2014 Technical Update

for Departments and Statutory Bodies

13 March 2014

Queensland Audit Office

Agenda

- Prescribed requirements
  - Bob Cui and Alison Cuthbert, Queensland Treasury and Trade
- Accounting Standards update
  - Michael Booth, Assistant Auditor-General
- Audit expectations for 2013-14
  - Karen Johnson, Assistant Auditor-General
- Case study – Financial reporting at the Department of Education, Training and Employment
  - Adam Black, DETE and John Welsh, Director
- Conclusion
  - Andrew Greaves

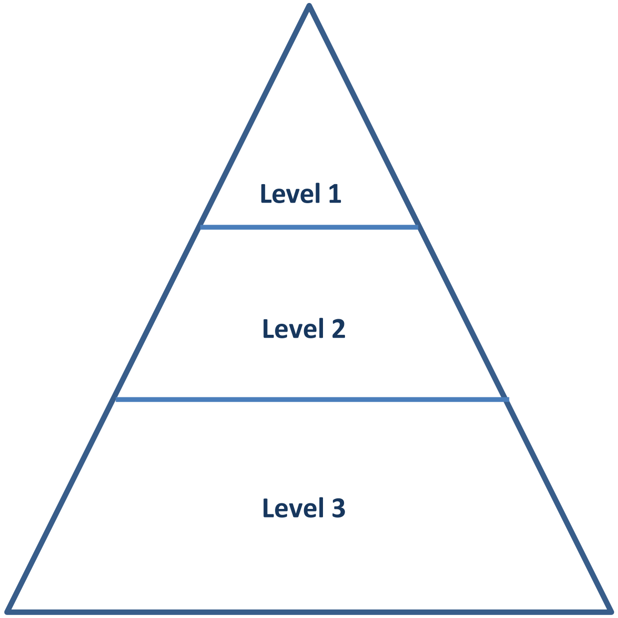
Non-current Asset Policies Update

Bob Cui
Fiscal and Financial Management Branch
Queensland Treasury and Trade

References

- NCAP 3 – *Valuation of Assets*
- NCAP 3 – Appendices
- Transitional Guidance (TG) to Accompany Draft NCAPs (emailed to agencies 11 February)
- Summary of Mandatory Treasury Policies
- Summary of Noteworthy Changes

AASB 13 - Fair Value Hierarchy



- Level 1 – *not applicable to non-current physical assets*
- Level 2 – *some land, office buildings and major plant and equipment*
- Level 3 – *some land, some (particularly specialised) buildings, some major plant and equipment, infrastructure assets and heritage and cultural assets*

?

Observable

Initial classification

?

Level 2

Level 3

Market-based

Level 3

Market-based

Entity-specific

Level 2

?

Level 3

Quoted

Unobservable

?

Level 2

?

Proposed Policy Positions

NCAP 3.4 – Guidance re fair value concepts

TG – No comparative AASB 13 information is required in the first year of application

