MOORE STEPHENS MARKHAMS
AUDIT AND ASSURANCE

Audit News

Spring 2014

Serious about Success

Audits – Q & A clears the fog around the mysterious world of audit

Auditors are often guilty of assuming that everyone knows what they do. In reality, most people don't understand much about what an audit is or what an auditor does. In order to clear the fog around the mysterious world of audit, we have written a series of brief articles answering frequently asked questions starting with …

So, why would we want an audit anyway?

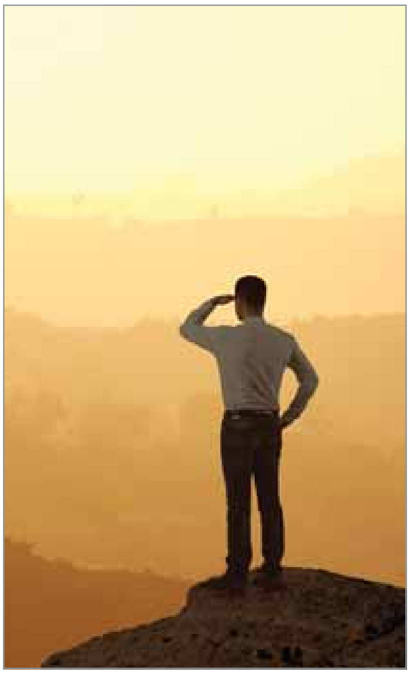
Firstly, an audit provides comfort to shareholders or members (and other interested people), that the financial reports of the organisation have been looked at independently, and that the information presented complies with the necessary reporting standards. This is especially important for people who are distant from the financial reporting process, and have limited or no control over the information provided to them. The shareholders (or members of an organisation) appoint the auditor, and the auditor reports back to them directly, or via an audit committee. Auditors report to the shareholders or members in the form of their audit report and auditor's management letter.

When financial statements have been subject to an audit, they are considered to be more reliable than accounts that have not been audited. An audit report therefore, lends credibility to the financial statements presented to potential investors, lenders, customers or suppliers.

An audit provides 'fresh eyes' over existing reporting and internal control systems, and may identify areas where management may improve controls or processes. Auditors' suggestions for improving internal systems are reported to management and the governing body. Communications around findings can add value to the company, and enhance overall quality processes.

Many people have the impression that an audit is about finding fraud. While this is not actually the focus of an audit, an auditor will always remain on alert for indicators of fraud, and will be sceptical about explanations and evidence provided to them. If suspicions of fraud are identified (either in advance of commencing the audit or during the course of the audit), the nature and extent of audit communication, procedures, examination of internal controls and processes would be altered accordingly. Often, merely spreading the word that an organisation is subject to regular external audits deters fraudsters, as it increases the risk that they will be caught.

Next time, we will look at the question: What is needed to assist a smooth and efficient audit process?



Inside

Accounting for the Emissions Trading Scheme (ETS)

The ETS started in 2008 following an amendment to the Climate Change Response Act 2002 (the Act). The Act has been revised since its introduction in 2008, with the Climate Change Response (Emissions Trading and Other Matters) Amendment Act 2012 (the 2012 Amendment Act) being the most recent revised Act at present.

The purpose of the ETS, as stated in the Act, is to support and encourage global efforts to reduce greenhouse gas emissions by helping New Zealand to meet its international obligations under the United Nations' Framework Convention on Climate Change and the Kyoto Protocol, and by reducing New Zealand's net emissions below "business-as-usual" levels (which are the estimated emissions levels if the ETS had not been implemented).

The ETS is now operating in the forestry, energy, industrial processes, and liquid fossil fuels sectors. In future years, it is due to come into effect in the waste, synthetic gases, and agriculture sectors.

The ETS is designed to move the cost of greenhouse gas emissions onto those who cause them. It is intended to provide incentives for managing greenhouse gas emissions, investing in clean technology and renewable power generation, and activities that absorb greenhouse gases (such as planting trees) in order to reduce New Zealand's net greenhouse gas emissions.

Under the ETS, the primary unit of trade is a New Zealand Unit (NZU), which represents one tonne of CO^2-equivalent emissions. NZUs are sometimes called 'carbon credits'. A NZU can represent one tonne of CO^2 or the equivalent of another greenhouse gas (referred to as 'carbon dioxide equivalent' or 'CO^2 equivalent'). Generally, each participant releasing CO^2-equivalent gases is required to surrender one NZU to match each tonne of CO^2-equivalent emissions. Participants who capture greenhouse gas (eg forests, fisheries etc) receive one free NZU for each tonne of greenhouse gas absorbed from government.

Currently there is no authoritative guidance on how to account for ETS by either participants or governments. This lack of guidance especially affects sectors (eg forestry) that are entitled to receive NZUs (when trees are growing) but are also liable to surrender NZUs when they release back absorbed greenhouse gas (eg when the trees are harvested). This has resulted in different methods of accounting for ETS.

The most common methods include:

- Either recognising the free NZUs and associated revenue at a cost of nil, or at the fair value of the NZUs; and
- Recognising the surrender obligation and expense at the fair value of the full obligation amount, or at the carrying amount of NZUs on hand (which could be nil for free NZUs) plus the fair value of the excess NZUs required to meet the obligation.

