Information Economy website —

www.iie.qld.gov.au/comminfo/guidelines.html#new

Further information about the Commonwealth Privacy Act is available from the Federal Privacy Commissioner at the following website —

www.privacy.gov.au

The Department of Innovation and Information Economy website includes a list of all standards currently under review and under development.

www.iie.qld.gov.au/comminfo/guidelines.html

WHOLE OF GOVERNMENT ISSUES

Non-Current Asset Accounting Guidelines

The Queensland Treasury publication *Non-Current Asset Accounting Guidelines for the Queensland Public Sector* was released in May 2001. The Guidelines may be accessed on the Internet at —

www.treasury.qld.gov.au/docalpha.htm

The revised Guidelines replace the *Recording and Valuation of Non-Current Physical Assets in the Queensland Public Sector* publication issued by Queensland Treasury in June 1997. That document provided guidance on how to apply 'deprival value' principles in valuing and revaluing non-current physical assets. From 1 July 2000, Australian Accounting Standard AAS 38 *Revaluation of Non-Current Assets* requires assets to be measured either at historical cost or fair value.

The purpose of the Guidelines as outlined in Section 1 is to "explain the policy framework for the recording, recognition and valuation of non-current assets, including intangibles, in the Queensland Public Sector."

The guidelines should be read in conjunction with the requirements for asset management contained in the *Financial Management Standard 1997*, Australian Accounting Standards and relevant Urgent Issues Group Abstracts.

The aims as stated in the Guidelines are to —

- clarify the definition of, and accounting recognition concepts for, assets;
- provide guidance on determining the periodic cost of using assets (depreciation/amortisation);
- specify a basis for valuing non-current assets;
- set out the approach to be adopted in regularly reviewing the carrying amount of assets; and
- where appropriate, writing down or revaluing assets.

The Guidelines do not deal with the accounting treatment for financial assets, tax assets, self-generating and regenerating assets or inventories.

Application

The Guidelines will apply to departments, statutory bodies, statutory GOCs and to controlled entities of these entities to the extent necessary to comply with AAS 24 *Consolidated Financial Reports*. The Guidelines do not apply to local governments.

The Guidelines have mandatory application for financial reporting periods commencing on or after 1 July 2001.

Points to note —

- Section 45 of the Financial Management Standard requires agencies to specify an asset recognition threshold with a maximum threshold of \$10,000 for physical assets and \$50,000 for intangible assets. This represents a reduction from the current maximum threshold of \$20,000 for physical non-current assets.
- All non-current assets with limited useful lives, including intangibles, must be depreciated in accordance with AAS 4 *Depreciation*. Assets whose service potential does not diminish with time or use (eg. many works of art) must not be depreciated.
- Under fair value, there is no revaluation threshold when revaluing assets.
- AAS 38 allows an entity to value a class of assets at either fair value or historical cost. The Guidelines provide that the following valuation basis should be used for each of the asset classes.

Fair Value

Land
Buildings
Infrastructure
Heritage and Cultural Assets

Historical Cost

All other non-current asset categories
eg Plant & Equipment, Aircraft, Libraries

In addition to the general valuation principles the Treasury guidelines also contain comment on the following issues —

- Goods and Services Tax;
- Valuations on acquisition;
- Acquisition at other than fair value;
- Leased assets;
- No reliable value available; and
- Renewals accounting.

Highest and Best Use

AAS 38 Revaluation of Non-Current Assets and the Queensland Treasury's Non-Current Asset Guidelines for the Queensland Public Sector require that land, buildings, infrastructure and heritage and cultural assets be valued at fair value. Section 5.1.6 of AAS 38 defines fair value as —

- the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- The Treasury Guidelines, issued in May 2001, provide guidance on measurement of an asset's fair value. This is explained as the maximum value that agency management would rationally pay to acquire the asset if it did not currently hold it, taking into account —
 - quoted market price in an active and liquid market eg listed shares;
 - the current market price of the same or similar asset eg land;
 - the cost of replacing or reproducing the asset, if management intend to replace the asset;
 - the remaining useful life and condition of the asset; and
 - cash flows from future use and disposal.

