

Client technical audit update

24 February 2017

Better public services

Welcome and agenda



Timeliness and quality of financial reporting

Accounting and Treasury update

Long form audit opinion

Asset valuation

Closing remarks

Timeliness and quality of financial reporting

Paul Christensen

Sector Director Central Agencies and
Financial Services, QAO

For statements to be useful, information must be relevant and accurate



Should be completed and available as **close to the end of the financial year as possible**

Information is less relevant to users if it is not timely

The quality of the processes used to prepare financial statements impacts on both the quality and timeliness of the statements.

At its most basic level:

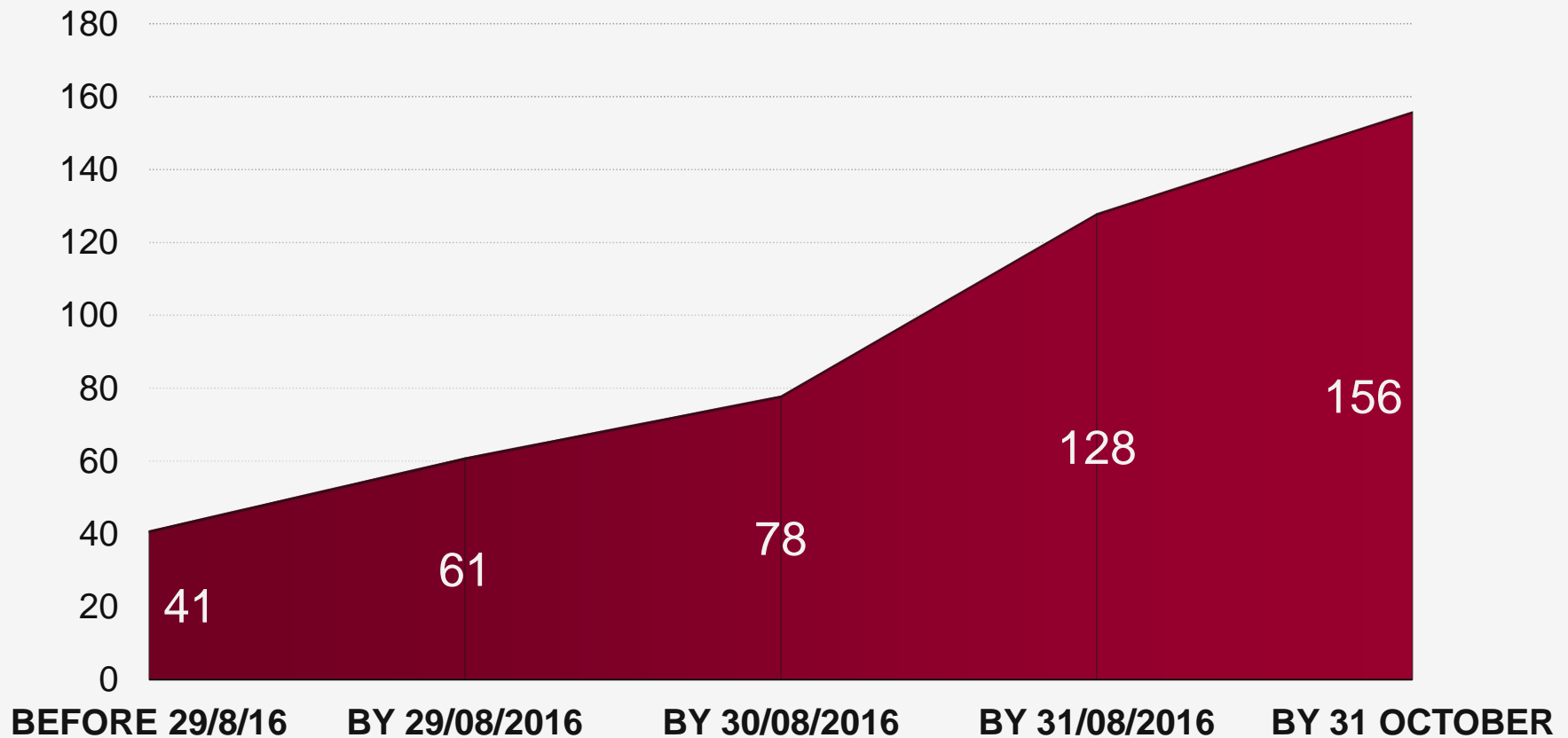
Timeliness is reflected in whether financial statements are prepared and audited within statutory deadlines

Quality is reflected in the type of audit opinion issued on the financial statements



