

**Audit and Reporting Requirements for
Government Owned Corporation Controlled Entities
and Investments**



**Queensland
Government**

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Introduction

This policy sets out audit and reporting requirements for entities in which Government Owned Corporations (GOCs) exert control or maintain an ownership interest. It will ensure that all GOC controlled entities are subject to audit by the Auditor-General. It will also improve scrutiny and accountability of GOC interests in entities that are not controlled by the public sector. The policy will apply to existing and future interests.

Application of the Policy

This policy applies to all GOCs and their controlled entities and is effective from the 2001-02 financial year onwards. The only exception is entities in which Queensland Investment Corporation [QIC] maintains an investment interest. This follows from QIC's status as a wholesale funds manager, with the core business of managing an investment portfolio. Audit and reporting requirements will only apply to QIC for entities it controls, or maintains an interest in, and which discharge a specific investment function in relation to QIC activities.

In addition, where a GOC can demonstrate that adherence to this policy may compromise a commercially-viable project, or its competitiveness vis-à-vis the private sector, the Treasurer may reconsider the policy's application, but only in circumstances where two or more GOCs together have a controlling interest in an entity.

Involvement of the Shareholder

At present it is not mandatory for particular entities controlled by GOCs to be audited by the Auditor-General [refer Appendix 1]. Arrangements contained in this policy aim to reinforce the core corporatisation principle of accountability, with boards of directors accountable to Shareholding Ministers for GOC performance and Shareholding Ministers ultimately accountable to Parliament.

The policy also reinforces the corporatisation principle of competitive neutrality. The policy only imposes requirements upon GOCs that private sector entities must legally adhere to, or which are consistent with standard commercial practice.

Audit and Reporting Requirements

Definition of Entity

This policy defines an entity according to Australian Accounting Standards Board [AASB] Accounting Standard AASB1024.¹ Under this standard, an “entity” is defined as:

“any legal, administrative, or fiduciary arrangement, organisational structure or other party [including a person] having the capacity to deploy scarce resources in order to achieve objectives.”

Definition of Control

For the purposes of this policy, control of an entity is defined as:

1. “the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity.” in accordance with AASB 1024²; or
2. where a number of GOCs, or a combination of GOCs and public sector entities, together own greater than 50% of an entity, or together are able to cast a majority of votes at a meeting of the board of directors or governing board of the entity, or at a general meeting of the entity.

Note that in the situation referred to in point 2 above, none of the GOCs satisfy the requirements for control in AASB 1024. However, such an entity will be required to comply with the audit requirements of this policy as if it was subject to GOC control.

Requirements where GOC control exists

This policy requires all entities defined as GOC controlled under point 1 above to have their accounts audited by the Auditor-General before being consolidated into the parent entity annual report. GOC constitutions should provide for the Auditor-General to be auditor of the GOC³.

- The *Government Owned Corporations Act 1993* (GOC Act) provides for the Auditor General to be appointed auditor of a company GOC and any prescribed company GOC subsidiary⁴. For those entities not prescribed by legislation, it is not mandatory for company GOC controlled entities to appoint the Auditor-General as auditor. This policy requires these entities to be audited by the Auditor-General.
- The *Financial Administration and Audit Act 1977* provides for statutory GOCs and their subsidiaries to have their accounts audited by the Auditor-General.

¹ The substance of Australian Accounting Standard Board AASB1024 is identical to that of Australian Accounting Standard AAS24.

² AASB 1024 identifies a number of factors that indicate the existence of control by one entity over another [refer Appendix 2].

³ Note this is consistent with the statement issued by the Treasurer on 19 March 2001 “GOC Subsidiaries: Key Shareholder Requirements for Constitutions”.

⁴ Prescribed company GOC subsidiaries are those subsidiaries of company GOCs which have been prescribed by regulation under the GOC Act 1993. Energex Retail and Ergon Retail were prescribed as part of the deregulation of the electricity industry.

For the purposes of this policy, where control is deemed under point 2 above, the entity will be required to have its accounts audited by the Auditor-General as if it was controlled by the GOCs, but will not be required to consolidate its accounts into the accounts of any of the GOCs. Each GOC must exercise its rights as shareholder or its contractual rights to ensure that this requirement is complied with.

Pursuant to s. 341 of the *Corporations Act 2001* (Corporations Act), the Australian Securities and Investments Commission has made Class Order 98/1418, which exempts wholly owned entities whose holding company is a company from the requirements of this Act to prepare and lodge a financial report, director's report and auditor's report. Where wholly owned entities of company GOCs obtain relief or if a report and audit are not otherwise required under the Corporations Act [e.g. because it is a small proprietary company] then financial reporting requirements would not apply to the entity, with the following exceptions:

- Prescribed company GOC subsidiaries comprise an exception to this requirement in that they are required to prepare separate audited annual reports under the Act.
- Where it is considered appropriate, Shareholding Ministers can require [under section 131(1) of the GOC Act] controlled entities to be reported upon within their parent company's annual report.