AAS 38 requires that an asset's fair value should be measured having regard to the highest and best use of the asset for which market participants would be prepared to pay. Highest and best use in relation to market value is commonly defined as that use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately justified and financially feasible, which results in the highest value for the asset valued.

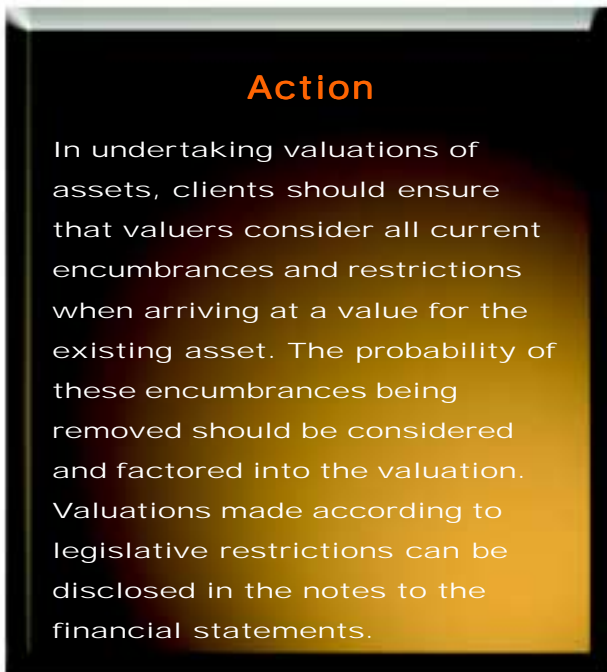
In determining a valuation, the following factors must be taken into consideration —

- Any legal/zoning restrictions on the particular asset.
- The highest and best use of that asset given the legal/zoning restrictions, and any other restrictions outside the control of the entity which owns the assets.
- The probability of any of the restrictions being changed.
- Whether the entity has the power to apply to have the restrictions changed or lifted.
- Whether any of the restrictions are in the process of being changed.

For example, the Botanical Gardens could be valued as land for office buildings. However, given the restrictions on the land and the probability that these restrictions will not be changed in the near future, the land would be valued as parkland/public gardens, not as land subdivided for office buildings.

When valuing the asset and taking all restrictions into consideration the valuers choose —

1. Market buying price/replacement cost
2. No market price - replacement cost less depreciation (if applicable).



CORPORATE UPDATE

Change in Name of Corporations Law

From 15 July 2001, the title of the Australian corporations legislation changed from the Corporations Law to the *Corporations Act 2001*.

From the date of commencement of the Corporations Act 2001, the provisions of the Corporations Law will no longer apply. Therefore, all documents prepared and lodged after 15 July 2001 should refer to the Corporations Act 2001, rather than the Corporations Law. This will include financial reports for the year ended 30 June 2001 signed after the date of commencement of the new Act.

In annual financial reports, this change will affect such items as —

- the directors' report and directors' declaration;
- the audit report;
- the accounting policy note; and
- lodgement of forms and documents with ASIC.

Care should be exercised where financial reports are being prepared and signed in respect of prior financial years. Under the transitional provisions contained in the Corporations Act 2001, all financial reports signed after 15 July 2001 in respect of financial years ending after 7 July 1998 must refer to the Corporations Act 2001. However, financial statements in respect of financial years ended on or before 7 July 1998 must refer to the Corporations Law.

Application of State Purchasing Policy to Company Government Owned Corporations

On 11 May 2001, a notice was published in the Queensland Government Gazette regarding the application of the State Purchasing Policy to company Government Owned Corporations, specifically Brisbane Market Corporation Ltd. This advised that Brisbane Market Corporation Ltd, its subsidiaries and controlled entities, are required to comply with the revised State Purchasing Policy (SPP) approved by Cabinet in June 2000. A similar notification has been issued to all company GOCs.

Statutory GOCs should already comply with the SPP by virtue of provisions contained in the Financial Management Standard 1997, subordinate legislation of the Financial Administration and Audit Act 1977.

ASIC Surveillance Program

ASIC has announced, as part of its annual surveillance program, that it will be reviewing compliance with AASB 1018 *Statement of Financial Performance* and AASB 1019 *Inventories*. ASIC will examine the application of the new reporting regime under the trilogy Standards, the disclosure of specific revenues and expenses and whether there is adequate disclosure of inventories.