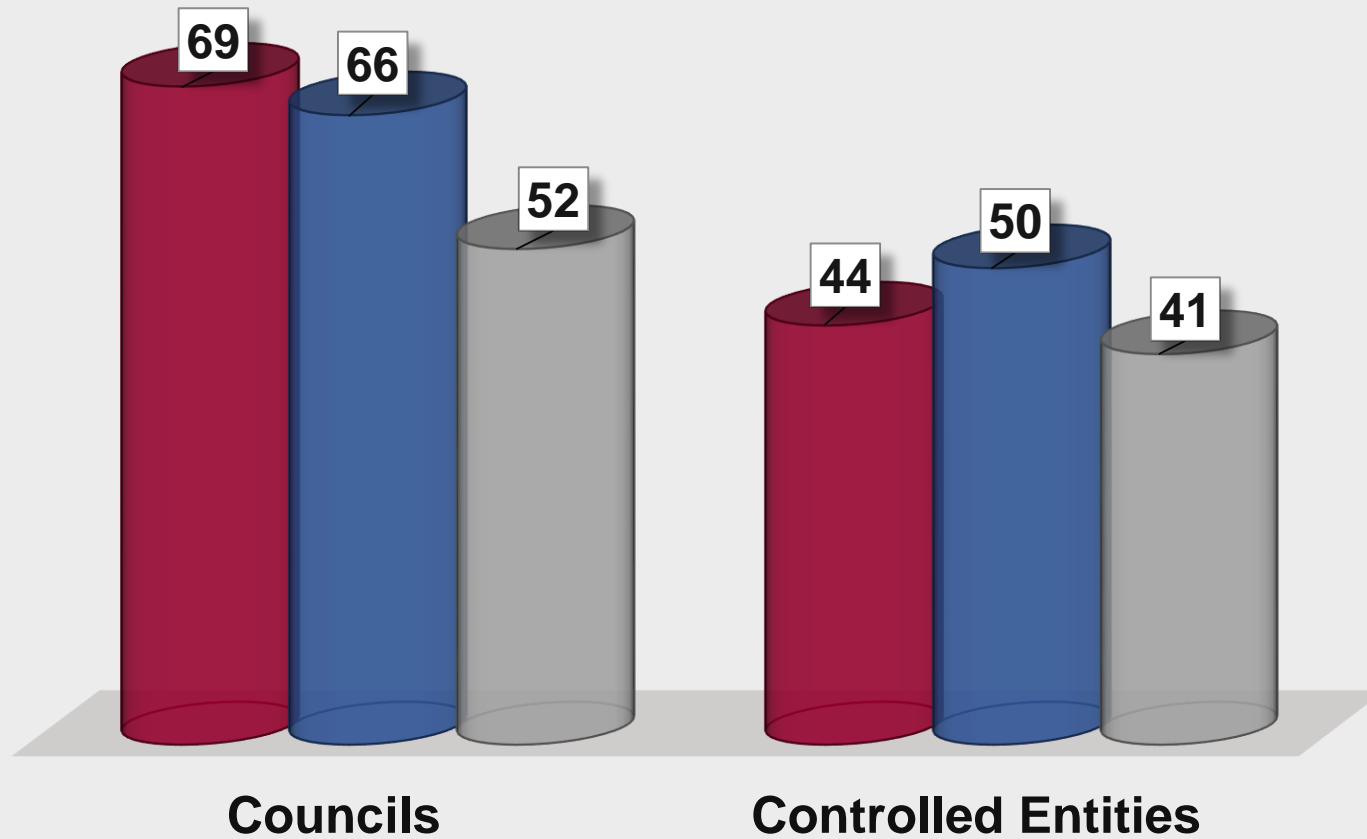
However, we are now reporting on other measures that reflect on the timeliness and quality of financial reports.

Certification of financial statements



SIGNED BY 31 OCTOBER

■ 2015–16 ■ 2014–15



Our rating	Timeliness of draft financial statements assessment
● Effective	Acceptable draft financial statements were received on or prior to the planned date
● Generally effective	Acceptable draft financial statements were received within two days after the planned date
● Ineffective	Acceptable draft financial statements were received greater than two days after the planned date

- Non-current asset valuations by 31 May
- Pro forma financial statements by 30 April
- Resolving known accounting issues by 30 April
- Completing early close processes
- Concluding all asset stocktakes by 30 June

Our rating	Year end close process assessment
● Effective	All five key processes were completed by the planned date
● Generally effective	Three of the five key processes were completed within two weeks of the planned date
● Ineffective	Less than three of the five key processes were completed within two weeks of the planned date

- Total revenue
- Total expenditure
- Net assets

Our rating

Quality of draft financial statements assessment

● Effective	No adjustments were required
● Generally effective	Adjustments for any of the three key financial statement components were less than five per cent
● Ineffective	Adjustments for any of the three key financial statement components were greater than five per cent

New look parliamentary reports

Entity	Internal controls					Financial statement preparation		
	CE	RA	CA	IC	MA	YE	T	Q
Entity type								
Entity 1	●	●	●	●	●	●	●	●
Entity 2	●	●	●	●	●	●	●	●
Entity 3	●	●	●	●	●	●	●	●
Entity 4	●	●	●	●	●	●	●	●
Entity 5	●	●	●	●	●	●	●	●
Entity 6	●	●	●	●	●	●	●	●

- CE = control environment
- RA = risk assessment
- CA = controls activities
- IC = information communications
- MA = monitoring activities