Exemption from the Corporations Act requirements, to prepare and lodge financial reports under Class Order 98/1418, does not exempt the subsidiaries from audit for the purpose of review and consolidation.

All future approvals for the creation or acquisition of a subsidiary given under s. 163 of the GOC Act 1993 will only be provided on the basis that the Auditor-General is to be the auditor of the subsidiary. The subsidiary's Constitution will be required to embody this requirement.

Requirements where GOC control does not exist

It would be against convention for minority public sector interests to determine the audit and reporting requirements where control is held by a private sector company. It is not feasible, therefore, to impose a mandatory requirement on such entities to be audited by the Auditor-General. Further, such a policy requirement would not be competitively neutral and may weaken the position of GOCs in future negotiations over joint venture or investment arrangements.

The Corporations Act incorporates comprehensive audit and reporting requirements. However, there are no legislative requirements for entities including sole traders, partnerships, private trusts and unincorporated joint ventures to prepare an annual report or to be audited under Corporations Act.

More rigorous scrutiny of GOC investments will occur as part of normal performance monitoring. In addition, a process of post investment monitoring, that incorporates a requirement for GOCs to keep Shareholding Ministers informed on the commercial effectiveness and financial viability of their investments, shall take place. These matters are incorporated within the *GOC Investment Policy*.

Since GOCs have the ability to invest in a range of entities that may or may not be subject to the Corporations Act, separate policy positions have been established for both eventualities as follows:

GOC minority or equal interests in Corporations Act entities

GOCs must supply an audit report to the Auditor-General for entities in which they maintain an interest, but which are private-sector controlled and audited by a private sector auditor. Where an annual report is required to be produced under Corporations Act, this should also be provided to the Auditor-General. Reports should be provided as soon as possible after the GOC receives the report or the report is finalised.

GOC minority or equal interests in entities or ventures not subject to Corporations Act

GOCs must ensure that the annual accounts of all other entities [e.g. private trusts, joint ventures, partnerships] are prepared and audited. This is standard commercial practice that shareholding Ministers would rightly expect a GOC to follow. An audit report must be provided to the Auditor-General, where the Auditor-General is not appointed as the auditor. Where an annual report is available, this should also be provided to the Auditor-General. Reports should be provided as soon as possible after the GOC receives the report or the report is finalised.

- Unincorporated joint ventures are accounted for in a GOC's accounts [under AAS19 or ASRB1006] and as such the Auditor-General will audit these arrangements as part of the GOC's audit.
- Unincorporated joint venture agreements and partnerships should include a right of access to the books and accounts of the entity or venture by the GOC and its auditors.

Schedule of Interests

GOCs are required to incorporate within their annual report a schedule of entities in which they have control or an interest. Changes to this schedule should be advised to Shareholding Ministers via quarterly reports. Shareholding Ministers are empowered to impose this requirement under section 131(1) of the GOC Act – Matters to be included in an annual report.

Appendix 1

Legislated Powers of the Auditor-General

Specifically, the power of the Auditor-General to undertake audit arrangements with respect to Government Owned Corporations [GOCs] and related entities are covered as follows:

- for statutory GOCs and their controlled entities – section 127 of the Act applies the provisions of the *Financial Administration and Audit Act 1977* as if they were statutory bodies
- for company GOCs and prescribed company GOC subsidiaries section 128 of the Act applies the auditing and report requirements of the *Financial Administration and Audit Act 1977* to them specifically;
- the Auditor-General is registered as a company auditor under the *Corporations Act 2001* [section 1281] and is therefore permitted to audit companies under the *Corporations Act 2001*; and
- by virtue of a direction issued under section 124 the Auditor-General will be required to be appointed auditor of a GOC's controlled entity (both incorporated and unincorporated) if it has not already appointed the Auditor-General to this position.

Accordingly it is clear that:

- the Auditor-General must audit all GOCs;
- the audit of statutory GOCs is carried out under the *Financial Administration and Audit Act 1977*;
- the audit of company GOCs is carried out under the *Corporations Act 2001* and the *Financial Administration and Audit Act 1977*;
- the audit for controlled entities [subsidiaries] is carried out under *Corporations Act 2001*; and
- the Auditor-General is permitted to carry out an audit of a controlled entity, which is a company.

In addition to the above, all GOCs are required to comply with a direction given to them under the Act and must take steps to ensure it is complied with by any of its subsidiaries [section 124(2)].

Accounting Requirements for Control

Australian Accounting Standards Board Accounting Standard AASB1024 points out a number of factors which indicates the existence of control by one entity over another. These factors include:

- the capacity to dominate the composition of the board of directors or governing board of another entity;
- the capacity to appoint or remove all or a majority of the directors or governing board of another entity;
- the capacity to control the casting of a majority of the votes cast at a meeting of the board of directors or governing board of another entity;
- the capacity to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of another entity, irrespective of whether the capacity is held through shares or options; and
- the existence of a statute, agreement, or trust deed, or any other scheme, arrangement or device, which, in substance, gives an entity the capacity to enjoy the majority of the benefits and to be exposed to the majority of the risks of that entity, notwithstanding that control may appear to be vested in another party.