ASIC has advised that part of the regular financial reporting surveillance program will focus on the new disclosure requirements for cost of goods sold.

AASB 1018 and AAS 1 *Statement of Financial Performance* require that the value of cost of goods sold be disclosed, either in the notes to the accounts or on the face of the statement of financial performance, if the entity has also disclosed an amount of revenue from sale of goods. The cost of goods sold figure will be related to the values disclosed as inventories in the financial statements. ASIC states that compliance with AASB 1019 *Inventories* will also be examined as part of its surveillance, which will consider how the value of inventories has been established and audited.

Lodgement of Financial Reports with ASIC

Section 319(3) of the Corporations Act 2001 requires a corporate disclosing entity's financial report, directors' report and auditor's report to be lodged with ASIC within three months after the end of the financial year. Therefore, a company with a balance date of 30 June 2001 will be required to prepare and lodge its financial report with ASIC by 30 September 2001.

The time for lodgement for any other entity required to lodge the above named documents with ASIC is within four months after the end of the financial year.

WHAT'S NEW IN ACCOUNTING?

This section provides an update on UIG Pronouncements and Australian Accounting Standards and Exposure Drafts.

UIG Abstracts

UIG Abstract 39 Effect of Tax Consolidation Proposals on Deferred Tax Balances



This Abstract states that the proposed tax consolidation system legislation must be taken into account in determining the carrying amounts of deferred tax liabilities and assets when and only when the legislation —

- (a) is relevant to the entity; and
- (b) has been enacted or substantively enacted.

Substantive enactment of the proposed tax consolidation system legislation must be taken to have occurred once the proposed legislation has been tabled in the Parliament and there is majority support for the passage of the legislation.

This Consensus applies to all reporting entities for reporting periods ending on or after 14 June 2001.

University Operating Grants - Veto Exercised

The Board considered a proposed Abstract *Operating Financial Assistance Paid to Universities* and exercised its reserve power of veto. In exercising its reserve power of veto the Board was not satisfied that the payments made to universities are reciprocal transfers. The Board decided that the general issue of accounting for grants is of such a magnitude that it would include the topic on its agenda rather than remit the proposed Abstract to the UIG for further consideration. The Board did not decide when it would address the issues raised.

The treatment of these grants in Queensland will continue as in previous years, that is that operating grants are to be recognised as revenue in the year of receipt.

Accounting Standards

Revaluation of Non-Current Assets

The Australian Accounting Standards Board approved the revised AASB 1041 *Revaluation of Non-Current Assets* on 17 July 2001. The revised standard applies for annual reporting periods ending on or after 30 September 2001, but may be applied for annual reporting periods ending before 30 September 2001 where an election is made in accordance with subsection 334(5) of the Corporations Act 2001. AASB 1041, when applied or operative, supersedes AASB 1041 and AAS 38 (of the same title) as issued in December 1999.

The principal changes from the superseded Standards include —

- (a) The requirement to disclose a reconciliation of the carrying amount of each class of non-current assets at the beginning and end of the reporting period has been limited to each class of property, plant and equipment (rather than all non-current assets);
- (b) Entities are permitted to change from the cost basis to the fair value basis, or to discontinue applying the fair value basis, to measure a class of non-current assets at any time in the future, but only if such a change satisfies the criteria for a voluntary change in accounting policy in AASB 1001 and AAS 6 *Accounting Policies*;
- (c) A revaluation of non-current assets to fair value in consolidated financial statements required by other Accounting Standards, particularly AASB 1024 *Consolidated Accounts* and AAS 24 *Consolidated Financial Reports* is specified not to give rise to a requirement to subsequently revalue those assets;
- (d) The revisions specify that amounts are credited to the asset revaluation reserve in respect of a class of non-current assets either as a result of applying this Standard or by applying the requirements of another Standard;
- (e) The transitional arrangements have been amended to specify that when an entity initially applies the fair value basis to measure a class of non-current assets, any net revaluation increment arising upon revaluing the assets to their fair value must be credited directly to retained profits (surplus) or accumulated losses (deficiency) to the extent that it reverses a net revaluation decrement previously recognised in the Statement of Financial Performance, with the remainder of the net revaluation increment (if any) credited directly to the asset revaluation reserve;