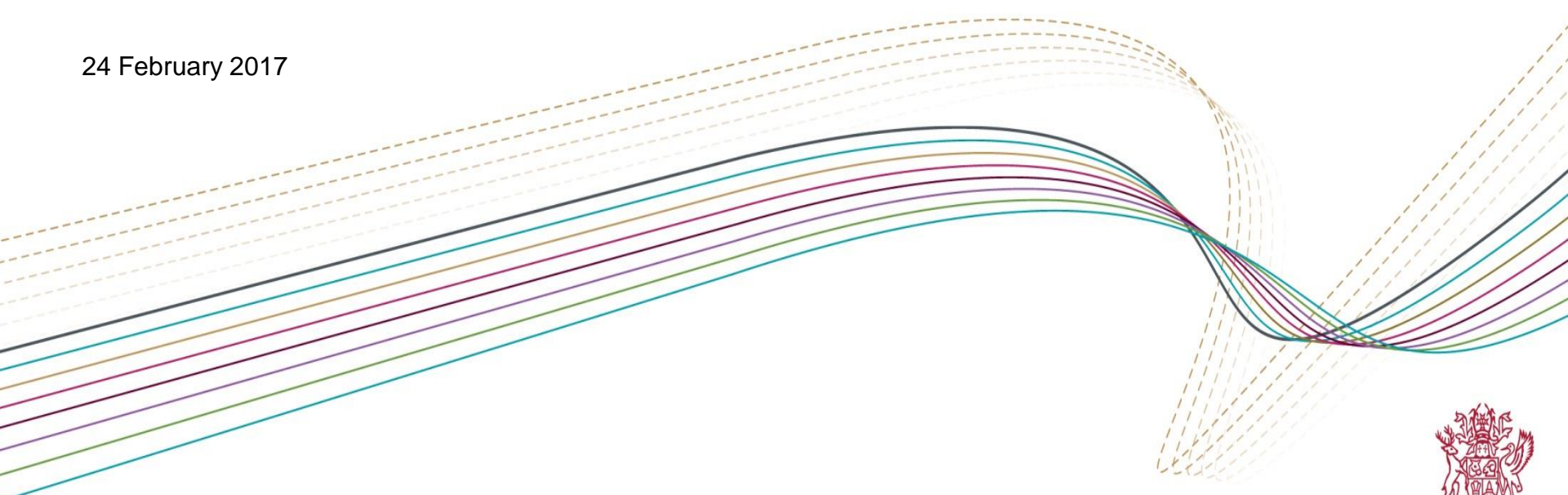
- YE = Year end close processes
- T = timeliness
- Q = quality

Q&A

2016-17 Reporting – Hot Topics!

Alison Cuthbert
Accounting Policy & Advice team

24 February 2017



Proposed new guidance

FRR 2D.1 Treasury Requirements for All Agency Financial Statements

By end of April -

- ✓ one-off/complex/significant accounting issues, changes in accounting policies
- ✓ pro forma financial statements

Draft financial statements (partial or whole) to Audit Committee/external audit members –
at least 5 days before meeting

Complete draft financial statements to external audit – *mid August at latest*

Financial Accountability Handbook - Information Sheet 5.2 Preparation of Financial Statements

FRR 4B.1 Non-current Physical Assets

By 31 May from 2017-18 – process annual revaluations in systems



Proposed deletion of selected requirements

FRR 5C.2 Presentation of Original Budget Information

- Budget vs actual comparisons only in notes (i.e. choice available)

FRR 5C.4 Explanation and Disclosure of Budget Variances

- Disclosure of % variances

Sunshine Department model financial statements amended to reflect new presentation choice



Model financial statements – full AASB disclosures

Illustrative dissections removed for (agencies to determine own dissections) -

- Note B3-2 - Supplies and Services
- Note B3-3 - Grants and Subsidies
- Note B3-7 - Other Expenses

Illustrative narrative disclosures enhanced for –

- componentisation of property, plant & equipment – refer to Note C7-2 - Recognition and Acquisition (Property, Plant and Equipment and Depreciation Expense) & Note C7-5 - Depreciation Expense
- fair value measurement – refer to Note D1-2 - Basis for Fair Values of Assets and Liabilities

FRR 3C.3 Disclosure of KMP & FRR 3C.4 KMP Remuneration Expenses

- AASB 124 now primary authority for remuneration disclosures + position-level detail in FRRs
- Watch out for non-monetary benefits for KMP e.g. through related party declarations

NB. Cabinet still considering implications for Ministers

Proposed to Cabinet that KMP for agencies likely to include Ministers from 2016-17 –

- departments - definitely
- statutory bodies - subject to agency assessment

but no remuneration to disclose for Ministers in agency financial statements

Proposed to Cabinet - KMP for Whole-of-Government - all Ministers

Related party disclosures

- **FRR 5B Related Party Transactions** - totally overhauled; includes guidance previously circulated & draft KMP declaration template
- Identify all related parties as per paragraph 9 of AASB 124
- Remember paragraph 1 objective of disclosure – financial implications for agency
- Follow disclosure requirements in paragraphs 18 – 19 of AASB 124
- Be mindful of materiality, conciseness, location of information
- Consider draft disclosures in model financial statements (which ignore materiality)



RDR entities – no need to disclose these transactions!

For all other entities –

- Requires awareness of which entities controlled by Queensland Government
- Applies to parent & controlled entities in Government context
- High level disclosures as per paragraphs 26 & 27 of AASB 124
- Individually significant or collectively significant transactions only



KMP need to –

- ✓ carefully read guidance re close family members, control of entities etc.
- ✓ complete declaration step-by-step, carefully reading questions asked
- ✓ understand the certifications they are signing-off on

KMP to step through logic of information requested –

- Who are my close family members? Identify them
- Do I, or any of my close family members, control or jointly control any entities? If so, identify them
- For any of the above people/entities – did any of them enter into any of the transaction types (listed in the declaration) with my entity? Tick Yes/No for each transaction type
- If answer Yes to any transaction type - provide the information requested for each one