Entities also need to decide on an accounting policy for subsequent measurement of any NZUs on hand at balance date. The two options are the cost model and the revaluation model. Under the cost model, the NZUs will continue to be measured at their initial recognition amount (which could be nil for free NZUs). Under the revaluation model, the NZUs will be revalued to fair value at each balance date with the movement going to a revaluation reserve.

Moore Stephens

Being an independent member firm of Moore Stephens allows us to call upon the resources of our nationwide and global contacts to deliver effective and efficient audit and assurance services.

In New Zealand, you will find a Moore Stephens audit firm in Auckland, Hawke's Bay, Wairarapa, Wellington and Christchurch.

For more information on us and our services, please head to our website **www.markhams.co.nz/audit**

NZ IFRS 15: *Revenue from Contracts with Customers*

Overview

Effective for periods beginning 1 January 2017 (early adoption is permitted) the New Zealand equivalent of IFRS 15: *Revenue from Contracts with Customers* will provide a single source of requirements for accounting for all contracts with customers (except for some specific exceptions, such as lease contracts and insurance contracts) and will replace all current accounting pronouncements on revenue, including:

- NZ IAS 11: *Construction Contracts*
- NZ IAS 18: *Revenue*
- NZ IFRIC 13: *Customer Loyalty Programmes*
- NZ IFRIC 15: *Agreements for the Construction of Real Estate*
- NZ IFRIC18: *Transfers of Assets from Customers*
- NZ SIC-31: *Revenue – Barter Transactions Involving Advertising Services.*

Consistent with current pronouncements, NZ IFRS 15 contains principles-based requirements. Nevertheless, the new Standard will have an impact on reported results of some entities, particularly those entities that:

- Provide customers with bundled products and services
- Provide customers with warranties or rebates
- Have contracts with customers where the collectability of the consideration varies significantly from contract to contract
- Have contracts with customers where the amount of consideration potentially varies; and/or
- Regularly renegotiates the scope and/or price of its contracts with customers.

The new Standard requires entities to adopt a five-step model for recognising revenue from contracts with customers.

To apply this model, an entity will in some circumstances need to exercise significant judgement when considering the terms of the contract(s) and all of the facts and circumstances in relation to the contract(s), including implied contract terms. IFRS 15 also contains requirements applicable to items that are not normally considered to be revenue, including some costs associated with obtaining and fulfilling a contract and the sale of some non-financial assets.

The core principle underpinning the requirements in NZ IFRS 15 is provided in paragraph 2 of the Standard, which states, in part, that:

…the core principle of this Standard is that an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Consistent with this core principle, NZ IFRS 15 requires an entity to apply the following five-step model for recognising revenue from contracts with customers.

The steps to apply the Core Principle in IFRS 15 are as follows:

1. Identify the contract(s) with the customer
2. Identify the distinct performance obligations
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognise revenue when (or as) a performance obligation is satisfied.

It is important clients get their heads around how this standard may affect them. Please contact your local Moore Stephens Markhams advisor for more specific details.

Team News

Auckland

Christy Chui, who previously worked in Wellington, has joined us and we expect Andreea Serbanescu back from maternity leave in September.

Wellington

We welcomed Diana You in July as our new audit graduate. Diana recently completed her Master of Professional Accounting at Victoria University and has worked part time in an accounting practice in Wellington.

Wairarapa

We are pleased to announce our recent appointment of Matt Kerr as our Audit Manager. Matt is from Masterton and has extensive experience in working on audits in the Wairarapa Region.

Christchurch

The whole team has been busy with audit work over the last few months. There have been a number of new and challenging assignments, together with our favourite long-term audits.

In September, Richard is taking a well-deserved holiday in Europe with his wife. We look forward to sharing their adventures.

Jennifer and Christi have been honing their technical knowledge by taking an online financial reporting and audit standards course via the Chartered Accountants Australia and New Zealand (CAANZ – formerly NZICA).

In brief

Changes to Charities annual return requirements

From 1 July this year, an Annual Return filed with Charities Services is not recognised as complete until payment is received. This only applies to charities with a total gross income over $10,000.

New legislation brings in fines for not complying with audit requests

The new Financial Reporting Act 2013 requires that entities specified in the Act must ensure that auditors have access at all times to the accounting records and other documents of the entity.

The Act also states that an auditor of a specified entity is entitled to require from a director or an employee of the specified entity, the information and explanations that he or she thinks necessary for the performance of his or her duties as auditor.

Failing to comply with these requirements could lead to a fine on conviction not exceeding $50,000.

Real Estate Agents (Audit) Regulations amended

On 1 April this year, the Real Estate Agents (Audit) Regulations were amended to change the definition of who can audit a real estate trust account, stating that only qualified auditors can audit the trust account. It refers readers to section 36 of the Financial Reporting Act 2013, which defines what a qualified auditor is. Your local Moore Stephens Markhams Audit firm continues to meet this new definition and is suitably qualified to audit real estate trust accounts.

Changes to Inland Revenue payment deadlines

From 1 October 2014, Inland Revenue requires cheque payments to be received by them on or before the due date. Otherwise, penalties and interest will apply.

For more information visit: www.markhams.co.nz/library/newsletter_articles/taxation

Should you have any questions about any of the articles in this newsletter, please contact your local audit team.

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