- (f) The Standard now includes an additional transitional arrangement for entities that changed from a revaluation basis to the cost basis for a class of non-current assets under the transitional arrangements set out in AASB 1041 and AAS 38 as issued in December 1999. This additional arrangement enables these entities to apply the fair value basis to measure a class of non-current assets by reversing the effects of the previous application of the cost basis on the asset revaluation reserve and retained profits (surplus) or accumulated losses (deficiency), to the extent of the net increment or decrement in the carrying amount of that class of noncurrent assets;
- (g) The Standard now clarifies that where public sector entities have partially completed a progressive revaluation of a class of property, plant and equipment, and the transitional arrangements permitting continuation of an existing revaluation basis other than fair value expire, the fair value basis must be applied for the remainder of the progressive revaluation; and the assets already revalued on the existing revaluation basis as part of that progressive revaluation need not be revalued to fair value until the first reporting period after that progressive revaluation is completed;
- (h) The transitional arrangements have been extended for public sector entities (other than listed corporations) revaluing a class of property, plant and equipment on a progressive basis. This extension specifies that revaluation adjustments resulting from the progressive adoption of the fair value basis that would otherwise be recognised as revenues or expenses would instead be made directly to retained profits (surplus) or accumulated losses (deficiency) in each affected reporting period until the first reporting period after the expiry of the transitional arrangements; and
- (i) The commentary on fair value has been amended to remove the potential for interpretations that those non-current assets of not-for-profit entities which would be exempted from the recoverable amount test in Accounting Standard AASB 1010 and Australian Accounting Standard AAS 10 Recoverable Amount of Non-Current Assets if they were measured on the cost basis may need to be written down on the basis of their net cash inflows as part of a cash-generating operation if they are revalued to fair value under the Standard.

This Standard applies to annual reporting periods ending on or after 30 September 2001.

Employee Benefits (Revised)

The AASB has released revised Accounting Standard AASB 1028 *Employee Benefits*. The Standard is presented as a single Standard in accordance with the Board's new policy and replaces AAS 30 and AASB 1028 *Accounting for Employee Entitlements* which were issued in March 1994.

The revised AASB 1028 becomes operative for annual reporting periods beginning on or after 1 July 2002 (but may be applied earlier). Similar to the superseded AASB 1028/AAS 30, the Standard prescribes general recognition criteria for employee benefits. The revised Standard also requires a range of disclosures about compensation that will be settled with equity instruments of the employer.

The Standard does not yet require the fair value of share options or other similar rights granted to be disclosed nor does it deal with the recognition of post-employment benefits that are superannuation or medical benefits.

Key differences in the new Standard include —

- specific recognition criteria for wages and salaries, compensated absences, profit sharing and bonus plans, termination and post-employment benefits (other than superannuation and medical benefits);
- a requirement to measure employee benefits using remuneration rates that an entity expects to pay when an obligation is settled; and
- in relation to disclosures about equity-based compensation benefits, the revised Standard contains more comprehensive requirements.

Earnings per Share (revised)

The AASB has issued revised Accounting Standard AASB 1027 *Earnings per Share*, which replaces the October 2000 version of the Standard, and is applicable for reporting periods beginning on or after 1 July 2001.

The June 2001 AASB 1027 deals with an anomaly in the earlier version of the Standard regarding the adjustment of earnings on potential ordinary shares that are classified as equity and clarifies application of the notion of adjusting for shares issued for no consideration.

AASB Asks for Feedback

The Australian Accounting Standards Board (AASB) has invited preparers and users of financial reports to provide feedback on issues arising from the implementation of the trilogy Accounting Standards. The Board would like to hear of any difficulties in preparing or using the revised financial reports, or any views on their impact on reported financial results.

The AASB has also asked for views in respect of the operations of its subcommittee, the Urgent Issues Group.

Responses are required by 19 October 2001.