Related party disclosures – Ministerial KMP

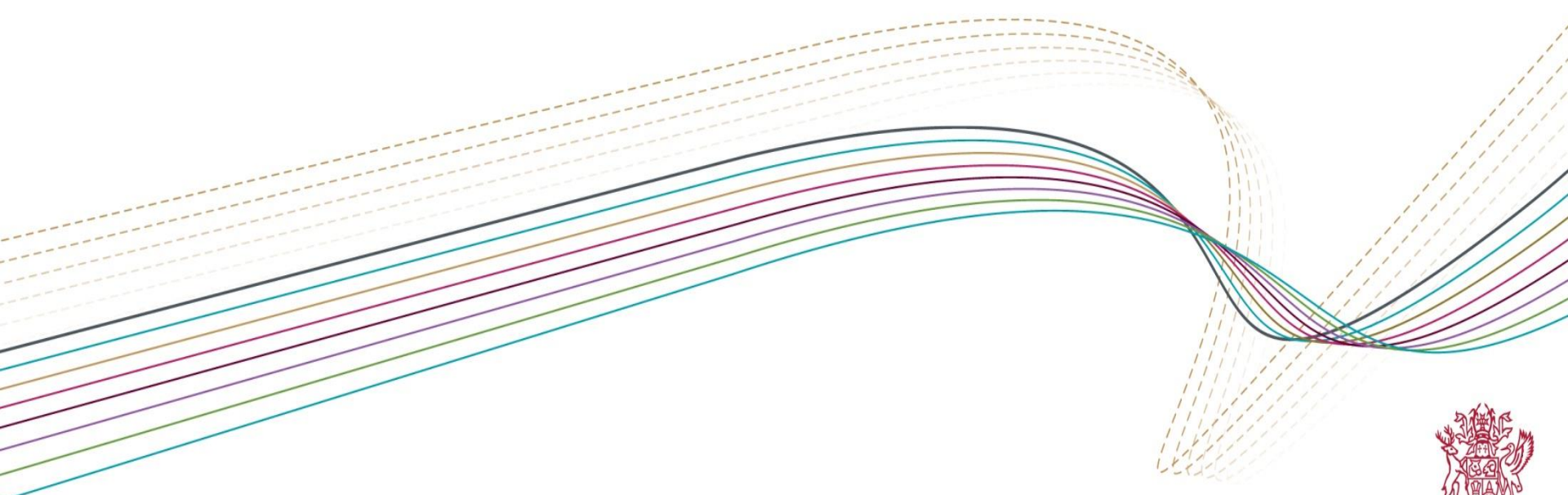
Cabinet still considering information collection process; entities will be advised after Cabinet completes its deliberations

Entities (departments, statutory bodies, GOCs) not to collect info from Ministers, even as part of their KMP

Planned for minimal involvement by entities –

- Integrity Commissioner proposed to collect information from Ministers
- Treasury & DPC plan to determine & draft potential disclosures, including consultation with Ministers & negotiations with QAO
- entities may need to promptly validate information & source additional details for Treasury/DPC for disclosure
- planned that entities include agreed disclosures in financial statements; no further effort required

**For Treasury advice – email
fmhelpdesk@treasury.qld.gov.au**



Accounting and Treasury update

Accounting standards update

Focused financial reporting

David Hardidge

Technical Director, QAO

Objective of AASB 124

‘...to ensure that an entity’s financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, such parties’



Upcoming changes

2016–17

AASB 124 Related Party Disclosures

New long form audit reports

2019–20

AASB 15 Revenue + AASB 1058 Income for NFPs

AASB 16 Leases

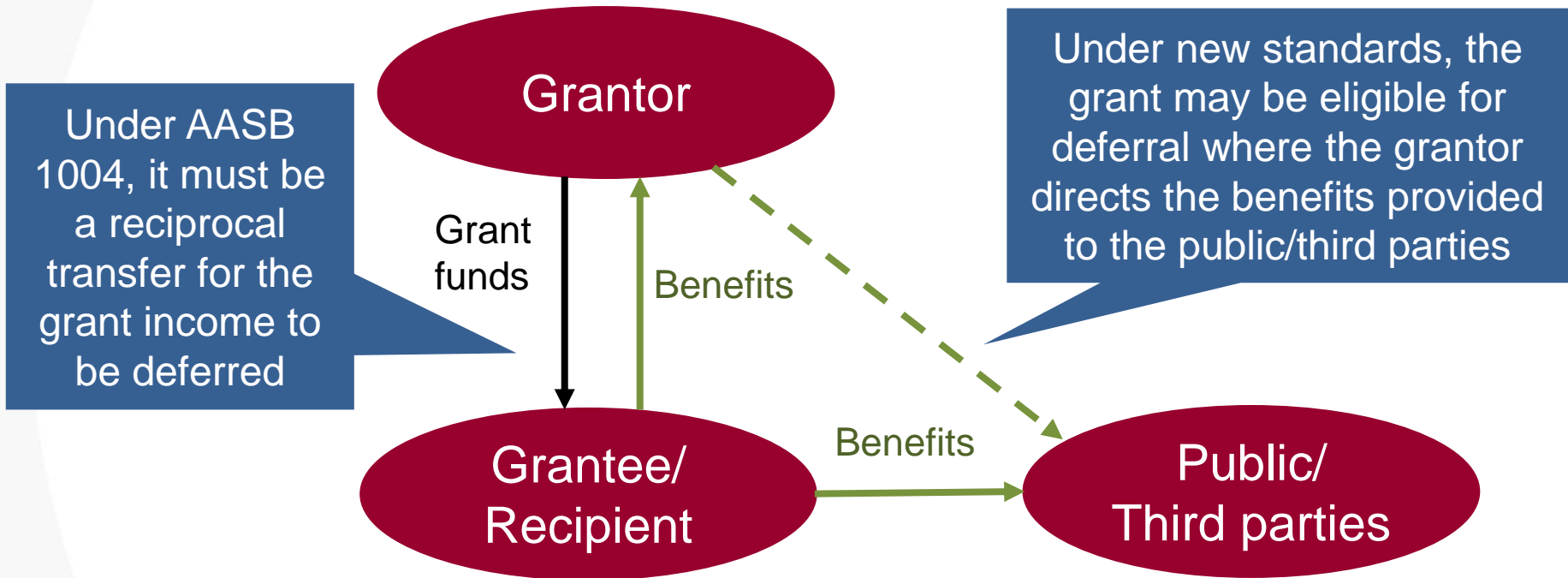
Service Concession Arrangements (PPPs)