TG – No impact on planned revaluation cycles

TG – Initial application of fair value hierarchy

TG – Transfers between fair value levels

NCAP 3 Appendices

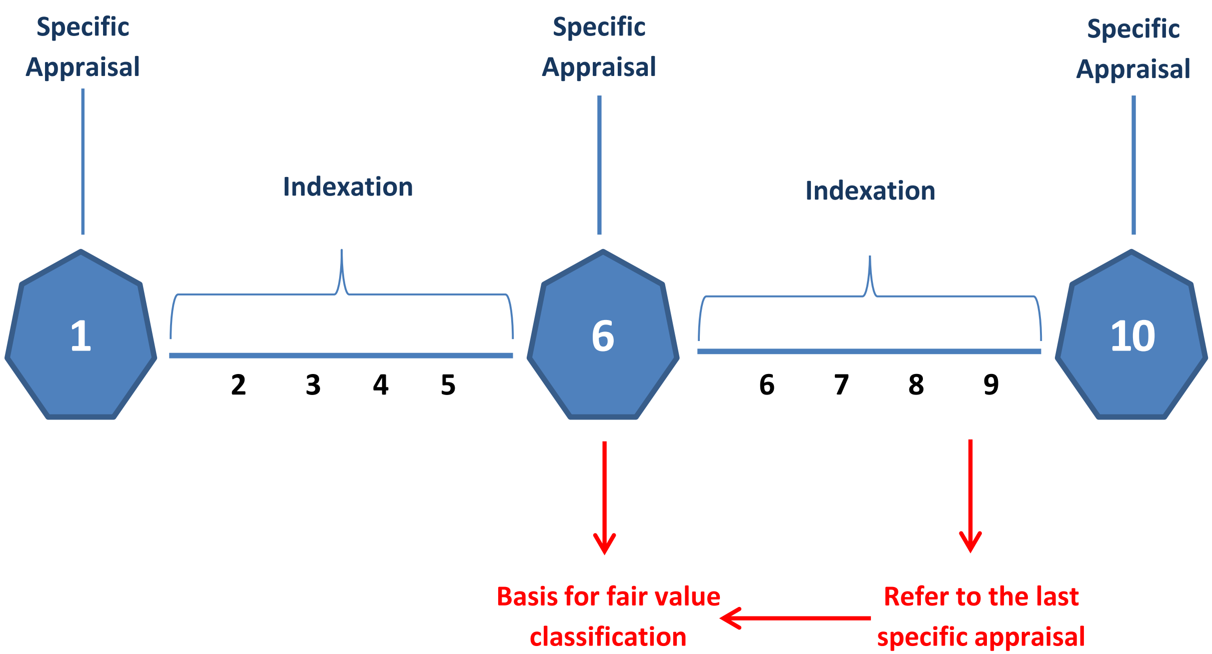
NCAP 3 - Appendices

Send queries to our help desk:

fmhelpdesk@treasury.qld.gov.au

Determine Fair Value Classification

QTT Proposed Policy – Application of indices not change the fair value level at the last specific appraisal



Refer to NCAP 3.5, Transitional Guidance and Appendix 3.2 Fair Value Measurement Expectations

Transfers between Fair Value Levels

AASB 13 Paragraph 93

"…any transfers into or out of Level 3…"

QTT Proposed Policy

For non-current physical assets – Not required to disclose transfers between fair value levels in the first year (only) of applying AASB 13

Refer to Transitional Guidance

Net vs Gross Method of Revaluation

AASB 116 *Property, Plant and Equipment* (para *35)*

'Proportionate Restatement' ('Gross') or 'Net' Method

Previous NCAPs

The Gross method of revaluation was mandated

New proposed requirements (NCAP 3.5 & 5.6)

- Gross method for Depreciated Replacement Cost (DRC)
- Net method for market/income based valuation techniques

Intend to defer to 2014/15

New Mandated Asset Class – Dwellings (intend to defer to 2014/15)

Buildings

Dwellings

Accumulated depreciation → Accumulated depreciation

Asset revaluation surplus → Asset revaluation surplus

Refer to Appendix 1.1 & 1.2 to NCAP 1

Wrap up

AASB 13

- Initial classification against fair value levels
- Transfers between levels of the fair value hierarchy in first year
- NCAP 3 including Appendices

- Gross method for DRC and net method for market/income based valuation (intend for 14/15)
- Dwellings class (intend for 14/15)
- Digital collection classes (intangibles) (13/14)

2013-14 Financial Reporting Requirements Update

Alison Cuthbert

Fiscal and Financial Management Branch

Part B - Minimum Reporting Requirements

- Corporate services received for no cost (no reliable fair value) – *see FRR 5, also amended APG 2 + Sunshine model statements' Grants and Other Contributions note*
- Key management personnel remuneration *(see FRR 5)* –
  - further clarification re what to include
  - performance payments guidance included – *also updated model statements' note*
- Management Certificate *(see FRR 10)* – compliance with wording of certificate in model financial statements (+ additional paragraph)

Part C – Accounting Policy Guidelines

- APG 1 AASB Pronouncements – all new/amended standards/interpretations issued to February 2014 – *also amended model statements' New and Revised Accounting Standards note*
- APG 8 Controlled & Administered Transactions & Balances – enhanced guidance re controlled vs administered + agency/trust transactions
- APG 9 Accounting for Contributions by Owners & Distributions to Owners – further clarification where transferor has insufficient equity for net assets transferred
- APG 12 Financial Instruments – guidance where transaction price not fair value