Survey forms soliciting views and posing specific questions are available from the AASB web site at -

www.aasb.com.au/survey/uig_survey.htm

Exposure Draft

AAS 25 Financial Reporting by Superannuation Funds

The Institute of Chartered Accountants has issued an Exposure Draft of proposed revisions to AAS 25 *Financial Reporting by Superannuation Funds*. Comments are open until 30 November 2001. Copies of the Exposure Draft are available for download from the website —

www.icaa.org.au/upload/download/ED_AAS_25.pdf



WHAT'S NEW IN AUDITING?

This Section provides an update on Australian Auditing Standards, Exposure Drafts and Guidance Statements.

The Auditing and Assurance Standards Board (AuASB) of the Australian Accounting Research Foundation (AARF) has issued a number of audit pronouncements which are discussed briefly below.

Auditing Guidance Statement

AGS 1008 Audit Implications of Prudential Reporting Requirements for Authorised Deposit-Taking Institutions (ADIs)

The revisions to AGS 1008 have been necessary as a result of the implementation of a set of harmonised Prudential Standards by the Australian Prudential Regulation Authority (APRA), which are now applicable to all Authorised Deposit-taking Institutions (ADIs).

APRA now assumes the role in prudential supervision previously undertaken by the Reserve Bank of Australia (RBA) in respect of banks and the former Australian Financial Institutions Commission (AFIC) and other State supervisory agencies in relation to non-bank ADIs.

The revised AGS 1008 —

- provides guidance for reporting engagements undertaken for client ADIs in conformity with APRA Prudential Standard APS 310 *Audit & Related Arrangements for Prudential Reporting*;
- provides example engagement letters appropriate to undertaking engagements under APS 310, including a suggested format for "Targeted Area of Review" engagements;
- provides example report formats that meet the reporting requirements of APS 310, including those for audit periods where transitional arrangements apply; and
- describes transitional issues of relevance to auditors as client ADIs move to the harmonised Prudential Standards from the previously separate Bank and non-Bank requirements.

As guidance is provided in the revised AGS 1008 for all ADIs - ie banks, as well as non-bank ADIs including building societies, credit unions, and other approved deposit taking financial institutions, the separate guidance contained previously in AGS 1010 *Audit Obligations of the Financial Institutions Scheme* (October 1995) is no longer required and has accordingly, been withdrawn by the AuASB.

AGS 1030 Auditing Derivative Financial Instruments

The purpose of this revised Auditing Guidance Statement (AGS), which was issued in June 2001, is to provide guidance to the auditor when planning and performing auditing procedures for financial report assertions related to derivative financial instruments.

This AGS focuses on auditing derivatives held by end users, including banks and other financial sector entities when they are the end users. An end user is an entity that enters into a financial transaction, through either an organised exchange or a broker, for the purpose of hedging, asset/liability management or speculating. End users consist primarily of corporations, government entities, institutional investors and financial institutions. An end user's derivative activities are often related to the entity's production or use of a commodity. The accounting systems and internal control issues associated with issuing or trading derivatives may be different from those associated with using derivatives.

AGS 1056: Electronic Commerce: Audit Risk Assessments and Control Considerations

The AuASB issued AGS 1056 in August 2000 to provide guidance to auditors where an entity uses a public network, such as the Internet, for electronic commerce (e-commerce). This AGS identifies specific matters for the auditor to consider in —

- determining the significance of e-commerce to the entity's activities;
- monitoring the impact of e-commerce on the auditor's assessment of risk; and
- developing audit strategies to respond to different risks arising from E-commerce.

The guidance provided to auditors in AGS 1056 includes —

- the auditor's need for IT skills and Internet knowledge to be able to understand the client's business;
- the auditor's assessment of inherent and control risk will be affected by the way in which an entity uses IT for e-commerce;
- audit procedures to assess the reliability of financial information relating to e-commerce transactions are largely concerned with procedures which confirm the reliability of the systems in use for capturing such information;
- there may not be any paper records for e-commerce transactions;
- the auditor must consider business continuity plans;

- traditional relationships between financial report account balances may no longer be appropriate, which may have a significant impact on the use of analytical review;
- profit is probably not an appropriate base on which to establish materiality;
- qualitative factors will affect materiality for assessing the outcome of inquiries; and
- many entities engaged in e-commerce activities report significant losses in their start-up phase.