Beyond

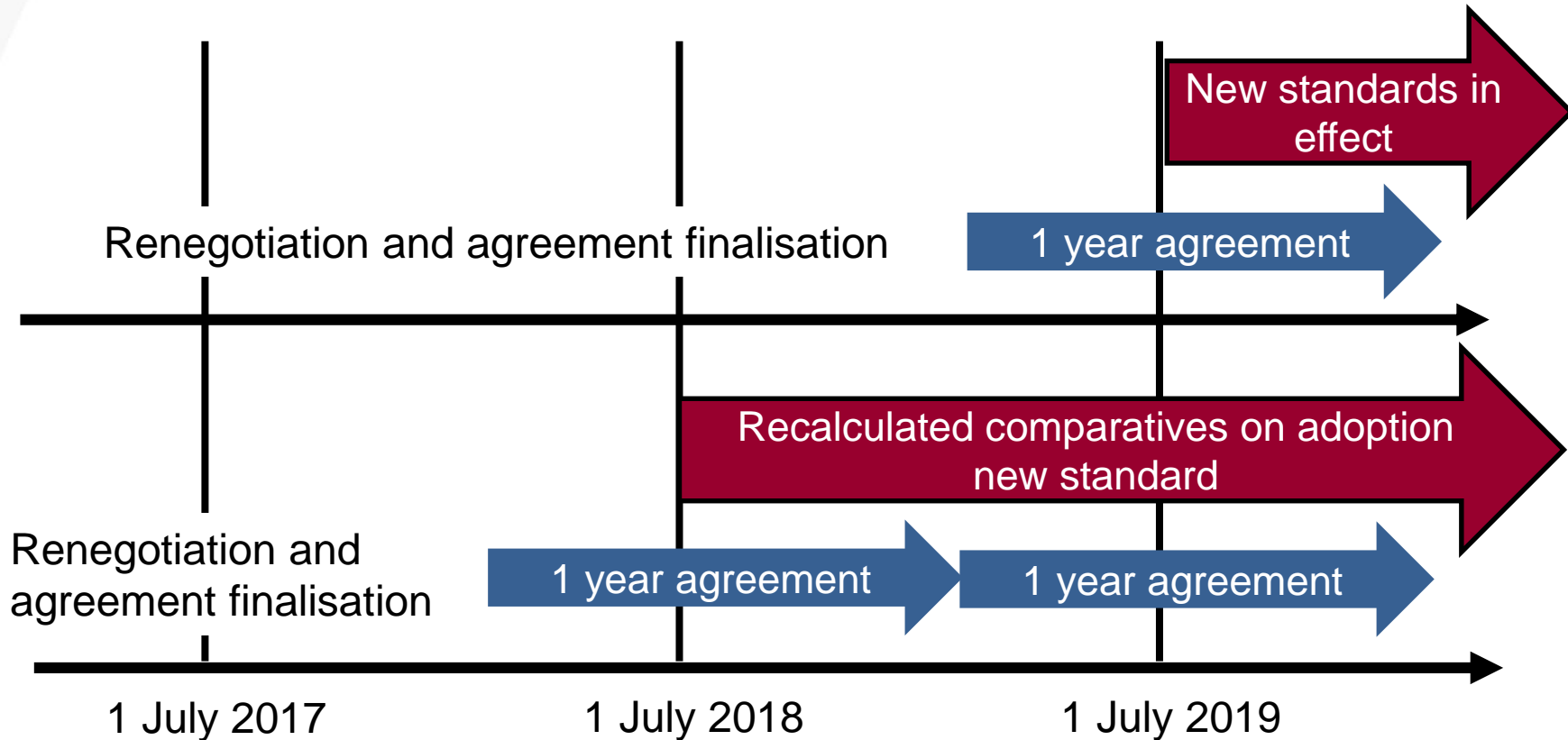
RDR

Reporting entities

Conceptual change from AASB 1004



Planning ahead



Note: Replace July with January for entities with 31 December year ends.

Finance lease accounting based

- Determine term
- Determine rental payments (cash flows)
- Determine discount rate



Recognise

- Lease liability
 - lease interest
- Lease asset (right-to-use asset)
 - depreciation