Part D – Sunshine Dept Model Financial Statements (Tier 1)

- Line items in statements + administered items note – expanded for completeness, terminology changed to align with 2014-15 Service Delivery Statements
- AASB 13 *Fair Value Measurement* disclosures – Summary of Significant Accounting Policies, Non-current Assets Held for Sale, Property Plant & Equipment, Investment Property, Financial Instruments notes
- Management Certificate – additional paragraph included *(already consulted departmental CFOs)*

Part E – Future Bay Regional Health Foundation Model Financial Statements (Tier 2)

- AASB 13 *Fair Value Measurement* disclosures – Summary of Significant Accounting Policies, Property Plant & Equipment
- Revised AASB 119 *Employee Benefits* – consider impacts where annual leave and/or long service leave liabilities accounted for
- Management Certificate – additional paragraph included

How to contact us

Financial Management Helpdesk:

fmhelpdesk@treasury.qld.gov.au

To be part of our distribution list for emails:

fmbregistrations@treasury.qld.gov.au

Accounting Standards Update

Michael Booth

Assistant Auditor General,
Audit Policy and Standards

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Session outline

- New Standard Requirements for 2013-14
  - AASB 13 *Fair Value Measurement*
- New Standard Requirements for 2014-15
  - AASB 10 *Consolidated Financial Statements*
  - AASB 1055 *Budgetary Reporting*
  - AASB 124 *Related Party Disclosures*
- Other matters
  - The Australian Charities and Not-for-profits Commission (ACNC)

New standard requirements for 2013-14

AASB 13 *Fair Value Measurement*

Audit Expectations

- Significant changes in agencies' revaluation policies in terms of:
  - assumptions used on principal market / advantageous market / market participants
  - valuation techniques and justifications thereof
  - fair value hierarchy level and input assumptions
  - grouping of assets to the respective fair value hierarchy level and disclosures required in Financial Statements
- Agencies' management demonstrate understanding of AASB 13 and expert valuation reports (where applicable)

AASB 13 - Audit expectations

- Prospective application and comparatives are not required for FY 2012/2013
- Separate note to the Financial Statements on Fair Value Measurement
- PPE balance as disaggregated into the fair value hierarchy level can be reconciled to FS line item

AASB 13 - Audit expectations

- For subsequent years application of AASB 13:
  - The amount of transfer between fair value hierarchy levels, transfer reasons and the agencies' policies on transfer
  - Any changes in valuation technique(s) and the reasons thereof
  - Reconciliation from opening to closing balances on Level 3 fair value hierarchy, disclosing the changes during the period:
    - Total gains/losses in profit or loss / other comprehensive income
    - Purchases, sales, issues and settlements
    - Transfer

AASB 13 - Audit expectations

Financial Instruments

- AASB 13 applies within the scope of AASB 139 *Financial Instruments: Recognition and Measurement / AASB 9 Financial Instruments*
- The disclosure requirements in AASB 13 are <u>independent and separate</u> from AASB 7 *Financial Instruments: Disclosures* and AASB 132 *Financial Instruments: Presentation*

New standard requirements for 2014-15

AASB 10 *Consolidated Financial Statements*

Changes to control?

- AASB 10 <u>has not</u> introduced any new element to control
- AASB 10 merely clarifies and refines control principles providing detailed guidance to grey consolidation areas such as:
  - Potential voting rights
  - Agency relationships
  - Relationships with structured entities
  - Power without majority of voting rights

AASB 10 - Define control

Accounting Standard	**Definition of Control**
AASB 127 *Consolidated and Separate Financial Statements*	The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities
AASB 10 *Consolidated Financial Statements*	(a) Power over the investee; and (b) Investor's exposure to variable returns; and (c) Investor's ability to use power to affect the amount of variable returns

Reference - AASB 127 Para 4
AASB 10 Para 7

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AASB 10 -Three elements of control