The auditor must use professional judgement to assess the appropriateness of the going concern assumption.

AGS 1058 Auditing Mortgage Investment Schemes

This Auditing Guidance Statement (AGS) has been prepared to provide general guidance to auditors of mortgage investment schemes which are regulated by the Australian Securities and Investments Commission (ASIC) and are subject to Chapter 5C of the Corporations Act 2001 (the "Act"). The guidance in this AGS should be read in conjunction with that contained in AGS 1052 *Special Considerations in the Audit of Compliance Plans of Managed Investment Schemes* for audits of mortgage investment schemes compliance plans undertaken pursuant to section 601HG of the Act.

Auditors of mortgage investment schemes are required to adhere to the basic principles and essential procedures contained in Auditing Standards (AUSs). This AGS has been developed to clarify auditors' responsibilities in respect of such engagements, and to provide guidance to the auditors on additional considerations which may be taken into account when undertaking financial report and compliance plan audits of mortgage investment schemes.

It is important to note that this AGS does not impose any responsibilities on the auditor beyond those which are imposed by AUSs and the requirements of the Act. The provisions of the Act in this area are supported by ASIC Policy Statement 144 *Mortgage Investment Schemes* and other ASIC policy statements, including those applicable to managed investment schemes, as well as modifications to the Act made by individual orders or class orders issued by ASIC.

Revised Auditing Standard

AUS 306 Materiality and Audit Adjustments

This Auditing Standard, issued in June 2001 and effective from the issue date, revises AUS 306 *Materiality* issued in October 1995, to further clarify the existing practice regarding the auditor's consideration of materiality in planning an audit and evaluating audit evidence.

Some important aspects of the revised Standard include —

- The auditor ordinarily uses a quantitative materiality level as a threshold to plan audit procedures and selection strategies. However, although the auditor's preliminary assessment of materiality is largely based on quantitative factors, when evaluating audit evidence, both the amount (quantity) and nature (quality) need to be considered.
- The major area of revision to the guidance relates to the auditor's evaluation of the effect of misstatements.
- The guidance recognises that as the auditor's knowledge of the entity changes as the audit progresses, the quantitative materiality level selected for a preliminary assessment of materiality may be revised during the course of the audit.
- The revised Standard recognises the need to evaluate individual misstatements to assess quantitative and qualitative materiality. A consideration of qualitative factors will not always result in adjustment of individual items in the financial report. However, matters arising from a consideration of qualitative factors ordinarily impact on corporate governance or internal control, therefore the auditor will communicate with management and the audit committee, as appropriate.
- Further guidance regarding reporting responsibilities is also provided in the revised Standard.
- The revised Standard provides discussion of matters for consideration by the auditor prior to aggregating the numerical amounts of remaining uncorrected misstatements.

Exposure Drafts

ED 77 The Auditor's Responsibility to Consider Fraud and Error in and Audit of a Financial Report

ED 77 expands the basic principles and essential procedures previously contained in AUS 210 in relation to the auditor's responsibility to consider fraud and error when planning, performing and reporting on the audit of a financial report in a number of ways, that include —

- emphasising the distinction between management fraud and employee fraud and expands the discussion of fraudulent financial reporting;
- clarifying the discussion of the inherent limitations of an audit to detect fraud;
- emphasising the importance of professional scepticism when planning and performing an audit, including being alert to evidence that brings into question the reliability of management representations;
- making a more extensive inquiry of management when planning the audit, to obtain an understanding of the accounting and internal control systems in place to prevent fraud and error;
- determining whether management is aware of any fraud or possible fraud or of any material errors discovered. The auditor is also asked to seek the views, discuss and communicate fraud related matters with the appropriate level of management and those charged with Governance of the entity; and
- assessing and documenting inherent and control risk issues in relation to fraud and error and responding by designing specific audit procedures to address the risks in the audit.

ED 78 Consideration of Laws and Regulations in an Audit of a Financial Report

The AuASB proposes issuing ED 78 as a separate Auditing Standard, that now addresses the basic principles and essential procedures relating to "Other Illegal Acts" as "non-compliance" with laws and regulations. ED 78 also includes additional Australian specific guidance on understanding the legal and regulatory framework applicable to the entity and industry, and the reporting of non-compliance to management, users of financial reports and third parties from the existing AUS 210.