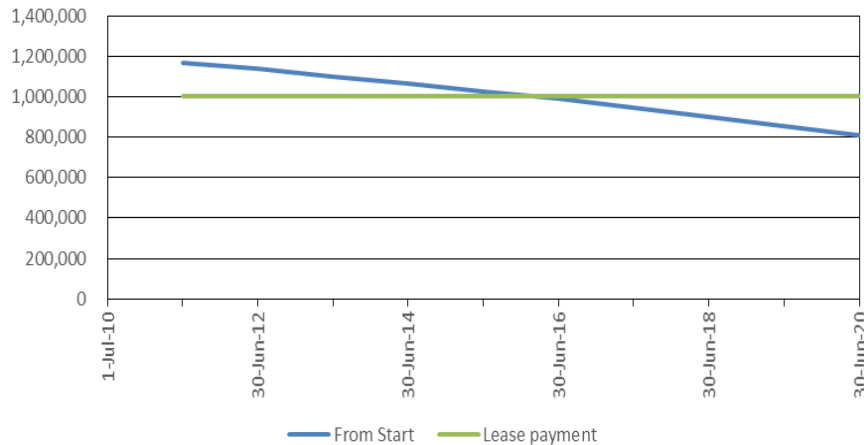
Parallel universe

Leases—profit or loss effect

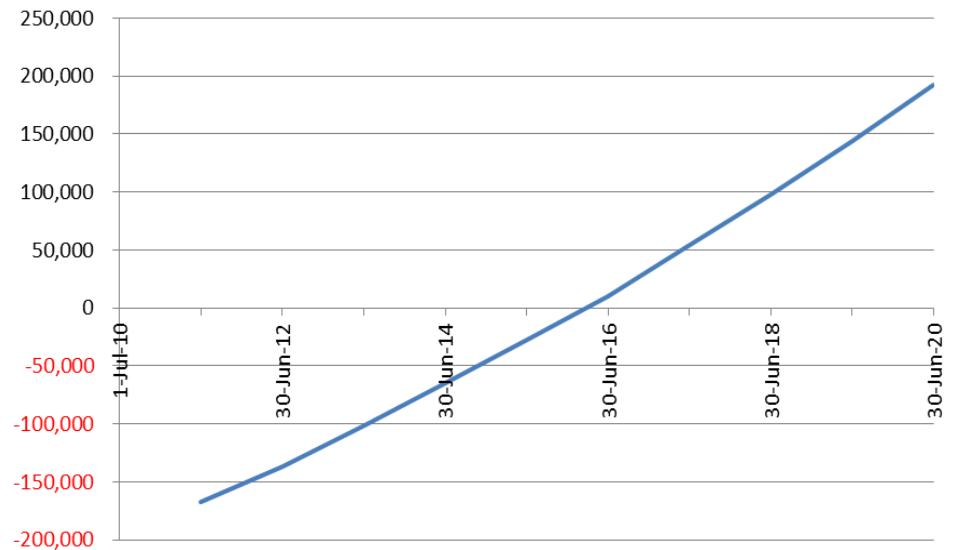
Comparison effect on expenses and net profit