Elements of Control	Principles
(a) Power over the investee Ref AASB 10 Para 10 – 14	• The investor has existing substantive rights, and therefore the ability to direct relevant activities of the investee unilaterally • Substantive right is the practical ability to exercise the right to direct relevant activities that would significantly improve investee's performance, and thereby ultimately affecting investor's variable returns • Such rights do not include protective rights • The investor's returns can be only positive, or only negative or both
(b) Investor's exposure to variable returns Ref AASB 10 Para 15 – 16	
(c) Investor's ability to use power to affect the amount of variable returns Ref AASB 10 Para 17 – 18	

AASB 10 - Indication of control

Grey Area	Considering factors
Potential voting rights Ref AASB 10 B47 – B50	• Potential voting rights could arise from convertible instruments or options taking into consideration the purpose and design of the instruments • Potential voting rights are only considered when they are substantive
Agency relationships Ref AASB 10 B58 – B72	• Delegated decision making power does not constitute control • Broadly, the greater magnitude of the decision maker's economic interests relative to the returns from the investee, the more likely the decision maker is a principal

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AASB 10 - Indication of control

Grey Area	Considering factors
Relationship with structured entities Ref AASB 10 B5 – B8	• Assess the purpose and design of the investee e.g. voting rights are not the dominant factor in deciding control, and that relevant activities are directed via contractual arrangement between the investor and /or the investee / other parties • Consider the risk the investee was designed to be exposed to, and the risk the investee was designed to pass on to the parties involved with the investee (including the investor). Such risks include downside and/or upside risk (i.e. risk and rewards assessment) • i.e. consideration of substance over legal form
Power without majority voting rights Ref AASB 10 B38	• Contractual arrangement between the investor and other vote holders on voting rights and/or other decision making rights

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AASB 1055 *Budgetary Reporting* - Purpose

- AASB 1055 removes the disclosure requirements of budgetary information in AASB 1049 *Whole of Government and General Government Sector Financial Reporting*
- All budgetary reporting requirements applicable to public sector entities are now located in AASB 1055 *Budgetary Reporting*
- AASB 1055 aims to assist users in assessing the entity's discharge of accountability and performance when comparing budgeted to actual amounts

Reference - AASB 1055, PREFACE, Page 5
AASB 1055, Para 15

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AASB 1055 - Main requirements

Budgetary reporting disclosures applicable to:

- financial statements of General Government Sector (GGS)
- Whole of Government (WoG) general purpose financial statements
- the general purpose financial statements of not-for-profit entities within GGS

Reference - AASB 1055, Para 2

AASB 124 (and ED 214) *Related Party Disclosures*

- Currently does not apply to NFP Public Sector Entities but note ED 214
- It <u>does not</u> change the current practice given that individual key executive remuneration disclosures are required by the Financial Reporting Requirements as issued by the Queensland Treasury and Trade

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AASB 124 - Main changes

- AASB 2011-4 made amendments to remove individual key management personnel (KMP) disclosure requirements
- KMP compensation disclosure in total is still required under AASB 124
- Applied from annual reporting period beginning on or after 1 July 2013 (early adoption is not permitted)

Other matters

Australian Charities and Not-for-profits Commission (ACNC)

- Overview
- Definition of charities
- What is a government entity within the Charities Act
- What does ACNC mean for the Agencies

ACNC Overview

- Independent national regulator of charities
- ACNC is established under the *Australian Charities and Not-for-profits Commission Act 2012 (Cth)* (ACNC Act)
- Currently ACNC does not regulate the not-for-profits sector other than entities / organisations which are defined as charities under the *Charities Act 2013 (Cth)* (Charities Act)

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Definition of charities

s.5 of the Charities Act defines a charity as an entity:

- that is not-for-profit; and
- all of the purposes which are charitable for the public benefit; and
- does not have a disqualifying purpose; and
- that is not an individual, a political party or a government entity
  - Government entity is an entity
    - within the meaning of the *A New Tax System (Australian Business Number) Act 1999*; or
    - established under a State / Territory law and prescribed by the Minister by legislation; or
    - a foreign government agency (within the meaning of the Income Tax Assessment Act 1997)