TAX UPDATE

National Tax Equivalent Regime (NTER)

Currently, the income of State and Territory government business enterprises is exempt from income tax under Division 1AB of the *Income Tax Assessment Act 1936* (ITAA 1936). However, the States and Territories have imposed tax equivalent obligations on these bodies to promote competitive neutrality with their private sector counterparts and to improve financial management. In Queensland, this was known as the Queensland Tax Equivalent Regime (QTER).

With the introduction of taxation reform in Australia and the new tax system, the respective Heads of Government under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations of June 1999, indicated their intention to harmonise the tax equivalent regimes of the States and Territories by introducing a National Tax Equivalent Regime (NTER). Consequently, the NTER was introduced and applies to income derived by NTER entities after 30 June 2001 and replaces the QTER.

The NTER is an administrative arrangement under which taxation laws will be applied notionally to the NTER entities as if they were subject to those laws. The Federal Commissioner for Taxation and the Australian Tax Office will undertake the administration of the NTER on a cost recovery basis. Each NTER entity will be required to remit its income tax equivalent liability to the Treasury or Revenue Office of the State or Territory to which it belongs.

Previously, Queensland Treasury administered the QTER and the Tax Assessor's position was contracted to KPMG.

The most significant difference between the two regimes is the basis under which income tax is calculated. The QTER required entities to calculate their tax liability under Income Tax Assessment Act principles as amended by the QTER. The NTER applies full Income Tax Assessment Act (ITAA) principles. Audit has undertaken a preliminary review of the NTER subject entities and the findings indicate that, in general, the changes do not appear to have any material effect on the taxation balances in the financial statements. Audit found that some NTER entities have self-assessed the impact of the NTER as low whilst some other NTER entities have utilised the services of external taxation experts to gauge the impact of the NTER.

Local Government Tax Equivalent Regime (LGTER)

Corporatised local government entities were not exempted from federal income tax under Division 1AB of the ITAA 1936. However, certain non-corporatised units within local governments (eg. transport) while not subject to income tax legislation, have been required to pay income tax to their controlling councils pursuant to the Local Government Tax Equivalent Regime (LGTER). The LGTER was established to comply with the Commonwealth Government's National Competition Policy (NCP).

Recently, Taxation Laws Amendment Bill (No 6) was passed to amend ITAA 1936 to extend tax exemption to corporatised local government entities that are owned or controlled by local governments. These entities will be subject to the LGTER, and under the revised arrangements, will pay tax equivalents to the controlling local government council. This amendment applies to income derived after 30 June 2000.



REMINDER . . . Don't forget that you can access INFORM on our website at www.qao.qld.gov.au

QAO PUBLICATIONS

- INFORM Issue 6 (April 2001)
- INFORM Issue 5 (May 2000)
- INFORM Issue 4 (Nov 1999)
- INFORM Issue 3 (June 1999)
- INFORM Issue 2 (Feb 1999)
- INFORM Issue 1 (Sept 1998)
- Our Audit Process (Feb 2001)
- Best Practice Guidelines – Information Systems (Revised) (Feb 2000)
- Consideration for Better Management of General Procurement Practices (Jan 1999)
- Best Practice Guidelines for the Sale of Material Public Sector Assets (Jan 1999)
- Guidelines – AAS 34 /AASB1036: Borrowing Costs (Dec 1998)
- Guidelines – AAS33/ AASB 1033: Presentation and Disclosure of Financial Instruments (Jul 1998)
- Guidelines for the Implementation of New Generation QGFMS (SAP R/3) (Jun 1998)
- Guidelines on AAS29 – Financial Reporting by Government Departments (Nov 1996)
- QAO Auditing Standards (Jul 1996)
- Guidelines for the Conduct of Audits of Performance Management Systems (Mar 1995)

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

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QAO in-charge auditors are usually the first point of contact for technical matters. QAO Audit Policy and Reporting Unit provides technical and policy advice to QAO in-charge auditors and staff.

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