Gross effect P&L

Interest and dep'n c/f lease payment



Net effect P&L



New long form audit report wording

Key Audit Matters

Other information

Change in auditor responsibilities



Change in process—watch out for delays

Charities

Statutory bodies—also complying with the ACNC Act

Companies—complying with the ACNC Act

Q&A

Long form audit opinion

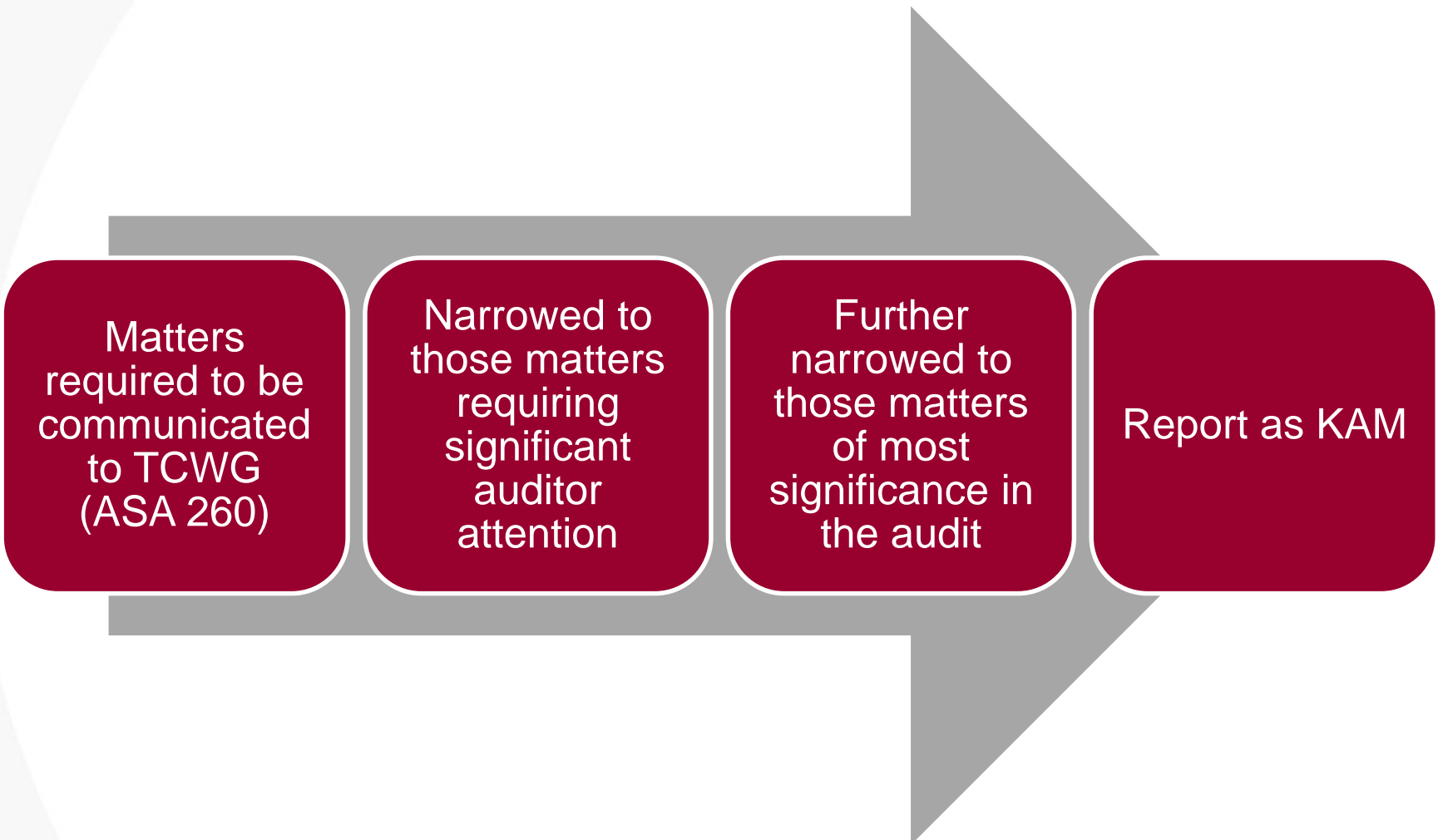
Rachel Vagg

Sector Director Natural Resources, QAO

What is a key audit matter (ASA 701)?

‘matters that in the auditor’s professional judgement, were of most significance in the **audit** of the financial report of the current period.

Key audit matters are selected from matters communicated with those charged with governance’



Matters
required to be
communicated
to TCWG
(ASA 260)

Narrowed to
those matters
requiring
significant
auditor
attention

Further
narrowed to
those matters
of most
significance in
the audit

Report as KAM

Details

Why the matter was considered of most significance in the current year audit

Must cross-reference to any relevant FS note disclosure

Audit

Our approach to the matter

What we did (key audit procedures only—not necessarily all)

Outcome

How the matter was addressed in the audit

No separate opinion expressed

What do we think could be a KAM?



Assets

Current replacement cost

Depreciation/useful lives



Provisions

- Employee entitlements
- Onerous contracts



Recognition

- Revenue
- Contingents

Key Audit Matter

Those matters that, in our professional judgement, were of most significance in our audit of the financial report of the current period. These

Valuation of Buildings at current replacement cost (\$X)

(Refer Note(s) X and X)

Buildings are material to <insert client name> and are measured at fair value. Because of their specialised nature, market value is not an appropriate basis of

The comprehensive revaluation model used to value these specialised buildings involves the use of significant assumptions and judgements in the key inputs to its basis of calculation, as follows:

Assessed key inputs to the comprehensive valuation model

The allocation of each building to one of the standardised building types based on its asset type (use) to assist in calculating the key cost drivers for determining its replacement cost

How our audit addressed this key audit matter — key procedures included:

For a sample of buildings across each of the standardised building types, we assessed the:

- reasonableness of the allocation, based on our understanding of the buildings' current use.
- consistency of the allocation, by comparing to the building's allocation in prior years and allocations of buildings with a similar use in the current year.

State government



Local government



Q&A

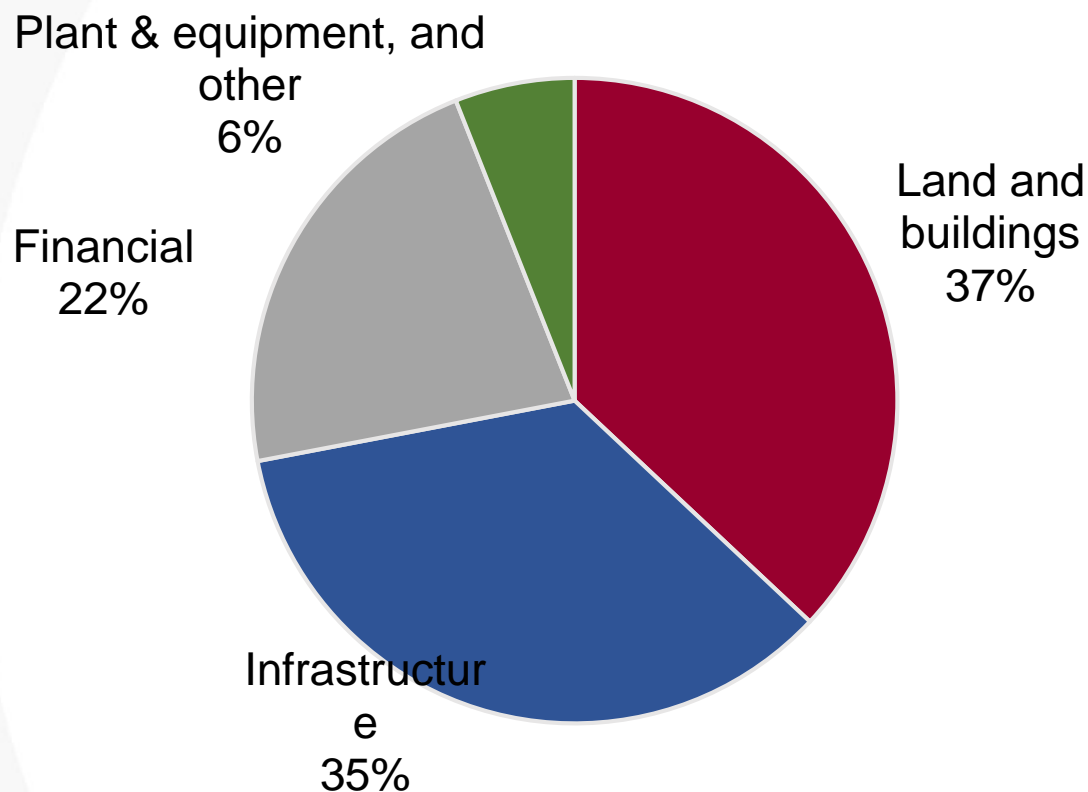
Asset valuation

Key areas of audit focus

Rachel Vagg, Sector Director Resources, QAO

David Adams, Sector Director Infrastructure, QAO

Total state sector assets by type 2015–16



Valuation related transactions make up more than **93%** of the of the value of movements in PPE balances

AASB13 fair value measurement

‘to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions’

Is there a market?