What is a government entity

a. Commonwealth Department; or
b. State / Territory Department; or
c. Department established under the *Parliamentary Service Act 1999*; or
d. Executive Agency or Statutory Agency (within the meaning of the *Public Service Act 1999*); or
e. an organisation that:
   - is not an entity; and
   - is either established by the Commonwealth / State / Territory to carry on an enterprise for a public purpose by an Australian law; and
   - can be separately identified through its activities or location
   - the above applied regardless if the organisation is part of (a), (b), (c) or (d)

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What does ACNC mean for the agencies

- The definition of government entity is wide and would capture majority of government agencies i.e. government agencies are unlikely to be a charity for the purpose of ACNC
- However, agencies need to assess if companies / funds set up by agencies are in fact a charity and therefore regulated by ACNC

Audit Expectations for 2013-14

Karen Johnson

Assistant Auditor-General,
Specialist Audit Services

Queensland Audit Office

Results of financial statement audits 2012-13

Timeliness of financial statements

Financial statements prepared and audited within timeframe	FY 2012/2013	FY 2011/2012	Variance
Departments	100%	96%	4%
Statutory bodies	55%	67%	(12%)
Government owned corporations	100%	83%	17%
Public sector companies	78%	83%	(5%)

- The negative variance on statutory bodies mainly relates to small water board entities which were required to prepare general purpose financial statement for the first time in FY 2012-13

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CFO certification

- Purpose = to provide confidence to the DG that financial internal controls put in place by the CFO are operating and therefore the likelihood of a material misstatement in the financial statements is low

- In 2012-13 QAO found that most departments had robust CFO certification processes

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CFO certification

- Some areas for improvement:
  - Better documentation on how the process will work - from beginning to end
    - Apply a controls framework (eg COSO)
    - Clearly describe significant financial reporting risk and make explicit statements as to how those risks have been addressed
    - Consulting earlier with the DG to ensure a clear understanding of key controls and what level of assurance can be expected
    - Audit committee / Fraud committee oversight
    - Consider the type of assurance from external service providers and remote locations

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CFO certification

- The audit evidence we require to support the conclusion that the process is effective:
  - financial reporting risks are clearly aligned to financial statement balances
  - Identify the supporting information systems that also impact the financial reporting risk; evaluate their risks
  - Consideration of the risk of remote locations
  - Identify the key controls to address these risks
  - Plan the tools needed to evaluate and monitor the effectiveness of those key controls
  - Report on findings throughout the year

Month end processes & financial statement timetable

- Strategies outlined in letters from Under Treasurers in Feb 2013 and Jan 2014
- Timetable should work backwards from critical events
- Proforma financial statements and soft or hard closes are essential

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Month end processes & financial statement timetable

Strategies	Requirements
Monthly basis (with management review and endorsement)	• Variance analysis (with meaningful explanation) • All key balance sheet reconciliations are prepared, issues resolved and approved • Report on contingent assets and liabilities • Management's strategies on emerging financial risks
From 2014 endeavour to have	• Soft Close • Pro forma financial statement prepared by 30 April (includes comparatives and updated accounting policy notes) • Accounting issues resolved by 30 April • All asset stocktakes completed by 30 April
In longer term	• Non current asset revaluations completed by 31 March • Utilise internal audit function for annual financial statement reporting process • Independent members appointed to the department's Audit Committee (ideal ratio is 50%) • Hard Close

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Earlier identification & resolution of accounting issues

- Year end financial statements must:
  - present a true and fair view of the departments' transactions and financial position
  - present fairly in accordance with applicable accounting standards

- Consider one off, complex or significant transactions and changes in accounting policy

- Analyse these transactions under your accounting framework; seek independent advice

Earlier identification & resolution of accounting issues

- Update accounting policies and draft note disclosure
- Engage with QAO early particularly in controversial or emerging areas for which there is a lack of authoritative guidance

Subsequent events

- Historically, a large number of our “emerging issues” or adjustments for “prior year errors” have actually been undisclosed events that occurred after 30 June.

- QAO will be looking at the process the CFO has undertaken to ensure that the most senior staff understand those disclosure requirements and confirm that all events have been disclosed to us.