- Level 1—value using the quoted price

Can you derive value from a market?

- Level 2—value using adjusted quoted price

Use a valuation technique

- Level 2/3—
 - income approach
 - cost approach

Cost

Asset held for service

Funded through other mechanism

Income

Asset held for revenue flow

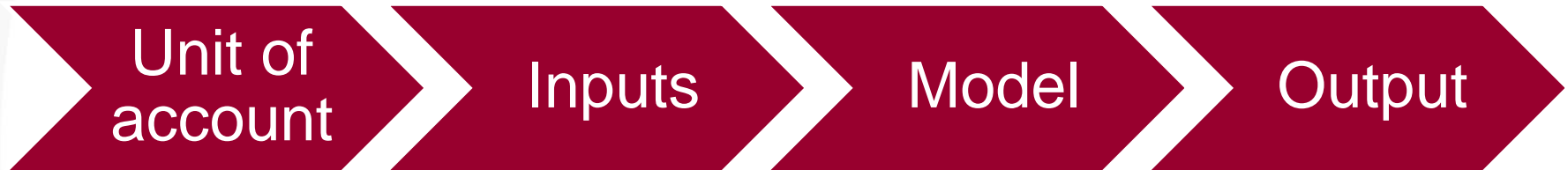
Funded by return on asset

Cost approach

- Current replacement cost
- Adjustments for obsolescence, consumed service potential, and condition

Income approach

- Present value techniques
- Option pricing models
- Multi-period excess earnings method





Unit of account

- Identification
- Different from cash generating unit

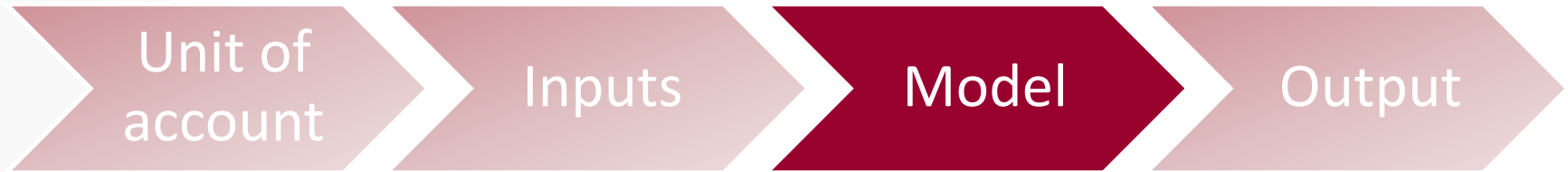


Inputs

- Governance of assumptions
- Correlation and logic of assumptions
- Key inputs:
 - cash flows
 - terminal value
 - discount rate
 - risk.

Regulated assets

- Is a regulated asset valuation model the same as a fair value model?



What makes a good model?

- Within one model (no black boxes)
- Version control
- Clear separation of inputs, calculation, and outputs
- Consistent formula
- Scenario and sensitivity analysis



Understand the output

Does the value make sense?

Why has it changed from last year? Or not?

How do you compare to other market participants?

- market multiples—EBITA, RAB
- recent sales

Income



- Unit of account
- External cash flows
- Market discount rate
- Highest and best use, obsolescence

Value in use



- Cash generating unit
- Internal cash flows
- Internal WACC
- Actual use



Key principles—current replacement cost

- Est. the minimum cost to replace, adjusted for excess capacity
- Valuation is a measure of the current asset's service potential
- Valuation is not the cost of reproducing a replica asset
- Concept of a modern equivalent (without gold plating)



Key principles—condition

- Measuring an assets life to date—(pattern of consumption)
- Service potential does not change over time
- Accumulated depreciation—we believe that economic benefits (or service potential) are consumed evenly over time



Key principles—remaining useful life

- Document the annual review of useful life
- Measuring an assets life to date—(pattern of consumption)
- Accumulated depreciation—economic benefits are consumed evenly over time

Conclusion

The goal is to establish what someone else would pay (to acquire or construct) a substitute asset of similar utility, adjusted for obsolescence.

1. Measuring the adjustment to gross replacement cost of the modern equivalent asset Current age and remaining life
2. Componentisation—how far is enough?
3. How condition affects fair value and useful lives
4. Current age, remaining life matching likely replacement timeframe - example Interim revaluations

When accounting life 	likely date of renewal	
	surface	pavement
previous RUL (av. in years)	4	13
revised RUL (av. in years)	20	83

What we won't forget


- ✓ To respond to feedback from you
- ✓ To apply the same scrutiny to asset methodologies (whether they are performed internally or externally)

What we want you to do

- ✓ Take responsibility for accurate fair value measurement
- ✓ Understand methodology and assumptions—consistent with AASB
- ✓ The modern equivalent asset needs to be adjusted for excess utility (to match the utility in the existing asset)
- ✓ Is to value and assess (RUL) together
- ✓ Useful lives should reflect the likely timeframe for replacement (e.g. funding)
- ✓ Assess your RUL against asset plans and the fiscal outlook
- ✓ Know your methodology

Q&A

Closing remarks



Anthony Close
Auditor-General (acting)

Q&A

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