Early assessment and evaluation of revaluation process and results

- Formal independent fair valuations are not expected every year, but we expect you to assess for indicators of changes to underlying assumptions

- Management and the valuer must work together to validate the key inputs and assumptions into the valuation methodology

- QAO will review the process to identify the lowest CGU

Early assessment and evaluation of revaluation process and results

- What we audit:
  - the methodology used by valuers, looking for consistency in the valuation approach
  - your evaluation of the key assumptions and inputs used by the valuers - ensure there is documented support for the key inputs and assumptions
  - understand the reason for significant movements in the asset values - do they make economic sense?
  - disclosure of the key assumptions and inputs in the financial statements

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Financial reporting at the Department of Education, Training and Employment - CFO Perspective

Adam Black
Assistant Director-General, Finance and Chief Finance Officer

13 March 2014

Topics

- DETE Business environment
- Internal control framework and improvements to the CFO Statement of Assurance
- Progress on improvements to the Department's Financial Statements.

DETE's Business Environment

OVER
$11.4 Billion
allocated for 2013-14

23% of Queensland state budget

OVER $536 million
in capital investment

$0.32 Billion — Early Childhood

$7.04 Billion — State schooling

$1.31 Billion — Training, Tertiary Education & Employment

$2.73 Billion — Non-state schooling & other education related services

OVER
84,000 staff

95% staff in schools and TAFEs

1,300 Locations

OVER 39,000 buildings

50,000
Queensland children enrolled in kindergarten programs in 2012
31,700 more kindy enrolments between 2009-2012

173% INCREASE in kindy enrolments
2009 to 2012

747,000
Queensland school students in 2012
498,000 state school students
249,000 non state school students

288,000
Queensland students enrolled in publicly funded Vocational Education and Training

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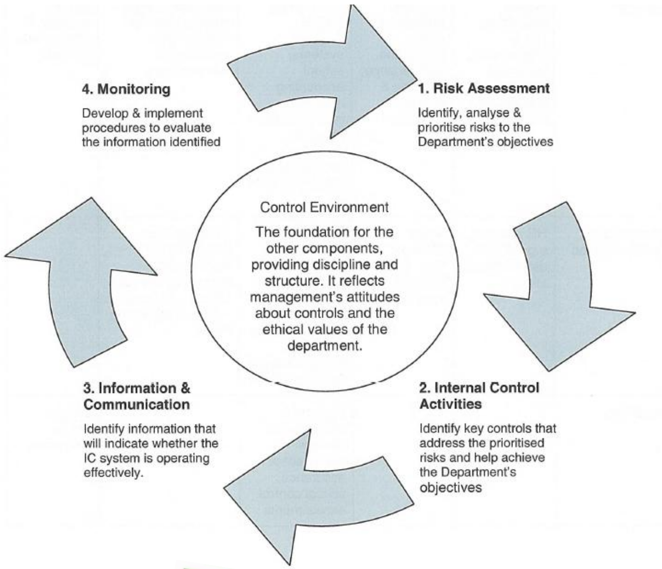
DETE's Control Environment



- DETE's control framework is aligned with an internationally recognised framework established by the Committee of Sponsoring Organisations of the Treadway Commission (COSO).
- QAO's 2012-13 management reports identified no high risk issues
- Financial Internal Control Improvements in 2013-14 include:
  - Early engagement with Director-General
  - Top Down Risk Approach
  - Documentation of process and introduction of eForms
  - Financial Delegations integrated with finance systems
  - Establishment of Fraud and Corruption Control Committee
  - Control Self Assessment for schools
  - Statement of Assurance to include Machinery of Government questionnaire.

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Financial Statement Improvements

Departments on a monthly basis, should…

Strategy	Status
Perform variance analysis with meaningful explanations	✓Financial Performance report produced each month (Day 10) ✓Monthly monitoring by Executive Management Board ✓Value of Year on year comparison is low due to significant changes in the department over the last 2 years. ✓New budget issued on budget day including deferrals (June)
Identify and outline strategies to address new and emerging financial risks and pressure points	✓Financial Performance report includes emerging issues and end of year forecast ✓Includes key actions with accountable Executive Management Board member for action ✓DETE Long Term Financial Strategic Plan 2013-17.
Ensure all bank and other key reconciliations, are prepared, issues resolved approved	✓Reconciliations monitored through Finance Branch program management framework on an exception basis ✓School reconciliations monitored through OneSchool finance system.
Report on contingent assets and liabilities	✓Monitored monthly through the Financial Performance report - emerging issues section ✓Collated centrally at end of financial year.

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Financial Statement Improvements

Departments commencing in 2014, should

Strategy	Status
Prepare pro forma financial statements	✓Soft close targeted for March ✓Draft financial statements to QAO in April – substantial change in 2013-14 with impact of Machinery of Government changes.
Resolved accounting issues for all one off, complex or significant transactions	✓Partnering with QAO is key - monthly QAO meetings to provide update on key organisational changes ✓ Key issues for resolution by end April include Machinery of Government changes arising from TAFE reform, changes to Grants definitions and Non Current Asset Policy.
Independent members to Audit committees	✓DETE has two independent committee members with 1 member being Chair of the Committee.
Completed all asset stocktakes	✓Completely progressively throughout the year – largely completed by April.
Capability and professional development	✓ DETE member of CPA employer program ✓ Strong supporter of Inter-departmental Accounting Group.

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Financial Statement Improvements

Long term strategies

Strategy	Status
Revaluations completed by March	✓Valuation brought forward in 2013-14 – expected completion March 2014.
Use of internal audit function in the annual financial statement preparation process	✓Internal audit key role in school audits and review of work papers and statements ✓Monthly update with Internal audit.

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In summary

- Create a ‘no surprises’ environment through timely budget management with monthly financial reporting
- Partnering with QAO an important factor in a healthy financial internal control framework
- Focus on continuous improvement in line with the Auditor-General’s and Under-Treasurer’s expectations.

Financial reporting at the Department of Education, Training and Employment

Monthly Reporting Reliance

John Welsh
Director

Queensland Audit Office

Audit use

- External audit can use robust effective monthly management reporting for two distinct purposes:
  - It is a key monitoring control which assists audit in assessing the overall control environment of an entity.
  - Assists in reducing year end work by bringing substantive work forward – early close

Audit use

- Only reliance if audit assesses reporting is operating effectively. Management actually using the reports.

Monitoring control

- Examples of information used by management:
  - Ratios, trends, and operating statistics
  - Monthly financial performance analysis
  - Budgets, forecasts, variance analysis
  - Employee performance measures
  - Monthly P/L, B/S and cash flow.
  - Key monthly reconciliations

Monitoring control

- Management would need to use and act on this information for audit to consider relying on this monitoring control.
  - e.g. Minutes and actions of EMB, budget committee, investment committee, audit and risk management committee

Early close

- Effective monthly management reporting enables audit to bring forward its end of year financial statement verification process.
- Concepts of early close, soft close and hard close not always used.

Early close

- Concept of testing balances/reconciliations at end of month e.g. March or April in May/June and then minimise the level of work performed in July/August to verify the 30 June figure.
- Works well for balances that move in a uniformed manner across the 12 months or little movement in last few months before year end.

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Early close

- Hard close ideally includes audit ready trial balance, the preparation of a draft set of financial statements with current policy notes and last year's numbers included provided to audit for early debate.
- Key to success is clear alignment of monthly financial reporting process with year end financial preparation process including the production of actual monthly reports.

Early close

- Year end process is viewed only as a special month end task not a problematic one off event.
- Government has moved from four months to two months over the past decade for financial statement audit certification QAO had to find smarter ways to operate.
- Early close processes are beneficial to management and audit only where there is effective monthly reporting.

Early close

- NSW Treasury have recently mandated early close procedures for state sector entities.

Conclusion

Andrew Greaves

Auditor-General

Queensland Audit Office

Conclusion

- Building partnerships - key to ensure an efficient and effective audit process is relationships and communication!

- Early engagement between clients and QAO focusing on the big ticket items is essential.

- Decisions should focus on efficient and effective use of public resources, and not be driven by the accounting treatment.

Questions?

Please email any questions about today’s presentations to:
apq@qao.qld.gov.au